

# R&D-Report

---

## Transformations of public sector and its financial system in Ukraine

Volume 1

Current issues of public sector  
accounting, budgeting and finances in  
Ukraine

Anatoli Bourmistrov  
Olga Iermolenko  
Veronika Vakulenko (eds.)

---

Nord University  
R&D-Report no. 40  
Bodø 2019

---



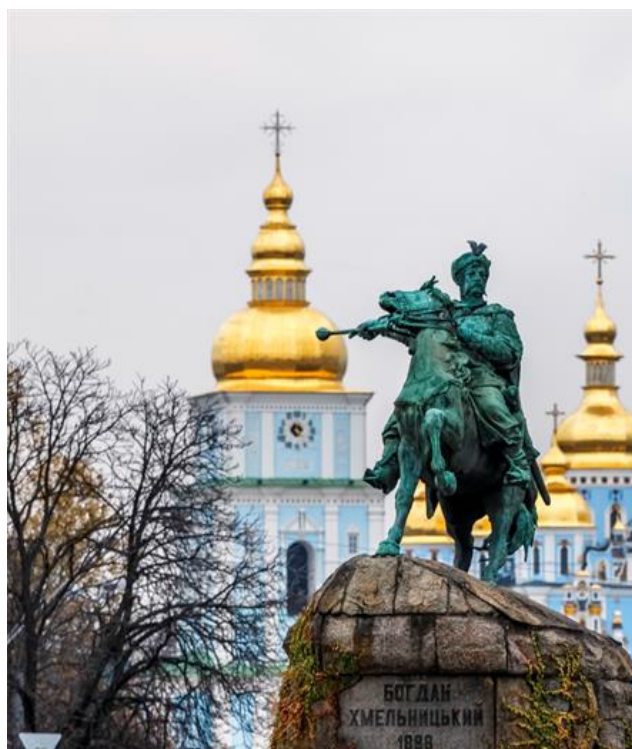
# Transformations of public sector and its financial system in Ukraine

Volume 1

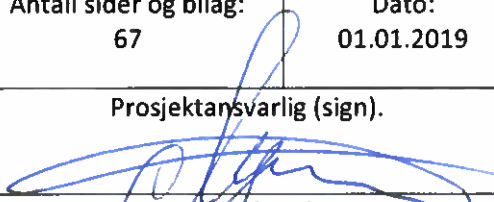
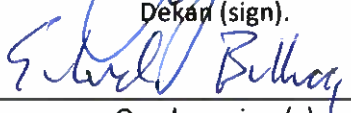
Current issues of public sector accounting, budgeting and finances in Ukraine

Anatoli Bourmistrov  
Olga Iermolenko  
Veronika Vakulenko (eds.)

Nord University  
R&D-Report no. 40  
ISBN 978-82-7456-801-3  
ISSN 2535-2733  
Bodø 2019





<b>Tittel:</b>  Transformations of public sector and its financial system in Ukraine Volume 1 Current issues of public sector accounting, budgeting and finances in Ukraine	<b>Offentlig tilgjengelig: Ja</b>	<b>Publikasjonsnr.</b> R&D-Report no. 40
	<b>ISBN</b> 978-82-7456-801-3	<b>ISSN</b> 2535-2733
	<b>Antall sider og bilag:</b> 67	<b>Dato:</b> 01.01.2019
<b>Forfatter(e) / redaktør(er):</b>  Anatoli Bourmistrov, Olga Iermolenko, Veronika Vakulenko (eds.)	<b>Prosjektansvarlig (sign).</b> 	
	<b>Dekan (sign).</b> 	
<b>Prosjekt:</b>  Norwegian-Ukrainian cooperation in Public Sector Economy Education: Accounting, Budgeting and Finance (NUPSEE)	<b>Oppdragsgiver(e)</b>	
	<b>Oppdragsgivers referanse</b>	
<b>Sammendrag:</b>  Utformet som en samling av vitenskapelige tekster representerer denne forskningspublikasjonen en felles innsats av norske, ukrainske og internasjonale forskere som deltar i samarbeidet "Norwegian-Ukrainian cooperation in Public Sector Economy Education: Accounting, Budgeting and Finance (NUPSEE) project" for å løse samtidsproblemene rundt transformasjonen av det offentlige finanssystemet i Ukraina.	<b>Emneord:</b>  Offentlig sektor, økonomi, regnskap, reformer, offentlig-private partnerskap, offentlige utgifter, miljøvern, Ukraina	
<b>Summary:</b>  Designed as a collection of scientific essays, this research publication represents a joint effort by Norwegian, Ukrainian and international researchers participating in the Norwegian-Ukrainian cooperation in Public Sector Economy Education: Accounting, Budgeting and Finance (NUPSEE) project to address the contemporary issues of transformations of public sector financial system in Ukraine.	<b>Keywords:</b>  Public sector, finances, accounting, reforms, public-private partnerships, public spending, environmental protection, Ukraine	



## Introduction to the volume

Designed as a collection of scientific essays, this research publication represents a joint effort by Norwegian, Ukrainian and international researchers participating in the Norwegian-Ukrainian cooperation in Public Sector Economy Education: Accounting, Budgeting and Finance (NUPSEE) project (project number CPEA-2015/10005) to address the contemporary issues of transformations of public sector financial system in Ukraine.

The first Volume of the scientific essay collection “Insights on the current issues of public sector accounting, budgeting and finances in Ukraine” acquaints a reader with multiple directions of public sector transformations. For instance, Iafinovych et al. gives an overview of development of public spending on environmental protection in Ukraine over the last 25 years. The essay argues that despite the financial crises, the process of reforming the public environmental policy is taking place, and this process is influenced by several coercive, mimetic and normative drivers. For instance, it is indicated that the Association Agreement with the EU, along with lessons drawn from the Polish experience with environmental protection, contribute to the development of a relevant and sustainable public environmental policy in Ukraine. However, the authors draw our attention to several challenges and gaps in the Ukrainian legislation that slow down the processes of reformation.

Lyutyy and Kanonishena-Kovalenko focus on Ukrainian public sector accounting reform and analyse the transparency and usefulness of accounting information for various groups of users. It is argued that improving the information environment of public finances and focusing on the needs of information users are prerequisites for increasing the efficiency of public financial management.

Maksymchuk and Kuruppu, by applying Rogers’ approach to diffusion of innovation, explore introduction of participatory budgeting, as a good governance practice, in Ternopil municipality and highlight the role of a nongovernment organisation in promoting participatory budgeting adoption. The study reveals some intricate details of the processes of persuading politicians and administrators to adopt participatory budgeting that result in political games and corruption scandals, as well as the confusion of citizens supporting projects for gaining personal financial benefits.

Finally, Knir provides a historical overview of public-private partnerships (PPP) and particular examples of public-private partnerships in the context of Ukraine. Although the practice of PPP is recognized in Ukraine as an important condition for the country’s successful social and economic development, analysing the experience of PPPs in Ukraine shows that in practice this form of partnership is difficult to be implemented. Knir describes political risks, poor reputation of the public sector organizations and low level of trust between the public and private sectors as some

of the main causes of the failures of PPP projects in Ukraine. The essay calls for more research of experiences in PPPs in attracting private partners to provide public services.

We believe that the four essays shading light on different aspects of public finance in Ukraine and the debates on the status of Ukrainian public sector reforms will promote the generation of new research questions needed to be answered in the future. We also hope that this collection of scientific essays in several volumes will become a useful tool for Master and PhD students to find relevant problem statements for their own research projects.

Best regards,  
The Editors

*Anatoli Bourmistrov*, Professor, PhD, Head of Department of Economic Analysis and Accounting  
*Olga Iermolenko*, Researcher, PhD, Department of Economic Analysis and Accounting  
*Veronika Vakulenko*, PhD student, Department of Economic Analysis and Accounting



## Contents

Public Spending on Environmental Protection in Ukraine: The mechanisms of Implementation	10
<i>Olena Iafinovykh, Nataliia Pohribna and Elena Dybtsyna</i>	
The Usefulness of Accounting Information as a Key Determinant of Public Sector Accounting Reform	25
<i>Igor Lyuty and Kateryna Kanonishena-Kovalenko</i>	
Participatory Budgeting in a Ukrainian Municipality: the Case of Ternopil Municipality	40
<i>Oleksandr Maksymchuk and Chamara Kuruppu</i>	
The Rationale for Public-Private Partnerships: the World Experience and the Prospects of Ukraine	52
<i>Mariya Knir</i>	

# PUBLIC SPENDING ON ENVIRONMENTAL PROTECTION IN UKRAINE: THE MECHANISMS OF IMPLEMENTATION

Olena Iafinovych,<sup>1\*</sup> Nataliia Pohribna<sup>1</sup> and Elena Dybtsyna<sup>2</sup>

<sup>1</sup> Faculty of Economics, Taras Shevchenko National University of Kyiv, Ukraine

<sup>2</sup> Business School, Nord University, Norway

## Abstract

The article discusses the mechanisms of implementation of public spending on environmental protection in Ukraine. For a transitional economy in a financial crisis, public financing of environmental expenditures is not a priority. However, the Association Agreement with the EU, along with lessons drawn from the Polish experience with environmental protection, can contribute to the development of a relevant and sustainable public environmental policy in Ukraine.

Keywords: *environmental protection, public spending, Ukraine*

## Introduction

Environmental protection appears to be a classic case of a public good: expenditure generates improvements that benefit large numbers of people simultaneously (joint consumption), and there are few prospects for exclusion. Pearce and Palmer (2001) state that little is known about environmental expenditures before 1970. Expenditures may be made by governments (central and local) and by regulated agents, mainly corporations. Public environmental expenditure has been increasing at a faster rate than private expenditure, which suggests that the burden of environmental protection is not shifting away from the public to the private sector as expected (Pearce and Palmer, 2001).

The peculiarities and complexities that characterize public spending on environmental protection make it an ideal context in which to study advanced topics of wider relevance. There is a call for more research on Eastern Europe and the European Union (EU) in the public sector (Anessi-Pessina et al., 2016). Eastern European countries, including Ukraine, may be a fruitful field of study as they have shifted from former regimes to new democratic forms and have been in the process

---

\*Correspondence to: Associate Professor, PhD, O. Iafinovych, Department of Finance, Faculty of Economics, Taras Shevchenko National University of Kyiv, Vasylkivska St. 90A, 03022, Kyiv, Ukraine.  
E-mail: 150500@ukr.net

of joining the EU. These developments have implied significant changes in administrative systems, and consequently in public spending (Anessi-Pessina et al., 2016).

Environmental management, conservation, and restoration of the environment are the requirements of the present world and essential for sustainable development of any country. Ignoring the objective laws of development and reproduction of the natural resources complex leads to catastrophic consequences for the environment – not only for a particular state but all humanity. Financing and investing in environmental measures as a whole occupy a special place among the factors that determine the state of the environment in a country.

The financial crisis in Ukraine has prevented public spending towards environmentally sustainable development from reaching the desired levels. This article describes and analyses the mechanisms of implementation of public spending on environmental protection and discusses ways to gain relevant and sustainable public environmental policy in Ukraine.

The essay is organized as follows: the introduction is followed by subsections that discuss environmental protection in transition economies and give an overview of the Ukrainian context; then, the methods of data collection are presented. The theoretical framework is presented in the next subsection. State funding for environmental protection, the Association Agreement between the EU and Ukraine with a focus on environmental issues, and Polish experience in public spending on environmental protection are empirically discussed. The essay concludes with a discussion of the kinds of mechanisms of implementation of public spending on the environment that are used in Ukraine.

### **Environmental protection and public finance in transition economies**

The aim of environmental protection is to provide social well-being and sustainable economic development. It is recognized that governments, through public finance, are responsible for financing environmental goods and services (UN Economic Commission for Europe, 2003). In particular, environmental expenditure in transition economies might be more effective in attracting government resources and foreign financing if they operated according to acknowledged standards of sound public finance. The UN Economic Commission for Europe (2003, p. 12) describes the Good Practices of Public Environmental Expenditure Management (PEEM), considering the quality of public environmental expenditure management, according to the following three dimensions:

- 1) the environmental effectiveness dimension measures the performance of public expenditure programs as instruments of environmental policy;
- 2) fiscal prudence measures the key aspects of alignment with the principles of sound public finance;
- 3) management efficiency measures how efficiently a financing institution utilizes financial and human resources.

Taking the example of the Czech Republic, Soukopova and Bakos (2010, p. 108) discuss how the issue of the relation between economic growth and environmental protection has become increasingly important in recent years. Also in question are the effects of environmental policy in individual regions and the influence of environmental policy on economic growth and other basic regional economic indicators, such as unemployment, inflation, trade and living standards.

Soukopova and Bakos (2010), analysing the efficiency of public (environmental) expenditures, state that most authors use the methodology of 3E – economy, efficiency, and effectiveness, which they explain in theoretical terms as follows (ibid, p. 110):

- Economy refers to using only enough public resources to meet the given objectives at acceptable levels of quality.
- Efficiency refers to acquiring the greatest possible amount, quality and contribution towards the given objectives with the smallest expenditure of resources. Economy and efficiency together are understood as cost efficiency.
- Effectiveness refers to using public resources to achieve the greatest possible output with respect to the desired outcome, which is a prerequisite for optimal fulfilment of goals set in advance. Therefore, effectiveness refers to how the produced goods and services (e.g., waste disposal) fulfil the objective (e.g., a clean municipal environment).

Later in this essay, we describe public expenditures in the Ukrainian context, and we analyse in more detail public spending on environmental protection and the kinds of mechanisms used under the process of policy transfer in light of the signed Association Agreement between the EU and Ukraine.

### **Ukrainian context**

After Ukraine's independence and during 2000-2008, the Ukrainian economy benefited from high metals prices, which kept real sector performance at an average of 6.9% (Boyarchuk et al., 2011, p. 10). Since economic performance was impressive, relatively few fiscal reforms were undertaken. The Budget Code was approved and provided the framework for the major principles of fiscal policies. As a result, local and regional governments were made responsible for a large part of spending, but they have not been supported with the relevant revenue base. As Boyarchuk et al. (2011, p. 69) underline,

*[...] over the last ten years, the Ukrainian economy passed through years of economic growth followed by a sharp economic decline. During these years, the Ukrainian authorities did not complete the structural reforms needed to stimulate future economic development. The most important fiscal policy measure was the approval of the Budget Code, which framed major provisions in state budget planning and execution and defined the distribution of financing among different levels of government. In 2010, the new version of the Budget Code was approved.*

However, there has been a concerted shift away from budgetary assistance in recognition of its limited effectiveness in Ukraine. Budgetary support was initiated in 2008 in Ukraine under the mantra of financing “policies and not projects”. During 2008-2014, in Ukraine, a total of €344 million was disbursed as budgetary support in six areas (energy strategy, energy efficiency, trade, environment, transport, and border protection) and €18 million as budget-support-related technical assistance (Wolczuk et al., 2017, p. 19).

In 2014 the Association Agreement between the European Union (EU) and Ukraine was signed with the aim of deepening political and economic relations between Ukraine and the EU through the establishment of an enhanced institutional framework and innovative provisions on regulatory and legislative approximation (Van der Loo et al., 2014). As Van der Loo et al. (2014) continue, the preamble to the agreement explicitly states (ibid, p. 3):

*Political association and economic integration of Ukraine within the European Union will depend on progress in the implementation of the current agreement as well as Ukraine’s track record in ensuring respect for common values, and progress in achieving convergence with the EU in political, economic and legal areas.*

Ukraine’s background as a transition economy with commitments towards the Association Agreement with the EU offers a relevant context to shed light on the mechanisms of implementation of public spending on environmental protection.

### **Theoretical framework**

Traditional public finance theory suggests that public goods will be underprovided in a market-oriented economy. Hence, there is a clear role for the state in providing those goods (Pearce and Palmer, 2001). Further on, Pearce and Palmer (2001) state that public expenditure cannot be reversed as easily as it can be expanded, and the instruments ostensibly under the control of government are not in fact in its full control, nor is there full understanding of the effects of policy choices.

Traditionally, budgeting has been the process through which governments decide how much to spend on what, limiting expenditures to the revenues available and preventing overspending (Anessi-Pessina et al. (2016) citing Jones and Pendlebury). In a broader sense, budgeting has increasingly been expected to perform further roles and functions, enforcing managerial responsibility and discharging external accountability.

In their review of the recent literature, Anessi-Pessina et al. (2016) note that the expanding weight of entitlements, the demands of supra- and international institutions, and the fiscal and economic crises have put enormous pressures governments to cut back expenditures, ensure balanced budgets and reduce the amount of accumulated public debt. At the same time, governments have

been expected to meet an increasingly strong, sophisticated and heterogeneous demand for services and to play a role in economic recovery and growth (ibid, p. 492).

For the purpose of this essay, it seems relevant to discuss the mechanism of implementation of public spending on environmental protection in Ukraine using the framework suggested by DiMaggio and Powell (1991). Lynn Jr. et al. (2000), analysing DiMaggio and Powell, state that their framework might look at the same facts and ask why there is so much similarity in structure. The observed differences in performance might be much greater if coercive, mimetic and normative isomorphism were not operating. Their predictors of isomorphic change include organization-level factors (i.e., dependence of one organization on another; centralization of resource supply; uncertain technologies or loose coupling; ambitious nature of organizational goals; education or professionalization of staff and managers) and field-level factors (i.e., membership in an organizational field dependent on a single source of support; degree of interaction/transaction among organizations in a field; number of alternative organizational models in the field; uncertain technology; professionalization; and structuration) (ibid, p. 243).

Mukhtarov (2014, p.71) states that

*[...] little is known about what makes certain policies spread widely while others remain limited in mobility. It remains a mystery why some policy ideas produce an impact on the ground as they travel across countries while others are formally adopted but rarely produce policy change.*

In this essay, we use DiMaggio and Powell's framework of coercive (Association Agreement with the EU), mimetic (Poland's implementation of spending on environmental protection, as an example similar to Ukraine) and normative (Ukrainian State Environmental Funds) mechanisms to describe and analyse public spending on environmental protection in Ukraine.

## **Methodology**

To fulfil the aim of describing and analysing public spending on environmental protection in the case of Ukraine, we have studied the legislatures and regulations of forms and levels of budget spending on environmental programmes in Ukraine. Further, we have analysed legal, professional and regulatory texts, which have provided important information for analysing state and local funds for environmental protection.

To discuss public spending on environmental protection, we have collected and analysed official governmental acts and documents from the last 20 years dealing with this issue, and we have studied the legislation and regulations from the Legislation of Ukraine database (<http://zakon2.rada.gov.ua/>) of the official website of the Parliament of Ukraine. The Legislation of Ukraine database was used for informational purposes by the Regulations on Web Resources of the Parliament of Ukraine. In this essay, we have analysed the laws and regulations of Ukraine

in environmental activities and various aspects of their funding from 1991 to 2016, and we selected about 80 legal acts devoted to forms and level of budget spending on environmental protection in Ukraine. Since Ukraine announced its desire to enter the EU, which requires adherence to and implementation of the obligations of the parties to the Association Agreement between Ukraine and the EU, some of the documents of basic principles of tax and environmental laws of the EU member states directly or indirectly relevant to the field of environmental taxation have been also considered.

We are using the statistical reports of the State Statistics Service of Ukraine (<http://www.ukrstat.gov.ua/>) and the Ministry of Finance of Ukraine (<http://www.minfin.gov.ua/>), which are available online. We also use information on environmental protection measures funded by enterprises, organizations and institutions of Ukraine.

### Public spending on environmental protection in Ukraine

Financing environmental activities is critical to protecting the well-being of the population and creating favourable conditions for the development of the national economy. Unfortunately, the economic crisis did not allow Ukraine to fully fund measures for environmental rehabilitation and restoration of natural resources. Statistical data on the financing of environmental activities from the consolidated budget in 2014-2016 shows the ecological imprudence of the budget of Ukraine (Table 1).

Table 1. Financing of environmental protection from the consolidated, state and local budgets of Ukraine in 2014-2016

Expenditure	2014			2015			2016		
	State budget	Local budget	Consolidated budget	State budget	Local budget	Consolidated budget	State budget	Local budget	Consolidated budget
Environmental protection mln. UAH, incl.:	2597,0	884,7	3481,7	4053,0	1476,7	5529,7	4771,6	1483,8	6255,4
Prevention and elimination of environmental pollution	2139,1	749,5	2888,6	3331,5	963,6	4295,1	4054,8	1179,8	5234,5
- Protection and sustainable use of natural resources	939,1	604,0	1543,1	1052,6	767,3	1819,9	1516,7	853,9	2370,6
- Waste disposal	318,8	57,3	376,1	468,0	97,3	565,2	383,8	136,9	520,7
- Elimination of other	881,3	88,1	969,4	1810,9	99,1	1910,0	2154,2	189,0	2343,2

environmental pollution									
Conservation of natural reserve fund	45,5	26,3	71,8	53,9	59,5	113,4	209,6	49,7	259,3
Fundamental and applied research and development in the field of environmental protection	65,6	-	65,6	81,3	-	81,3	84,8	-	84,8
Other environmental protection activities	346,9	108,9	455,8	586,2	453,6	1039,8	422,5	254,4	676,8

*Source:* Compiled by the authors based on reporting on budget execution in 2014-2016 (expenditures by functional classification of budget spending and lending) // State Treasury Service of Ukraine: <http://www.treasury.gov.ua/main/uk/doccatalog/list?currDir=146477>.

As shown in Table 1, the consolidated budget spending volumes in Ukraine demonstrate a positive trend of continuous increase. Thus, in 2014 the overall funding of environmental projects from the consolidated budget of Ukraine reached 3481,7 mln UAH, and in 2016, 6255,4 mln UAH, which is 1,8 times more than in 2014. The highest expenditure growth rates are for conservation of Ukraine's natural reserve fund (71,8 mln UAH in 2014, and 259,3 mln UAH in 2016, which is 3,6 times more than in 2014). Also, significant growth rates during the period are seen in the cost of eliminating environmental pollution (not related to waste disposal), which was only 969,4 mln UAH in 2014 but was 142% higher, at 2343,2 mln UAH, in 2016.

It should be stressed that of all public spending on environmental programmes in 2014-2016 in Ukraine, 73-76% came from the state budget and only 24-27% came from local budgets. Ukraine spent only 0,22, 0,28 and 0,26% of GDP on environmental projects from consolidated budget funds in 2014, 2015 and 2016 respectively.

### **Mechanisms of implementation of public spending on environmental protection**

#### *The Association Agreement between Ukraine and the EU*

Since gaining its independence in 1991, Ukraine has taken important steps in public spending on environmental protection. The country has established a comprehensive regulatory framework for environmental protection, has become a party to major international conventions, and has established the Ministry of Environmental Protection and Natural Resources (*Ministry of Environmental Protection*). It has also established a number of institutions and given them environmental protection powers, developed tools for environmental management and created funds for the protection of the environment and natural reserves.

On June 27, 2014, Ukraine signed and subsequently ratified the Association Agreement with the European Union, the European Atomic Energy Community, and their member states. In the Association Agreement, one of the priorities is environmental protection, the main areas of cooperation of which are:



- preservation, protection, improvement, and reproduction of environmental quality, public health protection, rational and efficient use of natural resources and promotion of measures at the international level aimed at addressing regional and global environmental problems;
- gradual approximation of Ukraine’s legislation to EU law and policy in the field of environmental protection;
- implementation of agreements in the field of environment protection.

The Association Agreement stipulates that, by the end of 2025, Ukraine has to bring its legislation closer to the EU legislation and implement provisions of approximately 350 directives, regulations and decisions in its legislation, as well as develop the procedure and roadmap for their implementation. Each document has its terms and requirements regarding the form of such implementation. As of November 1, 2016, Ukraine had to adopt the national legislation in seven areas, which constitute 44 commitments to adopt EU regulations:

- Energy - 13 obligations;
- Environment - 15 obligations;
- Public health - 5 obligations;
- Social policy - 2 obligations;
- The activities of companies - 4 obligations;
- Taxation - 2 obligations;
- Public procurement - 3 obligations.

According to the timetable, the environmental obligations are to be fulfilled (i.e., implementing EU norms in Ukrainian legislation) between July 1 and November 1, 2016. Of the environmental obligations, nine are in the process of implementation, and for the other six no adaptation is required.

Table 2. Assessment of fulfilment of obligations to adapt Ukrainian legislation within the framework of the Association Agreement in the field of environment from 2014 to 2016

Scope of implementation of EU norms to Ukrainian legislation	Obligations in the process of implementation	There is no adaptation process
Regulation of environmental management	4	
Regulation for Genetically Modified Organisms	2	
Regulation on the protection of nature		2
Regulation of atmospheric air quality		2
Water quality regulation, water resources management	2	
Regulation on Industrial Pollution	1	
Climate change and ozone layer protection		2
<b>Total</b>	<b>9</b>	<b>6</b>

Source: Compiled by the authors.

The Ministry of Environment and Natural Resources (Ministry of Environmental Protection) is the main executor responsible for adapting Ukrainian legislation to EU environmental legislation. As a whole, it is possible to calculate 15 obligations that fall within this period and concern environmental impact assessment and strategic environmental assessment, public access to environmental information, conservation of wildlife and fauna, the establishment of a state biosafety system, volatile organic compounds emission control, environmental policy on the marine environment, industrial emissions, greenhouse gas emission trading, ozone-depleting substances, and flood risk assessment and management. Several normative documents were adopted. As for the other commitments, eight of them are in a state of implementation, and for six obligations no adaptation is required.

It is worth noting that the field of environment is one of those areas where there is a significant amount of commitment, and this may have become one of the factors that delayed the process of adaptation. Also, the environment is not a priority in the national reform agenda, which also affects the pace of implementation of EU environmental legislation.

The correct step was that the Ministry of Environmental Protection began to adopt legislation to the most systematic directions, namely the development of draft laws on EIA (environmental impact assessment) and SEA (Strategic Environmental Assessment). However, perhaps because during the drafting of bills the interests of all involved parties were not taken into account and there was a lack of active explanatory work on social and environmental importance, the bills were vetoed.

With a significant number of commitments, it was possible to take a positive step towards the adaptation of the Water Directive, but it cannot be considered a complete adaptation of the provisions of the Directive. Such a result indicates the possible problems that are not voiced.

There are directives and regulations in each of the eight areas where adaptation is underway, the adaptation of which takes longer than required by normative activities. These are the EIA and SEA Directives, public access to information, GMOs, residences, sulphur and industrial emissions.

Particular attention is drawn to the directives and regulations in which adaptation was not initiated at all for unknown reasons. These include the directives on the protection of housing, the protection of birds, the control of emissions of volatile compounds, the marine environment, and trade in greenhouse gas emissions.

#### *State environmental funds in Ukraine*

The condition for Ukraine's transition to environmentally sustainable development is the improvement of efficiency of public funds in conservation measures to ensure environmentally favourable conditions for economic activity. Under the current legislation of Ukraine, state and local funds for environmental protection are established to finance environmental protection.

*The National Fund for Environmental Protection* was established in 1998. Its position was approved by the Decree of the Cabinet of Ministers of Ukraine from July 5, 1998, as amended. It is a part of the state budget of Ukraine and has been created to finance environmental protection programmes and measures related to the rational use and preservation of natural resources. The Fund receives a certain share of revenues from ecology tax payments and from other sources defined by the law (penalties for violation of rules and regulations on environmental protection, donations, and other funds). Data shows that the ecology tax makes up the largest share of the revenues of state and local environmental protection funds.

The ecology tax is paid by business entities, entities that do not conduct economic (business) activities, budgetary institutions, public and other enterprises, institutions and organizations, and permanent representatives of non-residents conducting activities in the territory of Ukraine and within the limits of its continental shelf and exclusive (maritime) economic zone involving:

- emissions of pollutants into the atmosphere from stationary sources of pollution;
- direct discharges of pollutants into water;
- waste disposal (except for the placement of certain types (classes) of waste as secondary raw materials (placed in their territory (objects)));
- generation of radioactive waste (including that already collected);
- temporary storage of radioactive waste in excess of that produced within the special conditions outlined in the licence terms.

Under current Ukrainian law, the object and base of ecology tax are:

- the volumes and types of pollutants that are released into the atmosphere from stationary sources;
- the volumes and types of pollutants discharged directly into water;
- the volumes and types (classes) of disposed waste, except volumes and types (classes) of waste as secondary raw materials (placed in their territory (objects));
- the volumes and categories of temporarily stored radioactive waste generated by business entities in excess of limits set out in the licence terms;
- the volumes of electricity generated by nuclear plants (NPPs).

Ecology tax rates are established by the Tax Code of Ukraine and vary according to the type of pollution sources (mobile or landline) and hazard class of pollutants. The tax amounts are charged in the tax (reporting) quarter by taxpayers or tax agents using formulas provided by the Tax Code. Tax agents, who import fuel on the territory of Ukraine, calculate the amount of tax on the date of customs declaration for customs clearance.

If a taxpayer pollutes in the course of doing business, the taxpayer must determine the tax amount separately for each type of pollution or each type of pollutant involved.

Limits of emissions from stationary sources of pollution are set by the Ministry of Ecology and Natural Resources of Ukraine (MER of Ukraine), which issue permits for emissions and discharges. The permits are issued free of charge by the regional MERs of Ukraine and are valid for at least five years. Emissions produced without obtaining permission are considered excessive. Thus, MER of Ukraine authorities have the right to charge financial penalties, which are calculated according to the cost of reimbursing the state for damages caused by excessive emissions.

Since gaining independence, Ukraine has changed the number and types of payments for the use of natural resources as well as for pollution of the environment. Also, the range of users of natural resources who are obliged to make environmental payments has been extended. However, the state is still not able to allocate over 2% of GDP for environment protection as do foreign countries.

Money from the National Fund for Environmental Protection is allocated to fund resource protection and conservation measures based on estimates approved by the head budget administrators. Head administrators are the MER and other central bodies of executive power, who are determined by the state budget for the corresponding year.

In addition to the National Fund for Environmental Protection, the environmental funds, operating within regional budgets and budgets of village and city councils, represent another source of funding for environmental activities in the country. According to the laws of Ukraine, the ecology tax, in the amount determined by the Budget Code of Ukraine, is the primary source of regional and local environmental funds, which partially finance environmental protection.

The process of reforming the economy in the direction of fiscal decentralization that began in Ukraine in 2014 caused a legislative initiative to change the structure of distribution of ecology tax revenue in the intergovernmental vertical and horizontal plane. Regulatory provisions of recent years dramatically changed the proportions of ecology tax allocation between funds of environmental protection at various levels – national, regional, and village, town, and city budgets, and budgets of united communities.

#### *Poland's implementation of public spending on environmental protection*

The need for Ukraine-EU interaction in the field of environmental policy is indisputable, not only given the prospects of integration but also, first of all, the need to preserve the environment in this part of the planet. The experience of implementing EU ecological policy is useful to Ukraine for reasons of expediency and efficiency of using modern technologies in the field of nature management. Poland can be an example of the effective use of economic instruments in the implementation of environmental policy. This country is not only a close neighbour of Ukraine, with similar natural and social conditions, but it is also an example of successful implementation of environmental policy instruments. The main elements of the economic management mechanism of nature management operating in Poland are:

- payment for the special use of natural resources;
- payment for pollution of the environment and other kinds of harmful effects on the environment;
- the system of financing and crediting environmental protection measures (state and local budgets, environmental funds, banks, enterprises funds, foreign incomes, and investments, etc.);
- ecologization of tax and price systems;
- support for the formation and development of the eco-industry.

Poland adheres to the main priority of environmental policy, generally recognized by all EU countries – to prevent environmental pollution through environmental prudence and care. It is implemented using the so-called “best available technology” (BAT – the application of those production methods that, at the current level of scientific and technical knowledge, provide the opportunity to guarantee the highest possible level of environmental safety). BAT was introduced in 1984 by directive 84/360 EEC to combat industrial pollution of atmospheric air.

The market regulators of nature management that are used in Poland include:

- Ecological tax. Poland, like other market economies, widely uses differentiated taxation depending on the “environmental benefits” of products. In this case, the concept of taxation is developed in such a way that enterprises whose production methods are environmentally safe have not been disadvantaged in comparison with competitors due to higher prices for products.
- Tax privileges and subsidies. The main task is to stimulate the more active use of modern scientific and technological achievements. Losses of budget funds due to the introduction of tax privileges are offset by revenues from taxation of enterprises using environmentally hazardous technology or producing environmentally harmful products.
- Preferential loans. It is an important condition for the maintenance of environmental investments for the purchase of capital goods by producers. In the list of preferential loans, noteworthy are methods such as interest-free or subsidized interest rates on loans. These include various types of preferential loans for financial support of economic entities that implement resource-saving and environmental technologies.
- Payments for environmental pollution.
- Reform of pricing. As the experience of Poland shows, thanks to the differentiation of prices for environmentally polluting and environmentally friendly products, positive results can be achieved by reducing environmental pollution.

Market realization of the right to pollute can be considered an effective and promising stimulus of environmental activity. This mechanism is part of the plan to encourage businesses to use non-waste technologies and use high-performance wastewater treatment systems. It is based on the difference between actual and environmentally acceptable levels of pollution. If the actual level

of pollution is lower than the specified ecologically acceptable level, the subject gets the right to pollute the environment in the form of a certificate that can be sold to others.

The system of environmental standards is thus constructed in such a way that it sets limits on the use of natural resources, encourages the use of certain technological processes, and sets parameters for finished products, the excess of which leads to economic, environmental and social damage. That is, environmental standards, in addition to their direct purpose, should act as mechanisms of environmental policy, through which they share environmental taxes and economic sanctions on the inefficient use of nature.

## **Conclusions**

Public spending on environmental protection is an important issue for the sustainable development of the society. From a research viewpoint, it includes not only public finance but also political, economic and legal perspectives. The changing institutional and socio-economic landscape in the transition economies requires a profound reassessment of institutions, actors and roles of those involved in the public finance of the environment. So far, there has been no attempt to make such a reassessment in the context of Ukraine. In this article, we have been using DiMaggio and Powell's framework to look at the kinds of mechanisms of implementation of public spending on environmental protection that have been used in Ukraine.

Our empirics show that since gaining its independence and becoming a party to international environmental conventions, Ukraine has made significant progress in developing its environmental legislation by adopting a wide range of legal acts and programmes covering most areas of environmental protection and the rational use of natural resources. However, environmental legislation has some shortcomings, such as that it is largely declarative, many acts are not consistent with each other, and there has as yet been only limited analysis of its influence.

The Association Agreement with the European Union signed by Ukraine in 2014 sets the task of adapting national legislation to the EU environmental regulations, which will allow more effective application of environmental legislation. However, in assessing Ukraine's compliance with the commitments to bring its legislation closer to EU environmental legislation under the Association Agreement in 2014-2016, it can be concluded that the environment is not a priority in the national reform agenda. And this situation is not conducive to improving the efficiency of financing of the environmental protection. So, being a coercive mechanism, the Association Agreement indeed puts some pressure on Ukrainian authorities. But since it has not yet been used to evaluate the implementation, it is still downplayed.

As for the normative mechanism of implementation, we show that Ukraine has not yet created an effective environmental protection system, one of the important elements of which is the state and local environmental funds. However, the direction planned by the Ukrainian government for

the development of the state shows the correct vector chosen for its development – “to ensure sustainable growth of the economy in an environmentally non-exhaustible way.” The creation and funding of state environmental objectives is essential for any state today.

Poland’s experience of public spending on environmental protection predominates the ongoing discussion of Ukrainian authorities on the further development of environmental expenditures. However, our analysis shows that this mimetic mechanism of using Polish experience exists currently only in the rhetoric between civil servants and researchers dealing with public spending on environmental protection.

Finally, we see that public spending on environmental protection in the context of Ukraine includes a mix of all three mechanisms set out by DiMaggio and Powell (1991). We argue that this mix of coercive, mimetic and normative drivers provides a potential richness in discussions of the ways to gain relevant and sustainable public environmental policy in Ukraine.

## References

- Anessi-Pessina, E., Barbera, C., Sicilia, M. and Steccolini, I. (2016). Public sector budgeting: A European review of accounting and public management journal. *Accounting, Auditing and Accountability Journal*, vol. 29, no. 3, pp. 491-519.
- Boyarchuk, D., Betliy, O. and Orlova I. (2011). Public expenditures on education and health in Ukraine before and during the global crisis. *CASE – Center for Social and Economic Research*, no. 104, Warsaw.
- DiMaggio, P.J. and Powell, W.W. (1991). *The new institutionalism in organizational analysis*. University of Chicago Press.
- Lynn Jr., L.E., Heinrich, C.J. and Hill, C.J. (2000). Studying governance and public management: Challenges and prospects. *Journal of Public Administration Research and Theory*, vol. 10, no. 2, pp. 233-261.
- Mukhtarov, F. (2014). Rethinking the travel of ideas: Policy translation in the water sector. *Policy and Politics*, vol. 42, no. 1, pp. 71-88.
- Pearce, D. and Palmer, C. (2001). Public and private spending for environmental protection: A cross-country policy analysis. *Fiscal Studies*, vol. 22, no. 4, pp. 403-456.
- Soukopova, J, and Bakos, E. (2010). Assessing the efficiency of municipal expenditures regarding environmental protection. *WIT Transactions on Ecology and the Environment*, vol. 131, pp. 107-119.
- Tax Code of Ukraine from December 2, 2010, No 2755-VI // Bulletin of the Supreme Council of Ukraine (SC), (2011), No. 13, No. 13-14, No. 15-16, No. 17. Art. 112 as amended, available at: <http://zakon3.rada.gov.ua/laws/show/2755-17/paran8575#n8575> (accessed 5 May 2017).
- United Nations Economic Commission (2003). Good practices of public environmental expenditure management in transition economies. Fifth Ministerial Conference “Environment for Europe,” Kiev, Ukraine.

- Van der Loo, Van Elsuwege, P. and Petrov, R. (2014). The EU-Ukraine association agreement: Assessment of an innovative legal instrument. EUI Working Paper LAW, no. 9.
- Wolczuk, K., Delcour, L., Dragneva, R., Maniokas, K. and Žeruolis, D. (2017). The Association Agreements as a dynamic framework: Between modernization and integration. EU-STRAT Working Paper Series, no. 6, September.



# THE USEFULNESS OF ACCOUNTING INFORMATION AS A KEY DETERMINANT OF PUBLIC SECTOR ACCOUNTING REFORM

Igor Lyutyy<sup>1\*</sup> and Kateryna Kanonishena-Kovalenko<sup>2</sup>

<sup>1</sup>*Economic Faculty, Taras Shevchenko National University of Kyiv, Ukraine*

<sup>2</sup>*Open Society Foundation, Kyiv, Ukraine*

## Abstract

The purpose of the investigation is to determine the main needs of accounting information users to provide effective public sector accounting reform. The theoretical part provides an approach to the users of public sector accounting information and their needs. The empirical part includes an analysis of the ability of the public sector accounting system in Ukraine to provide understandable and available information for all groups of users. Public interest in the activities of the government is increasing, especially in countries with high corruption levels, inefficient usage of public financial funds and low quality of public services. An increasing number of public organizations and scientific and analytical centres have set new requirements for public sector accounting information. It must satisfy the needs of both internal users (e.g., those responsible for managing public resources) and external users (e.g., foreign governments, international organizations, business entities and the general public) as a basis for decision making and to ensure public accountability. Transparent and understandable accounting information is the basis and at the same time the goal of public sector accounting reform. The current accounting system in Ukraine does not provide these features of accounting information, and financial, statistical and budget reporting are inconsistent. To solve these problems, further reform must be determined by new needs related to accounting information. Considering increasing needs in relation to accounting information, the discrepancy between accounting information users' needs and the information disclosed in public sector reporting in Ukraine is identified.

*Keywords: public sector accounting, information, usefulness, public sector accounting reform, public control*

---

\*Correspondence to: Professor, PhD, I. Lyutyy, Head of Department of Finance, Faculty of Economics, Taras Shevchenko National University of Kyiv, Vasylykivska St. 90A, 03022, Kyiv, Ukraine.  
E-mail: ig.lyutyy@gmail.com

## Introduction

Among the components that are necessary for a country's development are effective public administration that ensures fair distribution of public financial resources and a favourable business environment that provides opportunities for high rates of business activity and investment flows.

To provide these essential components, a transparent, complete and relevant information database on the activities of all sectors of the economy is required. It is important that such information be developed in a systematic, consistent manner across all sectors of the economy, both public and private. A tool for such database formation is accounting, so first of all it should be focused on providing information in a manner and form that meets the information users' needs. Considering the public sector in the context of accounting, it is necessary to allocate state budget, local budgets and government organizations, as state-owned enterprises and enterprises with state participation in the capital prepare financial statements under the rules established for the corporate sector.

The public sector accounting system covers only the general government sector, and users of this financial information include those entities that are interested in the data on operations that use public financial resources.

Public sector subjects use accounting information for management purposes. The efficiency of their operations depends on the completeness, accuracy and timeliness of such information. According to surveys, the main users of public sector financial statements are government, parliament and supreme audit institutions of the country (Figure 1).

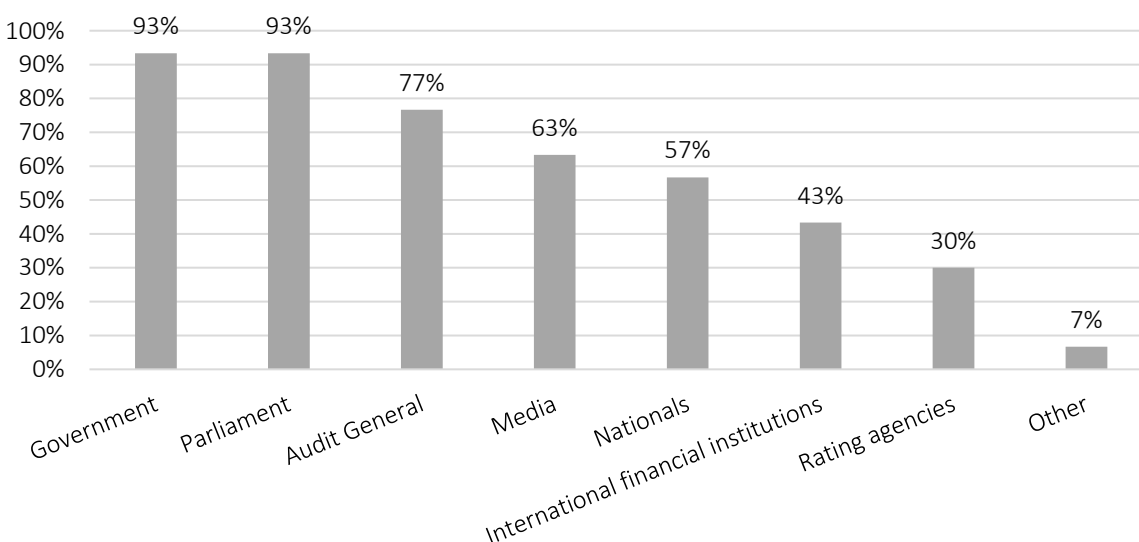


Figure 1. Users of public sector financial information

Source: compiled by the authors basing on EY.com, Survey Results: Accounting System Trends, [http://www.ey.com/gl/en/industries/government—public-sector/transparency-in-public-sector-accounting\\_survey-results—accounting-system-trends](http://www.ey.com/gl/en/industries/government—public-sector/transparency-in-public-sector-accounting_survey-results—accounting-system-trends).

Public authorities need accounting information for decision making, public finance management and public control. However, people, corporations, other countries and international organizations may also take an interest in public sector accounting information for different purposes. These purposes depend on the subject's role in relation to the state.

### **Public sector financial information users and their needs**

#### *An overview of modern approaches to the definition of users of public sector accounting information and their purposes*

Current public sector research pays considerable attention to the use of public sector information. In particular, the peculiarities of financial information and performance information use in the public sector are investigated (van Helden, 2016), and various aspects of the use of public sector accounting information by the parliament are explored (see e.g., Duisenberg (2016) example regarding the Netherlands).

The majority of studies are devoted to various aspects of the use of public sector information by politicians (van Helden et al., 2016; Moynihan, 2016; Giacomini et al., 2016; Jorge et al. (2016)). In particular, it is evident that the purposes of using public sector information depend on the stage of the political cycle. Some studies have considered how public sector information is used at the policy-formulation and decision-making stages (e.g., Giacomini et al, 2016).

Different patterns of political use of accounting information are defined. Politicians may use the information, for example, to get a free bail-out, to take political advantage in the electoral campaign or to justify proposed cutbacks (Guarini, 2016).

According to one approach, there are two purposes for using public sector accounting information: rational and political. "Rational use is supposed to be goal-driven, serving efficiency and effectiveness purposes, political use of accounting information aims to serve certain interests and values and to support the user's power over others" (van Helden et al., 2016, p. 473).

It is noted that despite the existence of democratic institutions, information can be manipulated. To discourage this behaviour, improvement of and compliance with public sector accounting standards are required (Guarini, 2016).

The described approaches emphasize such public sector accounting information users as politicians and government, while other users remain out of the scope of investigation. Therefore, it is necessary to consider other actors who may be interested in such information and explore their goals, needs and areas of interest.

#### *Roles of the public sector accounting information users*

Information on public sector activities is of interest to entities in other sectors. Different users are interested in different aspects of public sector accounting information, depending on the user's role. Internal users include public sector entities directly involved in public financial management. External users are the subjects of control, owners and agents of the economy, acting as investors, creditors, competitors and consumers (Table 1).

Table 1. Users of the public sector information

The role of information user	Subjects			
	People	Business entities*	The state (government agencies)	International organizations, other countries
Managers	+	-	+	-
Owners	+	-	-	-
Control subjects	+	-	+	+
<b>Partners</b>	<b>+</b>	<b>+</b>	<b>+</b>	<b>+</b>
Consumers	+	+	+	+

\* business entities of all forms of property (including public) and all legal forms.

Source: Compiled by the authors.

Management of government financial resources is the function of state authorities' employees and heads of budgetary institutions, but for some decisions, people of a particular region or the whole country can be engaged.

People also indirectly affect the management of public financial resources by electing specific political parties or figures that offer certain visions for regional or national development. The programmes these parties and individuals propose determine how and where public resources will be spent. There are also other forms of public influence on decision making in the public sector, such as public hearings on draft laws, discussions at official government portals, petitions, proposals, and recommendations and conclusions made by public and professional organizations.

State financial resources are essentially owned by citizens. These resources should be managed by public authorities for the public good, an activity paid for by citizens. Therefore, information about general government, budgetary institutions and state and local budgets must meet the people's needs with regard to such information.

The public can exert some control over spending of public financial resources. Such control makes it possible to detect failures to execute plans and to influence the management of finances. Thus, on the basis of public sector accounting information, individuals provide public control, voting in presidential, parliamentary and local elections. There are also other forms of public opinion expression, including through media, strikes and rallies, petitions (e.g., for the resignation of government officials), lawsuits based on violations of law and so on.

Procedures and mechanisms by which people can influence public financial management depend on the features of the country, form of government, the legislative framework and other factors,

but accounting and financial reporting in the public sector should provide information which can be the basis for public control and public opinion.

There are different forms of partnership among people and government agencies, such as volunteer work, charitable activities and patronage (which in fact save public resources as certain objectives are met without financial support from the government) or the purchase of public securities, in particular, government debt securities (in this situation, people act as creditors of the state).

The difference between public and corporate sectors in this context is that people play both roles – as owners of resources and as consumers of public sector services.

Business entities also use services provided by state government. They can act as partners of the state, creditors, investors, and in some cases, competitors (e.g., companies that provide services or goods that are also provided by public institutions).

The hierarchy of public governance involves accountability and controllability, therefore, public bodies and authorities can influence how state bodies and other institutions use public resources.

To implement state policy, public sector entities provide services to other government agencies and participate in joint management of public financial resources. In such cases, public authorities and institutions can be partners and customers to each other. The role of the state institution relative to other public sector entities determines the type of information required.

Information about the public sector may be of interest to international organizations and foreign governments that can act as partners in implementing joint programmes and activities; it may also be of interest to customers who are receiving financial assistance or advisory services. If an international organization or another country is a creditor of the state, public sector information of the recipient country can also be used for control purposes.

Thus, the degree of completeness, clarity and accessibility of information on public sector activities should be determined by the needs of users and limited according to requirements of national security and protection of state secrets.

#### *Aspects of public sector accounting information that is subject of users' interest*

The 2016 International Budget Partnership study on the use of budget information by citizens, which covered more than 70 countries, demonstrates that different users of information (citizens, community-based organizations, think tanks, policy research institutes) are interested in information on budget allocations and budget implementation (Figure 2).

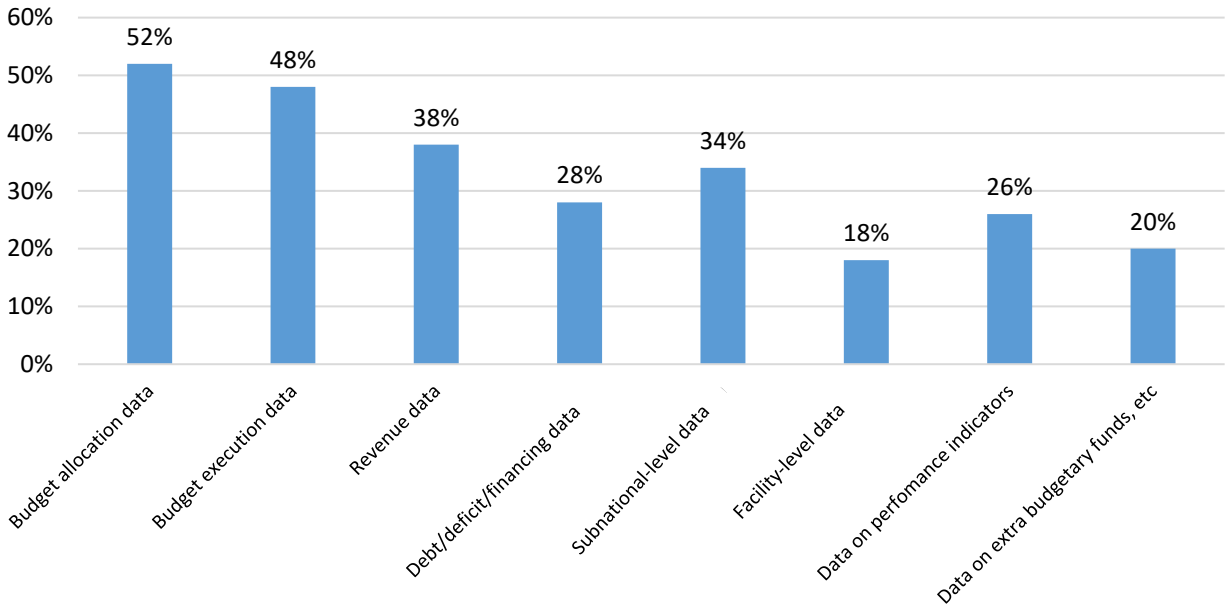


Figure 2. The demand for public sector information

Source: de Renzio and Mastruzzi (2016)

However, the needs of citizens, enterprises and international organizations in these aspects of public sector information also differ (Table 2), and disclosure of such information is important.

Table 2. Aspects of public sector information according to users' needs

Aspects of public sector information	People	Business entities*	International organizations, other countries	The state (government agencies)
Budget allocation data	<ul style="list-style-type: none"> <li>- Social standards</li> <li>- Expenditures by functional classification</li> <li>- Programmes for social purposes</li> <li>- Employee benefits of budget sphere</li> </ul>	<ul style="list-style-type: none"> <li>- Social standards</li> <li>- Programmes in the relevant field</li> <li>- Macroeconomic forecast</li> </ul>	<ul style="list-style-type: none"> <li>- Expenditure connected with international activities</li> <li>- Programmes funded by the IFI</li> <li>- Macroeconomic forecast</li> </ul>	<ul style="list-style-type: none"> <li>- Amount of financing</li> <li>- All aspects according to the competence of the body</li> </ul>
Budget execution data	- Execution of planned programmes and expenditures			
Revenue data		<ul style="list-style-type: none"> <li>- Tax revenues and their structure</li> </ul>	<ul style="list-style-type: none"> <li>- Volume of revenues and their structure</li> </ul>	
Debt/deficit/financing data	<ul style="list-style-type: none"> <li>- Terms and conditions of loans granted to the state</li> <li>- Amount and payments of debts</li> </ul>	<ul style="list-style-type: none"> <li>- Budget deficit</li> </ul>	<ul style="list-style-type: none"> <li>- Budget deficit</li> <li>- Amount and payments of debts</li> </ul>	
Subnational- level data	- Amounts and structure of financing of the region			
Facility-level data	- Volume and structure of social and infrastructure programmes financing		<ul style="list-style-type: none"> <li>- Volume and structure of financing of</li> </ul>	

Aspects of public sector information	People	Business entities*	International organizations, other countries	The state (government agencies)
			facilities funded by credit resources	
Data on performance indicators	<ul style="list-style-type: none"> <li>- Efficiency of public authorities</li> <li>- Effectiveness of social programmes' implementation</li> <li>- Budget violations and responding to them</li> <li>- Level of corruption</li> </ul>	<ul style="list-style-type: none"> <li>- Efficiency of public authorities;</li> <li>- Level of corruption</li> </ul>	<ul style="list-style-type: none"> <li>- Efficiency of public authorities;</li> <li>- Efficiency of credit usage</li> <li>- Budget violations and responding to them</li> <li>- Level of corruption</li> </ul>	
Data on extra budgetary funds, etc.	<ul style="list-style-type: none"> <li>- Amounts of social benefits</li> <li>- Deficit/surplus of budget funds</li> </ul>	<ul style="list-style-type: none"> <li>- Deficit/surplus of budget funds</li> </ul>	<ul style="list-style-type: none"> <li>- Deficit/surplus of budget funds</li> </ul>	

\* business entities of all forms of property (including public) and all legal forms.

Source: Compiled by the authors.

People’s demand for public sector information is due to a desire to know certain facts about their country or region, such as the approximate standard of living and amount of personal income (e.g., living wage, minimum wage, public sector wages, pensions and various social benefits) and the cost and quality of public services (e.g., infrastructure facilities, healthcare, education, cultural services, law enforcement agencies, judicial authorities etc.). Thus, information on the financing of the region and on the budgetary institutions in it is especially important. In addition, people are interested in public debt policy because they understand public debt as the burden of future generations.

Enterprises as the taxpayers are interested in the minimum wage, on which the payroll and financial position of social security funds depend, and significant deficit of their budgets could cause higher taxes in the future.

Enterprises, as taxpayers, are interested in the minimum wage, which has an impact on their payroll and on the financial position of their social security funds. A significant deficit in their budgets could result in their paying higher taxes in the future.

Business entities can also act as potential suppliers of goods and services to the state, so it is important for them to get information about government procurement, government programmes relating to the relevant industries and government support of the region, investment programmes, etc.

International financial institutions and foreign countries are interested in receiving information on the use of credit funds or financial assistance received from them, as well as indicators needed in

order to forecast future needs for additional loan financing (e.g., budget deficit, problems with public debt service, macroeconomic forecasts etc.).

Corruption levels and the effectiveness of anti-corruption measures are subjects of interest to all public sector information users as these factors directly affect the quality of public services and the efficiency of public financial management.

According to the IPSAS Conceptual Framework, accounting information in public sector financial statements should be relevant, faithful, representative, understandable, timely, comparable and verifiable. However, the above information needs of users give rise to additional requirements for public sector financial information, namely:

- disclosure of all aspects of interest to citizens, the corporate sector and international actors (within the limits imposed by the requirements of national security);
- submission of such information in a form that provides clarity for all users (e.g., budget for citizens, reports in languages other than the official language);
- frequency of disclosure, which allows users to make their own forecasts and make decisions based on them (publication of quarterly or semi-annual reports);
- technical accessibility of information for all users.

To ensure compliance with these requirements, certain conditions must be met. These include effective communication and cooperation between the subjects of the general government sector; harmonization of terminology and methodology of accounting and government finance statistics; harmonization and simplification of forms of fiscal and statistical reporting; legal compliance and actual installation timing of disclosure statements, and the technical ability to publish reports on official websites and portals.

#### *The ability of Ukrainian public sector accounting system to meet the needs of information users*

The problems of public sector efficiency in Ukraine are caused by various factors, but the formation of a transparent system of accounting and reporting in the public sector is a prerequisite for reform in other sectors.

Accounting in the public sector has been undergoing reform for several years. According to the strategy for modernizing public sector accounting for 2007-2015, the accounting system must be improved to meet international standards. Public sector accounting reform is not complete yet, and many objectives of the strategy have not been met, therefore, the time given to implement the strategy was extended.

The basis of the reform is the introduction of the national public sector accounting standards (NPSAS) based on International Public Sector Accounting Standards (IPSAS). The gradual implementation of NPSAS began in 2009. On January 1, 2017 there was a definitive introduction



of standards, but the problems with information support of the Ukrainian public sector have not been resolved.

Some IPSAS have not even been officially translated into Ukrainian; during accounting reform in Ukraine, there have been changes and supplements to international standards, and a few new standards have appeared. There are 39 IPSAS now (including IPSAS 15 and IPSAS 25, which were replaced with new standards) and the conceptual framework for general-purpose financial reporting by public sector entities. Of the 39 standards, 26 were translated into Ukrainian; some of these have been cancelled since the translations were done in 2009.

With the implementation of NPSAS 101 “Presentation of Financial Statements”, public sector entities are required to prepare financial statements that include a balance sheet, income statement, cash flow statement, statement of shareholders’ equity and notes accompanying the statements. There are also reporting forms for public sector entities according to the budget legislation (Table 3).

Table 3. Reporting of the public sector entities in Ukraine

Subject	Budget statements				Financial Statements	Total *
	Monthly	Quarterly	Annual	Total		
State budget	7	12	20	39	5	40
Local budgets	5	7	11	23	5	25
Budget institutions	9 forms and 16 budget reporting elements	12 forms and 5 budget reporting elements	12 forms and 5 budget reporting elements	21 forms and 21 budget reporting elements	5	23 forms and 21 budget reporting elements
Extra-budgetary funds	4 forms and 16 budget reporting elements	5 forms and 5 budget reporting elements	5 forms and 5 budget reporting elements	14 forms and 26 budget reporting elements	5	19 forms and 26 budget reporting elements

\* some forms of budget reporting duplicate financial statements, and total number of reporting forms without duplication is presented in the table.

Source: Compiled by the authors on the basis of the Budget code of Ukraine.

One problem is that there are too many different reporting forms, some of them partially overlapping. This places an excessive burden on the accounting services of the public sector entities. It also makes it more difficult for users to understand the reporting. Thus, to further reform the accounting system in Ukraine it is necessary to analyse the frequency and structure of the budget and financial statements with regard to information users of each form. Thereafter, forms that include information that is not of interest to internal or external users can be removed, and the remaining forms can be updated, reducing or expanding their positions.

Different approaches to the budget and financial reporting create the risk of having different indicators in various reporting forms. Thus, before implementation of NPSAS 124 “Revenue”,

revenues of public sector entities in accounting were classified according to budgetary classification, which is harmonized with the Government Finance Statistics by IMF methodology (GFSM - IMF): taxes, social contributions, grants and other revenue.

According to the NPSAS, revenue is classified for accounting purposes either as revenue from exchange transactions or revenue from non-exchange transactions. Accordingly, NPSAS 135 “Expenses” provides the same classification of expenses (it should be noted that currently there is no international standard for expenses, and Ukraine developed and implemented its own standard in 2017).

This leads to a situation where different classifications of revenue and expenses are used for the preparation and approval of budgetary institutions’ budgets and for financial reporting. In addition, the usefulness of this classification into revenues and expenses of public sector entities from exchange and non-exchange transactions for information users is not defined.

In addition, national standards do not define accounting rules for information on loans from the state and local budgets and their repayment, while, according to the budget legislation, such operations are carried out. Consequently, there is no comparability between planned and executed budgets of public sector entities. The harmonization of approaches to the preparation of financial, fiscal and statistical reporting in the public sector has not yet been achieved, and further reform requires a systematic approach.

Current research proves that the problem of public sector accounting information incompliance with information users’ needs is relevant for many countries. Lack of transparency and openness of public sector information is one of the preconditions for corruption and inefficiency in the use of public funds. The importance of public sector transparency and its connection with corruption level is demonstrated in Figure 3.

In addition, in Europe only five countries (Sweden, Norway, Czech Republic, France and Portugal) get more than half the points in the Open Budget rating, five countries (Italy, Croatia, Great Britain, Bulgaria and Slovakia) get scores below average, and in the rest of the European countries this document is not prepared (International Budget Partnership, 2016a). Ukraine recently implemented preparation of a budget for citizens, which should have positively affected the Open Budget Index in 2016 (International Budget Partnership, 2016b), but the Corruption Perceptions Index in 2016 for Ukraine was 29 points, two points better than in 2015 (Transparency International, 2016).

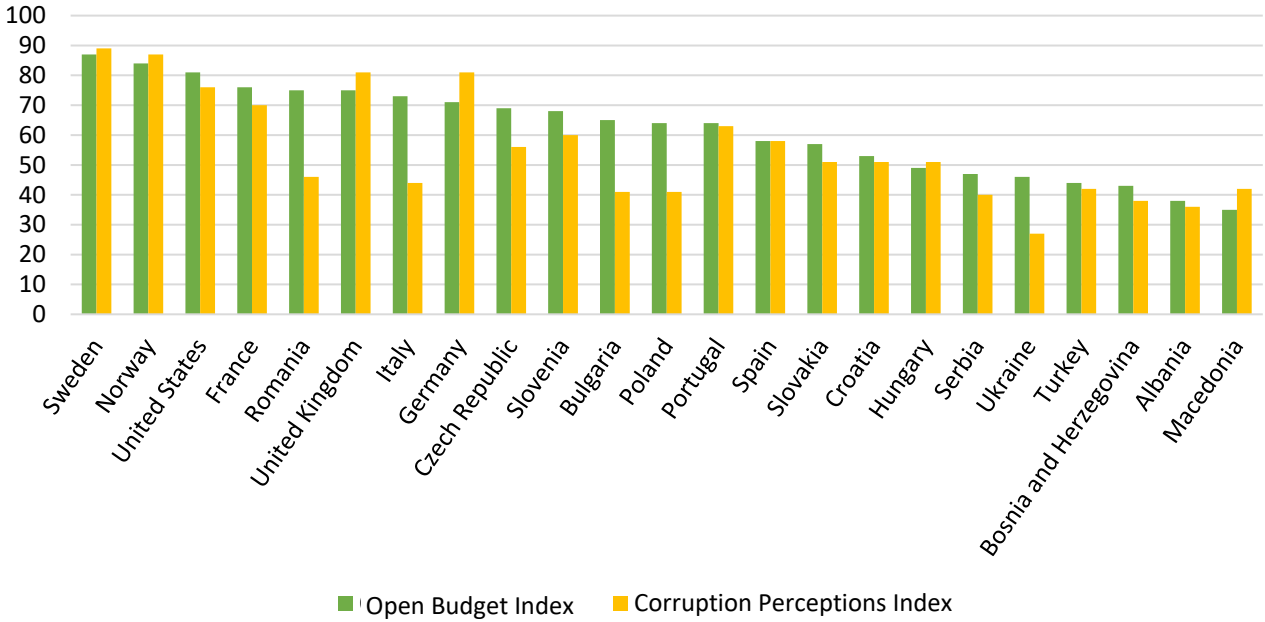


Figure 3. Open Budget Index in Europe and the US

Source: Compiled from data (International Budget Partnership, 2016a; Transparency International, 2016)

In foreign countries, the information that is most accessible to external users is information about budget allocation and execution, and the least available is information on local budgets, government agencies, non-budgetary funds and performance (Figure 4), and the latter information is important for enabling citizens to quickly evaluate the state authorities’ effectiveness and prospects of the region, its services, institutions and finances.

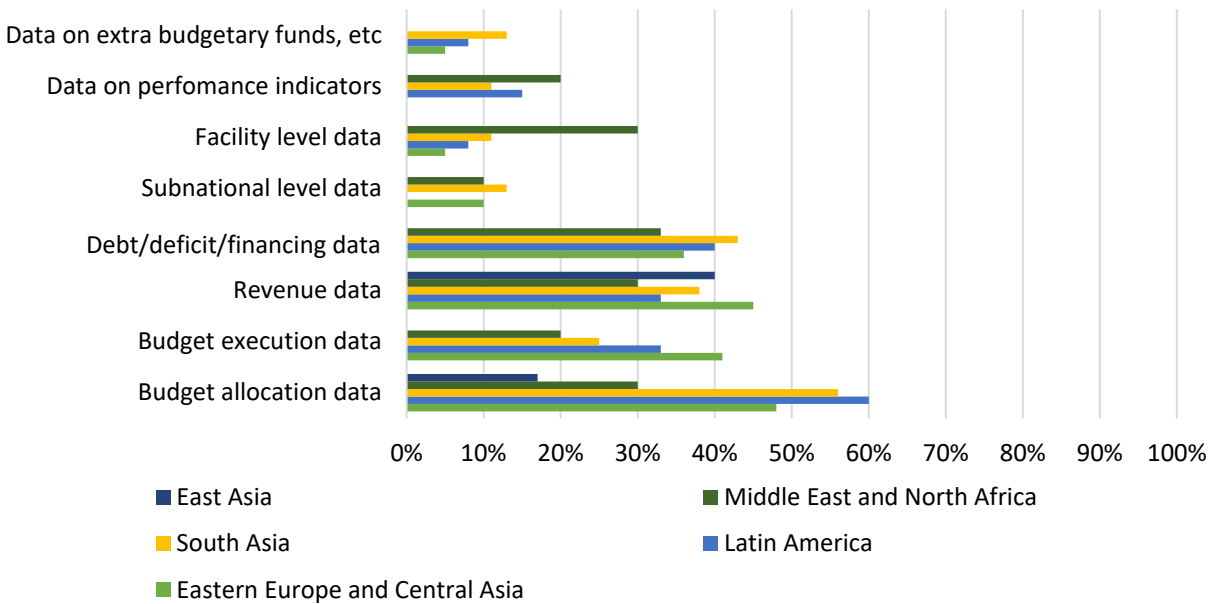


Figure 4. The availability of fiscal information  
 Source: Compiled from data by de Renzio and Mastruzzi (2016).

The most accessible information in Ukraine is that on the planned and actual performance indicators of the state and local budgets, and information on public debt. It also should be noted that power to control the revenues of a state budget was returned to the Supreme Audit Institution of Ukraine, the Accounting Chamber, in 2013. Therefore, another source of information in this regard became the Accounting Chamber reports. The main problem of the public sector information base is the lack of performance indicators of many state bodies and the imperfection of the calculation methodology of those indicators that are presented in public sector entities reports. Indicators of performance and effectiveness of budget programmes' realization also have a number of drawbacks and do not always describe the actual situation. Improvement of public sector accounting should help to solve this problem.

From the above analysis, it can be concluded that there are problems regarding compliance with the needs of those who rely on public sector accounting information (Table 4). These needs are growing in terms of increasing interest of individuals, community organizations and media regarding the effectiveness of public financial management.

Table 4. Compliance with users of the public sector information needs in Ukraine

<b>Information requirements</b>	<b>Positive features</b>	<b>Problems</b>
Qualitative characteristics of accounting information according to IPSAS: relevance, faithful representation, understandability, timeliness, comparability and verifiability	- The application of national public sector accounting standards based on international approaches	- Inconsistent terminology and methodology of various forms of reporting - Lack of comparability of planned and actual indicators
Disclosure of all aspects that are of interest to users	- Inclusion in the annual reports of information about revenues and expenses of state and local budgets, government debt indicators, macroeconomic indicators and forecasts	- Inaccessibility of many budget agencies' reporting forms - Lack of reports on budget programmes' implementation with appropriate performance indicators - Lack of performance indicators of state departments and agencies, or inaccurate calculations - Lack of information on the relevant responses to the results of control actions, and information identifying violations in budget area
Presentation in a form that provides clarity for all users	- Introductions for citizens on how to prepare a budget	- Large number of reporting forms; - Duplication of information - Inconsistent methodology that makes information in the reports more difficult for users to understand
Frequency of disclosure, which allows users to make their own forecasts and make decisions based on them	- Monthly and quarterly reporting	- Lack of semi-annual reports on the state and local budgets - Violation of statements' disclosure terms

Information requirements	Positive features	Problems
Technical accessibility of information for all users	<ul style="list-style-type: none"> <li>- Publication of reports on budget execution on the official websites</li> <li>- Publication of audit reports</li> <li>- Transparency of information on government procurement</li> </ul>	<ul style="list-style-type: none"> <li>- Inaccessibility of many forms of budget reporting, including budgetary institutions reporting</li> <li>- Lack of archives of certain documents in electronic form</li> <li>- Lack of unified structure and poor performance of official websites and portals</li> </ul>

Source: Compiled by the authors.

As a result of the reform of public sector accounting in Ukraine at this stage, the needs of all information users are not being met. It has been identified that the existing system of public sector accounting and reporting is inadequate in terms of meeting current challenges and it therefore needs further improvement.

**Conclusions**

In modern market economies as a consequence of democracy development, press freedom, social activity and globalization, the activities of public sector entities became a subject of interest among other sectors, including international organizations and foreign countries. Different subjects can play the role of consumers, supervisors, managers, creditors, investors or competitors. Depending on the role of information users, the needs in different aspects of public sector information arise.

Public sector accounting is a tool for creating an information base for decision-making by public authorities, international organizations and other countries, companies and people. Hence, public sector accounting should ensure that the needs of all information users are met. Information users’ main requirements are 1) disclosure of all relevant aspects of the subject of interest; 2) information that is understandable to a wide audience and 3) information that is published regularly and is easily accessed by the public (e.g., on official websites). Many countries, including Ukraine, have problems fulfilling these requirements, which is demonstrated by Open Budget Index rates, survey data and research.

Accounting reform in the public sector of Ukraine aimed to implement international public sector accounting standards. At this stage, the accounting system does not yet meet user needs due to a number of drawbacks, namely:

- inconsistent terminology and methodology of financial, budget and statistical reporting; inconsistent approaches to the classification, evaluation and display of certain transactions by the entities of public sector;
- the lack of comparability of planned and actual indicators;
- the large number of reporting forms, duplication of information and reporting forms, which are not oriented to information users;

- the lack of performance indicators in reporting forms on the use of public financial resources and performance indicators of state departments and agencies, or imperfect methodology used to calculate them;
- the lack of performance indicators of budget programmes' implementation;
- inaccessibility of many reporting forms, including reporting of budget institutions, in the public domain and untimely disclosure of these statements.

Improving the information environment of public finances is a prerequisite for increasing the efficiency of public financial management. Solving the problems that have been identified should become the next steps in accounting reform in the public sector of Ukraine, focusing on the needs of information users.

## References

- de Renzio, P. and Mastruzzi, M. (2016). How does civil society use budget information? Mapping fiscal transparency gaps and needs in developing countries, available at: <http://www.internationalbudget.org/publications/how-civil-society-uses-budget-information> (accessed 11 February 2017).
- Duisenberg, P. (2016). New development: How MPs in the Dutch parliament strengthened their budgetary and accounting powers. *Public Money & Management*, vol. 36, no. 7, pp. 521-525.
- Giacomini, D., Sicilia, M. and Steccolini, I. (2016). Contextualizing politicians' uses of accounting information: Reassurance and ammunition. *Public Money & Management*, vol. 36, no. 7, pp. 483-490.
- Guarini, E. (2016). The day after: Newly-elected politicians and the use of accounting information. *Public Money & Management*, vol. 36, no. 7, pp. 499-506.
- International Budget Partnership. (2016a). The Open Budget Index 2016. International Budget Partnership, available at: <http://survey.internationalbudget.org/#rankings> (accessed 20 February 2017).
- International Budget Partnership. (2016b). Ukraine: Open Budget Survey Document Availability Tracker, available at: <http://www.internationalbudget.org/opening-budgets/open-budget-initiative/open-budget-survey/country-info/?country=ua> (accessed 20 February 2017).
- Jorge, S., Jorge de Jesus, M.A. and Nogueira, S. (2016). Information brokers and the use of budgetary and financial information by politicians: The case of Portugal. *Public Money & Management*, vol. 36, no. 7, pp. 515-520.
- Moynihan, D.P. (2016). Political use of performance data. *Public Money & Management*, vol. 36, no. 7, pp. 479-481.
- Transparency International. (2016). Corruption Perceptions Index 2016, available at: [https://www.transparency.org/news/feature/corruption\\_perceptions\\_index\\_2016](https://www.transparency.org/news/feature/corruption_perceptions_index_2016) (accessed 20 February 2017).
- van Helden, J. (2016). Literature review and challenging research agenda on politicians' use of accounting information. *Public Money & Management*, vol. 36, no. 7, pp. 531-538.

van Helden, J., Argento, D., Caperchione, E. and Caruana, J. (2016). Editorial: Politicians and accounting information – a marriage of convenience? *Public Money & Management*, vol. 36, no. 7, pp. 473-476.

# PARTICIPATORY BUDGETING IN A UKRAINIAN MUNICIPALITY: THE CASE OF TERNOPIL MUNICIPALITY

Oleksandr Maksymchuk<sup>1\*</sup> and Chamara Kuruppu<sup>2</sup>

<sup>1</sup> Ternopil national economic university, Ukraine

<sup>2</sup> University College of Southeast Norway, Norway

## Abstract

This study explores the diffusion of participatory budgeting (PB) in Ternopil Municipality drawing on Rogers' diffusion of innovation. The study describes how a nongovernmental organization promoted the adoption of PB in the municipality. In the process of persuading politicians and administrators to adopt PB, its benefits were highlighted, whilst no criticism was directed towards the municipality's existing methods of budget preparation. The diffusion of PB had unintended consequences. PB was intended to propagate good governance but opened up opportunities for corruption to take place.

Keywords: *participatory budgeting, innovation, Ternopil, council*

## Introduction

The public sector has experienced a range of reforms under the rubrics of "New Public Management" (NPM) and "New Public Governance" (NPG). Such reforms, which persuade the public sector to introduce new accounting and budgeting practices, are considered to be public sector innovations. The adoption of new accounting and budgeting practices has been an important aspect of the diffusing of innovations in the public sector (Ezzamel et al., 2014; Adhikari et al., 2015; De Vries et al., 2016). Academic research exploring the diffusion of innovations, including accounting innovations in the public sector, is limited, however (Vigoda-Gadot et al., 2008). Such studies are scarce even in the context of emerging economies (EEs), which have experienced the diffusion of a wide range of reforms as part of strengthening their governance and accountability mechanisms (Van Helden and Uddin, 2016).

We observed that scholars have drawn attention to the diffusion of accounting and budgeting innovations in the developed countries (Ezzamel et al., 2014). However, research studies focusing on such innovations in the EEs are scarce. As such, it is important to undertake studies examining

---

\*Correspondence to: PhD student, O. Maksymchuk, Ternopil National Economic University, 11 Lvivska Str., 46009, Ternopil, Ukraine.

E-mail: sashamaxymchuk@gmail.com



the diffusion of public sector accounting and budgeting innovations in the EEs. Our essay explores the diffusion of participatory budgeting (PB) in a Ukrainian municipality. We have drawn on the theory of diffusion (Rogers, 2003) to shed light on the process of diffusing PB in Ternopil Municipality. The usefulness of diffusion theory in generating comprehensive insight into public sector innovations is evident in prior work (Ezzamel et al., 2014; Adhikari et al., 2015). Similarly, De Vries et al. (2016) have also pinpointed the importance of relying upon Rogers' theory of diffusion to explore the public sector innovations. Based on our knowledge, this theory has yet to be applied in exploring the diffusion of PB in EEs in general and in Ukraine in particular.

The remainder of the essay is structured into four sections. The following section presents the diffusion of innovation theory, after which the section dealing with the research method is provided. The third section analyses the diffusion of PB following Rogers' (2003) stages of the diffusion of innovations. The last section presents some concluding remarks.

### **Diffusion Theory**

Drawing on Rogers' diffusion theory (2003), our study explores public sector accounting innovations. This theory has particularly been used to investigate the trajectories of public sector accounting innovations in developed countries (Christensen and Parker, 2010; Ezzamel et al., 2014). Prior studies demonstrate that the ways in which public sector innovation is diffused and the ways in which different countries have approached reforms are diverse, and that both external and internal elements have influenced the reform process either through formal or informal channels of communication (Bhatti et al., 2011; De Vries et al., 2016; Hansen, 2011; Vigoda-Gadot et al., 2008; Walker, 2006). Diversity and complexity are perhaps the central features of the public sector. The diffusion theory is envisaged as a lens that enables researchers to capture such distinctive situations and that nurtures their understanding of public sector innovations in general (De Vries et al., 2016), and accounting and budgeting innovations in particular (Christensen and Parker, 2010; Ezzamel et al., 2014, Adhikari et al., 2015).

The diffusion of innovation often occurs through a specific process (De Vries et al., 2016). Rogers (2003) has presented a five-stage model to explore the diffusion of innovations whilst underscoring the existence of an overlapping connection between different stages. The first stage of the innovation diffusion process is the knowledge stage. In this stage, policy makers and other important stakeholders should become aware of the existence of innovations and their capabilities to embrace them. Prior work shows that politicians and top administrators are influential in the introduction of public sector innovations (Hansen, 2011; Walker, 2006). Similarly, their awareness of existing practices' weaknesses and their comprehension of a need for innovative practice are the key characteristics of this stage. Accordingly, attention should be focused on what alternative exists and how and why it works (Rogers, 2003).

“Persuasion” is the second stage of the diffusion trajectory in the Rogers model. Persuading a group or an organization to accept any innovation depends on the innovation’s complexity, compatibility with organizational beliefs and values, and relative advantages compared with the alternatives available (De Vries et al., 2016; Rogers, 2003). Environment and/or socio-economic drivers could particularly influence the adoption of innovations (Hansen, 2011). This is the stage in which stakeholders tend to generate either positive or negative attitudes towards the innovation (Ezzamel et al., 2014). Besides consultants (Christensen and Parker, 2010), administrative professionals can play a significant role at this stage, which, however, depends on their theoretical understanding of innovation and on their ability to justify its importance (Bhatti et al., 2011; De Vries et al., 2016).

The third stage in the diffusion model is the “decision stage”, which may range from straightforward acceptance of innovations to immediate rejection, and from later adoption to continued rejection (Rogers, 2003). This stage also includes a trial adoption of innovation that ensures its suitability and minimizes unintended consequences. Following this, the next stage is then to implement the innovation. Implementation of innovations is not straightforward and can be a complex and problematic endeavour (Rogers, 2003; Ezzamel et al., 2014; Adhikari et al., 2015). Implementation of an innovation may also take a long time depending on the complexity (Rogers, 2003). While actors representing opposition groups tend to present obstacles to the implementation process, pro-innovators are likely to alter, modify or reinvent the innovation to represent their interests. The last stage of the diffusion trajectory is “confirmation”, which may apparently have two opposing impacts on innovations (Rogers, 2003). Having realized the benefits of an innovation, the adopters may hail it and make the new practice/system/procedure an institution. On the other hand, a failure to engender the intended benefits may result in the rejection and abandonment of an innovation and give rise to a search for alternatives.

## **Method**

The origin of PB is traced back to the Brazilian municipality of Porto-Alegre and it is argued that nearly 3000 municipalities rely upon the PB approach (Džinić et. al., 2016). The PB approach is identified as a way of strengthening the process of decentralization (Bland, 2011) and grassroots democracy (Kuruppu et al., 2016). This study focuses on the diffusion of PB in the Ternopil Municipality. This section describes how data for this study was collected.

In the process of collecting data for our study, we have mainly used the methods of document analysis and interviews. We began by analysing the Ukrainian laws. In the process of analysing documents, we have seen that in the laws of central government there are no norms directly related to participatory budgeting. The laws do include general guarantees regarding receiving income and making payments as per the authority of local governments, and these make it possible to introduce participatory budgeting (Budget Code of Ukraine, 2010; Constitution of

Ukraine, 1996; Local self-government in Ukraine, 1997). Having analysed the central government's official documents, we then analysed the local authority's official documents. Ternopil Municipality's council made a decision to approve participatory budgeting and protocols at the meeting of the committee responsible for evaluating the citizens' project. This document sets out general rules about implementing participatory budgeting in the municipality, specifying periods for submitting projects and voting for projects and elaborating on other key aspects.

In addition to the above documents, we have analysed the content of web pages of city council and the Institute for Budget and Socio-Economic Research (IBSER), a non-governmental organization that initiated the introduction of participatory budgeting in the municipality under the theme "Citizen's project". We also viewed information on an electronic system used by citizens to submit projects for participatory budgeting as well as web portals where news about this process was published. We conducted four interviews with two citizens whose projects were included in the 2017 budget due to the introduction of PB, and one city council official was interviewed twice. Furthermore, we asked some of the residents who showed up to vote for projects in November 2017 to explain how they became aware of the introduction of PB.

We analysed our data by identifying themes and organizing them in accordance with the stages outlined in Rogers' diffusion trajectory. In particular, we developed five themes: knowledge of PB, factors persuading the adoption of PB reforms, the decision to implement the new budgeting process, the implementation process and the confirmation of the continuation of citizens' involvement. The data representing our five themes was then clustered and matched with evidence gathered through our literature review. In doing so, we were able to establish a link between these themes and develop narratives of our empirical findings.

### **Analysing the diffusion of participatory budgeting in the Ternopil Municipality**

In this section, we analyse how participatory budgeting innovation has emerged in the municipality and how it has passed through different stages following Rogers' (2003) diffusion model.

#### *Knowledge Stage*

Individuals' knowledge concerning the existence of an innovation and their understanding of how to use it in practice and their awareness of the existing practice's limitations (Ezzamel et al., 2014; Rogers, 2003) are crucial for the diffusion of innovations. The context of this municipality is characterized by many criticisms directed toward the political party leading it. The main criticisms made by residents of the municipality concern the inefficient and inappropriate use of funds and the lack of transparency in the distribution of funds. The most severe criticisms concerning the inefficient and inappropriate distribution of funds emerge in the wintertime because of the municipality's inability to cope with the task of clearing snow in a timely manner, which results in injuries to residents and ties up traffic. Another problem that has arisen because of this was the

inability to collect garbage effectively. Citizens argue that this is primarily because the waste collection contract was awarded not to the best qualified company but to a company associated with the deputy mayor. This is just one instance in which the city government has been accused of corruption and embezzlement of public funds.

The municipality is also accused of holding the public hearings on the budget very rarely and irregularly. The purpose of such hearings is to present a quarterly report on the budget execution to the public. Nevertheless, the relevant budget information is usually made public just one day in advance of these planned budget hearings at the city council. Even though the city council has a quota on airtime with two local TV channels, no information dealing with public hearings on the budget is broadcast. Moreover, the city council is criticized for maintaining a covert type of censorship. The residents believe that the municipality buys airtime from local broadcasters and the mayor capitalizes on such airtime to talk about the municipality's achievements. The purchase of airtime is treated as a way to bribe the TV channels, as they are discouraged from broadcasting any criticisms of the city officials or the political leadership in the council. Instead, a majority of the urban population is blamed for being politically passive as the last municipal council election's turnout was around 46.7%. Similarly, the TV programmes seem to reflect the view that residents are extremely vague and simplistic in their understanding of the budget process and do not appreciate how much work is required to bring about the adoption of an effective budget. In addition, a web resource (<http://provse.te.ua>) has accused the mayor of deploying hackers to remove from this site all articles criticizing the city officials and the mayor whilst leaving articles that credit his achievements.

The Institute of Budget and Socio-Economic Research (IBSER) has received financial support from the United States Agency for International Development (USAID) to introduce PB. The IBSER is a non-governmental organization (NGO) established in June 2007 to promote comprehensive and sustainable socio-economic development of Ukraine via analytical and applied research, dissemination of information on the budget and economic situation, and implementation of training programmes. Participatory budgeting is a part of its Municipal Finance Strengthening Initiative (MFSI-II) Rollout Project, which is promoted by the IBSER and USAID. At the end of 2015, the IBSER organized seminars to distribute information about the PB project among the municipalities. Its seminars have played a significant role in making grassroots politicians and administrators aware of the PB model. As revealed by one administrator, the city council learned about PB through its communication with other institutions that aim to strengthen democratic governance in the country:

*In Ukraine, there are a number of programmes for the implementation of e-democracy. We are constantly appealing to various organizations that offer assistance to implement certain activities. One of the proposals was to introduce a budgeting approach to enable*

*the residents' participation. This is a joint project idea of USAID Ukraine, IBSER and Social Boost.*

### *Persuasion Stage*

Gaining positive attitudes towards a particular innovation is very important, and that happens at the persuasion stage (Rogers, 2003; Ezzamel et al., 2014). Various actors (Rogers, 2003) and institutions (Adhikari et al., 2015) tend to pinpoint the benefits of the proposed innovation in this stage. The IBSER's seminars have been used to point out the benefits of introducing PB. Such benefits include: strengthening legitimacy through dialogue and communication with residents, increasing the effectiveness of the distribution of public funds, construction of social balance - representatives of local governments must reach agreement on the budget priorities of the residents, opportunity for the residents to comprehend the challenges and obstacles that the authorities encounter, making officials more responsible to the residents, increasing public activity and social cohesion as people representing different backgrounds make joint decisions, opportunity for local authorities to meet the real needs of their constituents, and increasing the transparency of the budget process as the residents are involved in the allocation of public funds are noteworthy. An administrator expressed the positive attitudes towards PB:

*I believe that this (PB) is a positive budgeting practice, which in the first place can increase the trust of residents concerning the city council and the efficiency of our activities. Also, this budgeting process can better identify the needs of the community.*

In addition, the IBSER underscored that it is ready to provide methodological and technical assistance in the process of introducing PB. For example, it offered to establish procedures to invite citizens to submit project proposals and to set up an electronic system to automate all stages of participatory budgeting – submission of proposals, e-voting on the proposals, and reporting on the projects. Moreover, it offered to support the system's operation for the first year of PB implementation. As illustrated by previous studies (De Vries et al., 2016; Bhatti et al., 2011), the availability of financial and human resources is central in the process of persuading others to accept innovative practices.

The country's Cabinet of ministers approved a proposal for reforming local self-government and territorial organization of power in Ukraine in 2014. This is a starting point of decentralization in Ukraine. The aim of the proposal was to determine directions, mechanisms and timing for the formation of effective local self-government and territorial organization and to maintain a proper living environment for the citizens. Similarly, the proposal is expected to make high-quality public service available and to strengthen the institutional democracy that will satisfy the interests of citizens in the territory and reconcile the interests of the state and local communities. The government's initiative is also a persuasive factor that has positively motivated some of the local authorities to introduce PB.

### *Decision Stage*

The decision to adopt any innovations is made after having nurtured positive views concerning the particular innovation (Rogers, 2003; Ezzamel et al., 2014). If there is any uncertainty or risk of controversy surrounding the innovation, the responsible authority is likely to postpone the decision to adopt it (Rogers, 2003; Adhikari et al, 2015) or may reject its adoption (Rogers, 2003; Ezzamel et al., 2014). After conducting seminars promoting PB, the IBSEER asked municipalities to inform them as to their willingness to introduce PB. In June 2016, the city council approved the regulation concerning “the citizens’ budget of Ternopil”, which enables the municipality to embrace the procedures of participatory budgeting. As stated in its regulation, the sum that is directly allocated by the citizens cannot be less than 1% of the local council’s budgeted revenues, and the duration of realizing projects cannot be more than one year. All the projects are classified as small projects, which need less than 1 000 000 UAH for their realization, whereas the projects that require 1 000 000 UAH or more are considered large-scale projects. Many municipalities have expressed an interest in participating in the project of adopting PB. The IBSEER chose 15 of them, including Ternopil Municipality. The selected municipalities and IBSEER then signed the memorandum of understanding with respect to the municipalities’ participation in the project.

### *Implementation and confirmation Stages*

A clear understanding of how the accounting innovation is used in practice is crucial for its successful adoption and implementation (Ezzamel et al., 2014). Having approved the “the citizens’ budget of Ternopil” regulation in June 2016, the city council started a promotional campaign about the new budgeting procedures. Specialists from the IBSEER conducted seminars explaining the PB implementation process and provided training to administrators. A seminar was also organized to show the officials how to compile the PB regulations and how to inform citizens about the new budgeting practice. At the same time, a special group was formed to further develop PB regulations in the municipality. The adoption of the participatory budget innovation in Ternopil occurred rapidly, with only six months between the presentation of participatory budgeting to the municipality and the municipality’s decision to adopt PB and approve all organizational and procedural arrangements. The city council then started a promotional campaign about the new budgeting approach. The duration between the announcement of a call for citizens’ projects and the first project submissions was less than one month. On the one hand, this shows the municipality’s ability to introduce participatory budgeting. On the other hand, it also shows that the city council failed to take into account many issues that could affect the implementation stage.

The procedures adopted in the process of applying an innovation in a specific context can generate unexpected consequences or barriers (Rogers, 2003; Adhikari et al., 2015). In the process of implementing PB, one main obstacle was visible. Although the city council intended to provide consulting services for residents to help them write their project proposals as per the regulatory

requirements, it is evident that the residents had not been informed that this service was available. Our search through the archives of different information resources, including the city council website, confirmed that the municipality had failed to publicize the service. The unavailability of technical assistance in the first year of adopting PB is described by a citizen who submitted a project proposal as follows:

*I learnt about the possibility of submitting the citizens' project proposals and implementing them at the cost of the council's funds at a meeting with the deputy representing our neighbourhood. The city administration did not give any assistance to prepare the project proposal and to estimate the cost.*

The problem of cost estimation error in the process of realizing projects appeared in the interviews with the administration of the council. One administrator reflected on this issue as follows:

*Last year (2017), the projects chosen by the citizens were implemented for the first time. There were certain shortcomings that caused a delay in the implementation of projects and there was some misunderstanding amongst the authors of the project proposals. For example, one project's real estimate exceeded the funding limit of that project by four times. Therefore, negotiations were initiated with the author of the project to reduce the scale of the project.*

Because citizens writing the proposals lacked knowledge about how to estimate their project costs, they made many mistakes in preparing their proposals. Therefore, the implementation of PB and the realization of the projects became very complicated and led to additional costs to reconcile all of the controversial issues. In order to overcome this problem, estimated costs of some kinds of works were included on the website of the citizens' budget. Similarly, a nomination committee – a collegial permanent advisory body responsible for coordinating the organization and implementation of the citizens' budget and for doing a preliminary review of the project proposals, was founded in 2016. The committee is also assigned the task of previewing the report on the implementation of projects in the budget. The committee consists of 12 members: four representatives of the NGOs, four local deputies and four city council officials. The way in which committee members were appointed was illustrated by an administrator as follows:

*There was an announcement calling for applications from the representatives of public organizations, deputies and employees of the city council who wanted to be members of the Nomination Committee. What happened is that the number of received applications coincided with the required number of committee members.*

The members of the committee established a time frame for different stages of the participatory budgeting process. It consists of five stages. In the first stage, the citizens are supposed to submit their project proposals for the ensuing year between October 1 and October 31 of the current

year. In the second stage, from November 1 to November 7, the proposed projects are evaluated. In the third stage, from November 8 to November 21, voting on the citizens' projects takes place. The decision and announcement of voting results is the fourth stage, which takes place between November 22 and November 30. The last stage of the budgeting process is the realization of projects, which is expected to take place from January 1 to December 31 in the ensuing year. A citizen commented on the progress of extending technical support in the process of writing project proposals:

*In the first year, the council organized a meeting in which they (administrators) provided us with general information about the requirements of projects. Well now, in the second year, we (citizens) are trained to write our project proposals.*

The local mass media (two local TV channels, local radio stations and newspapers) and web resources (website of the city council, its Facebook and local news portals) are used to inform residents about the projects that are selected for public voting. In addition, the citizens who proposed projects distributed information about them through face-to-face communication with others. The council initially allocated 5 million UAH to spend on the citizens' projects for the budget year 2018. The citizens submitted 71 projects that could cost 36.7 million UAH to realize. However, only 60 projects received a positive response from the committee, and the estimated cost of these projects was 32.4 million UAH (Citizens' project, 2017). There were 41 large projects and 19 small projects estimated at, respectively, 30.8 million UAH and 1.6 million UAH (Citizens' project, 2017). The projects positively evaluated by the committee were allowed to seek votes from the public. Based on the preferences of the citizens who participated in the electronic voting process, four large projects and 11 small projects were incorporated into the budget estimates for 2018. These projects represent four main categories: culture, sport, social protection and education.

The council has used an electronic voting system since the introduction of participatory budgeting in 2016. Although it is not possible to allocate money to realize all of the citizens' preferred projects due to limited funds, there is no restriction concerning the number of projects one could vote for. This situation creates an opportunity for bribery and corruption as the residents would tend to vote for projects not based solely on personal preference; they could vote a certain way in order to receive money offered by a third party. The administration of the council is aware of the claim that some citizens had been paid to vote for specific projects even though the implementation of those projects would have no direct impact on their well-being. The situation of accepting money to vote a certain way is criticized by a bureaucrat as follows:

*This practice (PB practice) has been implemented to ensure the selection of projects that are important for a certain community. It is not acceptable that people vote for money. We are doing our best to bring the perpetrators to justice. However, it is worth understanding that this is not just our problem. If there were no people who were ready to sell their vote,*



*this problem would not exist. We do not take the responsibility for solving such a problem. We believe that the responsible behaviour of every citizen is important to avoid it.*

In Ternopil Municipality, 1% of the budgeted revenue was distributed by citizens. Nevertheless, the turnout of the residents to vote for the listed projects was less significant in 2016 and 2017. For example, only 5499 citizens voted in November 2017 to decide which projects should be included in the 2018 budget, and the population of the municipality is around 217 900. Therefore only around 2.6% of the citizens participated in the distribution of public funds. Despite the low turnout for voting and other administrative issues, the municipality expressed its willingness to rely upon its participatory budgeting approach in the next year as well. As demonstrated by the literature, the top leaders of any institution have to make the sensitive choice to either renew their commitment and continue with the innovation or abandon it (Rogers, 2003). Based on the prevailing situation in Ternopil Municipality, it is likely to follow the PB approach at least for a couple more years.

### **Concluding Remarks**

PB is treated as a practice of good governance that can strengthen grassroots democracy (Kuruppu et al., 2016), and various actors, both in the developed countries and EEs, propagate its introduction as it encourages the involvement of residents in the distribution of local authorities' scarce resources. The introduction of PB by many developed countries and some EEs has been studied. Nevertheless, the initiatives to adopt PB in Ukraine have not been explored to the same extent yet. This study contributes to extending our understanding of the process of diffusing PB in Ternopil Municipality through Rogers' diffusion of innovation theory. Such a study is very important because agencies like USAID spend their valuable funds on these initiatives, funds that could have been used for their other development activities or in other EEs. As elaborated by our study, the IBSER, a nongovernmental organization, has acted as the driving force in diffusing PB. Its seminars have particularly improved the knowledge of politicians and administrators concerning PB and have persuaded them to adopt PB by identifying its benefits and this organization's readiness to provide technical assistance free of charge. However, this NGO has not directly criticized the existing way of preparing the budget in the municipality which could otherwise be an attempt to present a phantom image of idealized budgeting for the municipalities (see Christensen, 2005). Therefore, our finding is in contrast to the literature that has portrayed accounting and budgeting innovations as often propagated by underscoring the positive aspects of such innovations whilst criticizing the existing practice (Ezzamel et al., 2014; Adhikari et al., 2015).

The involvement of USAID in strengthening institutional capabilities (Adhikari et al., 2015) and grassroots democracy (Kuruppu et al., 2016) in EEs is evident in prior studies. Despite being aware

of the mixed results and controversies in adopting PB in EEs, USAID appears to contribute to the project of diffusing PB in Ukraine as well. In the context of Ternopil Municipality, the diffusion of PB has yielded mixed results during the first two years. In the first year, the municipality failed to furnish clear instructions on preparing project proposals and estimating costs. As a result, some of the project estimates were inaccurate and their implementation was delayed. In addition, voting for money is evident in Ternopil. This unsavoury practice may have occurred because the NGO's seminars were particularly organized to educate politicians and administrators and to change their attitudes and behaviour, whilst no initiative was taken to help the citizens appreciate the benefits of a good governance practice like PB. As such, our study shows the importance of educating citizens on why it is important to vote for projects that can raise the living standards of a majority of residents instead of supporting projects as a way to gain personal financial benefits. At least, the municipality has to change its voting procedure. Otherwise, instead of strengthening good governance in the context of Ternopil Municipality, PB could become a practice that facilitates corruption, and the idea of strengthening grassroots democracy through PB could come to be dismissed as mere rhetoric.

Our study has demonstrated how the diffusion of PB has happened and what kinds of unintended consequences have appeared in our research setting. Our findings highlight a number of directions for future studies dealing with PB in Ternopil and in Ukraine more broadly. It is important to further study what has been done to avoid corruption in the process of voting. As evident by our findings, the municipality has not publicized the projects approved by the nomination committee other than simply by listing them on the citizens' budget web page. As a result, individuals who have written the project proposals may use various strategies to gain votes for their projects. Our study has not focused on the issue of how the projects are being promoted by individuals. This topic deserves scholars' attention. Such studies can be helpful in understanding how people behave whilst campaigning for their projects. Similarly, it is important to explore whether and how it will be able to extend its service free of charge in the absence of financial assistance from USAID in the future. It is also important to discuss with USAID's representatives what they think of unintended the consequences of introducing PB. We have failed to conduct any interview with this vital stakeholder of PB. We therefore encourage scholars focusing on the diffusion of PB to shed light on their views as well.

## References

Adhikari, P., Kuruppu, C., Wynne, A. and Ambalangodage, D. (2015). "Diffusion of the cash basis international public sector accounting standard (IPSAS) in less developed countries: The case of the Nepali central government", in K. Jayasinghe, N. D. Nath and R. Othman (eds.), *The public sector accounting, accountability and auditing in emerging economies*. Bingley: Emerald Publishing, pp. 85-108.

- Bhatti, Y., Olsen, A.L. and Pedersen, H. (2011). Administrative professionals and the diffusion of innovations: The case of citizen service centres. *Public Administration*, vol. 89, no. 2, pp. 577-594.
- Bland, G. (2011). Supporting post-conflict democratic development? External promotion of participatory budgeting in El Salvador. *World Development*, vol. 39, no. 5, pp. 863-873.
- Budget Code of Ukraine. (2010). Budget Code of Ukraine, from 08.07.2010 page 8 of 13, available at: <http://zakon2.rada.gov.ua/laws/show/2456-17/page8> (accessed 01 June 2017).
- Christensen, M. (2005). The third hand: Private sector consultants in public sector accounting change. *European Accounting Review*, vol. 14, no. 3, pp. 447-474.
- Christensen, M. and Parker, L. (2010). Using ideas to advance professions: Public sector accrual accounting. *Financial Accountability and Management*, vol. 26, no. 3, pp. 246-266.
- Citizens' project. (2017). Citizens' project, available at: <https://pb.rada.te.ua/statistics> (accessed 10 June 2017).
- Constitution of Ukraine. (1996). Constitution of Ukraine, from 28.06.1996, available at: <http://zakon2.rada.gov.ua/laws/main/254%D0%BA/96-%D0%B2%D1%80> (accessed 09 June 2017).
- De Vries, H., Bekkers, V. and Tummers, L. (2016). Innovation in the public sector: A systematic review and future research agenda. *Public Administration*, vol. 94, no. 1, pp. 146-166.
- Džinić, J., Svidroňová, M. and Markowska-Bzducha, E. (2016). Participatory budgeting: A comparative study of Croatia, Poland and Slovakia. *NISPACEE Journal of Public Administration and Policy*, vol. 9, no. 1, pp. 31-56.
- Ezzamel., M., Hyndman, N., Johnsen, A. and Lapsley, I. (2014). Reforming central government accounting: An evaluation of an accounting innovation. *Critical Perspectives on Accounting*, vol. 25, no. 4/5, pp. 409-422.
- Hansen, M.B. (2011). Antecedents of organizational innovation: The diffusion of new public management into Danish local government. *Public Administration*, vol. 89, no. 2, pp. 285-306.
- Kuruppu, C., Adhikari, P., Gunarathne, V., Ambalangodage, D. Perera, P. and Karunarathne, C. (2016). Participatory budgeting in a Sri Lankan urban council: A practice of power and domination. *Critical Perspectives on Accounting*, vol. 41, pp. 1-17.
- Local self-government in Ukraine. (1997). On local self-government in Ukraine from 21.05.1997, available at: <http://zakon5.rada.gov.ua/laws/main/280/97-%D0%B2%D1%80> (accessed 11 June 2017).
- Rogers, E. (2003). *Diffusion of innovations* (5th ed). New York: The Free Press.
- Van Helden, J. and Uddin, S. (2016). Public sector management accounting in emerging economies: A literature review. *Critical Perspectives on Accounting*, vol. 41, pp. 36-62.
- Vigoda-Gadot, E., Shoham, A., Schwabsky, D. and Ruvio, A. (2008). Public sector innovation for Europe: A multinational eight-country exploration of citizens' perspectives. *Public Administration*, vol. 86, no. 2, pp. 307-329.
- Walker, R.M. (2006). Innovation type and diffusion: An empirical analysis of local government. *Public Administration*, vol. 84, no. 2, pp. 311-335.

# THE RATIONALE FOR PUBLIC-PRIVATE PARTNERSHIPS: THE WORLD EXPERIENCE AND THE PROSPECTS OF UKRAINE

Mariya Knir<sup>1\*</sup>

<sup>1</sup> Faculty of Economics, Taras Shevchenko National University of Kyiv, Ukraine

## Abstract

This essay aims to determine the rationale and the peculiarities of the formation of public-private partnerships (PPPs) in different countries, and in Ukraine specifically, to identify the interests of participants in modern PPPs and to substantiate the benefits that they acquire in such interaction. The paper is based on the overview of challenges and motivation issues for the realization of PPP projects and the interests of parties in the development of the PPP mechanisms and also uses a statistical-based approach to study the practical results of PPPs. The article is devoted to problems of development of public-private partnership as a necessary tool of state regulation of macroeconomic proportions. The article argues that for the effective development of public-private partnership projects in the country there should be full understanding of the benefits and clear motivation for all of the interested parties: the government, private sector and society. In light of the Ukrainian government's efforts to initiate PPP projects, this study makes some recommendations on the development of PPP in order to stimulate the strategically important sectors of the domestic economy.

*Keywords: public-private partnership, concession, public sector, state authorities, private entities, investment, project*

## Introduction

In most countries in the world, state authorities have played a significant role in the economic development. Along with large corporations and powerful trade unions, state authorities continue to participate actively in economic processes, and their functions are not limited to regulating social and economic relations.

Looking at the evolution of the role of the state in the economy, it is apparent that the nature and methods of state participation in economic processes are constantly changing. The realization of numerous social and economic projects is associated with constantly growing restrictions in the

---

\*Correspondence to: Associate Professor, PhD, M. Knir, Department of Finance, Faculty of Economics, Taras Shevchenko National University of Kyiv, Vasylkivska St. 90A, 03022, Kyiv, Ukraine.  
E-mail: mariya.knir@gmail.com

budget and financial spheres, as well as with the growing demands of the population regarding the quality of public services and infrastructure. In these conditions, it becomes urgent to search for new forms and instruments of influence on the economy that offer alternatives to direct regulation. One of the new forms that have proved effective both in the national economy and abroad is the specific system of partnership between the state and the private sector called public-private partnership (PPP).

Most recent economic and political events that have taken place in Ukraine require the search for new factors of economic growth ways to raise the level of the society's confidence and trust in the government. Certainly, to overcome the problems generated by the rapid dynamics of modern life, the simple increase in the existing quantitative parameters of economic development is not enough.

Ukrainian state authorities need to focus on the use of mechanisms that allow them to restore the business activity of business entities and to ensure benefits to the society. One such mechanism, the effectiveness of which is proved by world experience, is public-private partnership.

Also, scientifically based approaches to motivating public and private partners to engage in such cooperation have not been developed, and there is no mechanism for the exchange of information between them and society regarding the benefits of the created partnerships. All of this impedes the development of PPP in Ukraine and requires further research.

PPP is an economic category. It is a special mechanism for implementing long-term investment projects by public and private partners in order to achieve the objectives of social and economic development of public entities. It improves the accessibility and quality of public services through the sharing of risks and the attraction of private resources (World Bank Group, 2018).

The main features of public-private partnership include the following:

- 1) the interaction of the parties is official, established on a clear legal basis by concluding a contract/agreement;
- 2) the parties are the state and private business; the interaction of the parties is of an equal nature regarding both the conditions and results.

Some experts add to these criteria a socially useful direction of cooperation (Lutz, 2008).

With regard to the spheres and industries, PPP projects can be classified into the following types:

- state contracts for the purchase of goods and services;
- lease of state property;
- concession agreements;
- production sharing agreements;
- joint ventures with the participation of public enterprises and foreign companies;
- companies with participation of the state in the equity capital;

- contract forms of participation of public authorities in investment projects, including life-cycle contracts, which differ from concessions;
- special economic zones;
- projects financed with the participation of state investment funds (Meiduté and Paliulis, 2011).

All of these forms of interaction have specific features of PPP: the availability of specific projects, contract terms of interaction between the parties, and construction (reconstruction, technical modernization, modernization in general) of facilities for the provision of public services that have a long period of implementation and subsequent payback. In addition, private partners are selected through a competition carried out in public with transparent procedures that ensure the legitimacy of the choice.

With regard to sector, PPP projects are usually involved in areas PPP projects are usually implemented in areas for which public authority is responsible. In international practice, the cooperation of state and business representatives through public-private partnerships has been spread widely in most socially significant areas, including:

- social infrastructure (restoration and construction of medical, educational and cultural institutions and provision of full technological and organizational support);
- transport infrastructure (construction and maintenance of roads and railways, sea and river ports, airports and pipelines; and provision of related services);
- housing and utility services (restoration, construction and/or maintenance of gas, water, electricity and water treatment facilities).

The use of PPP mechanisms allows countries to improve their competitiveness, which is a common integral assessment tool of the country's development in general. Countries with a high level of competitiveness are characterized by a developed institutional environment that generates revenues, high-quality infrastructure, stability of the macroeconomic environment, and high quality of healthcare systems and higher education institutions. The openness of the market and the developed financial sector create the basis for the rapid introduction of innovations that contribute to improving the quality of life for the population.

### **Historical development of PPP**

The application of different mechanisms of state and business partnership has a long history. The related scientific issues have been studied for several centuries by scientists from countries with market economies, where significant changes have occurred in the economic relations between the state and the private sector in the context of liberal-conservative doctrines.

Analysis of the theory and practice of developing partnerships between the state and business allows us to distinguish the following main stages:

Stage 1: 17th–19th centuries – stage of the trust, in which the property belonging to the founder was transferred to the trust owner, but income received from the property belonged to beneficiaries;

Stage 2: 1919–1980 – the concession stage, in which the legal entity or individual was granted the right to create and manage a concession object in order to meet public needs on the basis of a concession contract on a fee and time basis;

Stage 3: Beginning of 1990s–present – a stage of modern PPPs, characterized by the launch of private financial initiatives, the emergence and development of new forms of PPPs, the spread of PPPs in a wide range of sectors of the economy, and the formation of global partnerships (Meiduté and Paliulis, 2011).

The main preconditions for the development of such a format of relations at the turn of the 20th/21st centuries are:

- the need for significant investments in modernizing infrastructure objects that, due to their strategic, economic and social significance cannot be privatized;
- quality transformation of the economic and social functions of the state and the need to improve their efficiency; inadequate conditions of fiscal, investment, science and technology instruments in the country as well as lagging industrial policy and regional development policies;
- establishing conditions for fair competition in the markets of goods and services, including social ones, the need to increase the competitiveness of the country's economy and its individual entities;
- the crisis in the system of public finances, the growth of fiscal imbalances, the introduction of tight budgetary constraints;
- growing mistrust in the state-business-society triad in countries with a transitory economy which is associated with miscalculations in economic and social reforms.

Appeal to the historical aspects of the formation and development of partnership relations between the state and business can reveal some changes in the definition of the goals of forming modern public-private partnerships. Thus, in the early 1990s such partnerships were initiated mainly for solving such problems of the economy as financing of capital-intensive or low-income sectors of the economy, infrastructure development, reducing the budget deficit at all levels of public administration, improving the quality of public services, and the mechanism of further denationalization of property. At the beginning of the 21st century the targets of such partnerships have begun to be more general in nature; they include the implementation of socially important and priority projects for the state, solving social and economic problems that are important for the whole society.

Partnership throughout all historical periods was flexible and stable, consistent with the conditions of the time and the countries' development goals. The development of forms and mechanisms of interaction continues to the present and proceeds in several directions:

1. Delegation by the state to business partners a wide variety of government functions and tasks, from major to smaller ones.
2. Having reached a certain degree of complexity of interaction between business and the state, PPPs strive to simplify this type of cooperation. This is manifested in simplifying the structure, mechanisms of interaction and other factors.
3. The initiative to create PPPs, in most cases, remains in the hands of state authorities, though it is possible to move this initiative to different levels: national, regional, local (Dudin, 2016).

For classification purposes, three generalized stages of PPP development can be distinguished.

In the first stage of development (the highest), the country creates the conditions and prerequisites for the effective implementation of PPP projects. The United Kingdom and Australia are the main representatives of this stage. These countries are characterized by a variety of partnership models involving different contributions and risks and covering all periods of the project life cycle, attracting various categories of investors, including private and pension investment funds. A well-known example is the PPP project in London that has attracted billions of pounds sterling to develop and modernize the London Underground and has brought profits to investors/participants of the project.

Other examples of PPP in the UK are also very illustrative. This country is one of the world leaders in the implementation of PPP projects. Over 130 public-private partnership projects have been implemented here in the healthcare sector alone during last few years, including the St. Bartholomew and Royal London hospital reconstruction project worth 1.1 billion pounds sterling.

At the middle stage are the majority of developed countries, including the USA, Japan, France, Canada and Germany. The application of the PPP mechanism in these countries is close to the variety of models applied to the first group, but the scale of coverage of industries and territorial levels is somewhat smaller. At the same time, the level of development of PPP models can be characterized as high. Special units are formed to deal specifically with implementing PPP projects in different spheres, using a wide range of financing instruments.

The countries of the third group are at the initial stage of development; this group includes Ukraine. These countries are just starting to form the legislative base and institutional environment for public-private partnerships. Discussions concerning PPPs have only recently begun at various levels of government and in the business community, the number of projects being implemented is small, and the forms and models used are not very diverse. The goal at this stage is for the countries to thoroughly study their own experience and that of other countries as



well as to shape public opinion and hire a staff of specialists to develop PPP models and realize PPP projects. Besides Ukraine, this group includes countries such as China, India, Slovakia, Latvia, the Czech Republic, Poland, Hungary, Belgium, Finland, Mexico, Brazil and Russia. In the 1990s, more than 130 low- and middle-income countries adopted different kinds of programmes for involving the private sector in infrastructure projects. The private sector participated in 2500 infrastructure projects with an attracted investment of 750 billion US dollars. The financial crisis of the late 1990s and 2008 led to a cooling of interest of private investors, but in recent years there has been a new investment boom (Oshima, 2016).

### **The rationale behind the PPP concept**

The term “public-private partnership” clearly indicates that one of the partners is the state. The state as a representative of society and government ensures satisfaction of the needs of the society in public goods, the support of state powers and functions, and the development of new, socially important functions that arise in a globalized world.

In the modern economy, the state is considered to be a full owner, an economic entity, endowed with appropriate functions and powers. The forms and methods of PPP have developed to a point where it is possible for the state to transfer part of its powers to the private sector, while preserving the most important parts of state ownership. These powers include, first of all, functions such as the construction, operation and maintenance of industrial and social infrastructure. Such a transfer by the state of a significant part of its administrative function distinguishes PPP agreements from other public-private transactions. It can improve the state’s fulfilment of its main functions, and it can also use the entrepreneurial abilities of its private partners to increase the effectiveness of project results and increase its own commercial effect.

The other side of the PPP, a private partner, is naturally a more efficient business entity as it is characterized by high mobility, flexibility and responsiveness in decision making, a greater capacity for innovation and risk taking that allows faster adaptation to change in the external environment and more efficient use of commercial opportunities. Knowledge of the particularities of the production process, rich experience in negotiating, contracting and exercising control over execution, efficient management and the practical application of modern financial management technologies make the private sector entities a much more effective project manager.

The main motivation, which is guided by a private partner in its economic activity, and the implementation of which directs its efforts and means, is to obtain maximum profit, regardless of the sphere of activity. Moreover, a strategically thinking business builds its priorities in the first place not simply in terms of profits but in the interests of sustainability of revenues from projects. Using such a form of joint activity with the state as PPP, private sector enterprises are given the opportunity to demonstrate their business activity in areas that were not accessible to them previously and thus expand the boundaries of their business. The global trend of growing demand

for public services, the preservation of which is predicted in the future, gives grounds to conclude that activity in this area could become a guaranteed source of long-term income. The ability to receive and increase revenues in a stable way over a long period of time attracts the private sector, especially in times of aggravation of macroeconomic uncertainty, when demand in other markets is shrinking. In addition, participation in the implementation of socially significant projects provides positive social advertising and enhances the reputation of a private partner, which promotes the growth of demand for its products as well as a manifestation of its corporate social responsibility. The provision of such standards is a prerequisite for the admission of the company to the markets of other countries and international financial markets.

The private sector as a state partner provides entrepreneurial initiative, knowledge, skills and commercial experience, partial or full financing of the project, updating of production assets and introduction of modern forms of production organization. Moreover it provides environmental protection through the use of innovative technologies and energy saving, and effective project management and management of risks that arise as the project is realized. The private sector usually carries out operational activities at different stages of the project: participation in its development and negotiating of agreements, financing, creation of the mission of the project and putting it into operation, exploitation of project results, collection of payments from consumers, settlement with partners, and return (transfer) of assets to the state partner, etc.

The development of the PPP is accompanied by a significant expansion of free movement of private capital. At the same time, private structures are able to invest in industries that were previously inaccessible to them, since they were considered a sphere of public investment. As private partners have different degrees of investment potential, not all of them can use these opportunities in full. Thus, PPP projects involving transportation, housing, energy, telecommunications, etc., due to their high cost and riskiness, can be realized only with the participation of partners that are able to accumulate significant financial flows and adequately distribute risks not only between direct project partners but also between the partners and financial market institutions.

The experience of developed countries suggests that such large financial partners of the state are usually large companies, financial and industrial groups, financial and banking groups, international financial institutions, and TNCs. At the same time, in the majority of developing countries, the range of companies that can participate in PPP projects in the infrastructure sector is limited to TNCs, which is explained, in particular, by the lack of development of large businesses in these countries. Capable large corporations produce competitive products, provide a rational balance of the specialization of national production, and fill the state and local budgets. Their participation in PPP projects tends to increase the supply of infrastructure services and improve their quality, as well as significantly increase budget revenues. At the same time, such companies always seek to take a monopoly position in the market at the expense of other participants,

therefore, without proper regulation of the PPP relations. Therefore, the penetration of capital of powerful private structures into strategic and infrastructure sectors may lead to the of a state monopoly by a private monopoly.

Let us remember that the basis of public-private partnership is the theory of mixed economy, put forward in 1939 by American economists J.M. Clark and P. Samuelson, which implies a mutually beneficial cooperation between the state and entrepreneurs (Araújo and Sutherland, 2010). Consequently, the main advantages received by the state from partnership with the private sector are:

- reducing the burden on public administration and increasing the effectiveness of the tasks that governments face in pursuit of social goals;
- stimulation of innovative activity of business entities and development of national science;
- increasing the investment capacity of the authorities and increasing the domestic and foreign investment of priority projects for the state and local governments;
- increasing the efficiency of the performance of the public finance system and expanding fiscal space in order to fulfil the socio-economic development objectives of the country;
- increasing the efficiency of public/utility property management;
- improving the quality and availability of industrial and social infrastructure services;
- reducing risks or redistributing them to business.

The private sector, as a party to the PPPs, obtains the following main advantages:

- expansion of investment opportunities;
- getting access to new markets, getting access to previously unavailable sectors of the economy, expansion of the spectrum of goods and services;
- reducing uncertainty in decision making and facilitating work with authorities in the process of issuing permit documents that are necessary for the implementation of the project;
- increasing the overall profitability of business and increasing the capitalization of enterprises (partners);
- reduction of risks;
- favourable conditions for innovative development;
- development of the company's human resources;
- implementation of a social strategy based on the principles of social responsibility.

In solving their specific tasks, each partner brings its own "exclusivity" into the overall project, so PPP projects have several advantages over projects implemented by the public and private partners alone. These are described below.

1. PPP makes it possible to significantly increase the financial and other resource support for infrastructure projects, which in turn makes it possible to implement more ambitious, innovative

and efficient projects on significantly reduced terms. According to the Practical Guidelines of the European Economic Commission on Good Governance in Public-Private Partnerships, the PPP opens government access to alternative private sources of capital, enabling the implementation of important and urgent projects that would otherwise not be possible. PPPs provide added value in terms of providing access to new sources of financing and overcoming structural problems in order to ensure a higher level of investment in addition to public assets in certain projects. Infrastructure investments are very important for the state because economic growth depends to a great extent on the state and development of infrastructure (in the spheres of transport systems, energy, water supply, telecommunications), as well as on the construction of new infrastructure segments and facilities (health facilities, educational institutions, objects of housing construction) (Singh and Kalidindi, 2009).

2. PPP intensifies the implementation of infrastructure and other projects. Involvement of interested private partners with their financial, organizational and intellectual resources, accompanied by the state's opportunities to implement projects, multiplies the effect, making it possible to significantly intensify the implementation of infrastructural and other projects and to significantly shorten the terms of providing infrastructure facilities to the consumer.

3. PPP is an effective way to reduce public spending on the implementation of a project and to ensure the most effective and optimal price-quality ratio in the public sector. PPP mechanisms have significant potential to create and implement infrastructure projects that allow for more efficient use of public resources and opportunities, partially release resources for other public projects, and offer conditions for governmental institutions to achieve a better price-quality ratio by improving the distribution of risks, innovation, better asset utilization and improved management practices. This is ensured by drawing on the experience of the private sector in project planning and implementation and by reducing the initial projected amount of budget expenditures for the project implementation by attracting private investments. At the same time, infrastructure projects implemented in the framework of PPPs act as powerful incentives for minimizing costs throughout the project's life cycle, which is extremely difficult to achieve within the framework of an established model of public procurement. Reducing the cost of the life cycle of an infrastructure project is often a key factor for deciding about the project's implementation (Araújo and Sutherland, 2010).

4. PPP allows continuity of the implementation of infrastructure projects (construction, renovation, modernization, etc.). PPP schemes are attractive because, even in situations where the public financial resources needed to implement a project are limited, the participation of private financing partners make the project possible.

5. PPP is an effective way to optimize the distribution of risks and to ensure high efficiency in risk management, based on the need to ensure that each side carries the risk that it is best able to

manage, with the least cost. The optimal distribution of risks is the main principle of any PPP scheme. The optimal distribution of risks means that certain risks that are more economically managed by public sector entities are managed by the state partner, and other risks that are more effectively managed by private sector entities are attributed to the private partner (up to the total transfer of all risks to the private sector). For example, risks associated with planning are better managed by government bodies, while operational risks can be better managed by the private sector. This ensures that the risks of the project should be handled by the most competent party, thereby reducing the cost of the project and dampening the risks themselves. Opportunities for effective risk sharing largely depend on the particular project being implemented and the PPP scheme chosen for its implementation. The more managerial functions are delegated to a private partner, the greater the risks are on its side. However, private entities cannot assume risks that they cannot readily manage. In general, private sector entities are more deliberate about the issues of risk assessment than the state. Taking this into account, optimizing the distribution of risks and ensuring the high effectiveness of risk management may be relative phenomena. A clear understanding by the relevant parties of the PPP of their own awareness and interest in risk management makes it possible to assess the real cost of maintaining the risks of the project for the state partner or transferring them to a private partner (Nisar, 2007).

6. PPP increases the efficiency of the use of public resources and ensures greater managerial innovation. A number of activities of public sector entities can be implemented with significantly greater efficiency when using private sector management technologies. According to the Practical Guidelines of the European Economic Commission on Good Governance in the Public-Private Partnership, the synergy of motivation and skills of the public and private sectors, as well as agreements signed with parties on a competitive basis, expand opportunities for using innovative approaches to the implementation of state infrastructure projects based on PPPs.

7. PPP presents real opportunities for the private partner to produce additional income for the further reduction of the financial burden on the state. Private partners can further reduce the financial burden on the state by independently creating additional revenues within the framework of the project being implemented (for example, by using reserve capacities or eliminating unnecessary assets).

8. PPP relieves the state of a significant share of the organizational and time load. The transfer of responsibility for the provision of certain public services creates an opportunity for public authorities to carry out regulative activities and focus on planning and monitoring without having to deal with the routine provision of these services. This makes it possible to exclude from the functions of state bodies a number of secondary issues that distract them from essential activities, thereby improving the efficiency of public administration.

9. PPP improves the quality of provided infrastructural and other types of facilities and services. Foreign experience in the implementation of PPP projects shows that the quality of services provided by PPPs is higher than those implemented through an established model of public procurement. Such a result can be achieved by optimizing the integration of the service providers involved, by saving due to the scale of the project and through the introduction of innovations.

10. PPP creates commercial value of public assets. Huge amounts of state funds are invested in defence, national security, and intelligence, particularly in the areas of advanced technological and information technology development. Although innovations achieved in these spheres have a very limited scope of application by the state, the involvement of the private sector (considering the necessary measures to protect national defence and security interests) makes it possible to significantly expand the areas of use of such achievements, benefiting not only private partners and consumers of infrastructure and other services, but also the state.

It is also worth noting the benefit of the third side of public-private partnership agreements, the society, which as the ultimate consumer of the results of PPP activities ultimately receives better and more affordable goods and services. Experience shows that the PPP mechanism is positively perceived by the public if it contributes to the possible realization of the goals of sustainable development and contributes to the society. For society as a global consumer of public services, the main advantage of PPPs is that they increase the number and overall availability of services and make it possible to obtain them in the best way, with higher quality and at a better price. But the PPP is able not only to meet the public needs for quality goods and services and to increase the welfare of the population but also to become a dialogue platform for the cooperation of interests and to prevent conflicts between society and government/society and business, to unite the population around meaningful ideas and to create the necessary conditions for the construction of a civilized society. All of this determines the necessity and relevance of building a communication process which involves the constant exchange of information between executive authorities, private structures and the population (Lutz, 2008).

### **PPP in Ukraine**

For Ukraine, public-private partnerships are one of the most promising ways to attract investments into the existing public and municipal infrastructure. This is all the more true, considering that the programme of total privatization is not fully implemented.

Due to the information campaign deployed by the government around the public-private partnerships, the population has formed a more or less generalized view of the types of objects that can theoretically be transferred to a private partner within the PPP model – roads, airports, seaports, water and power utilities etc. However, in reality, the range of PPP objects (including concessions) is much richer and more diverse than a standardized model formed in the public

consciousness. Even more, the Ukrainian practice of concessional mechanisms is now full of unusual examples that enrich our experience and reveal the potential risks of non-typical mechanisms (Table 1).

Table 1. Examples of different types of PPPs in Ukraine

No	Sphere	Example in Ukraine
1	Vintage castles and palaces	The idea of the transferring of castles in a concession was born in 2007, when the List of objects of state property right, which may be granted by the concession, was updated. The list identified three Ukrainian castles as potential concession objects. However, in practice, all attempts were unsuccessful - funding for projects has not been started.
2	Football ground and city lake	The Kolomyia City Council reported in 2017 about signing of an agreement within the framework of the PPP, the subject of which was the construction of a sports complex (football and athletics grounds) and the refinement of a city lake area. Under the conditions the benefit of a private partner was in obtaining the right to carry out the construction of multi-apartment residential buildings on the leased land.
3	Multi-apartment buildings	The construction of multi-apartment buildings is no longer hidden behind the motivation for social infrastructure development and is directly declared as the goal of the project by the organizers of the competition. At the same time, the percentage of the total area of living apartments and commercial premises that the winner of the competition has to transfer under the terms of the competition to the customer (the state), fluctuates within 5-20%.
4	Re-equipment of boiler-houses	The popularity of energy service contracts is due to the availability of budget guarantees. Projects on rebuilding boilers are not a panacea, therefore, they remain one of the unique examples of initiative of local communities.
5	Waste processing plant	For the realization of the project, 109 concession agreements were signed. But, unfortunately, this is only on paper. The idea of implementing a project for the construction of a complex of plants for the processing of solid waste in the Poltava region (it was planned to build four plants that would have to cover the region, for which the separate contracts were signed with all the village councils) collapsed, so now out of 109 concessions - zero realized projects in practice. This is a vivid example of a formal approach of the Ukrainian "reporting" on PPPs and concession performance.

Source: Compiled by the author basing on (USAID, 2013).

Scepticism concerning the development of PPPs in Ukraine most often refers to the lack of well-fledged, special legislation on PPPs. Indeed, the Ukrainian law "On Public-Private Partnerships", adopted in 2010, has not yet worked fully. However, the existing civil and economic legislation makes it possible to implement projects in the format of a classical PPP. A proof of this is a number of projects, the failure of which is not related to the lack of special legislation.

In Ukraine there were several attempts to implement PPP projects. Most of the projects concerned the development of infrastructure facilities and mining, which is typical for this kind of cooperation between the state and business. Let us consider the most advanced projects, both from the point of view of the implementation model and in terms of the stages of preparation.

*1. The joint development of the Simferopol International Airport (Autonomous Republic of Crimea).* Started in the summer of 2011, the project was planned to be implemented jointly with the Shanghai Construction Group (private partner, China), Investcap (coordinating partner, UK) and

the Council of Ministers of the Autonomous Republic of Crimea (state partner, Ukraine). The total cost of the project was about 30 million US dollars.

The PPP implementation model assumed the creation of a special purpose vehicle (SPV) with the distribution of shares between the private and coordinating as well as state partners in a ratio of 30/70. For the purposes of project financing, in addition to private partner funds, it was planned to raise borrowed capital from the China Development Bank (CDB) and Export-Import Bank of China (China Eximbank).

In this model, the role of the coordinating partner is remarkable; although it is on the side of a private partner, it has completely different functional responsibilities. Unlike a private partner that provides financing for part of the project and is responsible for the construction/modernization of the PPP facility, the coordinating partner performs all the “rough” work. It ensures the work of the project organization with borrowers, insurance companies, technical consultants, lawyers, and financial consultants; monitors implementation of the project; introduces advanced corporate governance rules in the project organization etc. In the Simferopol International Airport project, the coordinating partner also followed the implementation of the airport development strategy developed by Lufthansa Consulting.

The PPP project Simferopol International Airport passed all stages of coordination within the framework of the Council of Ministers of the Autonomous Republic of Crimea and was submitted for consideration to the credit committees of CDB and China Eximbank. The meeting of committees was planned for the spring of 2014; however, due to the events of February-March 2014 the project could not be completed.

*2. The project of the concession of the berths of Yevpatoria Sea Commercial Port.* The project was launched in December 2010. The Chinese company CNTIC (China National Technical Import & Export Corporation) was the coordinating partner, the Agency for Regional Development of the Autonomous Republic of Crimea was the private partner, and the Ministry of Infrastructure of Ukraine planned to become a state partner. The project foresaw the construction of a full-fledged commercial port with an estimated cost of more than 1 billion US dollars. The project was stopped at the stage of preparation of the feasibility study due to political force majeure (2014).

In the context of the history of PPPs in Ukraine, it is worth remembering the failed Production Sharing Agreements (PSAs) in the search/exploration for and production of hydrocarbons at the Yuzovsky and Oleskoe fields. Private partners under these agreements in 2013 were Shell and Chevron. Later, Shell and Chevron refused to participate in PPP projects. The reasons for the refusal were the political events in the east of Ukraine and the scandals surrounding the coordinating partner for both projects (USAID, 2015).



The PPP mechanism, properly functioning, provides wider benefits from investments in public projects, creating favourable prerequisites for sustainable, balanced development. In Ukraine, there is great potential for the development of many forms of public-private partnerships, but before that potential can be realized it is necessary to solve a number of fundamental problems. First, both sides of the partnership should recognize that effective PPPs cannot be regarded only as the attraction of additional resources to capital-intensive projects. It is necessary to consider the real interests of all parties of the agreement. In our country, the so-called political tradition is strong when the state plays an exclusive role and sometimes intervenes in the autonomous spheres of society, even undermining the competence of business, not always justifying its actions legislatively. Another obstacle to the development of PPP projects in Ukraine is the corruption of the public authorities at all levels of government, which prevents the establishment of confidential and constructive relations with entrepreneurs. Another partner, Ukrainian private business, remains a largely immature participant in the interaction with the authorities. The social orientation of business, its interest in solving not only its own private problems but also societal ones, is still not sufficiently developed. Large, medium and small businesses demonstrate the desire to mainly profit, redistribute budget and government funds, and avoid investing or participating in global projects that are of particular importance for the country's economy and improvement of its infrastructure. This situation seems to be a completely natural consequence of the peculiarities of the Ukrainian model of interaction between the state and business. Effective partnership can be realized only if the strategy for the country's further development is completely clear and predictable.

## **Conclusion**

The development of public-private partnerships synergies between the capacity of government bodies and local self-government bodies and the initiatives, experience and efficiency of private capital, which make possible significant investments in the economy on a medium- and long-term basis.

The interaction of government and business is one of the most important conditions for the country's successful social and economic development. Public authorities and businesses should work together in the national interest, forming partnership models of relationships in various spheres. Thus, it is extremely important to find the balance of interests necessary for the implementation of socially significant projects.

Each of the parties of the PPP has its own interests, unique resources and characteristics, the combination of which contributes to the more effective realization of the functions of the state and the private sector. This provides conditions for the achievement of the goals of social development, on the one hand, and the implementation of entrepreneurial initiatives for profit on the other. Combining the efforts of partnerships allows the parties to minimize their own

“weaknesses” and gain additional benefits. In order to prevent conflicts of interest among PPP participants and to ensure a positive public perception of the project, it is necessary to develop communication strategies for each project implemented and to establish a permanent exchange of information between the state authorities, private structures and the society.

Analysing the experience of PPP in Ukraine, we may conclude that the main causes of the failures of PPP projects are major political risks. These failures are caused by different kinds of political scandals, such as attempts to use PPP models in order to obtain control over important infrastructure objects or other force majeure political issues.

In addition to failures connected with the occupation of the Crimean Autonomous Republic, the reputation of both private and public partners is extremely important. The key to success is the non-biased parties, which are ready to assume the risks of managing PPP processes and become reliable full partners of the project.

Another negative feature of most PPP projects in Ukraine is the lack of experience in attracting a private partner to provide public services.

Prospects for further research in this area are the development of the PPP strategy and recommendations on the creation of a favourable environment for the implementation of PPP projects in Ukraine considering the international experience.

## References

- Araújo, S. and D. Sutherland (2010). Public-private partnerships and investment in infrastructure. *OECD Economics Department Working Papers*, no. 803.
- Dudin, M.N. (Ed.). (2016). Special issue: Government and business regulation: Regional and sector characteristics. Controlling the implementation of the public-private partnership (PPP) projects in the system of local strategic management. *Journal of Internet Banking and Commerce*, vol. 21, no. S4.
- Lutz, S. (2008). Happy together: Consumer expectation for a public-private healthcare system. *Journal of Healthcare Management*, vol. 53, no. 3, pp. 149-152.
- Meidutė, I. and Paliulis, N. K. (2011). Feasibility study of public-private partnership. *International Journal of Strategic Property Management*, vol. 15, no. 3, pp. 257-274.
- Oshima, K. (2016). Public-private partnerships, dividing operational stage, and optimal governance structures. *Public Organization Review*, no. 16, pp. 443-459.
- Singh, L.B. and Kalidindi, S.N. (2009). Criteria influencing debt financing of Indian PPP road projects: A case study. *Journal of Financial Management of Property and Construction*, vol. 14, no. 1, pp. 34-60.
- Nisar, T.M. (2007). Risk management in public-private partnership contracts. *Public Organization Review*, vol. 7, no. 1, pp. 1-19.

- USAID (2013). Public-private partnerships awareness in Ukraine baseline survey, available at: <http://ppp-ukraine.org/wp-content/uploads/2013/07/public-private-partnerships-awareness-in-ukraine-baseline-survey-eng.pdf> (accessed 3 August 2018).
- USAID (2015). Review of policy, legal and institutional framework for industrial parks in Ukraine, available at: <http://ppp-ukraine.org/wp-content/uploads/2015/12/annex-11-final.pdf> (accessed 3 August 2018).
- World Bank Group (2018). Public-Private Partnerships, available at: <https://www.worldbank.org/en/topic/publicprivatepartnerships/overview> (accessed 8 August 2018).