

PPP in healthcare: Critical issues. Best Practice and Kazakh Realities

Today, because of a shortage of budgetary funds development of PPP in Kazakhstan is considered as an important element of the new economic policy, not only to raise funds to the infrastructure but also as a way of improving the efficiency and quality of medical services.

The advantages of the PPP model have resulted in the active development of PPP in Kazakhstan in past decades. Although the transport and energy sectors used PPP, it is widely implemented in healthcare, education, telecommunications, utilities, and municipal sectors with a different level of success.

Kazakhstan being a developing country faces many challenges while developing infrastructure based on the PPP model. Despite significant improvements in PPP project implementation and overall positive dynamics, there are still several matters to deal with.

PPP's legal framework is one fundamental of the effective implementation and progressive development of PPP both in Kazakhstan and in any other country. Taking into consideration that PPP in Kazakhstan is under development, legal regulation of this cooperation between the state and business is also developing and definitely requires modernization on many directions, without which the PPP development in Kazakhstan can be seriously obstructed.

The main laws regulating PPP in Kazakhstan which are the Law of the Republic of Kazakhstan dated 7 July 2006 No. 167- III "On Concessions" (- the "Concessions law") and the Law of the Republic of Kazakhstan dated 31 October 2015 No. 379-V "On public, private partnership" (-the "PPP law") still require significant improvement. The above laws are the basic regulatory documents in the PPP sphere. Other key laws are: "Budget Code of the Republic of Kazakhstan" dated 4 December 2008 No. 95-IV, "On taxes and other obligatory payments to the budget (Tax Code) of the Republic of Kazakhstan" dated 25 December 2017 № 120-VI, Law "On Architectural, Town-planning and Construction Activity in the Republic of Kazakhstan" dated 16 July 2001 No. 242-II, the law "On Project Financing and Securitization", dated 20 February 2006 No.126- III and other.

In this article, we focused on the analysis of the current key concepts of Kazakh legislation that directly impact implementing the healthcare PPP projects in Kazakhstan. We also addressed legal aspects that hinder the successful implementation of PPP in healthcare. It bases the following review on the analysis of both Kazakh and general international PPP experience and particularly in healthcare.

International experience

The governments of different countries all over the world nowadays face a wide range of problems in healthcare caused by the demography change, an increasing burden of chronic diseases, rising health care costs, more informed patients and rapidly changing healthcare technologies. Healthcare systems try to widen the access and performance of high-quality medical services without increasing expenditures. More investments to the healthcare will be necessary in many developing countries, including Kazakhstan, where the healthcare infrastructure does not correspond to the modern standards, healthcare facilities do not have necessary managing skills and patient care staff to meet the growing needs of medical care.

As per PwC Health Research Institute, it will need big money infusions to solve the above problems. State healthcare expenses worldwide is expected to increase over 65% from 2010 to 2020, and the investment of more than \$ 3,6 trillion will be only in the countries of the OECD and BRICS. The countries more often began to use new models of partnership and cooperation to sponsor

healthcare projects and bring the skills to the sector. There is no exact answer to the question about the perfect combination of state and private financing in healthcare. The PPP turned into the tool of an alternative method of financing infrastructure development and healthcare service provision.

The PPP can be adapted to meet specific project needs; the private partner role may vary from technical maintenance of the facility and the provision of non-medical services (such as catering or laundry) to specialized medical services (such as laboratories or hemodialysis) to the complete hospital management, including all medical services.

Analysis of the countries' experience in PPP in healthcare allows to make the conclusions and recommendations about the conditions and factors that influence success or failure of the PPP projects. The main success factors of PPP in healthcare, under the international experience, integrated in the PwC and California University report "PPP in healthcare: models, lessons and trends for the future" are:

- Presence of political will;
- Proper legal support and regulatory framework;
- High-quality and flexible maintenance of PPP contracts and their effective management;
- Transparency;
- Public sector capacity;
- Private sector capacity;
- Broad stakeholder participation

As mentioned above, the proper legal support and regulatory framework is one of the most important success conditions of PPP projects in healthcare. Special PPP law and auxiliary regulatory framework are essential predecessors of PPP project development and planning. Despite that, many countries carry out PPP projects without corresponding legislative regulation and state policy, effective PPP legislative framework removes and eliminates many barriers that could slow down the planning process or scare away potential investors. Kazakhstan shows certain success. In 1991, the first law of the Republic of Kazakhstan "On Concessions" was adopted and regulated the legal conditions for provision of objects in concession on the territory of the republic only for foreign investors. The new law "On Concessions" (in force) was adopted in 2006 to end legal limitations and problems of PPP project implementation in Kazakhstan. In implementing the Concessions law, several barriers to its proper application were identified to eliminate which the law has been systematically modified and supplemented. In October 2015, the PPP law regulating other PPP forms stipulating a wide range of state support measures to infrastructure investors, including foreign ones, was adopted in Kazakhstan.

PPP in healthcare was mainly used for hospitals' construction and operation, because of the scale of first investment required, and also because of the complexity of PPP transactions, which make PPP model reasonable only for large projects. Real estate construction, expansion and maintenance are still the dominant areas in which PPP is used both in developing and developed countries. The situation is changing because the more PPP application areas in healthcare show its potential: from digital health care to health insurance, medical education and the extension of primary health care.

The rapid growth and success of infrastructure PPP projects, such as roads, airports and energy, have strengthened the confidence of the private sector in developing countries in terms of investment security. PPP in health care is considered a promising area. However, PPP is a relatively complex way of cooperation between the state and the private sector. Therefore, achieving benefits for all parties to PPP transactions in healthcare is not an easy task. PPP fails for several reasons based on international experience, but most often because of an imbalance in the transaction when one party does not see the benefits of such cooperation. As per the KPMG report Rethinking Public-Private Partnerships for Universal Healthcare, the most common mistakes in PPP projects include:

- Narrow goals of the project: inability to take into account the full scope of tasks of the private partner in the contract, because of which the private partner may become responsible for the treatment or provision of services that were not originally intended for him.
- The wrong partner: PPP is more than just a means of attracting private capital. The private partner will significantly improve the efficiency of the project compared to what the public sector can offer. Without a competent partner, it makes no sense to share risks with such a partner, since the state can independently take a loan and carry out a project.
- Incorrect predictions: The disadvantage of a PPP is its inflexibility. Contracts are usually concluded for 15-30 years, but the needs of healthcare and treatment can transform during this time, which makes detailed planning and stress testing one of the most important tasks.
- Inappropriate risk sharing: The transfer or acceptance of inappropriate risks can have a significant impact on the viability of a project. It is necessary to analyze such key risks as the demand for medical services, the possibility of changing the mechanisms and modes of service provision. Without this, the profitability of the project can be significantly reduced, which may later lead to adverse results.
- Strategic choice: it is often erroneous to attract the private sector only in those services where it is easier to make the profit, leaving only the most complex and expensive projects to the public sector.

Even if all these mistakes are avoided, the PPP, like any complex socially significant project, carries certain risks with it. Some of them are more considerable in developing countries than in mature health care systems, such as Western Europe.

When planning a PPP project, one should pay more attention to the PPP model that shall apply to the project. The choice of a right contractual and financial mechanism is important. However, the search for a perfect structure that would guarantee a positive result does not always produce results, since no single model is ideal. Success will depend on professionalism and careful analysis when adapting a particular model to local conditions and to a specific project.

Kazakh realities

The Government of the Republic of Kazakhstan focuses on the construction, reconstruction, development and modernization of medical facilities. The Kazakh healthcare sector requires the attraction of foreign investors to apply the best international professional practices and quality standards for ensuring effective medical care in Kazakhstan.

The list of major planned republican PPP projects in healthcare includes the construction and maintenance of several medical facilities. Thus, according to information posted on the official website of the Ministry of Healthcare of the Republic of Kazakhstan, the Ministry started concession projects for the construction and maintenance of two multifunctional hospitals. One at Asfendiyarov

Kazakh National Medical University with 300 beds in Almaty, another at Karaganda State Medical University with 300 beds, these projects are at the stage of tender documentation development. Big projects such as the construction of a joint university hospital for 1265 beds in Almaty at KazNMU (instead of 5 existing outmoded scientific research institutes / scientific centres), construction of a multi-profile regional hospital for 500 beds in Petropavlovsk (instead of 7 existing and outdated facilities), construction of a multi-profile hospital for 500 beds in the city of Nur-Sultan (to replace the 3 existing and outmoded facilities) are planned for implementation.

As for the regions, according to the report of the Minister of Healthcare of the Republic of Kazakhstan to the meeting of the Government on May 6, 2019 over the past three years, the regions signed 111 PPP contracts for 52 billion tenge. Ninety - three projects are still at the stage of tender procedures, and 83 projects are at the development stage. Primarily, the regions are implementing projects for the construction and operation of facilities of the outpatient service and projects for supply of medical equipment. As per the long-term plans for the development of healthcare infrastructure approved by regional akimats, the need for investments until 2025 is over 1.3 trillion tenge.

Being a country where the institute of PPP is at the stage of formation and development, the intention of our government to adopt an experience of developed countries in implementing PPP in healthcare and to apply the best foreign practices in Kazakhstan seems reasonable taking into account the specifics of local legislative system and the relations between the state and the private sector.

The experience of Turkey is one of the bright examples of successful implementation of PPP in healthcare. So the Minister of Healthcare of the Republic of Kazakhstan at the meeting of the Government on May 6, 2019 expressed intention to study in more detail relevant successful Turkish practices and apply them in Kazakhstan. In particular, according to the report of the European Bank for Reconstruction and Development of March 2, 2019, the PPP Hospital Program of Turkey for 2010-2023 is implemented with significant financial and advisory support from international financial institutions.

The main success factors of the program in Turkey are:

- Construction of facilities is implemented using private investment. In its turn, after the facility is commissioned, the state returns the invested funds via availability fees for 25 years and pays for non-medical services provided by the private partner. The investor is protected against currency and inflation risk and guaranteed with a least volume of services at the level of 70% of the project capacity;
- Transparent international PPP tenders and protection of investors' rights under international law;
- Efficient organization of project documentation development and holding PPP tender.

The same report of the Minister of Healthcare of the Republic of Kazakhstan suggest, to apply the Turkish model in Kazakhstan, certain amendments to the current legislation of Kazakhstan, and other activities are planned, in particular:

- provision of the authority to the Ministry of Healthcare of the Republic of Kazakhstan to develop and approve the Rules for Planning and Implementing PPP projects of "special significance" in healthcare;

- provision of the authority to the Government of the Republic of Kazakhstan to approve the main limits of healthcare projects of “special significance” (including: the financial rate of return, the contract period, compensation of the currency and inflation risk by the Government of the Republic of Kazakhstan, compensation of investment costs);
- Use of the “Success fee” mechanism for advisory support of “special significance” projects;
- creation of a Project Management Office in healthcare in the Government of the Republic of Kazakhstan;
- creation of a legal entity a Unified operator for implementing large infrastructure healthcare projects.

At this stage, no one can guarantee that a model successfully operating in Turkey will also successfully work in Kazakhstan. An important part of implementing the PPP model is the existence of a proper legislative framework and a political will to introduce amendments in the Republic's legislation of Kazakhstan. Turkish legislation in PPP and healthcare differs from Kazakh. Will it be possible to theoretically and practically implement the key legislative mechanisms of Turkey in the current legislation of Kazakhstan, and will they work effectively in practice?

In particular, the questions cause the following aspects:

Revenues of a private partner/concessionaire

Under Kazakh legislation, the availability fee within the concession project comprises:

- compensation of the investment costs of the concessionaire;
- compensation of the operating costs of the concessionaire;
- management fee

The Turkish model assumes that the availability fee includes only the compensation of investment costs and the principal debt, and compensation for currency risk and inflation. Separately, a private partner is paid for the provision of non-medical services during the operation of the hospital. Hence, to apply this scheme in Kazakhstan, we believe that it will be necessary to amend Kazakh legislation to change the elements of availability fees. In addition, the current version of the Concessions law does not explicitly provide for a service model under which the concessionaire will offer services to the grantor about the object of the concession under the concession agreement. It will probably be necessary to introduce the possibility of applying such a mechanism within the framework of a concession agreement in the Concessions law, taking into account that all large infrastructure projects in the healthcare are implemented within the framework of a concession.

Creating a Unified Operator for Implementing Large Infrastructure Healthcare Projects

It is expected that the creation of a unified operator in healthcare will ensure the effective management of large infrastructure healthcare projects, including within the framework of PPP. However, neither PPP legislation nor sectoral healthcare legislation stipulates the institution of a unified operator.

Comprehensive changes will be required to the sectoral healthcare legislation of the Republic of Kazakhstan and legal acts governing PPP issues in Kazakhstan to establish the status of a unified operator in healthcare, determine its powers, creation procedure, etc.

If the concession object is intended to be transferred to the ownership of the unified operator after its commissioning, it may be necessary to change the budget legislation of the Republic of Kazakhstan to ensure the possibility of paying the management fee and other compensation payments to the concessionaire for objects, that are not in a state ownership.

Besides the above aspects, there are other historical gaps in the legislation on PPP and concessions that need to be eliminated to increase the attractiveness of PPP projects for foreign investors and improve effectiveness of implementing PPP projects including:

- The current version of the Concessions law does not show how the qualification requirements for a consortium should be met. It is not clear whether the requirements for financial and (or) material and (or) labour resources shall be fulfilled by each member of the consortium. In proportion by all members of the consortium or the consortium regardless to the internal allocation of resources (for example, one participant may have funds, but may not have the assets to be provided by other members of the consortium together), or otherwise. As per the Concessions law each member of the consortium shall meet all the qualification requirements for the aggregate of financial and material resources of all members of the consortium in case a consortium takes part in the tender. It is not clear how the aggregate financial and material resources of all members in the consortium should be considered. In addition, a literal interpretation implies that since each member of the consortium must meet all qualifying requirements, each participant must have their own funds for at least 10% of the cost of creating (reconstructing) the object of the concession, which seems unfair.

It may be recommended to stipulate in the Concessions law that the qualification requirements for the required resources and own funds should be met by the consortium regardless to the internal distribution within the consortium (both with the creation of a special project company or without it).

- Financing large-scale projects usually requires the participation of several creditors. To increase the liquidity of secured claims of creditors in some jurisdictions, the security holder under a pledge agreement may be not only the creditor specified in the agreement but also the security agent. This allows creditors to assign their rights to security freely without having to assign and re-register security rights (since the security agent acts as a security holder on behalf of the creditors).

Kazakh legislation does not explicitly provide for the concept of a security agent (collateral manager) who can manage security in the interests of all creditors of a private partner / concessionaire. At present, each creditor will be considered a security holder under the concluded pledge agreement under the PPP project. Each creditor will have to enter a pledge agreement with the project company or its shareholders. Although creditors may appoint their representatives contractually and grant them powers of attorney to represent them, creditors will be considered security holders.

The existing approach stipulated in Kazakh legislation creates many formalities and sometimes ambiguities about syndicated lending. For example, if the security comprises a pledge of shares of the project company, then in this case it will be impossible to pledge the same shares in favour of several creditors with the same priority of claims.

Under the Project Finance Law, creditors can determine their representative in an agreement between creditors. Here, however, it is not clear from the law whether such a representative can act as a “security agent” on behalf of the remaining creditors.

A solution of the problem may be the introduction of the concept a ‘security agent’ in the relevant legislative acts of the Republic of Kazakhstan. The ‘parallel debt’ mechanism may be considered. Although the structure of a parallel debt is not regulated by Kazakh legislation, such a structure could work in Kazakhstan, based on the general principle of freedom of contract. We are not aware of the judicial precedents of this issue, and it is not clear how the Kazakh courts will enforce this structure.

- As per the current Concessions law, each potential concessionaire must develop, conduct necessary examinations and provide a feasibility study of the project within the framework of the two-stages tender. This can be one of the main obstacles for attracting investors, since preparing a feasibility study is a costly and time-consuming process.

Based on international practice, we believe that excluding the need to develop a feasibility study by all potential concessionaires could significantly increase the attractiveness of the concession projects. One way may be to impose the obligation to develop a feasibility study in a two-stages tender to the grantor itself, or only on a potential concessionaire, whose concession application is recognized as the best.

Besides the above-mentioned legislative restrictions, the tender organizers often face practical difficulties during development of tender documentation that negatively affect the efficiency of the PPP project. In particular, at the stage of preparing tender documentation often the tender organizers and the tender participants often face land issues. Thus, to make sure the proper level of investment attractiveness of a project, a potential concessionaire or a private partner should know all characteristics of the land plot which will be used to build a healthcare facility to assess risks during the construction and operation of the concession/PPP object.

For instance, in preparing tender documentation for one of the major concession projects to build a hospital in Kazakhstan, the lack of comprehensive information on the land plot, such as exact dimensions, area, restrictions, information on engineering systems and communications, geodetic and topographic data, information on transport accessibility to the site, information on the presence or absence of buildings or structures on the land plot to be demolished before construction, geotechnical and geological surveys, information about underground utilities became an issue for the tender organizer.

The lack of such documents and information on the land plot may affect the timing of the preparation and organization of the tender. Further, the lack of complete information about the site may lead to a decrease in the attractiveness and confidence to the project from potential private investors and credit organizations.

Although, there are positive examples of cooperation between the state and the private sector, a still further development of the PPP mechanism in large infrastructure projects in Kazakhstan is

characterized by relatively slow pace. Several projects were suspended for non-observance of contracts; Some projects cannot pass the stage of development of tender documentation or selection of a private partner/concessionaire. It is recommended to analyse sectoral laws with a view to remove obstacles, both considered in this article and other legislative gaps, to consider the possibility of introducing added tax and budgetary incentives for the active involvement of representatives of the private sector. Supposedly, effective solutions in these areas will have a positive impact on the results of the PPP model in healthcare.