



ECONOMIC NATURE OF GOVERNMENT GUARANTEES AND SUBSIDIES IN PPP FINANCING

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Abstract. Public-private partnership (PPP) projects have become a key instrument for infrastructure development and public service delivery worldwide. However, due to high capital intensity, long payback periods, and elevated risks, private sector participation often requires government support in the form of guarantees and subsidies. This article examines the economic nature of government guarantees and subsidies in PPP financing, analyzing their role in risk allocation, investment stimulation, and fiscal sustainability. The study highlights how properly designed financial support mechanisms can enhance project bankability while minimizing fiscal risks. The findings suggest that a balanced approach to guarantees and subsidies is essential to ensure both private sector participation and long-term public financial stability.

Keywords. Public-Private Partnership (PPP), government guarantees, subsidies, financial support mechanisms, fiscal risk, contingent liabilities, infrastructure financing, risk allocation, investment attractiveness, public finance management.

Introduction. Public-private partnerships (PPPs) have become an essential mechanism for financing and delivering infrastructure and public services, particularly in economies facing fiscal constraints and increasing demand for high-quality infrastructure. These projects typically involve significant upfront capital investments, long payback periods, and various types of risks, including construction, operational, and demand-related uncertainties. In this context, government guarantees and subsidies play a critical role in enhancing the financial feasibility and attractiveness of PPP projects by reducing risks for private investors and improving access to financing. At the same time, such support mechanisms create potential fiscal obligations and contingent liabilities for the public sector, making their effective design and management a key issue in public financial policy.

Public-private partnerships (PPPs) have become a central mechanism for mobilizing private capital in the development of infrastructure and public services. However, due to the inherent characteristics of PPP projects—such as high capital intensity, long investment horizons, and exposure to multiple risks—private investors often require additional financial support to participate. In this



context, government guarantees and subsidies emerge as essential instruments that shape the economic structure of PPP financing. Their fundamental economic nature lies in correcting market failures, redistributing risks, and ensuring that socially desirable projects become financially viable.

From an economic perspective, government guarantees serve as risk-sharing mechanisms between the public and private sectors. These guarantees may take various forms, including minimum revenue guarantees, debt repayment guarantees, and exchange rate protection. By reducing uncertainty related to demand fluctuations, macroeconomic instability, or regulatory changes, guarantees lower the perceived risk of PPP projects. This, in turn, reduces the cost of capital, as lenders and investors require lower risk premiums. Consequently, government guarantees improve project bankability and facilitate access to long-term financing, which is critical for infrastructure development.

Subsidies, on the other hand, represent direct or indirect financial contributions from the government aimed at bridging the gap between project costs and expected revenues. Economically, subsidies address situations where a project generates significant social benefits but lacks sufficient financial returns to attract private investment. For example, infrastructure projects in rural or less developed areas may not be commercially viable without public support. In such cases, subsidies ensure that projects with high social value are implemented despite their limited profitability. Thus, subsidies play a redistributive role, aligning private incentives with public welfare objectives.

Another important aspect of the economic nature of guarantees and subsidies is their impact on investment attractiveness. By mitigating risks and enhancing expected returns, these instruments create a more favorable investment climate for private sector participation. This is particularly important in developing countries, where institutional weaknesses and economic volatility may deter private investors. Government support mechanisms signal commitment and credibility, thereby increasing investor confidence. As a result, PPP frameworks that incorporate well-designed guarantees and subsidies tend to attract a broader range of domestic and international investors.

At the same time, the use of government guarantees and subsidies introduces significant fiscal implications. Guarantees, in particular, create contingent liabilities, which may not be immediately reflected in government budgets but can materialize in the future. If not properly managed, these liabilities can pose serious risks to fiscal sustainability. Similarly, subsidies require direct budget allocations, which may strain public finances if they are excessive or inefficiently



targeted. Therefore, the economic evaluation of these instruments must consider not only their benefits in terms of investment stimulation but also their long-term fiscal costs.

The presence of guarantees and subsidies may lead to moral hazard problems if private partners rely excessively on government support and reduce their efforts to manage risks efficiently. This underscores the importance of designing support mechanisms that maintain appropriate incentives for performance and accountability. For instance, guarantees should be partial rather than full, and subsidies should be linked to performance indicators. Such approaches ensure that both public and private partners share responsibilities and risks in a balanced manner.

The evolution of PPP financing has also introduced innovative forms of government support, including viability gap funding, blended finance, and performance-based subsidies. These mechanisms aim to optimize the allocation of public resources while maximizing private sector participation. They reflect a shift toward more sophisticated and targeted financial instruments that enhance efficiency and transparency. The integration of environmental, social, and governance (ESG) considerations into PPP financing further highlights the evolving role of government support in promoting sustainable development.

In conclusion, the economic nature of government guarantees and subsidies in PPP financing is multifaceted, encompassing risk-sharing, incentive alignment, and the correction of market inefficiencies. While these instruments are indispensable for attracting private investment and ensuring the implementation of socially beneficial projects, their effectiveness depends on careful design and prudent management. A balanced approach that maximizes economic benefits while minimizing fiscal risks is essential for the long-term success and sustainability of PPP frameworks.

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