

Realisation of Infrastructure Projects within the Framework of Public Private Partnership



Author:

Andrew Pushkin,
Executive Partner
Tensor Consulting Group



Annual losses of the Russian economy due to bad condition of roads and the insufficient level of their development exceed 1,8 trillion rubles, or more than 2% of GDP. Because of bad road infrastructure the transport component in the prime cost of production in Russia achieves 20%, while in developed countries this index doesn't exceed 8%. In Europe the average speed of cargo transportation is 1000 km per day, while in Russia it is not more than 300 km. Finally, the prime cost of transportation by road in Russia is one and a half times higher than that in the EU countries, and fuel consumption in Russia exceeds that one in Europe by 30%.

Russia has the lowest index among the 10 leading economically developed countries:

- by quantity of roads per square meter
- by quantity of airports
- by the level of development of the railway network.

The answer to this challenge should have become *the Transport Strategy of the Russian Federation for the period up to 2020*, adopted in 2005.

For the following 10 years this strategy provides further transformations aimed at development of the transport system within the framework of the conception of sustainable development, creation of reliable transport ties among the subjects of the Russian Federation. During the named period the following strategic measures must be realised:

- creation of the maximum favourable conditions for attracting non-state capital for construction and exploitation of new transport objects;
- reduction of the sphere of tariff-price control;
- extension of the circle of categories of transport objects which have no restriction on being privately-owned;
- realisation to the full extent of the principle of sustainable development with regard to reduction of ecological impact of transport.

Apart from this, it is provided that the obligatory condition of realisation of the transport strategy of the Russian Federation is creation of a stable financing system which takes into account specifics of transport as an infrastructure branch.

In particular it is necessary:

- to create a system of infrastructure financing with a medium-term horizon of allocations planning;
- to have a guaranteed fulfilment of assumed financial obligations on the medium-term period by the state;
- to change the structure of transport financing in the system "state-investor-user" in the direction of enlargement of users' and investors' share based on extension of public private partnership mechanisms (concessions, schemes "build-use-assign", long-term lease), and other mechanisms of investments attraction.

However, during the last five years – which is one third of the implementation period of this programme document – none of its ambitious slogans was realised. Citizens' mobility does not increase, death rate due to road traffic accidents does not reduce, the volume of transit carriages is still far from the figures stated, and trading ships choose other flags as before. Russia has no balanced transport

policy so far.

At the moment Russia is badly in need of modernisation and creation of a new transport infrastructure with innovation technologies application: there is a need for new railways and port terminals, highways and interchanges.

Such large-scale projects can be realised only with the support of the state and interaction with business on conditions of public private partnership. International investors, construction companies and financial organisations are ready to provide assistance in implementation of these projects.

However, general rules of interaction between business and the state should be worked out.

And above all, the state should answer the questions – what forms of participation of private organisations in development of the transport component of Russian economy are expected and what obligations will be imposed on each of the parties.

The Variants of PPP Mechanisms Implementation in the Course of Transport Infrastructure Development

Increasing understanding of necessity for infusion of large funds into infrastructure of Russian cities and regions and recognition of insufficiency of amount of budget investments make the state look for alternative mechanisms of financing of infrastructure expenses. One of such mechanisms is financing of socially demanded investment projects on the principles of public private partnership.

It should be said that PPP is the instrument of economic and, broadly speaking, governmental policy of developed countries worldwide, the appearance of which was the result of long-lasting evolution of relationships between the state on the one hand and the civil society and its separate corporations on the other. In Western countries they managed to set more or less parity relations between the authorities and business, to bring this equality under legal regulations and to institutionalize them as social and political interaction norms.

In Russia there is no such experience of historically stable partnership between the authorities and business, though PPPs in the form of concessions, coproratisation, etc. were widely used in the period of autocracy for modernisation of housing and utilities infrastructure of cities, construction and use of railway roads, development of metallurgy industry, etc. Concessions also existed in the Soviet Russia in the period of NEP (New Economic Policy), however, they didn't contribute greatly to development of economy, and later they were eliminated. To use this mechanism properly one should understand it correctly and unambiguously.

Until now this task has not been solved by Russian legislation, and this situation gives freedom to regional and local legislators. However, it entails necessity for the unified theoretical definition of PPP.

Three types of public private partnership are distinguished in theory:

- attraction of a private partner to enterprises controlled by the state, allowing sale of both minority and controlling block of shares,
- agreements under which the state undertakes to buy high-quality services provided by a private partner on a long-term basis. The driving force of such relationships is recognition of advantages of the private sector in the field of financial management and industrial process control. Such agreements are concluded on the basis of concession or franchising mechanisms and, as a rule, include not only the private partner's obligation to render certain services, but also his responsibility for maintenance and renovation of assets assigned to him, as well as creation of new assets required for maintenance of quality of provided services,
- partnership agreements, in which a private partner's experience and financial capacities are of vital importance for the project that presupposes use of commercial potential of the state assets.

In the global practice the most popular form of cooperation is organisation of public private partnership in which the private consortium on the basis of the contract with the state undertakes to work out, finance, create and manage the assets with the aim to produce certain socially necessary goods. The state in its turn guarantees to maintain conditions for realisation of corresponding services (goods) during a certain period and to pay a fee the amount of which is defined by the contract.

The evident advantage of such "division of labour" for the state is that there is no need to divert significant money from the budget during the whole period of an asset creation. Besides, ideally a private investor undertakes responsibilities for a long-term management of the created asset, releasing the state from expenses and worries connected to its maintenance.

Russian legislation allows for the following mechanisms of PPP:

Special economic zones (SEZs), which allow for formation of growing points on specially designated territories by means of investments attraction on preferential terms. The mechanism of SEZ presupposes preferences in three directions: tax and custom benefits, governmental financing of infrastructure, decrease of administrative barriers.

However in Russia there is a too rigid type-assignment of SEZs provided by the certain law, and it limits greatly possibilities of effective clusters formation. The present legislation does not allow to form such natural chains. Besides, by universal standards Russian SEZs have relatively small tax benefits, as a result they are not very attractive to global investors. Actually the state reduces only regional and local taxes and it makes this instrument less interesting for subjects of the federation.

It should be noted that legislation regulates neither selection of residents (investors) for a special economic zone being created nor distribution of plots among them. It provides the ground for corruption and provokes potential investors' distrust. Moreover, even investors who signed the agreement of intent at the stage of the application development have no formal guaranties and privileges.

Apart from federal SEZs the idea of special economic zones of regional and municipal level should be mentioned. As it was noted above, federal legislation on SEZs intends to provide main tax benefits out of the funds of regional and local budgets. The major contribution of the federal center is co-financing of infrastructure construction and tax benefits. Besides, SEZs of the federal type have a stronger branding component. So, regions can create SEZs independently without significant losses, and there is no need to win the federal tender. This aspect is the most relevant for projects which do not involve vast investment into the basic infrastructure and massive procurement of foreign equipment and which already have potential investors.

The Investment fund of the Russian Federation. This instrument is created to realise investment projects which have nationwide significance and are implemented on the conditions of public private partnership. The amount of funds to be distributed through this mechanism is quite large. Distribution of funds is realised centrally on the competitive basis.

However, the mechanism of the Investment fund, like that of SEZs, is still far from being perfect.

The bar set on minimal amount of investments pushes many important infrastructure projects aside from this instrument.

At the moment the state usually maintains not more than 25% of the total amount of investments of the winning projects by means of the Investment fund. Such support is more like additional cheap financing for existing projects than a starting pulse for new large-scale and crucially important tasks. It seems that the actual level of budget financing should be increased to 40-60% depending on the character of the project.

It should be pointed out that the procedure of the competitive selection of applications for getting money from the Investment fund has a vast space for subjectivity. Neither legislation on the Investment fund nor the Provision on this commission provides strict criteria of decision-making.

Concession – that is an assignment of an object of state or municipal property to a commercial organisation for construction, modernisation, reconstruction, exploitation, management, maintenance, etc. on the conditions fixed in the contract. The use of the competitive mechanism is obligatory when the property is transferred to concession.

The advantages of employment of this instrument are the following: possibility of attraction of private investments, implementation of modern management technologies, creation of business competition elements in monopolistic segments. At the same time, the level of preparedness of the Russian state system for

practical implementation of this progressive instrument is still not very high. Up to now many important mechanisms of realisation of the law *On Concession Agreements* (which as such has just a frame character) are lacking. Besides, now there is no balanced mechanism of risks division, which guarantees return of investments and gaining profit at the market rate to a concessioner.

On the regional level development of a concession is restrained not only by the lack of the corresponding regulatory framework, but also by the owner's unreadiness to assign the rights to his objects to private business. There is no clear procedure of such assignment, and technical unreadiness of elements of such assignment (registration of property rights, inventory valuation of such objects, cadastral plans of land plots, etc) is sharply felt.

Honesty of holding of concession tenders and realisation of specified conditions raises serious doubts. These problems can be solved by quality working-out of the tender mechanism, as well as by presence at the market of a sufficient number of companies which have necessary experience and resources.

The Problems of PPP mechanisms realisation

We have already mentioned several problems which appear when certain mechanisms of PPP are being realised. However, there are general, principle problems which influence relations between the state and business, including relations in the form of PPP.

The transport strategy up to 2020 defines concessions as a main form of partnership, primarily in the sphere of toll roads, railway construction, airports development, urban public transport. In particular such mechanisms are provided in the laws *On Concession Agreements* and *On Toll Roads*. More specifically they set some additional guaranties for investors who take part in financing projects of construction, reconstruction and exploitation of toll roads.

The general mechanism of implementation of joint financing and distribution of state and business functions in such projects is realised according to the following scheme:

As a rule, the state takes upon itself construction of infrastructure objects.

The task of business is direct construction of transport infrastructure objects.

Besides, within the framework of partnership the state may be engaged in land assignment, preparation of a plot for investments and organisation of the special favourable treatment in the form of all possible preferences.

Thus, implementation of public private partnership in Russia faces certain problems of different character: legal (lack of the required regulatory framework of PPP functioning), economic (underdevelopment of market relations) and management (state bureaucracy's weak knowledge of PPP principles and the fact that most civil servants have no professional legal background for working out corresponding contracts in this domain). In this connection the question appears if there are political conditions for realisation partnership relations between the authorities and business in our country and to what extent they predispose to it. It is evident that the authorities' activity in partnership will not appear by itself. The ability to conduct a productive and open dialogue without pre-existing suspicions and accusations does not come at once. Absence of communicative skills between representatives of different social institutes may also be attributed to downsides of developing market economy. In Russia these downsides have their specificity. It should be admitted directly that investors from the centre of Russia have to struggle with negative attitude towards visitors from the capital in regions. And of course, both sides do not have enough experience of civilised communication. In this case, like in any partnership, one should remember the equality principle, remember that you promise investments for the region to get a boost for further development, you create jobs and pay taxes. In the practical aspect it may look like a special section of a business-plan dedicated to the forecast of regional development.

Everything said about conditions for PPP functioning in our country does not mean that there are no examples of positive collaboration between the authorities and business in RF. In this respect one can name natural monopolies, some large corporations in the sphere of the energy industry, which have been for a long time and quite consciously cooperating with the federal government and its departments, authorities of the subjects of the federation in different spheres and in the course of national projects realisation. In reply to this the state renders help and significant support to these corporations in promotion

of their interests abroad, conclusion of contracts and economic expansion in other countries.

Investing to the transport infrastructure will depend on local initiatives, possibilities of attraction of finances mainly from regional and federal programmes. Each region should be interested in working-out of a real conception of development of the transport-logistics system, as well as in creation of the programme of its realisation.

Nowadays the PPP mechanism is at the stage of approbation. In practice everything is not as easy as it seems on paper. In this case political will of heads of the region plays an important role in the course of interaction with organisations representing business interests.

As variants of solutions to the present problems one should pay attention to certain principle actions from PPP participants' side.

On the part of the state it is required:

- To shift from superfluous incline toward political declarations and PR to strict orientation toward real economic effects and increase in the scale of using main instruments of structural policy.
- To consider PPP mechanisms as interrelated elements of economic policy. For example, nowadays assignment of SEZ status or allocation of finances out of the Investment fund are more likely to be treated as a nonrecurrent bonus for the corresponding region, and not as a part of complex governmental policy.
- To gradually shift experience of the federal level to the regional one.
- To remove superfluous restrictions and requirements.
- To provide further reduction of corruption capacity of the structural policy instruments, primarily in the course of holding of competitive tenders and selection of applications.

On the part of business it is necessary to take into account underdevelopment of Russian business which manifests itself in striving for property acquisition, and not for entrepreneurial activity as such. In chase of profit business puts up little capital in investments and provision of security systems, reduces expenses on staff training. Large, as well as middle and small businesses demonstrate striving mainly for profit-making, reallocation of resources of federal and regional budgets, governmental funds, and not for investment or any other kind of participation in infrastructure projects which have special significance for the economy of the country.

Tensor Consulting Group

mail@tensorconsult.com

www.tensorconsult.com