

FINANCING INFRASTRUCTURE PROJECTS THROUGH CONCESSION CONTRACTS

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Introduction:

Traditionally the public sector has been responsible for providing infrastructure needed for socio-economic activities such as transport, energy, telecommunication, water supply, sewerage, waste disposal and the like. Lack of domestic funds, restrains on international credit availability, and inefficiencies in the operation and management of public sector agencies in the recent past have been opening up the avenue for private entry in to this public domain. Concession contracts are emerging as a mainstream of financing and managing infrastructure projects by the private sector. This paper intends to discuss the phenomena of concession contracts as a mean of project financing together with pertinent issues.

Concession Contracts:

In brief, a concession is an arrangement whereby a project is placed under a private entity control for a specified period of time, given the task of financing, designing, constructing, operating and maintaining. It is a mean of non-recourse project financing relying on project revenue as the security rather than relying on direct sovereign guarantee for the project debt. The main advantage it has over complete privatization is the higher degree of government control throughout the project. The Build-Operate-Transfer (BOT) and Build-Own-Operate-Transfer (BOOT), which sometimes are used interchangeably, are the most popular forms among the variety of concession contracts in application.

Issues Facing Concession Contracts:

Concession contracts have become popular since the late 1970s and early 1980s. However, this concept is not new to the arena of infrastructure. In the 18th century, many infrastructure projects were in application in France and neighboring European countries. In the 19th century, mega projects like the Suez Canal and the Trans Siberian Railway were constructed and operated on concession basis. Many of these contracts came to a halt due to political reasons. Following the two World wars, the private sector participation in infrastructure declined as the public sector took control.

At present, though the concept has reemerged on a wide scale globally, the procurement and implementation of concession contracts still remain a complicated issue. The reasons behind are, concisely, the inherent risk element present in such contracts. These risks are twofold; one is the global risks that remain outside the control of the project element and cannot be controlled by the project promoter, such as the political, legal, commercial and environmental risks. The other is the elemental risks that remain within the control of the project element and could be controlled by the promoter. The former is the main issue that arrests the concern of the investors as well as the other parties involved.

The Case of Emerging Asian Nations:

The so called emerging Asian nations are said to be on the path of miracle growth. This sudden growth is not in par with the present supply of infrastructure. The governments are increasingly seeking to build and operate infrastructure projects through concession contracts. Numerous projects are formulated, but only a marginal number of projects proceeded, very few that have come to operation, yet none has reached the end of the concession period. An analysis of such projects from selected Asian countries has been done to find out the status of these projects, and to find out the reasons behind the comparatively lesser degree of success. The two tables below summarize this project information.

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Table 1: Distribution of Projects by stages

	a	b	c	d	e	f	g	Total	%
Proposed	5	3	9	2	3	12		34	25
Tender				1		14		15	11
Contract stage	12	17		2	11	3	4	49	36
Under construction	3	4	2	2	5	1		17	13
In operation	1	2	1		2	1		7	5
Abandoned			1			1		2	2
Status unknown	1			2	1	4	3	11	8
Total	22	26	13	9	22	36	7	135	100

Table 2: Distribution of Projects by sectors

	a	b	c	d	e	f	g	Total	%
Railway	5	5	3	2		4	1	20	15
Toll road/ Highway	12	15	10	3	14	13	2	69	51
Airport	1			2		2		5	4
Port	1	3		1	2	10	2	19	14
Other Transport	1	2			3	2	1	9	6
Power				1	1	2	1	5	4
Telecom.	1							1	1
Water Supply	1	1			2	3		7	5
Total	22	26	13	9	22	36	7	135	100

Source: Asian Infrastructure Monthly, various issues

Note: a-Indonesia b-Malaysia c-Thailand d-Philippines e-China f-India g-Pakistan

Table 1 illustrates that only 5% of the projects are in operation. More than 50% of the projects have reached the contractual stage. This indicates the enthusiasm of the governments to promote concession contracts. Many of these projects may reach the operation stage. But, it is difficult to make predictions since most of these economies are in transition and their political climates are volatile. It could also be observed that not many projects are abandoned. The distinct feature about majority of the projects is that the processing period prolongs when problems are faced than abandoned. The sector distribution, according to table 2, indicates that about 90% of the projects are in the transport sector, of which 51 % accounts for toll roads/highways. One reason could be the acute need for transport infrastructure in these countries. Another strong reason could be that the private participation is preferred in this sector, and is known to be true even in the developed economies, possibly, due to the easy revenue collection, relative accuracy in revenue forecasting and life cycle costing, less complicated operation and maintenance, and perhaps less likeliness to face public opposition than in the case of basic utilities such as water and sewerage. However, firm conclusions cannot be made based on this information, since the source of information does not cover the entire spectrum of projects undertaken at present.

Concluding Remarks:

The phenomena of concession contracts seem to attract the governments of the developed and developing world alike, but the success seems relatively higher in the developed countries. The influencing factors are the political stability, commercial viability and the availability of capital and credit markets. Apart from the risk factor, the availability of funds still remains a major obstacle in the developing countries. The commercial banks in less developed markets are still reluctant to extend their participation in this sector, and the capital markets also are very volatile in such markets. The multilateral funding agencies such as the International Finance Corporation and the Asian Development Bank are making attempts to promote the funding facilities to enhance private participation in these countries. Lack of expertise and inadequate legal framework to implement concession contracts are the other major obstacles faced by the developing countries. Hence, concession contracts entail reforms in the legal framework, financial markets and technical & managerial expertise in addition to a stable political and economic background for the enhancement of success.

References:

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