Financial Instruments of Concession Project Investment Under Conditions of Faltering Economy

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Abstract-The article is devoted to the key instruments of evaluating the economic feasibility of concession agreements as an investment activity. The current financing investment process instruments are outdated and new options are required. It is essential to consider financial guarantees and financial capacity of the sale of concessions on the part of each of the counterparties. For individuals investing in state and municipal property can reduce business risks, provide a long-term stable income and grant access to property that is monopolized. Public authorities, in their turn, become capable of solving their local issues by delegating them and spending extra-budgetary resources. As a result of the study, it is concluded that concession agreements are crucial for both public authorities and individuals, but require careful consideration and financial assessment of investment attractiveness before they are concluded.

I. INTRODUCTION

Concession agreements as instruments of investment activity receive recognition from economic entities around the world every year. Many countries assess the need for new investments in the economy of their country through the conclusion of concession agreements, as they allow the state to ensure modernization or creation of new socially significant facilities at the expense of private investors. In addition, the governments of both developed and developing countries pursue active economic policy in order to involve as many private participants as possible in the investment activities of the state.

II. DISCUSSION

The schemes of concession agreements were first mentioned in Ancient Greece and the Roman Empire (IV century BC). Having undergone a long historical development and modernization, this institution received legislative consolidation in the Russian Federation in 2005 with the adoption of “On concession agreements” Federal law as of July 21, 2005 No. 115-FZ. As a special type of public-private partnership in Russia, concessions have been actively developed and supported by the government, however, due to the current legal inadequacy and tough economic situation in the investment sector, private investors conclude such contracts with distrust and caution [1]. Thus, active participants of new agreements are mostly large financial enterprises.

The main point of concession agreements is to achieve mutually beneficial goals for both the government and a private legal entity. The state is interested in consigning its property and property-related maintenance tasks for outsourcing with subsequent modernization on the part of economic entities. In turn, entrepreneurs undertake the obligations stipulated by concession agreements in order to make a stable investment profit against guarantees, as a result of consigned property utilization.

Many countries are interested in the efficient utilization of their property with the possibility of simultaneously solving their social issues. According to McKinsey Global Institute audit company the global economy will require infrastructure investments worth of $ 57 trillion by 2030 [2]. Undoubtedly, authorities will not be able to provide such a considerable investment into the necessary socially significant facilities without private investment. However, few private investors are ready to actually freeze their funds for a long time. Thence some developing countries (e.g. Brazil, Chile) provide investors with tax incentives, as well as reduce land rent in order to attract as much private capital as possible into their countries’ economic development. Moreover, such developed countries as the USA and Germany, along with tax and land benefits, heighten investors’ interest by direct state support in the form of subsidies, as well as take an active part in consulting of concessionaires and successful implementation of a project in general.

Organizational types of concession agreements depend not only on the industry, in the sphere of which the contract is concluded, but also on a number of conditions, to which some scientists refer: the balance of risks among the parties, the amount of financial participation on the part of concession grantor, the availability of economic guarantees from public counterparty, the status of property during the concession agreement term [3, 4]. The main financial instruments for concession project investment are revealed...
in determining the most appropriate and acceptable economic solutions for each of the parties.

Due to its stability over time, concessions would greatly increase revenues of concession grantor’s budget by means of tax revenues from the concessionaire. This article considers taxation to be the most flexible financial instrument in concession legal relations. Owing to the adjustable tax rate, it is easy to adjust the cost of land use fees, income tax and newly created property in the framework of the concession obligations of an economic entity. Tax tools allow creating competitive market relationship between the state and a private investor. In fact, stipulated by the agreement reduction of the tax rate to a minimum allows the investor to increase the potential profitability of the contract in direct proportion. Taking into consideration that concession agreements are usually long-term (10 years and more) [5], economic effect of the invested funds can reach millions of dollars. It is advantageous for the government to adjust the tax rate during the negotiations, as this allows the concession grantor to choose among a larger number of potential counterparties and, thus, to determine the most qualified specialists to solve its problems. And if the concession agreement is concluded without competition with a single executor, the formal taxation system potentially increases the quality of the concession object, since the concessionaire’s funds in this case will be mainly invested into the property consigned under the agreement, but not to the tax payment. It means that the government reinvests money into solution of national problems.

The most significant financial instrument in concession agreements is the amount of investment that the future concessionaire is willing to risk. The amount of money is directly dependent on the concessionaire’s obligations under the concession. Moreover, the need for a potential concessionaire to make a preliminary financial investment in a technical inspection of housing and communal facilities might not obvious enough. Firstly, this procedure requires considerable financial costs, and, secondly, there is no guarantee that the private investor after all competitive procedures will get the right to conclude a concession agreement. In this case, without the active participation of the public authority, the possibility of successful implementation and fulfillment of contractual obligations decreases dramatically. The government should objectively assess the economic potential of the obligations imposed on the concessionaire, otherwise the subject of the agreement, and as a rule, these are socially significant objects, will be under risk, which will entail numerous risks of disturbance of public order.

Potential financial instruments for concession agreement investment include the investment proposal from an individual, which, within the framework of the concession agreement, is determined by a set of the following criteria: the period of works’ performance, quality of works, declared price (tariff) of works. The investor can significantly shorten the term and reduce the price of the concession agreement, thereby ensuring low competitiveness. However, economic entities need to take a responsible approach to the terms of the agreement, as in case of violation of the terms, the state will be forced to impose a large number of penalties on the legal entity and terminate the concession, which can lead to private organization’s bankruptcy.

The term of the agreement as an element of the investment proposal is predetermined by the economic model chosen by the parties. The first type of model is that the concessionaire makes a phased investment in the modernization and construction of the concession object and returns it with potential profit within a calendar year. The second financial model is based on uneven investment and income, as it directly depends on the activities and size of investment. Most importantly, before entering into an agreement, the parties need to determine an approximate moment by which the invested funds will have to be returned to the investor, and what the potential profitability might be. Taking this information into account, the parties can evaluate the possible economic effect and determine mutually acceptable terms of the concession agreement.

At the conclusion of the concession agreement, the parties also need to assess from a financial point of view the amount of the concession fee paid by the concessionaire to the concession grantor during the use (operation) of the object of the concession agreement, as well as the amount of the concessionaire’s fee under the concession agreement. In our opinion, these are ideal universal instruments for financing investment activities, by means of which the economic potential for each of the parties of the concession can be balanced before the conclusion of the contract. According to I.M. Shor the amount of the concession fee is equal to the amount of depreciation and property taxes [6]. In this regard, in the field of housing and communal services, which already has established tariffs, the amount of the concession fee is put in dependence from financially feasible factors, which, among all, include pricing conditions.

The unstable economic situation in the market may lead to the fact that the obligations of the parties under the concession may not be fulfilled. A public counterparty appears to be more financially stable than a private investor. Considering the fact that the concession agreements are long-term ones, the investor should expect that the invested funds will have been returned over time, which means that the concessionaire is provided certain economic guarantees under the agreement. In particular, the terms of the concession agreement may stipulate that upon termination of the agreement, the investor shall be reimbursed for the actual money spent [7]. In the most developed countries, additional financial guarantees are provided; for example, the concessionaire is paid monetary compensation for lost potential benefits in case of the actual non-realization of the concession agreement.

Having determined all the conditions of the future contract in advance, the parties cannot rely on its perfect
execution. Possible intergovernmental trade wars, global crises, unstable economic situation in the country – all these can lead to a great risk of termination of the concession agreement. In this situation, the value of the tariff is important for all participants of the concession [8; 9]. By indexing the tariff or adjusting the investor’s rate of return, it is possible to reduce the burden on the state budget and maintain a difficult economic condition in a private company. However, this tool plays a big role in how to eliminate the downside risks of lack of demand for the services of the concessionaire, and also allows distributing the surplus between the parties in the interests of both. However, tariff regulation is the most controversial instrument for financing investment activities, because shifting the burden of concessionaire maintenance on consumers of public services can lead to a complication of domestic political relations and only aggravate the economic situation in the country.

III. RESULT

The mechanisms of successful implementation of the concession agreement considered in this article are interrelated and can be chosen as an alternative to each other. The variability of contract terms, which first of all allows to be premised on the current economic situation, emphasizes the preference for the conclusion of a concession agreement among other types of long-term agreements (lease, service agreement, agreement on the implementation of the investment project). In turn, the available opportunity to adjust tariffs in the field of housing and communal services can significantly reduce budget subsidies and ensure greater investment attractiveness of the project [10].

Thus, the financing instruments correctly determined by the parties prior to the concession will allow the effective implementation of the investment of each participant of the concession agreement. Many countries depend on capital inflows, so reaching a mutually acceptable agreement will provide satisfaction from the realization of the economic potential of the invested funds for the concessionaire. Moreover, the government manages to ensure its interests by means of extra-budgetary funds, which will significantly reduce the burden on the state budget.

REFERENCES


