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# *New Development Challenges: Public-Private Partnerships Is Russia Ready?*

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Klaus Rohland  
Country Director for Russia

*Moscow, May 20, 2008*

**Conference of the  
ASSOCIATION  
OF EUROPEAN BUSINESSES  
IN THE RUSSIAN FEDERATION**



I. New Global Developments

I. New Challenges for Russia

I. Public-Private Partnerships: Is Russia Ready?



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# I. New Global Developments



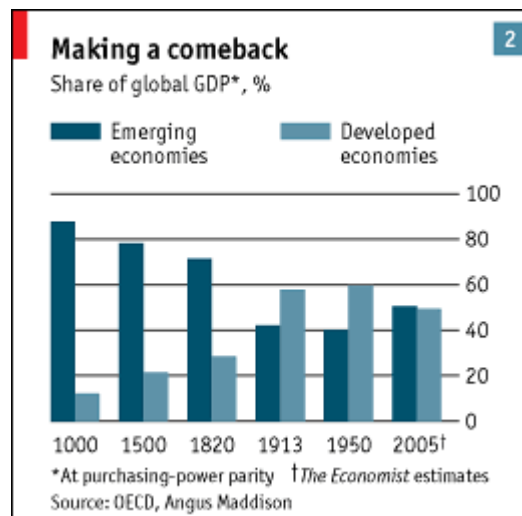
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# The Structure of the World Economy *and* Economic Growth Has Shifted Towards Developing Countries, especially BRICs

- In 2005, developing countries have *surpassed* the developed countries as a share of the world GDP, in purchasing power parity terms
- Developing countries already account for a large share of global economic growth
- BRIC countries (Brazil, Russia, India and China) are a major engine of global growth.



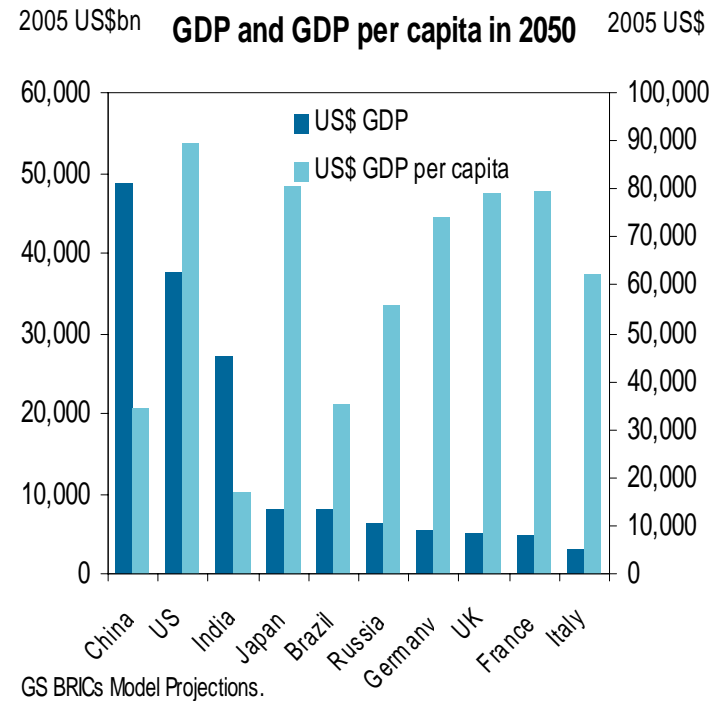
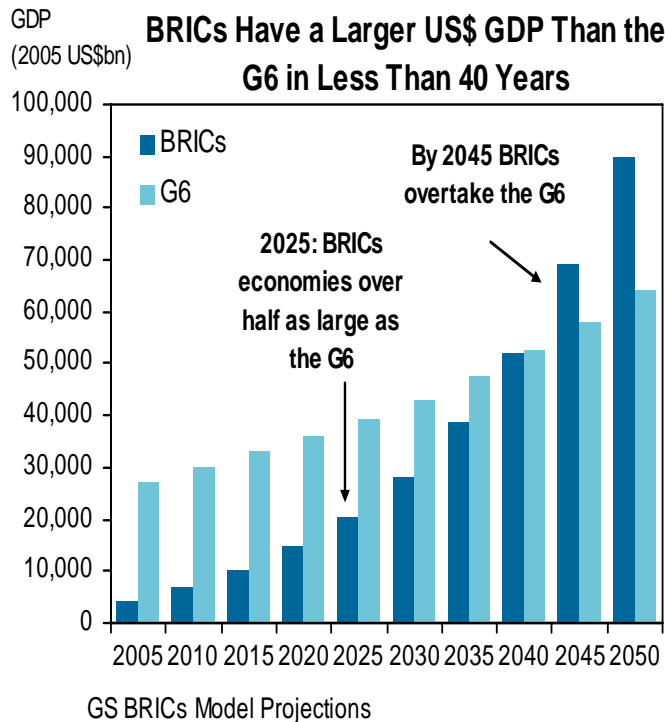
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Источник: *The Economist*

# It's a Long-Term Trend: BRIC Countries Will Overtake G6 in Importance in the World Economy by 2045

In 2050, Russia will have GDP per capita of about \$20,000 and will be one of the world's largest economies



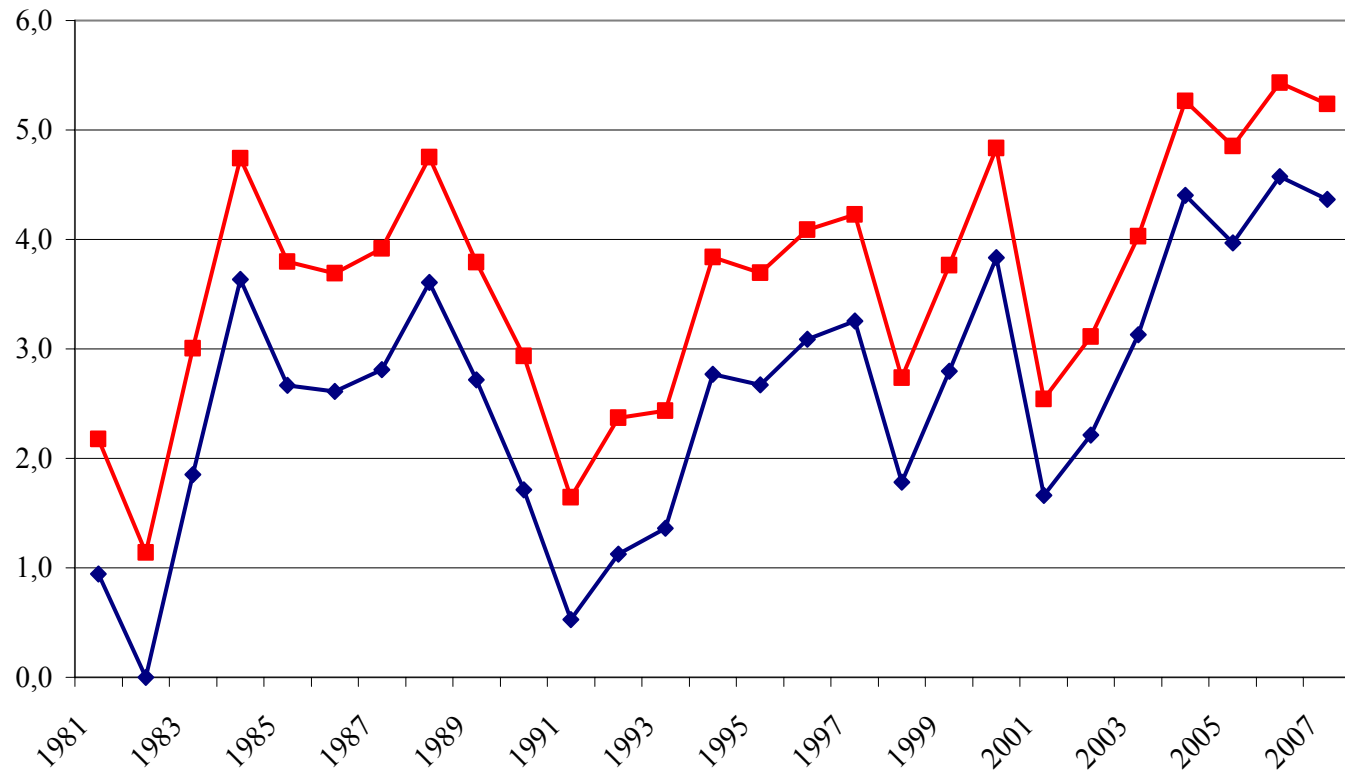
Source: Goldman Sachs



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# After Five Years of Accelerating Growth, the World Economy Has Begun to Slow Down

Real Growth of the World Economy, in percent



Source: WEO



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# Factors Behind the Global Economic Slowdown



## The Slowdown in the World's Largest Economy—US: Triple Whammy!

- **Housing market:** high liquidity and low interest rates resulted and a rapid growth of sub-prime mortgages and a housing market bubble collapse in US and UK. This shook *consumer confidence* in the US.
- **Financial sector:** massive and inadequately supervised use of financial derivatives based on sub-prime mortgages led to large losses among some of the largest *financial institutions* in the US and Europe. This adversely affected new credits, which dampened consumption and investments.
- **Stock Market:** the risk of recession in the US and the twin crises have shaken *investor confidence* in the United States, but also in the world at large. As investors withdrew capital from the stock market towards less risky financial instruments and cash and liquidity dried up, the world stock markets experienced major downward pressures.

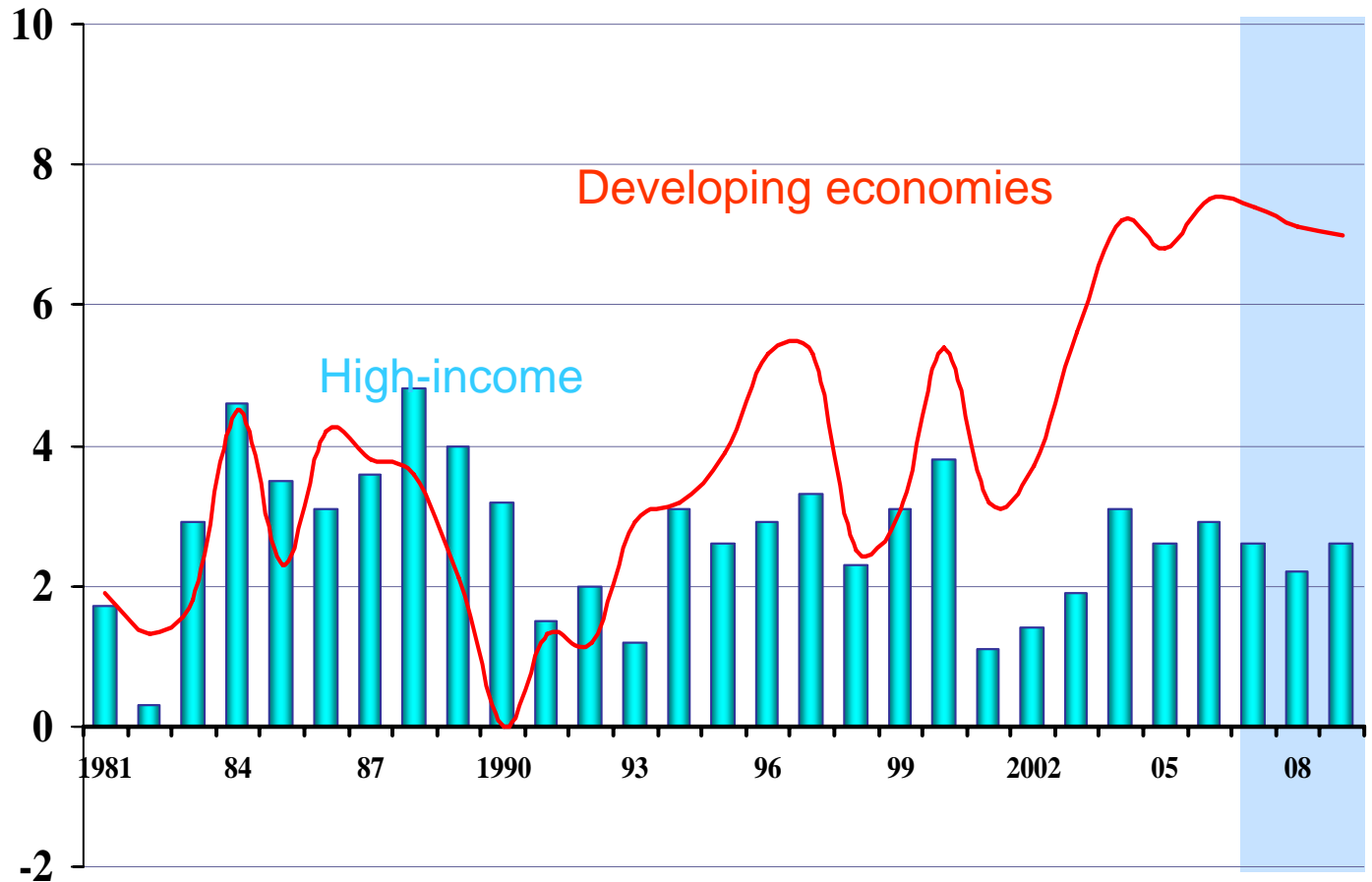


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# As A Result, There Will Be Global Slowdown, But Developing Countries Will Continue to Outpace High-Income Countries

Real GDP, percent change

Forecast



Source: World Bank, DECPG.

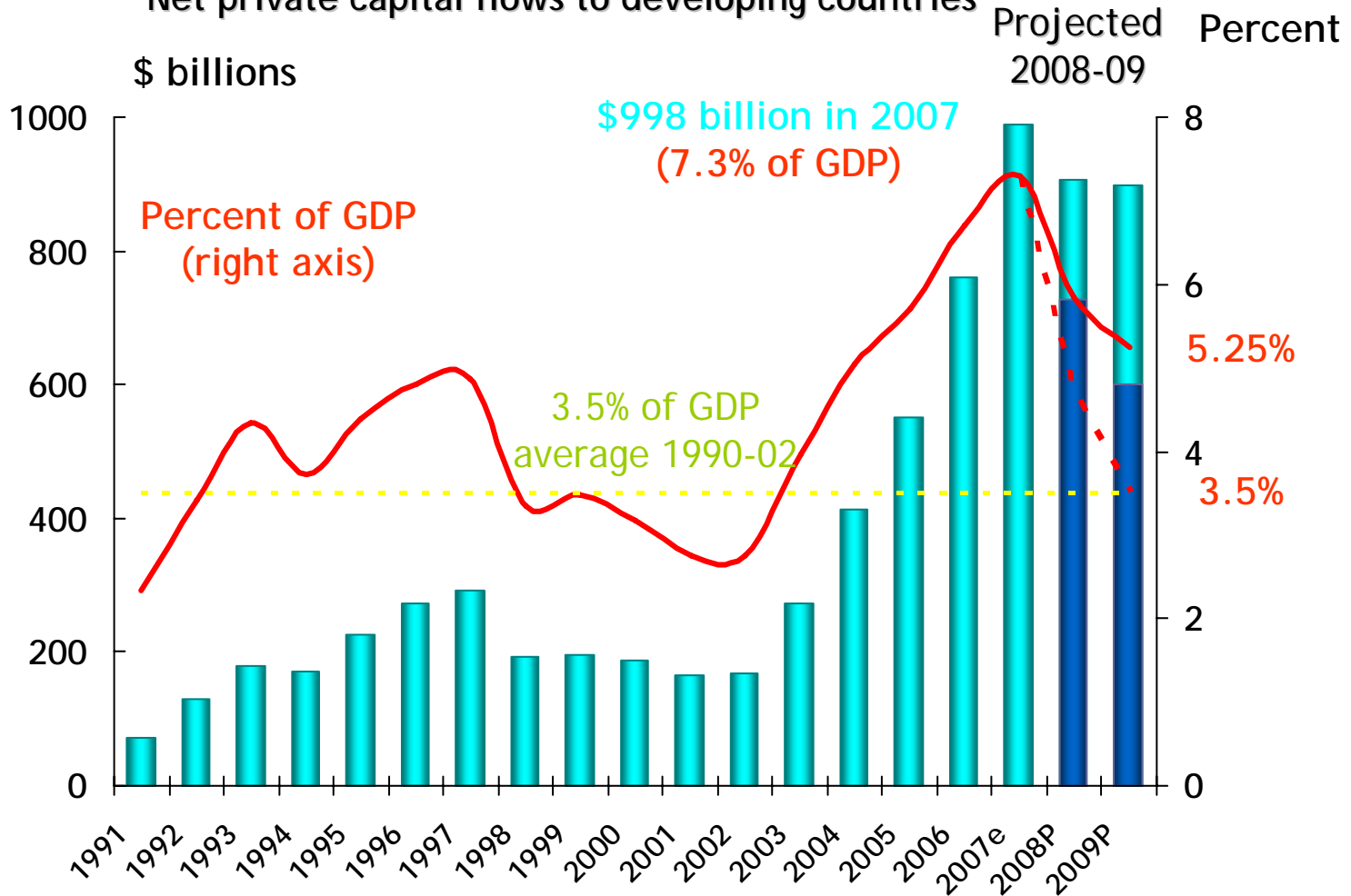


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# Private Capital Flows to Developing Countries, However, Are Expected to Ease from Record 2007 levels—More Competition for Scarce Funds

Net private capital flows to developing countries



Source: World Bank, DECPG



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## II. New Challenges for Russia



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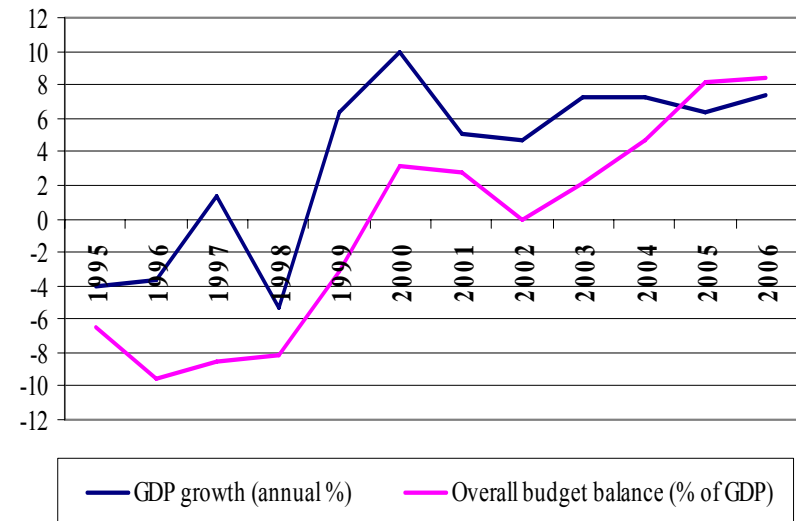
**OVER THE PAST 9 YEARS, THE RUSSIAN ECONOMY HAS PERFORMED  
VERY WELL BY MOST CRITERIA OF PERFORMANCE:  
GROWTH, FISCAL STABILITY, CAPITAL INFLOWS, POVERTY REDUCTION**

- In 1998-2007 period, **real GDP per capita grew by 90 percent.**
- **Growth averaged 7% in the 1999-2007 period**
- During 2000-2007 period, Russia ran **large fiscal surpluses and sound fiscal policy**
- Since 2004, **large capital inflows**
- **Poverty fell dramatically, from 29% in 2000 to 14,8% in the third quarter 2007 (Rosstat).**



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**Real GDP Growth and Balance of the Federal Budget,  
as % of GDP**



*Source: Ministry of Finance,  
Rosstat.*

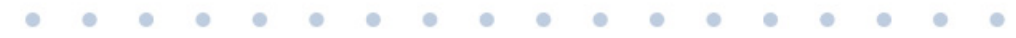
# MAIN CHALLENGES GOING FORWARD

- Strengthening macroeconomic environment:  
Reducing inflation and maintaining sound fiscal policy
- Accelerating structural reforms to:
  - Increase private investment levels and efficiency (improving investment climate, **public-private partnerships in infrastructure**)
  - **Meeting massive infrastructure needs**, promoting inter-regional trade, connectivity
  - Raise public sector efficiency
  - Reduce financial sector vulnerability
  - Maintain rapid growth of productivity
  - Diversify the economy
  - Strengthen the effectiveness of social programs

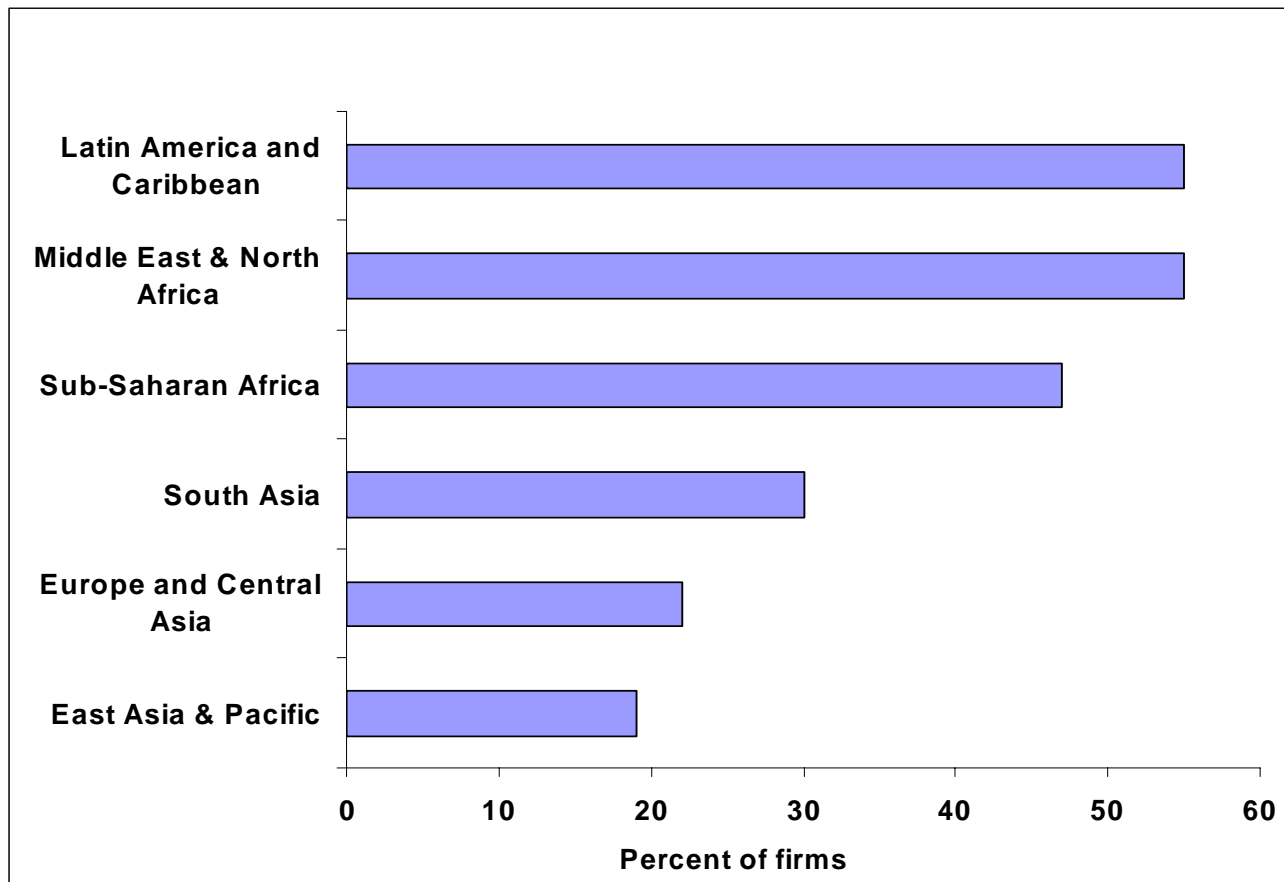


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### III. Public-Private Partnerships: Is Russia Ready?



#### Infrastructure Matters to Firms Worldwide



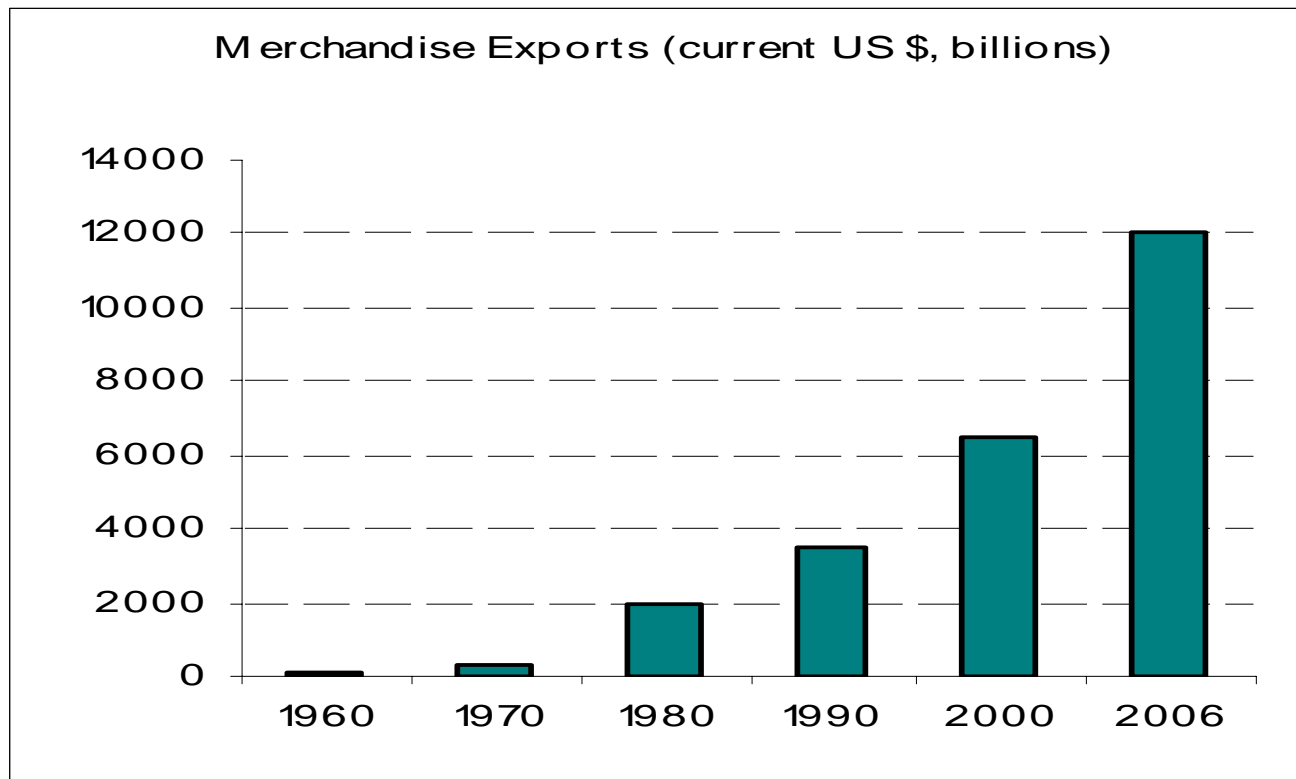
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## Stakes are High in World Trade

- 1960s merchandise exports under \$1 trillion
- In 2006, about \$12 trillion

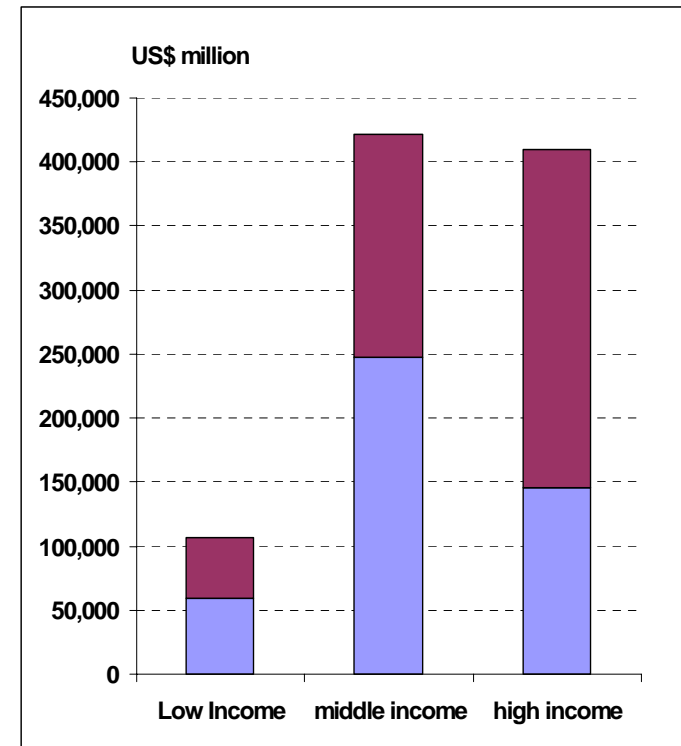
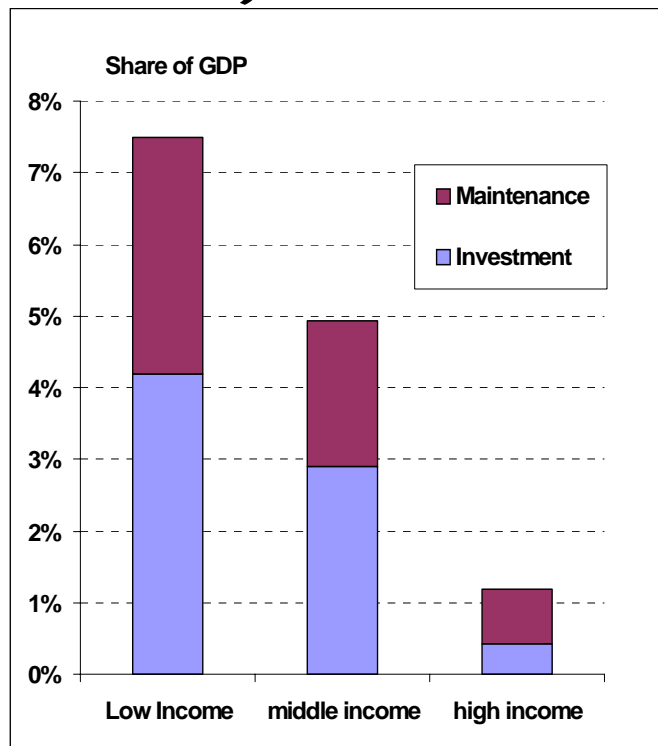


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As countries' infrastructure matures, maintenance takes up a larger share of expenditure needs

Estimated annual expenditure needs in infrastructure (*without* rehab) are large: 5% of GDP in middle-income countries (\$400 billion)



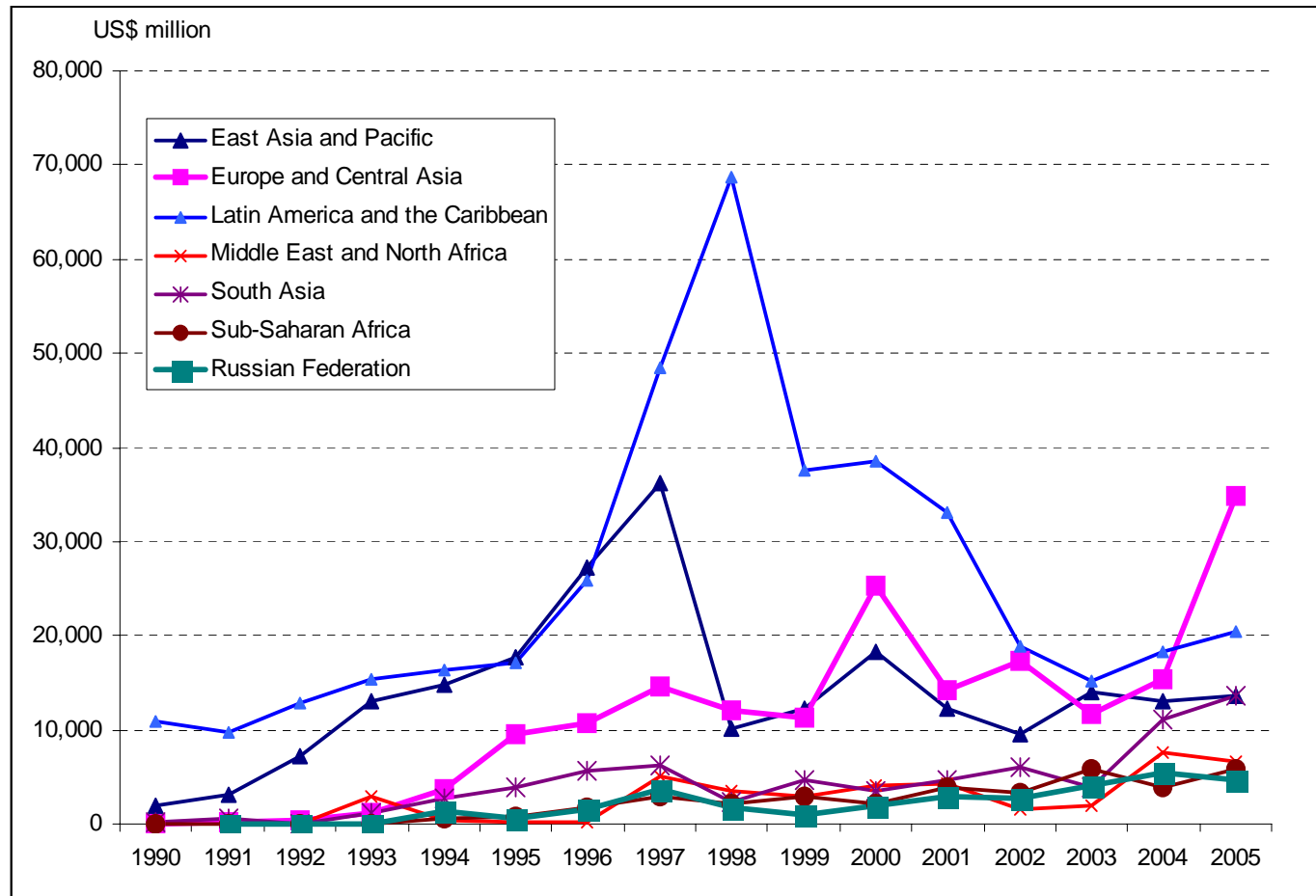
Infrastructure included water and sanitation, rail, roads, electricity and telecom. Does not include rehabilitation needs for which global estimates are not available.



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# The European and Central Asian Transition Economies are now the leading recipients of private investment in infrastructure

## Private participation in infrastructure (PPI) flows

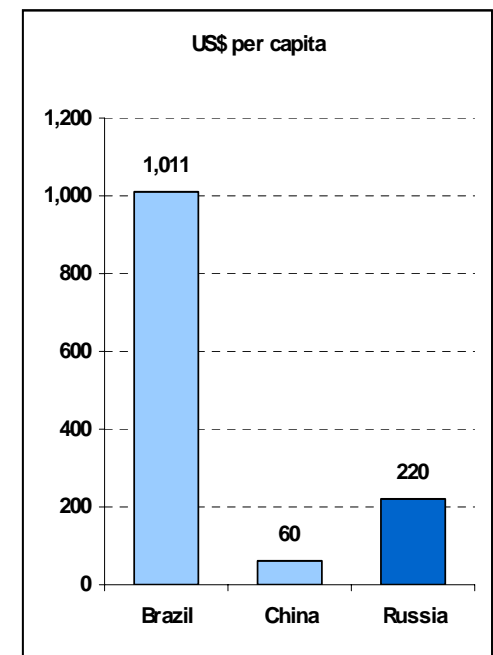
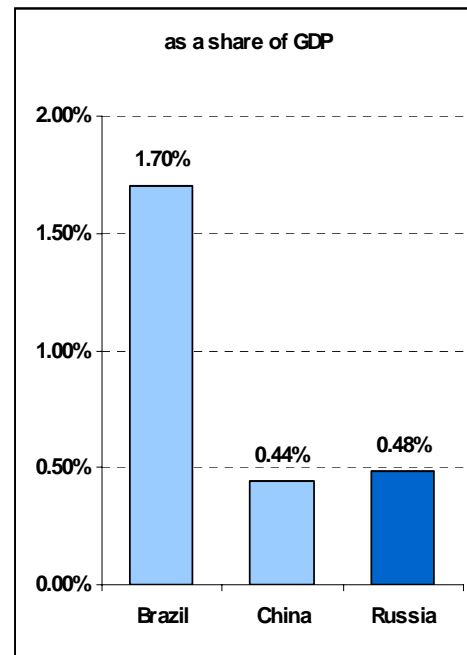
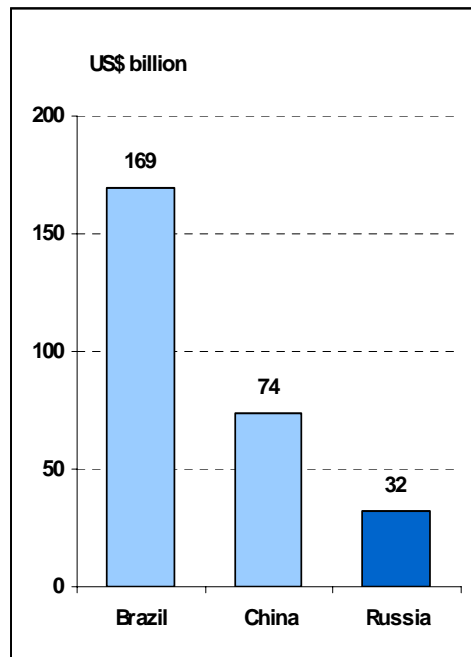


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But Russia has received relatively little PPI to date

## Private participation in infrastructure



Source: [ppi.worldbank.org](http://ppi.worldbank.org)

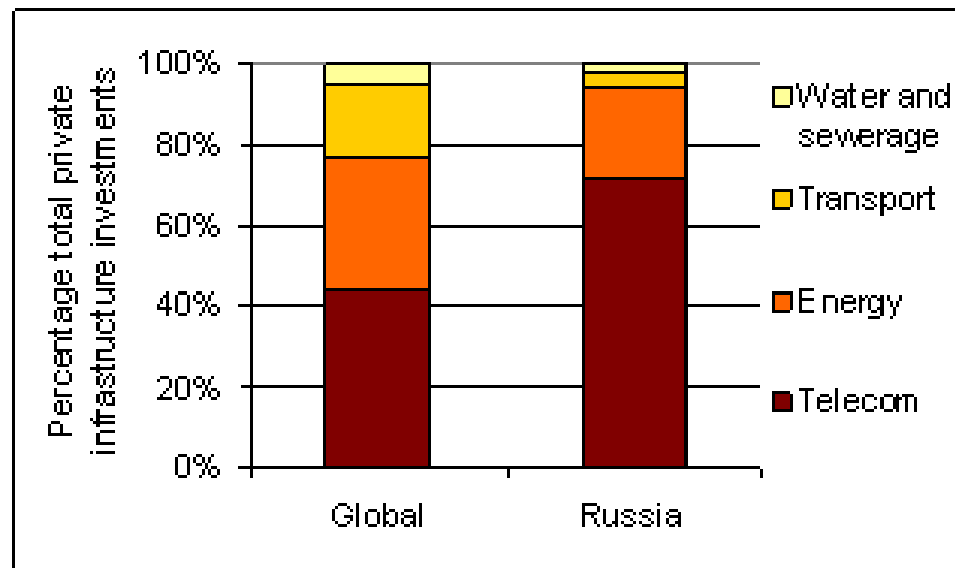
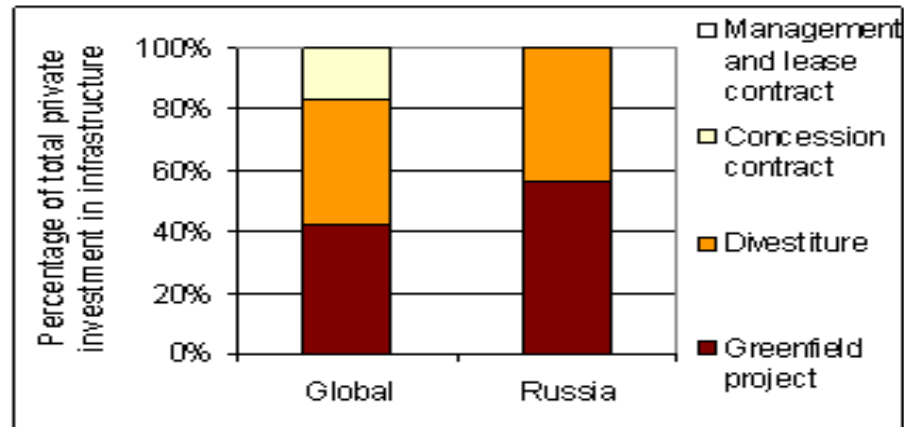


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And it has mostly concerned greenfield projects and telecom



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Source: World Bank Russia Infrastructure Finance Study, 2005

# Yet Capital Investment Needs in Russia Are Massive

- **Demand Over Next 10 Years** → **Over \$1 Trillion (close to Russia's 2006 Annual GDP)**
- **Expected Investments by 2020:**
  - Electricity Generation → \$350 Billion
  - Highways → \$300 Billion
  - Railways → \$400 Billion
  - Airports → \$30 Billion
  - Ports → \$50 Billion
- **PPP – Important Mechanism for Large Infrastructure Investments!**
  - When managed in fiscally prudent manner
- **Investment Fund – Important PPP Instrument:**
  - 12 Projects Approved
  - Total Cost of Projects is \$40 Billion
  - 25% Government Funds

*\* Figures are based on the presentation by First Deputy Head of Government, Mr. Ivanov, in Sochi, September 2007*



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# Appreciable successes

- A law on concessions
- Investment Fund
- About 10 projects
- Russian Development Bank
- Transport strategy
- A comprehensive approach in St. Petersburg



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# 10 challenges



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# Challenge 1: Policy and strategy

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- Lack of clear-cut policy
- No consensus on the use of PPPs
- Lack of coordination and institutions



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# Challenge 2 : Laws

- The law on concessions
  - The proposed amendments address many issues
  - However, improvements must continue
  - Only the BTO arrangement is allowed
- Other PPP forms have no legal and regulatory framework underpinning them
- Tax Code (VAT, profit tax)
- At the regional level only St. Petersburg has developed legal and regulatory frameworks for PPP



# Challenge 3: Risks

- No risk management mechanism
- Budget laws do not allow for provision of long-term guarantees
- 100 percent reserve provisions are required
- Too many risks for the private sector





# Challenge 4: Investors

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- Limited number of strategic investors
- Too many megaprojects carried out simultaneously in one sector
- Global competition
- The risk of projects competing for investors instead of investors competing against each other



# Challenge 5 : Markets

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- Shortage of construction materials
- High construction materials inflation
- Limited number of construction firms



# Challenge 6 : Finance

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- Lack of “long” money
- Limited number of institutional investors
- Banks have no experience in project finance
- Neither private sector nor public sector is willing to assume the currency risk



# Challenge 7 : Investment Fund

- Investment Fund as a budgetary subsidizing instrument
- The guarantee mechanism is not workable
- The term is limited to 5 years
- Appraisal criteria raise questions



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# Challenge 8 : Sponsors

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- Regional and municipal administrations, and also some federal agencies often do not have adequate experience, knowledge and resources available



# Challenge 9 : Projects

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- Lack of well-prepared projects
- Poor quality of projects
- No mechanisms/instruments to finance project preparation (other than the Investment Fund)





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THANK YOU