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Realizing Russia's Potential
RUSSIA'S AMBITIONS FOR INFRASTRUCTURE: HOW TO FINANCE IT?
Panel Discussion

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Moderator:

Yermolai Solzhenitsyn, Managing Partner, Moscow Office, McKinsey & Company

Panelists:

Oleg Budargin, Chairman of the Management Board, Federal Grid Company of Unified Energy System (FGC UES)

David Fass, Chief Executive Officer Europe, Middle East & Africa, Macquarie Group Limited

Yves-Thibault de Silguy, Vice-Chairman, Senior Director of the Board of Directors, VINCI

Maxim Sokolov, Minister of Transport of the Russian Federation

Yuri Soloviev, First Deputy President, Chairman of the Management Board, VTB Bank; Chairman of the Board of Directors, VTB Capital holding companies

Vladimir Yakunin, President, Russian Railways

Y. Solzhenitsyn:

Good afternoon, colleagues. Almost all the participants in our round table are here. Today we are discussing the topic of infrastructure: how much and what type of infrastructure should be developed, and how the planning process is established. This is the first set of issues. The second set of issues concerns the efficiency of verification processes, organizational capabilities, and skills. Will we be able to organize and complete the tasks that have been set for us? It is no secret that we are just beginning to embark on large-scale construction of infrastructure after the rather long hiatus that followed the collapse of the Soviet Union. How should the activities of builders, engineers, and designers be organized? And the third question we will address today is: how much will it all cost, and where will we get the money? Can we finance it solely through corporate loans? Does the government have the money? Does the planned privatization programme that has already been established and announced play any role here? Will the funds that are raised be enough? What lessons can be learned from international experience, including the experience of public-private partnerships? These are the main points of our discussion.

You know the participants in today's meeting. Among them are representatives of major Russian infrastructure companies: Mr. Budargin (FGC UES) and Mr. Yakunin (Russian Railways); representatives of Government authorities: the Minister of Transport, Maxim Sokolov; Deputy Mayor of Moscow, Andrei Sharonov; and colleagues from international companies. Many audience members today have expressed their desire to speak or ask a question. We will try to give them this opportunity at the end of this discussion. Be active; raise your hands, and after all the participants speak, we will listen to you.

Time is short; let us get started. Maxim, I want to turn first to you. Tell us: how do you perceive the overall theme of the meeting? What are the key points and priorities in this area over the coming years?

M. Sokolov:

Thank you, Yermolai. I want to welcome all participants of the Forum and say that we really have a very interesting topic today: Russia's infrastructure ambitions and how to finance them. The Programme for the Strategic Development of Rail Transportation until 2030 has a certain imbalance between the requirements that have been set, and finances. We all understand that there are certain infrastructural constraints on economic growth. At the same time, our goal is to remedy the lack of funding, to adjust the strategy in this respect.

As an introduction to the discussion, I would like to say a few words about what the transportation industry of our country is like today. There are 600,000 businesses and ten million means of transportation involved in the industry. Every day, about 60 million passengers use all kinds of transportation; that is almost every second person in the country. There are more than 28 million tonnes of cargo, and about two million tonnes of cargo per day. Transportation generates about 7% of the gross domestic product of the country. Moreover, transportation is effective not only in terms of the generation of gross domestic product, but also in terms of revenue for the budget. A little over half a billion roubles of tax payments were made and the federal budget received about RUB 400 billion roubles as a result of the organization and operation of transportation. And once transportation generates a flow of cargo along with a financial flow, it provides the necessary basis for the design of individual projects that can be co-financed by attracting extra-budgetary sources.

Of course, the financing of infrastructure is one of the main tasks of the government. During yesterday's discussion on the first day of the Forum, someone voiced the reasonably pessimistic view that we will not have sufficient revenue in the near future that we can direct toward the development of infrastructure to its full capacity, in accordance with the objectives set out in the strategy. It is therefore necessary to focus on those projects that can be co-financed from extra-budgetary sources, while at the same time honing in on eliminating the most serious infrastructure constraints.

We need to look at this problem from another side as well. The transportation sector consists of various sub-sectors: aviation, maritime, road, and rail. All modes of transportation provide a solution to one problem: from the perspective of businesses and passengers, it is delivery from point A to point B. Requirements that are imposed by both shippers and passengers are comfortable, safe, reliable, fast, and, preferably, cheap delivery. Therefore, in addition to growing individual industries, we must bear in mind the inter-industry balance: the extent to which strategies of sub-sectors combine with each other, and how we can redistribute the streams for more efficient use of limited resources while fulfilling the requirements of passenger and freight traffic.

We have estimated the opportunities for investment in transport. Over past decades, the volume of investment amounted to about RUB 1.2 trillion. This is approximately 11% of the total investment in the economy. About 49% of the investment in transportation, including the purchase of vehicles, came from extra-budgetary sources. Budget funds accounted for 51%, and from this share, 31.8% was funded by the federal budget, and 20% was taken from the funds of subjects of the Federation. These proportions indicate that business is ready to invest funds in the development of transportation and, therefore, to some extent, of transportation infrastructure.

In absolute terms, each of the sectors or sub-sectors of transportation can generate approximately RUB 200–300 billion a year during our next planning period (and this period is determined by the transportation system development strategy up to 2020). This also applies to automobile transportation, because the programme for activity of the state-owned company, Rosavtodor, which was approved by the Government last year, requires considerable investment. This is a good start for the beginning of investments in road infrastructure development. Yesterday a concession tender was launched for one of the sections of the Moscow – St. Petersburg toll road, for a stretch of about 40 kilometres from the St. Petersburg Ring Road to the other section headed toward Moscow that has already been implemented by concessionaires.

It may be noted that attracting investment is necessary not only for the implementation of projects for the elimination of infrastructure constraints, but also in terms of increasing expertise. Thus, we expect to have a substantial impact on the growth of the productivity and efficiency of transportation.

What are the tools that we can use to implement this policy? First, it is very good that last month, just in time for the Forum, we were able to structure projects in the area of road infrastructure development based on the principles of so-called life-cycle contracts. We are talking about amendments to the 115th Federal Law on Concession Agreements, which addresses the possibility of roads being assigned for long-term use, with subsequent financing of their design, renovation, and use, and the levying of a concession fee.

InvestFund is working quite effectively. Many projects in the field of road and rail infrastructure are now funded from this source. Of course, we could discuss the fact that the funds represent a relatively small amount, but better still, we should raise the question of the level of contributions into the InvestFund from the budget of the Russian Federation: this principle was originally a fundamental part of the work of the InvestFund. At the same time, we understand that the Ministry of Finance and the Government may have other priorities, but as the ministry responsible, we must consider the development of transportation infrastructure as a priority for the Government.

In our previous meetings, we discussed the need to use all available financial instruments, including so-called infrastructure bonds. I think the participants in our discussion today will still address this topic. There is no such concept as infrastructure bonds in our legislation; there are corporate or project bonds. The question is: what will they be secured with and how will a yield from these bonds be guaranteed, especially if we are talking about the possibility of raising funds from the pension fund and pension savings, which must be a safe investment? We will have to give an assessment of the possibility of using guarantees for the active use of an instrument such as infrastructure bonds in conjunction with the Ministry of Finance and the Ministry of Economic Development. I hope that other panelists

have something to say about this issue, so I will pass the baton, and I will be glad to answer questions.

Y. Solzhenitsyn:

Thank you. I would like to ask a few clarifying questions. Some people believe that businesses engage in construction in Russia mostly because they can make considerable money from it. Is there a clear understanding of how much and what kind of infrastructure this country needs to build over the next ten years? How do we plan effectively and make sure that we introduce the correct amount of capacity, and not end up building things that are unnecessary?

And I have a second question. It is believed that in many respects, it costs more to build here than it does abroad. In particular, this applies to roads. What is your opinion of this problem? Do we know exactly how much we need to build? Is it true that it is much more expensive to build here than it is abroad, or is that a myth? And, accordingly, how much money do we need?

M. Sokolov:

I will start untangling these issues from the end. As for the cost of construction of infrastructural facilities, competition will provide the best answer. As soon as we create a competitive market for construction work when building any infrastructure – airport, railway, road, or sea – all of these issues will disappear immediately, because competition is the only universal mechanism and criterion of the validity of project decisions.

Now I will talk about redundancy. According to some experts in the market, we lose about 3–4% of GDP due to current infrastructure constraints. This is a very serious figure. If translated into absolute numbers, this is about half a trillion roubles. This means that because of the underdevelopment of infrastructure, some goods cannot be exported or transported through our country. Given this, there can be no talk of a surplus of infrastructure.

It is necessary to build intra-industry balance: for example, to reduce passenger transportation by rail in favour of regional air transportation, or to facilitate freight flows, especially transit via railway, reducing the burden on the roads, particularly because the haul distance for certain types of cargo has now been extended up to three or even five thousand kilometres. It is also necessary to do that, of course.

Y. Soloviev:

I would like to share my experience in a fairly large number of tenders and touch upon issues of competition. Often, we have encountered a purely formal approach in the regions, when relatively large companies with no experience were winning these tenders without financial support. Then they were forced to resell the concessions or the mandates to stronger players, which extends the implementation time, reduces efficiency, and, as a rule, considerably increases the cost of these tenders. We have tried, in particular, the use the experience of the so-called fixed-price contract, in which the contractor fully guarantees the maximum price that will be spent.

There is a saying now about construction: everything has to be extended twice and the budget must be doubled. How does the VTB Group work? We participate in about 20 projects in Russia, Turkey, Romania, Bulgaria, and other countries. We hedge the risks of our contractors through guarantees of financial institutions and first-class foreign banks, thus providing a well-defined ceiling so that the budget and the deadline do not go beyond the limits of the existing project.

Competition must be created by certain instruments. I would now like to express my gratitude to two administrations on behalf of our group: The Administration of St. Petersburg, which is currently the leader in concession projects, and the Administration of Moscow, represented by Mr. Sharonov, who can probably describe some big plans. We really like the current dynamics of multiple-concession or project trends in Moscow. It is important not to just declare a tender, but to apply international best practices and make a selection, not only according to quantitative

indicators that can be changed during the process, but also according to qualitative indicators, and to ensure maximum transparency in conducting tenders. Thank you.

V. Yakunin:

Since Maxim has already spoken on the topic of development of infrastructure in general, I will not focus exclusively on railway infrastructure. I will only add that the Programme for the Strategic Development of Rail Transportation until 2030 that was approved by the Government was the first among all the infrastructure campaigns. They laughed at us: how could we think about the year 2030 when the state budget was only planned a year at a time? Now, however, it is planned for three years at a go. We invest much less in infrastructure, even in comparison with the US and Europe, not to mention China. In China, they spend more than 6% of the GDP, and we invest 2.2% of the GDP, but according to the calculations of the Centre for Strategic Studies, we need to invest 4–4.5%. Of this, it is necessary to invest 1.5% in the infrastructural development of the railways. There are specific expert assessments of how much of the GDP the Government will lose if it does not do this.

From all that has been said at this Forum, I, as the head of Russian Railways, am most interested in Vladimir's statement on the need to launch the so-called infrastructure bonds. It is clear that we must prepare the legal framework extremely carefully. By the way, for now, any kind of concession is impossible for Russian Railways. Moreover, referring to the privatization of Russian Railways itself, let us not forget that by law, only the Government can be the direct owner of the infrastructure.

Now, as to how we encourage competition, I can only say that I am 100% for competition: it is a necessary element. But at the same time, I am 100% for the fact that the conditions in which our economy is growing, including competition, should be supported by the relevant legislation.

Here is an example. A few years ago (and everyone here knows this), the Federal Antimonopoly Service actively lobbied for the establishment of a fuel exchange. As

a result, it is only possible to buy fuel at a higher cost on this exchange than we buy it on the market. Another example is the widespread development of competition in the provision of rail cars. There are more rail cars now than there were in the Soviet era. Why has the cost of transportation, not including the infrastructure component (which is limited by the Government), but the rail car component of the cost, risen during a period of artificial shortage of over 100%? It seems that there is competition, so what is the problem?

Every business strives to become a monopoly for at least one day, and, in addition, to maximize its profits. If the lack of responsibility for supplying rail cars can eliminate a margin much greater than behaving in a socially responsible way, what motivates a businessman to transport things more cheaply and receive less? Nothing. We do not have these kinds of mechanisms. We must create them in conjunction with the Ministry of Transportation and Economic Development.

On the question of how costly it is to build in Russia, when the construction of Olympic facilities had only just begun, we were asked to build an infrastructure for a combined road–rail system. At the request of the President and the Presidential Control Directorate, we conducted a study, and its results were given to the Government. What does it mean to build a kilometre of road on the Tuapse–Adler route? This does not mean just laying rails, installing poles, and hanging the power network. You also to take into account the presence of the beaches, because Sochi is a resort. If we had not invested a lot of money every year and laid down gravel, the beaches would have disappeared from Sochi long ago, and that puts pressure on the cost per kilometre of track. When we demonstrated all of this, neither the President nor the Control Directorate had any questions. Questions have arisen from the regional authorities. I received a letter from the Vice-Governor of Krasnodar Territory, who quite harshly blamed me for the fact that we were greatly inhibiting the growth of the regional GDP, reducing the price of construction. It was not profitable for them. We are constantly embroiled in lawsuits with our contractors, because we hold down the price. We have a fixed price, which was adopted by the Government, and nearby the same builders are paying considerably more. We are

not able to regulate this. Which market will regulate this besides Government agencies, which should by all accounts be involved in this process somehow? All of this must be borne in mind when we say that competition will solve everything. There were times when it was suggested that the market would settle everything. Tonight, Moody's investment rating agency downgraded the ratings of the fifteen largest banks. Some of these ratings were lower than the ratings for Russian Railways. Therefore, from the perspective of the attractiveness of infrastructure development, I think there are no problems. Problems are created by imperfect legislation and a lack of prudent regulation, which must be resolved through tariff and antimonopoly policies.

Recently, Mr. Artemiev admitted his guilt in the fact that Russia has not created a competitive environment. I have a simple question. The Government adopts a methodology for calculating an economically justified tariff for transportation of passengers in the regulated sector, and names a certain amount; then during the discussion by the Government, they cut six billion from this amount. From the perspective of antimonopoly legislation, is this right or wrong? In my opinion, it is wrong. Has anyone voiced their opposition to this? No one. There should not be such a one-sided contest. This also applies both to private businesses and the Government. If we ask our foreign partners, they will confirm this. Everyone has the same problems, and only the Western economy, despite its current instability, is stable in terms of the tradition, history, and development of legislation. But we are just in the process of being born, and we are now testing out for ourselves the established formulas of development that exist in the West, whether it be infrastructure or business in general, and to say that we are doing everything ourselves would be conceited at the very least. Thank you.

Y. Solzhenitsyn:

Thank you, Vladimir. Now I would like to turn to one of our international colleagues. Mr. de Silguy, I have a question for you. In your experience in Russia, in VINCI's experience working here, what is your view on the state of competition in the

infrastructure sector? What other issues have you come upon which you wish were easier or you think need to be solved for work in the developing of infrastructure to be quicker, easier, and more effective? Given the time, please focus just on the main points.

Y-T. de Silguy:

I think first there is a problem today in Russia for investors. We are investors who put liquidity in the infrastructure sector, especially in the highways, and with the authorities we are in the process of developing PPPs, public-private partnerships, in the broadest sense of this word. I think this model is very efficient for transport infrastructure in Russia. But, I think today the problem after the financial crisis is that there is a lack of liquidity. It is more difficult to get financing to develop this infrastructure. There are three ideas which would be useful to develop in Russia to be able to continue in the promotion of infrastructure with the help of the foreign private sector. The first idea is that we need to be able to find a good balance between private financing and subsidies. I think it will not be possible to develop in consultation without a good balance between public subsidies and private financing. In this case, I think especially in Russia, it is very important to find a solution to reassure the banks in terms of guarantees. As far as rate risk, it is difficult to find rules here for long-term loans, so the only solution is to put it in euros or dollars. For the banks that take the rate risk, an exchange risk, that is an important point. The second thing is to develop bond financing. I think in Russia there are big possibilities to raise cash. To build a project risk it would be useful to develop the use of bond-based funding based on cash deposits in Russia to fund money. The third idea that is important in Russia is the implication of multilateral and institutional banks. To help make projects more bankable it is necessary to have the support of the IFIs, the EBRD, the EIB, and other international investment public banks. I think today there is a lot of work to develop some IFIs in Europe – some instruments which would be useful to be an incentive to buy bonds. I think that is very important. On the last point, especially in relation to Russia's situation and in relation to IFI

implementation, very often the IFIs put conditions not only on financial aspects, but on other social-economic criteria, such as environmental quality and the impact on civil society. I think this is useful because to finance this project it has to be credible, and to be credible this project has to be acceptable. In occidental society this can create more and more difficulties because we have to take into account citizens' opinions, citizens' wishes, and we have to deal with problems as soon as possible. I think it is important that IFIs give an impetus to force the actors to take account of this dimension. In all experience everywhere in the world, more and more often we have to take into account this aspect of civil society. On my advice we have developed the process of taking this into account as soon as possible at the start of the project. When a company is designated as a preferred bidder I think its role is to tackle this problem to be more acceptable, because if your project is more acceptable at the start, the credibility will be higher and the cost will be lower. So, that is important. I would like to say today that it is my feeling that in Russia there are a lot of efforts to modify regulations and to implement some new rules, but I think there is probably some reluctance from private foreign companies who are not sure competition is equal for all the partners – for foreign and Russian companies.

D. Fass:

Let me make a comment, Yves, about something that has been said here at the table. I think this concept of infrastructure bonds is interesting. I think the international banks, as Vladimir has talked about, are obviously struggling for access to capital. At the end of the day, the success of infrastructure in any country is going to be dependent on the equity stakeholders that are taking the risk at the bottom of the capital structure and are going in first. Representing Macquarie, we are the largest international infrastructure manager the world. I will not talk very much about that today. But, what I will tell you is that there are hundreds of investment managers out there in the world today trying to raise infrastructure equity dollars and many of them are being successful. So, to be a little bit controversial I am not really sure that the issue here is that there is not enough money to get these

projects taken care of. I think there is more than enough money to get these projects taken care of. In fact the returns that we as equity investors are getting from infrastructure projects is now down in single digits, whereas five or 10 years ago nobody would invest in equity and in infrastructure projects that would earn less than 18% or 20%. So, if that equity layer is there and the pension fund managers and money managers and insurance companies of the world want to be investing in infrastructure I think it is incumbent upon policy makers, the competitive landscape, and the clarity and simplicity of contracts around tendering and tariffs to be very clear, very transparent, very open, very competitive, and very fair. I think if those fundamental things are there, there is no shortage of capital to come into Russia or any other developed economy that has those types of bases to it. The equity investors of the world, the insurance companies and the pension funds, they tried to play the equity market and they are all down 50%. They thought we have a good idea, let us buy senior debt of banks. That is down 50%, too. Then they decided let us buy debt from governments. Well, that is down 50%, too. So, there is plenty of equity capital available out there to get these projects financed and I think it is people around this table and around the room here that really have the answers as far as how to make that simplicity, that clarity, come through so that that equity will flow into the market and then infrastructure bonds, project finance bonds, and even the banks that are still left standing will make debt available to sit on top of that equity in a rational structure.

V. Yakunin:

With your permission, I have just one additional thing to mention. The management of the company of Russian Railways is aware that these bonds should be issued not by corporations, but by the state. Because the amount of needed money is so great that if I issue those bonds I will be downgraded by the banks and investment agencies. The bonds issued by the state will be more appropriate and more interesting for the structures that you are mentioning. I agree with you completely there is no shortage of money. The money market is very, very hot and everyone is

seeking the possibility to invest in a proper project, and infrastructure projects are the most attractive part of these possible investments. Thank you.

O. Budargin:

I support Vladimir, because the company has been operating under long-term parameters on the principles of RAB for three years, and over those three years, the principal regulator has changed the parameters four times already, so the work of the regulator should be carried out for us by the Government. Today, Vladimir Yakunin very confidently speculates about the long-term development of the company. He has grounds for this confidence, as he has maintained the unity of the company, which unfortunately cannot be said about the country's network facilities. Competition is not something that can be learned in ten years. We need a particular culture, a state of mind, a way of thinking. Today, the outcome of the reform of the electric power network forces us, the power engineers, to address some serious problems in quite a short period of time. First of all, this is a reliable electric power supply, and a reliable electric power supply means modernization. If we are talking about advanced development, we need to allocate money for modernization. More than 50% of the electric power network is currently physically deteriorated. Long-term planning and management should play a big role in solving this problem.

The second topic is synchronization. It is necessary to synchronize the development of the energy industry to the maximum degree. Over the course of two years, our company has been carrying out work on a plan for power generation, and generation is growing quite substantially. Of the 11 projects, we have completed nine on time, and this has kept up with generation. Hence, generation has only been among our responsibilities twice, and in nine cases, they lagged behind the network, even though we finished everything in time, and the networks were dormant and did not earn any money.

It is very important work, developing synchronization with the socio-economic development programmes of the territories and industries. How much infrastructure is needed, and where is it needed? Each region wants everything to be its own. But

is this necessary? Before building, you need to introduce the necessary amount of infrastructure.

I agree with Yermolai and Maxim that the public is now posing a lot of questions about cost and feasibility. We need to actively work with the consumer. The tariff policy should be transparent. We need to explain to consumers where the money specified in the bills is going.

What ways are there to develop the power industry? Competition, yes, but the cornerstone is longevity. As soon as we switched to a five-year plan, the price fell. Our partners have become more reliable. The market for energy services is still emerging, and there are special project organizations, special builders, and special equipment. The fact that companies such as Toshiba, Siemens, Alstom, Hyundai, and a number of other firms are building their factories in Russia today to manufacture equipment is a demonstration of confidence in our company. But they are interested in long-term projects. They cannot build a transformer plant in Kolpino to issue an order to operate for only a year. They request a minimum five-year contract. Price, reliability, and quality of equipment depend on the long-term contracts. Therefore, despite the fact that the distribution network has claims against RAB (and how was it possible to do this in two years, when the parameters were changed four times?), we need to maintain RAB regulation. The President helped us yesterday: he declared that it was necessary to create long-term infrastructure bonds. We have to begin working quickly, and to quickly implement long-term monetary infrastructure projects: pension and insurance.

Today we have an exceptionally good round table, and an interesting conversation. Of course, there should be competition, but on a long-term basis.

Y. Solzhenitsyn:

I have one clarifying question for you and Vladimir. Longevity in the area of tariff regulation – both the network regulation for the UES, and infrastructure and locomotive regulation for Russian Railways – is often discussed. If the rules are not clear, money will not come: what if everything changes at the end of the year? Tariff

regulation, which depends on meetings at the level of prime ministers, deputy prime ministers, and the president, is not serious because it can always change. I would ask the two of you to say what action you expect from the Government in the area of tariff regulation. Maybe Maxim will comment on what is said later.

O. Budargin:

I understand longevity like this: analyse the situation, adopt a decision for the next five years, and do not review the decision for that entire period of time. Maybe it is like with the reform in the electricity industry, when the special law 35-FZ was adopted. Now we are working out the mistakes. When we speak today about the merger of networks, it is not back to the future, but forward to the future. Moreover, it seems to me that a consistent five-year tariff should be established: a sliding five-year plan. Our partners – banks and equipment suppliers – will only work under these terms, and the price will drop. Hence, the result of our work will be a reduction in tariffs.

Y. Solzhenitsyn:

If the country's economic situation has changed, this should not lead to a change in the stated price.

V. Yakunin:

I totally agree with Oleg, and support his idea of five-year tariffs. But we must not have illusions that we can establish one tariff and not introduce some kind of formula that would react to changing economic circumstances.

Here is an example. I have been Head of Russian Railways for seven years. Over those seven years there have been no situations in which the forecasts of Ministry of Economic Development with respect to pricing indices coincided with reality. For example, earlier this year, the index indicated that the cost of fuel would rise by 0.1%, and by the middle of the year it was at 18%. You must agree that something

needs to change in terms of both planning and the institutional principles of influencing the development of the economy.

Y. Soloviev:

The process for approving tariffs for concession services cannot be predicted, because there is a great risk in absolutely every project. The second factor is the inability to pay the grantor, i.e., the inability of the Government agency to ensure a minimum level of revenue for the concessionaire or to designate the amount at which a given Government institution will take this project from the concessionaire. There is a third obstacle, and here I must disagree with David, because there is a lot of money in the world, but there is very little money that is ready to come here. For example, the European Bank for Reconstruction and Development will not work under the statuses and brands that exist in many areas in our country. It all depends on the Government.

We need inflation bonds. Who will issue them first? Russian Railways, for example, is a leader in our debt market. Who should set the curve? The Ministry of Finance, and then later project bonds can also be issued. The role of government is enormous, from tariffs to support of the legal framework, infrastructure and even the issue of such bonds.

M. Sokolov:

I would gladly listen to the comments the Minister of Finance, the Minister of Economic Development Minister, and the Head of the Federal Tariff Service. I think I will hear from them during our budget process. As Transportation Minister, I certainly endorse the views of my colleagues on the need for long-term tariff parameters. In announcing our openness to investment, including in the transportation industry, we must demonstrate the availability of financial models for these projects. The need for long-term tariff regulation applies to virtually all sub-sectors of transportation, including airport taxes. As for the stevedores, competitive mechanisms have already been formed in most sea ports.

I would like to raise another important point. Vladimir correctly said that we have only recently switched from annual budget approval to three-year planning, and that is also undergoing certain changes. It is impossible to guarantee the consistency of those parameters. So we need to develop other mechanisms for the relationship between the companies building the infrastructure, the investors, and the financial institutions. We have not yet discussed this topic, but I think that Vladimir will support it in terms of establishing an investment component in the tariff for rail freight. For investors and financiers, as well as banks and other financial companies, this will be a signal that there is a guaranteed source of cash flow independent of the three-year budget planning.

Y. Solzhenitsyn:

Andrei, can you do without the help of the Federal Government in Moscow?

A. Sharonov:

We have been discussing the problem of attracting investment in infrastructure for so long that it is hard to say something new. Rather, it is necessary to understand why the tool is not working.

The issue of investment in infrastructure is very relevant to Moscow. Problems of transportation and the expansion of Moscow create such a demand for investment that is certainly impossible to satisfy either from the budget of Moscow or from the federal budget. Attracting private investment is a key aspect of these projects. We are slightly envious of St. Petersburg with its Western High Speed Diameter project. In fact, this is an intra-city toll road. For our part, we are thinking about a project for a northern version (possibly also fee-based) of Kutuzovskiy Prospekt.

The world is still full of money, including long-term money, but on the other hand, we cannot find the money for infrastructure projects, while the rest of the world is somehow able to do so. I think there is another problem that reduces the interest of investors in these kinds of projects. Many infrastructure industries in Russia do not work on a market basis, but rather, let us say, on a public basis. They are heavily

subsidized, and any investment in infrastructure increases the amount of subsidies. This is one of the arguments about decreasing motivation. Why invest in something that generates more irreconcilable operating costs?

Here is the first possible conclusion: I agree that attracting investment in infrastructure is an issue not of money, but of contract discipline and rules that are clearly contrary to the budget legislation. According to budget legislation, you cannot assume obligations that exceed the budget planning period. But three years for infrastructure projects is nothing. The second conclusion, of course, is the tariff policy. The third is a guarantee of traffic. A guaranteed amount of traffic that allows you to create a business model is necessary for any project.

Based on these three points, I would say that we need to de-politicize the setting of tariffs. We have too much politics, and we are constantly in a cycle of pre-election and inter-election periods, which prevents us from soberly considering the issue of tariffs. Meanwhile, that is the number-one issue for any investor that will enter into an infrastructure project, so that cash flows can be planned.

We do not have any instrument like infrastructure bonds. Throughout the world, infrastructure bonds are usually issued by engineering companies against the cash flow generated by the project. If this instrument were to be made available by the Government, then they would immediately lose meaning. They would simply be sovereign bonds, having no relation to infrastructure. They would simply be, shall we say, the revenues from a general funding of the federal budget that are allocated to this project per agreement. In my opinion, the Russian market is not yet ready to buy these infrastructure bonds; they are a kind of a quasi-product artificially tied to projects. Maybe Yuri, as a banker, will correct me. Well, we have raised the topic of infrastructure bonds, but we are looking for some kind of breakthrough here.

V. Yakunin:

I absolutely agree with what Andrei said. When we say 'infrastructure bonds', we mean only the purpose for which the Government is collecting the money: for investments in infrastructure. I think that Yuri agrees.

Y. Soloviev:

We have a class of investors which is willing to allocate funds, but these investments also need to be broken up into clusters. I mentioned the inflation bonds because we have sufficiently large pension savings, and now there is quite a heated debate about where to allocate them. The obligation of pension funds is to save money and pay consumers, who thus get a positive effect from pension savings. If the Government issues inflation bonds and a macroeconomic environment and legal infrastructure is created, it will be possible to change the pension legislation so that pension funds can buy engineering companies' inflation bonds. This requires a project rating system, a system of risk assessment and so on, i.e., an entire infrastructure. It does not exist yet, but an investor base for these types of bonds exists. An example of this is the road show that we did with Russian Railways: there was a very high demand, from abroad as well as domestically. Project financing (we were able to attract several billion dollars to the markets with our partner, the Government of St. Petersburg) was done according to Western law, and we were able to place the senior debt in the debt capital structure in the Western markets. This is trade debt in the form of promissory notes. In particular, for Pulkovo there is about EUR 800 million of funding for ten years, and the traffic is partially offset by the Government of St. Petersburg.

Therefore, there is an investor base both inside and outside, but it is necessary to create special instruments, and here the role of the Government is most important. There will be no changes to the Civil Code, the law on securities and so on; money will not come to these instruments.

Y. Solzhenitsyn:

I have a question for all the participants that is, at first glance, indirectly associated with the topic. A Ministry of Development of the Far East has been created; one of the key objectives in the Far East is, of course, infrastructure. There is a network, transportation, ports, and roads. Are these integrative associations necessary on

the regional level? Do you see this Ministry as an instrument for the rational development of infrastructure, including the attraction of money? How can this be arranged? Or is this structure needed for something else entirely, and do the issues still need to be considered according to the traditional functional criterion?

M. Sokolov:

In my first speech, I said that we need to pay attention to the intra-industry balance of the distribution of freight and passenger traffic. And these kinds of issues are addressed at the Ministry of Transportation and at companies such as Russian Railways. The idea of logistics centres presented by Vladimir Yakunin already addresses the change in the approach to multi-modal transportation and the intra-industry balance in general. This is the future that the market is approaching. We just need to take up this idea in time and execute it in a proper manner.

O. Budargin:

I believe that the main task of this body is to generate a high-quality, well-balanced plan for the socio-economic development of the regions so that there is a quality product. So far, the Far East is suffering from a lack of this.

V. Yakunin:

When we were preparing the plan for the Programme for the Strategic Development of Rail Transportation until 2030, words relating to the subject of comprehensive development of the territory and the inter-industry balance did not exist in the lexicon of Government officials. We had to discuss that, because they had to understand where the work begins and ends. And we continue to follow this principle and believe that the creation of a special Ministry for the Far East Region is absolutely correct and meets its unique needs.

Y. Solzhenitsyn:

Thank you. Many people want to speak today. Now I will ask one participant from the audience. I would like to hear from MTS: how can you have infrastructure without telecommunications?

A. Popovsky:

A mobile phone operator in Russia is a good example of infrastructure development without Government guarantees, investment, or participation. Each of us – MTS, VimpelCom, and Megafon – has invested tens of billions of dollars in the development of the communications infrastructure. The issues that remain to be resolved in the transportation infrastructure do not represent a problem for mobile operators because they have a principal guarantee – a permanent cash flow – and it comes directly from the unregulated telecommunications industry.

I agree with Andrei Sharonov: development, particularly of the transportation infrastructure, hinders competition due to subsidized facilities: subsidized forms of transportation, free highways, and so forth. This seems to me to be a big risk. Any long-term investor understands that people will still travel and consume energy and other resources. You have to think about how to provide the necessary level of competition in the transportation industry. Since our company uses infrastructure created by other companies, we are also confronted with these problems, especially when we go to remote areas.

There is no one in the infrastructure market now except for public companies. We need to rectify this situation. You made a lot of accurate statements. The concession system gives us a certain degree of hope, but the road before us is still very long.

V. Yakunin:

Can I ask you a question? Could you please provide an example of the largest infrastructure project in your area and how long it takes to make a return on the investment?

A. Popovsky:

Over the past three years, we have invested over USD 6 billion in the 3G network alone. There is a return on these investments after more than five years.

V. Yakunin:

Do you know how long the period of time is for a return on investment for rail infrastructure projects?

A. Popovsky:

I believe that we are talking about ten or twenty years.

V. Yakunin:

You are comparing an area in which large-scale investment projects pay for themselves in five years with infrastructure projects that pay for themselves in 25 years.

A. Popovsky:

Yes, but why does it take 25 years for them to pay themselves off?

V. Yakunin:

Because it is the nature of the infrastructure. Ask Mr. Aro: he is a Finn, and he will tell you the same thing.

Y. Solzhenitsyn:

We are approaching the end of our session. Do any of the round table participants want to add anything? Are there any comments?

Y-T. de Silguy:

Thank you for the opportunity to participate in your Forum. I would like to draw your attention to another point in relation to the development of your infrastructure. When

I compare the bid system in Russia with bid systems in other European countries, I think we have to work together more deeply on the terms of reference of your international bids. I see very often that the terms are too rigid, and not always very coherent. When you cut highways into eight parts, that means a driver will have to change speed every 20 or 40 kilometres. There is a problem of coherence. I see very often that there is a 'means' obligation and not a 'results' obligation. That means that for the infrastructure you build and later have to manage, you will lose in terms of innovation, in terms of quality of services, in terms of respect, and in terms of long-term visibility. It is important to build for 40 years, 30 years, or 50 years. My wishes and advice would be to be able to discuss more deeply with national authorities to find a way to go along with the international standards of bids. I think it would be useful for your cities and for your country. I think that before launching an international bid, it is very important to have very deep conversations with all the stakeholders and specialists before writing the conditions of the bid. This would make the bid better in terms of quality and innovation. Thank you.

Y. Solzhenitsyn:

Thank you very much. I want to thank all participants in the discussion. I think it was a lively, important topic. I hope that this year we will somehow make some progress on some solutions to this often-addressed tangle of issues. Thank you!