

# **Private Sector Involvement in the Upgrading of Free Economic Zones**

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# 1. Introduction

In June 2016, the German Economic Team submitted the Policy Study “Policy Options to Reform Free Economic Zones in Belarus” providing the following recommendations:

1. Reposition FEZs towards a cluster-oriented model with a strong focus on FDI
2. Strengthen the focus on SME development
3. Base the positioning of FEZs on services and infrastructure and less on incentives
4. Intensify target group oriented investment promotion and extend after-care
5. **Assess if the private sector can be involved in the upgrading of the FEZs.**

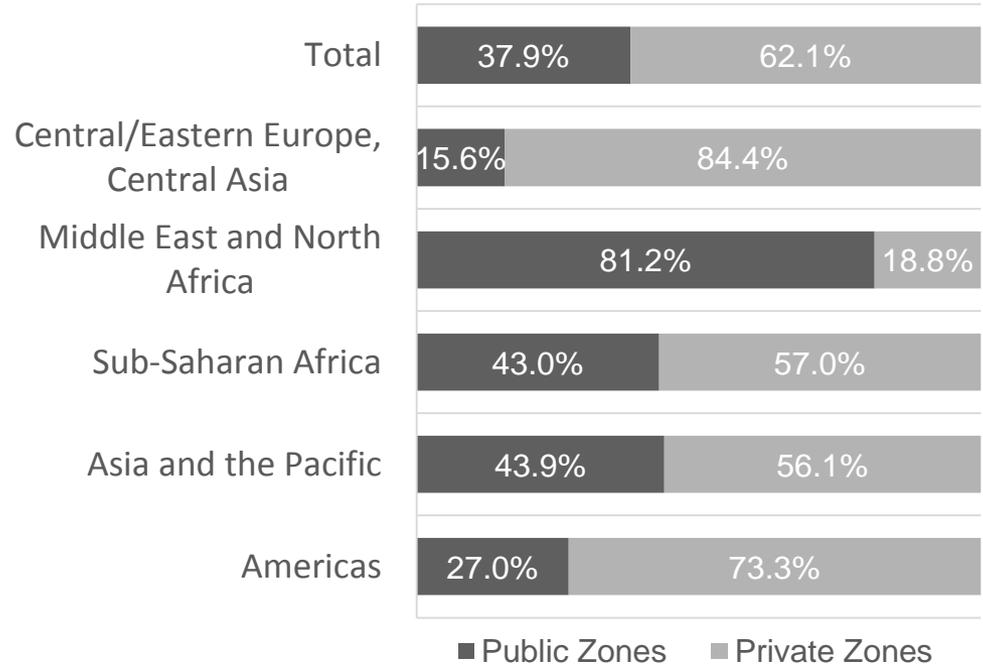
To specify the last recommendation and prepare the implementation, this policy briefing

- compares different forms of private sector involvement in zone programmes
- provides guidance on finding an appropriate model for Belarus, considering international experience as well as the local preconditions
- outlines the implementation process.

# 1. Introduction

**Private sector involvement in FEZ schemes has become a major trend. In 2007, 62% of zones in developing and transition countries were privately developed/operated – compared with less than 25% in the 1980s.**

- Private sector involvement has started with the operation of zones.
- Over time, involvement expanded to include development and ownership.
- Innovative PPPs have recently accelerated zone development blurring the line between public and private zones.



Public and Private Sector Zones in Developing and Transitions Economies (Source: FIAS, 2008)

## 2. Reasons for private sector involvement

**In the light of strained public budgets and increasingly sophisticated demand from tenants, private sector involvement can help to mobilize additional resources, increase the efficiency and meet infrastructure and service needs.**

- Private sector involvement is increasing in part due to the need to reduce the burden on public budgets and to mobilize additional financial resources.
- Furthermore, the expertise of the private sector can help to improve cost efficiency through lifecycle optimization.
- Collaborative approaches allow to allocate risks according to each sector's expertise in managing and mitigating the risks.
- Integrating private sector expertise can help to meet the increasingly sophisticated infrastructure and service needs from tenants and investors.
- Reviews indicate that private zones tend to be less expensive to develop and operate and yield better financial and economic returns (jobs, exports, FDI).

## 2. Reasons for private sector involvement

**Rising interest from the private sector and the emergence of specialized developers, operators and consultants has been another major driver.**

- The landscape of private developers and operators of zones is quite diverse.
- Worldwide, in most of the cases, private developers/operators are only involved in one or a few zones, typically in the country they are based in.
- Considering the high number of existing zones, there is only a small group of specialized companies with a strong international footprint, including (see exemplary profiles in the annex):
  - Engineering, construction and project management companies (e.g. Bechtel)
  - Government-linked companies (e.g. Jurong International)
  - Property developers (e.g. SembCorp)
  - Consultancies (e.g. Locus Economica).

### 3. Strategic options for private sector involvement

**A wide range of models for private sector involvement is used in zone programmes worldwide. The approach taken always needs to be aligned to the country-specific conditions and objectives.**

- The following questions help to narrow down the relevant options and plan the way forward:
  - Which functions of the zone programme should be covered by (a) the private sector, (b) the public sector, and (c) jointly by the private and public sector?
  - For which scope and type of assets/zones is private sector involvement sought?
  - Should a stage-based approach be implemented, extending the scope of functions and assets/zones covered in phases?
- The selection needs to take into account the legal and policy framework.
- Furthermore, it needs to be assessed if the option(s) preferred by the Government are also attractive for the private sector regarding the financial return and risks.

### 3. Strategic options for private sector involvement

Models for private sector involvement can be distinguished according to the functions covered. The only function that should always be vested with the public sector relates to strategy formulation and regulation. There are various interdependences (e.g. between finance and ownership).

| Functions  | Typical Models for Private Sector Involvement |   |  |                  |               |
|--|---|---|--|------------------|---------------|
|  | Service Contract                              | Operations & Maintenance (O&M) Contract | Build Own Operate Transfer (BOOT) Contract | Joint Ventures   | Private Zones |
| Support services (e.g. investment promotion, training)               | Private                                       | Private                                 | Private*                                   | Private & Public | Private       |
| Management and operation (e.g. maintaining facilities)               |   |   |  |                  |               |
| Design and build (e.g. developing the project, construction)         | Public  | Public                                  | Public                                     | Public           | Public        |
| Finance (providing capital e.g. for construction and maintenance)    |   |   |  |                  |               |
| Ownership (ownership of the assets)                                  |   |   |  |                  |               |
| Strategy formulation, regulation (incl. monitoring, public services) |   |   |  |                  |               |

\* Until the end of the contract period (typically 30 - 50 years)

### 3. Strategic options for private sector involvement

To mobilize private capital – without a full privatization – joint ventures and Build Own Operate Transfer (BOOT) contracts are frequently used.

|  | Advantages   | Disadvantages  |
|--|--|--|
| Service Contract                           | <ul style="list-style-type: none"> <li>Improving the quality of specific services integrating private sector expertise</li> <li>Comparatively easy to implement</li> <li>Government retains ownership and control</li> </ul>         | <ul style="list-style-type: none"> <li>Limited impact on overall zone performance</li> <li>Minimal risk transfer to private sector</li> <li>No infusion of private capital</li> </ul>  |
| Operations & Maintenance (O&M) Contract    | <ul style="list-style-type: none"> <li>Wider scope of services covered</li> <li>Proven method to import private sector know-how strengthening local capacities</li> <li>Government retains ownership and control</li> </ul>          | <ul style="list-style-type: none"> <li>Impact on zone performance strongly depends on investments by Government</li> <li>Limited infusion of capital (working capital)</li> <li>Moderate risk transfer to the private sector</li> </ul>  |
| Build Own Operate Transfer (BOOT) Contract | <ul style="list-style-type: none"> <li>Private company assumes equity, construction and other commercial risks</li> <li>Mobilization of private capital and expertise throughout the lifecycle</li> </ul>                            | <ul style="list-style-type: none"> <li>Limited Government control until end of contract</li> <li>Pre-tender enhancements often requiring substantial investments from Government</li> <li>Mainly used for greenfield projects</li> </ul> |
| Private Zones                              | <ul style="list-style-type: none"> <li>Private companies responsible for funding the investments and risks involved</li> <li>Reduction of financial burden on public budgets</li> </ul>  | <ul style="list-style-type: none"> <li>Very limited control by Government</li> <li>Investment decisions focusing strongly on financial return</li> </ul>   |
| Joint Venture                              | <ul style="list-style-type: none"> <li>Government still partly owns the zone and can influence the development</li> <li>Significant infusion of private sector capital</li> <li>Know-how transfer, developing local staff</li> </ul> | <ul style="list-style-type: none"> <li>Pre- and co-investments required from Government</li> <li>Demanding decision-making processes at the strategic and operative level</li> </ul>   |

## Interim conclusion

**Comparing joint ventures and BOOT contracts (and similar PPP structures), the former seems to be the more suitable option in the Belarusian context.**

- Build Own Operate Transfer (BOOT) and similar PPP structures are mainly used for greenfield projects in markets with an established track record allowing a full lifecycle perspective for the private sector.
- In the case of Belarus, it seems unlikely to involve the private sector in such a contract without substantial pre-investments and further risk mitigating measures from the public side.
- A joint venture in which a zone is co-owned and jointly operated by the public and private sector seems to be a more promising option with respect to balancing investments, risks as well as economic and financial returns.
- At the same time, a joint venture tends to make a larger contribution towards capacity building and know-how transfer.

## Interim conclusion

**From today's perspective, private sector involvement should focus on the upgrading of one or two pilot zones and should focus on the zone level.**

- Regarding the scope of zones, private sector involvement could cover (1) all existing zones, (2) a selection of existing zones, (3) only new zones.
- Regarding the scope of assets, private sector involvement could cover (1) entire zones, (2) only selected assets such as utilities, training centers etc.
- In the case of Belarus, the most suitable solution seems to be:
  - to start with one or two pilot zones to gain experience and build up trust
  - to focus on the zone level to maximize the impact of private sector involvement.
- Depending on the characteristics of the pilot zones and the legal framework, it might be necessary to start with a subzone, e.g. with production facilities for rent.
- Considering the high number of existing zones and similar support instruments, the private sector should not be invited to initiate new competing zones.

## 4. Prerequisites for private sector involvement

**Drawing from international experience, the following prerequisites and success factors for private sector involvement can be highlighted:**

### Business Case

- Promising business case for the private sector considering the entire lifecycle
- Balanced distribution of economic/financial returns and risks

### Legal/regulatory framework

- Conducive legal and regulatory framework (e.g. PPP laws, procurement laws)
- Supportive tax and incentive regime (e.g. FEZ incentives for developers)

### Institutional framework

- Regulatory agency separated from government roles of owner, developer, operator
- Ensuring level playing field between zones and competition within private sector

### Technical capacity

- Expertise in assessing the PPP potential, designing and procuring PPP projects
- Capacity to implement and monitor PPP projects

### Mutual trust

- Recognition of partners' needs and objectives
- Mutual trust considering the long-term nature of PPP projects and contracts

## 5. Preconditions in Belarus

**The current FEZ legislation does not foresee any form of private sector participation in the upgrading of the zones. However, PPP legislation could provide a way out**

- The Law on Free Economic Zones regulates that the administration of FEZ can only be a state-owned legal entity
  - Allowing for private operators would require changes in the legislation
- Other support instruments like the China-Belarus Industrial Park are based on special legal acts (Decrees of the President), which allow for more flexibility
  - The Development Company of the Park, which is in practice also supporting the operation in the Park, is a Joint-Venture Closed Stock Company
- New PPP legislation (effective July 2016) allows private investors to submit a proposal for a PPP project to an “interested (state) authority”
  - The typical functions of a private FEZ operator could be part of this proposal
  - State authorities assess the proposal, and (in a positive case) start negotiations on an agreement
  - However: Due to its recent adoption, no track record of successful PPP realisation so far

## 6. Conclusions and policy recommendations

**Considering the Belarusian context as well as international experience, the involvement of the private sector in the upgrading of FEZs offers promising potentials. However, it also represents a very demanding task to prepare and manage a PPP project balancing the risks and returns between the sides.**

- It should be noted, that the private sector expects a reasonable return for bringing in new sources of financing and technical expertise.
- Considering the mixed performance of FEZs, the state of the zones' infrastructure and the pioneering type of the project, it seems unlikely that a private company is willing to participate without measures reducing the risks such as
  - Pre-investments in the off-site and on-site infrastructure by the Government
  - Co-investments by the Government as a joint venture partner
  - Benefiting from the same or similar incentives as tenants in FEZs.

## 6. Conclusions and policy recommendations

**Against this background, a phased approach seems advisable allowing to build capacities and trust and to thoroughly prepare the joint venture and a large-scale roll-out.**

- It is proposed to enter into service / operation and maintenance contracts with private operators for one or two pilot zones before tackling a joint venture.
- Amongst others, these types of contracts have been used in Armenia to integrate the private sector into the zone programme.
- The pilot FEZs benefit from importing private sector efficiencies and technical know-how leading to a tangible impact in the short-term.
- During the contract period, the joint ventures can be prepared – e.g. regarding reforms in the legal and institutional environment as well as pre-investments in the zone infrastructure.
- The dialogue und collaboration with the private operators will also be beneficial for this process.

## 6. Conclusions and policy recommendations

The following phases are proposed:

### **Selection of Pilot Zone(s)**

- Screening development and PPP potential of zones
- Selection of pilot zone(s) by Belarusian Government

### **Service / Operation and Maintenance Contract(s) for Pilot Zone(s)**

Entering into contracts with private operator(s), e.g. investment promotion, maintaining infrastructure, added value services, training, staff secondment

### **Preparing Joint Venture(s) for Pilot Zone(s)**

- Planning and implementing legal, regulatory, institutional reforms as needed
- Pre-tender zone enhancement (e.g. infrastructure investments) as needed

### **Implementing Joint Ventures in Pilot Zone(s)**

- Structuring and appraising PPPs, designing contract
- Managing transaction (e.g. bid process) and contract

### **Refinement and roll-out**

- Refining the approach based on experience from pilot zone(s)
- Roll-out involving the private sector in further zones

## 6. Way forward

**As a first step, an international expert forum with stakeholders from Belarus as well as international experts and practitioners is proposed to discuss and refine the phases. The following topics could form part of the agenda:**

- Introduction to the FEZ scheme in Belarus and the planned reforms
- Overview of the legal and institutional framework for PPP projects in Belarus
- Key success factors for private sector involvement in FEZ schemes
- International case studies featuring different PPP models for FEZ schemes
- Key interests and requirements from the perspective of private developers
- Overview of the PPP development and implementation process in the FEZ context
- Site visit at one of the zones identified as a potential pilot
- Refining the proposal for private sector involvement in Belarusian FEZs and discussing the way forward

## Annex: Selected international developers, operators, specialists (1)

| Company  | Exemplary projects  |
|--|---|
| <p><b>Jurong International</b> (Singapore)</p> <ul style="list-style-type: none"> <li>- Consultancy &amp; Master planning</li> <li>- Infrastructure Design</li> <li>- Construction Management</li> </ul> |  <ul style="list-style-type: none"> <li>• Moglino SEZ, Russia</li> <li>• Doha Free Trade Zone &amp; Logistics Storage Zone</li> <li>• Lagos Free Trade Zone, Nigeria</li> <li>• Astana New City SEZ, Kazakhstan</li> </ul>   |
| <p><b>DP World</b> (United Arab Emirates)</p> <ul style="list-style-type: none"> <li>- Advisory services</li> <li>- Master Planning</li> <li>- Operation &amp; Management</li> </ul>                     |  <ul style="list-style-type: none"> <li>• Jebel Ali Free Zone, United Arab Emirates</li> <li>• Alyat Free Trade Zone, Azerbaijan</li> <li>• Khorgos Special Economic Zone and Inland Container Depot, Kazakhstan</li> </ul> |
| <p><b>Locus Economica</b> (United States)</p> <ul style="list-style-type: none"> <li>- Designing legal, policy &amp; institutional frameworks</li> <li>- Feasibility studies &amp; reviews</li> </ul>    |  <ul style="list-style-type: none"> <li>• Advise on the establishment of 3 SEZs in Qatar</li> <li>• Kuwait Economic Zones Feasibility Study</li> <li>• Advise on reforms of the Russian Zone Programme</li> </ul>           |

## Annex: Selected international developers, operators, specialists (2)

| Company   |   | Exemplary projects   |
|---|---|--|
| <p><b>Bechtel</b> (United States)</p> <ul style="list-style-type: none"> <li>- Design &amp; master planning</li> <li>- Construction</li> <li>- Facility operations</li> </ul> |    | <ul style="list-style-type: none"> <li>• Khalifa Industrial Zone Abu Dhabi (Kizad), United Arab Emirates</li> <li>• Dubai Free-Trade Zone, United Arab Emirates</li> </ul>   |
| <p><b>Amata</b> (Thailand)</p> <ul style="list-style-type: none"> <li>- Planning &amp; Development</li> <li>- Operation &amp; Marketing</li> </ul>                            |   | <ul style="list-style-type: none"> <li>• Amata Nakorn Free Zone, Thailand</li> <li>• Amata City Free Zone, Thailand</li> <li>• Amata City Bien Hoa Industrial Park, Vietnam</li> </ul>   |
| <p><b>SembCorp</b> (Singapore)</p> <ul style="list-style-type: none"> <li>- Planning &amp; Development</li> <li>- Operation &amp; Marketing</li> </ul>                        |  | <ul style="list-style-type: none"> <li>• Batamindo and Bintan Industrial Estates at Batam, Bintan, Karimun Special Economic Zone, Indonesia</li> <li>• Vietnam Singapore Industrial Estate (VSIE) Quang Ngai at Dung Quat Economic Zone</li> </ul> |

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