

PROBLEMS AND SOLUTION OF IDENTIFICATION AND APPROVAL OF PRIVATELY FINANCED INFRASTRUCTURE PROJECTS IN CHINA

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ABSTRACT : The governmental attitude toward private investment and financing for infrastructure projects has changed from the initial prohibition to the current encouragement in China, which has been embodied in the legal documents and administrative process. However, the problem of identification, bidding, and approval procedure for privately financed infrastructure projects has been observed in policies and administrative measures promulgated by different or even the same government branches, which is prohibitive factors for smooth project implementation. After analysis of the identification, bidding, and approval process of infrastructure projects, the authors proposed a simplified and alternative procedure and clarified the key points of relevant project documents.

Key words: approval procedure, China, infrastructure, private financing, and project

1. RESEARCH BACKGROUND, OBJECTIVE, AND METHODOLOGY

Since 1980s, with the quick economic development, the government investment in infrastructure projects became insufficient. Thus, BOT method was selected by the Chinese government as one of the alternatives for infrastructure development and operation in 1994, which involves private financing and investment [1]. Several legal documents were issued to regulate and normalize BOT infrastructure [1-3].

After China's entry into the WTO in 2001, pursuant to the principle of transparency, non-discrimination, and national treatment, the Chinese government began to revise its legal framework including laws, regulations, and administrative framework such as measures, guidelines, licensing procedures and requirements. The investment regime began to be reformed, too [4-8].

However, the inconsistency of identification, bidding, and approval procedure for privately financed infrastructure projects has been observed in policies and administrative measures promulgated by different or even the same government branches. Repetition has been found out in the contents of relevant project documents. The inconsistency and repetition are prohibitive factors for smooth project implementation.

With the purpose of identifying the problem in the identification, bidding, and approval procedure of privately financed infrastructure projects, all the legal documents issued by different government organs were collected and reviewed. In order to overcome these deficiencies, the authors propose a simplified and alternative procedure and clarify the focus of relevant project documents.

2. LITERATURE REVIEW

2.1 Identification, bidding and approval of privately financed infrastructure projects

The Bidding Law is enacted in 1999 in order to normalize the bidding procedure [9], which requires that the surveying, design, construction and supervision of large infrastructure projects and public utility projects, as well as relevant important equipment and materials, must be procured using bidding method

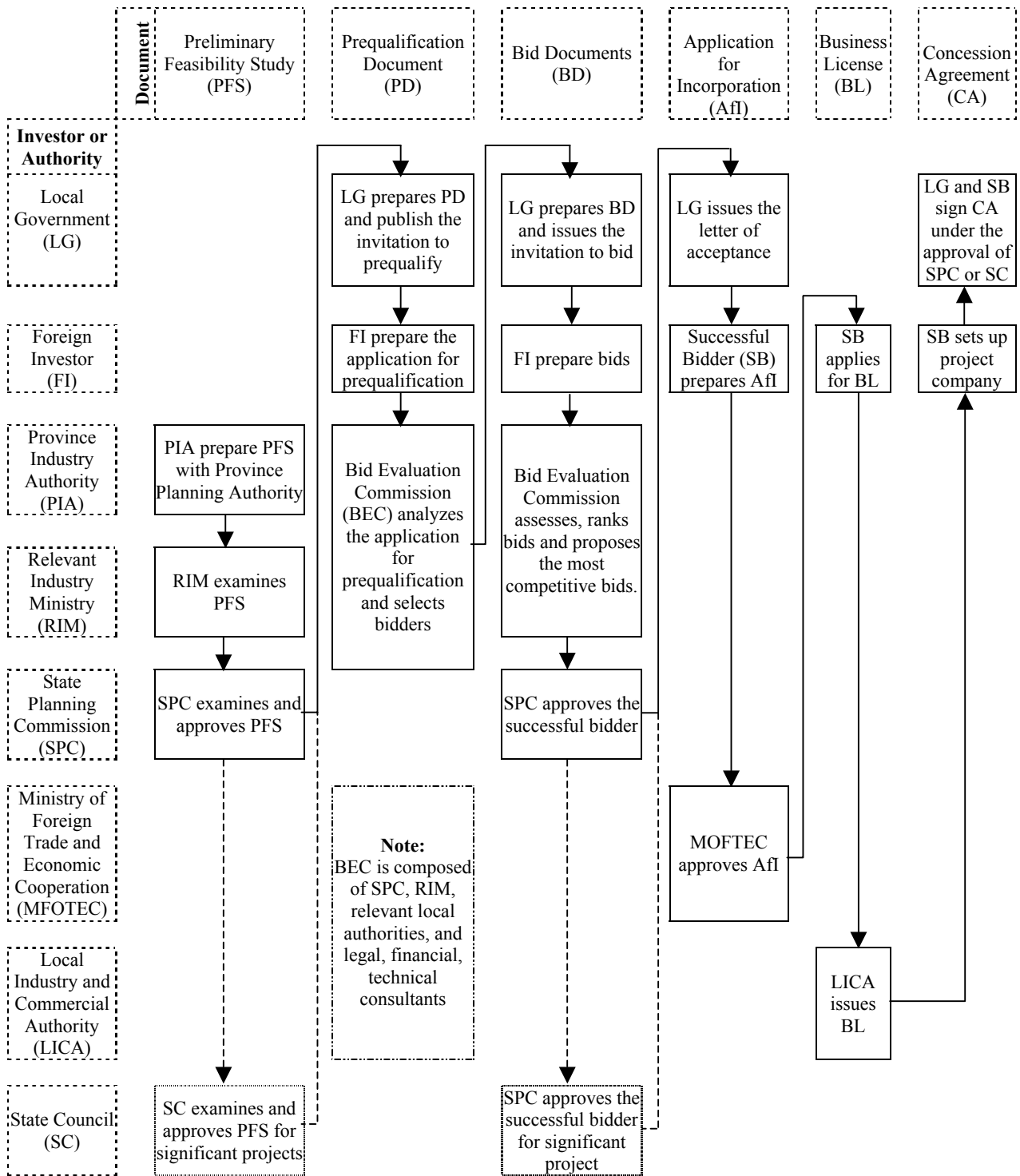
The principle of transparency, openness, impartiality, justness, competition as well as public interest first shall be followed in the implementation of privately financed infrastructure projects including the selection of concessionaires and subcontractor [10-12].

The identification and confirmation of privately financed infrastructure projects must conform to the five-year plan or ten-year program of the national economic development and social advancement [3], the national industry policy and urban development program [13] and the development program of urban infrastructure [11] and shall be adjusted according to economic growth and social development.

The State Planning Commission prescribed that the identification, bidding and approval of BOT projects and the selection of foreign concessionaire shall comply with the overt competitive bidding procedure in 1995, which covers road, bridge, tunnel, water supply plant and electric power plant projects. Based on the above prescription the authors depicted a flowchart to clearly show the due procedure in Figure 1 [1-2].

2.2 Approval procedure for concessionary projects in electric power sector

The Ministry of Power Industry adopted different procedures for submission and approval of the Chinese-foreign cooperative electric power projects (Chinese-foreign contractual joint venture projects or Chinese-foreign equity joint venture projects) and the wholly foreign invested electric power projects based on negotiation in 1995 [3].



Note: The dash line means that such procedure is necessary only in prescribed conditions.

Fig. 1 Identification, Bidding, and Approval Procedure for the Foreign-Invested Infrastructure Projects

2.3 Procedure of identification, bidding, and approval of public utility projects

The Ministry of Construction enacted the Administrative measures on concessionary operation of public utilities like water supply plant, wastewater disposal plant, and solid waste disposal in 2004 [10], which stipulates the necessary contents of the prequalification documents, bid documents and concession agreement as well as the procedure of

identification, bidding and approval of public utility project. Based on the above administrative measures the authors depicted a flowchart to show the procedure in Figure 2.

2.4 New administrative systems for projects invested by enterprises

Pursuant to *The Decision of the State Council on Reforming the Investment System*, the verification and

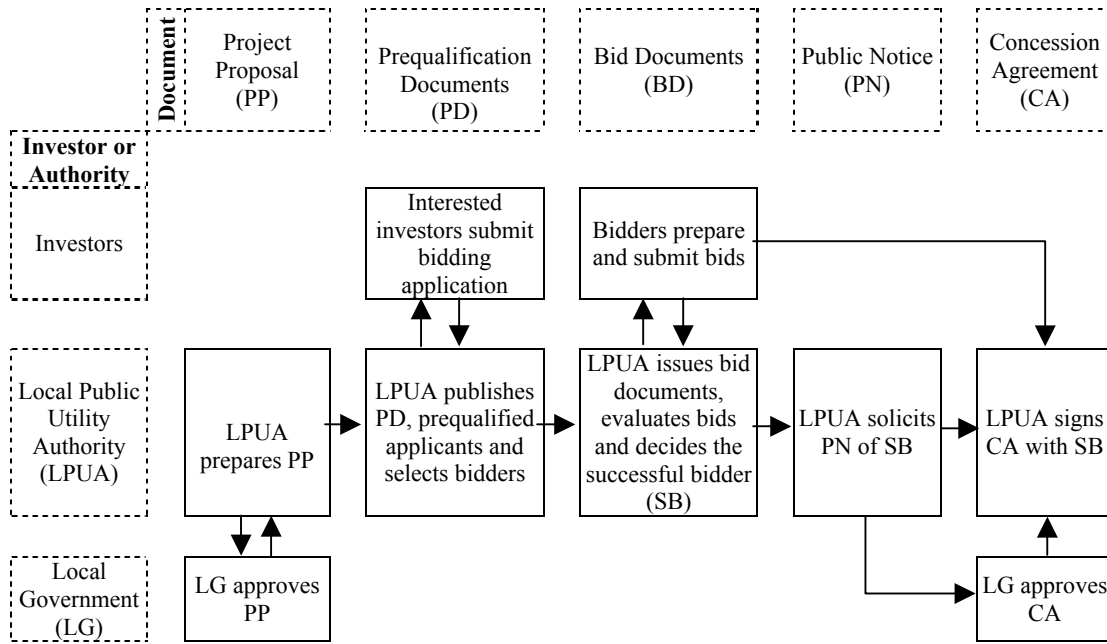
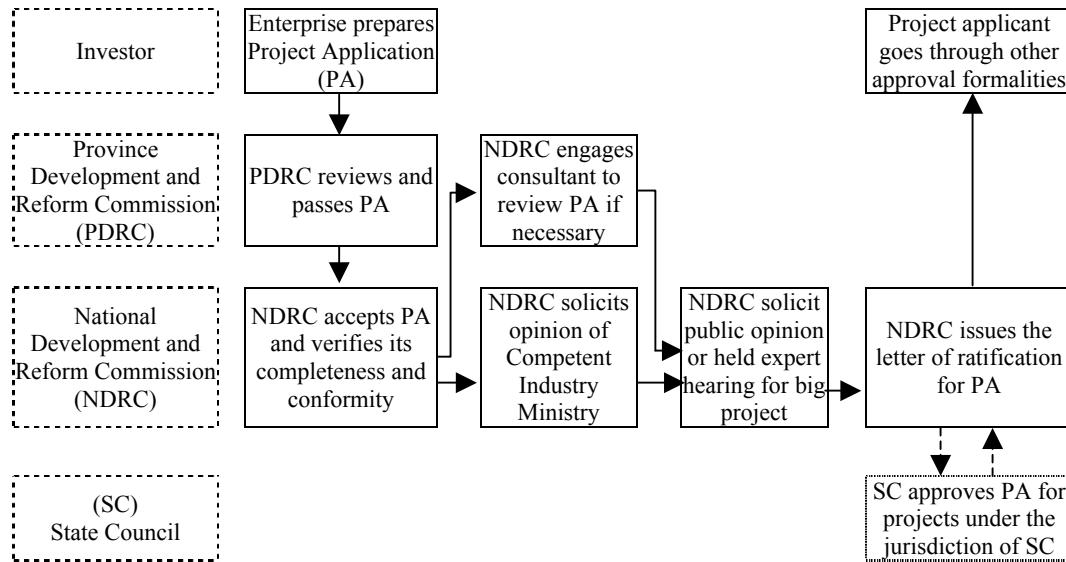


Fig. 2 Identification, Bidding and Approval Procedure for the Privately financed Public Utility Projects



Note: The dash line means that such procedure is necessary only in prescribed conditions.

Fig. 3 NDRC (or SC) Approval Procedure for Fixed Asset Projects

approval system and the registration system shall be respectively adopted for fixed asset projects invested with non-government funds according to different project conditions while the examination and approval system shall be applicable to projects invested by government funds [4].

- For the major projects and restricted type of projects invested by non-governmental funds the verification and approval system shall be adopted, and project application shall be submitted to the project approval authority (development and reform commissions at different level) for verification and approval.
- Regarding other type of projects invested by non-governmental fund the registration system shall be

adopted. Only registration in competent investment authorities for filing is necessary

Based upon government prescriptions the authors depict a flowchart in Figure 3 to show the procedure of verification and examination for capital project application [4-6].

3. PROBLEM IDENTIFICATION AND ANALYSIS

3.1 Project identification and planning

Since the local government executives in China are eager to promote local development and acquire economic growth by way of developing infrastructure projects, the premature development of infrastructure projects is prone to occur,

which inevitably cause wasteful expenditure of social resources and result in the excessive cost that the government or taxpayers shall have to pay.

One unsuccessful example is the Chengdu water supply plant. Although it had been successfully developed using BOT method, however, the demand for water is much lower than the forecasted one. The Chengdu government has to pay the project company a large amount of money during the first several years in the operation period [14].

Another unsuccessful example is the National Stadium Project using public and private partnership, which is to be used for the 2008 Olympic Game held in Beijing. Construction of the National Stadium started in December 2003. However, the construction had been suspended from July 30, 2004 until December 28, 2004 because the potential problem of project planning was exposed, i.e., a) the total floor area is overlarge, b) the structure is very complicated, c) the total investment is overhigh and d) the construction is difficult. After the expert reevaluation of the “bird’s nest” scheme, the following modifications were made: a) the total floor area was reduced from the 250 thousand square meters to 200 thousand square meters, b) the movable top cover was cancelled, and c) the total investment cost was lowered from Chinese Yuan 3.5 billion to 3 billion [15]. The case proves that the only consideration of partial project objectives instead of comprehensive balanced project objectives will inevitably cause inefficient project execution including cost overrun or delay. The project planning, particularly the confirmation of comprehensive project objectives including functional target, technical target, and cost target shall be prepared by consultants and appraised by expert review commission.

In order to avoid the premature project development and to ensure smooth implementation, the preliminary feasibility study of projects shall be appraised through the expert hearing and public hearing. The development schedule of infrastructure shall be carefully arranged to achieve the orderly, matched and coordinated development. The infrastructure network shall be developed in priority for facilitating the transfer of service or goods.

3.2 Bidding procedure and approval process

The documents issued by different government branches have different legal force or effectiveness. The rules enacted by the State Council or the State Planning Commission (or its successor, National Development and Reform Commission) shall be enforced in all infrastructure projects. The administrative rules issued by the Ministry of Power Industry (its function has been superseded by the Electric Power Supervision Commission) shall be implemented in all electric power projects. The prescription promulgated by the Ministry of Construction shall be enforced in public utility projects all over China. The method issued by the Beijing Municipal Government shall be enforced in all infrastructure projects in Beijing area.

Pursuant to The *Administrative measures on concessionary operation of public utilities* issued by the Ministry of Construction the power to award the concession right of public utility projects to private companies is decentralized to local government [10]. However the approval right of significant public utility projects is still remained in the hands of the National Development and

Reform Commission or even the State Council for foreign investment [13]. Regarding electric power plants, roads and railways, the central government still holds great power in the award of concession right.

Another problem is that the requirements in different legal and administrative rules enacted by different government departments are not in harmony. This inconsistency of rules causes inconvenience to private investors and low administrative efficiency. For example:

- The State Planning Commission enacted *the notice on questions concerning the administration of examination and approvals for foreign invested concession projects established on a trial basis* in 1995, which required that foreign concessionaires should be selected for transportation and electric power BOT projects by competitive method (in Figure 1).
- *The Interim provision and approval procedure on electric power project invested directly by foreigners* promulgated by the Ministry of Power Industry in 1996 stated the examination and approval procedure of Sino-foreign corporative projects and wholly foreign invested projects through negotiation, which is different from the above said *notice*.
- *The Provisions on Guiding the Orientation of Foreign Investment*¹ issued by the State Council (2002) required that the project owner should be selected competitively for the fixed asset projects (including infrastructure projects) that concern the utilization of state-monopolized resources and necessitate consolidated planning [7].

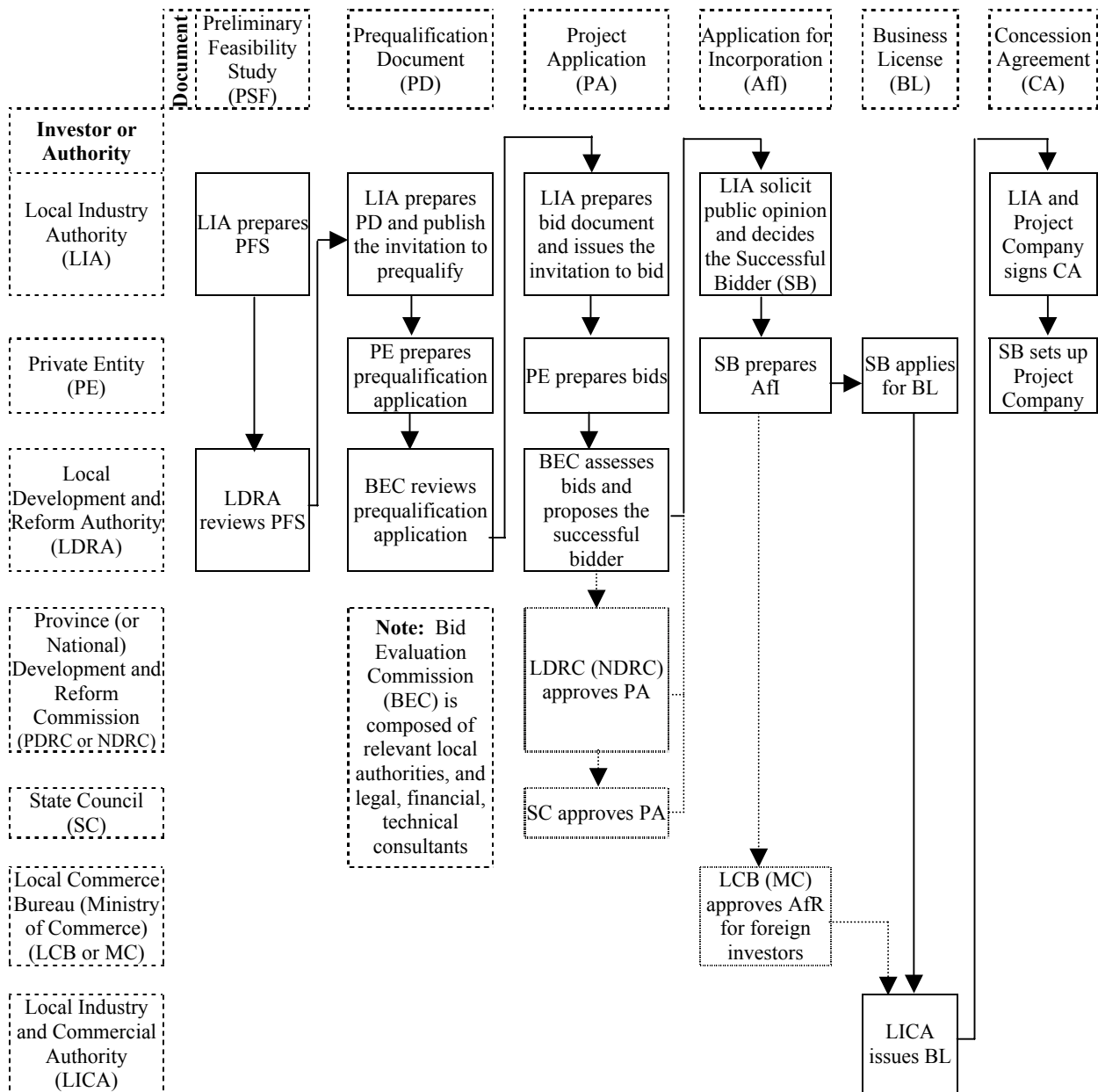
The State Council is the highest executive organ in China. Thus the provision issued by the Ministry of Power Industry shall be modified, and the selection of investors shall be based on competitive bidding procedure. However, the above *provision* did not mention any specific competitive selection method.

The third problem is that the prescriptions in different documents promulgated by the same government department are not well coordinated or harmonized. For example:

- The State Planning Council (the predecessor of National Development and Reform Commission) had issued the *notice* (mentioned in previous paragraph) to govern the bidding and approval procedure of foreign invested BOT infrastructure projects in 1995 (in Figure 1).
- The two *measures* issued by the National Development and Reform Commission in 2004 did not distinguish the infrastructure projects from other type of fixed asset projects, which may be directly verified and approved in conformity to prescribed criteria (in Figure 3).

If the bidding procedure prescribed in the previously said *notice* shall be used, the approval procedure in two *measures* will become improper. Though the purpose of the two *measures* is to simplify the verification and approval procedure and to facilitate the private investment, they actually cause confusion in a certain degree.

Moreover, the contents of concerned project documents like project proposal, prequalification application, and bid,



Note: The dash line means that such procedure is necessary only in certain conditions.

Fig. 4 Identification, Bidding, and Approval Procedure for the Privately Invested Infrastructure Projects

are not well compared and unified.

All these problems may be solved based on the principles of reasonable division of function among different government agencies and private entities.

4. RECOMMENDED IDENTIFICATION, BIDDING AND APPROVAL PROCEDURE

Because the concessionary operators of infrastructure projects are generally selected by the competitive bidding method, the procedure delineated in Figure 3 is not suitable for privately invested infrastructure projects.

Based on the principles of simplicity and harmony, the authors conduct necessary modifications of the bidding and approval procedure in Figure 1 and propose the procedure shown in Figure 4, which is considered suitable for the selection and approval process of concessionaires.

Because the objective of infrastructure projects confirmed by government agencies will influence the project implementation to a great extent, they must be meticulously planned and strictly reviewed based on the comprehensive investigation and thorough analysis of actual demand for infrastructure projects.

The competent industry authority shall prepare preliminary feasibility study (or project proposal) for related infrastructure projects within its jurisdiction by its own task force or by engaging professional consultants based on the infrastructure development program and annual development schedule. The preliminary feasibility study shall mainly focus on the analysis of the social demand on public service or goods and the definition of project objectives. The competent development and reform commission shall review and appraise the preliminary feasibility

study and confirm the project objective.

Following the confirmation of projects objective the competent industry authority shall specifically study the feasibility of projects and prepare prequalification documents, bid documents and model concession agreement by using its staff or engaging independent consultants.

The project feasibility study shall mainly concentrate on the establishment of technical standard, risk allocation, government obligation, and financial arrangement by comparing various implementation alternatives.

The contents of project feasibility study shall be respectively included in the bid documents and the bid evaluation criteria. In the bid documents the market demand, project size, technical standard, government obligation and support, basic requirements including price regulation, and the intended contract conditions, bid evaluation criteria shall be stated specifically.

For the convenience of project approval by the competent development and reform commission, the bid documents shall also integrate the contents of project application, which should be the basic requirement for concessionaires mainly including resource utilization, environmental and ecological impacts, construction scheme, economic and social effects such as financial scheme. In the model bid, the meticulous financial analysis shall be conducted based on the bid documents, and the model tariff scheme including price adjustment mechanism shall be prepared.

After the completion of prequalification documents, the competent industry authority will announce the request for prequalification. Based on the preliminary analysis of the invitation to bid, the private companies are able to decide if they will apply for the prequalification. The bid evaluation commission comprising the competent industry authority, the competent development and reform commission, the price authority, and other related authorities should engage relevant expert to check and evaluate the prequalification applications and shortlist the applicants to select the bidders.

After passing the prequalification, private companies will make a feasibility study of the project carefully, which will be expressed in the bids prepared by them. The financial analysis, pricing method and price adjustment mechanism are important components of bids. The bid evaluation commission shall check and evaluate the bids and recommend the successful bidder to the competent industry authority. Because the bid evaluation commission is composed of staff from relevant government branch, the successful bidder has passed the examination of relevant authorities. The bid evaluation and successful bid shall be announced to solicit public opinion within certain period. Under the condition of no objection to the decision, the successful bidder may apply to the competent development and reform commission for approval, following which the competent industry authority shall issue the letter of acceptance of bid to the successful bidder and initialed the concession agreement.

The successful bidder may apply to competent industry and commercial authority for the incorporation of project company. After getting business license and other necessary permit, the successful bidder may register as the project company, which shall sign concessionary agreement with the competent industry authority.

6. CONCLUSIONS

The problems of identification, bidding, and approval of concessionary projects have been analyzed, including the inconsistent and cumbersome procedure, the repetition of relevant project documents, and the incomprehensive definition of project objectives. The alternative procedure for identification, bidding and approval of concessionary infrastructure projects has been proposed to simplify and substitute the previous tiresome and confused procedure. The key point of relevant project document has been clarified, too.

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