



## Public-private partnership opportunities in Latvia and Azerbaijan

**Economic cooperation between Azerbaijan and Latvia - is it between our countries?** Even though agreements between the government of Azerbaijan and the government of Latvia on the principles of trade and economic cooperation have been signed, as well as the Convention on the elimination of double taxation and the prevention of fiscal evasion, Latvia and Azerbaijan are still not sufficiently evaluating their economic potential.

Just to mention that, according to the central bank of Latvia data, Azerbaijan's foreign direct investment in Latvia in 2017 amounted to about € 12 million, while Latvia's investments in Azerbaijan are negligible. In addition, there are now just over 40 joint Azerbaijani-Latvian companies in Latvia (compared with about one and a half thousand Latvian and Lithuanian companies in Latvia) in various sectors such as Construction, Wholesale and retail trade, Transportation and storage, Accommodation and food service activities, Financial and insurance activities, Real estate activities, Arts, entertainment and recreation.

Interesting, according to the State Customs Committee of Azerbaijan, trade turnover with Latvia in January-May 2017 exceeded \$ 3.7 million, most of which, \$ 3.4 million, is export from Latvia. In the last year, trade between countries increased by 11.5%.

Why is economic cooperation between Latvia and Azerbaijan so insignificant and can it be improved? It should be noted that Latvia does not define Azerbaijan as a priority country in Latvia's foreign policy, Latvia stimulates the eurointegration of other Eastern Partnership countries - Ukraine, Moldova and Georgia, as these countries are most actively moving to the EU. In turn, the Azerbaijani government "balances" between the West and Russia. Azerbaijan, being a serious exporter of oil, is on the "Eastern Partnership Roadside" without showing a strong initiative, while remaining among the countries of the Eastern Partnership. Positive political atmosphere would foster the interest of Latvian businessmen in Azerbaijan and its economic potential.

To strengthen economic relations between Latvia and Azerbaijan, the Latvian-Azerbaijani business forum is regularly held in Latvia, the last one was in July 2017. But this is too rare and too little to get to know the country and its economic potential in full.

According to the Doing Business 2018 ratings, Azerbaijan is quite attractive to domestic foreign investors:

	Azerbaijan	Eastern Europe and Central Asia	USA	Germany
<b>Index of Transaction Transparency*</b>	10.0	7.0	7.0	5.0
<b>Index of Manager's Responsibility**</b>	5.0	5.0	9.0	5.0
<b>Index of Shareholders' Power****</b>	7.0	6.0	4.0	8.0
<b>Index of Investor Protection*****</b>	6.5	6.4	6.5	6.0

Source: *Doing Business 2018*

\*The Greater the Index, the More Transparent the Conditions of Transactions. \*\*The Greater the Index, the More the Manager is Personally Responsible. \*\*\* The Greater the Index, the Easier it Will Be for Shareholders to Take Legal Action. \*\*\*\* The Greater the Index, the Higher the Level of Investor Protection.

Azerbaijan's strong points are: fast economic growth; an interesting geographic location; competitive production costs; cheap and qualified labor; developed energy sector; signed numerous bilateral treaties aimed at promoting trade; legislation that facilitates the establishment of companies and the protection of foreign direct investment. In turn weak points mainly are the following: the inadequate quality of its infrastructures; the high rate of corruption within the administration; the slowness of procedures; the destabilization risks due to the conflict in Karabakh; unevenly developed non-oil sectors.

What is the benefit of Public-Private Partnership (PPP)? For business - the opportunity to earn a certain profit from these projects over a long period of time. The state – receives renewed infrastructure, without financial investment, ensuring the implementation of the project and legal mechanisms to protect the private sector's interests. Citizens - better services.

It should be noted that the PPP mechanism is widely used to attract investment in the private sector, both in Eastern European countries and in countries facing various economic difficulties. PPP projects are mainly characterized by:

- *saving budget*, the implementation of larger projects provides the greatest economic effect. This is the reason why PPP projects are actively implemented in transition economies in the construction of roads, bridges and tunnels, underground, airport;
- in PPP format, *scientific and technological innovations* such as innovation in education (aimed at creating an innovation-oriented and competitive personality) can be implemented; organizational and managerial innovations (for optimization, improvement of efficiency and management quality in the social sphere); environmental innovations (unique methods for waste disposal and recycling, sewage treatment plants, etc.).

It is also important to consider potential risks in the implementation of PPP projects:

- PPP projects should be attractive to the private sector, there must be a prospect of financial profit; therefore, in practice, often the private interests of the partners are dominated by the public interest;
- the long term of the PPP contract may stipulate that the parties must resume the terms of the contract after some time, as it may become apparent that the initial planning was inaccurate or even erroneous;
- the complexity of the optimal distribution of risk between the parties to the PPP contract, because in the public service area the state remains responsible for the provision of these services.

Despite potential weaknesses, can PPP be considered an important and effective instrument in the practice of different countries, for example, in Azerbaijan and Latvia? State and business - how far can these relationships go to achieve two goals - improving infrastructure and making a profit?

**Experience in implementing PPP projects in Azerbaijan.** In Azerbaijan, the first PPP contract was signed in 1994. But now, PPP is becoming increasingly important for Azerbaijan. Why? From 2006 to 2015, Azerbaijan has invested \$ 30 billion in infrastructure development, including social infrastructure development, which is very important as it can provide GDP growth of 5-20%. Azerbaijan is currently continuing to invest in infrastructure development,

but the country's financial resources are not infinite. The public sector alone cannot eliminate the disadvantages of regional infrastructure, which means that more investment from the private sector is needed. Now, among the priorities of Azerbaijan - improving the competitiveness of the economy by attracting investments, development of logistics and communications, etc., after the PPP mechanism, major projects related to security, the development of the Caspian transport infrastructure, the construction and operation of were implemented. One of the most critical areas for the implementation of PPPs is the electricity sector.

In Azerbaijan, it is important to reduce the country's dependence on the oil and gas sector. Thus, the more active use of PPP facilities will give Azerbaijan an excellent opportunity to attract investment in non-oil sectors. At present, Azerbaijan has increased the share of GDP in the non-oil sectors by 60%, which is planned to increase to 80% by 2020, but it requires that the oil sector's growth be at least 7% annually.

It should be noted that Azerbaijan has not yet developed and adopted a law on PPP, which, however, is not a factor that negatively affects the development of PPP in Azerbaijan. About 80% of the national economy is concentrated in the private sector. Although there are no PPP-regulated laws, private investors are attracted by the strategic location of the country, which enables potential for export diversification, the availability of transport corridors between East and West, North and South, and a favorable business environment. However, a logical question arises, if there is no law, how is the legal and economic regulation of PPP projects ensured? There are general rules in the country, such as legislation on public procurement, on grants, on protection of foreign investments, on the budget system, as well as the PPP legislation in specific areas, such as the Law of the Republic of Azerbaijan on the use of energy resources, On Electricity, On Implementation of Construction and Infrastructure Investment Projects. However, this does not mean that there is no need to solve the lack of appropriate PPP legislation.

In 2018, Azerbaijan plans to set up a public-private investment fund, which is set out in the "Strategic roadmap for production and processing in the agricultural sector". The "Strategic Roadmap" consists of three phases: 2020 (short-term), 2025 (mid-term) and 2025 (long-term). The government will need 1.17 billion manat to implement agrarian projects as reflected in the "strategic roadmap". These resources are planned to attract from non-budgetary funds, state budget, National Fund for business support, Azerbaijan investment company, local government budgets, attracting foreign direct investment, issuing securities, attracting funds from international financial organizations and other sources.

**How is PPP implemented in Latvia?** The basis of PPP in Latvia was "Guidelines for Promoting Public-Private Partnership in Latvia", which defined the government's policy, basic principles, goals and priorities for promoting PPP in 2005-2009. So far, the state policy on PPP has not been defined in any regulatory enactments. In Latvia, in 2009, the Public-Private Partnership Law was adopted, according to which PPP projects in Latvia are characterized by the following criteria:

- cooperation takes place between one or more public partners and one or more private partners involved in the public-private partnership procedure,
- collaboration takes place to meet the needs of the community in the performance of construction or the provision of services,
- it is a long-term cooperation, lasting up to 30 years, but even longer,
- the public and private partner combines and uses available resources (e.g. property, financial resources, knowledge and experience);
- responsibilities and risks are shared between the public partner and the private partner.

In accordance with the Public-Private Partnership Law and other regulations, the functions of the PPP Supervisory Authority are performed by the Central Finance and Contracting Agency of the Republic of Latvia, and, in addition, a PPP Advisory Council is established in Latvia, with representatives of ministries and non-governmental organizations operating. The PPP Advisory Council is involved in solving PPP issues, carries out advisory and coordination functions. Thus, the supervisory function is delegated to the state and municipalities.

In Latvia, project ideas come primarily from entrepreneurs, as private investors are interested in raising funds, working well and making money. Practically there are plenty of ideas for PPP projects in Latvia. But the state thinks and analyzes - is it worth it, is it profitable? Thus, Latvia's progress depends directly on the political will and the government's support for PPP projects - the more active the government operates, the faster and more successful PPP projects are being launched and implemented.

It should be noted that the successful implementation of PPPs requires not only the availability of favorable legislative, institutional and financial environments, but also sufficient funds for the quality of project preparation.

In Latvia, PPP is used for the development of science and education infrastructure, for example, the construction of two multifunctional sports complexes and dormitories in the framework of the PPP project "Riga Technical University, University of Latvia and Riga Stradiņš University - infrastructure development and management", now sports complexes are available not only for the universities students, but for all residents, dormitories in the summer serve as hostels. An important PPP project is the "Reconstruction of the Ogre Business and Innovation Incubator". It is worth noting that the Ogre Business Incubator is part of the cross-border network Protolab, which was created under the cross-border cooperation program between Estonia-Latvia. Protolab Ogre offers services in the field of electronic systems. Within the framework of the project, modern laboratories have been created and equipped, seminars and personnel training have been organized. The project was financed by the European Regional Development Fund, with a budget of € 1 075 000, and the Ogre City Council funded about € 42, 000 in this project.

In Latvia, the market is very small, and it is difficult to find large PPP projects, but Latvia is starting to take the first steps in this direction. The first potentially serious PPP project in Latvia could be the construction of Kekava bypass. The project partner of the State Joint Stock Company Latvian Roads is the European Investment Bank. The term of the partnership agreement is 23 years, the first three years - design and construction, and another 20 years - maintenance of the road. The contract value is approximately € 160,6 million.

In Latvia, the PPP mechanism has been used successfully in cooperation between public research institutions, public education institutions, public enterprises and private sector companies, for example through the Horizon 2020 program, which focuses on three key areas: scientific excellence, leadership in production, community-based problem solving. In the framework of Horizon 2020, according to eCORDA, 186 projects with 219 participants were approved from the beginning of 2018, with a total funding of € 46 372 579. Partners from Latvia in these projects are usually state universities, research institutes and non-governmental organizations dealing with science.

However, it must be said that in Latvia PPP mechanism is not sufficiently active for several reasons, including some difficulties related to attracting EU funds to PPP projects. The preparation of large PPP projects is very expensive for both the private and the public sector,

although PPP projects are becoming increasingly popular, several successful projects are needed in one area.

Azerbaijan and Latvia still have some legislative weaknesses and the barriers faced by the business while participating (or considering participation) in PPP projects. There is insufficient information in both countries on the development, trends and substance of PPP projects. PPP projects must be reported in the media, and a PPP project database is required. The business lacks opportunities of exchanging experience with foreign partners, it is necessary to develop special platforms and measures for interaction between local and foreign participants in the PPP market. The register of PPP project participants can be useful as an information resource, but it is unlikely to help fight corruption and unfair competition.

Latvia should consider the need to develop additional rules governing the application of the PPP mechanism in specific sectors and areas. Azerbaijan needs to address the lack of a PPP implementation regulation.

In any case, it is important to consider the views of business representatives in order to identify barriers to PPP development and develop possible solutions to eliminate them.

PPP is an important and effective tool in the practice of different countries, which can promote economic development, infrastructure development, improvement of economic-political relations both in Azerbaijan and in Latvia. Latvia may use the opportunity to deepen cooperation with Azerbaijan in the areas of transit, air traffic and communications, Eurasian Transport Corridor development issues. Azerbaijan - to develop a non-oil sector in its own country.

Latvia is a bridge to other EU countries and can share its experience with Azerbaijan in good governance, regional cooperation, transport, small and medium-sized enterprises development and other areas of cooperation, logistics and trade opportunities.

Authors:

Dr.oec. Svetlana Jesiļevska, president of the EED (Latvia)

Ilqar Huseynli, president of the SSRAI (Azerbaijan)