

Study on Fund Raising Means for China's Railways

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ABSTRACT

The existing financing resources of construction fund for China's railways are presented in the first section of this paper. In the next section, The impacts and restrictions of the funding raising means were analyzed and a proposal of reforming the existing financing means was raised on the base of these analyses. The proposal included the following contents: construction funds for the railroads with different functions should be raised by using different financing means. The paper focused on means of fund raising for regional railway construction projects. It stated in detail how this kind of projects would attract social capital by relying on government supporting policies through the reform of the railway system. For instance, what kinds of projects are possible to attract direct international investments; what kind of projects can use BOT method and how to introduce it; what countermeasures should be taken for the deficit breach lines, etc.

I. Existing financing means of the railways of China

I.1 Existing situation

Along with the rapid growth of China market economy, the means of financing on China infrastructure fields has been greatly reformed. In contrast with them, just a little change happened in the railways. At present, the Ministry of Railways of China performs both functions of the government and enterprise and the financing means of the railways basically follows the old pattern of the planning economy. The investment decisions, such as which railway should be built, are solely made by the central government, but a little change than the past is different source of the capital of railway construction, which was shifted from the government's financial allocation to construction fund raising by the Ministry of Railways. The capital of railway construction comes mainly from surcharges of the freight tariff collected from shippers by railway enterprises and from loans borrowed from banks, and, the loans are unified borrowed and repaid by the Ministry. Actually, a chain of railway construction can be divided into three parts: the Ministry of Railways, an organism combining both functions of the government and

enterprise, bears the burden of railway construction investment; the engineering units are in charge of railway construction; and, the operation units will take on the responsibility of railway operation and management after the construction of a railway is completed.

An reform of the investment/financing system is currently being carried out in China, the functions of market economy for optimizing resources allocation are expected to act on and the prerequisite is that the responsibilities, rights and profits must be taken on simultaneously for the legal person. At present, the economic relationship for the chain of railway investment, construction and operation is broken, only the Ministry of Railways takes on the responsibilities for construction costs, engineering quality and investment return. In railway investment cases, very few market and commercial principles are used. The railways just try to raise fund from capital markets.

Certainly, since the reform and opening up policy of China, a series of researches for reforming railway investment/financing system have been done and some achievements have been made. Major breakthroughs are as follows: many joint-invested railways have been built, for these railways, the unitary investment body has been replaced by multiple investment ones; the regulation which specifies that the construction project must have equity capital has been carried out; the regulation which specifies that the legal person of the project takes on the responsibilities has been carried out in some railways and the pattern of multiple investors investing for railway construction has been initially formed. In addition, there are other important reforms happened in the railways, such as the following: gratuitous capital acquisition has become non-gratuitous one in small-scale projects; the regulations of supervision, open tender and contracting out for construction projects have been generally carried out; the power of decision-making for upgrading and heavy repair has been transferred to the lower administration level step by step; the railways have just started to take use of capital markets and issued bonds and stocks; and so on. However, these reforms take just a small proportion in the railways. In general, fundamental reform is needed for the railway system.

I.2 Major problems

Because of the unitary source for raising railway construction capital, the railway industry has a much lower speed in construction and development than the highway industry and the aviation industry.

The main bodies of the railway construction and their responsibilities are unclear and without defined responsibilities and risks control mechanism. Objectively speaking, the officials from the Ministry of

Railways have done a lot of painstaking work on project selection, construction management, fund raising and operating, etc. The work showed their considerable management quality. However, under the market circumstances, market is the key factor for resource allocation. In spite of many departments from the upper level to the lower level took part in railway management, no any department will take on all the responsibilities of main construction body and nobody will take on the real economic and legal responsibilities for t construction costs, engineering qualities and profits of the investment for the railway construction projects since the market principles are not used in railway construction. As a result, they certainly lack inner motive for taking responsibilities and risk control. The facts have proved that just relying on administration means carried out from the planning economic system is far from enough. The system must be fundamentally reformed so that the construct project could be rationally selected, construction costs and qualities could be strictly controlled, the capital could be collected from many sources, the series of the problems of investment/fund raising could be solved. Up to now, the capital sources of the railway construction are mainly from the surcharges of freight tariff and bank loans, the proportions of using capital markets for raising fund are very low. There two reasons about this situation, on one side, the railways have not fully realized the necessity of capital markets for railway construction and never worked on it. On another side, if the railways want to take use of capital market, they need to be accepted by the market. It means the related reform must be done for the railways themselves.

I.3 Analysis for the difficulties of reforming railway investment system

I.3.1 The railways faced intense competition while they have not been fully developed

From the end of this century to the beginning of the next century, a complete socialist market economic system will be formed in China. The international competitive capability will be greatly enhanced, the social production capacity, national comprehensive capability and people's living standard will be well improved. Social and economic development and China's sustainable strategy provide a rare chance to the railways for giving full play to their unique technical superiority and maintaining their dominant transport position.

In developed countries, after having completed a full development, the railways gradually experienced competition in the transport market. However, the railways of China faced intense competition while they have not been fully developed. It caused that the railways face many more complex problems,

especially the tough problem – fund raising issue. The transport market of China has great potential, the railways can give full play to their unique technical superiority in the special situation of the country. If the railways could developed faster and meet the requirements of the market, and, low level duplicated construction could be avoided, then the potential market would become a great actual market. The railways of China need not only to improve their services and lower the costs, but also increase the inputs and speed up the development to increase their competitive capability. The fundamental method of raising the competitive capability is to speed up railway development, but the competitive capability of the railways should be affected if the railways charge more to the passengers or shippers for collecting railway construction capital. This is a contradictory situation and it has never happened in developed countries. It will completely rely on our creation to solve the problems.

I.3.2 The features of railway construction project: great investment and long return term, difficult to raise fund from capital market

A great amount of investment and long payback period —this is the distinguishing feature of a typical railway construction project, and, “public obligations” is the characteristic of the railway construction project. Private capital can not bear the high pressure of enormous capital or capital stagnation caused by the differential time between investments and revenues. Consequently, resource allocation for the project with the characteristic of “public obligations” has to be conducted by the government. It is the major reason that railway construction projects were invested by the government in most market-oriented countries. Therefore, it reaches a conclusion that the railway infrastructure should be constructed mainly by the government. Under this prerequisite, how to finance railway construction from capital market will be given fully consideration. Since capital pursues profits, it has obvious difficulty for making use of capital market for railway construction projects.

I.3.3 Railway investment mainly benefits other sectors

The purpose of investments is to get the profits. However, railway investments mainly benefit other social sectors, but the investors do not get well payback from the project itself. This is why railway construction project is difficult to run in a market economic manner. In addition, many projects purely served for territorial development or military purpose, etc. Only for the investors and the operators, this kind of railways will have a deficit in a long period and no any profits, but they do have remarkable

social benefits. These features shows that market can not fully act on the railway infrastructure to allocate resources and the government must give the railways the policy and investment supports. Does this mean that railway construction projects can not be run in a market economic manner? The answer is not. The government can take many measures to transfer the outside benefits into the benefits inside the railways to enable that railway construction projects can be operated under the market economic situation.

I.3.4 A railway can hardly operate independently because of the feature of the integrate network

With very high dense transport capacity, the railways of China conspicuously shows their unique features: an integrate network with combined actions. With these features, railway construction projects can seldom operate independently after the construction completed. Many projects are not fit as independent legal entity, so the regulation that a legal person of the project will take on the responsibility of investment, construction and operation is hardly be carried out. Therefore, the reform of the railway investment system is more difficult than other industries. Firstly, it requests that the railways must have abundant transport capacity. Secondly, it needs a complete set of industrial management rules.

II. Analysis for China railways attracting foreign capital

During the transition period of Chinese economic system, financial budget of the government will not be in easy circumstances for quite a long time. The railways can not rely on the funds from the government budget or other non-market sources to satisfy the investment demands for railway construction. In other hand, the railways need to raise efficiencies and benefits of their operation through the market economic mechanism. Do the railways need foreign capitals? Is there any possibility for the railways to introduce foreign capitals? These problems need to be exploited.

II.1 Necessity for China railways introducing foreign capital

From changing railway economic growth pattern and enterprise's operation mechanism point of view, it is very helpful that China railways introduce foreign capitals. In capital market, a capital follows the price rules and flow into profitable industries and enterprises under the action of the price leverage and competitive mechanism. Therefore, In order to enable the projects to be attractive and successfully raise fund from

capital market, the railways must clearly define the functions of the government. The enterprises must be a real legal person and must take the responsibility for the property. They must thoroughly change the operation mechanism, operate by themselves and assume sole responsibility for their profits and losses. Based on the principle of market economy for resource allocation, the enterprises must optimize their assets, keep the assets with good mobility and increase the utilization of resources. Only these measures are fulfilled, can the railway enterprises have great vitality and hold a share in capital market. Foreign capital is helpful for changing the rigid management system formed in the long term of the planning economic system and railway people's hegemonical style of work, so that the railways can greatly enhance the competitive capability.

II.2 Possibility of foreign capital import for China railways

II.2.1 China railway has the potential of attracting foreign capitals

According to the characteristic and the operation mechanism, railway infrastructure construction projects can be divided into two types: one is pure "public obligations" project, it mainly serves for the public has no capability to gain profits and more rely on the government's support. Another one shows more private characteristic, it can obtain some profits while it serves for the public. Therefore, it can operate on itself and assume sole responsibility for their profits and losses, so it can be in good circulation. This type of railway projects have stable revenue for long period, less risk and better credit than such industries as manufacture and retail trade, so it attracted more and more international consortium to invest. According to statistics of the World Bank, infrastructure projects have higher return for the investment compare with other long-term investment projects. From 1974 to 1992, the average return rate of investment for infrastructure projects was 17%, some infrastructure projects, such as highway construction, the return rate was up to 29%. Therefore, the consortiums of developed countries are very interested in the infrastructures of developing countries. For example, assets of the subsidiaries of American consortiums outside the United States keep up a steady increase. The amount of American investment for foreign infrastructure accounted for 5% of total direct foreign investment in 1992, it was up to 8% in 1994 and the accumulated investment for foreign infrastructure was up to 14 billion US dollars. In capital market, there are a large amount of capital can be used for China infrastructure construction, which includes railway construction. Many construction projects of China railways, especially the projects in eastern part and developed coastal areas of China, would have good benefits if they are flexibly operated and strictly managed based on the market mechanism. Therefore,

the railway projects do have potential to attract foreign investment.

II.2.2 China railways will accelerate the pace of attracting direct foreign capitals

At present, the foreign direct investment for China railways is quite small both in amount and proportion. Mr. Fu Zhihuan, the minister of the railways, recently pointed out that the measures of China railways opening wider to the outside world are as follows: firstly, the railways will further open the railway market. In order to facilitate the development of joint-ventures, We will open some markets and give the orders for major products of some joint-ventures at the beginning. We will also permit the foreigners to invest in the main railroads under the prerequisite of china's hold the major shares. Secondly, under the macro-economic control of the state, the railways will be actively looking for foreign capital, it includes using various types of loans from international financial organizations and foreign governments, issuing bonds in foreign capital markets and selecting good railway enterprises to be listed in overseas stock market. Thirdly, the railways will expand technical exchange and cooperation with foreign countries, import sophisticated technology, purchase advanced equipment and learn foreign management experiences.

II.3 The pattern of China railway attracting foreign capital

If the railways try to attract foreign capital, they must reform the system. The reform can start from more independent construction projects and, many a little makes a mickle. On the one hand, the railways can obtain considerable capital, on the other hand, the strict rules of foreign country for using capital can change the railway operation mechanism, and, the continuous partial changes can change the whole system.

II.3.1 The railways must stimulate the reform of the system to meet the need of attracting foreign capital

From the present situation, the railways could not attract foreign capital. Most of railway enterprises currently do not break the management system which features combination of the government and enterprises' functions; the ownership of railway enterprises are still not clear in many places; non-operational assets have not separated from the railways; the enterprises have not had the right of pricing; contradiction between centralized railway operation control and self-operation of the

enterprises has not been eliminated; the enterprises are not very independent; half monopolistic operation of the railways seriously hinders the import of foreign capital and the rise of the economic efficiency. In addition, the railway enterprises are far from reaching the standards for modern enterprise that stipulated by the Company Law. These situations seriously affect the railways to attract foreign capital. If the railways try to attract foreign capital, they must make some profitable and more independent enterprises reformed to modern enterprises in accordance with the Company Law. Only they did like that, could the foreign capital be raised.

II.3.2 The pattern of China railway attracting foreign capital

The railway construction fund should be raised according to the principle of “different type of projects must be financed from different sources”. Every project that can obtain capital from market should not be interfered too much by government, while the problems that can not be solved by the market mechanism will need help from the government. The fund raising pattern of the railways should be: investment project for public service should be financed by the government; for the project with the characteristic of half-public service but still profitable, the means of issuing enterprise bond can used for raising fund (the government should support it by paying the interest of loans back to the enterprise); only the project with characteristic of profitable, flexible and quite independent can attract foreign capital, and, the stock company can be formed in accordance with the international standards and it can raise fund from foreign stock market or from foreign capital market by using some project-aimed fund-raising methods such as BOT, TOT and ABS.

The railways must formulate practicable policies to encourage foreigner to invest in China railways and select some railways to make a pilot financing operation as soon as possible. From the current situation, more independent projects, besides ferry operation and bridge projects, are almost the end lines and seldom profitable. The government can use some means to make the project be profitable, such as putting in some capitals or lands to the railway project gratuitously and combining it with other highly profitable land development projects, so that it can be accepted by capital market.

The means of China railways attracting foreign capital are as follows:

1) Issuing bonds

At present, the major means for Chinese enterprise raising fund in the international stock market are as

follows: (1) Chinese enterprise registered in China issues foreign capital stocks (B stocks) outside the country and put them on the domestic stock exchange of Shanghai or Shenzhen; (2) Chinese enterprise registered in China issues foreign capital stocks outside the country and put them on the international stock exchanges, such as Hong Kong (H share), New York (N share), Singapore (S share), etc; (3) Chinese enterprise registered in Hong Kong or foreign countries put their stocks on the stock exchange of Hong Kong or other countries.

As a pilot enterprise of the Ministry of Railways, GuangShen Railway corporation put their H stocks on the stock exchanges in New York and Hong Kong in 1996 after well preparation. The face value of the stock was 1 yuan YMB per share. It was issued for 1431.3 million shares in total. The issue price was 2.91 HK dollars per share in Hong Kong and 19 US dollars per 50 shares. The raised fund converted to 4.5 billion yuan RMB in total. Overseas financing work of China railways facilitated the reform of the system and operation mechanism. In order to meet the requirements of the international capital market, the companies prepared to be listed in stock market have made their assets appraised and restructured so that the properties become clear and good, they also removed the no-operational assets and some social responsibilities from themselves, and, the government had less control for them as well.

2) Developing international charter business

International charter business is a kind of fund raising by trade method. It uses the form of leasing goods to reach the purpose of raising fund. It can provide us both foreign capital and advanced equipment. At present, international charter businesses are handled by professional charter companies, such financial institutions as banks and insurance companies, and manufacturers. The business has a bright prospect in many fields of China railways, such as importing high-speed locomotives, rolling stocks and large modern permanent way maintenance machines.

3) Fully making use of property right exchange market

Under the circumstance of the modern economic market, an enterprise will be an object of trade in property right exchange market while it provides goods and services. Optimized allocation of capitals will be achieved through the change of property right. Through capital market, different components of capital mixed together, which enable a little state-owned capital to control enormous social capital. Through the operation mechanism of the standard enterprise, the railways of China restructure their assets so as to make good use of their owned assets and attract foreign capital. For example, railway enterprise can sell some branch lines or restructure them, some lines can be operated by a joint venture

company.

4) Actively trying such fund raising means as franchised operation and so on

Rationally and effectively making use of foreign capital to optimize the economic structure and improve the quality of people; guiding foreign capital to invest in the construction of the national infrastructure, fundamental industries and the upgrading of the existing enterprises; guiding foreign capital to invest in the industry with dense sophisticated technologies and the industry with high-value exported products; and, pursuing the opening up policy in the service and trade fields step by step. The above-mentioned are the targets of guiding foreign investment and optimizing foreign capital involved industries. Therefore, the government of China encourages foreigners to participate in the construction of our infrastructure with the characteristic of public service by using the means of franchised operation, such as BOT, TOT, etc. The railways will practice franchise means and try to find out a new way for foreign direct investment.