FINANCING INFRASTRUCTURE: PPPs AND CAPITAL MARKETS

CAREC meeting
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The presentation

Why private finance?

Public finance is insufficient to meet infrastructure needs

What is the size of privately financed infrastructure in CAREC?

Modest. The trend is down, unlike the rest of the world on average

What are the advantages and challenges of PPPs?

Well-designed PPPs save money and shift risks to the private sector.
Poorly-designed ones pose substantial fiscal and governance risks.

Can domestic capital markets help finance infrastructure?

Yes. A government debt market helps create a corporate one

What are the main obstacles to private financing of infrastructure?

Macro and country risks, a challenging regulatory environment,
no pipeline of investable projects, and lack of government capacity

Why private finance?

Why private finance?

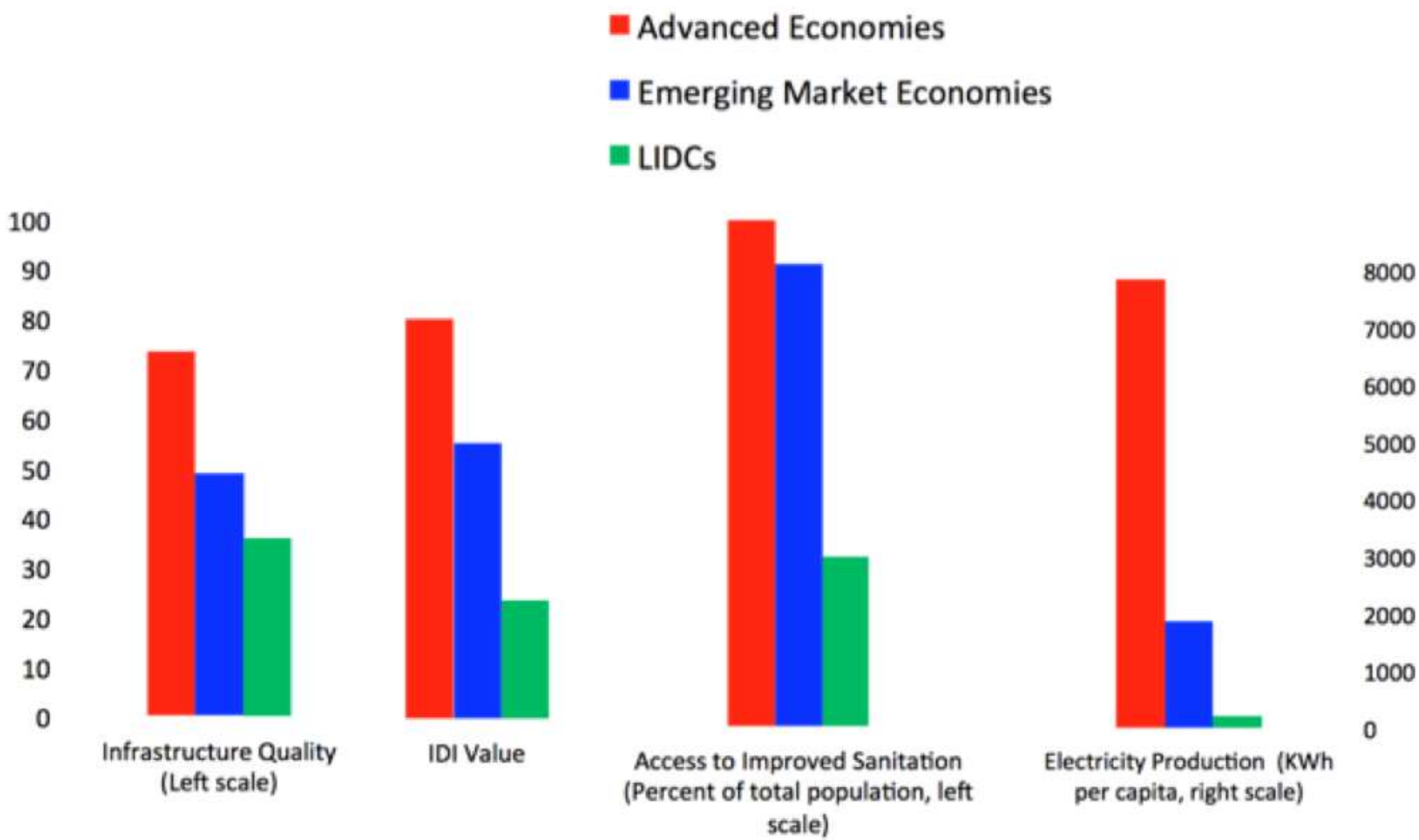
- Financial development is strongly correlated with economic development.

- Infrastructure needs are substantial.

- Public finance, domestic banks, and international financial institutions cannot provide all the finance

- Private finance needs to help provide adequate funding for infrastructure investment

Large gaps in infrastructure

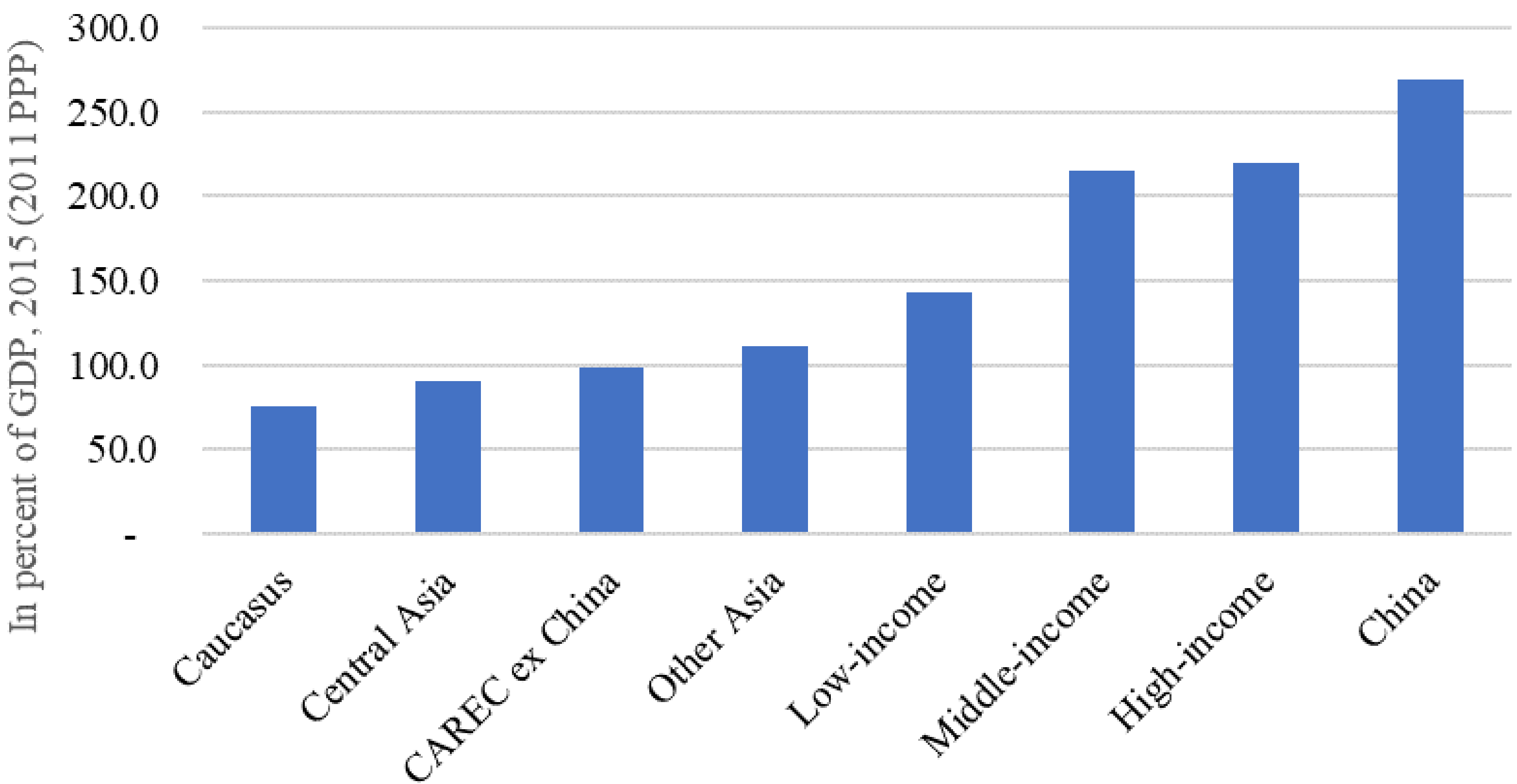


Source: WDI and ITU.
Note: IDI = ICT Development Index

Investment and capital stock

CAREC: modest capital outside China

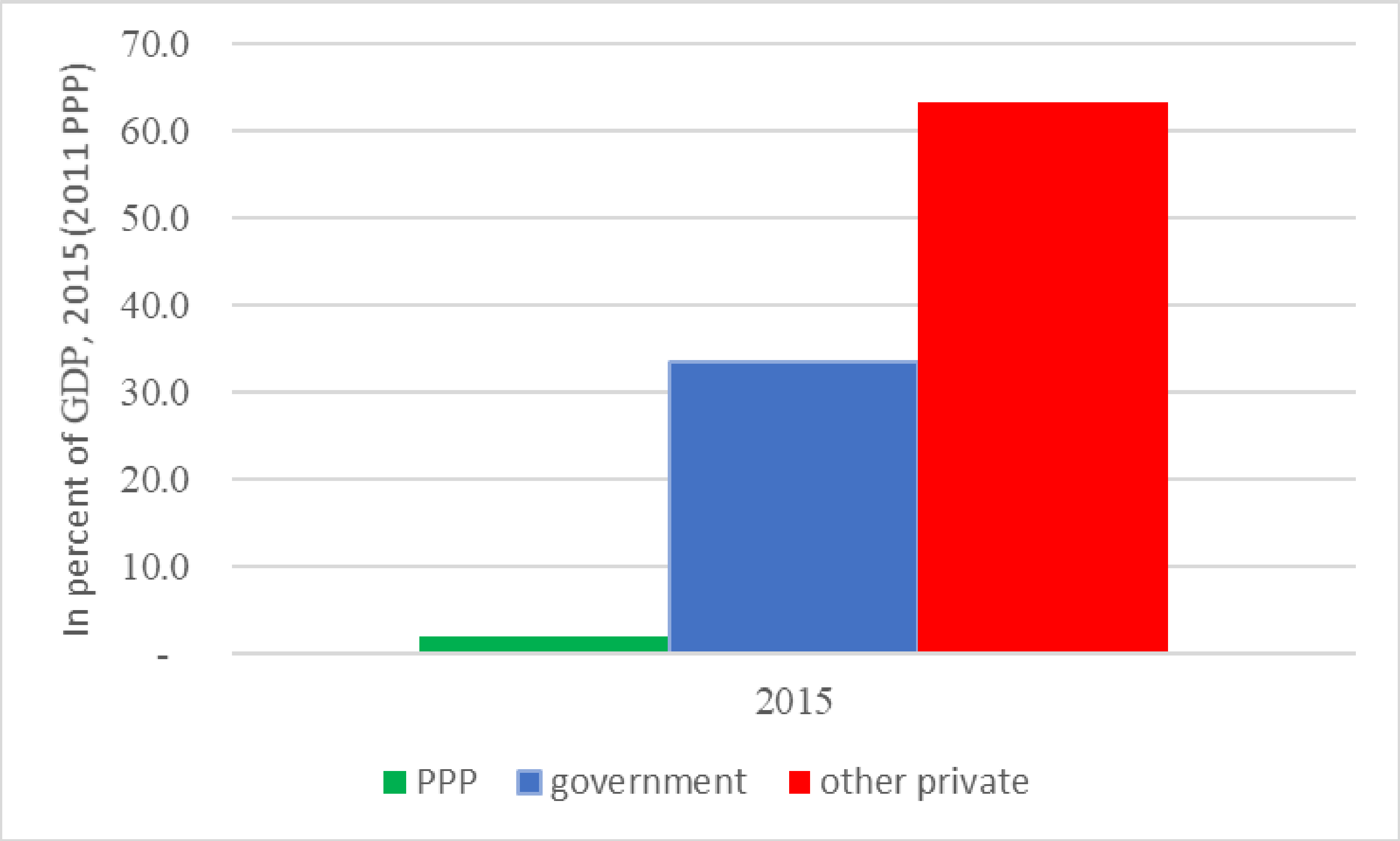
The stock of capital in the CAREC countries ex China is modest, below the averages for low-income, middle-income, and high-income countries



Source: Investment and Capital Database, IMF.

CAREC: PPP-financed capital is small

PPP-financed capital accounts for 2.5 percent of the overall capital stock



Few PPPs and low financing amounts

Cumulative number of PPP projects and commitments since 1990. Many more are in process or planned (Uzbekistan 11, Mongolia about 52)

	Number of projects	Total investment (in millions of US dollars)
Kyrgyzstan	2	
Afghanistan	2	21
Uzbekistan	2	320
Azerbaijan	4	375
Mongolia	4	422
Tajikistan	3	956
Georgia	14	1,087
Kazakhstan	11	1,724
Pakistan	85	23,866
China	1412	161,266

Source: Private Participation in Infrastructure, World Bank database.

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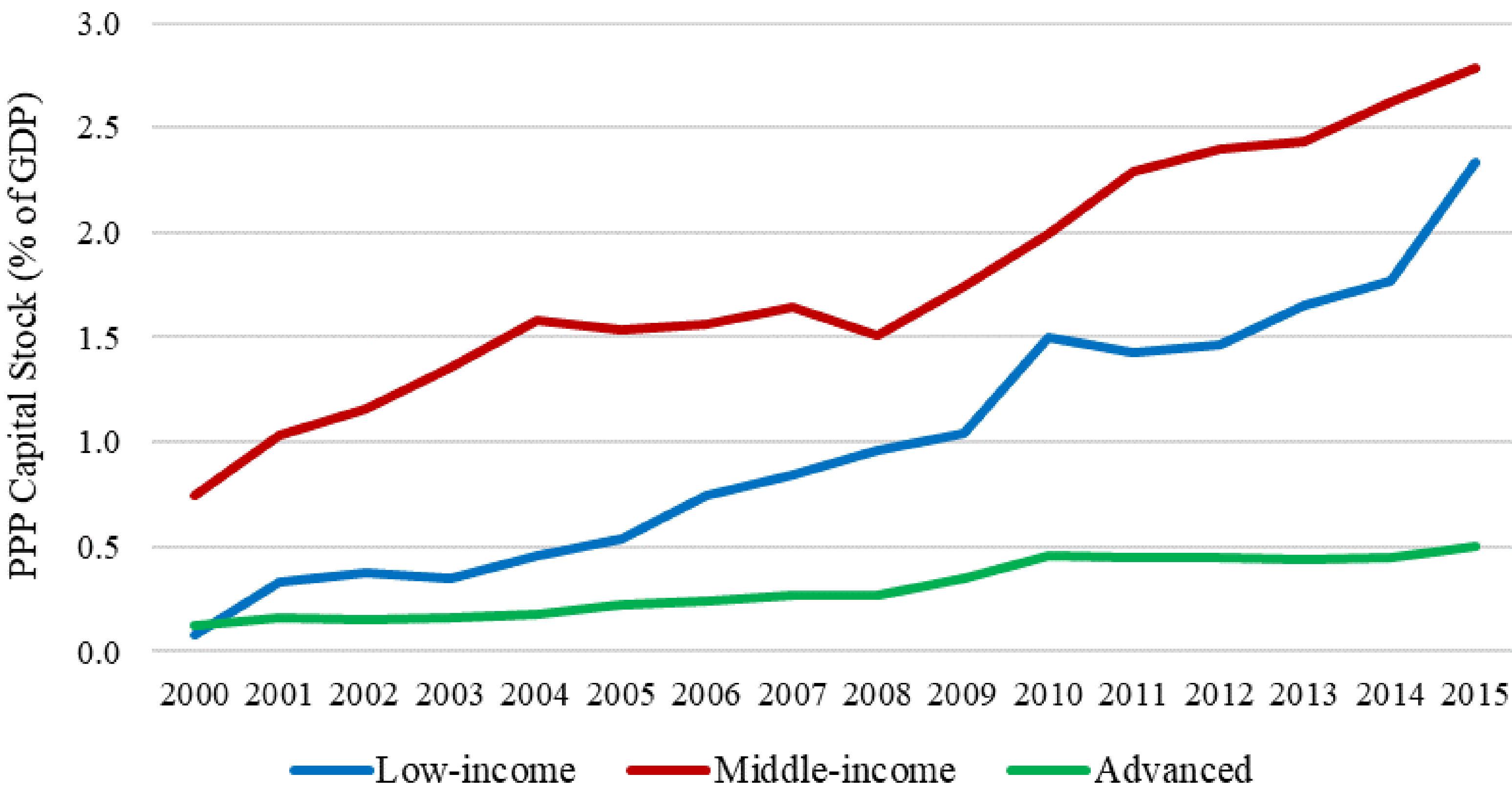
The global long-term PPP trend is up

The increase in percent of GDP is most substantial in developing countries



Source: Investment and Capital Database, IMF.

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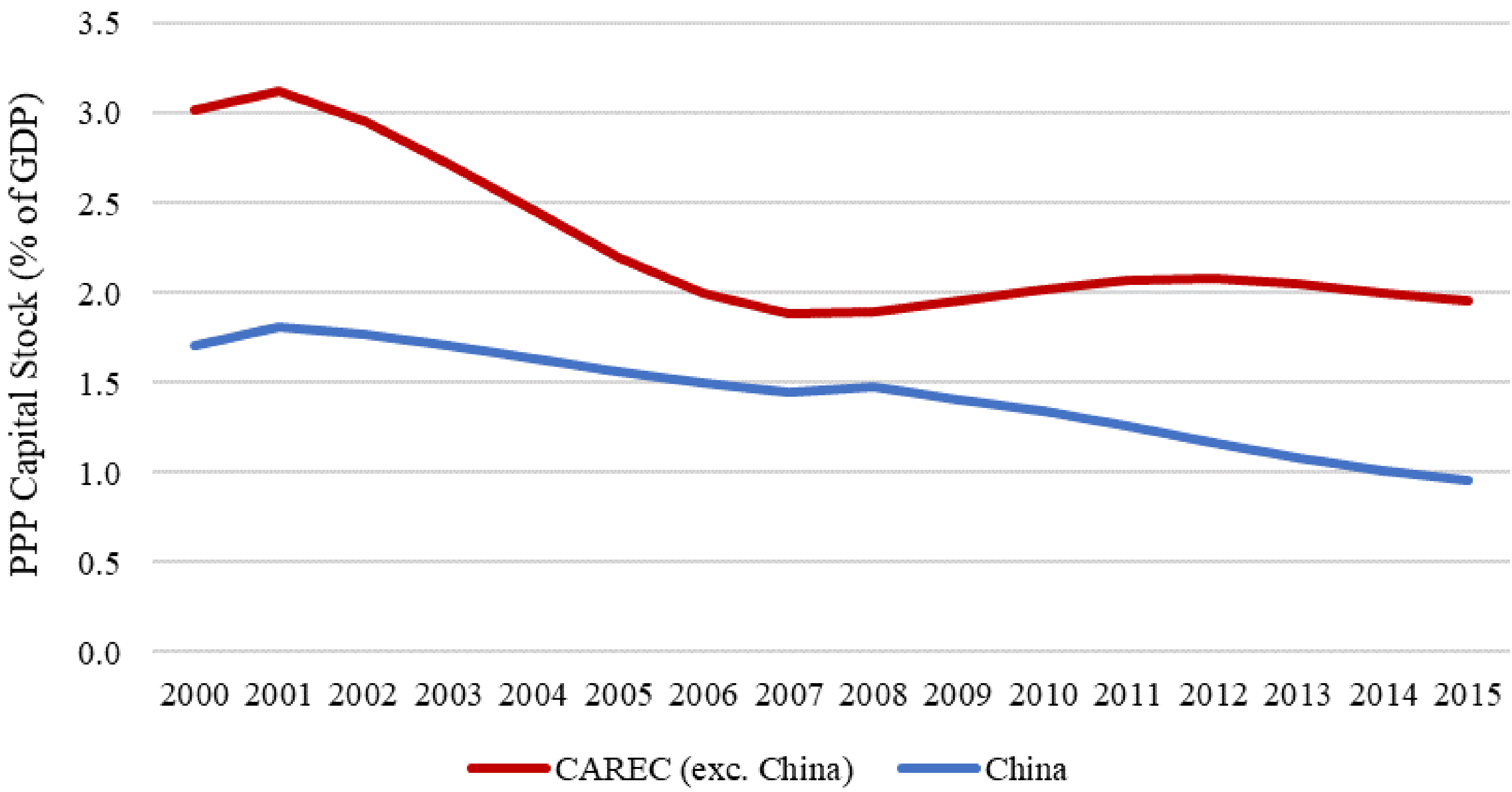
… not in CAREC

A downward trend from a higher level in 2000



Source: Investment and Capital Database, IMF.

Advantages and challenges of PPPs

PPPs: advantages

- PPPs can improve public services. They could introduce new technology, management practices, and make up for other capacity issues faced by the public sector
- In contrast to pure private investment, the public agency typically exercises considerable control over the PPP design
- In contrast to a pure public investment, the public agency contracts a firm that assumes responsibility for the service.
- Deferring payments until the service is available allows the government to hold the firm accountable
- In contrast to a pure public project, a well-designed PPP exposes the government to less risk: more risk transferred to the private sector

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PPPs: caution

- PPPs pose a problem for fiscal management because their costs are deferred (or contingent) and often uncertain
- PPPs may bypass the government budget constraints
- Thus, the government's traditional budgetary processes cannot be relied on to ensure that PPPs are used wisely.
- PPPs may not be efficient – the long time horizon makes estimates of the costs more difficult
- If not well designed, they expose the governments to much larger fiscal risks than traditional investment projects

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Avoid white elephants

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Problem: a PPP road in Europe

Good example: highways in Chile

- Robust fiscal institutions and rules
- Strong institutions for PIM
- 50 concessions (28 highways)
- 147 renegotiations (every 2.5 years)
- Upfront investment: $8.4 billion
- Renegotiated: $2.8 billion
- How? 83% bilateral, 17% arbitration
- When? 78% during construction

Making PPPs better

- Enact a PPP law. Have a strategy. Create standard contract documents, and establish standard operational procedures.
- Create a strong PPP unit in the MOF. The MOF needs to be the main gatekeeper for all decisions that might give rise to contingent liabilities.
- Strengthen the institutions of public investment management to identify, appraise, execute, and monitor infrastructure projects, including those financed via PPPs.
- Maintain a detailed PPP database

Should a PPP be used?

- Public investment: only if it provides value to society, it is affordable, and operation is sustainable once asset is operating

- Is the project good? Screen as all public investment projects.

- Forecast PPP flows. Analyze the risks.

- Determine the project's effects on government accounts

- Are there good reasons for doing the project as a PPP?

- Is the project is affordable in the long run and not too risky?

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Capital markets

Benefits of domestic debt markets

- Mobilize and boost private saving, reduce foreign exchange risk, and improve availability of longer-term finance

- Historically, EMDEs have had challenges in borrowing in local currency at longer maturities.

- Borrowing in foreign currency is cheaper but comes with exchange rate, rollover and interest rate risks: “original sin.”

Creating debt markets

- A government debt market usually precedes the creation of a market for corporate bonds. Scale matters.
- A stable macroeconomic environment. Close coordination between the MOF and the central bank
- Sound debt management policies. Medium-term debt management strategy, an annual borrowing plan, a regular and predictable issuance policy
- A stable and diversified investor base (foreign, too)
- A legal and regulatory framework for primary and secondary markets

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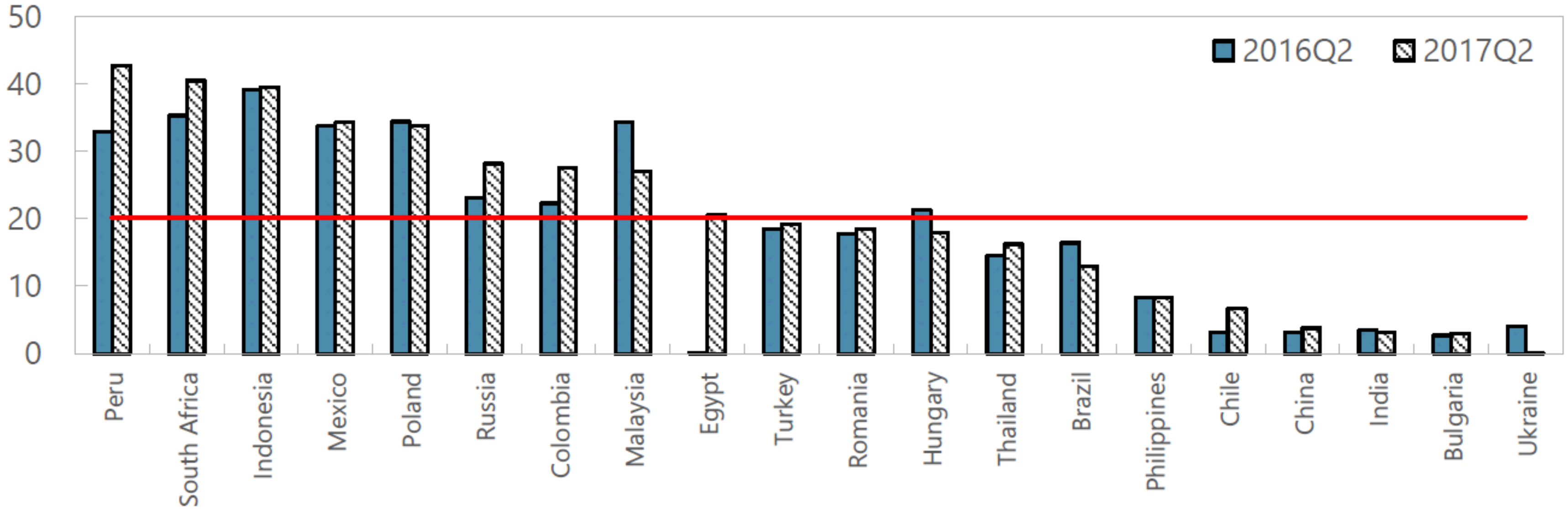
Nonresidents deepen domestic markets

Share of nonresident holdings of domestic currency government securities (in percent of the total outstanding)



Source: Note for the G20 IFAWG by the staff of the World Bank and the IMF.
https://www.imf.org/external/np/g20/pdf/2017/060317.pdf

Constraints to private participation in infrastructure

The key constraints

- Problematic macro and a volatile regulatory environment
- Substantial political and country risk. International financial institutions to help manage or insure risk.
- Lack of a feasible pipeline of projects ready for private – including foreign -- participation
- Lack of project preparation facilities and capable staff
- Lack of financial depth in small LICs of lower MICs
- Weak domestic financial sector that can provide working capital financing and a backstop

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The presentation

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