
Options for Financing Infrastructure – Fiscal and Budgetary Considerations

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1 Financing Infrastructure: Framing the Discussion

- Who Pays?
 - Taxpayers or Users
 - Current or Future Beneficiaries
 - Businesses or Consumers
- Who Owns and Operates?
 - Government: national, regional, local...
 - State-owned companies or utilities
 - Private Businesses
- Who Regulates?
 - De jure / De Facto: Minister, Independent Regulator
 - Rules-based or Discretionary
 - Regulatory Scope: market structure, pricing
- Who Provides Finance?
 - Government
 - Lenders: multilateral institutions, DFIs, banks, financial institutions
 - Investors
- Who Provides Assurance and Manages Risk?

2 But first: Should the project go ahead?

- There should always be more projects under consideration than can be afforded within the medium term –
 - Infrastructure requirements are huge, resources are constrained
 - Planning and budgeting are about making choices between well-developed options
- Sometimes it is right to say No even after substantial “sunk capital”
- Individual projects might pass the feasibility and CBA tests, but the overall investment programme and its future operations and maintenance have to be financed
- Far more effort and analysis should go into review of plans, priorities and sequencing:
 - Trade and growth should be primary considerations; “crowding in” of private investment
 - In building cities and meeting urban infrastructure and housing needs, take a long-term view – projects should pay for themselves over time

3 Taxpayers or Users

- Public vs Private Goods
 - Most infrastructure has both public and private attributes
 - Large water supply dams vs reticulation to households and businesses
 - Roads and rail networks vs maintenance and operations or rolling stock
 - Hospital and clinic facilities vs Allocation of scarce equipment
 - Electricity transmission grid vs Power plant fuel and operations
 - Blended finance (tax and user charges) is possible, but it is often better to keep things simple (payment responsibilities must be clear)
- Taxes or levies can be designed to approximate user charges (“benefit principle”)
 - But dedicated (“earmarked”) taxes interfere with budgetary discretion
 - “Betterment charges” can assist in passing costs on to indirect beneficiaries

4 Public vs Private Ownership

- Immense variety in the structure of infrastructure industries and services internationally
 - Regulation has become more stringent over public and private operators
 - Technology change has driven market structure change (energy, IT, transport)
 - Cross-border considerations are important, especially in small countries
- Competition is key to the potential benefits of private sector participation
 - But markets have to be constructed in law, licenses, decision processes and regulations
 - Competition is often also possible between publicly financed service providers
- Cooperation or partnership between jurisdictions (municipalities, neighbouring countries) is often key to effective public ownership
 - Requires careful attention to governance and burden-sharing
- Public-private partnerships can assist in keeping costs to budget commitments and ensuring timely delivery, but they are complex and require long-term trust and contract commitment

Utility pricing is a balance between cost recovery & fairness considerations

- In capital-intensive long-term infrastructure projects there is no market-clearing utility-maximising user charge...
 - If benefits are diffuse (economy-wide) and the fiscus can carry the burden, there is no reason to charge users more than the marginal cost (roads, ports)
 - If costs are recovered from users, the tariff structure has to take various fairness and efficiency considerations into account
 - The Ramsey Rule (inverse elasticity) helps – but distribution also relevant
- If private investors in a monopoly or quasi-monopoly sector have price-setting powers, clear rules need to be set in advance –
 - And there may be times when the fiscus needs to assist
- Taking account of investors' time-value-of-money considerations – tariffs are sometimes best structured to fall slowly in real terms

6 Commitment and flexibility

- Investors require commitment...
 - That debt will be covered by revenue, that users will pay for services
 - But the purpose of equity investment is to bring private sector capacity into cost control and risk management
- Lenders require assurance that debt will be repaid (and step-in rights in the event of default)
- The fiscus looks for certainty that costs will not over-run and demand will meet expectations
- A balance has to be found between commitment and flexibility
 - Contracts need detailed specification
 - But alternative timelines, re-contracting or adjustments can be accommodated
 - Large projects might need re-scheduling options attached to pre-determined milestones
- Detailed specification is not always possible: large IT projects evolve through many reviews and revisions

7 Co-funding and blended finance options

- Shared funding arrangements for large projects have several advantages:
 - Combined oversight and risk-sharing
 - Lower overall costs of finance
 - Alignment of interests, eg partial funding by mining or industrial users
- Funding can be secured in advance – “bookbuild” or “precommitment” – but it is the repayment of debt that really counts...
- State-owned development finance institutions (DFIs) can assist in bringing funders together –
 - DFIs have a poor record as direct funders of infrastructure and utilities
- A combination of on-budget funding and private (equity and debt) funding in PPPs is preferable if taxpayer contributions are needed
- Shared funding of the overall project is preferable to partial funding of discrete elements
- Specialist transaction advice is needed, and a lead funding arranger

8 Guarantees and off-budget liabilities

- For a lender to a long-term project or a state utility, risks and uncertainties contribute to raising the costs of finance; Some of these risks are under the control of government
- A strong fiscus can lower the cost of finance for a project or SOE by providing debt or revenue guarantees –
 - But the risk of a call on the guarantee is a contingent liability on the State's balance sheet
- Guarantees can also be provided by multilateral finance institutions (eg MIGA) – building on their specialist knowledge and standing in relation to government
- The absence of explicit guarantees (in “non-recourse” finance structures) does not necessarily eliminate fiscal risk (Integrated utilities are “too big to fail”)
- Terms and conditions are important – guarantees can be partial and limited to specific events or responsibilities

9 Summing up: Fiscal and Budgetary Considerations

- Finance options depend on who pays, owns, regulates, finances, provides assurance...
- Saying No is also an option
- Taxpayers or Users pay – but the burden can be distributed in many ways
- Private ownership has advantages under competitive conditions, but competition has to be constructed in law and regulations
- Pricing is a complex between users and taxpayers, across generations and industries...
- Infrastructure investment requires commitment and certainty, but also flexibility to adjust to changing circumstances
- Large projects need a diversity of funding sources and terms
- Guarantees and project assurance can lower costs, but raise the burden on the fiscus

- *But everywhere is different. Infrastructure commitments are political choices. And planning and implementation processes are always imperfect...*

Thank you