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Challenges and Opportunities in the Downturn

SUMMARY CONCLUSIONS OF POLICY PANEL 3

Infrastructure: Public and Private Roles after the Credit Crunch

Thursday 28th May 2009

Participants:

- Moderator: Nik Gowing, international journalist and broadcaster
- Rapporteur: Lord Macdonald of Tradeston, Macquarie Capital, Europe
- Dominique Bussereau, Secretary of State for Transport, France
- Roberto Castelli, Under-Secretary for Infrastructure and Transport, Italy
- Maciej Jankowski, Undersecretary of State, Ministry of Infrastructure, Poland
- Yves-Thibault de Silguy, CEO Vinci S.A.
- Enrique Diaz-Rato, CEO, Cintra, Spain
- Bert Klerk, Chairman, ProRail and President, European Rail Infrastructure Managers
- Mustafa Sani Sener, CEO, TAV Airports Holding

Background:

Governments are facing a need to upgrade essential transport infrastructure, which, combined with limited public resources, can limit trade and economic growth, as well as mobility. The OECD has discussed this in its project *Infrastructure to 2030*, warning of a growing gap between infrastructure needs, and the availability of funds (www.oecd.org/department/0,3355,en_2649_36240452_1_1_1_1_1,00.html).

OECD

The extensive transport systems built in the post-war period increasingly need to be upgraded or replaced. Also, new infrastructure needs to be built to meet changing travel patterns, such as the transport requirements of increasingly urbanised populations. In developing and emerging markets, infrastructure is often simply lacking, or built to very low standards.

Because of the limitations of state budgets to meet these demands, there has been an increasing movement toward engaging the private sector in infrastructure development, such as by way of public-private partnerships (PPP) or privatisation. The current round of deficit-based infrastructure funding will likely mean even less public funding available for infrastructure in future.

In reality, the true justification for the engagement of private financing in infrastructure funding should be to increase overall efficiency, and thus reduce overall costs, and not simply a lack of available public funds. In other words, the quality of the infrastructure funding arrangements is equally as important as attracting capital, as the success or failure of these arrangements has important long-term implications for overall social welfare.

The current global economic and financial crisis has had a profound impact on private investment in infrastructure. Many banks have ceased to lend, while others are lending less and focusing their activities on lower-risk projects in developed countries. The business model of the monoline insurers has also been placed in doubt. The crisis has tested the demand risk assumptions on which many existing projects are based, and the long-term implications are yet to be seen. At a general level, the result is that, where it is available, financing for private investment in infrastructure is more costly.

Some governments – such as the United Kingdom and France – are taking active steps to support PPPs, as are international financial institutions, like the European Investment Bank.

The crisis could have some positive impacts, as well, in the form of a fall in the cost of construction.

Organisation

Discussion revolved around three key questions:

1. **What is the impact of the current crisis on existing PPPs, and on the PPP market in general?**

Private involvement in infrastructure funding is highly reliant on the availability of credit, as these arrangements typically involve enormous up-front expenditures. Thus, the current crisis is having a major impact, by reducing credit availability for investment in infrastructure, and also increasing the cost of borrowing (and thus of private investment) due to increased risk. It is also reducing the revenues from existing infrastructure, due to lower use. Furthermore, the availability of monoline insurance has been greatly reduced. Recently, major projects have needed to be postponed or restructured, due to the lack of credit.

2. **What do governments need to do in the short term to mitigate the impact of the crisis on PPPs?**

In many instances, the lack of credit available to private firms investing in infrastructure will require some kind of public intervention in the short term. Countries are taking different approaches to this issue.

3. **What can be done to secure a stable long-term role for private capital and expertise in transport infrastructure?**

One thing is to stabilise private funding arrangements in the short term. However, this is temporary, and the real objective should be to establish stable funding arrangements in the longer term, especially if we accept that private funding will be required to meet future transport infrastructure needs.

Key Messages:

The following key messages emerged from the discussion:

- Given infrastructure deficits, as well as the expected shortfalls in public budgets after the current stimulus funding, there is a clear need to seek out new, non-public sources of funding for infrastructure investment. Although it will not resolve all funding needs, private financing will be an important source of this funding.
- In the current economic environment, characterised by the global economic crisis, levels of risk have been raised, and there is a heightened need for state intervention. The need for non-government sources of investment will likely be greater following the current stimulus funding, as governments will find themselves with a need to address large deficits and high public debt.
- The crisis has had a major impact on PPPs – both the number of potential financiers and the amounts available have shrunk, and the availability of monoline insurance has been greatly reduced.
- Governments are seeing a need to support PPPs through the current crisis, including loan guarantees or stepping in to lend money where financing is not otherwise available. However, it is important to note that PPPs are suffering as a result of a crisis in other areas of the economy – especially the financial sector – and this does not bring into question the validity or sustainability of private investment in infrastructure per se. This support should not be continued in the longer term, because it reduces the degree of risk transfer, which is the essence of PPPs. Government and/or international financial institutions should seek out mechanisms to ensure that the role played by monoline insurers continues to be undertaken.
- Important growth in demand for transport infrastructure should also be expected as economies begin to recover, meaning that governments should be ready to meet this demand.

- In the post-crisis environment, following the current stimulus funding, less public funding will be available.
- Also, private investors may become more risk averse, or place a higher premium on risk, which could have a disproportionate impact on developing and emerging economies.
- Private engagement in transport infrastructure can take a number of forms, including concessions and PPPs. Many mature assets could be concessioned or privatised, which could generate additional funds to support infrastructure investment. Governments should continue to seek out innovative solutions to meet infrastructure needs, and share best practices.
- In the longer term, private capital may be attracted to infrastructure as part of a "flight to quality", away from more high-risk investments. But this implies that infrastructure projects must be designed in a way that offers solid, reliable investment options.
- Insurance and pension funds, in particular, represent an important potential source of infrastructure funding that is largely untapped in most countries; the OECD estimates the availability of private pension funds in member countries alone to be approximately $18 trillion. Because pension fund money is ultimately essential to longer-term social and economic stability, its investment in infrastructure can result in greater public interest in insuring the stability of those investments. Sovereign-wealth funds also offer new potential.
- It is important to note that private financing is not a "necessary evil" – the primary reason for engaging private capital in infrastructure funding is not to fill gaps where government funding is not available, but rather to bring forward the expertise, innovation and competencies available in the private sector. It is important that these benefits receive more attention in public discourse, in order to achieve greater public buy-in where PPPs are concerned.
- There are a number of steps that governments could take to attract private capital to transport infrastructure:
    - Focus on "high quality" PPPs – meaning projects that will be stable and provide important benefits to society. Rigorous economic appraisal remains the best tool for ensuring that only well conceived and designed projects, which add value, go forward. Governments should avoid projects that are developed principally on the basis of political expediency.
    - Ensure that projects are clearly defined, and that the legislative and regulatory frameworks that govern PPPs and procurement processes are well defined and strictly enforced.
    - Provide appropriate pricing schemes for infrastructure use.
    - Ensure appropriate pricing of infrastructure.
    - Review accounting standards to ensure that they do not unfairly penalise PPPs in comparison to public procurement.
    - Improve risk allocation, and not seek to transfer risks that clearly cannot be managed by private partners (e.g., political risk, macroeconomic risk, much demand risk, etc.)