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LONG-TERM FINANCING OF INFRASTRUCTURE

This CICA Paper on Long-Term Financing of Infrastructure (LTFI) aims to identify the main obstacles to fill the infrastructure gap, and to make proposals for improvements and simplification to contribute more quickly and more widely to reduce it. CICA's works on LTFI aim primarily: (i) to promote a better consideration of the long-term nature of infrastructure investments; ii) to contribute to the reduction of risks and hazards; iii) to undertake sustained and continuous actions to strengthen the capacities of public managers.

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A statement

Three distinct areas are covered by the CICA LTFI Working Group:

- *The search for new sources of financing and funding:*
  - ✓ *to encourage the involvement of private actors;*
  - ✓ *to improve the sustainability of project funding;*
  - ✓ *to extend the maturity of the funding;*
  - ✓ *to strengthen the leverage effect of public aid;*
  - ✓ *to use the different forms of guarantees more widely.*
- *The adaptation of some public and private accounting norms and standards governing the financing of infrastructure projects:*
  - ✓ *the banking and insurance prudential rules issued by the regulatory authorities;*
  - ✓ *private accounting standards;*
  - ✓ *public budgetary principles and accounting rules.*
- *The good preparation of the infrastructure projects thanks to:*
  - ✓ *a centralized and holistic collection and exploitation of infrastructure data;*
  - ✓ *the use of tools such as the SOURCE platform.*

The estimate of the needs for infrastructure varies considerably depending on the sources and the incorporation or not of those needed to cope with the consequences of climate change, from USD 49 trillion by 2030 according to McKinsey Institute to USD 78 trillion by 2025 according to PwC and Oxford University. Governments are, more or less, able to cover only half of these needs. To respond, States, regardless of their level of development, focus on ways to circumvent their budget constraints and indebtedness.

States, seeking sources of funding with little or no support from their current budgets, are waiting for the mobilization of private investors and lenders (private financing). Private sector could be globally or separately investor, lender, insurer, guarantor, contractor and operator. But in each role, it needs to recover its equity with remuneration; its loan with interest, and payment for the risks taken in its various roles. This is why it is of utmost importance to make the difference between “funding” and “financing”.

“Funding” means the aggregate of funds paid by the end users and/or the tax payers (depending on a political decision) to reimburse the money provided by different categories of investors and/or lenders (including interest on loans or bonds and return on equity) for the development and construction of the project.

“Financing” describes the origin of funds raised for the construction and the operation phases of the projects.

For Public Private Partnerships (PPPs), “financing” covers i) the equity provided by the shareholders of the Special Purpose Vehicle (SPV) set up by the private partners ii) the loans or bonds raised iii) the grants, subsidies, guarantees (if any) provided by the Public Authority, all in order to fully finance the project during construction.

For projects under public responsibility, in their various forms of traditional public procurement, “financing” describes money coming from public bodies.

The PPP financial structuring of projects, avoiding the alienation of the common heritage of infrastructure and the definitive transfer of their property to the private sector (a politically sensitive subject), is therefore a preferred solution.

PPPs, although often wrongly presented as the solution to fill the infrastructure gap, represent only a very minor share of the investments. Most of the public investments are made in the traditional form, on a budgetary source, for a multitude of small and large projects. However, PPPs improve the efficiency of public funds. They will maximize the number and the quality of the projects.

In addition, there is a growing difficulty in taking full advantage of the participation of private actors. The growing distrust of the concept of PPP by public administrations and their auditing bodies (the French Audit Office — Cour des Comptes, the National Audit Office (NAO) in Great Britain, others), on the basis of truncated visions, relayed by the press, is fueling the reluctance of many politicians, citizens and users to this formula.

However, a lot of positive feedbacks exist. Their unbiased use provides the tools for a holistic approach to PPPs and Regulatory Asset Base (RAB). These feedbacks allow a good knowledge of all the factors to be taken into account. They contribute to a better understanding of the constraints that each actor must satisfy. On the basis of preliminary, complete and serious studies, the overall consideration of the advantages and disadvantages of each formula (PPPs/RAB or traditional public orders) can be achieved promoting project acceptance by all stakeholders and by civil society.

In this context, the resolution of the triptych: public debt control and limitation, satisfaction of the different needs of infrastructure, and long-term infrastructure conservation in the public patrimony, leads CICA’s working group to put forward proposals to attract new sources of financing and funding.

The search for new sources of financing

CICA advocates for improved financial instruments allowing i) the increasing participation of different institutional investors, and ii) the granting of long-term bonds and bank loans for infrastructure, up to 30/35 years.

It is needed to generate new sources of revenues to finance the creation, rehabilitation and adaptation of infrastructure, without increasing the tax burden, thanks to a strategy for recycling existing infrastructure and the resumption by the public authorities of the concessions at the end of their contracts, or close to it, with conservation of the tolls/user fees.

The recycling of existing infrastructure supposes the prior availability of a recyclable infrastructure park, on the one hand, and users' willingness and ability to pay for the use of an infrastructure previously perceived as being free for use, on the other hand.

These conditions are difficult to meet for fragile, post-crisis or low-middle income countries. The intervention of Multilateral Development Banks (MDBs), Development Finance Institutions (DFIs) and charitable institutions is essential in this case.

CICA is committed to participate in the works carried out on this subject by the MDBs, National Development Aid Agencies and International Organizations.

CICA believes that a greater use of the various forms of collateral would lead to more projects. To contribute to the acceptance of this use, regular identification and updating of the guarantees issued must be undertaken in accordance with the obligations of transparency and sincerity of the public accounts. The potential future costs that these guarantees represent must be easily available at all times, which is the IMF's position.

It is necessary to develop a better risk assessment, extend the coverage of political risk insurance or income coverages to realistically ensure the economic, financial and budgetary balance of projects.

It is also needed to have more recourse to "Blended Finance". This topic is the subject of proposals from the *European International Contractors* (EIC).

The search for new sources of funding

CICA recommends bringing into the commercial sphere the maximum of public services provided under the public authorities' responsibility, without neglecting the realization of environmental, social and cultural infrastructure, whose commercial character is weak or does not exist. This reduces the budgetary burden and reduces the opportunity cost of public funds.

CICA recommends optimizing the pricing of existing public services, while respecting the political acceptability of fares.

CICA recommends creating a sustainable policy framework with a long-term vision of meeting infrastructure needs, served by good governance principles and enhanced, accessible and understandable transparency.

CICA advocates for an improved project preparation, planning and prioritization to reduce the need for funding.

The revision of public and private norms and standards

- **Public budgetary and accounting rules**

States have acquired an important role as public economic agents delivering, directly or through private sector involvement, productive common goods: i.e. infrastructure. This role of public economic agent should be differentiated from the traditional tasks of sovereignty and general and social equilibrium that public authorities fulfill. The budgetary and public accounting rules covering the two roles should also be differentiated.

The realization of public infrastructure is an investment and not an expense. The overall financial balance of the projects must be taken into account over time. Without changing this basic paradigm, infrastructure facilities are no more than a vector of budgetary adjustment and not a factor of growth and employment.

CICA reviews the usual States' fiscal and budgetary principles and rules, as well as those of public accounting currently in force. This reflection should bring out proposals for adapting these principles and rules to better reflect i) the role of public economic agent played by the States, and ii) the ability of projects to balance over time their assets and liabilities.

- **Accounting Standards of the International Accounting Standard Board (IASB)**

The valuation fluctuations that the Fair Market Value imposes should be avoided. Consideration should be given to asset participation held on a long-term basis in the investor's balance sheet compared to that of a temporary holding; accounting standards principles should be adapted accordingly.

CICA believes that the recognition of the long-term nature of infrastructure investments must be clearly affirmed and reflected in the corresponding International Financial Reporting Standards (IFRS).

- **Decisions of the Basel Committee**

A better adequacy of the prudential rules, known as Basel III, of the Bank for International Settlements (BIS) and those resulting from the Directive of the European Parliament and the European Council (Solvency II), to the real level of the risks generated by investments in infrastructure is to be realized.

Based on the feedback and works of its member federations and the Moody's' studies, CICA is examining the possibilities of a more realistic assessment of the risk profile so that the different prudential ratios applicable to investments in infrastructure are commensurate with the risks actually incurred by lenders and investors leading to a realistic share of the financing between banks and financial markets.

The centralization of infrastructure information

Decisions to undertake or adapt infrastructure need to take into account many parameters: i) the identification of the needs that the envisaged infrastructure will have to satisfy, ii) the control of the technical, economic and financial aspects, iii) the integration and coherence of the infrastructure envisaged with the existing infrastructure, iv) the measurement of the environmental, climatic, societal and social impact generated by the infrastructure and the level of Sustainable Development Goals (SDGs') fulfillment, v) the effect on growth and employment, vi) additional long-term taxes and duties revenues originating from the realization, rehabilitation, adaptation of the infrastructure, vii) the reduction of operating and routine maintenance costs and viii) the overall resulting savings.

Statistical tools to take into account all these parameters, throughout the project life cycle, need to be improved and developed. The constitution of data, which new techniques of digitization allow, must be undertaken. Net externalities, positive or negative, will be more easily appreciated.

The centralization of these data:
- contribute to the simplification of procedures;
- help reducing delays, complexity and transaction costs across all phases of project life;
- allow a global knowledge of these parameters;
- strengthen the rationality of the public authorities' decisions.

This centralization should deliver relevant, clear and legible information for all stakeholders. It would promote better acceptance of tolls / fees by users. It would significantly improve infrastructure management.

This development would apply in a differentiated way to the major categories of infrastructure (different forms of transport, water, energy, information / telecommunications, etc.). It would rely on a management and trained agents recruited on the basis of demonstrated and acquired skills, supported by permanent policies of continuous training and loyalty of trained staff.

CICA promotes the development of data collection and improve the statistical system, insuring full transparency, wide and easy access for greater rationality of decisions and better acceptance of projects by all stakeholders.

CICA favors the development on a larger scale of ongoing capacity building actions for public institutions and their agents, accompanied by active policies for monitoring and loyalty of staff.

The works of OECD/G20

The OECD / G20 conduct consultations and make proposals on "Long-Term Financing of Innovation, Standardization and Benchmarks for Developing Infrastructure as an Asset Class". It deals with the following three topics:

- Exploring blockchain technologies for infrastructure;
- Standardization and application of the digital ledger for infrastructure assets;
- Standardization, prioritization frameworks and infrastructure modeling: policy implications for quality investment in infrastructure.

CICA should actively participate in the works and meetings of the OECD and the B20 successive Task Forces on “Financing Growth & Infrastructure”.

The relevance, scope and nature of the standardization applicable to complex long-term projects should also be questioned.

Risk control: the contribution of Source

The upstream phase of projects requires quality planning and prioritization. The resulting projects must be well-prepared; all necessary studies (technical, socio-economic, financial, environmental, societal) must be undertaken. One would expect of their good fulfillment:

- ✓ the reduction of the risk of delays and extra costs;
- ✓ the reduction of litigation;
- ✓ the slowdown in the occurrence of unethical behavior;
- ✓ an active contribution to the identification of sustainable funding sources.

To do this, the main MDBs and some DFIs have created a Swiss foundation: "Sustainable Infrastructure Foundation (SIF)". This foundation proposes for this purpose a tool of good preparation of the projects (WPP): SOURCE. CICA has been actively involved in its development.

For a rational and transparent driving of this whole process, CICA recommends the generalization of the use of tools such as the SOURCE interactive project preparation platform.

Conclusion

CICA considers essential to thoroughly review all the factors and mechanisms (institutional, legal, economic, financial, societal and social, organizational, etc.) that explain, justify and encourage the creation, rehabilitation and adaptation of infrastructure. They make it possible to make better known infrastructure real characteristics and the concrete contributions to economic development and populations' welfare.
To achieve this, CICA gathers useful information, the fruit of feedback from its members. Its working groups put forward proposals for full use of the opportunities offered by the different forms of private sector participation to fill the infrastructure gap.

The demonstration of the coherence and relevance of this set of measures must encourage the arrival of long-term investors and lenders and facilitate the intervention of MDBs and DFIs.
MDBs and DFIs generate revenue streams to State budgets and private actors which are diversified by nature and location, predictable and stable, correlated with inflation and offering investors an attractive and reasonable return on investment.
They present a better-controlled risk, low volatility and offer a low correlation with other forms of public commitments and the economic cycle.

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