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INFRASTRUCTURE

Sending the right infrastructure message

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How governments can encourage private-sector infrastructure investment.

The International Monetary Fund (IMF) recently downgraded its global growth forecast to 3.2 percent; for the developed countries in the G-20, it predicted just 2.1 percent. Central banks clearly understand the problem and have deployed monetary tools with vigor.

Interest rates are already low; there is even talk of "helicopter money"—having central banks print money to increase the money supply and therefore create inflation.

There is another way to stimulate growth: invest in infrastructure. Returns to growth from infrastructure are well established. According to the IMF, a 1 percent increase in spending on infrastructure leads to an average of 1.5 percentage points in GDP growth over four years. In countries where infrastructure is well planned and well executed, the return is even greater—2.6 percentage points over four years. The difference suggests how important government is to ensure that infrastructure delivers the biggest possible dividend.

The private sector has a role, too. Indeed, every conference on the subject features panels on infrastructure as an asset class and on how multilateral development banks can open new markets with innovative risk-sharing offerings. But that misses the point: the problem is the dearth of financeable projects, not of ways to divvy up risks.

To address that issue, governments need to look more closely at their own activities. The private sector can help make markets more efficient, but it is government that provides the structure in which markets work. And when governments improve these fundamentals, the evidence shows that the private sector will be willing to jump in.

The United Kingdom, which was a pioneer in encouraging the private sector to get involved in infrastructure, provides one example. In 1997, the newly elected Labour government placed building infrastructure at the heart of its economic strategy; to do so, it needed to accelerate investment. At the time, there was no active market for private infrastructure investment, and few projects had been completed using private funding.

Five years later, the United Kingdom had the largest public–private partnership (PPP) infrastructure market in the world, with more than 900 projects in construction or at the preferred-bidder stage. The private sector competed hard; debt terms went from 7 years to as many as 30 as the market matured. Over the same period, the cost of finance fell. There have been changes to infrastructure finance since, but the private sector remains a powerful force—it is the major investor, for example, in the 25-kilometer tunnel under the Thames known as Tideway that is under construction. The private sector also successfully participated in such major projects as Crossrail and the Olympics.

Three actions shaped the UK market. First, the British government placed building physical infrastructure at the heart of its economic strategy. While maintaining its authority, the government also recognized the limits of the public sector's expertise in areas such as procurement. On that basis, it made the case for working with the private sector. Second, the UK Treasury required that all new major projects had to be assessed for suitability as a public–private partnership before being considered for public financing. This sent a powerful message, both to the government and to the markets, that PPPs were the preferred method of procurement. Third, the government vested decision making into a single body, the Treasury Taskforce, which was directly accountable to the Chancellor of the Exchequer. This led to better project selection and planning; standardization of contracts and structuring quickly followed.

Britain's experience demonstrated that a well-designed public-infrastructure strategy, backed by sensible reforms, can engage the private sector. Can these lessons be applied to emerging markets? The Philippines is trying. On taking office in 2010, former President Benigno Aquino III made infrastructure a strategic priority. His government established a PPP unit and gave it significant authority; the unit assembled a carefully planned pipeline of projects, supported by updated regulations that allowed public- and private-sector risk sharing. The government also contributed serious money; the budget allocated to infrastructure spending has risen from 2.2 percent of GDP in 2012 to 5.1 percent in 2016; 14 major projects are being implemented and 15 more are in the works. That has helped boost the country's infrastructure-quality ranking from 104th in 2010 to 90th this year, according to the World Economic Forum.

Colombia has followed a similar path. In 2011, President Juan Manuel Santos established a national infrastructure agency, and the legislature passed an infrastructure law in 2012 that provides tools to ease land acquisition. Today there are 40 greenfield road concessions being let at a value of $25 billion, covering twice as many kilometers as in the past. The length of rail under concessions to the private sector is expected to more than double, from 900 kilometers to 2,000.

According to infrastructure and project-finance journal *IJGlobal*, in 2015, Britain, Colombia, and the Philippines had private infrastructure markets (measured as transactions closed as a proportion of GDP) double that of the international average. There is no reason that other countries cannot follow suit.

Lack of capital is not the issue: $106 trillion of institutional capital is available, in the form of pension and sovereign-wealth funds. The Organisation for Economic Co-operation and Development estimates that only 1.6 percent of this is directed to infrastructure. According to research from the Global Infrastructure Hub, 69 percent of institutional-investor funds want to increase allocations to the sector; there is particular interest in emerging markets.

What these funds need is a way to do this. The essential precursor to significant engagement with the private sector is political commitment. By providing leadership, defining a strategy, and creating effective planning and implementation agencies, governments can create the conditions that will encourage the private sector to invest in infrastructure markets. That, in turn, can help countries build the road, sanitation, and transport projects that fuel economic growth—and improve the well-being of people and communities around the world.

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