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Impact of the Financial Crisis on PPPs



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Main thesis

- Crisis represents a threat to the PPPs model as well as an opportunity
- The challenge is to maximize the opportunity and minimize the risk

Position in a nutshell

- PPPs in infrastructure is a vital ingredient in economic development
- The current economic crisis threatens its extended application
- Overall, the credit crunch is more severe for low income developing countries and those countries embarking on PPPs
- Critical lack of liquidity in the banking market for PPPs
- Significant too for PPPs, is the increasing role of the state in economic financial management combined with a growing hostility to the 'system' across society
- Needed are tools to bring back the banks and new institutions able to articulate a pro-PPP policy in the crisis (and those in the future)
- A Global advocate to spread support and the message around the globe: an alliance of PPP units ?

PPPs and its critical role in economic development

- Infrastructure is a cause and consequence of economic development. PPPs is *inter alia*:
 - An instrument for the investment of private capital
 - A way to transfer technology
 - A mechanism to upgrade skills and to increase economic integration

Global infrastructure needs

- Global needs of investment in infrastructure (OECD Project for the Future)
 - Developing countries: 930,000 million Euros up to 2015
 - OECD countries: 310,000 million Euros up to 2015
- Main drivers
 - Population growth
 - Economic growth
 - Decades of insufficient investment
 - Growth in international trade
 - Trend to change to urban life in developing countries

Rapid progress in the last decade

Since 1985 to 2008, a total of USD 1,188,454 million have been proposed to be invested to the following distribution:

Roads.....	580,265 million
Railways	42,190 million
Water sewerage and treatment	146,351 million
Administrative buildings, hospitals offices and others	119, 648 million

However, only 585,376 million USD have reached a financial closure. Source: PWF 2008

Impact of the crisis short-term

- Crisis has rendered financing and refinancing more difficult and harder to secure through bank lending;
- The shrinking capital market, characterized by inactive bond markets, the collapse of the syndication market, and the decline in foreign investment, has further fuelled the problem;
- The financial crisis has also raised the risk awareness of investors and financial institutions. As such, investors have shown less interest in new projects and tended to apply more stringent lending terms.

Impact of the financial crisis contd...

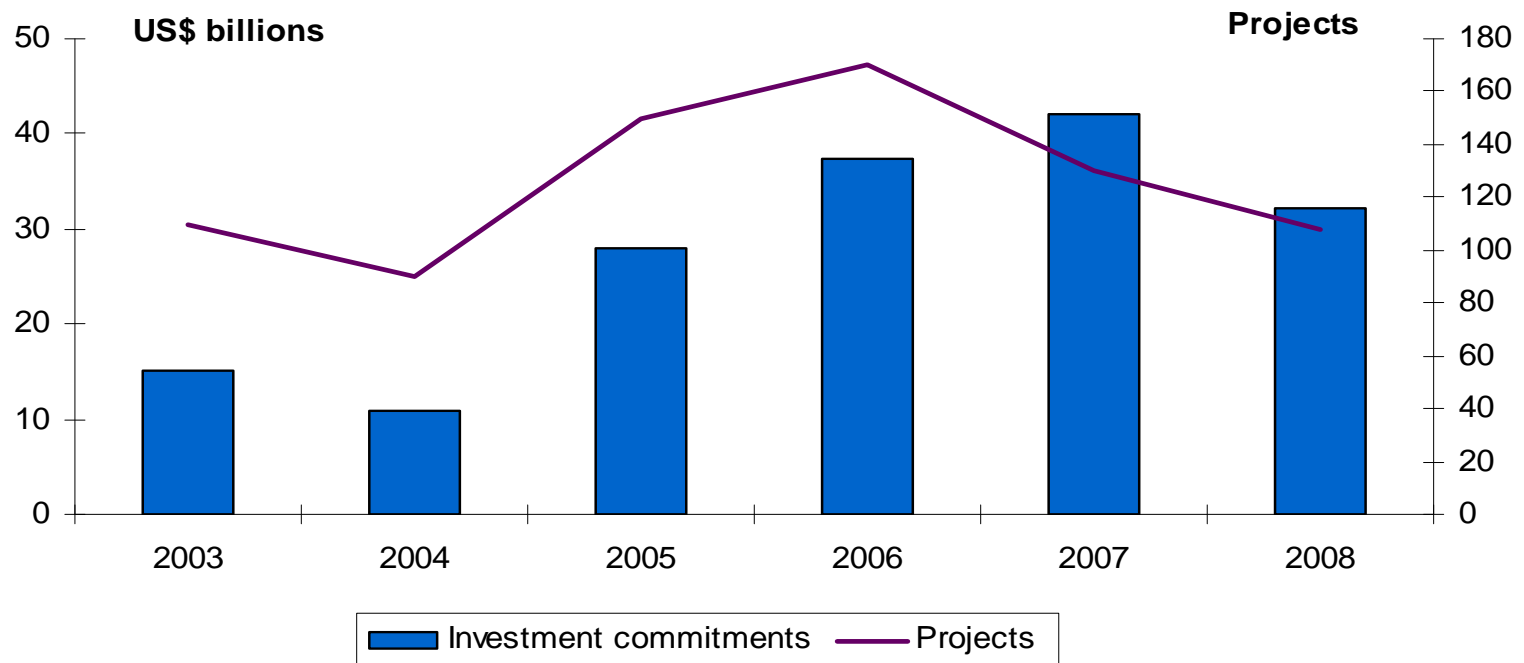
Overall, with the lack of liquidity in the banking market the following trends are becoming apparent:

- Increasingly, banks are more selective in the projects they finance;
- Previously international players, the banks are now focusing on their domestic markets;
- The difficulties of securing funding increases with project size : Now is not a good time to initiate large PPP projects.

Trends in new infrastructure with private participation

PPP projects continue to reach closure but at a slower pace than 2007

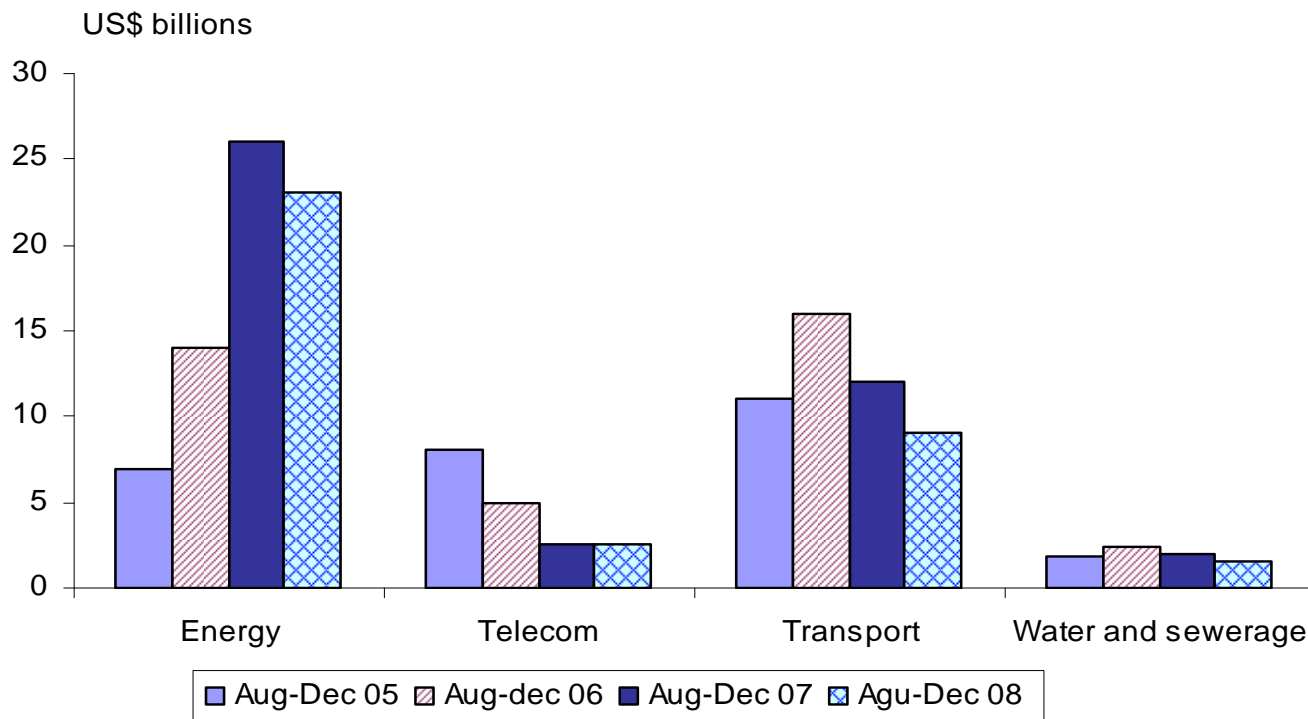
Figure 1 Infrastructure projects with private participation that reached closure in developing countries in Aug-Dec, 2003-08



The rate of project closure varies significantly

Transport, energy and water report lower investments, telecom more stable

Figure 2 Investment commitments to infrastructure projects that reached closure in developing countries in Aug-Dec by sector, 2005-2008



There is a need to:

Create the conditions for a return of the private banks to PPP lending. In identifying the remedy, it is important to recognise the root cause of the decision not to lend to PPP:

- In some cases it is due to the simple lack of money
- In others, it is because the PPP alternative is less attractive than the other options

Crisis is increasing the role of the state ...

- On the other hand, several factors have pushed governments to reverse private borrowing to government borrowing for public service;
- The financial crisis has resulted in credit problems for private companies, but less for governments. Banks and investors continue to lend money to governments and the cost of that has actually been falling in some countries;^[1]
- What is more important is that governments can borrow at an interest rate much lower than the private sector could obtain. The gap in the financing cost between the public sector and the private sector provides one argument for people advocating the withdrawal of the participation of the private sector in public service financing;
- The general belief that private sector would endeavour to protect stakeholders' interests and manage risks much better than the public sector has been undermined by the financial crisis.

[1] David Hall, "Economic crisis and public services", December 2008

PPP backlash?

- Discontent, even outright hostility, among the general public against the capitalist system has gained ground during the crisis;
- Concern stoked by massive bank bail-outs, generous pay-offs awards to leading financial services executives, financial fraud, and rising unemployment;
- The ‘system’ is mistrusted, and confidence in capitalism and its future is low;
- The crisis appears to have had its roots in the era of deregulation and is replaced by the growing role of the state in managing financial capitalism and exercising accountability previously absent in the system;
- Risk is that PPPs are equated with the now discredited privatisation and financial liberalisation.

There is a need to:

- Place more emphasis on good governance, accountability and transparency, and greater engagement and involvement with the end-users, citizens, workers and local communities;
- Broaden the objectives of the projects to include sustainable livelihoods as well as the needs of the socially and economically disadvantaged;
- More attention will be required for the training of PPP administrators to cope with these challenges;
- The great risk is that government will over-regulate PPPs and fail to allow them the flexibility from which benefits arise.

But PPPs will not be rendered irrelevant : the crisis brings opportunities

- The global crisis may be an opportunity for the prosperity of PPPs in the medium run, if PPPs policy-makers and practitioners can adjust the PPPs models to the new social, political, and economic environments in the post-crisis era.
- Infrastructure investments, traditionally considered as an antidote for economic downturn, could increase employment, stimulate economic growth and alleviate inflationary pressures by removing supply-side constraints, and restore the general public's confidence in the private sector.

The crisis brings opportunities contd...

- The potential demand for social infrastructure such as public lighting, hospitals, and schools, is amplified in volatile times when financial and economic crisis negatively affect low-income people's life.
 - The social infrastructure can not only serve as a safety net but also generate economic flow-on effects with increased human resource investment.
 - The loss of investors' appetite for economic infrastructure typically financed by private users may be compensated by the increased demand and interests in social infrastructure investment generally paid by a public authority.

The crisis brings opportunities contd...

- There are ongoing needs to restore and replace much of the existing physical infrastructures, to accommodate population growth and to deal with the threats of global warming in response to the call for sustainable development.
- In times of crisis, the speed-to-market investment in infrastructure is of utmost important, because governments are under pressure to take immediate action to address the crisis. PPPs projects, if properly managed, can be put into operation and bear fruit much quicker than traditional government funding projects.
- Reflationary policy, including higher government spending and tax cuts, has raised government deficits to an alarming level. PPPs could be a potential solution for public sector deficit, fulfilling the need for infrastructure investment and at the same time giving government flexible cash flows.

Conclusions

In the short and medium term the future of the PPP model is being threatened by the following:

- Withdraw of the banking sector from the PPP market;
- A growing role of the state in financial management that can threaten the freedom of public and private sectors to cooperate in PPP arrangements;
- A growing questioning or private sector methods in economic decision taking that may spill over to criticism of the PPP model itself.

Recommendations

- Faced with the threats, it is important that a greater role is given to the international advocacy of PPPs;
- To date, while PPP units have grown all over the world, there lacks an international body -- an agency that represents both the PPP Units and the private sector -- to address these issues;
- Such a body would perform the following: PR and communication on PPP issues, a more studied policy advisory role, for example, on how to bring back the banks to PPP financing, and finally, setting standards for PPP governance, transparency and accountability amongst civil servants involved in PPPs;
- Such a proposed institution could reassure societies that the PPP provides real social benefits.

Thank You For Your Attention!

<http://www.unece.org/ceci/ppp.html>

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