

Counter

Balance

Challenging
Public
Investment
Banks

 **Both ENDS**
Connecting people for change

A GROWING THREAT ON DEBT: THE NEW GLOBAL INFRASTRUCTURE AGENDA

Dams, motorways or oil and gas pipelines can be seen as either threatening livelihoods, cementing a business-based lifestyle, locking-in the use of fossil fuels, or as central drivers to boost economic recovery towards renewed growth, jobs and prosperity worldwide. The latter is the predominant view after the financial and economic crises in 2008.

Yet another way of looking at this kind of large infrastructure is considering them an asset class. What is new is that this generation of infrastructure is being promoted with the aim of making it a new asset class, in order to offer international investors new profitable assets which are missing today. Therefore infrastructures are not just seen as brick and mortars, but imply the construction of deepened capital and financial markets, together with related social movements building and operating them. In a nutshell, new infrastructures will be “financialised” since their conception¹.

Countries, especially those of the G-20, seek to mobilise the private sector to finance a new wave of megaprojects structured around multiple infrastructure initiatives and corridors. The OECD estimates that an additional \$70 trillion in infrastructure will be needed by 2030 – an average expenditure of more than \$4.5 trillion per year, compared to the \$3 trillion per year currently spent.

This unprecedented investment boom raises a number of crucial issues. The negative impacts of large-scale infrastructure development, in particular in developing countries, are well documented (from dams to mining, oil and gas, roads and ports). They range from environmental to social and human rights issues, but also entail wider development and macroeconomic concerns such as who benefits from these projects in the end, how they contribute to poverty eradication in the long-run, or how they can generate dependency from exports and Dutch disease.

At the same time, the new wave of financing mechanisms proposed for infrastructure - such as new types of Public Private Partnerships - will enhance a lock-in of the current development model based on large-scale infrastructure for many decades to come. Indeed, projects funded by large institutional investors have to produce some profits (whether operating well or not) in order to sufficiently compensate the money invested, and entail long term binding contracts as well as legislative changes at national level. Such an approach has significant development

The new global infrastructure agenda assesses infrastructure as pure “revenue streams,” and only secondarily as physical assets such as hospitals, schools, bridges, power plants or wind mills. Those assets, when traded on financial markets, will generate profits that are more relevant to investors’ calculations than the actual outputs of physical infrastructure projects.

In order to create, manage and trade the new volumes and types of financial assets, financial structures are being built: for instance, by dismantling “onerous restrictions on investments” for pension funds and insurance companies, bundling together Public Private Partnership (PPP) projects into PPP portfolios ready for trading, increasing derivative-based financial products, developing debt markets, and opening up to foreign banks.

A change of perspective on infrastructure is needed: infrastructure is no longer conceived as physical, but has been reworked by finance and politics as income streams, assets and revenues. For the financial world, infrastructure means „stable contracted cashflows for the long term“.

¹ Hildyard Nicholas (2014), Private-Private Partnerships, financial extraction and the growing wealth gap. The Corner House. See: <http://www.thecornerhouse.org.uk/resource/PPPs-extraction-wealth-gap>

implications for developing countries' future choices, and especially for affected local communities.



New threats on debt

The area of infrastructure finance represents a massive threat to future debt sustainability. Indeed, the billions and trillions planned to be spent in the coming decades for large-scale infrastructure projects are likely to pose a dilemma to many governments: will they accept further indebtedness or be accused of failing to meet the needs of their population by not financing infrastructure projects?

The Debt Sustainability Framework is an instrument put in place by international donors to avoid the creation of unsustainable debt levels in low-income countries. It has been criticized by NGOs for assessing whether a debtor country is able to service its obligations just on the basis of analyses of economic growth, external trade dynamics and the availability of external financial resources, instead of considering the consequences for human development that such payments entail².

Recent modifications to this framework are adding new concerns: they aim at enabling more debt-financed investments, assuming that infrastructure investments are viable and will generate sufficient return³. This means concretely that the "infrastructure as an asset class" approach will use revenue streams related to infrastructure projects for financing new debt instruments and the extraction of new extra profits and backing assets and their repayment. However, if something goes wrong, states will have to intervene through PPP contracts.

In addition, historical record of large-scale infrastructures demonstrates that corruption, political maneuvers, poor management and planning of project⁴ frequently lead to the creation of White Elephants – what has been labelled by citizen movements in Europe as „Useless and Imposed Mega Projects“.

If something goes wrong ultimately host governments and partially some International Financial Institutions – which again means governments - will pick the bill up. This long-term financing is likely to have a lock-in effect in the future with unpredictable negative impact

² <http://eurodad.org/debt?tab=2>

³ Caliaro Aldo (2014), Post-2015 infrastructure finance: The new debt threat? See: <http://www.developmentprogress.org/blog/2014/02/10/post-2015-infrastructure-finance-new-debt-threat>

⁴ Flyvbjerg Bent (2014), What you should know about megaprojects and why: An Overview. Project Management Journal. See: <http://ssrn.com/abstract=2424835>

The Castor Project: a disaster to be paid by Spanish citizens



In 2013, the European Investment Bank and the European Commission hailed the first project to be financed under the Europe 2020 Project Bond Initiative: the Castor underground gas storage plant off Spain's Mediterranean coast. Work at the Castor project commenced in Summer 2013. But by mid-September the Spanish government was forced to halt work at the plant after 220 mini earthquakes in the area had been detected in less than a month.

Work at the site has not since restarted and is halted for good. According to a clause in the project's contract, the Spanish government was forced to take responsibility away from the Work at the site has not since restarted and is halted for good. According to a clause in the project's contract, the Spanish government was forced to take responsibility away from the project's developer for the repayment of the € 1.4 billion bonds that were used to finance the Castor project.

Officially, the Spanish government appointed gas grid operator Enagas to reach an agreement with a group of banks to repay concession-holder Escal UGS. What will happen in reality is that Spanish citizens will foot the bill in the next decades via increased gas bills. This way, the € 1.4 billion would not count against the already high public deficit at a time of austerity measures in Spain but will be directly passed on to citizens.

The European Commission asked the consultancy firm EY to carry out an interim evaluation of the Project Bond Initiative. It concluded that the Castor project was a financial success for a number of reasons, including: "The successful financial close demonstrated that bond credit enhancement can support long-term investment in periods of economic turmoil and in difficult markets, such as Spain". This demonstrates how distant the notion of success for financial markets is compared to what citizens mean by a successful infrastructure project.

in terms of possible debt generation for governments in the long-run. In fact, the scale of the foreseen flow of money from private capital markets might be compared to the recycling of petro-dollars in the global South during the '80s which led to the first debt crises in the '90s.

Besides, a significant part of finance for infrastructure is going to developing countries but the estimations of return on investments are largely grounded on the assumption of more growth to come - taken for granted. This results in the award of loans that could hardly be repaid under any more realistic scenario. Alarmingly, financial experts⁵ expect investments in those countries to drop in the near future, because these economies are “debt saturated” and the perceived risk by investors is very high -more than what central banks announce. The debt already created will remain there and is likely to only get heavier – for instance with changes in monetary policies leading to a higher debt service in the future.

A worrisome push for Public-Private-Partnership

The new global agenda on infrastructure relies largely in Public-Private-Partnerships (PPPs) which are themselves an aggravating factor for debt creation. Multilateral lenders and International Financial Institutions are using public money to offset risks for long-term institutional investors such as pension funds and sovereign wealth funds, with the objective to unlock the massive amount of capital they are sitting on.

The risks linked to PPPs have been well documented over the last decade. A recent report by the NGO Eurodad lists a series of concerns linked to the cost and fiscal implications of PPPs. It concludes that PPPs are an expensive way to finance projects since the cost of financing is usually more expensive in PPP projects than in public sector works. Moreover, they entail higher construction and transaction costs and are subject to poor planning and project selection⁶.

A major risk is also linked to the black hole of contingent liabilities. These are payments required from governments if a particular event occurs or if a project is underperforming and have significant fiscal implications, severely increasing costs to the public purse. Those liabilities are often excluded from public scrutiny and taken out of „balance sheets“. In this way governments do not need to directly take loans, but costs will appear either in future periods (as governments assume a future debt), or be absorbed by users⁷.

⁵ http://blogs.elconfidencial.com/mercados/lleeno-de-energia/2015-10-02/el-efecto-aspirador-el-dinero-local-escapa-de-los-mercados-emergentes_1044633/

⁶ Eurodad (2015), What lies beneath? A critical assessment of PPPs and their impact on sustainable development. See: <http://www.eurodad.org/whatliesbeneath>

⁷ Hall, David. (2015). Why public-private partnerships don't work. The many advantages of the public alternative. PSIRU: <http://www.psiru.org/sites/default/files/2015-03-PPP-WhyPPPsdontworkEng.pdf>

The Queen Mamohato Hospital in Lesotho: an example of risky and expensive finance

In 2006, the government of Lesotho launched a PPP to build a national hospital to replace the aging and outdated main public hospital. A private sector consortium has been responsible for designing, building and operating the hospital and a network of refurbished urban clinics for 18 years. The government provides the private sector operator with an annual fixed service payment for the delivery of all services and then the healthcare network has to meet all performance standards to qualify for payment.

This PPP is the first for a hospital in Africa and is seen as a flagship model to be replicated across Africa. Therefore it has been supported by the World Bank Group, Sweden and the Netherlands among others. But a report launched in 2014 by Oxfam shows that the PPP hospital and its three filter clinics:

- cost US\$ 67 million per year – at least three times what the old public hospital would have cost today – and consume more than half of the total government health budget;
- have required a projected 64% increase in government health spending over the next three years;
- are diverting urgently needed resources from primary and secondary healthcare in rural areas where mortality rates are rising and where three-quarters of the population live;
- are expected to generate a 25% rate of return on equity for the PPP shareholders – this rate is underwritten by taxpayers' money;
- are costing the government so much that it believes it will be more cost effective to build a brand new district hospital to cater for excess patients rather than pay the private partner to treat them.

References: Oxfam. (2014). A dangerous diversion. Will the IFC's flagship health PPP bankrupt Lesotho's Ministry of Health? Eurodad (2015), What lies beneath? A critical assessment of PPPs and their impact on sustainable development.

PPPs remain attractive to decision-makers because they allow governments to circumvent legislated budgetary limits in line with the austerity policies that are currently prevailing. Instead of building infrastructure with capital upfront, PPPs use annual instalments from revenue budgets or user fees to pay for infrastructure. In a nutshell, new financing schemes and related PPPs will generate a new wave of foreign and domestic debt and they will socialise risks and privatise benefits.

How can we react?

The new global infrastructure agenda represents a huge challenge for civil society at large, since it is likely to be counterproductive and unsustainable. With megaprojects, the potential for building up unsustainable public debt is particularly high. A specific risk is that investors privatise gains and socialise losses, as documented in recent cases ranging from Spain to Lesotho.

Therefore it is key for civil society, and especially the debt community, to envisage the scale of this new infrastructure financing wave and develop new campaigning strategies around it. Exposing the weak points and vulnerabilities of the megaprojects model to the public and decision-makers will be a necessary step. Developing further the understanding of this new agenda will be crucial in this regard so that an ambitious and collective counter narrative can see the light.

About us

Counter Balance



Counter Balance – Challenging public investment banks is a European coalition of development and environmental non-governmental organisations (NGOs) with extensive experience working on development finance and the international financial institutions (IFIs) as well as campaigning to prevent negative impacts resulting from major infrastructure projects.

www.counter-balance.org Email: info@counter-balance.org

Creating alternative campaigns will certainly require to start from the real needs of populations, especially the most vulnerable and marginalised people. This could lead to the identification of lower scale, less risky and less costly infrastructure – quite the opposite of the current rush for financialised megaprojects. New governance models, increased public participation and strengthened democratic controls should certainly be part of those new strategies. Furthermore, new financing mechanisms mobilising domestic resources under public and community control should be identified and adopted to increase transparency and democracy.

Our NGO Working Group on Infrastructure Financing invites all parts of civil society – including groups and social movements working on debt - to join its efforts in developing this counter narrative and building a movement to address the issues linked to the new global infrastructure agenda.

Both ENDS



Both ENDS is an independent non-governmental organisation (NGO) that works towards a sustainable future for our planet. We do so by identifying and strengthening civil society organisations (CSOs), mostly in developing countries, that come up with sustainable solutions for environmental and poverty-related issues. Building on such effective alternatives, we create and support strategic networks capable of promoting social-environmental interests. At the same time we directly influence policies and promote our vision in fora that matter, both on national and international levels.

www.bothends.org/nl/ Email: info@bothends.org



This publication has been produced with the financial assistance of the European Union. The contents of this publication are the sole responsibility of Counter Balance and can under no circumstances be regarded as reflecting the position of the European Union.