

*Alok Sheel*

# Infrastructure Finance and Global Rebalancing

Infrastructure is both a developing country and developed country issue, with infrastructure and funding gaps more acute in developing countries. There has been large, but uneven, investment in infrastructure in developing countries: the big gap with advanced countries, especially in urban infrastructure, needs to be quickly bridged. In several developed countries infrastructure needs to be upgraded and rebuilt.

There is a basic difference between public investment infrastructure and most other kinds of public expenditure. The latter tends to deprive the private sector of resources that could be invested to boost growth, except during economic downturns, while public investment in infrastructure actually 'crowds in' more private investment by increasing investment opportunities and returns. It frequently involves building ahead of demand, on account of its multiplier, productivity and crowding-in effects. Borrowing for infrastructure is consequently eminently justified as it will pay for itself through higher growth and revenues.

## ***Cross border infrastructure***

Cross-border infrastructure -- broadly defined to include wholly nationally owned infrastructure with cross border connectivity to contiguous countries -- is particularly deficient mainly due to the difficulties of burden-sharing in international cooperation and the problem of political risk.

Since intra-regional trade (especially in Asia) is growing faster than total world trade, greater cross border connectivity is needed, particularly in South Asia which is the least integrated region in the world.

## ***Urban infrastructure***

Over the next few decades more people would move into urban areas in developing countries than the number residing in cities presently. *By any measure the financing requirements for urban infrastructure are mind boggling.* Several trillion dollars of investment is needed for orderly and environmentally friendly urbanization. There is a huge demand supply gap waiting to be bridged.

## ***Infrastructure and Rebalancing***

The absorptive capacity of several developing countries, which have been growing at much faster rates than before, has increased in the recent past. Large infrastructure investments will increase national income

and also make higher developing country growth rates more sustainable. This would also accelerate the global

convergence of per capita incomes and help bridge the development gap.

Infrastructure development typically requires, *inter alia*, huge public investment. While the fiscal position of EMEs is generally much better than those of advanced countries, national budgets would nevertheless need to be substantially augmented to meet the huge demands for infrastructure investment.

On the other hand, following the global financial crisis, the imperative of global demand rebalancing requires domestic demand in EMEs to grow faster. The challenge is to direct the large savings available in the global economy, which were in the recent directed towards unsustainable leveraged consumption in developed countries, to infrastructure, especially urban infrastructure, in developing countries for which there is a great demand and also prospects for good returns.

Since most of these savings are available in developing countries themselves, rebalancing also requires an 'enabling environment' for investment so that these savings are spent on infrastructure and not exported.

Thus, while it may be imperative to address global imbalances by letting exchange rates reflect economic fundamentals, and through structural reforms, *the question is whether it is also possible to take advantage of global imbalances of the first kind to address imbalances of the second kind, including, inter alia, bridging the infrastructure deficit.* The manner in which this can be done needs to be worked out.

## ***Financing Challenge***

Historical experience and current trends suggest that infrastructure investment, especially in cross-border and urban infrastructure is a big challenge in the best of circumstances. With many advanced economy facing recession and fiscal challenges, national budgets in advanced countries are in disarray, and foreign aid is likely to shrink in real terms.

Most accumulated savings in the EMEs remain with central banks rather than with governments. Meanwhile, the existing scale of financing by Multilateral

Development Banks (MDBs) is miniscule in relation to the infrastructure needs of EMEs.

The bulk of such investments would have to be publicly funded or guaranteed in the best of circumstances. Risk thresholds for private investment need to be lowered, and greater political acceptance of levies and user charges is required to reduce the need for public guarantees. Nevertheless, private investment is likely to be limited (presently this is mostly in telecom, transport and power), and even then, may still need to be guaranteed by governments.

EMEs also need greater sophistication in financial intermediation to attract private capital. For cross-border investments, political risks also need to be effectively addressed to attract global savings.

### **Solution?**

The challenge is to redirect the huge savings available in the global economy towards productive infrastructure investment, in EMES and developing, especially urban infrastructure, from consumption in advanced countries.

Firstly, public expenditure patterns must shift from subsidies to allocating more taxpayer funds for infrastructure investment.

Secondly, more private savings need to be attracted into infrastructure through public-private partnerships. This would entail a more enabling investment environment, especially greater political support for user charges to facilitate cost recovery, and development and deepening of financial markets, including long-term finance.

Thirdly, residual, unabsorbed, private savings would need to be redirected to government debt for investment directly or indirectly in infrastructure. What level of public debt is sustainable? This depends on potential growth (which is higher in EMEs) and interest rates. The *Domar debt sustainability equation* remains relevant, requiring interest paid on debt to be less than aggregate GDP growth, provided the primary balance remains nominal.

Fourthly, while an International Investment Fund is a possibility, this would entail foreign public debt for primarily domestic expenditure and revenue streams, and/or sovereign debt guarantees, and would be akin to existing MDB financing. Existing Multilateral Banks have a wealth of experience and expertise in the area of infrastructure financing to channelize global surpluses productively into financing infrastructure in developing countries and LICs. *MDBs can mop up the global savings glut and redirect the resources to infrastructure investment, thereby shifting the utilization of these savings from leveraged consumption to leveraged investment.* This will require massive recapitalization of MDBs, which is currently being resisted in certain quarters. Only a small proportion of this however needs to be paid up, the balance could be in the form of callable capital against which MDBs could borrow from governments and international markets.

Political and repayment risk would be addressed through MDB intermediation, since governments would generally be more willing to lend to and counter guarantee MDBs than individual countries. MDBs need not pass on such large funds as project finance, as this would require huge expansion of MDB staff and capacity. They could achieve the same objectives through national budget programme support.

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