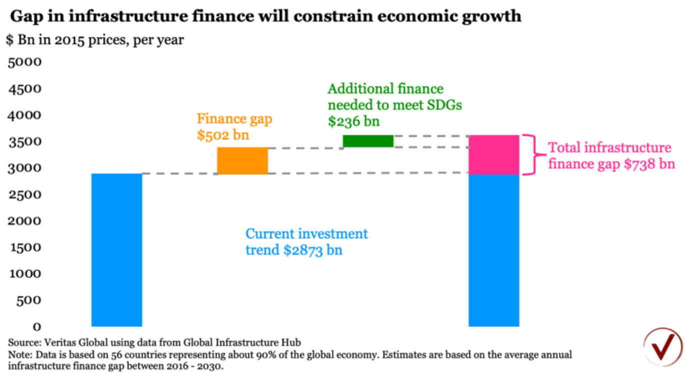
Veritas Global Briefing

Better Oversight Can Bridge Infrastructure Gap

Problem definition



Global Infrastructure Hub estimates that in 2016-2030 the gap in infrastructure spending will be $738 billion per year for transport, power, water and telecoms sectors (see Chart). Most of the shortfall is expected to be in developing and emerging economies.

However, others assess the infrastructure finance gap to be even greater. For example, McKinsey estimates[1] that if the UN Sustainable Development Goals (SDGs) are to be met, the gap, compared to current trend, would be $1.4 trillion per year. Research[2] from the Asian Development Bank also points to higher financing gaps.

If these gaps are not bridged, economic development will be suppressed. As shown by the impact assessment of the airport sector in the EU,[3] constraints can limit growth in sectors that rely on infrastructure, impose higher costs on consumers and stifle productivity in the wider economy. Constraints will make it harder for future generations to realize their potential. Lack of infrastructure can also contribute to greater inequality.

Solution

Central governments are not in a position to bridge the financing gap in infrastructure as fiscal pressures have increased significantly since the global financial crisis. Among emerging economies, infrastructure spending gaps are estimated to be largest in Brazil, India, Indonesia, Mexico, South Africa and Turkey.[4]

There are two broad possible solutions:

1. Make these investments more attractive for bond holders by issuance of ringfenced revenue backed bonds, this approach is commonly used in the US airport sector and in project finance transactions more broadly.
2. Entice investors to take an equity stake, particularly institutional investors, this approach is commonly used at airports in Europe and increasingly in parts of Asia.

To enable either of the above solutions to be realized there is a need to reduce the uncertainty of how business risks are treated by the regulator or under an oversight framework. Furthermore, equity investors may also have a greater need for instruments to manage country risk.

Infrastructure providers, including air navigation system providers and most major airports, tend to have monopoly power in markets they operate in. This means they need oversight over pricing, service quality and investment activities. Models of oversight vary significantly across jurisdictions. Oversight is usually built into the governance structure, undertaken by an economic regulator or a combination of the two. A key challenge is to have an oversight framework that provides a fair return to investors while upholding interests of consumers. Ensuring that consumer interest is served is key to realizing the wider economic benefits from infrastructure.

Appropriate oversight is a critical component to addressing the infrastructure gap. Veritas Global offers tailor-made solutions at the policy and transaction levels.

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[1] McKinsey & Company, Bridging Global Infrastructure Gaps, June 2016.
[2] Asian Development Bank, Meeting Asia`s infrastructure Needs, Feb. 2017.
[3] IATA, Foregone Economic Benefits from Airport Capacity Constraints in EU 28 in 2035, Feb. 2015.
[4] McKinsey & Company, Bridging Global Infrastructure Gaps, June 2016.

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