Сессия
«Применение механизмов ГЧП в работе институтов развития для привлечения долгосрочного частного капитала»,
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M. Dmitriev:

Please, session participants, take your seats. I would like to invite as many people as possible to sit at the round table. There are not so many of us, so I think almost everyone can sit at the table. It will facilitate the discussion. This time we are not pressed by the delays of the previous sessions, and I expect to have some time for intense and lively debate, so please take your seats at the table; that will be easier for all of us.

My name is Mikhail Dmitriev; I am President of the Centre for Strategic Research, which is the Russian economic policy think-tank, and the topic of today's morning session is on the role of PPP in infrastructure investment, facilitated by development institutions.

We have already had plenty of discussions yesterday and even the day before at the pre-conference workshop, and there are a number of questions which could be raised today. Why are the private investors in PPP so important for development institutions? How much does the quality of such investors matter, their capacity, experience, ability to raise funding from the market? And what should the role of the national governments be? Should they be just regulators, providers of guarantees, facilitators, etc? What is the role of the bond market, equity? What should the leveraging be? And there are lots of questions in this area.

We have here the advantage of James Stewart from KPMG, who has worked a lot with PFI people in the United Kingdom, which has a long history of successful PPP investments in all elements of infrastructure from social to transportation, and we will expect James to reveal his outlook from this UK experience that can be relevant and useful for other countries and development institutions.

The World Bank today is arguably one of the biggest issuers of infrastructure bonds, at least among the development institutions. So what can be learned from the World Bank and other international financial institutions in this regard for the national development banks? We also have issues related to that, although not quite directly. The Basel 3 regulation puts a strong emphasis on liquidity, and frankly, quite discriminates against infrastructure assets, which are the least liquid in the range. So what can be done in this regard? Should the Basel regulations be somehow reviewed in the future, to facilitate infrastructure investment, or there may be some other solutions.

Once again, what would the ideal optimal balance be between various types of investor, including sovereign funds, saving funds, pension funds, insurance companies and development banks? What is the reasonable balance? And, last but not least, unfortunately, as we learned from the last crisis, many kinds of investment, particularly private investment, are quite pro-cyclical. However, from past experience, we know that infrastructure investments may work as an element of counter-cyclical measures. How do we engage not just public assets but also private investors in this sort of counter-cyclicity? This is a question which we would like to raise as well.

We shall more or less follow the sequence of presenters as they are listed in the programme. However, in the interests of a more comprehensive review, I would like to invite Raffaele Delle Croce from the OECD to speak first. I know that he has a more or less comprehensive outlook, with an appropriate presentation, and that will be a good introduction to today's agenda. Please, Raffaele.

OECD
Raffaele Della Croce:

Thank you, Mikhail, and thank you for inviting me to be here today.

What I am going to talk about is a general overview also summarizing of the points which were made yesterday, and then focusing on the institutional investors' perspective on these issues, especially the policy initiatives that the OECD has been involved in with the G20, or other similar initiatives.

So, first of all, what are the needs? We know that infrastructure investment needs for growth are really significant and will continue to rise in coming years. The latest figures suggest that global infrastructure investment requirements may be in the order of USD 50 tr up to 2030, an investment flow of roughly USD 3 tr per year. This leaves an investment gap of USD 2 tr, according to estimates.

The choices we make today about infrastructure investment are critical to meet the climate change challenge in addition. If we make the wrong choices today, we will lock in high-carbon infrastructure systems and development patterns that are also vulnerable to the impacts of climate change. So there is an opportunity and an urgency to build right, not just to build more.

In the face of these growing infrastructure needs and fiscal constraints, such investment will require large-scale private sector engagement. Bank lending, one of the traditional processes of financing, is under major constraints, due to post-crisis deleveraging and new banking regulations. Corporates and utilities are also under balance sheet pressure.

In a recent report to the G20, the OECD identified among other things that the availability and composition of long-term investment financing had been affected by a combination of factors. Some were related to the global financial crisis and cyclical weaknesses in parts of the global economy. Others were related to structural factors and longer-term trends.

In particular, the OECD analysis focused on the role of banks, equity markets and institutional investors in long-term financing, and the main conclusions related to institutional investors were first of all that institutional investor such as pension funds, insurers and other funds, due to the long-term nature of their liabilities, represent a potentially major source of long-term financing for liquid assets such as infrastructure.

Over the last decade, institutional investors have been looking to new sources of long-term inflation-protected returns. The asset allocation trends of several of the last years have been towards a gradual globalization of portfolios, with an increasing interest in emerging markets, and diversification into new asset classes.

At the same time, the economic downturn is likely to have a lasting impact on the fund management industry and the long-term asset allocation strategies of institutional investors, on one hand, in promoting more cautious investment strategies and a greater focus on portfolio risk management in the coming years, on the other hand the prolonged low risk environment has highlighted the need for return-enhancing strategies, pushing some investors to invest in alternative assets.

More fundamentally, the role of institutional investors in long-term financing is constrained by the short-termness that is increasingly pervasive in capital markets, as well as structural and policy barriers, such as regulatory disincentives, lack of appropriate financing vehicles, limited investment risk management expertise, transparency and availability issues and a lack of appropriate data and investment benchmarks for liquid assets.

Institutional investors have traditionally invested in infrastructure through the equity and debt of listed companies, but with a few exceptions, such as the Australian or Canadian experience, they have generally shied away from direct unlisted investments which are more liquid. Interest has picked up since the financial crisis, as shown in a recent OECD survey monitoring the national level of how pension funds and insurers are investing, but also on a more general level, some of the largest investors, trying to understand the trends outside the equity fixed income allocation into asset classes such as real estate and infrastructure.

However, investment in infrastructure, although growing, is still very limited, and very few pension funds are currently making such investments. This report shows that less than 1% of OECD pension fund assets are allocated directly to infrastructure projects.

So several barriers to investment in infrastructure need to be addressed, some related to institutional investors, some others more generally to the private sector. These range, as I said, from financial vehicles to misalignment of interests, to lack of cooperation or pooling between investors to gain the necessary scale.

Some barriers have to do with the role of governments and otherwise well-intended financial sector regulations.

Institutional investment is ultimately complex. It requires proper understanding and analysis. Although considered as one of the alternative investment options, it has specific characteristics. A general shortage of objective information and quality data make it difficult for investors to assess infrastructure transactions and the underlying risks, especially for new investors less familiar with the characteristics of this type of investment. This is even more so in the so-called ‘green economy’ and new asset classes.

So, what is the OECD doing, given this situation and the challenges we are facing? In order to better understand the impact of the factors identified, we have launched a long-term investment project, partnering with members, some of which are institutions which are present here today, and some of the largest institutional investors back at the end of 2011.

Drawing from international experiences, the project focuses on how to engage the private sector in financing infrastructure, among other areas, making the asset class financially attractive to institutional investors. In addition to OECD countries, we are also working with the G20 members. Building on the research undertaken for this project, under the request of the G20 Russian Presidency, the OECD produced the High-Level Principles for Long-Term Investment Financing by Institutional Investors, which will be presented at the next Leaders’ Summit in St Petersburg.

The Principles are a set of general recommendations to help policy makers in facilitating the flow of capital into long-term investments such as infrastructure. The final version of the Principles, which is to be discussed here at the G20 Finance Ministers’ and Governors’ meetings, is the eighth version reviewed at the four meetings held by the OECD Task Force on Institutional Investors and Long-Term Financing, which was open to OECD, G20, FSB and APEC members. The Principles also reflect comments made in over fifty submissions received from a public consultation in the last months, and also benefitted from the G20 Russian Presidency OECD High-Level Round Table held at the end of May in Paris.

There are eight principles. The first identifies the pre-conditions for long-term investment, including a favourable business and investment climate, stable macroeconomic conditions, regulatory stability, adequate cost-benefit analysis, and opportunities for PPP. The second principle addresses the need to promote long-term savings to institutional investors through savings mobilization policies, and the need to enhance the efficiency and maintain the costs of such arrangements.

The third principle calls for strengthening the governance of institutional investors, providing the right incentives for a long-term investment perspective and ensuring that the governing body has the necessary skills to manage and oversee long-term investments, including the associated risks, such as those stemming from the often liquid nature of such assets, as well as longer-term risks such as those related to environmental damage and climate change.

Principles four and six set out basic objectives for financial and tax regulation, such as avoiding tendencies for cyclical investment strategies and facilitating international investment. Avoiding pro-cyclical strategies can be achieved in various ways, including by ensuring that the regulatory framework for institutional investors reflects the particular risk characteristics of long-term assets in the right way.

Principle five sets out the basic pre-conditions for public intervention in long-term investment projects, and this is particularly important, given this venue, and highlights the role of national development banks and other development agencies in supporting long-term investment financing. It also calls for a policy environment that addresses market failures, which inhibit long-term investment by traditional investors in SMEs, especially those with a high growth potential.

Lastly, principles seven and eight refer to the need for better information sharing and disclosure to facilitate long-term investment by traditional investors, as well as a stronger emphasis on financial education and consumer protection, linking to another major input to the work of the G20.

So, while investors are increasingly adopting an international approach to their portfolio allocation, we find that a coordinated policy response to the barriers which we have been going through briefly is still missing at an international level.

However, governments are starting to recognize that they need to reconsider their approach to financing, to secure new sources of capital to invest in infrastructure.

Developed and developing countries are in effect competing to attract institutional investors to infrastructure. Progress has been made in investors' groups coming together to use their scale and build their expertise in infrastructure investment. From the public sector, often through the action of IFOs and national development banks, actions are on their way to scale up investment, create risk-mitigating public finance mechanisms and co-investment funding structures.

Examples are the UK, which we will talk about, and the EU Project Bond initiatives approved in May 2012. The experience of countries such as Mexico and Chile also suggest that institutional investors, in particular pension fund assets, have been instrumental to the growth of the corporate bond market and in turn to the provision of development finance.

So, we see that the policy makers have an opportunity to act now, moving from the current mindset to a longer-term investment environment, which requires a transformational change in investment behaviour. It is a new big agenda, as was said yesterday. A new investment culture will be defined.

The market, by its own nature, is unlikely to deliver such a change. Major policy initiatives are needed.

Altogether, the Principles which I went through represent a comprehensive picture of the many different policy areas that need to be addressed in order to promote long-term infrastructure investment by institutional investors. At the same time, they are clearly set at a high level. They need to be complemented with more practical guidance.

The OECD is already planning to develop follow-up work to develop effective approaches for implementing these principles, and we will look for cooperation from the institutions present here. Such work will also build on the reports on the analysis of governmental market-based incentives and instruments to promote long-term investment financing which have been mandated to be developed by the G20 to the OECD, with inputs from other international organizations.

We are looking forward to the seminar on infrastructure financing which we will be co-organizing with the APEC Indonesian Presidency at the end of August, focusing on the role of institutional investors in infrastructure financing.

So, ultimately, there is a lot to do to further promote the role of institutional investors in infrastructure, and the role of the international financial institutions and national development banks is critical. There is a call for further data and analysis, as I already mentioned, and we welcome initiatives such as the one from EDHEC that we will know more about in a moment, on analysing the various obstacles to long-term investment and the development of related policy recommendations.

As I mentioned, OECD has developed a huge project on long-term investment: we are building on large networks of financial authorities in charge of institutional investors and on institutional investors themselves, as APG, and we welcome the help of international financial organizations and development banks. Thank you.

EDHEC Risk Institute
Frederic Blanc-Brude:

Thank you, Mikhail. Yes, the EDHEC Risk Institute is an academic organization. It specializes in asset management and risk management, and I am in charge of its research programme on infrastructure investment by institutional investors.

The discussion we are having today on long-term investment refers to two issues, really. One is the large demand for long-term capital investment in the economy, and that is not disputed – I am not going to dispute it, anyway – and the second issue is the question of whether the supply of long-term capital can come from institutional investors such as pension funds and insurance companies.

This is an apparently intuitive idea, and an appealing idea: long-term money needs long-term capital and long-term investment. However, it may not be as simple as it sounds, and one of the questions here is what role the development financial institutions can play.

The first point that I think need to be made is that infrastructure investment can be a risky business. If you have studied the history of private investment in infrastructure, as I have, it is often marked by a lot of very sad stories, from local governments not respecting their commitment to raise water tariffs, for example, to a constant game of re-negotiations, hold-ups, regulatory capture, etc., between public and private players, who seem to come out victorious over this game about half the time on each side, so it is not quite clear what the outcome is, to a quite frequent tendency to an optimism bias, especially of optimistically excessive traffic forecasts on behalf of the private sector, which means that a lot of projects under-perform. And finally, there are cases of straightforward expropriation by the public sector of private investors.

So, this is not necessarily a business for the faint-hearted, and traditional investors in infrastructure projects, project developers, which tend to be construction companies as well, large conglomerates, typically their business model is to receive a return from their equity investment but also to receive an additional return through sub-contracts, construction contracts, operating contracts, which are typically given to their subsidiaries.

For a pure financial investor, like a pension fund, the historical evidence suggests that the notion that you should take a bet on whether the government will keep its word for the next 30 years, in some cases can be a bit naïve.

However, as my second point, even though it is a difficult business, it can be done: it is possible to invest sustainability and well in infrastructure in the long term. Private banks, another pure financial player, have been doing this for decades, and that is what project financing is all about.

So the creation of a governance and incentive structure through which all involved will commit beyond reasonable doubt to a certain course of action for the next 30-40 years is what project finance allows.

This is where the first case in which public sector institutions like development banks or develop financial institutions can play a role in spearheading properly designed PPP models, showing that it can be done.

So, risk at the project level, if projects and contracts are well-designed, can be managed, and it is a very important positive and reassuring point.

Nevertheless, why should a pension fund decide to invest in such an infrastructure project, even if it is well-designed and sustainable over a long period of time? That is my third point. Effectively, there is no reason, per se: there is no reason why infrastructure in itself should be interesting for a pension fund. The responsibility of pension funds is certainly not to finance the economy. Neither is it the responsibility of insurance companies. The responsibility of pension funds is to pay the pensions at the right amount, on the right date, and also to respect their own regulatory requirements, in particular in terms of funding ratios.

So what pension funds want is not to finance long-term infrastructure capital, it is to buy cash flows that extend long into the future and allow them to meet their obligations. Normally they would achieve this through a portfolio of bonds: a typical liability-matching portfolio. But today, because of market volatility, which has increased considerably for the past few years, and because of variable interest rates, they struggle to achieve this objective of meeting their liabilities through typical bond portfolios, and there is a particular issue with anything that is listed and the volatility of listed assets, including bonds, and how it affects the volatility of the funding ratios of a pension fund.

That is why pension funds may want to invest in infrastructure projects. It has to offer an attractive yield: it has to allow them to do better than what they can achieve with a portfolio of bonds.

And I think the PFI, which is probably the most successful PPP programme in recent history, is a good example of this. It has succeeded in delivering a great deal of long-term financing by offering an attractive investment proposition. So, that is my fourth point.

I wonder how we can reconcile this with one important aspect of what development finance institutions do, because what development financial institutions are supposed to do is address market failures, right? They are supposed to go where the market cannot go: when the cost of capital is too high for projects to be bankable, they come in and subsidize the cost of capital. You could say that they misprice risk, that they own the price risk.

But that is the last thing that pension funds actually want, is to invest in mispriced risk. On the contrary, their objective, as I said, is to remunerate pension savings and, in the case of long-term investment, to capture a liquidity premium, so, again, the whole idea of pension funds investing in infrastructure is that it is supposed to offer an attractive risk return profile.

So, what can we do to try and square this circle? I have three ideas that I would like to put forward to this panel and this meeting. The first would be to reverse the risk-sharing structure in projects involving development finance institutions and have development banks take the junior tranche in capital structures. So, instead of subsidizing and socializing, effectively, the risk of the more senior tranches, to take the equity tranche, to expect to have a lower return than what the market would accept, and to let financial institutions like pension funds or insurance companies come in at the senior level in the financial structure of these projects, either directly or indirectly, via an investment fund, at the adequate price.

The second idea, which is very important, is to focus on diversification. So, we know that we can improve the risk profile of individual project investment by designing adequate PPP models, and that is already an important thing to do. But what we also need to do is to allow institutional investors to diversify the project-specific risks and to access the infrastructure asset class on a well-diversified basis. In practice, this means investing in a large pool of reasonably standardized PPP projects. We are not interested in the investment characteristics of this bridge or that power plant: we are interested in the average project risk profile, the systematic risk, the one that the market remunerates.

Now, again, there is a role here for the public sector. It implies that the public sector tenders enough projects, that they are investable, that they are bankable, and that they create the right financial securities and investment opportunities that pension funds, again, actually want for their own purposes, such as, for example, inflation-linked debt.

The third suggestion is that we need to develop our understanding of the investment characteristics of infrastructure project finance, because that is still something that is not very well documented. The key here is to benchmark what is a well-diversified basket of project finance debt, for example.

This is what my team is working on in Singapore, where my Institute is based – we are a French organization but we have a presence in Asia. In the next few weeks and months, we are planning to publish a scientific methodology for risk measurement and asset valuation in project finance, which is both practical and implementable but grounded in asset pricing theory, and we are also launching a major data collection initiative with our partners, including with the OECD, to try to bring this benchmark to life in the near future.

Finally, I was mentioning the regulatory constraints that institutional investors have. We are proposing to create a project finance risk module in the prudential frameworks, such as Solvency 2, for example, which affect investment decision and the cost of investing for institutional investors. Our early results of calibrating a project finance module within Solvency 2, for example, indicate that this would considerably lower the regulatory costs for insurance companies to go into these projects.

So, we are quite hopeful that in the weeks and months to come, and years to come as well, we will be in a position to argue that the regulatory framework should be changed in order to allow institutional investors to come into these projects and that a viable and more predictable investment environment will be created around infrastructure for institutional investors. Thank you.

UNECE
Geoffrey Hamilton:

Thank you very much, Mr. Chairman, and thank you, too, for the excellent organization of this very important event. Alexander Bazhenov has done so much work. And thank you, too, for inviting the United Nations to address this prestigious audience. The United Nations likes to speak in front of international financial institutions and the development banks, and we appreciate the opportunity.

I represent, as you say, Mr. Chairman, the United Nations Economic Commission for Europe. We are based in Geneva and have 56 member states, and I am responsible for the public-private partnership programme.

Last year, the United Nations Economic Commission for Europe, working on behalf of the other UN regional commissions, established the International PPP Centre of Excellence, whose goals are to identify best practices and to help governments to implement these best practices successfully.

The UNEC International Centre of Excellence is a global body. Its Executive Board comprises governments from all over the world, many of the governments represented here, and the UNEC is the only organization within the UN system that actually deals with public-private partnerships with an inter-governmental body.

We also have specialist centres set up by governments, again, around the world, dealing with different PPP sectors, like water, wastewater, health, renewable energy, green PPP and many others, and also we work very closely with the private sector, and we have James Stewart, who is going to speak later, our former Head of Partnerships UK, who is the Chairman of the Business Advisory Board of the Centre of Excellence.

Mr. Chairman, the United Nations takes public-private partnerships very, very seriously. PPPs address many of the world’s problems: climate change, food security, poverty, access to basic services like health and education, and developing best practices in these relevant sectors will contribute significantly to helping the UN achieve the Millennium Development Goals and the Post-2015 Development Agenda.

This session concerns the role of international financial institutions and development banks, and let me start off by immediately making a rousing call for three cheers for the international financial institutions! Because they have done a tremendous amount to bring public-private partnerships forward.

The development banks around this table have been pioneers in public-private partnerships. Vnesheconombank is a good example. They have provided stability during the financial crisis to PPP, helping to make adjustments, introducing innovative financing techniques, trying to get some stability and to fulfil the gap that has been left by the banks retreating from delivering and financing PPP as was in the past. And there is a strong need for the international financial institutions to go forward to develop the capital markets for long-term financing.

But the difficulties lie on the one hand with financing, but there is another very, very important challenge on the other side of the coin, and that is, basically, the lack of governments doing projects, the lack of government ability to develop project pipelines.

My central thesis, which I would like to present to you, is twofold. First, we urgently need best practices in public-private partnerships and standards in public-private partnerships that can effectively be used by governments; and secondly, I think we need a better relationship between in the international financial institutions and the development banks and the United Nations on the other hand.

Let me, if I may, Mr. Chairman, start with the first argument here. What are international best practices? Well, frankly, best practices are not really very well understood. Many people think best practice is just a few governments looking at their experiences and saying, "Well, that's best practices", and indeed, a few years ago, when you were organizing a conference of this kind, you would look at France, you would look at the UK, you would look at Spain, different models, PFI, concessions, and that is best practices.

But it is a little bit more complicated now, and what we are looking for is international best practices, not national best practices, but based on an analysis and assessment of experiences around the world, where we can assert and evaluate what actually international best practices are. Best practices are not the same as standards. Best practices are, if you like, the beginnings: what we are presenting and what Raffaele was talking about, general principles. Standards are something much more basic, more coherent and more useable by governments. And they come after a valorisation process, which I would argue the UN is quite good at, and I will explain a little later on.

So, basically, best practices are very badly needed. Most governments, when they start out in public-private partnerships, it is a leap in the dark: it is a leap into uncharted waters. They have no assured and standardized templates or models to follow. PPP laws are inconsistent, contradictory and not reassuring enough to foreign investors, and guidance really is rather poor. There are many, many gaps in important areas, particularly procurement.

So, consequently, many governments do not get over the first hurdle. They develop an interest, but they do not translate this into a project pipeline. And this is not just developing or transition economies: this is not just poor economies. Germany, for example, took twelve years from the time it started with a policy interest in PPP before it actually graduated to the development of a project pipeline.

If we had more knowledge on what is best practice, I am convinced that we would have more successful public-private partnerships, that PPPs would not be negotiated after a few years, and there would be fewer failures in public-private partnerships. And by international best practices, I am convinced that we can accelerate the use and expand the benefits that public-private partnerships can bring to our populations.

Let me give you an example. As I told you, we work in the Palais des Nations in Geneva, and I am sure some of you might be familiar with that building. It is a privilege to work in the Palais des Nations. It was built from 1925-1933; it took a long time to be built. And it is a splendid sight. But it is in huge need of investment: the building is actually collapsing, and it is dangerous for the employees to work there. There is lots of asbestos. And the government has asked the United Nations office in Geneva, who run the building, to explore the PPP option, to explore whether PPP could be used for the renovation of the building.

They were anxious to avoid the cost over-runs and time over-runs that the renovations of the United Nations in New York had had. Now, the United Nations office in Geneva freely admitted that they knew nothing about public-private partnerships. They had never heard of public-private partnerships. So they asked us, in UNEC, the only organization in the UN who knew something about public-private partnerships.

It took six months before we could answer their questions successfully. We had to do a review of what worked in PPPs in renovations, look at all the experiences, and finally came up with a DBMF model that we thought could actually be useful for the renovation. And in that period, the UNOG became uncertain.

What I am saying is that what our office in Geneva faces is what governments all over the world face when they go into this leap in the dark. We need models. We are not just wanting a menu: we do not want a menu of best practices that governments can just select and say, “Yes, we’ll start with this, we’ll have this and we’ll maybe have this and a little bit more aperitif and a little bit more salad and so on”. That is not what governments need. They need to be given actual instructions as to what is good for them. They do not want to make choices.

So that is what I am looking for. But you may say every PPP is different, every PPP is unique. But there are common problems existing all over the world. Successful PPPs, best practice in PPPs are more than just what works. We have to also look at a vision of what PPPs are supposed to achieve. And these are the development goals of the United Nations in making public-private partnerships more in the interests of the ordinary citizen, so that we can actually address some of the public relations problems that have affected public-private partnerships over the last ten years.

The second argument, if I can, Mr. Chairman, if you allow me, was this development of a new relationship between the United Nations and the international financial institutions. I think it is very important to recognize that best practices are what all conferences are about. They basically come to a meeting and present best practices: that is what basically many meetings on public-private partnerships are.

What fails to be made into something credible and useable is what I think the UN is quite good at: that is, a valorisation process, an endorsement which involves all stakeholders, which involves governments taking decisions as to what types of best practices are wanted: a kind of step-by-step process. And we have in the International Centre of Excellence what we have called an Open Assessment Approval Process by which stakeholders can be involved in developing these standards in a particular sequence and order, so that at the end of the process – and I am not talking about ten years, I am talking about a period of about eight months – you can move from best practice to something like a standard, something that can be used and followed with confidence by governments and private sector.

The International Centre of Excellence has established specialist centres to develop best practice. France is doing work on law and policy; Morocco, renewable energy; Republic of Korea, green public-private partnerships; Azerbaijan, broadband, ICT; and Russia is doing work on the regions.

And the relationship, finally, that I am looking for, is something which I think will provide some coherence to the international system. There is a little bit of duplication; there sometimes is a little bit of overlap, but I think if we can see, on the one hand, the development of best practices and standards with the international financial institutions working with the United Nations at the upstream of the project, and then the international financial institutions selecting the best models that have been approved and selected as having the confidence to be taken forward, in the implementation at the financing stage – that, I think, would be a very good synergy, and I think that would be something that would be a real target.

So, I think, finally, Mr. Chairman, public-private partnerships will help to deliver and I think standards in the development of public-private partnerships will help to deliver and make the promise of PPP that has always been anticipated a reality. Thank you, Mr. Chairman.

KPMG
James Stewart:

Thank you. Good morning, everybody.

As the Chairman has said, I spent twelve years of my life at the centre of the UK infrastructure and PPP policy, but in the last two years at KPMG, I have probably visited nearly 40 countries, talking to governments and the private sector participants about infrastructure programmes.

So I am going to give both a global perspective, but also obviously talk about the UK a little. And really what I want to talk about is the role of development banks and multilaterals in helping governments pursue PPP projects, and I have got four points that I want to make.

The first is to spread the message that PPPs are not the magic solution to every infrastructure project. We have heard that 134 countries are pursuing PPPs; we have heard about the scale of investment. But, too often I hear that PPPs are viewed as free money, and quite simply, PPP is just a method of procurement. It does not turn an unviable project into a viable project. You still have to find the means to pay for the infrastructure.

And also, as Frederic said, PPPs are a very, very complex form of procurement. They are very difficult to do. They are very dangerous in the wrong hands. I use the analogy: it is a bit like putting a Ferrari in the hands of a teenager, and expecting the instruction manual to show them how to drive. Unfortunately that will result in many, many crashes.

The UK have done something like 850 PPP transactions over the last 20 years, and I would say that around 300 of those should never have been done. They were either too small, or they were being done by small local authorities who simply do not have the ability or the experience to negotiate the contracts and, perhaps more importantly, to manage the contracts once they are in place. So that is my first point.

The second point is that development banks and multilaterals should help to solve this problem that we have of all the projects that are stuck in the development pipeline. In all the conversations that I have had in the last year in this sort of forum, this has been identified as the major issue: not financing – it is the fact that too many projects are stuck at the development stage and are never coming out to tender or are never getting to the stage where they need financing.

And my plea is for development banks and multilaterals to get tougher with governments and project teams that they are working with, because the fact is that particularly the multilaterals are providing a lot of the funding for capacity building and for the support of project teams, and very rarely are conditions attached to funding that goes towards developing projects.

I realise that it is very difficult to even think about withdrawing that money, but unless there is some kind of stick, I do not believe that behaviour will change, and the fact is, the current methods are not working, because we have this problem of so many projects being stuck.

My third point is that I believe there is a role to support the development of PPP units, central infrastructure agencies. In my experience, good infrastructure investment programmes coincide with strong public sector infrastructure, PPP, agencies. Best in class in my view is Canada, with Infrastructure Ontario and Partnerships BC. These agencies require investment in resources, which is not always forthcoming, and they need support in the setup phase and the first few years of their life before they gain the necessary experience.

I think that the multilaterals can certainly help, and I think the development banks can certainly be the host for a PPP agency in particular circumstances.

My last and fourth point is that I believe that the multilaterals and development banks can support the development of private sector long-term financing markets, and we have heard a lot about that over the last day or so.

I am going to distinguish here between debt and equity, and I am going to talk about debt, because I think the equity markets are working reasonably well, there is good liquidity around the world, and for well-structured projects, equity should be available. So what I am going to talk about is debt, and I think the long-term institution private sector debt market is in its infancy.

There is an enormous amount of talk about insurance companies and pension funds providing a long-term debt into infrastructure, but on the ground, there are very, very few deals happening. The fact is, the risk appetite of private sector institutions remains very low post-financial crisis. Very few institutions have teams that have any sort of experience in transacting these deals, and that presents a major barrier.

And, there is a real lack of infrastructure debt funds. The reason that I say that is because if you look at the equity market, the way the equity market got going was the setting up of infrastructure funds who put in place teams, and that provided a route to market for the institutions to put their equity in. Only now, ten-fifteen years after the setting up of those infrastructure equity funds, are we really seeing direct investment from institutions into projects.

So I think it is vital that we see infrastructure debt funds come to the market to provide this route to market.

Now, I am confident that within five years, we will be in a very different place, but only if governments and multilaterals play a role in developing this market, acting as a catalyst for institutions coming into the market.

At the moment, in the emerging markets in particular, governments and multilaterals do the vast majority of the lending. Brazil, with the role of BNDS, and India, with the role of the state banks, are two extremely good examples.

One of the problems that can present is that actually the multilaterals and the development banks can be the competition to new private sector entrants. There is a very interesting example in Europe which has just emerged over the past two weeks, which is Hadrian's Wall Capital. This was a private sector fund which had raised money. It was going to put mezzanine finance in to credit-enhance infrastructure deals in Europe, to allow institutional debt finance to come into those deals on a higher rating. Hadrian's Wall have just announced that they are going to return their funding to their private sector investors, because they could not find the deals. And one of the reasons why they could not find the deals was competition from the EIB's Project Bond Initiative, and also the fact that the governments are increasingly providing support.

So, rather than the government support and the multilateral support being complementary to that product, it was actually proving to compete.

My view is that it is very important for the multilaterals and the development banks to have a strategy to both provide capacity and also to support the development of these institutional debt markets. And that is all about thinking about the type of intervention or the type of support that is available. That might be devising products, as I said, that credit-enhance, and the European Bond Initiative is an example of that; offering guarantees – the UK and France are examples, and I will talk about the UK in a moment; tax incentives for infrastructure bonds, which we have seen in Australia, India and Brazil; helping to establish debt funds, sponsoring debt funds, and India is a good example of that at the moment; and lastly, something I have seen very little of is financing deals during the construction phase of a project and then actually selling them into the institutional market once they reach the operational phase, and once they have become less risky and more attractive.

I think the UK is a good example of where interventions have been made, and the two big ones are the UK Guarantee Scheme and the Green Investment Bank, and I have been asked to say something briefly about both of those.

Firstly, the Green Investment Bank is slightly misnamed, because it is more an equity fund than a bank, but it has GBP 3 bn of capital and its purpose is to help green infrastructure projects: renewables, waste and energy efficiency projects, and to provide capital into those projects, alongside private sector capital, to push them along.

The UK Guarantee Scheme is, in some eyes, a very surprising initiative. The government has made available GBP 40 bn of balance sheet capacity to provide guarantees for any infrastructure project in the UK. That could be a government-funded project or it could be a private sector port operator making a capital investment purely in the private sector, with private sector revenues. So it is not just government-funded projects: it is any kind of infrastructure project.

Now, I think that there are three policy objectives behind these two initiatives. Firstly, it is to provide capacity, and that is particularly true for the Green Investment Bank.

But secondly, and more importantly, particularly the rationale behind the Guarantee facility, it is to speed up these deals. The UK Government is desperate to use infrastructure as a boost to the economy, a way of driving the UK out of recession, and they see the current procurement process and the whole process of arranging the finance as too slow. So the purpose of the UK Guarantee Facility is to make the raising of finance easier and to speed up these deals and speed up the spade actually going into the ground.

And thirdly, and alongside that speed point, it is to help develop the private sector institutional debt market, and in that sense, the Guarantee Facility has a clear exit. It is only being made available for a limited period of time, and the government are quite clear that at the end of that period, they wish to see an institutional debt market having been formed.

So, just to conclude: to me we have some major challenges in supporting infrastructure investment across the world. This is going to require a combination of governments, development banks, multilaterals, and the private sector. However, the private sector's risk appetite and capacity has been reduced by the financial crisis, and with this increased level of investment that is required all over the world, governments, multilaterals and development banks are going to have to play a larger role than might have been the case five years ago. Thank you very much.

M. van Leuvensteijn:

Thank you for the opportunity to talk here and to give my view and the view of APG on long-term investment in infrastructure projects in PPP projects specifically.

Let me first introduce myself. I am from Corporate Strategy and Policy, so more on the regulatory side of APG and I work together with the asset managers.

APG itself is the asset manager of several of the pension funds in the Netherlands. We have EUR 315 bn assets under our management. We are not only interested in infrastructure, but also as Frederic already mentioned, we are interested in matching the long-term cash flows with the needs we have and our long-term obligations. We also prefer this to be in an inflation-linked way.

With regard to APG's infrastructure portfolio, we have EUR 5 bn assets in infrastructure equity, and we have altogether 260 projects here. We started in 2004, so we have now been running for nine years.

What is the interest of the pension funds? Again, like Frederic said, we are interested in a very good risk-adjusted return for our participants. In the end, we are interested in providing them with the benefits that we promised to them, 30 years after the scheme has started. So this is really one of the major things that we want to achieve. We want a very good return so that we can meet the obligations that we have to our participants.

The second point that I want to make is about regulation. It is very important for APG and also for the pension funds that regulation does not prohibit the possibility to invest long term. Right now, there is regulation being proposed on pension funds in Europe by the European Commission, and this kind of regulation, which only increases the buffers that we have to hold in order to be able to invest long term, is not really helping us to reach our objectives. The same is true for a lot of regulation with regard to the investments themselves. I am talking about the FTT, of course, the Financial Transaction Tax; I am talking about the Credit Merchant Codes that we have to keep in order to do transactions. We have to keep them in a buffer to have the transactions. All of these kinds of regulation are keeping more money in the system, instead of our being able to use the money to invest long term in, for example, PPP projects, or infrastructure.

That is really important. But a lot of these things are more on the European level. First I want to make some points which are really relevant for us if you are talking about long-term investment: these are points which may be more things which could enhance the possibility of investing long term. I am talking about taxes.

There is always the risk that we are taxed both in the home country and in the source country. We do not like to be double-taxed. We like initiatives such that we can be taxed at the source, and also initiatives that help to mitigate the procedures that involved in this taxation. With regard to this, there is a very good OECD initiative called Trace, and they are trying to halve the red tape with regard to taxation, to at least harmonize this between the different countries, so that we do not have to reinvent the wheel the whole time or find out how it works in this country again.

Another point that I want to raise that I think is quite important is that it is very important to build knowledge about long-term investment. I think over the past couple of years, the OECD has done a tremendous job in this, to increase knowledge on long-term investment. They have had several initiatives. APG itself has a project with the OECD on the risk return of infrastructure projects as an asset class. We are trying to learn more about the real return that we can get from this asset class.

Frederic already mentioned their collaboration with the OECD: they have a number of services that are put forward and so we are very happy with this knowledge building. It is not only on the side of the long-term investors like the pension funds, it is also on the side of the PPP, the public-private partnerships. They have a unit at the OECD which has become very knowledgeable. The fact that I am talking to you today, which I am very happy about, is only because Ian Hawkesworth of the OECD was not able to participate in the meeting, but he is the guy from the PPP unit. It is very, very important indeed to build up this knowledge and APG likes to be a part of it.

It is also a part of the Long-Term Investors' Club in which CDC, KFW and the European Investment Bank are also participating in this build-up of knowledge at OECD.

Something which could be bifacial for investment could be ratings by Standard & Poors and Moody's: these would really help. Finally is the point that I wanted to make in the beginning: if you are talking about pension funds, one of the major risks that we have is the risk of risk inflation: the risk that in a few years' time, the benefit will have a much lower purchasing power than it has today. So we really like to invest in inflation-linked debt.

Having said all this, there is one major point I want to make at the end. That is a point which was also made yesterday by the EBRD and JBIC, the Japanese Bank of International Cooperation. This is about the stable economic and political environment and the importance of having a stable legislative and regulatory framework.

This is really important. The remark made by the EBRD that PPP projects should not be seen as a one-off game is, I think, a very important remark. It should be a repeating game, and should be seen like this.

I just want to illustrate this. A few weeks ago, I was at Begijn in Amsterdam, and they had an exhibition about a very tall guy coming from far, far away, to Amsterdam. He was more than two metres tall, a really tall guy, and he wanted to learn something. Well, also these days, when people come to Amsterdam, they want to learn something, but he really wanted to learn something, and he found out that he could not learn it from the books: the knowledge was within the people. So, he asked people whether they were willing to come over to his country, far, far away.

Can you imagine what kind of decision these people had to make: this was a really long-term investment decision they had to make. You are standing in Amsterdam, you have an expectation about what your life will be 3,000 miles away.

By now you all know I am talking about Peter the Great. And you know that the expectation that you have in Amsterdam, how that may not match the outcome by the time you are in Moscow.

So how did he convince these people? He was committed to these people. He had the commitment to these people. He was standing behind them: he was backing them. And I think that is the important thing: if you have the opportunity to go to the exhibition, it is said that these people became French for life. So it was a really personal investment on the part of Peter the Great in these people.

I want to explain what is happening when you have this kind of commitment. I will explain this by a very simple example that happened a few days ago, when I was driving here in Moscow from one hotel to the other. I had an agreement in advance about the price and the way I was going to pay, and I went in the taxi, and of course we were driving to my hotel, you understand that the closer you get to the hotel, your negotiation position gets less and less, but OK, I got to the hotel, and I found out that we did not agree in the end about the way the payment was done, and we also disagreed on the price. At that time, I really wanted to have the opportunity to say to this guy, “Yeah, well, let me call up my Peter the Great”. I think you understand immediately what would have happened.

Two things would have happened: my negotiation position would have improved right on the spot, big time, and the other thing that would have happened is that this taxi driver would immediately realise that this is not a one-off game. There is going to be a repeating game.

I just want to tell you in this way how important it is that governments are supportive in their policies with regard to infrastructure and PPP projects, and there may also be a role for development banks in this sense, especially the national development banks, they have the opportunity to take the first hit or to have a better negotiation, because the example I gave just now about this taxi driver, who in the end did not deliver the promises that he had made when we started off, it is of course the same thing that can happen when you are building a road. The guy says, “Yeah, you know, something happened and we have to re-negotiate”. This is also very close to the point that Frederic made.

So, I think that commitment is a very important thing. Thank you.

Division Chief on PPP from Vnesheconombank Alexander Bazhenov:

Thank you. Although we have learnt today and before that PPP is not magic in order to resolve all of the problems of infrastructure development and economic growth, somehow we are still attracted by this model. What is the reason for this attraction?

Sometimes we think it may be because there is an inherent connection between infrastructure development and economic growth, although sometimes, and in more developed countries, this sensitivity of economic growth to infrastructure development is getting less important than it is maybe in developing countries. On the other hand, we would also like to refer to the fact that in the OECD’s economic study of infrastructure in 2007, they came to the conclusion that infrastructure investments could not be repaid simply by the commercial revenues generated by infrastructure services, or at least they could not repay these infrastructure investments outright with the commercial services provided by the infrastructure operators, and the principal source for repaying this investment is economic growth and the growth of budget revenues coming with the economic development of the area provided with the infrastructure.

In this regard, PPP is important and its important distinctions is that it is not public procurement where they finance infrastructure from the existing means of the government, and it is not exactly, let's say for example, a concession, where we have to pay for the budget investment for infrastructure from the future commercial revenues which are subject to significant political, regulatory and commercial risks. In this regard, we have seen in many countries in Europe that the initial aspirations to develop the infrastructure only by private means have been scaled down, and let us say that finally the country puts the European policy to stand somewhere in between public procurement and concessions, firmly using PPP where the private sector could transfer the risk in financial design and building and maybe maintaining and operating these infrastructures, but the fact is that for many pieces of infrastructure principal, social infrastructure, education, healthcare, the way in which the private sector could be engaged and given proper risk that it could manage, is through PPP, where the infrastructure is developed by private finance, but is repaid by the government, by the public sources, over the time of the operation of the asset.

This is important also for institutional investors, because this may be the response to the need to standardize infrastructures as a specific asset class, because if you go into the old diversification of potential commercial models for how we can exploit infrastructure in one city or another, in one industry or another, we will never have a clear understanding of how all of these peculiar models could work and operate, and how it could be regulated.

On the other hand, once we develop clear and transparent ways of developing infrastructure by private investors with all the expertise and resources of the private sector and where the economic life of this asset is covered by public funds coming from the economic development of the area, which is also measurable and transparent, then probably we are coming to some contractual model which could be a subject for development by institutional investors.

In fact, once we see the experience of PFI programmes in the United Kingdom, I remember when we discussed it, we said we have plenty of contractual models for public-private partnerships, but we choose one where we provide public service with a private infrastructure, but we are paid by the government. In this regard, it could be a very clear and understandable model for institutional investors.

And in fact, the PFI model was fully supported by institutional investors through the bond market.

If we look at the other corner of the globe, for example for the development of municipal infrastructure in the United States, the tremendous success at times of revenue bonds issued by municipalities based on a tax increment finance scheme developed under specific national and state laws, and developed for specific, smaller pieces of areas divided into counties, and for these counties the infrastructure was provided and financed by institutional investors, but repaid through specific revenues taxed on the new economic activities in the area.

Again, we see that there is reason to believe that there is potential in PPP in this specific form of PPP to be a standard model for this institutional class of assets for institutional investors.

In this regard, we also see a trend for development banks have increased investment, at least based on our experience, considering it as a problem solver for this type of development. We see that it is very much dependent on the way that the national infrastructure market develops and the stance the development bank will take on the development model for infrastructure, whether we can employ certain regulations and certain conditions on the way the government or regional or municipal government or private investors try to develop infrastructure, or whether we believe that we are individual tailors waiting for various municipal and regional governments and private investors to come to us in order to tailor an individual suit for them.

So, if it is individuals, then we will never have an increase in the scale of the infrastructure market and over time we would be opportunistic in our development.

In this regard, based on our experience, development banks are increasingly given the responsibility to develop and to be engaged in the development of the pipeline on the site with the public authorities, and this is an important role for development banks, so they should not be waiting for the deal to come to them: they have to work together with the public authorities in order to develop a pipeline of infrastructure projects in the proper framework that could be financeable by development banks as well as by institutional investors.

In this regard, it is an important role for development banks to provide the necessary expertise to the public sector on infrastructure, because the public sector does not have the necessary expertise to structure these projects and foresee the long-term effects of mistakes they make right now in the structuring process.

In addition, we have to provide specific funds for this type of development: development for the private financing of public infrastructure is a costly exercise, and therefore we have not only to provide expertise and initiate the development, but we also have to take risks in developing these projects together with the public sector.

The third role as a problem solver in this development which is being increasingly given to the banks and we are struggling somehow to understand how we can better perform in this role is the role of risk mitigator. It is very much dependent on the business model of development banks. For example, in our case, we are quite limited in providing guarantees or developing an insurance model or providing equity to projects, and therefore this role is provided by the government on a very limited basis, and it slows down the process of developing projects, as well as limiting the amount of funds that can be provided by institutional investors to infrastructure projects.

In this regard, without specific risk mitigation tools provided by development banks in the Russian sector, we are mostly limited to providing institutional finance only to corporate models of infrastructure companies, so, those who are corporatized. Their capacity to develop projects is quite limited, because they are limited in their ability to raise debt based on their existing assets.

The development of this problem-solving role of the development banks requires significant changes in the business models and we think that we are not alone in feeling that these problems are somewhat universal for many development banks.

First of all, one of the problems that we see is that we are somehow the artificial creation of the government, but given the natural role of developing the market. We have to understand that the source of funds for development banks should not be limited by the capital contribution of the government and also the debts they can raise in the market. There could be some systematic approaches in order to provide capital from public sources in order to support these long-term investors in their role.

Another problem is, unlike our many colleagues from Brazil, KFW and France, we have to understand that the value of increasing guarantees where rating agencies suspect that we would be provided with support by the government in our transactions is much less valid than explicit support. Therefore, we have to either have this fixed in the loan development bank, or we have to be an operator, given our expertise, and given our specific role in developing the infrastructure market, to be a sort of operator for guaranteed funds such as have been established, for example, in the United Kingdom. This would be a much better model for mitigating risk with the involvement of the development banks.

Then I think there is a universal problem for development banks in developing projects with the public procurement issue. Somehow, these public procurement laws limit many development banks, although they do not limit international financial organizations in the national markets, on how to transact these municipal and regional governments, and therefore our expertise and our support could not be provided on a timely basis to the public sector, because either it would require a certain kind of interruptions and tenders for unnecessary competition, or even as in the case of Vnesheconombank, we are prohibited by law from providing this type of support, for example to municipal governments. So, this requires change.

Then, another problem which has been mentioned today already: the problem of competition between different forms of the public support to infrastructure development. We see it because other than just the public funding of infrastructure develop, we have seen a number of tools developed by the government for specific sectors of infrastructure.

In this regard, these tools are managed by different Ministers, administered based on different approaches and somewhere they are not coordinated with the potential instruments of development institutions and development banks.

Therefore, what has been developed is not used: instead, we see a lot of reinvention of the wheel by many branches of the Ministry.

Finally, there is clearly the issue where we have to understand what is the right model of governance of development institutions, because on the one hand, we have to be engaged with public policy proactively, maybe with certain policies to be developed based on our experience and not only implied to us by the public sector; we have definitely been controlled by the public sector. On the other hand, this role of control of the development institutions by the public sector of course should be limited to the professional judgement of those who are involved in infrastructure. This governance model is different in different development institutions, and we increasingly see that the role of the hostage of the government simply in developing infrastructure could damage our ability to provide longer-term commitments and longer-term support to the development of economic growth. Thank you.