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Off the Books:

Understanding and Mitigating the Fiscal Risks of Infrastructure

Significant infrastructure spending needs, but limited resources

Annual spending needs in low- and middle-income countries ❯ 2.6% / 2.8% of GDP

Public (on-budget) spending on transport and power sectors ❯ 1.9% – 2.7% of GDP in 2010–20

Even when spending through SOEs and PPPs is included, spending remains below what is needed

Increased urgency of creating sustainable fiscal space for infrastructure

Heavy debt burdens

Increasing interest rates

Declining growth rates

Governments provide infrastructure through:

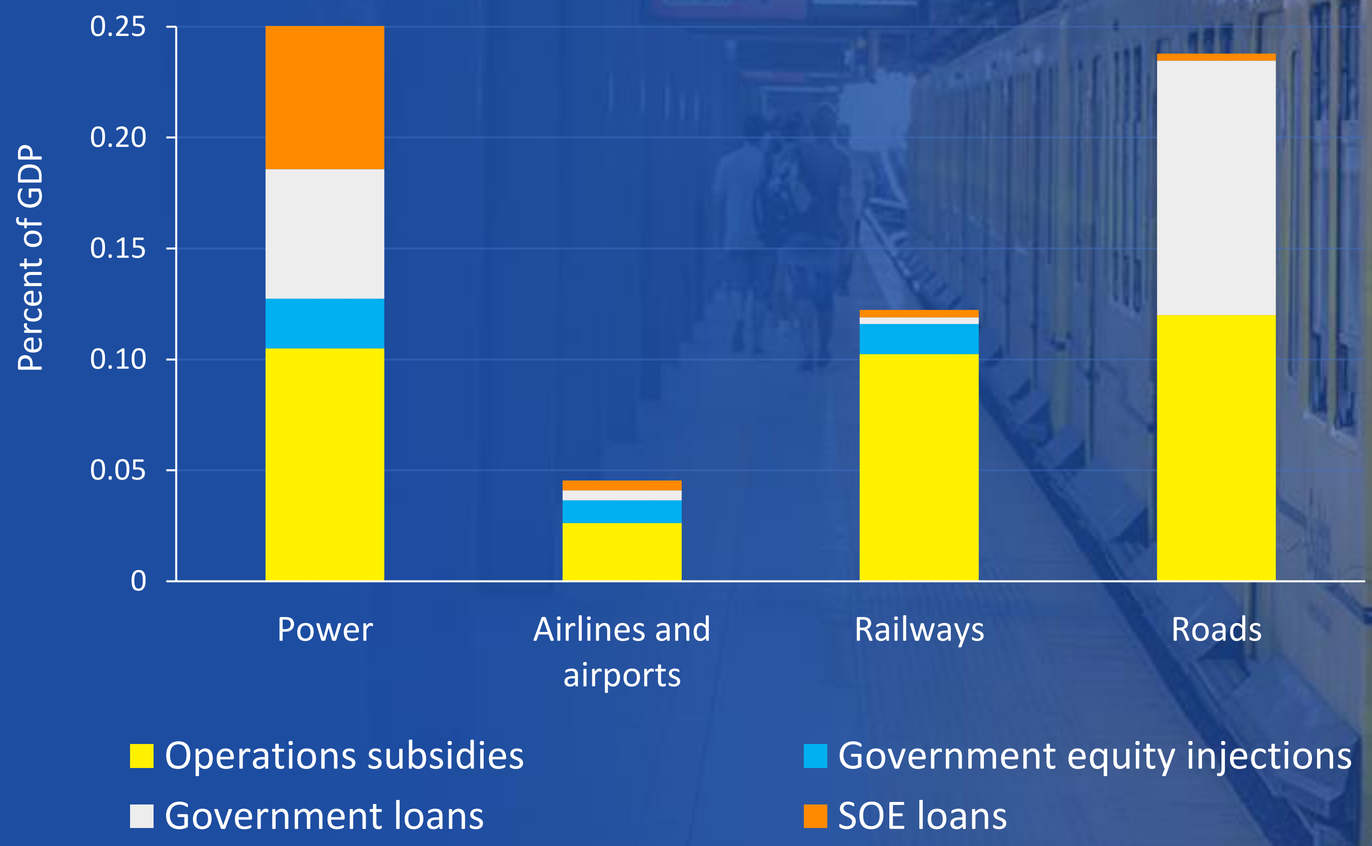
Ministries, agencies, authorities	SOEs	PPPs

Risk of fiscal surprises—infrastructure costing more than projected

How frequent and large are the fiscal risks of infrastructure?

Transport SOEs require average annual fiscal injections of 0.04% - 0.24% of GDP to remain afloat

Fiscal injections to infrastructure SOEs by sector, 2009–18

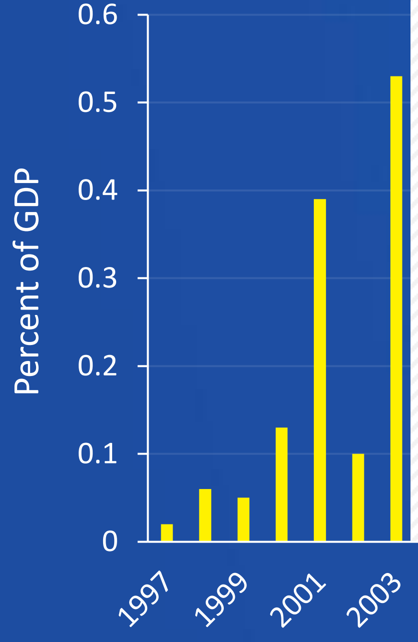


Instances (country-years) where SOEs received fiscal injections:

49%

33%

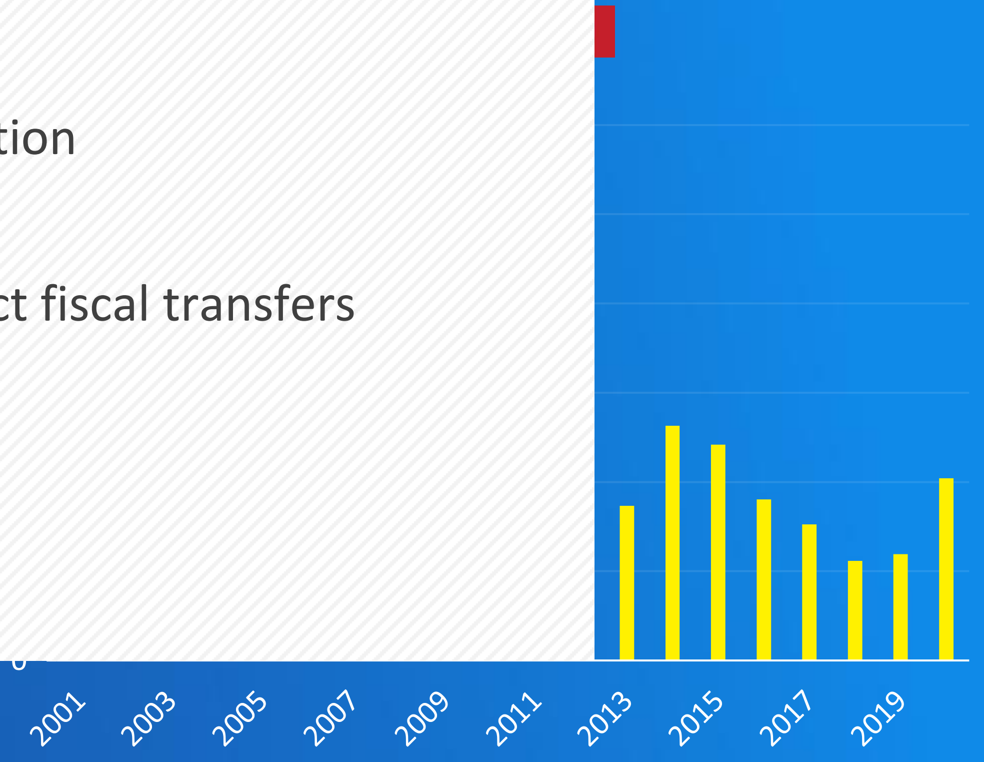
PPP renegotiations represent a small but frequent drain on fiscal resources



Transport PPPs

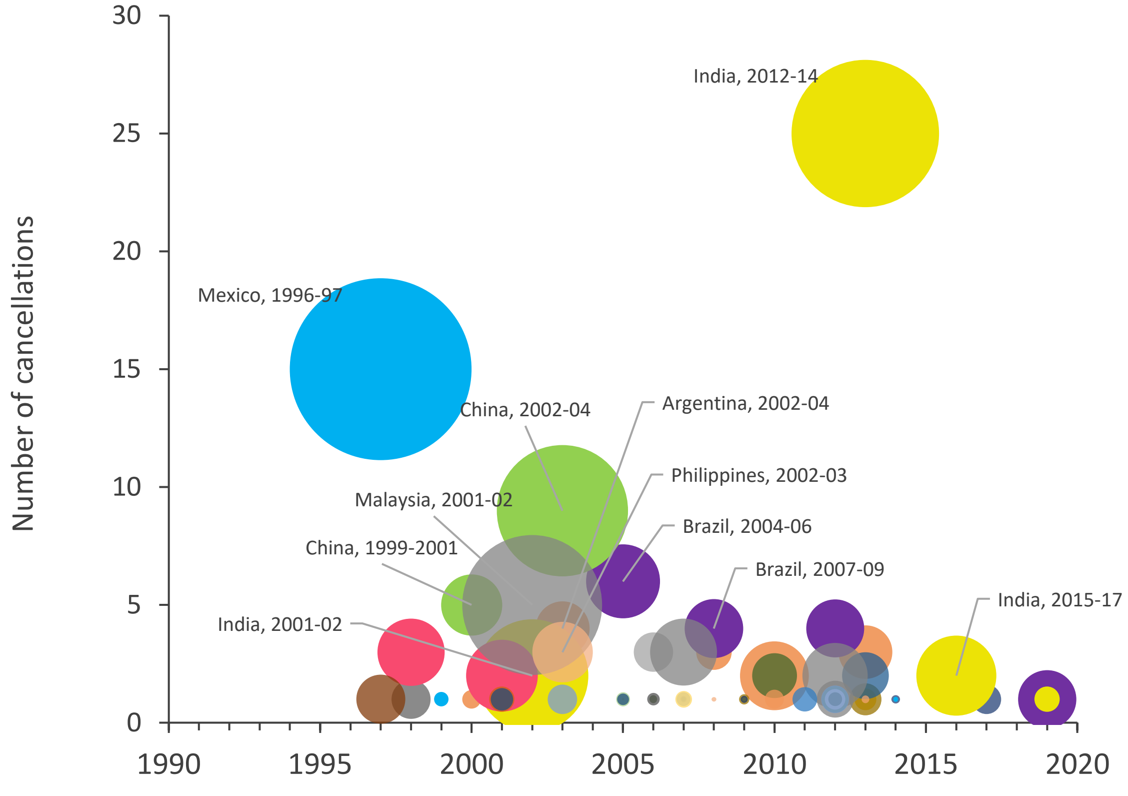
- have a higher rate of renegotiation
- are renegotiated sooner
- are more likely to result in direct fiscal transfers

than power PPPs

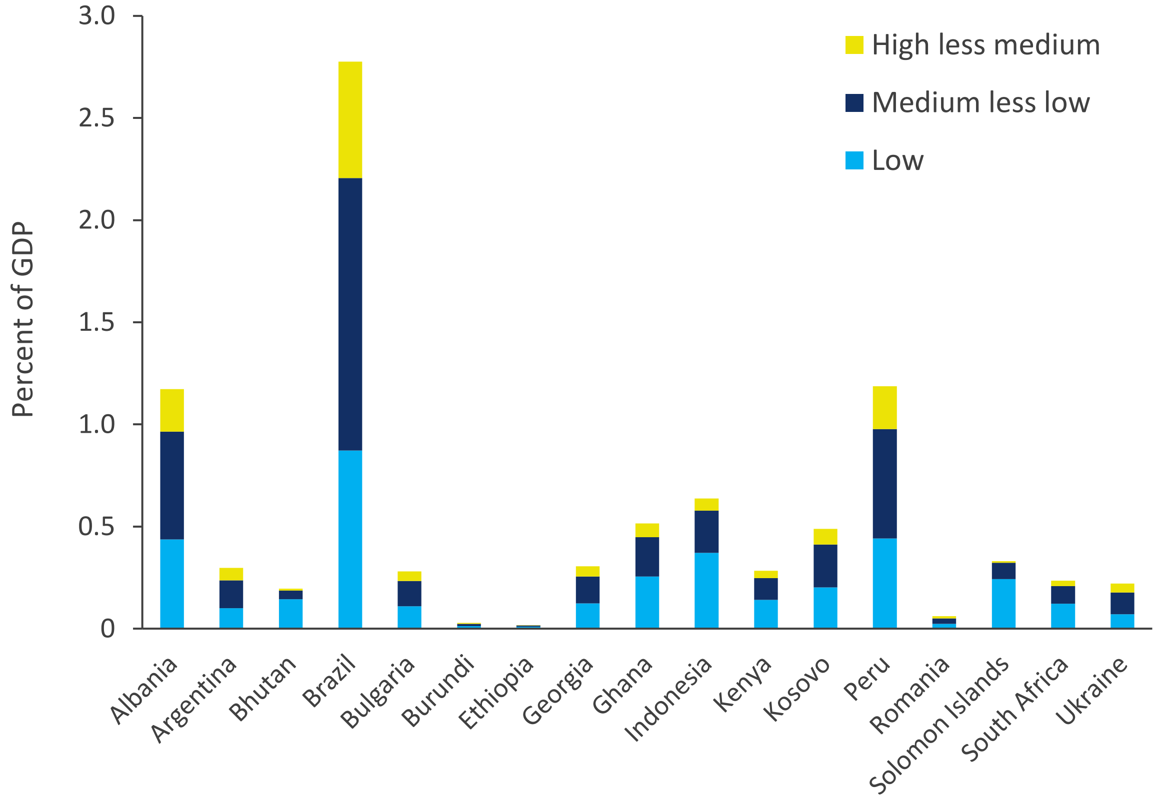


Early termination of PPPs is less common than renegotiations, but the fiscal costs tend to be higher

Almost 3% of electricity and transport PPPs in developing countries were terminated early in 1990–2020, and 75% occurred in clusters



Developing countries need to set aside significant resources to be prepared to cover the fiscal costs from early termination of infrastructure PPPs



On-budget provision leads to fiscal surprises in the near and medium term

Low budget execution:

69% in roads

37% in power

risk of project delays and cost overruns

Road sector

Strong capital bias

Capital expenditure = 7 times maintenance expenditure

↓ **productivity** and

↓ **efficiency** of spending

growing investment liabilities

When it rains, it pours…

During an economic downturn:

On-budget infrastructure spending is a soft target for budget cuts

SOEs

Fiscal injections increased – equivalent to **30%** of average capital ratio

Capital spending decreased – equivalent to **40%** of average capex

The fiscal risks of early termination of PPPs are **12-19 times higher**

What are the root causes of the fiscal risks of infrastructure?

Vulnerability to exogenous shocks and perverse incentives (1/2)

SOEs: Soft budget constraints ⌄

- Imposition of (uncompensated) public policy mandates
  - Pricing below cost-recovery level
  - Employment
- Preferential access to financing
- Flaws in corporate governance

Vulnerability to exogenous shocks and perverse incentives (2/2)

PPPs

- Inadequate fiscal (i.e., budgetary, reporting, and accounting) treatment of PPPs
  - Limited authority of MoF
- Unregulated contract renegotiation and early termination
- Inadequate risk allocation

Direct public provision & PPPs

- Weaknesses in public investment management

How can the fiscal risks be mitigated?

Building blocks to mitigate the fiscal risk of infrastructure

Mitigation of fiscal risks of infrastructure

Integrated public investment management	Effective fiscal and corporate governance of SOEs	Robust PPP framework	Integrated fiscal risk management

Government capacity

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THANK YOU!

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