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

Public (on-budget) spending on transport and power sectors

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% for power
- 33% for airlines and airports

Legend:
- Operations subsidies
- Government equity injections
- Government loans
- SOE loans
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:
- Roads: 69% execution
- Power: 37% execution

Risk of project delays and cost overruns.

Road sector:
- Strong capital bias: Capital expenditure = 7 times maintenance expenditure
- Decrease in productivity and efficiency of spending
- Growing investment liabilities

↓ productivity and ↓ efficiency of spending
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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