Emmanuel Tumusiime-Mutebile: Needs, expectations and willingness of the private banking sector and possible facilitating frameworks

Remarks by Mr Emmanuel Tumusiime-Mutebile, Governor of the Bank of Uganda, at the Trans-East African Networks Regional Match-Making Conference, Kampala, 4 July 2013.

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I would like to begin by thanking the organisers for giving me the opportunity to speak at this important conference. Sub-Saharan Africa lags way behind other developing regions in most indicators of infrastructure provision, such as electricity production per capita and paved road density. The closing of the infrastructure gap will only be possible if resources can be mobilised in a sustainable manner; i.e. in a manner that is consistent with the economic viability of projects, taking into consideration their commercial nature, and the fiscal sustainability of the Governments which back infrastructure projects. It is these issues that I will focus my discussion on today.

In assessing the appropriate frameworks for financing infrastructure projects, it is useful to consider separately two distinct types of project. The first type is projects that produce “public goods”; which can be defined as goods for which it is not normally optimal or even possible to charge consumers for their use. Most roads, with the exception of toll roads, fall into this category, as do many other types of public infrastructure. Infrastructure services which have the character of public goods are paid for out of general Government revenues (i.e. by taxpayers). Hence, any debt that is contracted to finance the construction of this type of project must be serviced out of general Government revenues. As such, the key factors which will determine whether Government can mobilise finance from the private sector for these projects, and the terms on which finance can be raised, depend on the overall sustainability of public finances and the credibility of the Government’s management of public finances, as well as the Government’s credibility to maintain macroeconomic stability. Let me elaborate further on these points.

Governments will usually prefer to finance infrastructure projects which have public good characteristics with long term local currency denominated debt. The debt is long term because public infrastructure projects typically have very long payback periods and hence their indirect impact on tax revenues only materialises over the long term. The debt should be local currency denominated because the bulk of tax revenues are mobilised in local currency. Most Governments in the East African Community are now able to mobilise long term local currency finance by issuing Treasury instruments such as Treasury Bills and Bonds through regular auctions. Issuing local currency instruments on the domestic market is the optimal vehicle for raising private sector finance for the budget. With such instruments auctioned in competitive market and actively traded in the secondary market, their pricing is relatively cheaper than other forms of debt such as commercial bank loans.

The main investors in local currency denominated Government bonds are pension funds, insurance companies, commercial banks and, to a lesser extent, offshore portfolio investors. All of these investors are acutely aware of the need to balance risk with competitive rates of return. The main risk facing investors in local currency bonds is that the Government’s fiscal position becomes unsustainable, such that it either defaults on its debt or has to resort to inflationary finance to service its debt, which would then erode the real value of the debt. Hence to mitigate these risks, Government must be able to demonstrate, in a credible manner, that it will not allow its fiscal position to become unsustainable.

To generate confidence in the sustainability of public finances, Governments should formulate their budgets within a medium term fiscal framework which clearly shows the path of the fiscal deficit over at least the next five years and the associated path of public debt. A fiscal framework in which fiscal deficits are so large as to require continuously rising public debt to GDP ratios will be perceived as being unsustainable and is, therefore, not conducive to mobilising long term finance from the private sector except at very high interest rates. Therefore, the prerequisite for mobilising long term finance for infrastructure projects is a prudent fiscal framework, in which the future path of public debt remains comfortably within sustainable levels. The most important message which I want you to take from my remarks this morning is that any consideration of mobilising finance for infrastructure by Governments must take place within a framework of fiscal sustainability.

The second category of infrastructure project is that of commercial projects. These are projects for which it is feasible, and usually optimal, to sell the services produced by the infrastructure directly to the users, with the tariffs charged covering the full cost of producing the service, including its debt servicing. They include electric power generation and port facilities. Such projects are usually owned by separate legal entities from Government; e.g. limited liability corporations. Increasingly in East Africa, as elsewhere in the world, the corporations which own and manage these projects are owned by the private sector, or are joint ventures between private investors and the Government.

In principle, commercial infrastructure projects can be financed independently of Governments, provided that potential creditors are convinced that the project will generate sufficient revenues over the long term to service its debt in full, as well as meeting its other costs. Furthermore, these types of projects may benefit from financing that is specifically structured to meet the idiosyncratic requirements of the project, especially in terms of its cash flow and upfront capital expenditures. Hence it may be more optimal for finance to be raised through bank loans or syndicated bank loans, rather than through bonds.

Commercial projects are often financed with foreign currency denominated loans raised on external capital markets, either because the quantum of finance required is too large to be mobilised domestically or due to a large share of the capital costs of the project taking the form of foreign currency payments. If debt is contracted in foreign currency, the Government must provide a commitment that the debtor will always be able to purchase foreign currency to service its debt and that no capital account restrictions will be imposed to prevent the debtor from paying its creditors.

Beside the commercial viability of the infrastructure project, the other key requirement for raising finance for commercial projects is an institutional framework that guarantees the legal rights of creditors, including appropriate legislation and honest and efficient commercial courts. If the domestic legal framework is not perceived as being adequate, creditors may require that any disputes be settled in a foreign jurisdiction.

A key feature of many, although not all, commercial infrastructure projects is that they operate in monopsonistic markets; for technical reasons they can sell their output to only one customer, which is often a state owned enterprise. This is usually the case for power generation projects. As a consequence, the project is vulnerable to the abuse by the monopsonist of its market power, which could have serious consequences for the commercial viability of the project and thus its ability to service its debt. To safeguard the viability of the project, it will usually be necessary for the monopsonistic user of the infrastructure services to sign a legally binding long term agreement to buy the services at predetermined prices. Again, if these agreements are to be credible, the local legal system must be able to enforce their implementation.

Finally I would like to make a few remarks about public private partnerships (PPPs) as a vehicle for building infrastructure projects. There are several sound reasons for using PPPs to develop some infrastructure projects. In particular, projects may be implemented more efficiently if private sector companies, with specialist expertise, invest in, and manage the project and bear the risks that the project will not be completed on time and within budget. These are important advantages, not least because project implementation capacity is weak in Uganda and some other countries in the region. However, it is a misperception that PPPs reduce the fiscal burden on the Government over the long term; instead they usually only extend the time frame over which the fiscal costs are incurred. PPPs in many countries have also entailed substantial quasi fiscal liabilities because of implicit or explicit public guarantees given to private investors. PPPs should be one of the options considered by Governments for developing infrastructure but they should not be seen as a panacea for a shortage of budgetary resources.

Thank you very much for listening.