

INFRASTRUCTURE FINANCE

A KEY TOOL FOR SUSTAINABLE DEVELOPMENT

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In the worldwide search for tools to support truly sustainable development, attention is focusing more and more on the need to invest in shelter-related infrastructure. This paper briefly assesses three main policy thrusts that are at the core of a growing consensus among experts from both developing countries and international assistance organizations. How these policies can work effectively in practical terms is illustrated by examples drawn from current and recent developing country experience to which USAID has been able to provide financial and technical support.

First, there is a growing consensus that developing countries must invest a significant part of their limited resources, including the international assistance funds that become available, to supporting the provision of shelter-related infrastructure in their cities.

By now, it has become widely recognized that it is in the cities of developing countries that most of the world's population growth and much of its economic expansion will occur. But unless we can cope with the pollution that accompanies this expansion, its environmental consequences will overwhelm the health and well-being of the hundreds of millions of people who live and work in urban areas. City residents and businesses urgently need adequate supplies of clean water and must gain the means to dispose safely of solid and liquid wastes.

Around the developing world, the traditional policy attention to housing as the mainstay of

urban development has broadened. Today, the governments of developing countries and the executive heads of international agencies alike accept that most housing should and can be self-financed or self-built by its occupants. It is far more crucial that the scarce financial resources and technical talents available for public sector intervention be devoted to the difficult tasks of planning, financing and installing shelter-related infrastructure such as water supply and sewerage. Thus, efforts are beginning to shift toward greater targeting on infrastructure as a key component in attaining the long-run goal of sustainable growth in the developing world.

We must realize that this will be neither a cheap nor an easy task. Over half the total capital cost required for urban residential growth is due to infrastructure. As yet, we have only the beginning of an understanding of how big these capital costs may be. The rough estimates that are available suggest that about \$US 20 billion a year will be needed for shelter-related infrastructure to serve the urban population growth forecast for developing countries in the coming decade. But this is not the end of the story. Similarly large sums are needed to install the critical infrastructure components now absent in areas already urbanized. In addition, substantial amounts -- that have only begun to be estimated even in industrial world cities like New York and London -- will be needed to repair and maintain existing, aging infrastructure.

Total shelter-related infrastructure investment needs far exceed the sums of international aid likely to be available. The international community is estimated to be able to generate about \$4 billion per year in loans and grants for shelter-related infrastructure, far below the sum needed by the world's cities. Most of this international assistance will come in the form of loans from multi-lateral agencies such as the World Bank and the associated regional development banks. USAID, too, is committed to playing a role in the worldwide effort to investing in infrastructure, despite the many other compelling demands on our own resources.

Competition for resources will be the name of the game everywhere. Allocating the limited financial resources available from national budgets in developing countries and from

international loans and grants to shelter-related infrastructure will have to be done in a fierce struggle with other, equally worthwhile investment opportunities. There are legitimate demands for funds to invest in primary, secondary and advanced education, in preventive and curative health programs and institutions, in economic enterprises such as farms and factories -- to cite only a few of the potential competitors. Resources will have to be stretched to cover all of these fronts. To meet the world's commitments to urban infrastructure, we in the international institutions and our colleagues in the developing world will have to learn together to leverage every dollar available so as to help stretch the scarce resources available.

Second, in order to mobilize the additional financial resources needed for investment in shelter-related infrastructure, there is growing agreement on the need to expand the roles played by other institutions in infrastructure provision. These include the private business sector and community-based organizations, and especially municipal government, .

Around the world -- whether in socialist, capitalist or mixed economies -- it is becoming accepted that it is important to achieve greater involvement of the private business sector in infrastructure provision. There will always be a major infrastructure role to be played by government in order to control environmental pollution, pay for the "public goods" aspects of infrastructure, and make sure that the needs of those too poor to pay are not ignored. But there are many steps in providing infrastructure which private firms can accomplish less expensively and faster than government. Expanding the infrastructure involvement of private business firms and banks makes it possible to benefit from market-based responsiveness and to help create more jobs and new businesses.

An example of private involvement is offered by Thailand. That country has just announced creation of a five-year, \$150 million program for infrastructure loans to Bangkok and 15 other Thai cities. With leveraging from private banks, the total lending facility will be able to lend as much as \$1.5 billion for waste water treatment, solid waste and potable water projects needed to protect the country's extraordinary complex of river basins. USAID is supporting the Thai program by providing loan funds.

Less widespread, but growing in a number of countries, is acceptance of the idea that there

is a valid role for community-based organizations in the development process. These local organizations can help assure that governmental programs of shelter-related infrastructure are more responsive to the needs and wishes of residents of poor neighborhoods. The participation of local communities in infrastructure efforts can also help win support for the use of inexpensive appropriate technology which can deliver a basic level of service at a cost that even the poorest can afford.

Last year, the governments of the Central American countries began working together on LOGROS (Local Governments Regional Outreach Strategy). LOGROS will give particular emphasis to promoting citizen participation in the development process in all countries in the region as an integral part of its programs. Among the effort's particular targets are opening up financial markets to municipalities. LOGROS will utilize the help of the Central American Bank and private commercial banks to make investment funds available. USAID loan funds will also be invested.

A major problem in many developing countries has been the lack of effective and capable municipal governments. The reasons are complex and varied, but the result is all too uniform: few municipal governments have significant resource mobilization and financial management capacities. This will have to change if the primary responsibility for shelter-related infrastructure is to become that of local, not national, government, consistent with the economic principles that both the costs and benefits of shelter-related infrastructure are essentially local. The severe constraints on many national budgets is another factor compelling such a shift in policy direction.

The city of Tetouan, Morocco, has designed and begun implementing an integrated infrastructure expansion program for the 30% of the city's population who lack water and sanitation service. Activities include securing clear land titles for residents of informal communities and extending infrastructure services to urban growth areas via contracts with private companies. A USAID loan and a technical assistance grant help support the Tetouan program.

To be successful in the long run, efforts in urban shelter-related infrastructure must include significant attention to capacity-building. The cities of developing countries need to use their own resources better and also need to mobilize untapped private sector and community resources. To help build capacity, training and technical assistance will be needed in such

fields as urban financial management so that cities can more effectively plan and control their recurrent and capital investment budgets.

This March, the Government of India announced a five-year assistance program known as the Financial Institutions' Reform and Expansion. FIRE is designed to make loans for commercially-viable urban environmental infrastructure projects to both municipal organizations and public-private partnerships. Under the program an Indian government organization (NIUA) will deliver capacity-building technical assistance and training to selected states and municipalities in infrastructure-related financial management practices such as cost recovery. USAID is supporting the FIRE initiative.

Third, there appears to be growing agreement that the range of financing tools available for infrastructure finance in developing countries will have to be broadened. More widespread use will have to be made of effective and innovative financing techniques to install and maintain shelter-related infrastructure.

Finance is at the heart of the matter because providing shelter-related infrastructure is costly. But it seems highly unlikely that the current heavy reliance in developing countries on international loans and central government subsidies to finance infrastructure in urban areas can continue unaltered in this era of structural adjustment. Severe fiscal pressures on national budgets and the very large scale of investment needs that can be foreseen call for a shift from dependence on central government appropriations and scarce international aid to primarily local-based finance for most shelter-related infrastructure.

There is a growing agreement among international authorities that this can best be done by enhancing local capacity to mobilize resources. This means more cost recovery from the direct recipients of water and sewer services, who must be called on to pay to the full degree of their benefits and financial ability. It also means more delegation by central governments of authority to municipal governments so that they can pay for the unrecoverable "public goods" costs of shelter-related infrastructure and can deliver at least a basic level of service to the poor. Also, it will be important to increase the use of appropriate technology to reduce the cost of providing infrastructure services to those unable to pay market rates for more conventional systems.

The municipality of Quito, Ecuador, utilized appropriate technology and changes in the structure of its water charges and incentives to extend water and sanitation service to its low income neighborhoods. These changes made it possible for the Municipal Water Authority to extend service coverage to four out of five city residents, including the poorest. At the same time, the MWA raised its revenue collection rate from only 57% of operating costs to full self-sufficiency. This was another case where assistance from USAID enabled the city to move its program ahead more rapidly.

In order for infrastructure investment programs to be sustainable over the long run, they must rely primarily on local action, rather than depending on loans, grants and subsidies from central government and international organizations. A major means to achieve this goal would be for national governments to extend to their municipalities the basic "home rule" powers they need. These include adequate taxing authority based on productive revenue bases such as real property and motor vehicles, permission to "piggy-back" local surcharges on national income and sales taxes, and a predictable degree of revenue-sharing from national budgets. If the sound principle of cost recovery to the greatest feasible extent is to be achieved, it will also be necessary to create more local public and private enterprises that operate on business principles to deliver integrated water and sewer services, charging their customers at economically sustainable rates. Establishment of special districts for infrastructure services is an idea that has fully proved its effectiveness in the United States. It would appear to have applicability to urban areas elsewhere as well.

In Jamaica, a USAID-financed technical assistance project is assisting the Kingston Restoration Company, a private sector organization of the business community in Downtown Kingston, to examine the potential for setting up a Business Improvement District, a public-private partnership. Using government's legal power, the BID would levy a charge on all commercial property in the downtown area to finance additional security and solid waste collection services. Also being explored is for the BID to subcontract with the National Water Commission to deliver water and improve sewer service in the waterfront business center.

Even with additional local fiscal capacity, there will be a need for new credit mechanisms to cope with the "lumpy" character of capital investment. Installation of shelter-related infrastructure typically calls for major capital spending at the outset to construct substantial systems that can then serve for generations. Long-term financing, designed to be repaid over a period of years, is therefore essential to an effective infrastructure program.

Regrettably, it is not presently feasible for most developing countries and their municipalities to gain access to the same sorts of municipally-issued long-term bonds that are used for infrastructure finance in industrial world countries. It will take time and careful effort to foster private sector-operated municipal security markets in many parts of the world. Meanwhile, however, governmentally-backed lending programs can move to adopt practices consistent with proven principles of private sector lending. These include making loans at market interest rates, requiring appropriate collateral backing, and enforcing debt repayment.

In Indonesia, the Regional Development Account has been operating since 1991 with initial assistance from USAID. RDA is designed to be a sustainable local government credit system. It lends to municipal governments for shelter-related infrastructure and other capital projects at positive real interest rates that reflect the cost of the funds, administrative expenses and inflation.

There is growing backing for the approaches to infrastructure finance cited in this paper because they are increasingly seen to be right. They are essential to achieving sustainable development and avoiding environmental catastrophe. As USAID Administrator J. Brian Atwood said recently, "The cost of *not* addressing...these problems will be far greater than the cost of effective action."

To sum up: there is a growing world consensus about the vital importance of shelter-related urban infrastructure and about the ways to finance it. These include actions to strengthen the resource mobilization capacity of municipal governments and to place more reliance on the private business sector. The cities and countries of the developing world can utilize these and related actions to make leveraged use of their scarce financial resources and that foster the sustainable capacities of urban areas everywhere.

USAID welcomes the opportunity to share in the combined international effort to achieve sustainable development through investments in shelter-related infrastructure. None of us have all the answers or all the resources that will be needed, but together we can make an enormous difference.