Investment opportunities in infrastructure regardless of financial crisis

Oportunităţi de investiţii în infrastructură în pofida crizei financiare

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Abstract

During these times of dramatic change and financial market disorder, the challenge of infrastructure development is being drawn more into the highlight. Infrastructure will be rising in importance over the next years. The availability and quality of infrastructure directly affect where business operations are located and expanded. In this context, roads and power generation are the most urgent infrastructure needs. The paper reveals a few economic characteristics of current stage of infrastructure, the future role of infrastructure in business competitiveness, availability of infrastructure as a critical issue for businesses, infrastructure investment problems go further than the financial crisis in progress, sectorial approach, partnership between state and private sector in infrastructure projects, infrastructure investment needs in Central and Eastern Europe region, and a few aspects about infrastructure investments in Romania.

Keywords: *infrastructure development, investment, economic global slowdown*

Rezumat

În această perioadă de tulburări dramatice de pe piaţa financiară, dezvoltarea infrastructurii se evidenţiază ca reprezentând o provocare. Astfel, importanţa acordată infrastructurii va fi în creştere în următorii ani, disponibilitatea şi calitatea acesteia afectând direct localizarea şi extinderea afacerilor operaţionale în străinătate. În acest context, drumurile şi producerea de energie necesită cele mai urgente nevoi de infrastructură. Lucrarea tratează câteva aspecte considerate relevante privind caracteristicile economice de actualului stadiu al infrastructurii, viitorul rol al infrastructurii în competitivitatea afacerilor, disponibilitatea infrastructurii ca o problemă critică pentru companii, problemele investiţiilor în infrastructură dincolo de criza financiară în curs de desfăşurare, abordarea sectorială, parteneriatul public-privat în proiecte de infrastructură, necesitatea investiţiilor în infrastructură în regiunea Europa Centrală şi de Est şi în mod particular în România.

Cuvinte-cheie: *dezvoltarea infrastructurii, investiţii, încetinirea economică globală*

JEL Classification: G01, H54, G11

Introduction

The infrastructure sector provides significant investment opportunities for long-term investors, even in the context of the global financial crisis. The infrastructure as a key requirement for economic growth needs to be developed to an adequate and efficient standard. The economic crisis stimulates the call for infrastructure revitalization from many industries.

Governments from the United States to Romania consider proposals aimed at economic recovery. The United States administration proposes an 850 Billion dollar investment in infrastructure projects. The American Association of State Highway and Transportation Officials plan approximately 5,000 projects coming to a total of 64 billion dollar. Most improvements are focused on rehabilitation of infrastructure and are prepared to put people to work.

A few economic characteristics of current stage of infrastructure

The physical structures that provide or permit transportation, energy generation and transmission, water distribution and sewage collection, and the provision of social services such as health and education - all support the quality of life as well as the ability of economies to function effectively. They provide goods and services that are critical for the efficiency, competitiveness and expansion of production activity. Moreover, access to affordable electricity and drinking water is an important determinant of the living standards of a country's population. The fundamental role of infrastructure has been brought into sharp relief in recent years, as an increasingly growing number of countries cross the entire developing world have been drawn into a cycle of growth and a greater participation in the global economy, but by doing so are finding further growth constrained by the quantity and quality of their infrastructure.

Many low-income countries face huge infrastructure investment needs but lack the necessary capacity domestically to meet them. Mobilizing financial and other resources to respond to these needs, especially in the developing countries, are among the main challenges which covered governments and the international community. The terrible gap between these needs and the availability of necessary resources has been one of the drivers following the fundamental change in the role of the State in the provision of infrastructure around the world.

Governments from developed to developing countries have opened up infrastructure industries to much larger participation by the private sector. This recent relationship between the State and the private sector has in some cases been helped out and shaped by technological changes. These changes have opened up opportunities for the introduction of competition in industries that are in the process of shedding their natural monopoly characteristics. This has been the case, especially in telecommunications and in parts of the electricity industry, such as power generation. As a result of greater openness in many countries, transnational corporations have come to adopt an important responsibility in the provision of some infrastructure services.

The internationalization of infrastructure has taken varying paths in different parts of the world. Developed countries observed the appearance of a number of large infrastructure transnational corporations in the 1990s. In general, they arose out of previous public monopolies. Their overseas expansion contributed to increased foreign direct investments and other forms of transnational corporations participation, such as concessions and management contracts, among developed countries as well as in some developing and transition economies. In the latter, new investment opportunities emerged from major privatization programs of State-owned infrastructure assets. In addition, the liberalization of infrastructure industries in developing countries has contributed to the emergence in the South of a number of transnational corporations in these industries.

The future role of infrastructure in business competitiveness

Many businesses in developed countries may not be feeling the impact of aging infrastructure in their books yet. But with the average infrastructure project taking several years from project start to completion, governments should act now to develop strategic approaches to the issue before it becomes a crisis situation.

While it is important for developing, but faster growing, countries to make a commitment to infrastructure investment, it is equally important for more mature markets to replace their aging infrastructure or risk losing their competitiveness.

Analysts estimate that two trillion dollars will be spent on infrastructure globally on an annual basis until 2015. However, business representatives in every region expressed concern that infrastructure investment would not be adequate. The business leaders in Eastern Europe and Asia Pacific were most focused on the issue, respectively, expressing concern. Besides, it is obvious a high level of concern as well in mature markets.

Availability of infrastructure as a critical issue for businesses

Availability of infrastructure has an important impact on operating costs and is therefore a major factor in strategic planning and decision making. In business environment there is agreed that the availability and quality of infrastructure affects where businesses are located and expanded, a judgment that was extraordinarily constant across all geographies.

An example is offered by AT&T that in 2008 moved its headquarters from San Antonio to Dallas in part because of the latter's better air transportation links, according to the company. As well, in 2006, improved infrastructure made it possible for the Coca-Cola Company to move its Africa group headquarters from Britain to South Africa.

But people can become satisfied about the quality of their infrastructure, especially residents in developed countries. Spending on high-cost infrastructure projects is often delayed and as a result can lead to underinvestment. Sometimes it takes a spectacular failure to remind people of infrastructural inadequacies, such as the loss of power to 50 million people in North America in August 2003 after the impact of a few trees falling on power lines in Ohio spiraled out of control.

People are concerned about the future impacts of poor infrastructure on their businesses, too. Many representatives of business environment are to some extent concerned that current infrastructure investment in the country where they work will not be suitable to support the long-term growth of their organization. And it is an issue for developed and developing countries alike. An Economist Intelligence Unit research reveals that 95 percent executives from India, 93 from Poland 86 from Russia, and 86 from South Africa affirm that current infrastructure investment is insufficient to support the long-term growth of their organizations. Even in developed regions, such as Western Europe, the figure is 64 percent, and in North America it reaches 73 percent. And these concerns are likely to grow. The research also discloses that 80 percent believe that infrastructure will be even more important to their companies five years from now. Global business rarely speaks with one voice, so such figures indicate a notable level of consensus no matter of geography or level of economic development (KPMG International & Economist Intelligence Unit, 2009).

Infrastructure investment problems go further than the financial crisis in progress

The economic decline that began in 2008 affects the funding of infrastructure improvements. In an Economist Intelligence Unit research, the business representatives are optimistic and expect the economy where they operate to improve over the next five years.

But, the problems for infrastructure spending, however, go beyond the current financial crisis. Finding the money for infrastructure will be a problem. The economic conditions will slow down the necessary investment. Even the optimists fear there won't be enough money to invest in infrastructure.

Thinking specifically about the country within which are located, the most influent factors that could affect the infrastructure investment that would support the long-term growth of businesses are: economic condition, governmental effectiveness, availability of financing, availability of relevant skills and political environment.

The above mentioned results of study highlight widespread concern among global business leaders that governments need long-term strategies for infrastructure, adequately funded and backed by political will. With limited government funding and a limited skills pool to address overall infrastructure needs, and with the importance of this issue expected to grow, there is a true award, in terms of competitive advantage, to those governments that can work with business to face up to this challenge effectively.

Sectorial approach

Infrastructure consists of assets comprising the backbone of countries offering stable returns generally highly correlated with long-term economic growth.

The current condition of transportation is providing the biggest infrastructure challenge to business. It is largely accepted in business environment that existing transportation infrastructure increases operating costs for companies, influences companies' competitiveness, ability to grow, and attractiveness to qualified employees.

The most important transportation challenges come from roads, and railroads. In general, better roads constitute the area of infrastructure in the most urgent need of investment. Actually, roads are one of the top two concerns in every region of the world. The British Chamber of Commerce, for example, found that 80 percent of U.K. companies considered road congestion a national problem, in 2008. The American Society of Civil Engineers, meanwhile, estimated in 2005 that bad roads cost American economy overall an additional 63 billion dollar because of time spent in traffic jams. Despite over a quarter of the country's bridges are considered structurally deficient or functionally obsolete, American roads are generally safe compared to other regions. India, for example, has 10 percent of the world's road deaths with just one percent of its automobiles. In sub-Saharan Africa, where only 14 percent of roads are paved, the death toll from traffic injuries is the world's highest, 28 in 100,000.

Railroads arouse widespread concern: in all geographies except Western Europe, the need for investment is urgent. In Western Europe, which has traditionally sought to keep high-speed rail competitive with air travel, it is the most pressing infrastructure issue. In developed regions, airports also pose a significant problem especially in North America and Western Europe where the infrastructure is one of the priorities.

Another significant sector is energy. Poor energy infrastructure is driving up costs. The situation of existing energy and power supply infrastructure is adding greatly to the operating cost of organizations, and consequently a negative financial effect. This makes energy a bigger cost issue than even transportation. As a result, businesses see power generation as the second most important of all infrastructure areas requiring investment. This is particularly true for 86 percent South African companies and 62 percent Indian companies.

As a conclusion, globally, roads and power generation are the most urgent infrastructure needs.

Partnership between state and private sector in infrastructure projects

Infrastructure is at a critical crossroads, and governments have an incredible opportunity to make decisions that will impact many future generations. The business leaders believe governments should partner with the private sector to finance and administer major infrastructure projects.

Today, the private sector is a significant participant in many infrastructure industries globally, and its role is likely to increase further because of the huge investment, technology, skills and management needs in developed and developing countries alike.

There is expressed concern that poor economic conditions along with the challenges facing governments will prevent the needed investment in infrastructure. The business representatives are looking for government to partner with the private sector to develop effective financing solutions.

The moves towards liberalization in infrastructure industries, starting with the late 1970s and 1980s in developed countries, and progressing in the 1990s in Africa, Asia, Latin America and the Caribbean, and South-East Europe and CIS reformed their infrastructure industries. Many of these countries opted for market liberalization through divestitures of State assets and other forms of private participation, including the involvement of transnational corporations. Other developing countries took different approaches, for instance by choosing a strategy based on the process by which formerly public assets or functions are sold or given to corporate entities as the central or major plan of their infrastructure reforms. However, such an approach is generally feasible only in countries that have: relatively good State-owned infrastructure facilities that can be restructured and are able to absorb new technologies and skills; the funds necessary for restructuring; and effective planning processes capable to implement a long-term vision.

Many states have identified public private partnerships as the most effective way of improving infrastructure and stimulating economic growth. The administrations have made commitment to improve the transport network, water supply, waste management and commercial infrastructure. These require substantial financial input which the state governments are unable to fully pay for out of its own pockets. It has therefore decided to adopt a public private partnership model to address these problems.

The thinking behind public private partnerships initiative is to involve private companies to assist the governments in fulfilling their mandate to the people. Public private partnerships projects can be structured in a variety of ways, but in most cases the financial burden is transferred from the state to the private sector. Projects are however structured in a manner which allows the private sector to realise a reasonable return on investment.

Another advantage of involving the private sector in infrastructure development is that governments don't always have the necessary technical skills and experience to execute these projects successfully. Public private partnerships have been implemented successfully in countries such as Canada, the United Kingdom, Australia and the United States for projects ranging from road construction, bus rapid transport systems and monorails to health care facilities and schools.

Infrastructure investment needs in Central and Eastern Europe Region

As a result of historic underinvestment in public and social infrastructure, countries within the Central and Eastern Europe region are facing an "infrastructure gap" and need to make significant capital investments to reach the infrastructure development levels witnessed across Western Europe.

Despite the difficulties in making accurate projections, current estimates of essential infrastructure investment needs in Central and Eastern Europe (so-called "catch-up" expenditure) exceed 500 billion Euro in total.

More than a third of these relate to the maintenance and renewal of the existing water supply infrastructure. An additional 22% of total projects are in the energy sector driven by the need to construct conventional power plants to address the rising energy demand. A further 14% of the investments are targeted at environmental projects, such as constructing power plants based on renewable energy sources, with an estimated 80 billion Euro of investments relating to road and railway projects for the development of new transport infrastructure, as well as modernisation of already existing infrastructure.

This investment need is driving the activity in the civil engineering sector throughout the region, which in many Central and Eastern Europe countries is expected to achieve higher output in the short to medium term relative to housing and non-residential construction.

This also presents significant opportunities for international construction companies and developers, in the form of key construction opportunities, asset purchase and development or asset development in partnership with national and local governments.

The focus of the remainder of this paper is on the asset development opportunities in large scale infrastructure projects, and in particular those projects which will use Public Private Partnership structures.

Infrastructure investment in Romania

Romania is currently the second largest beneficiary of foreign direct investment in South-Eastern Europe. The country has grown to become one of the most attractive business destinations in the region after it introduced reforms and changed its taxation regime.

The Romanian infrastructure (roads, ports, airports and railways) is in overall need of modernisation and development works due to underinvestment for the last three decades.

During Romania's process of transition towards market economy, the transport sector was restructured in response to: the decline in the heavy industry, the re-orientation towards international trade, the elimination of regulatory restrictions to road freight traffic, the privatisation of road hauliers and the progressive alignment to market conditions, the restructuring of state-owned transport undertakings and the rapid increase in personal car ownership. This restructuring resulted in an overall decline of rail transport, and an increase in the roads sector.

Massive infrastructure investment is the best anti-crisis measure. In this context, Romanian Government has allocated 20 percent of its 2009 Budget, or 10.2 billion Euro, for such investments.

Massive public investments in infrastructure provide the best anti-crisis solution, as they preserve and create jobs and also allow the Government to sustain the Romanian economy faced by a shortage of domestic and external business orders. Given that lending to the private sector is difficult, the Government has to set lending back in motion by a massive cash injection in the economy.

To accelerate the all-encompassing growth of the State, it is imperative to especially promote infrastructure development. Development of infrastructure facilities has direct impact on industrialization and investment. A state like Romania essentially requires enormous investments in order to match international standards of infrastructure facilities or to be at par with advance states from the EU. It is not possible for the government to make investments of such volumes from its own resources. Therefore, it will be necessary to invite and encourage private participation on a large scale for expediting the development of top grade infrastructure facilities. Similarly, government expenditure on sick or non-profitable activities will have to be compulsorily reduced.

According to business representatives in Romanian market, the most attractive sectors in 2009 are infrastructure and all projects which receive Government and EU financing.

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