James Stewart's speech at "PPP DAYS 2012"

It is a great pleasure to be here this morning to give this keynote address. In speaking to you I feel like I am wearing two hats - my old hat from Infrastructure UK and Partnerships UK, where I spent 10 years working on the public sector side of the fence, and my new role at KPMG, where I seem to spend most of my time on an airplane but more seriously have had the privilege to visit nearly 30 countries over the last 9 months or so to discuss their infrastructure programmes.

This morning I want to set some global context for today's infrastructure market, look at some of the challenges, and then perhaps suggest how things might move forward in the future.

So, first the global context: the infrastructure and PPP markets are the most exciting markets in the world to me. Whichever part of the world you look at, infrastructure investment is on the increase, and the primary driver for that increase in investment is the desire to achieve economic growth. There is now a commonly held view that infrastructure investment is a major lever to achieving economic growth. Just to give you one example, if you look at Italy, recently Mr. Monti, announced perhaps the severest austerity budget in the country's history, but at the same time also announced a four billion Euro investment in infrastructure.

What about the other factors driving the step change in infrastructure investment? In the developed economies, it is about aged infrastructure, obsolescence of existing infrastructure. For example in the US nearly 80 percent of bridges are past their design life; in the UK, if we don't invest in power generation assets the lights will go out in the next five to ten years. Alongside obsolescence of existing assets is the climate change agenda, which in particular is driving investment in the energy sector, for example Renewables.

In the developing economies, there are some different drivers. Perhaps the biggest is population growth. Last year in October the seventh billionth person in the world was born and the six billionth was only eleven years old, by 2030 there will be nine billion people on this planet and they will all require water, power and all the other services that infrastructure provides. Alongside population growth we have an increasing number of people moving into our cities, so we have to cope with challenge of urbanization. 135 thousand people

a day are moving from the countryside to cities in Asia, that is over a million people a week. And then we have to deal with poverty - 40 percent of those people in cities in Asia live in slums. Infrastructure investment is all about providing essential services to those who currently don't have it.

And the last driver I would pick out is a new one: natural disasters. Whether it is Japan, Queensland, or Christchurch, the fact is we seemed to be having far more natural disasters. This puts enormous pressure on a country's infrastructure and produces a major spike in investment. I think in the future we need to think more about the resilience of our infrastructure.

What does this all mean? Well it means something like 40 trillion US dollars of investment over the next 25 years, which is too big a number for any of us to understand. Nearly half of that will be in water; nearly 25 percent - 10 trillion US dollars - will be in water in Asia. The next biggest sector will be energy.

As I've said this represents an explosion in demand for infrastructure investment, sometimes a doubling of an investment programme within a particular country. Delivering this major step-up in investment brings with it many many challenges, but I think three stand out right now:

Firstly, funding, the ability to pay for infrastructure. **Secondly**, finance, how do you raise private sector capital in the current volatile and capacity constraint markets? And **thirdly**, public sector delivery capability - the major theme of this conference. That covers a multitude of issues: for example the quality of the people, institutional structures, pipeline management and procurement frameworks.

So where do these three challenges leave us right now? Well, to me not in a great place. Actual delivery is going to fall way short of governments' ambition, desires, and perhaps most importantly, needs. Unless things change, on the delivery front, many governments are going to fail to deliver the infrastructure programmes they need to put in place.

Many of the sessions over the next two days are going to address these three challenges in more detail, but just a few comments from me:

I. Funding

First of all, funding, the ability to pay for our infrastructure. To me we are going to see far more innovation on funding. Currently a government has three main choices. It can use central government taxation, it can use local government funding - local taxation, or it can use user-pay charges.

There is still a heavy bias around the world towards central government funding or taxation. There is a reluctance to charge for water, there is a continuing subsidy for power. Why in Vietnam is the cost of power to the consumer 25 percent of the surrounding countries?

So what can we do about funding? Two thoughts about the future: Firstly, I think, there will be more user-pay charges. There is a political schizophrenia about user-pay charges. On the one hand politicians love them, because they get the funding of infrastructure off a country's balance sheet, but on the other hand they are nervous about them because voters don't like increased utility charges. And so politicians have a difficult balance to weigh up. In the future I think we will see more real tolls on roads, I think we will see more water charges, I think we will see higher energy prices.

The second thing I would offer on funding is more local funding solutions. As cities get more and more important in a country's economy, they will need to take their destiny into their own hands and raise the money for local infrastructure, city infrastructure, within their own means. To give you two examples, in India, I think we are going to see more monetisation of land banks by local authorities and cities. And another example close to my heart is Crossrail, a fifteen billion pound metro project going east to west in London. 4 billion pounds of the Crossrail funding is being raised by a local business rate tax supplement - local taxation.

So, that's funding, now move on to finance.

II. Financing

With a second financial crisis upon us, private sector capital is becoming more constrained, and less mobile, i.e., less ability for banks to move their capital across the borders. This is particularly true on the debt side. On the equity side - there is far more liquidity and much more availability of capital. In the debt markets, governments are putting pressure on banks to apply their debt domestically into the country's own infrastructure and businesses Also regulatory pressures, such as Basle III in Europe, are putting pressure on banks and reducing their available capital, leading to liquidity pressures and so reduced debt tenors. This isn't necessarily a problem. Australia moved to short term five to seven year debt in the last financial crisis; India has always had five to seven year debt. Europe has enjoyed 25 year project finance for the last 20 years or so but in my view that is about to come to an end. In Europe we will see the same term of debt available as elsewhere in the world.

So, what is going to happen in the future? First, I think that we are going to see more government intervention in the financing markets. This lack of debt capacity will force governments and multilaterals, which ultimately are funded by governments, to take a bigger role, and particularly, for greenfield projects, i.e. the development phase of these big infrastructure projects. Examples of government interventions at the moment would be the Green Investment Bank in the UK, talk about a National Bank in US, and the Indian Debt Fund. I think the other key issue is whether governments are going to structure their interventions, so that there is an exit for government from the capital they are putting in; and also are governments going to put their capital in a way that encourages the private sector market to develop and recover? The second thing I think we are going to see on the financing side is the emergence of the pension funds, who are the natural long-term debt providers for infrastructure.

III. Public Sector Delivery Capability

My third challenge and one of the key themes of this conference is public sector delivery capability.

What does good public sector delivery capability look like? Well in my view best in class is Canada and I think it is worth examining why. Canada does have strong political sponsorship for their PPP programme, there is low political risk, there is a transparent and fair procurement process, there is a clear transparent pipeline with a manageable deal flow going into the future; all of which help attract international developers to the market.

These are all very important characteristics and sometimes we take them for granted in some markets, but to me the most important feature of the Canadian market and where they excel is in the caliber of their central infrastructure agencies, for example, Infrastructure Ontario and Partnerships BC. What are the main features of these agencies? Firstly, the government or rather the state have invested heavily in developing the capability - bringing in people from the private sector skills, being prepared to pay for those people and creating a critical mass of expertise in the agencies. Also these infrastructure agencies have been empowered to actually do the work.

When I was at Partnerships UK and Infrastructure UK, essentially we were advisors to the different parts of government who were responsible for delivering the infrastructure projects. This often put us on the back foot when we were tackling difficult issues. To me if you want to recruit good experienced people, put them in a position, where they can really add value and make a

difference and that means controlling the PPP procurements. It doesn't mean deciding what the specification is. It means controlling the procurement.

So what else the governments can do to improve the capability? I am biased, but I think there are many merits in producing a national infrastructure plan, which sets out a clear picture on the vision, priorities and the delivery mechanism for the infrastructure investment programme. Amazingly there are still relatively few national infrastructure plans around the world. I would point to Nigeria. I think it is very exciting document. I like the UK one for obvious reasons, but it is also worth looking at Australia and New Zealand.

Secondly I think we are going to see more PPPs used around the world. At their simplest, PPPs are about outsourcing the delivery of infrastructure projects to the private sector. They should never be a panacea, but PPPs give governments the ability to leverage their infrastructure programmes and accelerate investment. And quite simply, to put responsibility on people in the private sector, where there is capacity to deliver infrastructure.

The third way forward on improving delivery capability is to increase the level of investment in the resources and the processes. Why is it that governments around the world are so chronically underinvesting in delivery capability? Two weeks ago I was in a country, that should remain nameless, that has had a significant increase in investment in its pipeline to take it to a multibillion dollar programme, but still only has 5 people in its infrastructure unit, the same number as existed before the massive step-up in investment levels. This was an inadequate number before, but going forward is just a crazy way to proceed. Too often, wherever I go the enabling budget almost entirely comes from the multilaterals and governments continue to lean far too heavily on them. Governments have to commit more funding and resource, however difficult it might be, into people, into the processes, into the structure of these procurements. Otherwise, the step change in investment will never happen. And that is the most important point here, we are looking at a major increase - step change - and yet there has not been a parallel increase in the resources available.

Conclusion

I thought the best way to conclude would be to give you some headline conclusions from a global survey that KPMG recently carried out in infrastructure, which I think, does capture some of the messages that I have been trying to get over.

So, the first message, the public and the private sectors do not see the world of infrastructure very differently. Secondly, the largest impediment to infrastructure investment is the lack of stable, adequate, long-term financial resources. Thirdly, and perhaps most importantly, government effectiveness is seen as a significant barrier to delivery. Fourthly, and something I haven't talked about very much, PPPs are part of the solution, but not the only solution. And lastly, from both a public and private sector we need better planning of infrastructure and less politicization of infrastructure.

Thank you!