Regional multi-stakeholder consultations on "Financing access to basic utilities for all"

(organized by the Financing for Development Office/DESA and Friedrich Ebert Foundation)

Regional multi-stakeholder consultations on "Financing access to basic utilities for all" (1)

Purpose:

- Meetings mandated by General Assembly resolution 60/188 of 22 December 2005, which requested the Financing for Development Office to continue the organization of (…) multi-stakeholder consultations to examine issues related to the mobilization of resources for financing development and poverty eradication.

Focus:

- The consultations explore long-term funding mechanisms and cost recovery strategies for providing water and electricity to the poor. Macroeconomic factors were also taken into account.

Modalities:

- The meetings bring together experts from governments, municipalities, utility providers, regulators, civil society, private sector and academia in an informal and interactive setting with the goal to develop concrete and actionable proposals and initiatives.

Output:

- Detailed meeting reports, working papers and presentations of participants, final UN publication, Secretary-General's report on implementation of the Monterrey Consensus. Output will feed into Follow-up International Conference on Financing for Development to Review the Implementation of the Monterrey Consensus in Doha, Qatar in the second half of 2008.

Regional multi-stakeholder consultations on "Financing access to basic utilities for all" (2)

Meetings held:

(1) Agenda-setting expert group meeting in New York on 26-27 June 2007.

(2) First regional multi- stakeholder consultation on 11-13 December 2006 in Brasilia, Brazil (in cooperation with Ministries of Cities from Brazil and UNDP International Poverty Center).

(3) Second regional multi-stakeholder consultation on 23-25 April 2007 in Lusaka, Zambia.

(4) Final regional consultation in Asia towards the ends of this year.

Working agenda: Sources of revenue and financing mechanisms for utility providers in developing countries

Expenditures:

- Recurrent expenditures
- Capital expenditures

Revenue generating mechanisms:

- Own revenues (user fees) and municipal taxes (mostly property taxes)
- Transfers from central government (tax revenue at national level)

Financing (borrowing) mechanisms**:**

- Borrowing schemes (municipal bonds, pooled financing arrangements, commercial or non-commercial bank lending, microfinance, local credit schemes, etc.)
- Multilateral and bilateral development assistance (ODA, loans, etc.)

Macroeconomic implications

- How can potential risks be mitigated (currency, interest rate, exchange rate)?
- What are the adequate fiscal and monetary policies?

- This presentation will only focus on financing mechanisms and macroeconomic implications.

Challenges of financing (borrowing) schemes –fiscal restrictions (1)

- The fact that borrowing on national and international capital markets is limited by fiscal responsibility laws was identified as the biggest financing constraint.
- For instance, in Brazil the main constraint municipal borrowing has been the Fiscal Responsibility Law (Supplementary Law 101, of May 2000)
  - Public debt as a percentage of current receipts cannot exceed a limit established by the Brazilian congress for states and municipalities (2 x total net current income for states and 1.2 x total net current income for municipalities) nor the total personnel expenses (60% of the total net current income).
  - If a municipality does not respect those limits it is not allowed to contract internal or external credit operations, including revenue anticipations, except for the refinancing of the updated principal of securities debt
- Similar fiscal responsibility laws exist in other Latin American countries, including Peru and Colombia, where these laws are effective at all level of government.

Challenges of financing (borrowing) schemes– fiscal restrictions (2)

- In Brazil, almost all of 5560 Brazilian municipalities have approached or exceeded the limits established by the Fiscal Responsibility Law. As a result, most municipalities have not been allowed to contract internal or external credit operations, including revenue anticipations, except for the refinancing of the updated principal of securities debt
- As a result, the market for subnational bonded debt in most of Latin America is shallow. However, there are success stories.
  - The first city in Latin America to successfully issue a bond in the international capital markets was the municipality of Rio de Janeiro in 1996 to re-finance its existing debt, (10.3/8% for US$125 million over 3-years). The bond was unsecured despite the fact that this was the municipality's first public international debt issue.
  - The Argentinean province of Mendoza had also successfully issued an international bond in August 1996 with a USD 125 million six-year offering to refinance its debt. The bonds were secured by oil royalties paid by oil companies.

Challenges of financing (borrowing) schemes– fiscal restrictions (3)

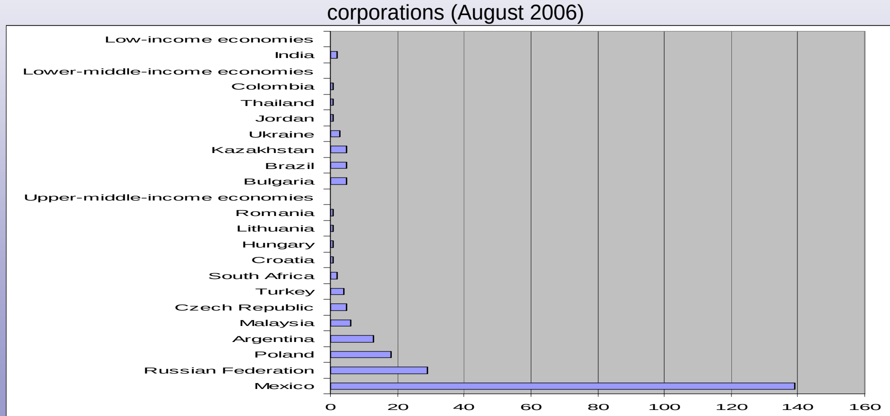
- Participants also stressed t the crucial role of national development banks in providing long-term financing. Despite a recent decline following financial sector liberalization these have been indispensable where no commercial borrowing is available to meet the financing gap.
- Discussants at the meeting in Brasilia were optimistic that the new parliamentary legislation passed at the time of the consultation (11-13 December 2006) will lift expenditure ceilings for municipalities in sensitive areas and acknowledge the difference between current and investment expenditures of municipalities and states.
- This will make more resources available for infrastructure and social spending and could serve as a model for other countries in the region with similar restrictions, hopefully without jeopardizing overall fiscal stability.

Challenges of financing (borrowing) schemes– creditworthiness and ratings (1)

- Participants stressed that national creditworthiness imposes a ceiling on sub-national ratings, .i.e. prospects of cities and states to raise finance on capital markets could practically never exceed those of the federal government.
- Subnational creditworthiness is critical for municipalities in developing countries to obtain a national or international credit rating. Appropriate regulatory environment can help strengthen creditworthiness
- However, fees to obtain a rating from a major credit rating agency (e.g., Moody’s, S&P, Fitch) are often prohibitively high, while an insufficient number of local rating agencies exist in developing countries. Participants suggested putting further efforts into connecting local with international credit rating agencies.
- Pooled financing arrangements of municipalities within and possibly even across countries could reduce risk and make it easier for issuers to be considered creditworthy (i.e. Findeter in Colombia).

Challenges of financing (borrowing) schemes– creditworthiness and ratings (2)

Number of subnational issuers in low and middle-income countries rated by the three major credit rating agencies, including states, cities, and state-or municipally-owned corporations (August 2006)



Lessons learned from Johannesburg bond issuance

- In 2002 the city experienced a capital expenditure backlog of R8 Billion. After a bailout by national treasury the city consolidated finances and issued bonds that were well-received by the market, succesfully raising long-term finance.
- Following steps were important in establishing the bonds:
  - Establishing the City Treasury.
  - Obtaining a rating (even though, it came out low it served as a benchmark for improvements)
  - Study tour to Mexico to learn about international experiences with municipal bonds).
  - Eliciting political support for the move and developing a 10 year financial plan.
- Crucial steps during the implementation phase:
  - Appointing of advisors on the type and structure of the bonds.
  - Selection of underwriters and guarantors
  - Road shows to show investors new utility networks and distribution systems
  - Book building (taking orders of investors) before the bond is put on market.

Macroeconomic factors of financing utilities- risks at national and subnational level

- Currency risk
  - Many countries import the equipment required for network extension from outside the country. Whoever invests in these parts, whether public or private investor, is exposed to foreign exchange
  - Water project assets, once installed, may not be redeployed. As a result, it is more difficult for investors to exit the investment in order to minimize foreign exchange losses.
  - Water outputs are usually non-tradables. Currency movements are not compensated for by increases and decreases in revenue.

- Currency risk may not directly affect sub-national finance. For instance, in Peru sub-national governments' external borrowing needs approval and guarantees from the national government which bears the foreign exchange rate risk.

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Macroeconomic factors of financing utilities- Risks at national and subnational level

- Interest rate risk
  - Currency risks can lead to real interest rate shocks and have an indirect impact on sub-national fiscal sustainability. Moreover, higher interest rates that result from a currency crisis may decrease the incentive of the government to honour price regulations to curb the abuse of monopoly power in the water sector.
- Participants discussed protective mechanisms against foreign exchange risk of investors
  - (i) the use of local currency instruments
  - (ii) currency hedging
  - (iii) exchange rate guarantees (often based on-tariff indexation);
  - (v) other innovative mechanisms such as liquidity facilities, sovereign guarantee pools and escrow accounts.
- Discussions on mechanisms should be guided by who is bearing the risk for what (private investor or government).

Macroeconomic factors of financing utilities – Fiscal and monetary policies

- Monetary and fiscal policy takes place at the central government level
- Participants stressed that macroeconomic stabilization should not only be about consumer prices.
  - Other indicators such as employment and exchange-rate targeting should be included as well.
  - It was suggested that exchange-rate policies should aim for undervalued, not overvalued exchange rates. Encouraging exports and discouraging imports helps a developing country maintain a healthy trade balance in an open economy setting. A managed floating rate would help minimize exchange-rate instability.
- Participants stressed that interest rate policy has to be geared towards maintaining a positive real interest rate. It was pointed out that there is no empirical evidence for a positive correlation between interest rates and savings.
  “Where investment leads, savings and finance will follow”

Obrigado!

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