What's The Question?

- **Does it matter who provides capital?**
- **Quick economist's answer:**

Yes, No, Maybe

- **Depends on:**
  - Types of projects
  - Situations
  - Risks

Why Private Sources?

- **Perception: infrastructure needs not being met**
- **Reluctance to use public capital**
- **Private partners are available**

What is Private

- **Is private capital financing a P3?**
- **What's a P3?**

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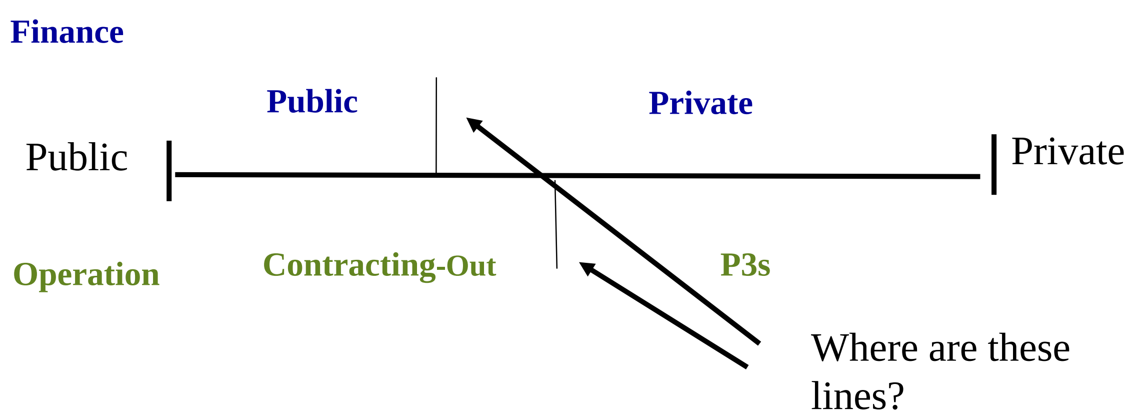
Public-Private Continuum



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Define P3 by Partnership

- **New element: sharing**
  - Risk
  - Authority for decision making
- **Long term relationship**
- **Areas of partnership**
  - Financing
  - Operation
  - Ownership

Capital vs. P3

- **P3 = sharing of authority**
- **Private capital**
  - Project specific finance
  - Repayment from project revenue stream
  - **Project as collateral**
- **Public capital**
  - Payment out of general revenues
  - Public control
  - Room for private role

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Myth #1: Public Debt is Cheaper
Part A: Project Debt

- **Pricing project debt**
  - Project risk
  - Operator risk
- **Does it matter public vs. private?**
  - Nature of collateral
    - Project design
    - Project condition
  - Operations

Myth #1: Public Debt is Cheaper
Part B: General Public Borrowing

- **Public borrowing**
  - Corporate borrowing, corporate guarantee
  - No bankruptcy - unlimited tax base
- **Getting the price right**
  - Marginal cost of debt > average cost
    - Average is loan interest rate
    - Marginal adds effect on cost of general borrowing
      - Can increase cost of new borrowing
      - Rollover of existing debt

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Myth #1: Public Debt is Cheaper Part C: Opportunity Cost

- **Alternative uses of public funds**
  - Limit to public tolerance of debt
  - Use for projects the private sector will not take
- **Economic cost of taxation (20%)**

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Myth #1: Public Debt is Cheaper Bottom Line

- **Project risk defines borrowing cost**

Myth #2: Private is Better

- **Efficiency comes from competition**
- **Competition can be internal**
- **Depends on appropriate incentives**

Why Private Finance?

- **Political limits on direct govt. borrowing**
  - Federal vs. local taxing powers
  - Political environment
- **Repayment: user fees vs. taxes**
  - User fees politically problematic for govt.
  - Private financing and fee repayment
    - Less susceptible to political game playing
    - Maybe not

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Huge Opportunities

- **World awash in capital**
  - Sources
    - > Boomer savings
    - > Commodity returns
  - Capital market integration
- **Low costs:**
  - Interest rates vs. Growth rates
    - > Real = borrowing cost – % growth in tax base
  - Yield compression

Issues that Economists Worry About

- **Private finance**
  - Exclude public benefit calculation
    - > Benefits to non-user public
    - > Thus, private sector under provides capital
  - Contract design issues
  - Risk issuea: avoid desirable large projects
- **Public finance**
  - Unwilling to close down bad projects
  - Mis-price cost of funds
  - Effects operations =>efficiency concerns

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Private Financing, Works Best

- **Smaller projects**
- **Clear cash flow**
- **Project has market value as collateral**
  – Real estate
  – Infrastructure
- **Incentive design issues are clear**

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Public Financing is Preferred

- **Greater spillovers/externalities**
- **Large projects**
- **Project has lower value as collateral**
- **Challenges in design market incentives**