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?

Public-Private Continuum

Finance

Public  |  Contracting-Out  |  Private
Public  |  P3s
Operation

Where are these lines?
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
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

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
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%)

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
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
Private Financing, Works Best

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

Public Financing is Preferred

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