

*“Mobilizing Urban
Infrastructure Finance in a
Responsible Fiscal Framework:
Lessons from Brazil, China,
India, Poland and South Africa”*

Jaipur-January 6-8, 2005

Conference Theme

- Look at two potentially competing objectives:
 - Sound fiscal management
 - Mobilizing urban infrastructure finance
- How to expand the finance envelope without compromising fiscal discipline
- Ask decisionmakers –”practitioners” to discuss how they strike the balance

Structure

- Session I : Reconciling Fiscal Discipline and Subnational Investment Needs
- Session II: Mobilizing Finance for Infrastructure Investment
- Session III: Recovering Capital Costs for Urban Services

Session I

<i>MACROECONOMIC AND FISCAL PERSPECTIVE</i>
Brazil Luis de Mello, <i>Organization for Economic Co-operation and Development(OECD)</i>
India Subhash Garg, <i>Joint Secretary, Ministry of Finance, Government of India</i>
China Qiu Wenjin, <i>Deputy Director, Department of Foreign Capital Development, Shanghai Development and Reform Commission</i>
Poland Krzysztof Ners, <i>Vice Governor, Council of Europe Development Bank</i>

Session I

SUBNATIONAL PERSPECTIVE
Brazil Sol Garson, former Secretary of Finance, City of Rio de Janeiro
South Africa Philip van Ryneveld, former Chief Financial Officer, Capetown
China DeepakBhattachali, World Bank

Session II

DESIGNING AN INVESTMENT FINANCING STRATEGY
China Gao Guo Fu, President, Shanghai, Urban Development Investment Corporation
Brazil Aser Cortines, Vice President, Caixa Econômica Federal
MOBILIZING FINANCE THROUGH MUNICIPAL DEVELOPMENT INSTITUTIONS
India L. Krishnan, Special Secretary-Finance, Government of Tamil Nadu

South Africa
Johan Kruger, Founder and Former CEO, INCA

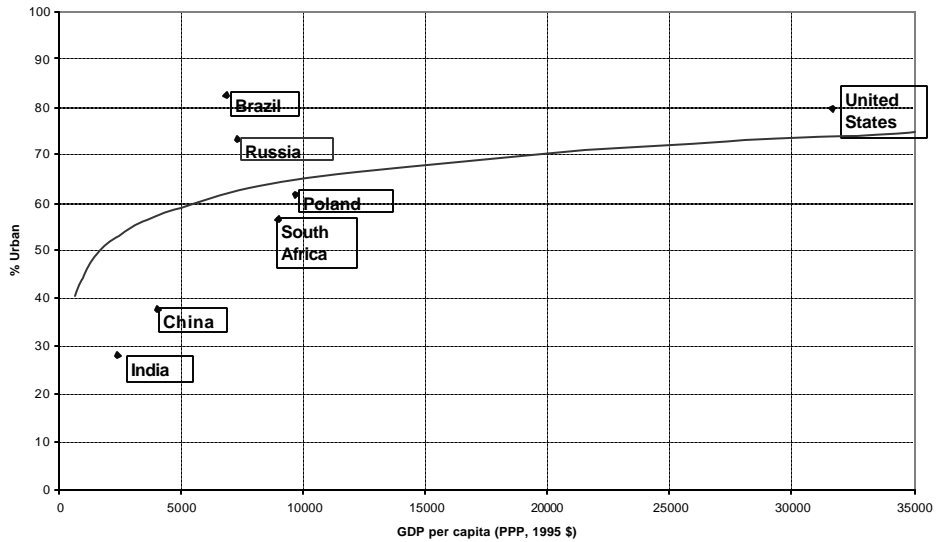
Session II

<i>MOBILIZING FINANCE THROUGH SPECIALIZED INSTITUTIONS</i>
Environmental Funds: The Experience of Poland and EU Accession States Sonia Hamman, <i>World Bank</i> George Peterson, <i>Urban Institute</i>
India –Private Infrastructure Investment and Special Financing Vehicles P.V. Ravi, Vice President, Urban Infrastructure Development Finance Company Ltd.

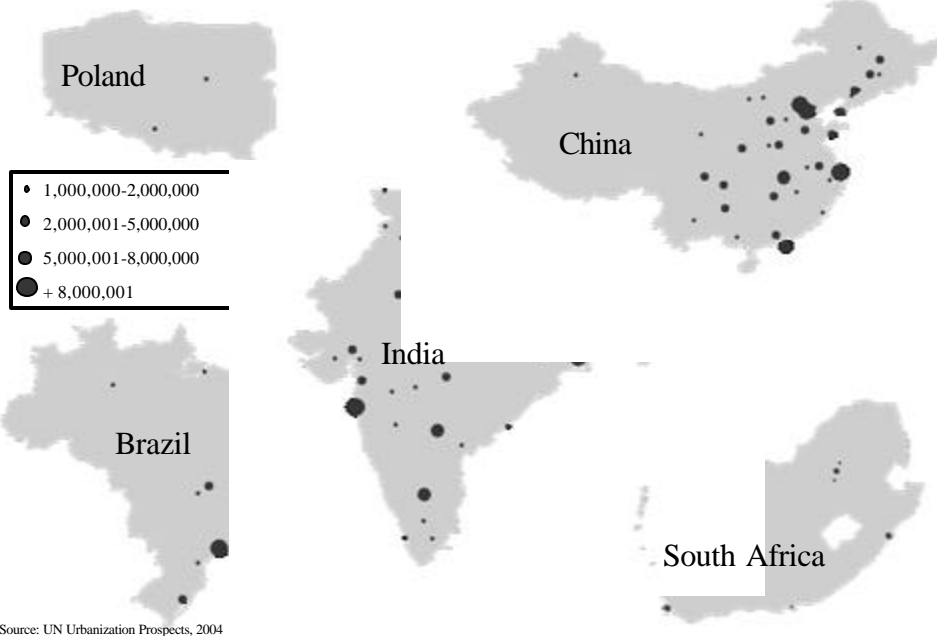
Session III

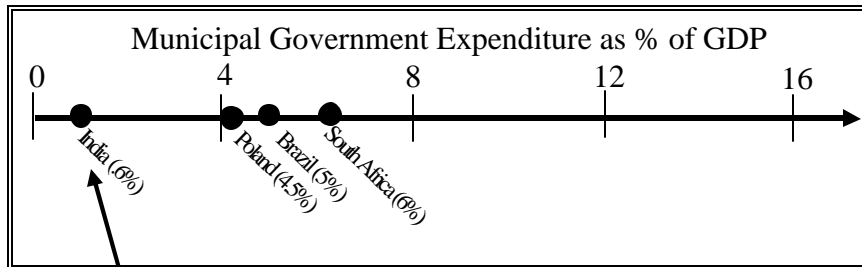
<i>COST RECOVERY AND PRICING POLICY FOR THE POOR</i>
Three Country Panel Discussion Carlos Antonio Luque, <i>Deputy Secretary of Economy and Planning, State of Sao Paulo (Brazil)</i> Gao Guo Fu, <i>President, Shanghai, Urban Development Investment Corporation</i> Qiu Wenjin, <i>Deputy Director, Department of Foreign Capital Development, Shanghai Development and Reform Commission</i> Sameer Vyas, <i>Managing Director, New Tiruppur Area Development Corporation Ltd.</i> Om Mathur, <i>IDFC Chair in Urban Economics and Finance, National Institute of Public Finance and Policy (India)</i>
INTERGOVERNMENTAL ROLE IN INFRASTRUCTURE FINANCE
Brazil Sol Garson, <i>former Secretary of Finance, City of Rio de Janeiro</i>

Urbanization vs. GDP



Urban Agglomerations





Unchanged since
74th CAA

Key Insights

- Risks of decentralization are real, but manageable
- Tapping private savings is key for expanding the financial envelope, but it takes more than macro financial sector reform
- Land is a municipal asset—often underused for financing infrastructure
- Attracting private investment infrastructure remains a hope, but performance lags well behind expectations

Decentralization: too risky?

- Poland devolved considerable responsibility and resources(esp. assets—land) to LGs in the transition
 - Risky environment
 - Uneven performance of LGs but manageable from macro perspective
 - Iterative reforms were necessary: LG borrowing rules brought in later. (debt<60% of revenue; debt service<15% of revenue)
 - 15% of investment spending now at LG level

Decentralization: too risky?

- South Africa: significant decentralization was part of transition from apartheid
 - Large municipalities incorporating rich white areas with poor black townships.
 - Performance of LGs uneven.
 - Municipal bankruptcy reform in late 90's
 - Constitutional prohibition of sovereign guarantee for local borrowing from the outset
 - Strong accounting and “sunshine” rules
 - Local Government collects 6% of total taxes.

Service expansion can accompany fiscal adjustment

- Case of South Africa

Individual Water supply connections

1994	2001
------	------

60%	85%
-----	-----

Fiscal Deficit % of GDP

1993	2004
------	------

9.5%	2.3%
------	------

Brazil: LG caught in the middle

- Constitution earmarks large amounts of revenues for health and education (42%)
- Debt service takes 13% of revenues
- Investment reduction dominated adjustment in early 90's while wage bill and pension liabilities increased.
- Over 75% of LG Debt is held by 3 LGs: Rio, Sao Paulo and Bahia.

Brazil: LGs get little reward for good performance

- 10 year moratorium on LG bonds
- Stringent exposure restrictions for lenders
- E.g. SABESP State water utility, ADRs on NYSE, full cost recovery but limited use borrowing in current market

China: Shanghai

- National Framework—decentralization key to move to market economy in 1990's
- Rapid growth of LG revenues—fiscal receipts grew at average of 21% p.a. since the early 90s
- Land leasing mobilized \$12 billion over 12 years
- GDP growth exceeded 10% p.a. for twelve years

Dramatic Physical Improvements in Shanghai

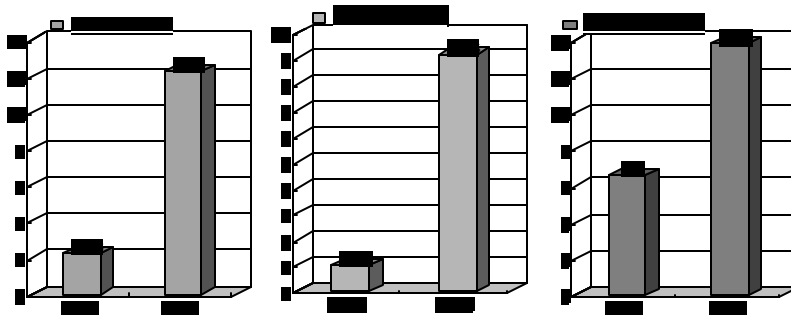


Chart: Per capita of road area, public green area and net living space (in m²)

India

- Rapid growth >6% for 20 years has not translated into infra spending in ULBs
- High fiscal deficit (10% of GDP) of which 2/3 is revenue deficit
- Low capital expenditures 3.5% of GDP
- Is there a risk-free road to healthy municipal finance?
 - “Municipalities must prove their worth before decentralization”—can they with so little money?
 - 0.6% of GDP spent in cities unmoved for the twelve years since CAA
 - Limited admin autonomy and responsibility for cities highly fragmented (DA's)

Using the Financial Sector to Impose Discipline in LGs

- South Africa—arms length relation between CG and municipalities, good financial sector, accounting, municipal bankruptcy regulation
- Poland—quick transition to tapping banking system and capital markets
- Brazil—prohibition of bond issuance for 10 years, balance sheet regulations although 3 muni's have the debt
- Chinese cities—worked around municipal borrowing prohibition with infrastructure companies—risky to financial sector, now reining this in
- India—embryonic relationship so far due to limited headroom and low revenue base

Financing Strategies

- Borrowing from financial sector promising:
 - But limited impact without steady stream of revenues in LGs and sufficient autonomy to manage finances
 - South Africa, China, Poland all tapped private funds markets but had good revenue streams
 - India –declining municipal bond issues in declining interest rate market, IDFC frustration, limitations of financial engineering with current low revenue base
 - South Africa– private specialized intermediary successful competitor to Govt muni fund using balance sheet finance model
 - Broad financial sector reform not sufficient
 - Accounting and disclosure, foreclosure rules, important in South Africa

Financing Strategies

- Private Investment in Infrastructure
 - Performance lags behind expectations (PPP law in Brazil indicates optimism)
 - Examples of JVs in all countries, but each special circumstances difficult to replicate
 - Tirappur in India took 10 years, and strong cross subsidization may be difficult to replicate in areas with less dire water shortage (rate differential 9X)
 - Shanghai subsidized water concession from general municipal revenues
 - SABESP in Sao Paulo recovers costs, traded on NYSE but industrial client base eroding

Own Revenue Sources: India- policy constrained, much scope for improvement

- Property Tax
 - Administration—receives most emphasis
 - Weak collections
 - Difficulties following city growth—role of Development Authorities
 - Value of Base—still a major constraint
 - Rent control depresses annual rental value
 - Stamp duties depress declared values for capital value or area-based schemes
 - Land Regulations, ordinances, zoning, ULCRA etc depress land prices
 - Water Charges –low cost recovery and poor operational efficiency

Limited Enforcement / Collection

Rate of tax collections across a sample of municipal corporations is low but improving, except in Mumbai

<i>City</i>	<i>1998-99</i>	<i>1999-00</i>
Ahmedabad	17.59	19.42
Mirzapur	19.00	31.00
Calcutta	50.00	55.00
Bangalore	54.90	63.78
Mumbai	57.43	55.56
Ludhiana	60.00	70.00
Hyderabad	66.56	74.78

Table Source: Ravindra (2002). Property Tax Issues and Options. Paper presented at the National Seminar on Reforming the Property Tax System in India, Bangalore, Feb. 14-15, 2002.

Performance of capital value assessment

Estimated property taxes under alternate assessment systems - BANGALORE

<i>Property Tax Assessment System</i>	<i>Estimated Average Property Taxes (Rs.)</i>	<i>Percent Change from Rental Value System</i>	<i>Percent change from Area Based System</i>
Rental Values	1818.05		
Area Based System	2937.52	61.58%	
Market Rents	3910.67	115.10%	33.13%
Market Values	3890.20	113.98%	32.43%

‘Stamp value’ based assessment is considerably lower than valuation using ‘market values’

Reductions in stamp tax rate and improved administration can close the gap between these systems

Data Source: Bangalore urban household survey 2001

Impacts of rent control –revenue issues

- Evidence from Pune (‘high’ rent control city) shows considerable property tax losses from rent control (400%)
- In cities with ‘moderate’ rent control (Bangalore), the effects are relatively modest – around 115%

Estimated increase of property tax in comparison to rent control scenario

<i>Property Tax System</i>	<i>Estimated Property Tax (Rs.)</i>	<i>Increase in comparison to rental values using initial rent</i>	Significant Revenue implications
Rental Values (Initial Rent)	1714		
Unit Value System	9355	445%	
Rental Values (Market Rent)	10186	494%	

Note: Data are only for renter occupied housing units

Closing Thoughts

- India’s macro economy has performed very well amongst countries in this group
- India’s financial sector is among the best of developing countries
- Yet:
Indian cities haven’t benefited from above strengths because they have substantially less money and autonomy. That is key constraint to further urban infrastructure finance in India

Want to know more? Website: External Address

<http://www.worldbank.org/uifconference/>