N. Kloppenburg; H.-H. Taake: Public or Private Funding of the Economic Infrastructure in Developing Countries – Does Lack of Capital Constitute a Development Policy Problem?

There are numerous reasons why richer countries give development aid to poorer states. What should be mentioned here are humanitarian as well as security policy and economic motives. The fact is that improving living conditions in the developing countries is a task that must be addressed not only by those countries themselves but also by the industrialised nations.

There can be no doubt that economic infrastructure plays an important role in fighting poverty and achieving the millennium development goals. This role is emphasised at high-ranking international events, such as the World Bank's Annual Bank Conference on Development Economics that took place in Tokyo in May 2006. In the fight against poverty, the economic infrastructure even plays a double role. On the one hand, transport routes, communication media, and electricity are location factors that are essential for private domestic and foreign investments, and on the other, a lack of infrastructural services is a clear sign of poverty.

According to estimates of the World Bank, the investments needed by the economic infrastructures of developing countries amount to 465 billion US dollars per year. In response to this, the World Bank adopted its Infrastructure Action Plan in 2003 and significantly increased its investments in the economic infrastructure of the countries mentioned, a gesture which was also meant to be a sign for the international donor community. To promote Africa's economic infrastructure, the African Union, the NEPAD, the African Development Bank, the ECOWAS, the World Bank, and the European Commission have recently proposed to found an Infrastructure Consortium for Africa, while an international trust fund stated that it would provide up to 260 million Euros in the form of interest-subsidised loans within the period from 2006 to 2007. Yet is it justifiable for international donors to provide such capital assistance to support the economic infrastructure in developing countries? Cannot the required capital be raised from private sources or national and international capital markets? Questions of this kind must not only be asked but also answered.

Indeed, the private sector has invested large sums in the economic infrastructure of many developing countries for more than ten years. Nevertheless, this commitment only accounts for somewhat less than 14 percent of the total demand, so that it would be unrealistic to expect that it might be possible to cover the upcoming investments from this source alone.

Private investors are facing a whole series of obstacles which include economic and exchange rate-related risks, political uncertainties, and the fact that the payback period of numerous investments in infrastructure is rather long. What is more, defects in basic sectoral and legal conditions, such as the complexity of contracts, do nothing at all to encourage the private sector to get involved in this field. Due to its moderate use, there is little 'consumption competition' in the transport infrastructure, so that this field will hardly look profitable to the private investor. And finally, the general economic and political framework conditions in many developing countries hardly offer any incentive for private engagement. To be sure, many developing countries profess allegiance to the rules of market economy in principle, but their policies often do not reflect the theory of this avowal.

One important carrier of investments in the infrastructure is the state itself. However – hitting a sensitive spot – its financial engagement ought to be increased. Public budgets are desolate at almost all levels; solid budget management is to be found hardly anywhere. That the budget of regional governments, regional corporations, and communities is at a minimum mainly results from a centralist tax system which allows for only insufficient financial returns to the lower

levels of government. In view of this situation, it is of particular importance to open up local financial resources.

Increasing rates and taxes would be one option to make funds available to the state. Across the board, the share of the central governments' tax revenues in the GDP amounts to no more than twelve percent in the developing countries, while in East Asia it is down to ten percent. In the Euro zone, however, the quota is 18 percent. The reason for this is not only that the majority of taxable persons in the developing countries do not pay direct taxes, but also that a large part of the economy is located in the informal sector, evading taxation.

What is more, next to increasing taxes it would be possible to expand the state's scope of action by increasing the rates for certain infrastructural services. Another option could be to redeploy public spending should the occasion arise. This would include putting a wide range of expenditure items to the test, such as the high expenditures on the military, the weighty tax burden on pay, the civil service as a whole, and electricity and fuel subsidies.

Another tool to mobilise funds would be to increase the national debt. There would be various economic reasons in favour of this route: On the one hand, investments in the infrastructure could activate growth, and on the other, investments made today would lead to a capital stock that could enable the next generation to reach a higher degree of prosperity. However, there are negative sides to this as well. Most developing countries have piled up a huge mountain of debt under the cloak of economic investment. In many of these countries, the central bank is dependent on the government, the consequence being that the latter partially or completely relieves its budget deficit through loans from that bank, thereby opening the floodgates to inflation. Financing national debts through the local capital market, however, means that the state uses funds that were reserved for the private sector – a process that is known as crowding out. To arrive at a tolerable debt service burden it would be important to fix and observe realistic limits in any case.

In principle, it is justifiable to increase public revenues and to restructure expenditures, or even to raise the national debt in order to provide funds for the infrastructure. Yet this does not solve the key problem, for the investment needs that are to be met by the state are far higher than what may be covered by the tools mentioned. Both private investors and the state can and must draw on the financial sector. A financial system that works efficiently is the nerve centre of any national economy; it mobilises resources, and it diversifies and controls risks. Financial institutions must be able to work professionally and without political pressure. Therefore, it is all the more unfortunate that, in some developing countries, you should find conditions that threaten development, such as interest rate caps, and loans being channelled to selected companies. Another negative point is that in many countries, investors do not trust the financial system, a fact that, on the one hand, results in a lower savings-to-income ratio, and on the other, in people placing priority on short-term investments.

In view of all that, it is not surprising that government bonds, for example, are issued only in exceptional cases, if at all, and that regional corporations and particularly municipalities are not admitted to the bond market. Thus, especially in the communal infrastructure, financing through bonds is almost impossible.

Acquiring capital to finance the infrastructure still poses a problem in development policy, especially as neither the private sector nor the state is able to meet the demand. Thus, development cooperation is of great importance. Financial cooperation especially offers diverse tools to serve its purpose: grants for particularly poor countries, projects supported by

concessionary loans, support loans, and loans from the DEG (Deutsche Investitions- und Entwicklungsgesellschaft, German investment and development society), to name but a few. In the latter case, the conditions for the capital provided would have to be adapted flexibly to the capability of the country or area concerned.

Capital aid requires a broad structural dialogue. The World Bank postulates a link between capital aid and structural efficiency. However, there are also other forms of cooperation between donor and partner countries, such as the Sector Wide Approaches (SWAp) initiative.

In international and German development cooperation, there is a link between financial aid and improving internal structures in the recipient countries. However, this link may only be successful if the partner countries are indeed willing to carry out reforms. In the long run, the objective must certainly be to abolish the developing countries' dependence on development cooperation. As long as this goal is not reached, development cooperation may be valuable when it comes to reducing, or even eliminating, the lack of capital.