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Shoring up infrastructure funding

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China should take moves to optimize and shore up funding for the development of its infrastructure facilities in a move to meet the increasing demand for massive infrastructure financing, according to a number of senior government officials and scholars.

Speaking at a recent seminar sponsored by the Ministry of Finance and the Asian Development Bank (ADB), they called for a transfer of responsibility for public infrastructure financing, management and operation to local governments and the non-government sector, including the private sector.

The government should also minimize its allocation of financial, institutional and human resources to public infrastructure. These government contributions should be limited to the greatest extent possible to those infrastructure sectors and projects where State investment is vital to national interests, said Edward Leman, president of Canada-based Chreod Ltd and the chief economist invited by the ADB to study ways to strengthen infrastructure investment policy in China.

Seminar participants agreed that a high-quality statutory, regulatory and policy framework should be developed and put in place by 2005 to promote efficiency, competition and innovation, which will result in the attraction of new investment, technology and management capacities.

Financial management, reporting and service delivery to customers in China still falls short of international standards. Significant improvements are needed to facilitate commercial operations, improve the quality of services and attract new investment and management.

Of particular importance is for the burden of financing and operating public infrastructure of private and merit goods to be transferred from taxpayers to users, agreed these officials and scholars.

A comprehensive standard for accounting, auditing and reporting practices for infrastructure development should be developed as well.

Regulations including the rules on the Build-Operate-Transfer (BOT) and other related regulations and legislation should be updated to increase foreign and domestic financing in the private sector and improve management of the massive infrastructure spending.

China's annual spending on infrastructure facilities by 2010 could hit 2.3 trillion yuan (US$378.11 billion), doubling the current figure and representing the heavy spending used to back up economic growth and restructuring, accelerated urbanization and improvement of eco-systems, a report drafted at the seminar said.

In the 10th Five-Year Plan period (2001-05), total infrastructure expenditure would total 7.1 trillion yuan (US$858.52 billion), while during the 11th Five-Year Plan period (2006-10) infrastructure investment requirement could approach 10 trillion yuan (US$1.2 trillion), the report said.

To meet these investment requirements, infrastructure sectors and service providers need to attract a greater share of capital funds from financial markets, commercial banks and private investors as the share of infrastructure investment coming from government allocations has fallen since the opening of the market.

And the tension is mounting, especially when the enormous pressure the central government will feel on its fiscal, institutional, organizational and decision-making capacities in the coming 10 to 20 years is considered.

The report outlined that these pressures will come from a number of sources, including financing for its western development campaign, completion of the reform of the State-owned enterprises and the financial sector, development of a well-established social welfare system and reduction of rural poverty.

In a time when the existing resources of public finance cannot satisfy demand for investment in essential public goods and common property, a market-oriented property tax earmarked for capital and recurrent financing of public infrastructure should be introduced.

And the huge pool of pension funds and the deposits saved in the Postal Savings Bureau should be invested in those sectors that expect long-term but stable returns, said Tang Min, chief economist with the Asian Development Bank's China Resident Mission.

Non-State-owned companies must be provided access to domestic capital markets, which is not suitable for financing by commercial banks.

The seminar's attendants also vowed financial policies should be introduced to the market, including the introduction of short-term fixed-income instruments for project financing for these firms.

They also highlighted the importance of improving access to the long-term corporate bonds market and facilitating issues of long-term enterprises bonds through intermediaries pooling higher risk infrastructure credits of non-State companies.

But China is today in a stage of transition from the State-owned-producer-pays to the user-and-taxpayer-pays model where users do not pay the full costs of infrastructure services, and tax revenues are too low to handle the full costs. Consequently, a large portion of costs are allocated to future taxpayers through deficit financing.

They also urged for more favourable taxation policies, such as exempting returns on investment in infrastructure service provision from business and individual income taxes.

Meanwhile, the existing barriers keeping out foreign and domestic private investment should be ironed out in sectors like water distribution, sewage collection and electricity transmission, said Derek Ireland, another senior expert invited by the ADB.

A redefinition of the roles of the government, State-owned enterprises and non-State sectors should also be clarified, the participants said.