Financialization of infrastructure

Losing sovereignty on energy and economy

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What is financialisation?

The increasing importance of finance, financial markets, financial institutions, and financial elites in the operation of the economy broadly explain the process of financialisation. Within financialisation the patterns of accumulation move towards being generated through financial channels instead of trade and commodity production. Financialisation is also the attempt to open new markets, converting public commons into income revenue streams often underpinned with legal agreements with public institutions to guarantee profits.

Introduction

Increasingly many aspects of our lives are becoming financialised. The development of markets around essential services and natural commodities has reshaped the world economy and is putting finance firmly at its centre. The markets spawned by this process offer a perplexing selection of financial products all designed to generate wealth from the instrument far beyond the initial value of the product or service. In the world of infrastructure, investment funds are financing the building of mega-projects around the world, when the projects produce reliable income flows (often supported by public guarantees) the fund sells the project to other investors. Financialisation features a shift away from production to economic rents.

The drive towards the financialisation of the wider economy is synonymous with more privatisation of public services and the transfer of power over the economy to financial institutions, trans-national corporations and markets. Despite financial institutions paying over $100 billion in compensation in the US alone [1] for their role in the creation of the financial crisis, their role in our everyday lives is being expanded and amplified. Public commons once protected from the dangers of the market are being expropriated by capital to be used as a tool to extract wealth and move it up the chain. Financialisation fuels the further concentration of wealth into fewer hands which affects our sovereignty and disenfranchises us from deciding how the economy should be managed. Once financialisation has taken hold its own internal logic dictates that it must unrelentingly expand into new markets to guarantee investors' returns.

This serves as the backdrop to what is currently happening in the area of infrastructure and suggests what the consequences are likely to be if infrastructure is increasingly opened up to financialisation. In the post-crisis economy investment in infrastructure is now being presented in the EU to its citizens as the solution to our problems and a route straight back to pre-crisis levels of growth whilst in the developing world

1 http://www.ft.com/intl/cms/s/0/802ae15c-9b50-11e3-946b-00144feab7de.html#axzz3CiXNOktN

infrastructure investment is meant to be the tool to finally unlock and realise its potential. Certainly, infrastructure is high up on the political agenda. However, increased privatisation via PPP (public-private partnership) projects is being presented to EU citizens as the only way to address the "infrastructure finance gap" across the EU.

PPPs are central to the acceleration of the financialisation of public assets such as infrastructure by providing banks, private equity funds and increasingly pension funds with a long term-low risk investment underpinned by legal agreements with governments guaranteeing revenue streams for decades to come even if the infrastructure becomes obsolete or does not perform to expectations. The sale of equity in PPP projects is creating a huge secondary market (income streams are converted into financial instruments and sold on international markets) that is nothing more than a wealth machine for construction companies and finance capital. Yet despite widespread concerns over PPPs they remain popular with international institutions and governments alike. The EIB [2], EC [3], World Bank [4] and the IMF [5] all support the increased role of PPP financed projects.

The increased financialisation of infrastructure has repercussions over what infrastructure is built, who stands to gain most and who is most likely to be at risk. Moreover, the financialisation of infrastructure touches upon finance, environmental and social issues therefore it requires a clear understanding of how the processes embedded in it operate and what its likely outcomes are.

2 http://www.eib.org/attachments/thematic/eib_ppp_en.pdf
3 http://ec.europa.eu/internal_market/publicprocurement/docs/ppp/comm_2007_6661_en.pdf
4 http://ppi.worldbank.org/
5 https://www.imf.org/external/np/fad/2004/pifp/eng/031204.pdf

Increased financialisation through PPPs justified on a 'cost' basis does not stand up to inspection

What are PPPs?

Public-private partnerships (PPPs) are business ventures operated through a partnership between government and one or more private sector companies. PPPs can take various forms but usually feature a private company offering services on behalf of the governmental or local authority. Typically PPPs are medium to long term arrangements, often 25-30 years. In infrastructure, the private sector is often charged with building and maintaining the infrastructure but is allowed to charge users through tolls or bills (or receive payments from governments) for offering a pre-agreed service. PPPs have been controversial throughout their development, often provoking costly public rescues and transferring decision making over what infrastructure gets built to the private sector and therefore away from public consensus.

PPPs work on a "buy now-pay later" basis and lock governments into long term debt commitments which are "off the books" and is not recorded as public sector borrowing. The public body enters into a long term commitment with the private provider often based on expected revenue generation during the life of the project. Incorrect demand forecasting, common in PPP projects, ties governments to underperforming infrastructure and thus a debt is created.

Debt repayments related to PPPs swell on the balance sheets of public bodies and create a lower expenditure flexibility and thus more pressure on other areas of the budget – as part of the concession agreement with the project promoter, PPP repayments are protected by national law (and effectively prioritised) and so if the body needs to cut its operating costs, these cuts will fall on other services such as health and education. If the public body's credit rating is lowered, as we have seen during the financial crisis across the EU, the cost of

servicing this debt also increases, trapping the public body into a spiral of debt and further enriching its creditors.

As private sector finance is always more costly to raise, this additional cost is borne by the public sector and end user of the concession. A study into toll roads in Spain found that 55% of the toll fee for the end user related to the added cost of private finance. [6] Moreover, it notes that over a 9 year period the additional returns to the providers of finance was €4,8bn more than it would have cost through traditional public sector borrowing

What is the problem with the secondary market infrastructure finance?

Due to the scarcity of new deals across Europe, investors are increasingly buying and trading securities attached to PPP projects in infrastructure -the so called secondary market. The guaranteed yields represent secure returns in an unsure investment climate. However, the excessive profits and windfall gains on secondary market sales suggest the market is nothing more but a bonanza for finance capital, far from serving the population and its needs.

The financialisation of infrastructure is creating a secondary market at odds with democratic accountability

Under creeping financialisation, once the construction (the riskiest phase) is complete, the concession holder can refinance the project, thus opening space for the secondary market, at much more favourable interest rates whilst the public sector is lumbered with the original higher priced loan. The augmentation of secondary trading which is central to the financialisation of infrastructure will strengthen the position of capital over countries and thus reduce democratic accountability.

The refinancing of large scale projects is used by construction industry as a tool to raise equity in order to bid for new projects, maintain growth and create and fuel the market. In the Spanish case of ACS with the Castor project, it allowed the company to fund its diversification into the gas market.

After a string of scandals in the UK relating to the excessive profiteering of companies, profit sharing was introduced as a way to limit excessive profiteering. However, with no requirements on the sale of equity, companies have been able to bypass this requirement by presenting it as a take over or merger to distinguish it from refinancing. An international market in secondary trading on infrastructure projects would thus pose new questions on the legal position of foreign owners (and their identities) of public infrastructure and increase the distance between the population and ownership of infrastructure.

Financialisation is being used to sustain dependence on fossil fuels and promote energy grabbing

The European Commission's Connecting Europe Facility has identified infrastructure projects across energy, transport and communications which it believes will close Europe's infrastructure gap, create jobs and boost growth. The list portrays a clear bias towards the commission or the renewal of existing fossil fuel (especially gas) based infrastructure which is at odds with its own emissions targets under the 20-20 initiative. [7]

6 CRESC Working Paper Series, Working Paper No. 44 *Taking its toll: The private financing of roads in Spain.* Basilio Acerete, Jean Shaoul and Anne Stafford CRESC, The University of Manchester, December 2007

7 Concretely for 2020, the objective is to reduce emissions in a 20%: http://ec.europa.eu/clima/policies/package/

Yet on closer inspection, these priority projects display a tacit acceptance of the new global realities; that great strain is being placed on natural resources and so energy corridors and pipelines must be built to facilitate the process of energy grabbing and extraction to maintain the EU's energy consumption. This in turn, further perpetuates the EU's dependence on fossil fuels. Investments of this type are functional to the needs of the market but, as argued by several NGOs, it does not seem credible that this type of infrastructure promotes sustainable growth when wreaking so much socio-environmental havoc. [8]

Infrastructure investment can exacerbate illicit outflows

In Africa infrastructure can often be built with the sole intention of creating networks that sustain large scale projects of foreign investment – this is particularly true in the extractive industries such as mining [9] (the mine is often a central point to which all local infrastructure is intended to serve) with the subsequent profits generated are quickly spirited out of the country through the process of capital flight via tax havens. [10 11]

When discussing the 2013 Africa Progress Panel report "Equity in Extractives"[12] former UN Secretary General Kofi Anan attacked the extent of corruption in the energy and mining sectors across Africa and accused it of "bleeding wealth from Africa" through huge illicit financial outflows that dwarf the international aid it receives. The report refers to the companies which operate the Mopani copper mine in Zambia; a complex corporate structure of subsidiaries via Bermuda, Canada, and London. Opaque ownership structures such as these are a way to avoid public disclosure requirements but moreover, the presence of subsidiaries creates the structural conditions for trade mis-pricing, aggressive tax avoidance and tax evasion by maximising the profit in low tax jurisdictions which then enables the company to direct the profits out of the continent via tax havens. It has already been widely reported that the biggest multi-nationals working in extractive industries create complicated corporate structures to aggressively reduce their tax bill to avoid paying their fair share. [13 14 15 16]

Furthermore, an International Finance Corporation Report (the private arm of the World Bank) remarks that mining infrastructure related PPP projects are increasingly being undertaken by the big four mining companies present in Africa which are able to use the mine itself to underwrite the transaction that increases the attractiveness of the investment. According to the IFC, the mine has the potential to become a "transport backbone for the whole region/country"[17] or under a more critical reading – a behemoth dominating the local economy, extracting resources and shipping the profits out of the region via tax havens to its international investors.

Financialisation of infrastructure promotes social exclusion and inequality

Infrastructure developed by the private sector has the sole objective of generating profit for its investors. In practice this means those that cannot afford to pay are simply excluded from the service.

8 http://www.counter-balance.org/counterbalance-eib.org/wp-content/uploads/2013/06/Infrastructure-briefingOK.pdf
9 http://www.oxfamamerica.org/static/oa3/files/poverty-reduction-or-poverty-exacerbation.pdf
10 http://www.taxjustice.net/cms/upload/pdf/Eurodad-WEED-CRBM-BWP_Capital_Flight.pdf
11 http://www.gfintegrity.org/storage/gfip/documents/reports/gfi_africareport_web.pdf
12 http://africaprogresspanel.org/publications/policy-papers/africa-progress-report-2013/

13 http://www.counter-balance.org/counterbalance-eib.org/wp-content/uploads/2011/03/Mopani-Report-English-Web.pdf
14 http://www.theguardian.com/business/2011/oct/19/tax-avoidance-in-netherlands-becomes-focus-of-campaigners
15 http://www.bbc.co.uk/news/business-22638153
16 http://www.smh.com.au/business/glencore-tax-bill-on-15b-income-zip-zilch-zero-20140626-3awg0.html
17 http://www.worldbank.org/content/dam/Worldbank/document/Extractives/Mining%20Indaba%202014/Pierre%20Pozzo%20di%20Borgo%20INdaba%202014%20Presentation%20v2.pdf

In Spain, the price of electricity increased 69% between 2006 and 2011 compared to an EU average of 14% [18] and now means Spain has the 3rd highest energy costs in Europe which increasingly becomes difficult to avoid fuel poverty when contrasted against the terrible employment situation in Spain.

One of the biggest energy companies in Spain, Endesa, is owned by Italian conglomerate ENEL, and since 2012 as part of its dividend policy it has promised 40% dividend [19] on net ordinary income every year to its investors. As part of the takeover of Endesa, ENEL became the most heavily indebted energy company in Europe and in a bid to keep its credit rating at AAA it undertook a €3 billion retail bond offering and signed a €3 billion loan refinancing [20] whilst at the same time cutting investments and reducing costs – the group shed 1000 jobs in Spain in 2013. [21] Such intense pressure to keep its profits in order cannot be compatible with any policy to reduce fuel poverty (nor other types of poverty). Therefore, it can only promote more social exclusion and inequality through the dispossession of individuals as consumers deprived of these services, but also through the dispossession of communities in the area of the infrastructure (or of the materials needed) where the wealth is extracted, reproduced, but not kept.

Local authorities are outwitted - or complicit?

Increased financialisation offers a baffling array of financial products and that are built on extremely complicated foundations that take bets well into the future on the use or usefulness of infrastructure whilst not knowing the shape or direction of financial markets of the future. This complexity often means that public institutions are outwitted by financial institutions whilst at times it seems they are actively involved. In the case of Spain, an abusive clause included into the Castor Project resulted in state having to repay the concession holder for the value of the project after it was stopped due to safety fears. [22] It is unclear if this was due to government negligence, ambivalence or outright compliance. The fact that confidentiality agreements prevent the population being able to ascertain such information points to a shortfall in democratic accountability that is a feature of PPP projects.

In 2002 Italy changed its law to allow local councils to participate in complex financial trades such as derivatives which saw local governments take on €35 billion worth of derivative contracts sold to them by international banks. [23] In total more than 500 municipalities signed up to such deals but within the decade the products has turned sour and Italian authorities dragged the institutions into court. After being described as the "Milan Derivatives Inquisition" the banks were found guilty (overturned on appeal later) but already the damage had been done – the debt on the books will mean budgetary sacrifices for the next 20-30 years. To really unpick and qualify risk of these financial products is extremely complex and as the prosecutor for the state explained, "the skills and knowledge that were almost exclusively possessed only by one of the counterparties, the banks." [24] The relationship between the financial institutions and public authorities (especially those in the developing world) is cast by the private sector as a "worldly corporate entity versus unsophisticated local partner" [25] therefore it is easy to see how

18 TEN/420 Energy poverty – the impact of liberalisation and the economic crisis http://www.eesc.europa.eu/?i=portal.en.ten-opinions.19528
19 http://www.enel.com/en-GB/investors/stock_market/dividends/
20 http://www.reuters.com/article/2012/02/23/enel-loan-idUSL5E8DN85720120223
21 http://www.elconfidencial.com/economia/2013/03/21/enel-ordena-recortar-1000-empleos-en-endesa-tras-el-rejon-del-gobierno-117286
22 http://www.odg.cat/sites/default/files/financiando-proyectos-inutiles-las-deudas-del-proyecto-castor.pdf
23 http://online.wsj.com/articles/SB10001424052748703444804575071352329954616
24 http://online.wsj.com/articles/SB10001424052748703444804575071352329954616
25 http://www.miga.org/documents/eur3929_miga.pdf

the private sector takes advantage of this unequal relationship.

In both cases, the sheer complexity that financialisation entailed meant that the professionals in finance were able to use their superior knowledge to outfox public institutions, with the same result in both cases – the continued extraction of wealth from the public.

How PPPs are functional to the financialisation of infrastructure

The design of PPP projects is inherently functional to the financialisation of infrastructure by opening up the project to finance but also bringing other actors into the project but under a financialised remit. Raising the capital for the project is increasingly being undertaken by infrastructure funds, pension funds and private finance as banks slowly fall out of the market (the banks are still dealing with the fallout from the previous financial crisis.) The loans made to the special purpose vehicle (SPV) are often securitised which means they can be pooled to diversify risk so that they can be re-sold. If the project begins to be successful (its revenue streams are on target, or it has state-guaranteed revenue streams) it can sell equity on the equities market at a profit, and it is often reinvested back into another early stage PPP project. The securitisation of the infrastructure is supported by the population, as we are effectively turned into income streams in order to tranche the securitised payment streams and price them. This poses fundamental questions regarding the extent to which the private sector will monitor our financial standing through big data to assist them in "pricing" individuals effectively.

This trading of equity in PPP projects is fuelling the creation of an enormous global market. Evidence from the private sector suggests that companies have anticipated an IRR (internal rate of return) of 13%-15% and have been able to generate much higher returns by selling equity in the secondary market. [26] They are then able to pay out handsome dividends to shareholders or reinvest into new PPP projects. Secondary trading, refinancing, securitisation and a lack of oversight by government are features of this secondary market and also the main drivers of the collapse in the US housing market which caused the financial crisis. Moreover, the effects of the collapse of the housing market in Spain created a situation in which thousands of homes stood empty whilst thousands of citizens were evicted for falling behind on their mortgages – when this secondary market in infrastructure inevitably collapses as the housing market has done, where will it leave members of the population that simply cannot pay? And where does it leave those who already cannot pay the increasing bills of the services provided by these infrastructure projects?

During the negotiation phase with the government or public body, all risks are identified and allocated between the private company and public body with legal guarantees underpinning these agreements. In this situation incorrect demand forecasting can place great importance on how these risks were allocated during the contract negotiation. Demand forecasting, when applied to users on roads and railways has a history of inaccuracy. [27] Indeed, the most accurate analysis undertaken by the financial services industry found that on average traffic volumes were 23% lower than predicted. [28]

Depending on the type of PPP concession users of the infrastructure can be charged (such as in toll roads). Additional charges for third party users can be built into the contracts which open an additional revenue stream. This could be developed further to take in changes in the use of the infrastructure with the same objective – to commodify and marketise

26 http://deloitteblog.co.za/wp-content/uploads/2013/07/PPP-Secondary-Markets.pdf

27 http://www.eleconomista.es/empresasfinanzas/noticias/6524436/03/15/Fomento-pagara-losplatos-rotos-de-ACS-la-deuda-del-AVEEspanaFrancia.html#.Kku8GYbTUxNZUta

28 http://www.infrastructure.gov.au/infrastructure/public_consultations/files/attach_a_bitre_literature_review.pdf

every aspect of the infrastructure in order for it to be opened up to global financial markets.

The Project Bond Initiative: development of finance comes with a high price for local populations

The Project Bond Initiative was drawn up by the European Commission and the European Investment Bank in the post financial crisis landscape. It was presented as a cheap solution to reignite Europe's stagnant economy and update its infrastructure in order to remain competitive. Despite being presented as innovative by the EIB and EC, it was essentially a PPP design which gave government backing to infrastructure projects which increased the rating of the emitted bonds in the hope of attracting institutional investors to make up for the shortfall left by the banks after they left the market. Innovative it was not and more than anything it consisted of a new round of private sector initiatives with generous public subsidies to artificially prop-up the market in infrastructure.

The development of financial products around infrastructure that is at the heart of the initiative was sold to EU citizens as a cheap way to finance infrastructure; yet two years on it is now clear that this subsidy was a wealth grab by the private finance that also further removes the population from the decision making process on what type of infrastructure gets built and will further entrench Europe's dependence on fossil fuels -at odds with the EU's own climate change policies.

The first project to be financed using Project Bonds was the underground gas warehouse located off the Catalan and Valencian coast. Despite already existing seismological studies undertaken by independent groups warning against the injection of gas into the earth, the company behind the project, with the blessing of the government, began the injection which has now been proved to have provoked 1000 earthquakes in the region. Due to the safety fears the project was paralyzed by the government due to safety fears.

Due to clauses in the concessionary agreement between the project promoter and the government, ACS the company behind the project, is entitled to compensation which will amount to €1,35 billion and is to be socialised by an increase in gas bills in Spain. The EIB has shrugged off the Castor debacle as in isolated incident and insisted on the soundness of the initiative. However, the housing crisis in the US, the euro zone crisis and the bail out of numerous infrastructure projects in EU states [29] clearly shows the systemic danger increased financialisation poses; namely public rescues for the mistakes of the private sector and public guarantees for future profits of the investors.

Where are we now? The creation of a European capital market union

Central to the presidency of the new EC commissioner Jean-Claude Juncker is the issue of banking union and parallel to that is the idea of the creation of a EU wide capital markets union to end Europe's over reliance on banks for finance. It is claimed by the European Central Bank that the creation of a capital markets union would free up and better allocate liquidity in the system, expand the non-bank finance and better insulate Europe from future economic shocks. [30] An EU wide capital markets union would require a further bout of deregulation across the EU and would inevitably lead to a secondary, highly financialised market based on complex financials trade and swaps. Essentially, momentum is gathering in the EU to construct the exact same structural conditions which precipitated the crash of the US housing sector and instigated the current financial crisis.

We know that regulation is not able to police markets and when they eventually crash it is the public that funds the rescue. Whereas before, the

29 Another case, appart from Castor Project is Passante di Mestre in Italy: http://www.counter-balance.org/wp-content/uploads/2014/07/CSO-Letter-to-EIB_Passante-di-Mestre_8-July-2014.pdf
30 http://www.ecb.europa.eu/press/key/date/2014/html/sp140910_1.en.html

crash in the housing sector led to families being evicted from their homes as thousands of houses lay empty, what would such crash have on the infrastructure landscape? In the Spanish context, failed infrastructure debts have been socialised by the population whilst companies' profits have been insulated. The creation of an EU wide capital markets union as a response to the previous crisis is sowing the seeds for future crisis. The dynamic of market failure then government rescue is becoming established and is exposed as a wealth grab by the super rich and as a driver of inequality.

Conclusions

1) The financialisation of infrastructure is taking us down the same path that led to the meltdown of the US housing market. Finance is lauded as a mechanism for the limitless creation of wealth yet we know it only generates wealth for those at the top whilst the rest of us are only involved when the market needs public money to be bailed out. The cycle of markets make this crash an inevitable occurrence – we have seen the damage this has done to housing, what would it do to infrastructure?

2) Financialisation of infrastructure is functional to the advancement of increased privatisation and the acceleration of the sale of public commons to the private sector at knockdown prices. The current half way position of owning and operating key infrastructure is a foothold for the total privatisation of health, education and social services. This paper has discussed PPP and Project Bonds as tools of financialisation, but more mechanisms exist and others will be developed.

3) The increased financialisation of infrastructure puts market preferences over the needs of the population. Large centralised projects come at the cost of more effective decentralised ones due to the lack of interest of the market for such projects and cheaper fossil fuel infrastructure takes priority over long term renewable energy needs. The needs of the population are sidestepped and their voices not heard in order for infrastructure to be functional to the needs of the market.

4) Increased financialisation of infrastructure is also synonymous with corruption and lack of transparency. Capital flight via the use of tax havens administered by first world countries fuels corruption in the developing world. Financialisation of infrastructure increases the speed of this capital flight until it is converted, and thus legitimised, as a part of a financial instrument bought and traded on the world market.

5) The complexity of the process of financialisation creates a new set of disparities in which the financial institutions can use their superior knowledge to mis-sell, misrepresent or outright lie about what financial product is being bought and traded.

6) Public risk sharing such as the Project Bond Initiatives offer a glimpse into the future of the total financialisation of infrastructure; illegitimate projects chosen without public consent are bailed out by governments at the same time that investors' capital is protected when the project does not perform as expected. Alternative infrastructure projects are bullied out of the landscape as competing projects are ruled out in PPP contracts and income revenue streams protected. Financialisation attempts to establish its own sovereignty -its own regime- by preventing alternative competing projects. This sovereignty will come with the loss of our own and that of others.

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