

EMERGING COUNTRIES AND PUBLIC FUNDING**Latfe Jabar ZAQEER***Sumer University, Faculty of Administration and Economics, Thiqar, Iraq
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marwajuma1989@gmail.com***Abstract**

The paper focuses on the elements that have prevented the governments of developing countries to establish a sustainable infrastructure. The focus on investments in the infrastructure of developing countries should be more significant. The analysis of the infrastructure development in developing economies comprises two main phases. The first step refers to the funding of infrastructure projects, which do not produce sufficient funds to cover the original investment. The second phase is the financing part, which refers to the aspects related to the capital markets functioning in developing economies (World Economic Forum, 2014). The present article analyses the financing and funding opportunities in emerging economies and demonstrates the possibility of advancing investments in renewable energy. Providers of long term funds, such as the New Development Bank can establish an infrastructure company with expertise in projects developed in emerging markets, in order to access significant equity investment that uses this potential of development.

JEL Classification: O32**Key words:** *emerging countries, infrastructure improvements, development, state-owned enterprises (SOEs), international investments***I. INTRODUCTION**

The economies of emerging countries are in a phase caught between “developing” and “developed” (Beattie, 2011). Generally, emerging markets occur in countries that go through high infrastructure and technological development and GDP growth. Generally, these countries experience faster economic development than countries with developed economies, such as the US. They are characterized by growth potential.

Investing in public infrastructure can positively influence productivity and results. The production function described in the paper “Is public expenditure productive?” by David Alan Aschauer indicates important improvement of the output growth because of infrastructure. The concept of state-level fixed effects is based on reducing infrastructural investment returns (Garcia-Mila and McGuire, 1992; Holtz-Eakin, 1993, 1994). Currently, public investment effects are not regarded as influential on productivity, in the light of the past development were the correlation between productivity and investments in infrastructure has become indirect. GDP is influenced by numerous variables. For instance, the development of the telecommunications infrastructure improved the communication speed and reduced the costs of transactions. Lower economies are more affected by the telecommunication costs than more developed economies.

Maintaining and developing the infrastructure have been in the government responsibility. However, governments have been unable to obtain balance between the requirements for the infrastructure and accessible resources. Economic growth and reducing poverty depend on the development of the infrastructure, as governments are very well aware of. Infrastructure development has been allocated to state-owned monopolies after the Second World War. This approach has led to keeping prices below the costs for social reasons, inability to meet the increasing expectations, overstaffing and overall poor management. In this context, private investments became more suitable. As an example, in Buenos Aires and Guinea, private investments in water and sanitation generated domestic welfare advantages of \$ 1.4 billion and \$ \$ 23 million, respectively. (Harris, 2003)

During the 1990s, governments have started to focus on attracting private investments and management know-how for developing water, telecommunication, transport and energy projects. This approach reached a maximum by 1997. However, after that year, the investments reduced to more than half of the previous amounts. Between 1997-1998 the fastest growing economies were affected by the Asian crisis, Argentina entered into a macroeconomic crisis and the Brazilian situation related to the power reform project have encouraged investors to withdraw their support in these areas. Investing in developing countries became less attractive. The crisis has extended to developed countries, and not only the developing countries. For instance, the occurrence of the power crises in California, or the bankruptcy declared by the British infrastructure companies.

II. FACTORS PREVENTING THE DEVELOPMENT OF EMERGING MARKETS

The privatization of the emerging markets did not reach the expected outcome, thus governments have started to focus more on examining the situation. The satisfaction level of the citizens has improved through the proper implementation of infrastructure projects that follow suitable plans.

Pricing

The pricing policy was one of the factors that generated negative results. Governments considered infrastructure projects as a benefit for the entire population of the country, as a benefit that can be used even by the citizens with lower incomes, by keeping the pricing low. The revenues reported by electricity and water provides in the 1990s were 60% and 30% respectively. The efficiency of was improved through investments from the private sector, it was still necessary to increase the prices. The price increase measures were, however, postponed or avoided by governments, although it was necessary. The devaluation of the exchange rate was also not managed by the politicians. This led to the loss of interest of the foreign investors in the emerging markets investments.

There are numerous countries worldwide that need better infrastructures. In the developed countries the challenge is replacing or updating obsolete infrastructure, which generates high re-investment costs. In developing countries, there is an important difference between the needs and the available infrastructure. The development of goods production and services in these countries to levels not reached before has also increased the demand for reliable infrastructure. Infrastructure is essential for maintaining an efficient, reliable and cheap supply and distribution chain.

Exchange rate

The type of exchange rates adopted by governments has always been a matter of debate. It has been a matter of choosing a fixed, floating, or generally fixed and at times shifting exchange rate. (Guillermo A. Calvo, 2003). A fixed exchange rate can be supported in emerging countries either by using a foreign currency instead of in addition to local currency (dollarization) or by currency board. In case of adopting the currency board, a conversion rate is established by the relevant authority (the central bank or the government) and this authority is able to change foreign currency. In case of full dollarization, the local currency is completely replaced with a foreign currency, as euro or US dollar.

In Argentina the currency board approach was applied. The situation of the financial sector was one of the best among emerging markets, with a prudential regulatory regime management. However, it was weakened by the large budget deficit. The recovery of the previous system was not possible even through the adoption of an expansive monetary policy, and the Argentinian currency collapsed due to the fact that the debt titles were based on dollar. Under these conditions, the currency board experiment was not able to stop the collapse of the economy.

Governments are even more reluctant to adopt the floating exchange rate approach, as in emerging countries the risks are also increased. In this case, several factors must be taken into account, such as all the connections between imports, exports, flows of capital at international level and the exchange rate risk. The emerging countries usually do not have solid financial, fiscal and monetary organizations. Also, their economies are weakened by dollarization of liabilities and by the currency replacement. Additionally, they are very vulnerable to capital flows from external sources being stopped unexpectedly. (Guillermo A. Calvo, 2003). Monetary authorities may also face great challenges attempting to cover the generation of high inflation through debt.

In a system using floating exchange rate, the monetary authorities are able to follow a countercyclical monetary policy. However, it is important that the authorities have the proper implementation abilities. Price stability and establishing reliable monetary authorities should be the priorities of the central bank. In numerous emerging economies, the independency of the central bank is not properly supported by laws in the process of maintaining prices stability.

The exchange rate system is not standard for all the countries and generally, the international financial institutions (the World Bank, The International Monetary Fund or other development banks) have preferences regarding one system or another. This leads to recommendations of inadequate system and to disregard the specific

of the country's economic and political systems, together with its institutions. Sustainable financial and fiscal institutions can be obtained by focusing on reorganizing financial institutions, financial regulations, by fiscal control and obtaining a general agreement for the establishment of a sustainable and predictable monetary policy, which leads to more trading opportunities. (Guillermo A. Calvo, 2003)

III. FUNDING OF INFRASTRUCTURE

For infrastructure investments, it is not enough to have a solid capital structure and funding instruments, as it is insufficient to only finance these types of investments, they need to be funded. Despite of the significant social, economic and environmental benefits of the infrastructure development, the generated revenues are not sufficient for covering the initial investment. The population in emerging economies have less financial possibilities of sustaining these projects, compared to population in more advanced countries.

In electricity generation, for the same results, the incremental costs of low-carbon versus high carbon investments, the principle of user payment needs to be combined with the polluter payment principle. Low-carbon investments are covered by the governments from governmental funds or through SOEs (state-owned enterprises) in economies with high income unbalance, not applying the user-pays principle. Generally, in emerging economies, monopoly is prevalent, but there are economies that are open to international infrastructure investments, such as China, especially in renewable energy, leading to liberalization of the power sector.

From the investors' viewpoint, the consumer imposed price is more sustainable than government funding. In China's case, the majority of the investments were supported by SOEs and there is no incentive to replace the payments that support SOEs, as the dividends disbursed by the SOE to the government would reduce and would not produce net savings.

There are several methods to generate funds for the projects of renewable energy. One of the most important methods considered by the World Bank is improving taxation capacity (World Bank, 2013). The tax revenue generated in the emerging economies represents a smaller part than in developed economies. Natural resources exploitation is also another source of capital flow generation for low-carbon infrastructure. Increasing the efficiency of spending is also a potential improvement aspect. According to the McKinsey Global Institute, infrastructure productivity should be improved in order to save large amount of money.

Financing of Infrastructure

The banking systems in emerging economies is generally strong, with liquid financial markets. International investments in infrastructure is very low. Only 2.5-3% of the infrastructure investment is sourced from Overseas Development Assistance, as the World Bank concluded (World Bank, 2013).

Capital inflows are characterized by short-term excess. Funds are withdrawn from developed countries due to insufficient returns, while they are directed toward emerging economies. (Group of Twenty, 2013). This is one of the reasons for the development to depend on high growth rates. Financing of the infrastructure has mainly been provided through syndicated loans granted by European and US banks. International sources of capital is also associated to evident risks. As a result of the European banks having to reduce debt, the syndicated loans for the emerging markets have been ceased. The finance environment has become interesting for sovereign wealth funds, pension funds looking for yield and specialized funds.

In emerging countries, capital was attracted also in government bonds, although the main focus of corporate bond issuances has been to refinance the existing debt. At international level, more than half of the infrastructure spending is in emerging markets (Oxford Economics, 2014).

The internal capital sources of the emerging economies should become more solid through the economic progress on the development ladder. The New Development Bank was created by the BRIC countries for providing support to development of the emerging economies (Griffith-Jones S, 2014). Local banks in the emerging countries are able to create additional lending capacities by attracting the unbanked population in the developing countries. The leverage ratios in developing countries of the infrastructure financing are still low. The capital for infrastructure is still mainly generated from government enterprises or government funding in countries such as China. In Austria, 84% of the infrastructure investment comes from private source, while in India, only 35% is private (McKinsey Global Institute).

IV. CONCLUSION

This paper states that progress in infrastructure development in developing countries should be supported by an optimal capital structure and funding mechanisms. The structure of the financial system and financing patterns in developing countries have led to low borrowing rates and a credit scarcity: most of the capital channeled to developing countries by international investors is a potentially reversible, which does not necessarily remain in the country for a long time. The New Development Bank and other long-term fund providers should set up an infrastructure company with experience in developing projects for developing and financing countries that could access large amounts of quoted capital investment in order to benefit of the high growth potential.

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