CAPITAL & ECONOMICS

Life In The Fast Lane: Infrastructure Investment's Opportunities And Challenges

OVERVIEW

Thousands of years ago, the Silk Road carried goods and spices from trading cities in China and central Asia through to cities like Baghdad and Venice. It was one of the world's earliest examples of transcontinental infrastructure.

Right now the world's infrastructure is getting ready for a 21st century upgrade. China's "One Belt, One Road" policy initiative is looking to echo the past glories of the Silk Road, connecting Asia to Europe by land and sea. The project is piecemeal, and there's little idea of its total cost, but some estimate it to be at least $1 trillion.

Meanwhile, on the other side of the world, U.S. President Donald Trump has pledged his own $1 trillion infrastructure plan, designed to renovate the country's crumbling infrastructure, stimulate the economy and grow jobs. It's expected that, despite the current political climate, a proposed infrastructure bill could garner warm bipartisan support. That could be good news – any functioning economy relies on the strength of its infrastructure. But what do businesses need to know if infrastructure spending is to intensify over the next few years?

IN DEPTH

Need for investment

There is no question that infrastructure spending is needed in the U.S. The World Economic Forum (WEF) rates national infrastructure on a seven-point scale. In 2016, the U.S. was given a score of 6.1. In 2017, it was 5.9.

The deterioration becomes more dramatic the further back you go. In 2005, 16 percent of U.S. roads were rated "poor or worse", according to government data. By 2016 that figure had doubled to 32 percent. The Federal Highway Administration estimated in 2011 that restoring and maintaining these roads would require between $73 billion and $78 billion every year, from 2011 to 2030. Similarly, renovating water infrastructure could cost up to $1 trillion, according to estimates from the American Water Works Association.

Infrastructure is also needed to plan for the future. As more and more people flock to our cities to work, more strain will be put on existing infrastructure. It's estimated that 1.5 million people are added to global urban populations every week. On its own, India is expected to add 500 million people to its towns and cities over the next 40 years. These metropolises will need new roads, housing, hospitals and schools to cope with the next generation of city-dwellers. More than 80 percent of the world's economy is generated in cities, so keeping these organs pumping is vital for the overall health of the global economy.

The increasing digitization of the economy is something else that has to be considered. In the near future, people and economies will rely on broadband and Wi-Fi as much as they will on roads and drainage. The European Union has said that it would need to fill an $800 billion cyber infrastructure spending gap if it were to compete with China and the U.S. in attracting and serving businesses.

Good infrastructure development needs to keep one eye on the future at all times. Vast projects of the past have been rendered obsolete by new technology. Anyone spending big on building steamboats at the turn of the century would have been left out of pocket, as trains, cars and eventually planes transformed logistical infrastructure over the following decades. Similarly, would spending more on high-speed rail or improved roads be the best idea if Elon Musk's Hyperloop becomes the transport of the future?

While lots of this sounds as though it should be the responsibility of the state, it isn't just a matter for the public sector. Private companies stand to benefit in two distinct ways. First, no matter where the money comes from, it's private contractors, technologists, and commodities suppliers that will do much of the work in building and maintain these infrastructure projects. Companies that deliver in this area stand to win big.

Second, better infrastructure benefits everyone, private enterprise included. If transport infrastructure is fixed, people can be in the office on time, and if digital networks are upgraded, people can spend less time once they're in the office waiting for web pages to load, and more time being productive. Strong infrastructure underpins value creation across the economy.

The Spoils of Development

Between the U.S., China, and other big projects in development around the world, it's estimated that in the 11 years up to 2025, a grand total of $78 trillion will have been spent on infrastructure – or about the size of the current global economy.

When that much money enters the economy, there are going to be far-reaching consequences. It will pay for new commodities, new capital equipment, and more labor. Every company or worker that gets paid can then spend their money elsewhere, generating more and more wealth as the initial spending radiates into the wider economy.

It's what is known in economic theory as the Multiplier Effect – the total value of economic growth relative to the initial spend. And infrastructure spending is a huge source: the WEF estimates that every dollar spent on infrastructure can generate between 5 percent and 25 percent in economic returns.

The benefits of big infrastructure projects are likely to spread well beyond the borders of the country doing the spending. For instance, much of the talent around developing high-speed rail comes from China and Japan.

There are also what are called "positive externalities." For example, the internet originated from computer networks associated with the U.S. military and has transformed business, economics, and society as it has grown. New projects might yield similar results.

Who pays?

Funding for these projects will come from multiple sources. Governments are one source, but there is also likely to be heavy involvement from other kinds of institutional lenders, such as pension funds, who will see infrastructure investment as a good way of generating long-term returns for beneficiaries.

"Public-private partnerships (or P3s) are likely to play a significant part on implementing infrastructure improvements and development," says Grace Hartman, Director, Aon Infrastructure Solutions. "Take the I-66 beltway outside Washington DC, where the introduction of congestion-relieving tolls as a revenue source encourages long-term private investment in the project. With financing and funding on board, Spanish firm Ferrovial and U.S. construction firm Allan Myers will build a 20-mile stretch of toll road in conjunction with their equity partners and the Virginia department of transportation."

The Trump administration's infrastructure spending plan is likely to lean heavily on private enterprise or P3s like this. While exact figures have not been discussed, House Speaker Paul Ryan has suggested that for every $1 spent by the government, $40 should come from the private sector.

Challenges

Infrastructure is needed. But this doesn't mean implementing it will be straightforward.

Massive, national-scale infrastructure projects require participation and co-operation from a broad range of stakeholders, working across national boundaries. This may prove difficult, however, in a protectionist political environment. While infrastructure spending offers considerable opportunities for companies to generate new business, protectionism could hit international supply chains. Withdrawal from or failure to sign up to major regional trading blocs may cause similar complications for companies contracted into providing this infrastructure both domestic and foreign. The KentuckyWired P3 project, includes Australia's Macquarie, Japan's Fujitsu and Canada's Ledcor, along with domestic firms. If the North American Free Trade Agreement (NAFTA) were to be unraveled, the role of Canadian suppliers and partners in U.S. infrastructure projects could be compromised.

Another key economic plank of the Trump administration has been to "buy American, hire American". This could force businesses to contend with dwindling supply and rising prices on domestic goods and labor. Potential suppliers and contractors will need to assess how this might affect their supply chains and operating costs, and ability to hire the right talent to get the job done.

There could also be macroeconomic challenges. Massive infrastructure spending should lead to higher levels of growth as money is cycled back into the economy. But while growth is good for an economy, the high levels of inflation that are a byproduct of it are not. This could push central banks to raise interest rates, making it more difficult to borrow the money to fund infrastructure developments in the first place.

Building A Better Future

Massive-scale infrastructure spending is sorely needed in the U.S. and across the world, and the political will exists to do it. But Rome wasn't built in a day. Nor will the world be renovated in a few years, with token initiatives.

"Building the foundations for a new world and bringing benefits for a huge range of stakeholders will take time. Business in particular stand to benefit passively – thanks to better infrastructure making their operations easier, and actively – when they help in financing and developing these infrastructure projects," says Tariq Taherbhai COO, Global Construction and Infrastructure at Aon. "But all of this is reliant on political will, he explains, which can shift."

It can cost millions in legal fees to secure lucrative infrastructure contracts. This money could be wasted if companies then find their supply chains or access to talent and resources jeopardized by shifting political sands. A broad commitment to infrastructure spending is a cause for business optimism; but only with a touch of caution can that optimism be justified.

TALKING POINTS

"How do we use the opportunity to consider infrastructure investments that are real game-changers? How do we create transformative infrastructure projects that will help our businesses thrive? Infrastructure investment is key. The right kind of investment — with input from private and public sectors — will make all the difference for businesses and for our economy" – Paul Horgan, North America CEO, Zurich Insurance

"[Infrastructure] projects must deliver competitive returns and that will often require efficiencies that can only be achieved through private ownership… Policymakers, workers and unions must work together to find a model that will allow private enterprise to generate the long-term returns necessary to attract capital and build a more prosperous future" – Larry Fink, CEO, BlackRock

FURTHER READING

- Trump Says He's Willing To Raise The Gas Tax For His Infrastructure Plan – Business Insider UK, May 1, 2017
- Trump Wants $200 Billion For Infrastructure, Mulvaney Says – Bloomberg, April 20, 2017
- Funding New Infrastructure: Global Perspective On A US Challenge – Pensions & Investments, May 4, 2017
- Nigeria Banks On Infrastructure Spend To Exit Recession – Financial Times, May 4, 2017
- Investments In Digital Infrastructure Can Spur US Jobs Growth – Fortune, April 21, 2017
- Aon Infrastructure Solutions – Latest publications and reports
- Assessing Political Risk In Public-Private Partnerships – Aon Webinar
- Risk Management Solutions For Supply Chain Risks – Aon Webinar

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