Introducing the Tax-Kicker Bond: Budget-Neutral Financing of Private Infrastructure by Back-End Participation in Future Tax Revenue Growth

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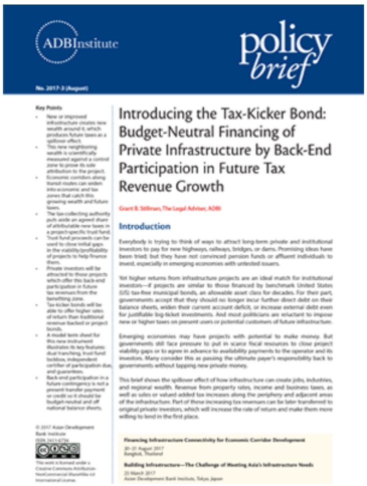
ADBInstitute policy brief

Introducing the Tax-Kicker Bond: Budget-Neutral Financing of Private Infrastructure by Back-End Participation in Future Tax Revenue Growth

Introduction

This brief for practitioners shows how to attract private investors to infrastructure. We propose a new form of retail debt security instrument with a model term sheet.

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Everybody is trying to think of ways to attract long-term private and institutional investors to pay for new highways, railways, bridges, or dams. Promising ideas have been tried but they have not convinced pension funds or affluent individuals to invest, especially in emerging economies with untested issuers. Yet hig om infrastructure projects are an ideal match for institutional investors—if projects are similar to those financed by benchmark United

States (US) tax-free municipal bonds, an allowable asset class for decades. For their part, governments accept that they should no longer incur further direct debt on their balance sheets, widen their current account deficit, or increase external debt even for justifiable big-ticket investments. And most politicians are reluctant to impose new or higher taxes on present users or potential customers of future infrastructure. Emerging economies may have projects with potential to make money. But governments still face pressure to put in scarce fiscal resources to close project viability gaps or to agree in advance to availability payments to the operator and its investors. Many consider this as passing the ultimate payer's responsibility back to governments without tapping new private money. The "tax-kicker" bond being proposed here, with more elaboration and trials, could prove that new sources of future tax revenue are feasible to attract private investors with back-end participation in a budget-neutral way.

Key points

- New or improved infrastructure creates new wealth around it, which produces future taxes as a spillover effect.
- This new neighboring wealth is scientifically measured against a control zone to prove its sole attribution to the project.
- Economic corridors along transit routes can widen into economic and tax zones that catch this growing wealth and future taxes.
- The tax-collecting authority puts aside an agreed share of attributable new taxes in a project-specific trust fund.
- Trust fund proceeds can be used to close initial gaps in the viability/profitability of projects to help finance them.
- Private investors will be attracted to those projects which offer this back-end participation in future tax revenues from the benefiting zone.
- Tax-kicker bonds will be able to offer higher rates of return than traditional revenue-backed or project bonds.
- A model term sheet for this new instrument illustrates its key features: dual tranching, trust fund lockbox, independent certifier of participation due, and guarantees.
- Back-end participation in a future contingency is not a present transfer payment or credit so it should be budget-neutral and off national balance sheets.

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