The Infrastructure Forum

Infrastructure Investment – Finding the "Sweet Spot"

Issue: How to increase the flow of private investment into infrastructure, whilst maintaining financial market confidence in public sector financial reporting.

Preface

Governance of the key public bodies which ultimately determine how private investment in public infrastructure is reported (Office of National Statistics "ONS", Financial Reporting Council "FRC" and HM Treasury "HMT") should balance the requirement of credible reporting with the need to stimulate economic growth. In the case of ONS and FRC, to achieve this balance will require changed governance duties.

Working practices of the ONS currently constrain the flow of private investment into infrastructure. This constraint could be quickly removed by increased transparency and engagement with project sponsors. ONS is currently delivering its independence by being operationally remote and largely inaccessible.

Classification rules which treat infrastructure projects as either wholly on the Government's balance sheet or wholly off, in a binary way, do not match the reality of projects and can stifle public-private cooperation and investment. If the UK is to maximize the potential cooperation of public and private finance for major infrastructure projects, it needs to tackle this classification issue urgently. A similar issue arises with the binary accounting principles that are applied to infrastructure investments.

Increased private investment in infrastructure would be released by greater use of Government Support Packages (GSPs), similar to those deployed on Thames Tideway Tunnel and Sizewell C projects, if accompanied by the proposed measures concerning governance, working practices and classification rules.

Recommendations

Short Term:

(1) HMT should significantly expand the availability of GSPs for privately financed infrastructure projects, with risk reporting models developed along the lines of insurance products[1].

(2) The work of the ONS should be developed in the following ways:

(a) Transparency – publish clear rules for the classification of infrastructure transactions, including those involving Regulated Asset Base (RAB) and GSP models, using case studies to support the methodology;

[1] With a sufficiently large portfolio of GSPs in issue, it may be possible to introduce private capital to underwrite a capped first-loss strip, which will further extend the benefits of a risk-based proportional allocation model when classifying infrastructure investment.

(b) Engagement – enter open dialogues with those responsible for infrastructure delivery (including project sponsors) to assist proactively in the design of viable solutions, which optimise the flow of infrastructure investment in the economy[2];
(c) Governance – to be given a Growth Duty[3] (or equivalent governance duty) to facilitate the use of private finance in infrastructure investments; and
(d) Reporting Framework – introduce infrastructure investment classifications based on proportional allocation[4].

(3) The FRC has responsibility for how financial accounts report infrastructure investments, through its interactions with the International Accounting Standards Board (IASB), which sets accounting standards. Accordingly, the work of the FRC should be developed in the following ways:

(a) Governance – to be given a Growth Duty[5] (or equivalent governance duty) to facilitate the use of private finance in infrastructure investments; and
(b) Reporting Framework – develop financial accounting principles for infrastructure investment based on proportional allocation and consolidation, with increased transparency.

Medium Term

(1) **HMT** should further develop: GSP provision through an insurance company model; and the NISTA projects pipeline, to show potential private investors where and in what form private finance will be welcomed; and should develop standard templates for such projects so that sponsors do not have to negotiate each one ab initio.

(2) **ONS** should engage with Eurostat[6] to establish whether a common approach can be developed in the EU and UK, which is most supportive of growth stimulated by increased private investment in infrastructure, combining principles of proportional allocation with Eurostat treatment of public-private partnerships in the provision of infrastructure.

(3) **FRC** should engage with the IASB and other relevant national and international stakeholders, to promote proposals involving proportional allocation and consolidation models for the accounting of infrastructure investments; and, depending on the outcome of this engagement, implement agreed proposals.

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1. Background

Investment in public infrastructure is reported and attenuated under three separate inter-dependent frameworks: (i) fiscal rules (HM Treasury - HMT[7]); (ii) financial accounts (Financial Reporting Council -

[2] Currently HMT intermediates between those sponsoring infrastructure projects – whether within the public or private sectors – and ONS; moreover, only a limited number of individuals within HMT are allowed to speak to ONS – in short, a classic process bottleneck.
[3] Through secondary legislation made under the Deregulation Act 2015, the Government issues an Economic Growth (Regulatory Functions) Order, under which the public body must, by law, have regard to the desirability of promoting economic growth when exercising its regulatory functions.
[4] Since Brexit, ONS is bound under the European Union (Withdrawal) Act 2018, to follow ESA 2010 (which applies binary allocation principles – viz an entity is classified either wholly to the public or the private sectors, with few exceptions), but is no longer bound to do so under EU Treaties. Hence, it is within the discretion of Parliament to adopt proportional risk based allocation of infrastructure investment, if it so decides.
[5] See footnote 3
[6] And potentially also the IMF Fiscal Affairs Department
[7] HMT sets the UK fiscal framework and rules that shape fiscal policy and the constraints on public borrowing and debt; these rules materially influence how much public capital can be made available for infrastructure.

FRC[8]); and (iii) expenditure classification (Office of National Statistics - ONS[9]). In each case there is a natural tension between, on the one hand, the need to produce credible reports which give confidence to financial markets; and, on the other hand, the need to optimise the flow of infrastructure investment within the economy.

2. Purpose

The purpose of this paper is to recommend a series of steps which the Government can take to ensure that the right balance is being struck year-on-year, by respectively HMT, FRC and ONS, between credible reporting and infrastructure investment. Within this context, it can be generally noted that the *best is the enemy of the good* when it comes to reporting frameworks. That is to say, the **over-**reporting of private investment (in public infrastructure) as public investment, adds neither to the credibility of the reports nor to growth in the economy. The objective should be to find the "sweet spot" at which credible reporting and optimised investment in infrastructure are simultaneously achieved.

The foundation stone of all successful infrastructure investments is a robust business case and, in the case of private sector project sponsorship, a clear rationale and value-for-money justification for the deployment of private capital. Nothing in this paper departs from these principles. The Government and private sector project sponsors are closely aligned in their shared desire to see private investment in infrastructure maximised, so relieving pressure on public accounts for other capital expenditure priorities, such as defence.

3. Duty to Promote Growth

The primary mechanism by which the right balance should be struck between credible reporting and infrastructure investment should sit within the governance of the body responsible to the respective reporting framework, namely: HMT, FRC and ONS. In the case of HMT, this tension is naturally played-out via its twin roles as both Ministry of Finance (credible reporting) and Ministry of the Economy (growth promotion). However, in the case of FRC and ONS, they have no duty to promote growth. Under the Deregulation Act of 2015[10], over 50 public and statutory bodies have been given a Growth Duty, including the Financial Conduct Authority (FCA) and Health and Safety Executive (HSE), as well as the economic regulators such as Ofgem. It is understood that FRC and ONS were excluded because their roles were seen to be primarily about market integrity and, in the case of ONS, also about measurement of growth in the economy. These assumptions deserve to be revisited, as the decisions of ONS and FRC can unnecessarily constrain the flow of private investment into infrastructure by taking reporting beyond the "sweet spot".

If the natural tension between credible reporting and infrastructure investment is not played-out within the governance of FRC[11] and ONS[12], then where is it played out? A single governance focus on credible reporting neglects the natural tension which needs to be reconciled; and, without a Growth Duty (or equivalent governance duty, which recognises the economic realities of infrastructure projects and avoids reporting frameworks that artificially limit the range of investment delivery models), the FRC and ONS are essentially unconstrained in pursuit of what they view as "best"

[8] FRC regulates corporate reporting, audit and actuarial standards in the UK, issues UK accounting and auditing standards and enforces compliance; it supervises how entities apply UK GAAP/IFRS but does not itself author IFRS, which is done by the IASB.

[9] ONS applies international statistical guidance (ESA 2010 / SNA) to classify entities and transactions; it decides whether a project or entity is recorded in the public sector, for national-accounts purposes.

[10] As extended in 2024

[11] Including through its lobbying and interaction with IASB, and interpretation of its standards

[12] Including through its lobbying and interaction with Eurostat, and interpretation of its standards

reporting, if necessary to the detriment of optimal investment in infrastructure. Such unbalanced governance is an expensive luxury for the economy when it comes to infrastructure, because of the critical role it plays in national productivity, growth and resilience.

By contrast, consider the case of the HSE, a public body responsible for the health and safety of the population within the workplace and the public domain more generally, where nothing ranks higher in society than the health and safety of its citizens. In consequence, it would have been easy to claim that the HSE should have an unfettered obligation to promote health and safety. Yet the HSE's governance has shown itself fully capable of managing the natural tension between the health-and-safety imperative and a Growth Duty. It is relevant to note for the discussion which follows below, concerning FRC and ONS, that HSE manages these tensions by adopting risk-based assessments rather than rigid determination, and transparency.

Moreover, if these natural tensions are not reconciled through appropriate governance within FRC and ONS, then the results are not just a sub-optimal scale of investment into infrastructure but also, potentially, a reduction in its quality (value for money) stimulated by an incentive to navigate dysfunctional accounting and classification frameworks which are insufficiently based on financial substance, to which we turn next.

4. Reporting Frameworks in Practice

4.1 Fiscal Rules

The fiscal framework (2024) introduced an investment rule requiring Public Sector Net Financial Liabilities (PSNFL) to fall as a share of GDP, to ensure that Government borrowing would be sustainable, while still allowing borrowing for investment. Crucially, PSNFL accounts for both liabilities and offsetting financial assets (aka a balance sheet approach), so making space for the Government to undertake financial transactions that support growth, provided they generate returns. PSNFL's broader scope means infrastructure investment that creates financial assets is treated more favorably than under Public Sector Net Debt (PSND) – the traditional measure used by EU member countries. PSNFL is more comprehensive, but it also makes the fiscal target harder to meet if investments don't generate offsetting assets. The adoption of PSNFL was explicitly designed to balance borrowing for investment with credibility within the gilts market. However, to fully realise this benefit, the supplementary reporting[13] of infrastructure investments which strengthen national productivity, resilience and future revenues, would be helpful to ensure that their long-term benefits are not rejected solely because a narrow debt statistic may worsen inside a five-year forecast window.

4.2 Financial Accounts and Expenditure Classification

The right way to approach a discussion about accounting and classification rules is to focus on the **financial substance** of the underlying infrastructure transactions and ask whether it is this which drives their reporting. Infrastructure investments can be commercially complex, and so it would be surprising if the correct characterisation of their financial substance should always neatly fall into a narrative which treats each investment as being either a wholly private-sector, or a wholly public-sector liability – a so called "binary" accounting and classification[14] model. And yet this is largely how the current principles and practices operate. The disadvantages of a binary allocation model,

[13] For example, the measure of PSNFL could also be calculated for infrastructure investments including the added value they create for national productivity, resilience, and future revenues.

[14] The principle of binary expenditure classification is enshrined within ESA 2010, which was repatriated to the UK under the European Union (Withdrawal) Act 2018.

implemented within a framework which does not seek to balance credible reporting with growth, is self-evident in terms of always erring on the side of caution, including effectively treating as public sector liabilities private sector loans which are low investment grade. The second consequence of a binary allocation model is that they create knife-edge decisions and perverse outcomes; and when this is compounded by a lack of transparency, the result is a "black box" process which is unpredictable and inefficient.

The guiding principles for these reporting frameworks should be: **proportional allocation**, informed by ex-ante risk assessments of liabilities which may crystallise to the public sector; and **substance over form**, such that assets and associated liabilities are only recorded to the public sector to the extent that the lender providing the loan which finances the asset, and/or credit agencies evaluating the loan, agrees that they are actually *in substance* AA-rated the credit strength (equivalent to the UK sovereign rating), not low investment grade (BBB+). The significance of divergence between a risk-adjusted proportional allocation and a binary determination of infrastructure investments is currently hidden from view.

The national accounts are prepared on the principle that the *economic owner* is the party who has the majority of the risks and rewards associated with an asset and, in accordance with binary allocation, the expectation is that there will be only one owner[15]. Where a privately financed infrastructure project involves contingent Government guarantees which respond only in a narrow and remote set of circumstances[16], such as the GSPs provided to the Thames Tideway Tunnel and Sizewell C projects, this can affect the classification of a project notwithstanding their private sector sponsorship. A GSP instrument is no different from an insurance policy[17] and, accordingly, it shouldn't lead to the entity which benefits from the GSP being classified to the public sector any more than someone's home which is insured by, for example, Aviva being deemed an asset of Aviva's. An approach based on financial substance would use a risk-based rather than binary allocation of economic ownership, and open the way for increased deployment of GSPs in support of private investment in infrastructure.

Foremost, ONS needs to become more **transparent,** by publishing clear rules for the classification of infrastructure transactions, including those involving RAB and GSP models, using case studies to support the methodology; and **supportive** of infrastructure investment generally, by engaging pro-actively with those responsible for its sponsorship and delivery, to help design viable solutions which optimise the flow of infrastructure investment into the economy. Currently, project sponsors are left in the dark about what might or might not work from a classification standpoint[18]. We need to move away from the status quo in which ONS's *independence* has become more like *remoteness*, where the latter leads to investment delays, increased costs and sub-optimal outcomes for the economy.

Whilst FRC is not itself directly responsible for setting accounting standards applied in the preparation of national accounts, it is the UK body which interfaces with IASB, which does set these (IFRS) standards. National accounts follow the SNA[19]/ESA frameworks, which use as **source data** financial

[15] Although international statistical guidance does sometimes allow for an asset to be split - known as "partitioning", which separates legal ownership from economic ownership to reflect the actual distribution of risk and reward. This will typically arise in the context of equity joint ventures between public can private sector entities.
[16] Which cannot be insured through the commercial markets on term offering value for money.
[17] With the relevant "insurance" premium being paid to HMT, under subsidy control regulations.
[18] In contrast to the approach taken by Eurostat, which is committed to transparency in its advice to member states.
[19] The System of National Accounts (SNA) is an international statistical standard developed and maintained by the UN (in consultation with IMF, World Bank, OECD and Eurostat) and is endorsed by the UN Statistical Commission. The ONS implements these standards through the European System of Accounts (ESA) framework in compiling the national accounts. Following Brexit (see footnote 4), the UK also has flexibility to directly implement SNA25 (published last year), which could be advantageous, given that it is much more principles-based than previous versions.

statements prepared under IFRS. So the starting point for bringing closer alignment between the accounting for infrastructure investment and financial substance, is the FRC.

5. Conclusions

The reporting frameworks which apply to infrastructure investment have steadily evolved over the years and need to keep evolving, to ensure that credible reporting and optimised investment in infrastructure co-exist. In 2024, the Fiscal Rules were modernised and this process now needs to continue with respect to both expenditure classification and financial accounting as they relate to infrastructure investment. Infrastructure plays a unique and central role in a thriving economy and, for this reason, deserves to be treated as a special case within reporting frameworks. Accordingly, this paper's recommendations are targeted solely at the reporting of infrastructure investment. They are divided into two time periods: Short Term (within one year); and Medium Term (within two years).

The proposed measures concerning governance, working practices and classification, and an approach to GSP deployment, which is based on an insurance model, create opportunities for significantly expanding the flow of private investment into infrastructure, supported by GSPs. This flow would also be assisted by: the NISTA projects pipeline showing potential private investors where and in what form private finance will be welcomed; and the development of standard templates for such projects, which help avoid the need for project sponsors to negotiate each project ab initio.

Even in the short term, meaningful steps could be taken to improve governance, transparency and the processes by which infrastructure investments are reported and so help to accelerate the implementation of projects, and ensure that the *sweet spot* is sustained in balancing **credible reporting** with **infrastructure investment**. Their implementation will likely require strong Ministerial sponsorship, given their implications for revised working practices within independent public bodies. The prize is substantial, in terms of optimising the flow of investment – public and private - into infrastructure. The net effect of these proposals will include greater disclosures to credit rating agencies and other financial market participants on the flow and nature of infrastructure investments.

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