G20 DEVELOPMENT WORKING GROUP

INFRASTRUCTURE

REPORT ON INFRASTRUCTURE AGENDA AND RESPONSE TO THE ASSESSMENTS OF PROJECT PREPARATION FACILITIES IN ASIA AND AFRICA

G20 Development Working Group: report on infrastructure agenda and response to the assessments of project preparation facilities in Asia and Africa

OVERVIEW

This paper summarises the main outcomes of the Group of Twenty (G20) Development Working Group (DWG) program of work for 2014 and proposed multi-year infrastructure agenda for 2015. This includes:

- the DWG response to the *Assessment of Project Preparation Facilities in Asia* which lays the basis for commitments in 2014 and a multi-year agenda; and
- possible new work arising out of a DWG-commissioned report *Misperception of Risk and Return in Low Income Countries* (2012).

This year the DWG has commissioned and delivered an *Assessment of Project Preparation Facilities in Asia*; this was framed to build on a similar assessment of project preparation facilities (PPFs) in Africa. These two assessments provide a substantial evidence base on: features of effective project preparation facilities; suggestions for multilateral development banks (MDBs) and donors on the organisation and funding of PPFs; and, for developing countries, on aspects of the enabling environment and improving all project preparation. In addition, the DWG has reviewed reports produced for the G20 finance track; analysed implications for low income countries (LICs), and then provided advice to the G20 Investment and Infrastructure Working Group (IIWG) on aspects of its work program relevant to LICs and other developing countries. In addition, the DWG has re-examined key reports commissioned by the DWG, including on *Misperception of Risk and Return in Low Income Countries* (2012), to inform possible future actions.

The DWG can play an important role in ensuring challenges are addressed from an inclusive and poverty-reduction perspective. This entails promoting sustainable, economic, social and environmental development. The DWG forward work program is focused on progressing work to strengthen the demand side of infrastructure investment in LICs and other developing countries. This includes a particular focus on aspects of the enabling environment, including upstream work in relation to project preparation. A new action on addressing misperceptions in the risk of investing in infrastructure in LICs has also been identified. Other new actions are based on the combined analysis of the assessment of PPFs in Asia, and the previous assessment of PPFs in Africa (Infrastructure Consortium of Africa report, 2012).

The following sections provide an overview of key components, outcomes and commitments arising from the 2014 work program. This work lays the basis for a multi-year infrastructure agenda, commencing in 2015.

RESPONSE TO ASSESSMENTS OF PROJECT PREPARATION FACILITIES

The 2013 G20 leaders' declaration recognised the importance of improving the prioritisation, planning, and funding of investment projects. It also emphasised the need to make better use of PPFs. In support of this, the 2013 St Petersburg Development Outlook specifically requested the DWG to:

> *Assess the effectiveness of PPFs in regions in addition to Africa in promoting long-term investment financing for infrastructure, increase understanding of the obstacles to implementation, disseminate this knowledge through a common platform, and consider the creation of a global network of regional PPFs.*

In December 2013, the DWG agreed that Australia, in consultation with infrastructure co-facilitators (India and the Republic of Korea), would lead the development of terms of reference (TORs) for the assessment of PPFs in Asia. The TORs were agreed out-of-session in March 2014. The objective of the Asia assessment was to:

> *Evaluate the effectiveness of PPFs in Asia in promoting long-term investment financing for infrastructure.*

The assessments of PPFs in Africa and Asia found that there was a need to significantly increase the resources devoted to project preparation to improve its quality and to facilitate increased infrastructure development. In Africa, there was a particular problem with developing large scale regional projects, whereas in Asia these types of projects had been successfully developed in the past. Both assessments advocate:

- greater transparency in the operation of PPFs;
- consideration by donors of the financial viability of smaller PPFs; and
- greater movement towards cost recovery for project preparation to increase the ownership by government of projects and improve the financial sustainability of PPFs.

In addition, both assessments strongly advocate an approach to project preparation that supports third-party financing and syndication of funds between PPFs. In Africa, a recent step towards greater cooperation between PPFs has been the establishment of a PPF Network, which met for the first time in June 2014.

The lessons from the assessments of PPFs in Asia and Africa provide G20 members with the opportunity to support new approaches to project preparation that are aimed at preparing high quality infrastructure projects. This is important for attracting finance from a range of sources that can bolster resources already committed to fund infrastructure through domestic and other traditional sources of finance. Without additional financing for infrastructure investment in LICs and other developing countries, infrastructure needs will not be met, and both growth and development prospects will be negatively affected.

The recommended actions fall into two broad categories and are consistent with the agreed DWG focus on the demand side of infrastructure investment and project preparation. They include actions to strengthen the upstream capacity for project preparation and those aimed at maximising the effectiveness of PPFs to prepare quality projects for financing from a range of sources, including through public private partnerships (PPPs). This recognises that greater engagement of the private sector in infrastructure can benefit developing countries through providing access to technology, markets, experience and increased efficiency in infrastructure operations.

Strengthening the upstream environment for infrastructure project preparation

The World Bank Group (WBG) estimates that between 2014 and 2020 up to US$1.3 trillion per annum may be required to meet infrastructure demands in LICs and other developing countries. The Organisation for Economic Co-operation and Development (OECD) estimates that approximately US$ 800–900 billion is currently being spent on infrastructure per year in these countries. The vast majority of financing for infrastructure investment in developing countries is from domestic sources, including the public sector (55–75 per cent), and approximately 20–30 per cent is financed by the private sector. Official development finance accounts for only 5–8 per cent of infrastructure financing (OECD, 2014). While domestic resources and official flows will remain vital contributors to infrastructure investment in developing countries, increasing private sector finance could help fill the investment financing gap and drive an expansion in infrastructure investment that could stimulate growth, and address key development issues such as food insecurity, access to energy and other key services.

The DWG recognises that LICs and other developing countries face major constraints in meeting their infrastructure needs. The DWG has identified that demand-side factors may need to be addressed and that the DWG can play an important role in ensuring that challenges are addressed from an inclusive and poverty- reduction perspective. LICs may have insufficient and poor quality data on infrastructure gaps and requirements, low capacity to prioritise infrastructure needs, identify and prepare projects, and a lack of technical expertise to create the right domestic settings to attract private investors. These demand-side factors are often referred to as “upstream activities” for project preparation. While developing-country governments must take the lead in building an enabling environment for infrastructure, G20 members can provide support through identifying aspects of the enabling environment that are critical to increasing both public and private infrastructure investment. This may include specific support for aspects of the enabling environment that relate to the financing and funding of infrastructure from domestic and other sources.

The proposed Action 1 (below) seeks to draw on the experience of key international organisations, such as the OECD Investment Policy Reviews, and work of MDBs, to identify a range of indicators that could be used on a voluntary basis by developing countries to help in identifying and prioritising reforms to their enabling environment for infrastructure investment, and to identify areas that may require capacity building or technical assistance. **G20 members could commit** to support critical reforms identified by governments such as: improvements to the policy, legal, institutional, operational investment climate and financial environment. Support could be provided by the provision of technical assistance, through MDB advisory services and via MDB-based PPFs that include a focus on upstream support for PPPs and other forms of private sector participation in infrastructure. Support that strengthens the enabling environment for private sector investment in infrastructure, for example through addressing regulatory reforms or strengthening government capacity to prioritise projects, will also lead to more efficient and targeted public investment in infrastructure.

As countries develop, and there is greater interest in pursuing PPPs, the complexity and cost of project preparation for infrastructure rises. This is due to increasing standards of project preparation and the complexity of structuring projects for multiple financiers. Social factors must also be considered to help ensure its sustainability. Moreover, green and climate resilient infrastructure also present specific design, regulatory and financing challenges, as they require access to specialist expertise and are less familiar to investors. In this context, governments, MDBs, donors and PPFs need to have realistic expectations in relation to the difficulties and cost of project preparation and be prepared to provide adequate funding. **G20 members could also commit** to increasing transparency in relation to the cost of project preparation financed through official development assistance (ODA). This would be a first step towards increasing appreciation of the real cost of preparing projects that follow good design practice and that maximise the economic, social and environmental returns for the government. Increased appreciation of the cost of project preparation should lead to an allocation of more funds for the preparation of public financed infrastructure and PPPs. Together with improved capacity for upstream activities and project preparation, increased funding for quality project preparation should increase the number of projects being prepared that are successful in attracting finance and being implemented.

The DWG’s responses to recommendations 1 and 5 of the *Assessment of PPFs in Asia* report (at Annex 1) address aspects of supporting the enabling environment for infrastructure.

Maximising the effectiveness of project preparation facilities to leverage greater co-financing arrangements, including through public-private partnerships

Increasing the number and quality of infrastructure projects ready for financing in developing countries will require close coordination between a number of stakeholders including; international finance institutions, G20 member countries and national level governments and institutions. Dedicated PPFs currently undertake the minority of preparation for infrastructure projects. There is an opportunity to scale up delivery of infrastructure by fostering the engagement of catalytic, specialist PPFs to prepare projects that can attract finance from a range of sources, including the private sector.

There are a range of approaches being considered by MDBs to leverage their funds, country and technical expertise, access to de-risking and leveraging operations and their reputations to work with the private sector to meet the infrastructure challenges facing developing countries. These initiatives directly respond to the G20 High Level Panel report that asks that MDBs make their capital "work harder and smarter" to crowd in private sector support. They also address calls for MDBs to transition from a lending culture to an enabling culture. Improving the capacity of MDB-based PPFs to work together would significantly enhance the overall capacity to engage with the private sector and move towards establishing infrastructure as an asset class for a broad range of national and international long term investors.

Infrastructure investment is long term and has particular risks associated with it at different times in project implementation. To some extent these risks are magnified in developing countries. MDB-based PPFs are well placed to help manage the risks of infrastructure investment in developing countries, including through providing potential investors with access to country and sector level knowledge and expertise. MDB-based PPFs are also well placed to work with developing country governments to make information accessible that can be utilised by the private sector in their investment decisions. The importance of such information being available was highlighted in the G20 High Level Panel (HLP) on infrastructure report (2011), which noted that the private sector will not "invest in the dark". In order to fulfil their potential role in attracting greater private sector involvement in infrastructure investment in developing countries, MDB-based PPFs must be able to work collaboratively on project preparation, development and in some cases, financing for specific infrastructure projects. Given this, **G20 members could call** on new MDB-based PPFs with a focus on increasing private sector financing of infrastructure to maximise their capacity to collaborate with each other, with country financed PPFs, the private sector and governments. Specifically, the **G20 members could call** on MDB-based PPFs to:

- move towards approaches to country specific sector diagnostics and project prioritisation the outcomes of which can be utilised by other MDBs (elaborated on in proposed Action 2 below); and
- prepare projects so as to maximise financing options including through having an "open access" approach to possible sources of funds.

In this context, the **G20 DWG notes** the continued development of the Global Infrastructure Facility (GIF) and **welcomes additional information** on it when available.

The *Assessment of PPFs in Asia* has identified a need for a regional based approach in Asia that will focus on preparing infrastructure PPPs, with a particular focus on assisting countries where there is insufficient scale or capacity to support national level PPFs. The proposed Asian Development Bank PPF in Asia (the AP3F) will be a standalone facility that will focus on PPPs in which the private sector will provide the majority of financing for projects. The AP3F design has incorporated recommendations from the *Assessment of PPFs in Asia* in its design. These include recommendations that the AP3F includes capacity for targeted support for upstream activities in relation to project preparation, is open to consideration of project concepts from partner governments, multilateral and bilateral donors, other MDBs and private consortia, and that it prepares projects that can be financed by a range of investors. The **G20 DWG welcomes** the continued development of AP3F, and **notes its design is intended to** respond to recommendations of the *Assessment of PPFs in Asia*.

The **G20 DWG welcomes** the incorporation of Africa 50, which responds to a conclusion of the Assessment of PPFs in Africa for a dedicated facility that has African ownership and the ability to crowd in nontraditional sources of finance, especially from the private sector. Africa 50 will work closely with other project preparation facilities and is designed to incorporate a high degree of collaboration with other institutions.

Although not the subject of the assessments commissioned by the G20, existing PPFs in Latin America and the Caribbean, managed by the Inter-American Development Bank (IDB), have helped to successfully prepare both national and regional infrastructure projects. Going forward, the IDB's experience can provide useful lessons that can contribute to the knowledge sharing in the design and implementation of new MDB-based PPFs.

To ensure that the benefits of MDB-based PPFs are sustained and flow to all project preparation, including for domestic financed projects, MDB-based PPFs must be well integrated with MDB loan operations, advisory services and government project preparation efforts. To this end, the **DWG could welcome** the capacity to provide upstream support which has been integrated into the designs of the GIF and the AP3F. The DWG will work with the IIWG on ensuring that links between new MDB facilities and broader MDB activities in infrastructure in developing countries are maximised. For example, the World Bank Group has produced a set of principles for the prioritisation of infrastructure to maximise development impact as part of an ongoing work program in the IIWG on a range of leading practices and principles. The DWG could draw on this work and that of other MDBs when taking forward its future Action 2 (ii) (below) requesting MDB-based PPFs focused on PPPs for infrastructure to move towards government approved lists of prioritised projects.

At the same time, where support is provided for small PPFs and other project preparation, **G20 members may individually consider** whether national project preparation systems can be strengthened to achieve required scale, or if needs would be better served by consolidating funds in a regional or global facility such as those mentioned above. To increase the sustainability of PPFs which focus on PPPs for infrastructure, the **DWG could call** on MDBs and development assistance agencies to consider moving towards partial or full cost recovery as countries develop and their project preparation capabilities improve.

Potential **DWG responses to recommendations** 2, 3, 4 and 6 of the *Assessment of PPFs in Asia* report (at Annex 1) address different aspects of maximising the effectiveness of PPFs to leverage increased private sector investment and to strengthen all project preparation, irrespective of the funding source.

CROSS-CUTTING ISSUES

Analysis of reports from the G20's finance track on a range of issues affecting investment in infrastructure confirmed that some developing countries face difficulties in accessing capital for investment in infrastructure. Many developing countries face limitations in their capacity to raise finance in their own capital markets, which may lack depth and breadth. LICs, in particular, can find international capital markets difficult to access due to poor sovereign risk ratings. The HLP report noted that the actual risk involved in infrastructure investment in LICs may be lower than the perceived risk. Some of the difference in actual versus perceived risk may be related to a lack of access to reliable information on the investment environment in LICs. In cases where there are legitimate factors related to the enabling environment for infrastructure that contribute to higher sovereign risk, the expertise may not exist in the country to either diagnose the problem or to address it. Access to good quality technical assistance is therefore particularly important for LICs and other developing countries who wish to create an attractive environment for investment.

The May 2014 DWG meeting endorsed the value in follow up work on the issue of the real versus the perceived risk of investing in infrastructure in LICs. Australia and DWG infrastructure co-facilitators have explored the potential for follow up work in this area, including by assessing the specific recommendations of the DWG commissioned report on *Misperceptions of Risk and Return in Low Income Countries* (2012). Potential work has been identified that would involve drawing on the collective experience of MDB-based and other donor funded organisations that focus on increasing investment in infrastructure in LICs to identify pragmatic ways of assessing and managing risk throughout the investment cycle. Potential work in this area could include efforts to address the lack of risk ratings on infrastructure projects in LICs, and analysis of different insurance and credit enhancement products available to manage risk. The option of opening a dialogue with private sector investors, including commercial banks and equity houses could also be explored. It is anticipated that as **Action 3** the G20 DWG will, in coordination with the IIWG, initiate a dialogue on factors affecting risk perception in LICs, with a view to better informing risk management and mitigation approaches. As a first step, the DWG will explore the possibility of facilitating engagement between international investors and other potential stakeholders.

NEW ACTIONS: A MULTI-YEAR INFRASTRUCTURE AGENDA

Increasing investment in infrastructure in developing countries is a long term agenda that requires efforts to: establish a good enabling environment; address issues related to the risk associated with infrastructure investment; increase the supply of projects ready for financing; and attract increased finance. The following proposed multi-year agenda for DWG infrastructure work is consistent with the agreed DWG focus on the demand side of infrastructure investment and project preparation, and builds on the foundation of the assessments of PPFs in Asia and Africa. The summary of the DWG response to specific recommendations of the *Assessment of PPFs in Asia* report is at Annex 1.

Based on the DWG response and further analysis completed, the DWG **commits** to three new actions for 2015, outlined below.

NEW ACTION 1: STRENGTHENING THE UPSTREAM ENVIRONMENT FOR INFRASTRUCTURE PROJECT PREPARATION

The **G20 requests** key international organisations to consult with and share information with developing countries on policy indicators that can be used on a voluntary basis to identify the most essential reforms in the enabling environment for infrastructure investment**.** G20 members and MDBs could be encouraged to provide capacity building support in response to reform priorities identified by governments.

NEW ACTION 2: MAXIMISING THE EFFECTIVENESS OF PROJECT PREPARATION FACILITIES TO LEVERAGE GREATER PRIVATE SECTOR INVESTMENT

Take concrete, practical steps over several years to ensure that MDB-based PPFs collaborate to support governments develop prioritised lists of infrastructure projects. These steps recognise that for substantive collaboration to take place, it should build on the cooperation that already exists, and be paced to allow for agreed approaches to be evaluated by the relevant institutions.

(i) The G20 **requests** MDB-based PPFs that are focused on PPPs for infrastructure to report on the key elements of their current approach to country-specific sector diagnostics, as a first step in moving towards sector diagnostics that can be exchanged with other MDBs.

(ii) The G20 **requests** MDB-based PPFs that are focused on PPPs for infrastructure to report on current approaches to project prioritisation as a first step to moving towards government approved lists of prioritised projects.

NEW ACTION 3: PROMOTING BETTER UNDERSTANDING OF RISK AND RETURN IN INFRASTRUCTURE INVESTMENT IN LICS

The DWG will, in coordination with the IIWG, initiate a dialogue on factors affecting risk perception in LICs, with a view to better informing risk management and mitigation approaches. As a first step, the DWG will explore the possibility of facilitating engagement between institutional investors and other potential stakeholders.

Annex 1: G20 Development Working Group response to specific recommendations of the Assessment of Project Preparation Facilities in Asia

Recommendations of Assessment of Project Preparation Facilities in Asia *(numbers 1–6 from Executive Summary)*	**G20 DWG response**	**Comment**
1. Priority should be given to strengthening developing country governments' capacity for upstream activities leading to the identification of prioritised investment programs.	**Agree**	The experience of international organisations could be drawn on to identify a range of indicators that could be used on a voluntary basis by developing countries to identify and prioritise reforms to their enabling environment for infrastructure investment, and to identify areas that may require capacity building or technical assistance. **Action 1:** The G20 **requests** key international organisations to consult with and share information with developing countries on policy indicators that can be used on a voluntary basis to identify the most essential reforms in the enabling environment for infrastructure investment. G20 members and MDBs could be encouraged to provide capacity building support in response to reform priorities identified by governments.
2. The common practice of selecting the financing modality for a project prior to feasibility study should ideally be reversed otherwise it necessitates better upstream project investigation and flexibility during project preparation.	**Agree in principle**	The G20 **recognises** that it may not always be possible to follow the ideal project preparation approach with respect to when the financing modality for a project is selected. Given this, MDBs and donor funded technical assistance can build capacity for governments to take the necessary decisions regarding the appropriate financing approach for a particular investment at the right time.

3. The scale of project preparation needs to be ramped up to support enhanced infrastructure development.	**Agree**	There is a case for greater **transparency** in relation to the cost of project preparation, particularly where it is financed through government resources and grant aid. An appreciation of the real cost of preparing projects that follow good design practice and that maximise the economic, social and environmental returns for the government may lead to an allocation of more funds for preparation. This, in turn, should lead to more and better infrastructure projects being financed and implemented. G20 members **could commit** to increasing transparency in relation to the cost of project preparation funded through official development assistance sources.
4. Funding for project preparation should be rationalized and increased.	**Agree in principle**	Both the Africa and Asia assessments question the sustainability of some PPFs, and raise issues about the scale of operation necessary for a standalone PPF focused on infrastructure. In the case of Asia, support should be provided at a regional level to project preparation in infrastructure, particularly in countries where a stand-alone facility would be unlikely to have sufficient scale to prepare large and complex projects for public private partnerships (PPPs). Such support could be delivered through a facility developed by a regional development bank, such as the proposed Asian Development Bank regional PPF (the AP3F), or via a regional presence of a global facility, such as the proposed Global Infrastructure Facility.
5. There should be a clear path for countries to transition from receiving grant support for project preparation to eventually being willing to finance it themselves as their economies develop.	**Agree in principle**	The G20 **recognises** that as countries develop, the complexity of their project preparation may increase and yet their capacity for project preparation may remain under-developed. This issue must be taken into account when considering the path for transitioning from grant support for project preparation to it eventually being financed through government resources. PPFs with a focus on preparing infrastructure projects to attract private financing, may help in the transition through seeking partial or full cost recovery for projects prepared. Moving towards more cost recovery will also improve the sustainability of PPFs, and ensure that more projects are prepared ready for finance from a range of sources.

6. Improved efforts are needed to make better use of the private sector in infrastructure design, funding, delivery and long-term operation and to leverage the overall benefits of private sector participation.	**Agree**	To maximise the capacity of MDB-based PPFs to work closely with the private sector and leverage greater private sector funding into infrastructure in developing countries, PPFs must be encouraged to collaborate with each other. Ideally, governments and all PPFs working in a country would work from the same sector diagnostics and list of prioritised projects. This would improve the environment for all public and private sector involvement in infrastructure and it would send a positive signal to investors. **Action 2 (i):** The G20 **requests** MDB-based PPFs that are focused on PPPs for infrastructure to report on the key elements of their current approach to country-specific sector diagnostics, as a first step in moving towards sector diagnostics which can be exchanged with other MDBs **Action 2 (ii):** The G20 **requests** MDB-based PPFs that are focused on PPPs for infrastructure to report on current approaches to project prioritisation as a first step to moving towards government approved lists of prioritised projects.