G20 and Infrastructure

Submission on behalf of Think20 to the G20 Investment and Infrastructure Working Group Meeting, 4 June 2014

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Introduction

Following is a submission in advance of the 4 June 2014 meeting of the G20 Investment and Infrastructure Working Group. This submission is on behalf of the Think 20 process, but the views are entirely those of the authors. It contains commentary and specific recommendations.

Summary of recommendations:

- The G20's narrative around infrastructure investment should clearly take into account that each countries needs and priorities differ.

- The IMF, OECD and World Bank should publish a joint paper in advance of the Brisbane Summit highlighting what they consider are the priorities that each G20 member should address in order to improve its domestic investment climate. This will provide a benchmark to help strengthen G20 members' commitment to undertake the necessary reforms.

- The G20 needs to prioritise the key requirements that are necessary for increased infrastructure to support growth and jobs. Towards that end, it should emphasise that the top priority of all governments should be to ensure that the 'right' infrastructure projects are selected, namely those that provide positive net social benefits.

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- The G20 should focus on ensuring that all infrastructure, both existing and new, is used as efficiently as possible, and that the important role of user-pays and congestion charges is recognised.

- G20 members should commit to make the selection and assessment process, including the cost-benefit analysis, of all infrastructure projects fully transparent.

- The G20 should require that a decision to use private financing through a public-private partnership (PPP) is dependant upon whether it would result in lower production costs, better maintenance, and a higher level of service than if the investment was financed totally by public funds.

- The G20 should provide political impetus to strengthening the role of the multilateral development banks (MDBs) in promoting productive and sustainable infrastructure investment in developing countries, particularly by ensuring that their core financing and indirect catalytic activities pass the additionality test.

- In addition to engagement sessions with outreach groups as part of meetings of the G20 investment and Infrastructure Working Group, and given travel constraints, each member of the working group should engage with outreach groups in their own country.

The Context

Infrastructure has been identified by Australia as a priority for the G20 in 2014.

But infrastructure is not a new priority for the G20. At previous G20 summits, leaders have endorsed the importance of infrastructure investment for growth and jobs and they have committed to lift infrastructure investment. For example:

- At the Seoul Summit in 2010, as part of the Multi-Year Action Plan on Development, leaders said they were committed to overcoming obstacles to infrastructure investment, developing project pipelines, improving capacity and facilitating increased finance for infrastructure investment.[3]

[3] G20***. Multi-year action plan on development.*** Seoul, 12 November 2012: http://www.g20.utoronto.ca/2010/g20seoul-development.html.

- For the Cannes Summit in 2011, a High Level Panel was established to identify measures to scale-up and diversify sources of financing for infrastructure, make projects bankable and enhance knowledge by sharing skills with low income countries.[4]
- At the Los Cabos Summit in 2012, leaders emphasised that infrastructure is critical for sustained economic growth, poverty reduction and job creation. They noted that while public financing of infrastructure development projects remained critical, it should be complemented by private sector investment.[5]
- At the Saint Petersburg Summit in 2013, leaders re-emphasised the key role of long-term investment, particularly in infrastructure and committed to put in place the conditions that would promote financing for infrastructure investment, including mobilising private investment.[6]

With G20 leaders regularly emphasising the importance of infrastructure investment, it is curious to see calls that a priority for the Brisbane Summit should be a "strong affirmation of the critical importance of infrastructure and investment as a key part of the G20 vision".[7] Infrastructure is already an established part of the G20 agenda. The challenge for Australia is to move beyond the rhetoric of emphasising the importance of infrastructure investment and deliver on Prime Minister Abbott's commitment for some tangible outcomes from the Brisbane Summit.

The G20's current narrative on the issue appears to be that there is a worldwide infrastructure gap that cannot be totally financed by the public sector, particularly given that many countries are constrained by high public debt levels. There is however, no shortage of private capital available to finance infrastructure and the central challenge is to unlock this private capital, particularly pension funds, so that it can be used to lift infrastructure investment. As Prime Minister Abbott stated "it should be easier to get big new road, rail, port and dam infrastructure off the ground – and we can do that through attracting more private capital".[8] Similarly, the

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[4] G20. ***Cannes summit final declaration.*** Cannes, 4 November 2011: http://www.g20.utoronto.ca/2011/2011-cannes-declaration-111104-en.html.

[5] G20. ***Leaders' declaration.*** Los Cabos, 19 June 2012: http://www.g20.utoronto.ca/2012/2012-0619-loscabos.html.

[6] G20. ***Leaders' declaration.*** St Petersburg, 6 September 2013: http://www.g20.utoronto.ca/2013/2013-0906-declaration.html.

[7] Robert Milliner. Unlocking Private Sector-led Growth and Investment. In: The Lowy Institute for International Policy. ***G20 Monitor Issue 9 - G20 2014: Perspectives from business, civil society, labour, think tanks and youth.*** 21 March 2014: http://www.lowyinstitute.org/files/g20_2014_monitor_9_web.pdf.

[8] Tony Abbott. ***Address to the World Economic Forum, Davos, Switzerland***. Davos, 23 January 2014: http://www.pm.gov.au/media/2014-01-23/address-world-economic-forum-davos-switzerland-0.

Australian Treasurer, Joe Hockey, said that the centrepiece of the G20 agenda under the Australian chair would be to "undertake domestic reforms that tangibly improve the investment environment and so unlock private sector investment, particularly in the area of infrastructure".[9]

However, lifting infrastructure investment is not a priority for every G20 member. For example, while China may need to improve the quality of its infrastructure investment, its overall challenge is to increase consumption expenditure relative to investment spending. Japan is another G20 country where raising infrastructure spending is not a priority. ***It is recommended that the G20's narrative around infrastructure investment clearly takes into account that each country's needs and priorities will differ.***

The need to focus on the fundamentals

Focusing on the financing of infrastructure investment, particularly increasing private sector investment, raises a wide range of issues. As the Australian Treasurer outlined, there is the important task of all countries improving their domestic investment climate. This involves ensuring macroeconomic and political stability and providing certainty for investors in such areas as regulation, taxation, accounting and governance. With the aim to lift private sector involvement, attention inevitably turns to the role of public-private partnerships (PPPs) and the contractual challenges of dealing with the range of risks associated with the construction and operation of infrastructure projects.

Another dimension of infrastructure financing is the impact of post-crisis regulatory initiatives on the traditional project financiers, particularly in the construction phase, namely commercial banks. Banks are facing credit constraints as part of new regulatory requirements and their investment horizon has been shortened. This leads to the importance of developing capital markets, particularly in developing countries.

The relative importance of these various factors will vary across each G20 country. As such, it is important that the growth strategies each member is preparing for the Brisbane Summit clearly demonstrate what action is being taken to improve the investment environment in order to facilitate a lift in infrastructure spending. To strengthen this process, ***it is recommended that the IMF, OECD and World Bank***

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[9] Joe Hockey. ***Australia's role in strengthening international consultation and cooperation -*** Speech at theLowy Institute for International Policy. Sydney, 6 February 2014: http://www.joehockey.com/media/speeches/details.aspx?s=126.

publish a joint paper in advance of the Brisbane Summit highlighting what they consider are the priorities that each G20 member should address in order to improve its domestic investment climate. This would be a significant step in strengthening G20 accountability, as it would provide a benchmark to assess the progress each G20 member will be making in improving their investment climate as part of implementing their growth strategies..

Priorities are necessary

Much of the focus of the discussion on infrastructure has been directed at 'transaction' issues associated with infrastructure financing. For example, there have been calls from the business sector for governments to develop a stock of long-term 'bankable' infrastructure projects (which will encourage institutional investors to develop the skills to analyse investment projects), the standardisation of the process and materials for the preparation of projects, and time limits be set for regulatory and environment assessment processes.[10]

All of these elements are relevant to increasing infrastructure investment and the G20 has launched initiatives dealing with most of them. But it represents a crowded agenda and there has been little attention to prioritise efforts. For example, as mentioned, the business sector has called for standardisation of processes, materials and documentation for infrastructure projects. While the cost of bidding for a PPP may be high, it is not clear that a lack of standardisation and high bidding costs are key impediments to increased infrastructure investment. If the G20 is going to deliver tangible outcomes on this issue in 2014, the first task should be to prioritise its efforts and identify the fundamentals to lifting infrastructure investment that will contribute to supporting long-term economic growth. In this context***, it is recommended that the G20 identifies that the top priority of governments should be to ensure that the 'right' infrastructure projects are selected.*** Specifically, too much attention is being focused on how infrastructure can be financed rather than ensuring that the funds are being directed to support the most appropriate projects.

Focussing on project financing options presumes that the decision has already been made that the investment is the best use of limited resources. But the source of financing itself cannot fundamentally alter the economics of a project, and a necessary first step is to ensure that the 'right' projects are selected, that is ones that

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[10]Robert Milliner. Unlocking Private Sector-led Growth and Investment. In: The Lowy Institute for International Policy. G20 Monitor Issue 9 .- G20 2014: Perspectives from business, civil society, labour, think tanks and youth. Issue 9. Lowy Institute for International Policy 21 March 2014:

generate net social benefits. Bertrand Badre from the World Bank recently made a similar point.[11] In particular, that promoting infrastructure investment requires more than money. He observed that some countries generate massive growth benefits from their infrastructure spending, while others hardly see a return. The lesson is that governments must pay more attention to the selection, quality and management of infrastructure projects as well as to the quality of the underlying investment environment.

The importance of project selection is fundamental, but it remains a weak link in many countries. Moreover, emphasising the need to rapidly close the large global investment gap, along with suggestions that governments should set specific targets for lifting infrastructure spending, runs the danger of excessively emphasising the quantity of infrastructure without paying sufficient attention to the quality of that investment. The same concerns arise when increases in infrastructure spending is used for demand management purposes and as a way to boost short-term economic growth. In these circumstances, it is more likely that governments will build 'bridges to nowhere'. There are 'white elephant' infrastructure projects in most countries and the quest to lift infrastructure investment, be it publically or privately financed, cannot be at the expense of rigorous processes to ensure that the highest value projects are selected.

The top priority for many governments is to comprehensively overhaul their processes for the assessment and development of public infrastructure projects. As the Australian Productivity Commission has pointed out, without such reforms, more spending will simply increase the cost of infrastructure to users, taxpayers, and the community generally and lead to the provision of wasted infrastructure. One of the factors that works against the selection of the right infrastructure projects is the tendency for governments to select projects because they are popular or for political reasons rather than because they generate the highest net social returns.

Better pricing of infrastructure services

Another factor working against the selection of the most appropriate projects is the failure to use existing infrastructure as effectively as possible. In many respects this comes down to poor pricing and regulatory policies by governments. For example, as has been widely demonstrated, the way to deal with road congestion is not to

[11] Betrand Badre. ***Infrastructure unbound.*** Project Syndicate, 26 March 2014: http://www.project-syndicate.org/commentary/bertrand-badre-cautions-that-money-is-not-enough-in-meeting-countries--public-investment-needs.

build more roads.[12] It will require the use of congestion charges in order to use existing roads more efficiently, along with better urban planning. The failure to properly price the services from infrastructure not only results in their inefficient use, it also represents a barrier to increased private sector financing.

The good news is that the ability to better price the services from infrastructure, which would ensure their more efficient use and make them more attractive candidates for private financing, is being facilitated with advances in technology. An obvious example is how technology can allow the application of congestion charges without disrupting journeys. But a fundamental question that the G20 should address is why new technologies are not being applied and why governments continue with policies that result in the inefficient use of existing infrastructure and impede new investment. Some of the factors working against the up-take of new technologies may include agency limitations, a bias towards the status quo, regulatory constraints and political factors – such as the electorate not wanting to pay tolls or higher charges***. It is recommended that the G20 focus on the importance of ensuring that infrastructure is used as efficiently as possible and the role of user pays and congestion charges.***

Are governments the problem?

Governments generally take the lead role in infrastructure development. This is often to ensure equitable access to infrastructure services (such as providing services to those who are not able to pay), market failures (not enough of the good or service being provided or the existence of natural monopolies), or for historical and cultural reasons. But as noted, governments can be the main impediment to the efficient use of existing infrastructure and political influences can result in inferior infrastructure investments.

One response to pressures which results in governments selecting less efficient infrastructure projects has been to propose that 'G20 governments and business jointly develop long-term bankable infrastructure plans for each country, supported by objective, independent assessments of national priorities, and freed from the uncertainties of the political cycle'.[13] While such an approach is understandable, it is questionable whether it will gain much traction among G20 counties. It is effectively

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[12] Clifford Winston. ***The private sector's potential to improve public transportation infrastructure: with and without privatization – Presentation at the*** conference 'Financial Flows and Infrastructure Financing'. Sydney, 20-21 March 2014: http://www.rba.gov.au/publications/confs/2014/pdf/winston.pdf.
[13] ***The private sector's potential to improve public transportation infrastructure.***

saying that governments cannot be trusted with infrastructure planning and project selection and the direct involvement of business in the planning process would result in better outcomes.

As noted, there are a range of factors that have resulted in governments being largely responsible for the provision of infrastructure. These cannot be ignored. Moreover, the cost-benefit analysis associated with selecting infrastructure projects is different from the financial analysis of investment undertaken by firms. The cost-benefit assessment for infrastructure has to be broad and take into account social, distributional and environmental considerations. These are ultimately matters for which governments have to take responsibility.

The key requirement to improve infrastructure planning and project selection is transparency. In many respects, it does not matter who undertakes the project assessments, provided all the factors taken into account in making a decision are fully disclosed and available for public scrutiny. ***It is recommended that G20 members commit to make the selection and assessment process of all infrastructure projects fully transparent***. This would help not only improve the quantity, but also the quality of infrastructure investments.

Caution with PPPs

PPPs are not a magic bullet for increasing infrastructure investment. Whether a PPP makes sense depends almost exclusively on the economic characteristics of the infrastructure, not on the way it is financed or funded. PPPs can work when objective performance standards can be written into a contract between the public authority and the private firm. One of the main advantages of PPPs from the government perspective is that they allow for investments while keeping future obligations off balance sheet and outside parliamentary control, but this has no bearing on whether a PPP delivers better value for money.

It is recommended that the G20 endorse that a decision to use private financing through a PPP should depend on whether it would result in lower production costs, better maintenance, and a higher level of service then if the investment was financed totally by public funds.

The role of MDBs

Infrastructure investment is largely a domestic policy issue. As such, the question often raised is how international summits can contribute to lifting infrastructure investment. However, strengthening the MDBs to enable them to play a significant role in supporting infrastructure investment in developing countries represents a clear international dimension of this policy area and one where the G20 may be able to provide political impetus.

Promoting infrastructure investment has traditionally been a core role of the MDBs. However, over the last two decades, the infrastructure mandate has lost relative weight in their operations, with growth in other areas such as health and education. Given this broader set of priorities, it is all the more important that the MDB's engagement in fostering infrastructure investment is as efficient and effective as possible. Additionality is the key test to determine how and where the MDBs can meaningfully contribute to promoting infrastructure investment. True additionality depends on whether a project would have gone ahead without MDB involvement.

MBDs provide various dimensions of additionality in the area of infrastructure investment. Financial additionality covers their ability to attract funding from other sources based on the official 'stamp of approval' that MDB involvement in a project implies. This is often referred to as the MDB's 'core' catalytic role.[14] Policy additionality refers to the MDB's indirect role in fostering infrastructure investment by addressing the underlying investment conditions, for example by providing technical assistance in areas such as capital markets development, governance and regulation.[15] This 'indirect' catalytic role may even be even more important than their financial contribution.[16] Other related dimensions of additionality include demonstration additionality (demonstrating potential success by supporting 'first-mover' projects), design additionality (in project design and implementation) and

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[14] A variety of factors is attributed to creating this financial additionality, including the MDB's solid finances and in particular their preferred creditor status, their long-standing technical expertise in countries all over the world, their long-term outlook and their strict adherence to governance and project standards in project selection and implementation. These advantages also may allow MDBs to secure better financing terms, such as lower rates and longer maturities, for a project. See: Willem Buiter and Steven Fries. ***What should the multilateral development banks do? Paper prepared for the Annual World Bank Conference on Development Economics – Europe, June 2001***. European Bank for Reconstruction and Development. Working paper No. 74. June 2002. Jeff Chelsky, Claire Morel, and Mabruk Kabir. Investment Financing in the Wake of the Crisis: The Role of Multilateral Development Banks. ***Economic Premise*** 121. World Bank. June 2013.

[15] ***Investment Financing in the Wake of the Crisis***.

[16] Jeff Chelsky and Claire Morel. ***Official-Sector Non-Concessional Long-Term Financing - The Role of Multilateral Development Banks. G20 Work Program on Long-Term Financing for Growth and Development***. 16 February 2013.

selection additionality (through improved project selection on the basis of strict governance and accountability standards).[17]

There is also a political economy dimension to MDB involvement in infrastructure projects. MDBs may serve as a 'scapegoat' for politically sensitive decisions that are associated with a project.[18] MDB conditionality may serve borrower countries as a justification for the need for reform. The MDB's reputation as an 'honest broker' may help fostering policy change that ultimately contributes to improving investment environments.

The MDBs can make a major contribution to reducing the global infrastructure gap, provided their client base and their core and indirect catalytic activities pass the test of additionality. Lending should be concentrated on low and lower middle-income countries that lack other funding options. In terms of both financial and technical assistance, additionality needs to be further strengthened. The MDB's can further increase the productivity of their lending by further reinforcing recent efforts to more strongly embrace financial innovation. The MDB's technical assistance will benefit from a stronger integration between the infrastructure agenda and efforts to combat climate change and promote inclusive development. Given the enormous challenges in terms of infrastructure investment, in particular in developing countries, an efficient and effective MDB system is of utmost importance.

It is recommended that the G20 provide political impetus to strengthening the role of the MDBs in promoting productive and sustainable infrastructure investment in developing countries, particularly by ensuring that their core financing and indirect catalytic activities pass the additionality test.

Engagement with outreach groups

The initiative by the Investment and Infrastructure Working group to have an engagement session with outreach groups is welcome. However, travel constraints will preclude many groups from participating. In order to strengthen the engagement process, ***it is recommended that each member of the working group engage with outreach group members in their own country***.

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[17] ***Investment Financing in the Wake of the Crisis***.

[18] Rebecca Nelson. ***Multilateral Development Banks: Overview and Issues for Congress. CRS Report for Congress***. Congressional Research Service. November 8, 2013.

Conclusion

Australia has nominated infrastructure financing, particularly the involvement of the private sector, as a priority for the G20 in 2014. This could lead to a crowded agenda, with various aspects and details of infrastructure financing being pursued. There would be value in identifying the basic building blocks that are necessary for increased infrastructure investment to contribute to lifting long-term growth and creating jobs and the G20 can effectively contribute to this process. The most basic building block is ensuring appropriate project selection. It is essential that, as part of the comprehensive growth strategies that G20 governments will be presenting at the Brisbane Summit, they include the reforms required to ensure that the most appropriate infrastructure projects are selected. The core component of these reforms should be complete transparency over the factors taken into account in the project selection process. It is also essential that the G20 focuses on ensuring that the MDBs are as effective as possible in assisting developing countries in meeting their infrastructure needs.