

For Official Use

DCD/DAC/FA(2000)3



Organisation de Coopération et de Développement Economiques
Organisation for Economic Co-operation and Development

OLIS : 21-Dec-1999
Dist. : 23-Dec-1999

Or. Eng.

**DEVELOPMENT CO-OPERATION DIRECTORATE
DEVELOPMENT ASSISTANCE COMMITTEE**

PARIS

**DCD/DAC/FA(2000)3
For Official Use**

Working Party on Financial Aspects of Development Assistance

MEETING INFRASTRUCTURE NEEDS INTO THE 21ST CENTURY

This document is submitted for CONSIDERATION at the meeting of the Working Party, to be held in Paris on 21 January 2000.

Contact person: Bill Nicol [tel: 33 1 45 24 91 37/fax: 33 1 44 30 63 33]
Email: william.nicol@oecd.org

85836

Document complet disponible sur OLIS dans son format d'origine
Complete document available on OLIS in its original format

Or. Eng.

TABLE OF CONTENTS

MEETING INFRASTRUCTURE NEEDS INTO THE 21ST CENTURY 3

I. Introduction..... 3

II. Outline of the chapter 3

 a) Identifying problems and assessing needs..... 3

 b) Developing strategic objectives for co-ordinated donor assistance 4

 c) Operationalising a co-ordinated strategy: design and implementation issues..... 5

III. Questions for Discussion..... 7

MEETING INFRASTRUCTURE NEEDS INTO THE 21ST CENTURY

I. Introduction

1. Increasing the provision of appropriate, reliable and efficient infrastructure in developing countries is an essential complement to broader efforts geared to increasing growth, raising productivity and reducing poverty, particularly in the less advanced developing countries. Despite progress, the needs are huge, multiple and on-going. There are major challenges at all stages -- planning, financing, building and operating infrastructure, and at all levels -- regional, national and sub-national. Meeting these challenges will require financial and managerial systems capable of generating and maintaining infrastructure of all kinds and at all levels. Key actors (governments, the private sector, donor agencies) will need to assume new, and often quite different roles.

2. With this background, this note provides an outline for the chapter on infrastructure in the proposed "compendium" on *Development Finance for Private Sector Led Growth in Less Advanced Developing Countries* [see DCD/DAC/FA(2000)1]. The suggested approach is similar to that proposed for the other "thematic" chapters on financial systems and enterprise development [see DCD/DAC/FA(2000)2].

3. The remainder of this note sketches out the sections of the chapter, which will deal with:

- identifying problems and assessing needs (section IIa);
- developing strategic responses (section IIb);
- and, in more detail, what this means for donors in designing, implementing and co-ordinating actions to support infrastructure development (section IIc). The latter section is intended to form the basis of the "good practices" that should be developed in this chapter.

Finally, section III of this note raises issues for discussion.

II. Outline of the chapter

a) *Identifying problems and assessing needs*

4. The May 1998 workshop on "Meeting Infrastructure Needs into the 21st Century" highlighted that *the real gap to be filled to meet infrastructure needs in sustainable ways, and which foster an enhanced role for the private sector, is a policy and institutional capacity gap, rather than a financing gap. It follows that systemic approaches rather than project-based approaches are essential.*

5. On this basis, the generic issues that need to be addressed to identify problems and assess needs from a systemic approach will include the following areas:

- *Regulation and governance* -- sound and stable regulatory systems are required to replace contract by contract approaches. This is a key role for government, especially in relation to

the need for governments' roles to evolve from financing and provision to facilitator and regulator.

- *National and local responsibilities* -- meeting needs at different levels of government will require an appropriate devolution of responsibilities and powers (authority, financing) between national and local governments.
- *Capacity building needs and modalities* -- major efforts are required to strengthen capacities of institutions and individuals in all fields (e.g. regulatory, managerial, technical, financial) and at both national and local levels.
- *Maintenance and rehabilitation* -- investment, both human and capital, is crucial for the sustainability of projects and to ensure they continue to deliver broad benefits over the expected life of the project.
- *Financial markets* -- reforming and developing systems is essential to mobilise and allocate domestic and foreign capital.
- *Pricing, risks and guarantees* -- Pricing policies and tariff structures must provide a predictable and reasonable rate of return on private investment if the private sector is to fully meet its potential as a provider of infrastructure. Sovereign guarantees will remain important, but new types of guarantee and risk sharing mechanisms are needed, particularly at the sub-national level.

6. Taking a systemic view of the infrastructure “sector” requires some form of overall framework within which problems are identified and needs are assessed and prioritised. However, the various parts of the infrastructure “sector” (e.g. telecommunications, power, transport, water, health, education, etc.) are often not strongly interconnected at the national level, or for a given type of infrastructure, between national and local levels. A key question is, therefore, how all stakeholders, together, can build a systemic view of infrastructure needs and priorities. If there is no appropriate overall framework, what are the elements (e.g. medium term investment plans, sector strategies, etc.) that could be used and better brought together for these purposes?

b) *Developing strategic objectives for co-ordinated donor assistance*

7. To identify strategic roles where actions are catalytic and “system building”, donors must identify their value added niches in relation to other key actors in the provision of infrastructure. They must take full account of important evolutions in the roles of other actors (private sector, government at national and local levels) and design strategies and implement policies in ways which underpin and promote trends in the following areas:

- Strong expansion of the private sector in financing and providing infrastructure.
- An important but changing role for government, which should evolve from financing/provision roles to those of facilitator and regulator. Where private finance is not available, governments will retain a major role in financing infrastructure, but even here they should be looking for roles and involvement of the private sector (e.g. supply, maintenance).
- Growing devolution of responsibility between national and sub-national levels of government;
- Greater involvement of and consultation with civil society and the users of infrastructure services.

8. In light of these trends, appropriate roles and targets for effective donor support are likely to cover the following major areas:

- Support for institutional capacity development to plan, finance, prioritise, implement and manage infrastructure provision;
- Support for strengthening the framework conditions and policy stances required for countries to move to the levels and structures of finance needed for sustainable infrastructure provision;
- For countries and sectors where the government and donors may still need to play important roles in the financing of infrastructure for some time to come, targeted financial assistance should be provided in ways that do not displace private capital and that seek to bring in private sector finance and expertise where available.

9. In order to define roles, which must reflect these evolutions, and develop strategic responses, donors will need to develop approaches to address, simultaneously and in a medium to long-term perspective, different policy areas and capacity needs. They will also need to engage in a more continuous and broader policy dialogue with national and sub-national governments, the private sector and civil society.

10. Once needs are assessed and prioritised, donors will also need to develop/strengthen ways to work together, collectively, and with other key stakeholders, to organise and implement their efforts in ways that maximise their impacts.

11. Important strategic directions for donor co-operation and co-ordination are likely to include the following areas:

- Mechanisms for planning, co-ordination and co-operation;
- Capacity building and meeting urgent needs;
- Preconditions, enabling environment and regulatory framework for infrastructure investment;
- Improving private sector perceptions of investment opportunities;
- Strengthening local capital markets and developing new financial instruments;
- Unbundling and targeting donor assistance;
- Working effectively with governments at both national and local levels;
- Targeting poverty, environment and gender in systemic, rather than project-specific or ad hoc ways.

c) *Operationalising a co-ordinated strategy: design and implementation issues*

12. The last section of the chapter will deal with how donors can best support agreed strategies, objectives and priorities through projects and other activities. Within each of the strategic directions set out above, the May 1998 workshop indicated a number of specific activities for donor efforts:

- Mechanisms for planning, co-ordination and co-operation:
 - Donors, together, should work with partner countries to develop systemic infrastructure plans at the general and sectoral levels and improve co-ordination and co-operation mechanisms;
 - Are the tools available (e.g. a Medium Term Expenditure Framework, sectoral strategies, other) to allow a systemic overview (including at the sub-national level) or do governments and donors have to create new tools?
 - Co-ordination is necessary to ensure coherent approaches, including in areas such as policy advisory services and technical assistance.

- Capacity building and meeting urgent needs:
 - The demand for capacity building and meeting urgent needs in support of infrastructure is both massive and wide-ranging. Judicious use of foreign expertise and a priority to using and building local capacity are recommended.
 - Priority areas for donor assistance include a sound enabling environment, (macroeconomic, legal, regulatory, financial) at national and, particularly, sub-national levels; the infrastructure policy framework; tariff structures; privatisation; utilities management; project negotiations; maintenance and operations.
- Meeting pre-conditions for infrastructure investment in low income countries:
 - Donors can help governments to prepare for and take on changed roles and to meet the preconditions for increasing the participation of the private sector in infrastructure (in areas such as rehabilitation, investment studies, regulatory framework and enabling environment);
 - Governments need both a policy framework and specific assistance to move from provider/financier to policy setter and regulator;
 - Efforts are required to promote opportunities for private sector participation, including those short of ownership, which can lead to important efficiency gains (e.g. management and maintenance contracts, leased concessions, privatised revenue collection, etc.).
- Improving private sector perceptions of investment opportunities:
 - Development co-operation agencies could have an important role to play in improving the perceptions of private sector investors about the opportunities for investment in developing countries' infrastructure by ensuring investors have up to date and complete information about the investment climate in partner countries;
 - New legislation, strengthening transparency and the rule of law, protecting investors, ensuring repatriation of profits, and providing an equitable basis for adjusting tariffs when costs change, all create investor confidence. In many countries, liberalisation to allow foreign investment in infrastructure is recent or incomplete.
- Strengthening local capital markets and developing new instruments:
 - The mismatch between borrowing in foreign currency to build infrastructure which generates local currency revenues, which was highlighted by the Asian financial crises, has reinforced the need to strengthen local capital markets and develop new instruments.
 - Partner countries have a great need for financial sector assessments (such as those being undertaken by the World Bank/ IMF and some other institutions), to identify strengths, weaknesses and developmental priorities;
 - Long-term savings instruments, including government bonds, which will attract private pension and insurance funds, are necessary to develop a yield curve and to match local currency revenues with long term local borrowing. Donors, and their private sectors, have a great deal to offer in these areas.
- Unbundling and targeting donor assistance:
 - Donors should be less involved in the direct funding of infrastructure (hardware) and provide more support to infrastructure policy, project preparation, enabling environment and capacity building. Unbundling projects, so that technical assistance can be provided

- separately from financial support, allows more attention to developmental objectives (poverty, gender, environment, social impacts, etc.);
- Capital assistance, when provided, should favour maintenance, rehabilitation and the provision of services to poor populations which could not reasonably be reached by commercial providers. Particular attention should be paid to the financial sustainability of projects after donor involvement ceases.
- Decentralisation and working effectively with governments at sovereign and sub-sovereign levels:
 - There is an increasing trend to infrastructure projects being implemented at sub-sovereign levels. Decentralisation of infrastructure provision is a positive trend in terms of local ownership of the development process and slowing excessive urbanisation.
 - Donors will have to adjust the ways they carry out infrastructure projects so they can assist effectively in project delivery at the grassroots level. This implies more decentralisation to the field level, working with local authorities and using local staff.
 - Targeting poverty reduction:
 - As the twin trends to private sector participation and service delivery by local authorities gather momentum, donors are in an advantageous position to help ensure poverty is targeted and gender and social impacts are adequately taken into account;
 - The implications of infrastructure development on the livelihoods, the environment, and the quality of life of the poor must be assessed in advance; people affected should be fully consulted at the design phase, and involved in project planning and implementation;
 - Financial issues are key to the viability and sustainability of infrastructure projects for the poor. Donors can assist by advancing discussions on issues such as intergovernmental transfers, an adequate local revenue base, and on the design and implementation of user fee and bill collection systems.

III. Questions for Discussion

13. Members are invited to comment on the following issues:

- **Does the above outline and contents correspond to what Members wish from this chapter?**
- **In respect of section IIb above, have the main elements of strategic donor roles been identified?**
- **In respect of section IIc above, how can the various suggestions for donor assistance be developed to provide the sort of guidance Members wish from this product? What are the main difficulties with co-ordinating donor approaches and how can these be overcome?**