

**OECD-AfDB Seminar on addressing  
policy impediments to private  
investment in African infrastructure**

## **Session issues note**

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**IGC** International  
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## 11:00-13:00 Session 1 : Better regulation in home and host countries to unlock the supply of finance

Africa needs far more infrastructure than its governments can afford to finance through tax revenues and aid. The scale of the region's infrastructure needs is too large for its existing funding sources. According to the Africa Infrastructure Country Diagnostic (AICD), USD 93 billion needs to be invested annually in order to address the continent's infrastructure deficit. After considering what public spending can provide, this leaves a funding gap of USD 31 billion. Nonetheless, this gap is trivial relative to the size of world capital markets: financing opportunities appear to be vastly underutilised when compared to the contribution they could potentially make to infrastructure development on the continent.

In order for investors to seize the available investment opportunities, regulatory interventions are necessary on behalf of both African governments (as the 'host' countries of investment inflows, so as to render the investment environment more attractive), and 'home' governments (the countries from which key investors – be they utilities, pension funds or other long-term institutional investors – originate). These respective roles and requirements are considered in turn below, followed with prospects for stimulating investment in low-carbon, climate-resilient (LCR) infrastructure.

### *Unlocking the supply of infrastructure finance*

On the home-country front, long-term investment finance is intermediated by the financial system in different ways across G-20 economies through various intermediaries – including banks, insurers and pension and mutual funds – and via financial markets. Since the crisis, the ability of some of these intermediary mechanisms to allocate funds to long-term investment and to channel funds from savers to investors, both within countries and especially across borders, has been impaired:

- In the past few years, the funding of infrastructure investment in projects has become characterised by high specificity, low re-deployable value and high intensity of capital and has increasingly taken the form of project finance.
- On the equity side, the bulk of financing has been provided by corporate sponsors and developers.
- On the debt side, the prominent role has been played by bank syndicated loans. The collapse of major insurers has had the effect of reducing the potential amount of funds that institutional investors can commit to infrastructure investments.
- The availability of credit for investment, especially long-term projects, has been curtailed by lack of risk appetite by banks, resulting from post-crisis deleveraging and structural weaknesses in their business models. New banking regulations (Basel III) could also affect negatively the ability of banks to provide long-term financing.

Taken together, this means that private sector finance has yet to develop sufficiently to make up for the reduction of the availability of public finance for infrastructure development. This financing gap could be reduced if institutional investors (such as pension funds, insurance companies and mutual funds) were to increase their role in infrastructure investment. In OECD countries alone, these institutions held over USD 80 trillion euros in assets in 2012 and pension funds collect around USD 1 trillion in new contributions each year. Sovereign Wealth Funds and Public Pension Reserve Funds are also growing rapidly. Given the low interest rate environment and volatile stock markets of recent years, institutional investors are looking for new sources of long-term, inflation-protected returns. Investments in real productive assets such as infrastructure could potentially provide this type of income.

However, growth of investments in infrastructure by institutional investors is held back by the lack of appropriate financing vehicles; insufficient investment and risk management expertise to deal with infrastructure investments; regulatory disincentives, including difficulty in investing in overseas infrastructure markets; lack of quality data on infrastructure; and absence of a clear and agreed investment benchmark for illiquid assets. Regulatory reform on all of these questions should feature high on the agenda of 'home countries' seeking to unlock their supply of financing for investment in Africa's infrastructure.

### *An attractive regulatory environment for investment in infrastructure*

Beyond immediate uncertainties, investment in Africa's infrastructure is in part held back in structural terms, by risk factors at 'host country level' that may reduce returns to investors. Among others: on the legal front, insufficient protection and predictability granted to investors engaged in Public-Private Partnerships and other forms of infrastructure procurement; on the institutional front, weak public sector capacity and co-ordination to plan, negotiate and manage infrastructure projects alongside private partners; and on the regulatory front, disincentives to private investment which could be improved via more predictability and cost-recovery in price-setting, a more active and autonomous role of infrastructure sector regulators, and better corporate governance of State-Owned Enterprises operating in infrastructure markets. Restrictive market regulations that reduce the ability of firms to undertake new activities or enter new markets (including the regulation of capital-intensive network industries and ownership restrictions) are also in need of review in several African countries.

Safeguarding a competitive environment for private operators, reducing concerns over regulatory discretion, easing and simplifying market regulations (notably by reducing barriers to domestic and foreign entry and improving procurement procedures), and ensuring a level playing field between public and private parties, including state-owned enterprises but also foreign utility operators, are thus all at stake. These inter-related factors frequently require active policy reforms in several policy areas – among others, investment and competition policy, as well as public procurement and corporate governance frameworks.

These reforms should notably serve to reinforce government "commitment technologies" – that is, governments must establish a credible policy commitment (sometimes through national strategic plans) for long-term private participation in infrastructure sectors. This can notably help diminish risks posed by long-term investment horizons, and mitigate the complexities of project planning and of co-ordinating multiple central and local stakeholders. Such "technologies" would moreover help tackle the current 'communication gap', whereby global capital markets continue to view African infrastructure as highly risky, and credit rating agencies provide an oftentimes negative picture of investment opportunities in the sector. Better regulation in host countries can reduce these perceived risks and effectively prepare and manage infrastructure investment opportunities, thereby providing both investors and consumers with stronger assurances of consistent and fair arrangements for infrastructure development.

### *Investment in low-carbon, climate-resilient infrastructure (LCRI)*

Alongside the above considerations, all actors involved must shoulder the crucial responsibility of 'greening' infrastructure investments. Indeed the AICD figures cited above are estimates made under a "no climate change" presumption. In order to cope with climate change, financing costs may be much higher and targeted investment attraction and financing strategies are all the more necessary. For LCRI investment to be financially sustainable, 'host country' governments will need to address existing incentives, which often provide limited or no pricing of carbon, subsidise fossil-fuel use, or do both. Meanwhile on the financing side, barriers to long-term investor activity in LCRI include a lack of: appropriate financing vehicles; liquid markets for debt instruments; high-quality data; and experience in evaluating potential LCRI investments.

To create an enabling policy environment for LCRI investment, 'host country' governments will need to provide investors with clear and long-term incentives and predictability, and avoid rapid or retroactive changes to renewable energy support policies, which are particularly damaging to investor confidence. Well-targeted and time limited renewable energy support policies, such as feed-in tariffs, tenders, long-term renewable energy targets and long-term power purchasing agreements can provide the inflation-linked cash flows these investors seek. These policies also can provide predictability if they are designed to remain cost-effective (and therefore fiscally and politically sustainable) as technology costs evolve over time. Governments can also usefully provide published infrastructure pipelines to ensure investors that a stream of bankable deals is forthcoming. On the 'home country' side, governments will also need to consider potential unintended consequences of regulations establishing investment restrictions for pension funds, insurance companies and banks.

*Relevant work-streams to be considered:* Reducing barriers to long-term financing and institutional investment in infrastructure, including with regards to the financing of green and clean energy infrastructure; exchange of good practice in utility regulation (including regulatory independence and predictability of tariff-setting); and building a network of African regulators.

## 14:15-15:45 Session 2 : Managing risks across the project cycle

As different risks are apparent at different stages of the project cycle, a proactive approach to managing the project cycle is needed. Ways of doing this more effectively can include: unbundling projects into planning, building and operating phases, and addressing the key constraints and risks at each stage; improving arrangements for negotiation and agreement of contracts, and for arbitration of disputes; encouraging private investors to invest in the stages where they can best shoulder the risks; and building capacity in the public sector to understand and manage risks across the project cycle.

### *Building public sector capacity, including for contract negotiation and dispute resolution*

Ensuring that private investment in infrastructure is successful and delivers the expected benefits requires carefully managing the risks entailed. Private participation in infrastructure delivery (in particular through public-private partnerships or PPPs) is a relatively recent form of procurement in many countries. Over the past two decades, 37% of PPP projects have been conducted in “lower middle” income countries, and 4% only in “low income” developing countries. To limit risks for private investors, laws and regulations governing infrastructure sectors must be clearly defined and transparent. Institutional roles and responsibilities should be also demarcated and understood by all parties, as well as bolstered by sufficient financial capacity and technical expertise. Procuring authorities, PPP units, the central budget authority, and sector regulators require clear mandates and sufficient resources to ensure a prudent procurement process and clear lines of accountability. Public sector capacity for project design and implementation is also indispensable in order to get value-for-money and avoid unbalanced risk-sharing arrangements which can lock the public partner into fiscally unsustainable contracts.

Given the long time-lines of infrastructure projects and the unpredictable nature of many of the risks involved, it is likely that most infrastructure contracts will be renegotiated at least once during their lifetime. This points to the importance of adequately addressing the need for contract renegotiation in long-term contractual arrangements – through flexible contracts and renegotiation structures on the one hand, and appropriate mechanisms for dispute settlement in case of disagreement between public and private parties on the other hand. Striking a balance between contract resilience and excess flexibility can help ensure that VFM and competitiveness are retained as priorities throughout the lifetime of the infrastructure project. Alongside, a reliable structure for domestic arbitration can help settle public-private disputes. Indeed taking disputes to international arbitration can be extremely lengthy and costly, including for the host country, and also sends out negative signals to potential future investors. Providing sufficiently protective domestic frameworks, consistent with host countries’ international commitments, is paramount in order to anticipate and manage potential investment disputes in infrastructure projects without necessarily referring them to international arbitration. Greater standardisation of contracts in ways that conform to local legislation would also reduce transaction costs and increase certainty.

### *Unbundling project stages and allocating risks*

Careful project preparation is essential to ensure efficient investment in infrastructure. Feasibility studies can help determine the extent and desirability of public participation in a given infrastructure project – that is, whether the project is amenable to private sector involvement or whether it would be better suited to traditional procurement. Project appraisal should include cost-benefit analysis and environmental impact assessment, as well as a careful analysis of value-for-money (VFM) and of the risks to be borne by the public and private sector partners.

Infrastructure project risks should be allocated to the party who can best control it or bear it at least cost. The private partner is best suited to assume commercial risk (linked to variations in demand and revenue from users), while the public partner is better able to assume legal, regulatory

and political risks. The balance of risks differs across infrastructure sectors. When a sector is politically sensitive, the revenue risk (due to variability in user fees and government subsidies) and sub-sovereign risks (as capacity for management at local level may be weak) are greater. When the quality of existing infrastructure cannot be adequately assessed, the possible hidden costs of maintenance and rehabilitation can represent important contractual risk. For these reasons it may be useful to ‘unbundle’ projects into planning, building and operating phases, and to address the key risks at each stage. This can help guide ultimate contract design as regards risk-sharing between public and private partners.

*Relevant work-streams to be considered:* Lessons learned from reviews of host countries’ policy frameworks for infrastructure investment (including options for managing contract renegotiation, and pitfalls to avoid from past cases of investor-state disputes); building formal mechanisms that reduce uncertainty and build trust into projects from the beginning; developing standardization around key documents and processes (including regarding what contract structures work in what contexts and sectors); partnerships with PPP practitioners and Budget Officials; and reviews of project preparation facilities’ effectiveness.

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### 16:00-17:30 Session 3 : Using public risk-bearing capital more effectively

Public risk capital is a scarce resource, so it is important to allocate it efficiently and to avoid using it in ways that duplicate what private investors are ready to finance themselves. Efforts can for instance be made to securitise participation of Multilateral Development Banks (MDBs) in completed projects through vehicles for institutional investors, including local investors. Meanwhile for projects that are not yet in operation, improved project preparation by relevant public bodies and their private partners should be facilitated. The use of concessional funds for project preparation and for improving the infrastructure investment environment could be prioritised. In this light, several means of better leveraging financing from multilateral and bilateral development partners for infrastructure investment, including in low-carbon, climate-resilient infrastructure, are considered below. Options for making more effective use of private investment across various industries (notably in the extractive sector) so as to expand ancillary infrastructure networks also deserve consideration.

#### *New means for multilateral and bilateral partners to leverage private investment for infrastructure*

Multilateral and bilateral development partners disbursed USD 48 billion for infrastructure in 2011 by financing the hardware, helping improve the enabling environment, supporting the preparation of bankable projects and providing financial instruments for specific projects. Among donors and development finance institutions (DFIs) that support the private participation in infrastructure, on average 15% was disbursed directly to the private sector in 2011, mostly through non-concessional loans and equity. In addition, development guarantees provided by DFIs – while they are not included in the amount above as they do not constitute ‘flows’ in the strict sense of the term – mobilised on average USD 1 billion per year from the private sector over 2009-2011.

In recent years, DFIs have developed more sophisticated financial instruments to enhance private participation in infrastructure. Several bilateral and multilateral DFIs now provide mezzanine capital (preferred equity, subordinated loans), blended loans, and asset-backed securities—the latter being mostly used by Islamic development finance institutions.

In terms of sectors, 60 % of the support in 2011 directed towards the private sector was for energy—particularly hydro, wind, solar and geothermal energy. This was followed by transport (20%), ICT (15%), and water (5%). In terms of regions, Africa was the least favourite destination—compared to Europe, Asia, and the Americas, in that order. Furthermore, South Africa and Ethiopia were the only African countries that ranked among the top ten recipients. However, there are some donors that prioritise Africa—aside from AfDB—although some of the amounts are channelled through multilateral institutions.

This low support to Africa reflects difficulties in attracting the private sector in countries with a weak enabling environment when many DFIs expect returns on investment. This highlights the importance of improving the regulatory framework for infrastructure investment in host countries

(as addressed in Session 1 above). Yet at the same time, the excessive focus on Upper Middle Income Countries—particularly where the local financial sector is relatively developed such as Turkey, India, and Brazil—raises the question of additionality of DFI support to crowd-in private investment in these emerging markets. Furthermore, while DFIs are increasingly sharing evaluation methods (both ex-post and ex-ante, in terms of project appraisal), commercial confidentiality and a lack of an official forum limits standardisation, monitoring and evaluating of their activities in a transparent and accountable way, particularly regarding development impact.

Following the recommendations of the G20 High Level Panel on infrastructure in 2011 and the request of G20 Ministers of Finance and Central Bank Governors in 2014, the World Bank Group (WBG) and several other actors have been very active in finding new ways of leveraging private investment for infrastructure, including in Africa. For example:

- In February 2014, the WBG Executive Board decided to optimise the Bank's balance sheets by increasing IBRD's lending capacity to middle-income countries (including for infrastructure financing) and approving a MIGA/ IBRD exposure exchange agreement. IBRD is also leading an MDB Working Group with Regional Development Banks to explore the possibility of carrying out exposure exchanges between MDBs.
- WBG is in the process of setting up the Global Infrastructure Facility that aims at mobilising resources for both upstream and downstream support for infrastructure projects. The facility is expected to be used by other MDBs as well to pool financial instruments.
- The IFC created the Asset Management Company (AMC) to raise and manage capital from institutional investors, governments and development partners. The AMC manages the Global Infrastructure Fund which has raised USD1.2 billion so far to invest in infrastructure projects in developing countries.

Alongside, innovative approaches by other organisations include the AfDB's Africa 50 Infrastructure Fund. This is a new delivery vehicle aimed at mobilising private financing to accelerate the speed of infrastructure delivery in Africa. Africa50 is to be structured as a developmentally-oriented yet commercially operated entity. It will be complementary to and legally independent of existing development finance bodies in Africa.

#### *Avoiding duplication of what private investors are ready to finance themselves*

Whether they come from African governments or from development partners and DFIs, public funds (including for risk capital) are a scarce resource. It is therefore important to allocate these funds efficiently and also to avoid using them in ways that crowd-out or duplicate what private investors are ready to finance themselves. To this end, DFIs could explore the scope for:

- Securitising and selling down infrastructure assets on their balance sheets;
- Using scarce capital to further develop financial technologies such as risk-insurance products, first-loss positions in projects, and other vehicles that leverage private investment, tailored to the project cycle; and
- Bringing in hard-window capital for high-return projects in IDA-only African borrowing countries.

Alongside, sector-specific action can also be taken to make better use of existing private infrastructure investments. For instance in the energy sector, private power plants can be encouraged to sell to the grid, and possibly matched with off-take by individual private companies. Host governments could also usefully explore possibilities for setting up constructive partnerships with private companies (especially those engaged in natural resource extraction) for the expansion and wider use of backbone infrastructure networks.

Indeed in several African countries the exploitation of natural resources has coincided with a burst of accompanying infrastructure investment. In fact in anticipation of greater mining opportunities in the future, several mining companies have begun negotiating contracts with governments ex-ante, to develop the necessary infrastructure to support their operations. Protocols could be established for these mining companies to open their infrastructure to wider use on appropriate terms. Similar protocols could encourage private companies to export power to the national grid, or through the grid to end-users ready to pay for more security of power. Alongside, host governments must carefully monitor the development of such ancillary infrastructure: such

projects should not be undertaken by individual companies in isolation and each according to its own needs, but rather than within a coherent national framework, which would build on joint economies of scale, tackle coverage gaps in the national network, and address the domestic population's needs.

*Using public risk-bearing capital for investment in low-carbon, climate-resilient infrastructure (LCRI)*

To promote investments in African LCR infrastructure by institutional investors, DFIs/MDBs can provide de-risking services including for foreign exchange risk. Such hedging has become more expensive for investors with the onset of regulations for over-the-counter derivatives. Political risk insurance provided by DFIs/MDB can be an important tool to facilitate LCRI investment, as political risk and its perception, are a major barrier to investment, and institutional investors are not well-placed to manage these risks. Co-investment with institutional investors also facilitates LCR investments, as the presence of a DFI/MDB in a transaction provides added confidence for investors. In such cases, the DFI/MDB can arrange project structures with all of the key parties and offer off-take to institutional investors, which benefit from DFI/MDBs' on-the-ground relationships, consortiums of various project-related services (engineering, legal, financing), and the local technical and economic acumen needed to ensure that greenfield projects come to fruition.

Non-OECD institutional investors are also seen as a potential source of private infrastructure investment in LCRI. Domestic institutional investors may be better suited than some foreign investors to take on local risks, such as currency risks. Some countries such as South Africa have recently moved to prompt their international investors to consider environmental and social governance in making investment decisions and have started to make green investments. Another advantage in emerging markets is that as the pension fund industry is often at earlier stages of organisation and governance, they are able to come together in a collaborative way, to develop industry-wide tools for green investment.

*Relevant work-streams to be considered:* Scope for: securitising and selling down infrastructure assets on IFI/DFI balance sheets; bringing in hard-window capital for high-return projects in IDA-only African borrowing countries; and for IFI/DFIs to use scarce capital to further develop financial technologies such as risk-insurance products, first-loss positions, and other vehicles that leverage private investment, tailored to the project cycle.



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