The role of international cooperation in increasing infrastructure investment

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Increasing infrastructure investment has been identified as a priority for G20 countries in 2014 as part of their target of lifting G20 output by at least 2 per cent above existing projections in the next five years. This recognises the importance of infrastructure for sustained economic growth and the significant infrastructure ‘gap’ confronting many advanced and developing economies. The OECD has estimated that the global infrastructure gap will be US$70 trillion, 2.5 per cent of world GDP, by 2030.1

While governments are traditionally the major provider of infrastructure investment, government balance sheets are currently constrained, along with their capacity to lift infrastructure investment, given the high levels of public debt in many countries. As a result, attention has turned to increasing the role of the private sector in infrastructure investment. In outlining Australia’s priorities as chair of the G20 in 2014, the Australian Prime Minister, Tony Abbott, said ‘it should be easier to get big new road, rail, pipe and dam infrastructure off the ground and we can do that through attracting more private capital’.2

Infrastructure is not a new priority for the G20. At previous G20 summits, leaders have endorsed the importance of infrastructure investment to growth and jobs, and 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

> Prior to 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 developments remained critical, it should be complemented by private sector investment.5

> At the St Petersburg Summit in 2013, leaders re-emphasised the key role of long-term investment, particularly infrastructure, and committed to put in place the conditions that would promote financing for infrastructure investment, including mobilising private investment.6

The challenge facing the G20 in 2014 is to move beyond rhetoric and identify specific steps that the international community can take to help bridge the infrastructure gap.
Attributes of and influences on infrastructure investment

Infrastructure projects are generally large, long-lived and require long-term financing. Cost-benefit calculations are often difficult given the long life of the project, different opinions on discount rates to be used and accuracy around demand estimates, such as the use of a highway. Moreover, judgments need to be made on whether the project should be based on today's demand, or look well into the future and consider whether the project can be a catalyst for future development. It is also necessary to take into account costs and benefits that go beyond the direct financial returns associated with the project. For example, social, distributional and environmental costs and benefits have to be included when deciding whether to undertake a project. The scale of projects is often too big for a single investor and collective financing is required. Given the long life of the project, the stability of the investment environment is important, particularly the stability of the legal, regulatory and tax systems as well as the overall macroeconomic situation.

Large infrastructure projects can be politically contentious. Often there are substantial externalities associated with infrastructure projects, with benefits accruing to those who cannot easily be required to pay for the service. Even when it is practicable to charge the users of the infrastructure projects, which would not only provide for the funding for the investment but also contribute to its efficient use, there is often strong public resistance and the expectation that the service should be provided free. For example, there is often public opposition to the introduction of toll roads and congestion charges.

The scale of infrastructure projects can also be such that it is only practicable to have one provider of the service, resulting in monopoly situations. In such situations, pricing may have to be set by regulatory authorities, and there may be political pressure to keep prices low.

Taking into account all of these considerations, the first priority is selecting and prioritising the ‘right’ infrastructure projects, namely those where the benefits from the project exceed its costs, with all of the social and environmental costs and benefits being taken into account. Focusing on project financing options presumes that the decision has already been made that the investment is the best use of limited resources. Moreover, the source of financing, be it public or private, cannot fundamentally alter the economics of the project. However, the economics of the project will influence its attractiveness to private investors.

When looking at the range of factors that will influence which projects are the priority infrastructure investments for a country, it is evident that they lie in the hands of each government. Some of the issues are technical, but many are political, particularly when it comes to project selection. 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. In this context, with infrastructure investment largely a domestic issue, what role does international cooperation in general, and the G20 in particular, have to offer?

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The role of international cooperation

There are a number of channels through which international forums can assist countries in increasing infrastructure investment. There can be a collective commitment to address the fundamentals required to increase infrastructure investment, recognising that implementation will depend on each country's actions but that the benefits of collective action will exceed those from individual responses. The international organisations can assist in identifying and monitoring the steps countries need to take to increase infrastructure investment, as well as
being a source for sharing knowledge and capacity building. This can be particularly beneficial for developing countries, along with the financial support that the international organisations can provide. It is also important to ensure that international standards, particularly those applying to the financial system, are not impeding the financing of infrastructure investment. These issues will be considered further in the context of the G20.

Infrastructure and G20 growth strategies
In February 2014, G20 finance ministers and central bank governors committed to developing new policy measures with the aim of raising the level of G20 output by at least 2 per cent above the then projected level in the next five years. This collective commitment is to be translated into specific actions — growth plans — by each country. A key part of achieving this aim of lifting growth is an increase in infrastructure investment. In this regard, at their February 2014 meeting, G20 finance ministers committed to creating a climate that facilitates higher investment, particularly in infrastructure and small and medium enterprises. This is critical for the global economy’s transition to stronger growth in the short and medium term. We will undertake reforms to remove constraints to private investment by establishing sound and predictable policy and regulatory frameworks and emphasising the role of market incentives and disciplines.

As noted, given that the steps necessary to increase infrastructure investment will depend on specific policy measures by each country, it is appropriate that the translation of the collective agreement by the G20 to increase infrastructure investment is contained in individual country growth strategies. The relative importance of the various factors impacting on the environment for infrastructure investment will vary across countries. Moreover, increasing infrastructure investment is not the same priority for every country. 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 country where raising infrastructure spending in aggregate is not a priority. In contrast, the IMF has indicated that in order to achieve the collective G20 growth ambition, public investment, particularly on infrastructure, has to be increased by 0.5 per cent of baseline GDP in the US, Germany, Brazil, India and Indonesia.

While the steps necessary to remove the obstacles and to facilitate infrastructure investment depend on individual country policy action, commitments made at international forums can help in advancing domestic agendas. Peer pressure can assist, as can the advice and monitoring of the international institutions. For example, there would be value in international organisations — such as the IMF, World Bank and OECD — focusing on and publicising the specific priorities that countries should address to improve their investment environment. These institutions have noted that the barriers to increased infrastructure investment in the G20 include: unfavourable regulatory conditions, financial regulations and a lack of markets for long-term financing, constrained public investment, and a lack of capacity to plan and deliver projects. But, as noted, the significance of these barriers will vary across countries. For example, the IMF identifies that key steps which India must take to increase infrastructure investment include simplifying and making contracts more enforceable, facilitating land acquisition and making it more predictable and equitable, and diversifying funding sources beyond the banks. In the case of Australia, the OECD recommends that there is a need to enhance capacity and regulation in infrastructure in a cost effective way, such as through expanding user and congestion charges.

In summary, the international organisations can play an important role in identifying the specific steps that countries need to take to increase infrastructure investment, publicise these recommendations, and monitor countries performance in addressing them.
Setting priorities
The recommendation from the B20 — business representatives from G20 countries — is that G20 leaders should reaffirm the critical importance of infrastructure and set infrastructure investment targets for 2015-19. As noted, G20 leaders have repeatedly emphasised the importance of infrastructure investment at previous summits. Hence a lack of affirmation regarding the importance of infrastructure investment does not appear to be evident. While it may be standard practice for private companies to set targets for investment spending, it may not readily translate as an efficient method to spur increased quality infrastructure investment.

The challenge facing governments is not only to improve the quantity of infrastructure investment but also to improve the quality of such investment and the efficiency with which infrastructure services are used. The danger associated with countries making commitments at an international forum to lift infrastructure investment by a certain proportion of GDP by a set date is that the focus will be on the quantum of spending rather than the quality of such spending. Often, there is also political pressure for large infrastructure projects at the expense of periodic maintenance and of small-scale options that could postpone or even avoid the need for more costly asset expansions.

As noted, selecting the right infrastructure projects is the highest priority facing countries. The B20 have recommended that all G20 countries should establish, publish and deliver credible national infrastructure pipelines that have been rigorously assessed and prioritised by independent national infrastructure authorities which take full advantage of private sector finance and expertise. Governments generally take the lead role in infrastructure development. This is often to ensure equitable access to infrastructure services, to counter market failures, or for historical and cultural reasons. While Australia has a degree of independent assessment over infrastructure investment through the operations of infrastructure Australia, the concept of an authority that is independent of the government with the mandate to select and prioritise infrastructure projects may not be acceptable in all countries. In addition, what constitutes ‘independence’ may be a variable concept when applied internationally. In addition, 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, along with management and operation, is transparency. In many respects, it does not matter who undertakes project assessments, provided that all of the factors which are taken into account in making a decision are fully disclosed and available for public scrutiny. The international community can make a positive contribution to advancing infrastructure investment if forums such as the G20 emphasise the importance of making the selection of infrastructure projects fully transparent, as this would help not only improve the quantity but also the quality of infrastructure investments.

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Sharing best practice
While country circumstances may differ and policies need to be tailored to domestic conditions, many of the challenges which countries face in increasing infrastructure investment are similar and much can be gained from sharing experiences and seeking best practices. Towards this end, the B20 have advocated the establishment of a Global Infrastructure Hub that would have a mandate to collect and disseminate leading practice, collaborate with key stakeholders on project preparation and capacity building, and design and promote appropriate standards.
The argument is that while there is a wealth of information and support on leading practices available globally, it is fragmented and seldom integrated into decision-making processes and practices. However, the B20 have not indicated who would finance such an infrastructure hub, beyond saying that it should be adequately resourced and draw on professionals with private sector experience.

An existing major source of infrastructure experience is the multilateral development banks (MDBs), such as the World Bank, and regional development banks, such as the Asian Development Bank. When originally established, the main function of these banks was the provision of infrastructure, although the MDBs pulled back from supporting infrastructure investment following criticism of the social and environmental impacts of some projects along with demands for increased expenditure on areas such as health and education. The MDBs are in the process of increasing their support for infrastructure investment and they can make a significant contribution by better coordinating the technical expertise that they have assembled over many decades.

The World Bank Group has announced that it is establishing a Global Infrastructure Facility with the aim of making better use of the World Bank’s resources to leverage additional financing for infrastructure, progress active partnerships with other development banks and be a focal point for integrated technical and advisory assistance to infrastructure development. While it is proposed that this new infrastructure facility be housed in the World Bank, its governance arrangements are yet to be finalised. It will be important to ensure that any proposed Global Infrastructure Hub does not attempt to duplicate the activities of the multilateral development banks in coordinating their infrastructure expertise. Also, given that the extent of the involvement of development banks in infrastructure investment and the depth of their expertise, it would be preferable for the G20 to support efforts at helping to coordinate the existing international institutions, including injecting more private sector expertise into their operations, rather than attempting to establish a new global infrastructure body.

Facilitating private infrastructure financing
The B20 have highlighted that there is no shortage of private capital that could potentially be deployed to finance global infrastructure. The challenge is getting the right policy settings in place to access the full potential of this pool of capital. As noted previously, a key component of facilitating a favourable investment environment is ensuring that there is policy certainty, particularly with respect to regulatory, legal and tax policy.

The B20 also note that risk sharing between the government and the private sector should be seen in the context of value for money (as part of a cost-benefit analysis). Public-Private Partnerships (PPPs) are often presented as the key to gaining greater private sector financing of infrastructure investment. However, whether a PPP makes sense almost exclusively depends on the economic characteristics of the infrastructure, not on the way it is financed or funded. The international community and the international institutions should advocate 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 than if the investment were financed totally by public funds.

An area where it is important to ensure that there are no unnecessary impediments to preventing the flow of private financing into infrastructure is through international regulatory standards. For example, the provision of project financing and long-term financing generally will be affected by the Basel III rules on capital and liquidity requirements. These rules are an important component of ensuring stability in financial markets but it is important that they do not unnecessarily inhibit the flow of finance to support needed investment. One area of concern that has been identified by the B20 is that the imposition of high capital charges for long-term assets held by insurers may unnecessarily reduce their incentive to investing in infrastructure debt. This is an issue that the G20 and Financial Stability Board need to keep under review.
The role of Multilateral Development Banks in supporting developing countries

Strengthening the MDBs to enable them to play a significant role in supporting infrastructure investment in developing countries should be a priority area for an international forum such as the G20.

As noted previously, promoting infrastructure investment has traditionally been a core role of the MDBs although, over the past two decades, the infrastructure mandate has lost relative weight in their operations. Given the broader set of priorities now confronting the MDBs, it is even more important that their engagement in fostering infrastructure investment is as efficient and effective as possible. ‘Additionality’ should be the key test to determine how and where the MDBs can meaningfully contribute to promoting infrastructure investment. This means that the MDBs should not be involved in supporting an infrastructure project if it would have gone ahead without their involvement.

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The MDBs’ support for infrastructure investment can be through the direct provision of finance as well as facilitating access to other sources of finance by providing an official ‘stamp of approval’ that comes with their involvement. The MDBs can also provide an indirect role in fostering infrastructure investment by helping to improve the underlying investment conditions, for example, by providing technical assistance in areas such as capital markets development, governance and regulation. In addition, as already mentioned, the MDBs are an important source of technical expertise in areas such as project design and implementation, and accountability standards.

For MDBs to pass the test of ‘additionality’ in supporting the infrastructure needs of developing countries, their lending should be concentrated on low- and lower-middle-income countries that lack other funding options. The MDBs can further increase the productivity of their lending by reinforcing efforts to more strongly embrace financial innovation. Their role in providing technical assistance would benefit from a strong integration between the infrastructure agenda and efforts to combat climate change and promote inclusive development. Given the enormous challenges in terms of infrastructure investment, particularly in developing countries, an efficient and effective MDB system is of utmost importance. As such, a key focus of forums such as the G20 should be on strengthening the role of the MDBs and ensuring that they have the capacity to effectively promote productive and sustainable infrastructure investment in developing countries.

Conclusion

Increasing infrastructure investment is a major challenge facing many countries, both advanced and developing. The factors that will determine whether there is the required increase in investment are largely in the hands of each government. But international cooperation does have a role to play. In particular, to the extent that there is a collective increase in investment, there will be significant positive spillovers and the combined impact on global growth will be larger than if each country operated independently. Moreover, international forums and institutions can help identify and monitor the steps that each country must take to increase investment. The international organisations also play an important role as a source for sharing knowledge and assisting with capacity building. In addition, forums such as the G20 should ensure that the MDBs have the capacity to assist developing countries in meeting their infrastructure requirements.
Notes
1. Australia 2014 G20, Investment and Infrastructure, available at www.g20.org/g20_201_agenda/investment_ and_infrastructure
5. G20, 2012, G20 Los Cabos Declaration, Los Cabos.
6. G20, 2013, G20 Leaders’ Declaration, St Petersburg; St Petersburg.
7. G20, 22-23 February 2014, Communiqué of Finance Ministers and Central Bank Governor’s Meeting, Sydney, Australia.
10. IMF, February 2014, Global Prospects and Policy Challenges, Washington DC, USA.
11. IMF, April 2012, 2012 Article IV Consultation Staff Report, Washington DC, USA.