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

15 July 2014, Paris

Summary of discussions & way forward

I. Addressing the policy intensity of infrastructure investment

The purpose of the 27 February 2014 roundtable in London had been to identify some of the “killer risks” that investors (and policymakers) face in building infrastructure in Africa, and to think holistically about systemic solutions. One of the roundtable’s most important conclusions was that the inadequate level of infrastructure investment in Africa does not fundamentally result from a dearth of available capital. Rather, some key policy efforts remain necessary to mitigate risk – both perceived and real – in infrastructure investment projects, and to put in place institutional mechanisms and contract structures that can help enhance the sustainability of these projects throughout their lifetime. **As put by Paul Collier in opening the seminar in Paris on 15 July 2014, infrastructure investment is policy intensive**.

The Paris seminar took a closer look at the key policy efforts required. On the one hand, the lack of broader enabling legal and regulatory frameworks does not necessarily hamper investment if there is the necessary level of commitment among key public and private actors to drive key catalytic projects. Well-designed sector plans put in place at national level can be important in attracting this form of investment, and DFIs have a key role to play in crowding in private sector in such cases, by de-risking projects almost up-front. This is an avenue for making a difference more immediately and in the shorter-term, while more sustainable regulatory frameworks are being put in place for the long-term. For the majority of infrastructure projects however, **tackling the framework conditions and regulatory environment for infrastructure investment is essential in order to attract investors, enhance returns on infrastructure investment, and pave the way for downstream project preparation work**.

At the broadest level there is a need to reinforce government “commitment technologies” – that is, **governments must establish a credible policy commitment 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 one of several ‘communication gaps’, whereby global capital markets continue to view African infrastructure as highly risky. Indeed in many cases and as emphasised by both the AfDB and the Lagos Office of PPPs, **perceived risk seems to be higher than real risk.** This is exacerbated by the short-sightedness of credit rating agencies (which often provide an overly negative picture of investment opportunities in Africa) and by the fact that individual projects cannot be rated higher than the sovereign rating of the host country.

Infrastructure investment policy must be leanly and efficiently designed – otherwise it runs the risk of working at cross-purposes with the goal of stimulating greater private participation in infrastructure projects. According to the SADC 3P Network, infrastructure procurement processes in Southern Africa routinely take five years whereas they should really be concluded within 24 months. According to the AfDB, reaching financial close for projects can take seven to ten years, in addition to seven years for construction. This is a considerable brake on investor attractiveness.

Red tape and complex processes are not the only reason for lengthy upstream processes. **There is also a dearth of capacity for dealing with the complexity of infrastructure project preparation, negotiation and implementation in Africa's public sector**. These capacity gaps are very uneven across countries, and for this reason in addition to active training and capacity-building efforts, policy frameworks have to protect public interests. As put by one PPP practitioner, when the private sector finds a weakness in government it will exploit it. The AfDB's African Legal Support Facility has been a game-changer in that regard. The recently launched Africa50 infrastructure fund aims to go further, by taking projects through to financial close (through its project development arm); and thereafter to the end of construction (through its project finance arm). The idea of **establishing a taskforce at supra-regional level to exchange on best-practices and foster capacity as well as public-private dialogue** (along the lines of the SADC 3P Network, which brings together the PPP Units of 14 Southern African countries) was also warmly received by participants.

II. Unlocking new sources of finance for infrastructure investment

In parallel, while it is agreed that finance for infrastructure investment is not the dominant bottleneck in this equation, some actionable steps can be taken to unlock further financing. With the possible exceptions of South Africa, Nigeria, Mozambique and Angola, Africa's capital markets are underdeveloped to support long-term investment projects and to source local funding. However **there is considerable room for growth in financing infrastructure by long-term institutional investors** – based both in Africa and in G20 economies. By 2050, USD 7 trillion of assets will be managed by African pension funds; in order to unlock this vast latent capacity, national regulations need revisiting. In Nigeria as in most other African countries, investment in private equity (which usually finances infrastructure) is capped at only 5% for pension funds. Meanwhile in G20 countries, the ability of banks, insurers and pension and mutual funds to allocate financing to long-term investment and to channel funds from savers to investors, both within countries and especially across borders, has been impaired, particularly since the crisis.

The extent to which home country regulatory environments might be adapted to encourage more investment in infrastructure abroad needs further analysis. Institutional investors face a 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. Institutional investors also need a sufficient pipeline of projects in which to invest over the long-term, and as few countries can on their own provide such a pipeline, for the infrastructure fund Meridiam this requires taking a pan-African view. Indeed as confirmed by the Private Infrastructure Development Group (PIDG), the only way to access institutional finance in Africa will be through bundling portfolios of assets.

III. Well-structured projects to secure high-quality, long-lived service delivery

Once all the actors, public and private, are in place for a given infrastructure project, the key question becomes **how to secure the resilience of the project to changing economic conditions, and to ensure that project outputs match the expectations of end-users**. As put by one participant, the market is ready to finance infrastructure in Africa, but projects need to be better structured and more broadly, there is a need to change ways of thinking about infrastructure investment.

Indeed for the SADC 3P Network, **a mind shift needs to happen – it is essential to bring the private sector in much earlier on when planning infrastructure projects**. Indeed poor preparation is partly to blame for the failure of many infrastructure projects in Africa: neither public nor private partners fully understand risk profile, causing costs to go up and increasing the need for contract renegotiation or even dispute resolution. The private sector, and especially financiers and commercial banks, is often unwilling to take on any substantial risk in such projects and expects sovereign guarantees to cover all contingencies. Meanwhile many poor African countries do not have the technical expertise to negotiate contracts on an equal footing with private investors, and cannot commit their treasuries to such guarantees. Very simply, there is a communication gap here: **there is a clear need for creating more spaces where public and private sectors engaged in infrastructure investment can engage in constructive dialogue.** This can also help reassure private partners in infrastructure projects, and lead them to identify risk with reward.

In terms of concrete project preparation, several of the facilities established for this purpose have been somewhat dysfunctional to date. A few private investors have begun to recognise and address the need for a change in mind-set and approach. General Electric now has offices based in Nairobi, **allowing much earlier engagement with public partners upstream of infrastructure project delivery**. GE Africa has established a project development facility to help infrastructure projects come to fruition, including a project financing team and a project development team working directly with governments. Another means of usefully improving project preparation could be **developing more standards, tailored to the African context, by which projects are prepared and feasibility studies are conducted**. Alongside, African countries need to develop credible processes to deal with unsolicited bids, which can deliver technological and efficiency breakthroughs if managed in a fully transparent and equitable manner.

IV. Economic incentives for private participation in infrastructure

To attract more private investment into infrastructure, basic elements of market structure and economic incentives also need to be tackled. First, this requires **considering the role of state-owned enterprises as potential partners with private actors**. Safeguarding a competitive environment for private operators, simplifying market regulations and making them more transparent, and ensuring a level playing field between public and private parties, are all at stake here. While these imply long-term structural changes that were not the focus of the Paris discussions, they are essential for African governments to keep in mind going forward.

On a more immediately actionable level, addressing economic incentives also calls for **an assessment of pricing structures for infrastructure services**. Often official tariffs are held artificially low in the interest of end-user affordability. GE estimates that African power utilities generally want to deliver at 5-6 US cents per KW/h, compared to a delivery price of power through gas which stands at 10-12 cents per KW/h. This distortion hampers cost-recovery for infrastructure operators, forces state-owned utilities to rely on fiscally costly subsidies rather than operating according to commercial principles, and results in compression of service as well as fiscal and regulatory uncertainty. As tariffs are frequently below the marginal cost of new supply, expansion of infrastructure grids is also hampered. Moreover these tariffs do not always help the poorest who may not be connected to national infrastructure grids and pay much higher prices for self-supply in electricity and water.

Tariff-setting can be more predictable if taken care of by an independent sector regulator; indeed participants raised that **while regulatory capacity can pose constraints, the issue is often more the authorising environment in which the regulator can proceed**. Frequently regulatory independence in only nominal, and sector regulators are heavily influenced by line ministries as well as state-owned utilities. Encouragingly however, as noted by EDF, **the political cost of bad power distribution is becoming higher and higher in Africa**. Therefore regardless of whether infrastructure markets are independently regulated or not, when engaging in infrastructure partnerships African policymakers will have to determine how to 'sell' higher power tariffs to their populations with the assurance of better service – given that most of Africa has a very poor history in terms of power service improvements. This is a second key communication gap to be bridged.

One specific approach would be to **enable new private generators to sell power directly to industrial users** who are ready to pay a remunerative price for uninterrupted supply, using the national State-owned transmission and distribution system with some appropriate fee for this service.

Local content is also becoming an increasingly looming issue in terms of infrastructure investment – Ghana's draft power sector plan for instance requires local fabrication of 80% of all power equipment, which is simply infeasible given existing domestic supplier capacity. Moreover these **local content considerations risk further fragmenting regional supply chains** for power and water whereas, for many small countries, economies of scale and scope can only truly be reached through cross-border infrastructure development. Where possible, countries concerned with building greater business linkages between foreign and domestic infrastructure investors should focus on supplier development – in possible partnership with private actors – rather than relying too heavily on arbitrary local content restrictions.

Other more effective means of making infrastructure investment work for development include the possibility for **shared use of mining infrastructure**, extensively discussed during the seminar. There is vast opportunity here, especially as almost all mining companies involved in Africa build excess power capacity in case of outages. However there is also considerable complexity and risk involved. The mining industry is extremely competitive, and infrastructure is often used as strategic asset to control the pace of mineral development. For such reasons, second-mover mining companies might need to pay more than first-movers to compensate the latter for the risks and investments taken. **A pan-African institution may help take care of these issues on the regulatory front, and IFIs may need to adapt some of their lending to be better aligned with the goals of shared use**.

V. Mitigating risks in infrastructure projects

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 were discussed, including: 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 building capacity in the public and private sectors to understand, share and manage risks across the project cycle. Greater standardisation of contracts in ways that conform to local legislation would also reduce transaction costs and increase certainty.

On the DFI front, a few innovative changes can be undertaken to make a quick and effective difference. As public risk capital is a scarce resource, it is important to allocate it efficiently and to avoid using it in ways that duplicate what private investors are ready to finance themselves. **There is an opportunity for DFIs to rotate their portfolio to get institutional investors involved post-completion** (which is typically a less risky part of the project cycle), perhaps with MIGA insurance against political risk. PIDG for instance runs a tiered debt fund (the Emerging Africa Infrastructure Fund), the bottom tier of capital being made up of public equity. DFI lending makes up the next tier, in the form of subordinated debt components; and finally senior lenders contribute the third tier, creating somewhat of a risk cushion through PIDG equity as well as the subordinated debt.

MIGA also provides a 'cushion' against risk (by re-insuring especially political risk), thus serving as a conduit between the World Bank's influence and the market. In fragile countries, MIGA's new Facility for Conflict-Affected and Fragile Economies (CAFEF) is financed by donors to provide first-loss coverage so that if risk materialises in the country, it is first taken by the CAFEF after which MIGA covers risk and re-insurance. In addition there are options for using ODA not just for public projects, but through IFC and MIGA to enable the latter to take more risk than they would otherwise. **Such first-loss facilities and tiering of capital can thus help leverage the maximum from the private sector through more effective use of public risk capital.** Yet alongside all these risk mitigation instruments, it can be important for host countries to take some of the first-loss tranche themselves, as an addition signalling mechanism or 'commitment technology' vis-à-vis private investors.

VI. Possible areas for further research and engagement

Attendees raised several options for concrete follow-up to the policy issues discussed during the seminar. Promising avenues for joint work include:

1. Tackling the public-private communication gap and creating coalitions for change

- There is urgent need for a platform for focused public-private dialogue, **creating more 'spaces where public and private sectors can talk'.** This exists in some form at the sub-regional level (SADC 3P network) but could be replicated at a higher level of decision-making for the whole of Africa, and with active participation from 'home country' governments and institutional investors.
- This would follow a similar vein to the initiative spearheaded by Dr Yumkella to **support 'energy champions' in a set of African countries**. In view of creating integrated and commercially viable regional power pools for mutual energy security and prosperity, Dr Yumkella has proposed the creation within each Regional Economic Community of an African Energy Leaders Group (AELG) to lead the creation of regional public-private-partnership platforms, with the purpose of driving large transformative investments in national and cross-border energy projects. This proposal has received strong endorsement from the AU Commissioner for Infrastructure and Energy, and the AfDB and OECD could effectively contribute to a focussed PPP platform to crowd-in private sector energy investments in Africa.
- A third similar avenue for work is Paul Collier's proposal to **promote public-private reform coalitions for infrastructure investment with pilot countries**. Participation by the OECD and bilateral and multilateral DFIs can help inform such initiatives.
- Fourthly, the meeting noted the potential of IFI initiatives, including Africa50, to move forward the preparation of catalytic projects, and demonstrate in a practical way how additional investment can be delivered.

2. Tackling the risk perception gap

- **Firm action needs to be taken by G20 and OECD governments to review the powers granted to credit-rating agencies** in essentially 'making or breaking' infrastructure deals. These agencies have no multilaterally granted mandate and yet their impact on the willingness and ability for investors to participate in Africa's infrastructure development is phenomenal. Alongside a mind-set shift is needed for private investors to accept to take on more risk in projects, not necessarily in exchange for sovereign guarantees, and to also participate in public-private projects far earlier in the project cycle.
- Alongside **there needs to be a strong push for data on infrastructure investment**, as well as on the financial situation of state-owned infrastructure operators and on the quality of existing infrastructure networks. This can help reassure investors, strengthen the credibility of government commitments, and avoid risks of asymmetric information between public and private partners in infrastructure projects.
- Another useful form of data collection could be the **development of an "infrastructure doing business index"**, rolled out for just a few countries to start with, which would assess all relevant factors for attracting private investment in infrastructure (from the economic incentives and regulatory features of infrastructure markets, through to the transparency of procurement and PPP procedures, and to the level of public sector capacity for managing infrastructure projects).

3. Tackling the expectations gap with end-users of infrastructure partnerships and making infrastructure investment work for development

- In several countries projects have ultimately failed because of an end-user backlash, who refused to accept tariff increases or tolls when the project came on-line (even if this entailed higher-quality and more predictable services). **Careful ex-ante communication with the general public, and involving end-users systematically in project planning, design and monitoring**, are all essential to manage such ex-post risks and to ensure good project performance.
- To make infrastructure investment work for development, beyond the expansion of infrastructure networks it is crucial to develop sound investment linkages with domestic entrepreneurs. This requires **moving beyond local content requirements, to building stronger supply-side capacity for infrastructure investment at the domestic level** (and including for small-scale, local infrastructure projects).
- **G20 economies and African governments could collaborate to explore opportunities for shared-use of mining infrastructure**, perhaps through establishing a regional platform which could pilot some shared-use solutions and develop best-practices for addressing the complex policy and contractual challenges involved.