



POLICY BRIEF
**POLICIES FACILITATING
INCREASED PRIVATE
INVESTMENT FINANCING FOR
HIGH-IMPACT, SUSTAINABLE
INFRASTRUCTURE PROJECTS**



Task Force 3

**INFRASTRUCTURE INVESTMENT
AND FINANCING**

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موجز السياسة سياسات تيسير زيادة تمويل استثمار القطاع الخاص في مشاريع البنية الأساسية المستدامة عالية التأثير

فريق العمل الثالث
الاستثمار في البنية التحتية وتمويلها



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ABSTRACT

This brief identifies methods to increase global private sector investment in infrastructure projects in developing and emerging market countries. Policies to enable private sector investment can benefit countries with low levels of corruption and good governance. Reliable, real growth record, productive regulatory and legal environments, and a record of good infrastructure project experience, including a well-developed and logical infrastructure pipeline, are also critical. Investment enablers also include the demand for “smart” and larger infrastructure projects, suggesting that, in some cases, consideration should be given to regional infrastructure projects when appropriate and justifiable for economies of scale.

يحدد هذا الملخص طُرقاً لزيادة استثمار القطاع الخاص العالمي في مشاريع البنية الأساسية بأسواق البلدان النامية والناشئة. يمكن أن تفيّد سياسات تمكين استثمار القطاع الخاص البلدان ذات المستويات المنخفضة من حيث الفساد والحوكمة الجيدة. كما أن الموثوقية والسجل الواقعي للنمو والبيئة الإنتاجية التنظيمية والقانونية، وسجل الخبرات الجيدة في مشاريع البنية الأساسية، بما في ذلك مسارات البنية الأساسية المنطقية وجيدة التطوير؛ تُعدّ جوهرية أيضاً. كما تتضمن عوامل تمكين الاستثمار الطلب على مشاريع البنية الأساسية الذكية والكبيرة، وهو ما يوحى في بعض الحالات إلى ضرورة النظر في مشاريع البنية الأساسية الإقليمية عندما تكون مناسبة ومُبررة بالنسبة إلى وفورات الحجم.



CHALLENGE

The main challenge is to identify policies to increase private investment in infrastructure projects in developing and emerging market economies.

There are five sources of external finance to developing and emerging markets, which totaled about \$1.3 trillion in 2018. These capital flows are concentrated in a small number of countries, of which Asia receives about three-quarters of the total. The largest and most stable flows are foreign direct investment (M&A and greenfield) by multinational corporations and private equity firms, at about \$700 billion, but this investment is plateauing. The second-largest source of funds is diaspora remittances, which grew in recent years by 8-9% annually to \$530 billion in 2018. The third source of funding is from official development assistance, which has been stable at \$150 billion for several years. The two remaining sources of capital flows are comparatively volatile, which makes them unreliable sources for infrastructure projects with the present selection of financial instruments available. They include portfolio investment in developing country capital markets that consist mostly of equities, and other investment inflows consisting primarily of bank loans.

This brief proposes seven policy actions to attract private sector funding for infrastructure projects. Infrastructure project finance is not easy, especially in developing and emerging markets, as they involve private and public cooperation. Therefore, anything that can simplify and expedite the process would remove a significant barrier for the country, as well as for many private sector investors unfamiliar with the target countries. It is also essential to not only mobilize more funding, but attract even better funding. Thus, sustainable infrastructure issues, including nature-based solutions, and ecosystem approaches that preserve natural capital and prevent biodiversity losses, should be a priority in addressing critical problems. Private sector investors already focus more on environmental, social, and governance from a liability avoidance perspective and are building a reputation for supporting human wellness.



PROPOSAL

1. Increasing private investment in infrastructure projects in developing and emerging markets.

Proposed policy actions:

- Simplify the infrastructure funding process by combining investors and borrowers in an infrastructure investment clearinghouse with UN/World Bank/IMF advisory oversight.
- Establish a Board of Private Infrastructure Investor Representatives with membership from large funders, including institutional investors, pension funds, sovereign wealth funds, endowments, insurance companies, commercial banks, multinational corporations, private equity companies, and infrastructure engineering and construction companies.

The Board's purpose is to establish infrastructure funding pre-qualification standards for countries and a standardized Request for Funding Proposal format for the country's infrastructure funding bids, which the Board will review quarterly.

The UN/WB/IMF can verify that the private investor representatives' pre-qualification standards are satisfied before the target country can submit a request for funding bid. Funding proposals must include evidence of the infrastructure project improvement on the indexes for corruption and governance, social and education levels, and environmental improvement, as well as an analysis of relative comparative advantage impact. The funding proposal should also show the extent to which the project will raise the country's Human Development Index (see also the UN Agenda 2030).

The UN/WB/IMF can present a country's infrastructure project proposal to the Board of Private Infrastructure Investor Representatives from pre-qualified countries for review and advice on fundability. The Private Infrastructure Investment Representatives will advise on appropriate funding sources and structures (term sheets) for specific infrastructure projects for the country's review and acceptance.

The countries with a proposed infrastructure project may then submit a Request for Funding bid that would build on existing initiatives within the Multilateral Development Banks (MDBs), or through the Infrastructure Cooperation Platform (ICP) linked with the G20 Infrastructure Working Group (IWG). Private equity firms established "infrastructure as an asset class," which provided more stable performance through the 2007–8 financial crisis than any other asset classes.

2. The UN/WB/IMF, regional development banks, and local governments should focus on expanding risk coverage guarantees/insurance programs to encourage and protect increased private infrastructure investment.

The main concern of private investors in infrastructure projects is the risks associated with corruption, governance, and country mismanagement resulting in delays, defaults, and rescheduling for infrastructure projects. The UN/WB/IMF, regional development banks and local governments should focus on providing sufficient insurance and guarantees to offset these risks to attract private sector investors and strengthen their influence over timely project completion. Using insurance or guarantees to remove risk would increase private investment in infrastructure projects. To some extent, lower funding costs will offset the cost of insurance, as private funders do not have to bear the cost of insurance. Finally, the UN/WB/IMF and regional development banks can work with countries and governments to establish acceptable governance rules and actions to eliminate corruption.

3. Support the creation of and help fund an organized secondary market for private infrastructure investors to add market liquidity options to the infrastructure transaction, as private investors desire.

Private investors prefer short- to medium-term maturities and risk mitigation options. Developing a secondary market in private or public infrastructure investments can help meet this preference. Being able to sell a single or bundle of infrastructure investments to gain liquidity when desired removes a significant barrier to private funding in infrastructure projects.

Establish a secondary market fund(s) and co-investment funds to provide alternative mutual fund investment opportunities for family offices, pension funds, insurance companies, and so on, for infrastructure investments in developing and emerging market economies (Please see, for example, Lexington Capital Partners headquartered in New York at www.lexingtoncapitalpartners.com).

The development of a robust secondary market for infrastructure investments would create a way for private sector investors to access liquidity if desired. Secondary market products could include infrastructure project bonds, equity, loans, and other forms of investments supporting the infrastructure project. The creation of a secondary market will significantly increase private investment in infrastructure projects.

A secondary market entity could facilitate the syndication and securitization of private-sector investment obligations in infrastructure projects and accommodate the sale of entire portfolios of private-sector infrastructure investments in one or several

countries. In addition, a secondary market entity could facilitate capital recycling of existing mature “brownfield” assets to support new “greenfield” infrastructure projects to retain private sector funding already in the native country or several countries.

4. Create a G20 Infrastructure Funding Consortium Emergency Reserve.

The G20 might consider establishing an emergency infrastructure reserve fund to ensure that approved crucial infrastructure projects receive their required funding for launch, unforeseen emergency needs during construction, or project completion and delivery disruptions due to natural disasters. Funds could be managed by an investment manager such as Merrill Lynch, Morgan Stanley, Goldman Sachs, and so on. Member countries could fund the G20 Infrastructure Emergency Reserve by establishing global taxes on very wealthy individuals and families and collecting these taxes regardless of location or residency. For example, wealthy individuals/families would pay a 4% wealth tax on all forms of total assets above \$50 million and a 6% wealth tax on total assets above \$1 billion as determined annually in June.

A country’s Infrastructure project receiving G20 Emergency Reserve funding would be required to repay the amount received plus a 3% simple annual interest rate over 20 years.

The G20 Emergency Reserve could be available on request and sponsored by the UN/WB/IMF on behalf of the country(s) with infrastructure financing problems due to natural disaster-related crises. It could be explicitly accessible to finance any funding issues that delay the construction, completion, and implementation of product delivery for infrastructure projects in developing and emerging markets. The G20 Emergency Reserve could also be used to buy out shareholders, grantors, offtake purchasers, input suppliers, lenders, insurers, operators, construction contractors, and funders not performing appropriately. Additionally, the G20 Infrastructure Emergency Reserve could be used to assist with the establishment of a secondary market infrastructure funding entity to resell private- or public-sector investments in infrastructure projects.

5. The G20 members might consider offering tax credits for member countries’ citizens or companies that invest in G20 Infrastructure Funding Bonds or loans that help reduce pollution in the global economy and support the infrastructure project’s environmental, social, and governance sustainability.

These financial infrastructure project securities, protected against default through insurance by the WB, MDBs, or the IMF, could guide the investee countries’ governments on how they manage economic policy during the infrastructure

construction and delivery period. Based on the value of the bonds or loans purchased, the amount can serve as a deduction or to offset federal tax payments, which could be usable annually until the G20 Infrastructure Bonds mature. However, the tax credits should not be redeemable for cash at any time and used only to offset federal tax obligations.

6. The G20 could support the establishment of a global diaspora infrastructure investment fund to channel diaspora remittances into a legacy-impact country, regional, or world infrastructure project fund.

Diaspora remittances each year are substantial, at over \$600 billion, and many diaspora communities have savings of about an equal amount, with both growing continuously. The G20 could simulate the USAID-India model for the Indian diaspora in the US globally. Alternatively, they could adopt other measures to provide diaspora communities with investment portfolios composed of various financial instruments to meet their needs (savings accounts, CDs, mutual funds, equities, bonds, etc.). For example, Western Union created a platform for the Haitian diaspora to finance renewable energy projects in Haiti. Construmex, developed by CEMEX in 2001, collects remittances from the US-based Mexican diaspora to invest in the construction of homes for themselves and relatives in Mexico. Homestrings.com is an online platform that connects diaspora investors with projects and funds in their region or country of interest and handles regulatory issues and fund transfers. The USAID-Indian Diaspora Investment Initiative partnered with the Calvert Foundation and private Indian Foundations that purchase a Calvert Foundations Community Investment secure note. The Foundation lends to Indian financial institutions that focus on social enterprises such as clean water, health care, and sanitation improvements. These funds could finance legacy-impact infrastructure projects in their home country, a region, or any country they designate, or they could be used to invest in a secondary infrastructure fund. Diaspora communities from different countries have different investment interests, and in many cases, accept various levels of risk, which would benefit developing and emerging markets.

A diaspora community could specify their preferred type of insured financial instrument and where they want the funds used. Market conditions would determine the return. A diaspora investor could transfer the ownership of a portfolio of financial instruments to family members or anyone, or sell them to cash out. They could also donate the instruments to the G20 Diaspora Fund for Global Infrastructure Projects and receive a tax credit.

7. Encourage all governments through the example of G20 member countries providing tax reduction or subsidy incentives to support all workers willing to obtain continuous education in STEM skills relevant to companies adopting new technologies for infrastructure investments with some private-sector-supported investment.

In many advanced, developing, and emerging market economies, governments are pushing efforts to adopt new technology and innovations to stimulate GDP, productivity growth, and improved standards of living. Much more can be done, as only four countries score more than 80 on innovation capability (Germany, the US, Switzerland, and Taiwan) in the World Economic Forum's (WEF's) Global Competitiveness Report 2019. Enabling this change requires human capital investments, especially with relevant educational support, to provide the new skills required by more capital-intensive technology-driven companies. Furthermore, the WEF Report emphasizes the need for countries to improve "talent adaptability and mobility," which requires a well-functioning, flexible labor market that supports and protects workers to embrace new technology-impacted careers. Workers must be confident that the government will support them and their families through this transition to ensure that they embrace the educational-driven transition at no cost, such as through tax incentives or subsidies to labor. Human capital investments are one of the most critical factors to enhance productivity and expand GDP growth in the future.

Disclaimer

This policy brief was developed and written by the authors and has undergone a peer review process. The views and opinions expressed in this policy brief are those of the authors and do not necessarily reflect the official policy or position of the authors' organizations or the T20 Secretariat.



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APPENDIX

Private Investor Requirements to Invest in Infrastructure Projects

There have been many surveys and studies on private investors' requirements to invest in infrastructure projects in developed, developing, and emerging market economies. The World Bank and United Nations–UNCTAD (UN) developed a measure of critical criteria for acceptable or beneficial infrastructure projects with three components: environmental, social, and governance (ESG). Private investors in infrastructure projects in developed countries are increasingly supporting these goals. The first step in attracting private investment in infrastructure projects, specifically for developing and emerging market economies, is to propose projects that private investors find attractive in terms of size, maturity, sector, management, and return, and which have an acceptable risk level. Additionally, infrastructure investment must have the desired social and environmental impact. A precondition and primary requirement for private sector investment in any country is the degree of corruption, level of governance in business, and a supportive political environment, as every major financial risk assessment institution reports. Investors have higher comfort levels investing in infrastructure when the country has a democracy with a free market system or a stable and respected leadership with widespread support.

A functioning legal and judicial system that enforces the statutory policy and supports equal human rights for everyone is necessary. Investors also desire educational institutions that provide well-trained and qualified labor, managers, and executive leadership. Additional desired qualifications include a prudentially managed financial system and a skilled and independent central bank, as well as a reasonable amount of natural resources or service revenues. Private investors would also like to believe that where and what they invest their expertise, time, and money into will also be of positive value to the future well-being of the people, the local economy, and the environment. The sequence of criteria for increased private infrastructure investment should therefore be GSE instead of ESG.

Thus, the factors driving private investment, in terms of their importance, fall into four major categories: 1. Corruption and governance, 2. the risk-return relative to alternative investment opportunities, 3. social impact, and 4. environmental impact (World Federation of Exchanges 2018; 2019). Each category is currently measured by one or more indexes that rank the countries for which data are available. A coun-

try-composite index may be created based on the importance or weighting assigned to each component by private sector investors. Summing these weighted indexes for each category for each country will provide a more holistic picture to identify the most likely countries to be acceptable as private sector investment targets. This weighted index can be tracked over time to monitor the country's performance direction and success of proposed infrastructure projects. It can also provide a holistic picture of which countries are more likely to be candidates for increased private sector infrastructure investments based on each investor's acceptable risk appetite and current investment portfolio or exposure.

This also provides a precise guide for what a country must do to influence its index ranking in each category to make itself more attractive (higher index) overall to private sector infrastructure investment inflows. Therefore, the responsibility to attract private sector investment shifts to the leadership of the developing and emerging market economies. They can observe and monitor the criteria used to determine how attractive the country is to foreign private funders. If the country's leadership wants to improve the country's attractiveness, they can make the necessary policy changes to improve its ranking in the country's weaker areas. Therefore, nations have an incentive to enhance their private sector investment opportunities by raising the index of the most deficient element(s). A higher index also provides a measurable way to demonstrate their improvement and attractiveness for private investment relative to other countries.

Any country that desires additional private sector infrastructure funding can then seek assistance from the UN/WB/IMF and their regional development bank, and any bilateral /multilateral aid granting agencies. These institutions can advise them on how to improve in any one or several categories to raise their attractiveness for private sector funding. This approach identifies the necessary changes and places the responsibility for making essential changes on the country and its leadership. By implementing appropriate policy changes, the nation will become eligible to attract more private sector infrastructure project funding. Since the conditions for attracting increased private sector investment come from private investors and public sector agencies, terms may be more acceptable to the country's people and their leadership.



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