GEGAFRICA
GLOBAL ECONOMIC GOVERNANCE

POLICY BRIEFING | NOVEMBER 2016

IMPROVING INFRASTRUCTURE FINANCE FOR LOW-INCOME COUNTRIES: RECOMMENDATIONS FOR THE ADF

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EXECUTIVE SUMMARY

Low-income countries (LICs) in sub-Saharan Africa face a substantial infrastructure-financing gap. Multilateral development banks (MDBs) have traditionally played an important role in mobilising finance for infrastructure in LICs, but their funding alone cannot match demand. The African Development Bank's (AfDB) concessional window, the African Development Fund (ADF), is a key infrastructure financier for African LICs, and comprises 37 regional member countries (RMCs), including emerging markets and fragile states. However, in recent years the ADF has faced funding and technical constraints. This policy brief, based on a discussion paper, outlines the ADF's role in providing infrastructure financing to LICs and the challenges that countries face in accessing these funds. It also examines the changing context confronting LICs as they weigh their infrastructure demands against the requirement to maintain

POLICY RECOMMENDATIONS

1. In order to target growing international concerns around debt sustainability, the ADF should increase its efforts to work with countries in understanding and managing their debt levels.
2. The ADF should continue to streamline its approval and implementation processes, targeting national capacity bottlenecks as early as possible and ensuring the continuity of AfDB officials from the appraisal to monitoring stages.
3. The ADF should direct efforts towards increasing LIC awareness and understanding of its private finance mobilisation tools through greater promotion and dissemination of information, and should increase technical support and training for PPPs. It should place greater focus on measuring the developmental impacts of projects, especially where the private sector is involved.
4. Project preparation requires more ADF funding, and the ADF's PPF should explore cost recovery mechanisms to ensure sustainability. LIC governments should create better co-ordination and unified support around proposed projects to decrease risks.
5. LICs should be assisted in accessing the non-concessional ADB funds available to them.

sustainable debt levels. Lastly, the brief explores the challenges and opportunities of mobilising additional finance for LICs.

INTRODUCTION

The UN Conference on Trade and Development (UNCTAD) estimates that between $1.6 trillion and $2.5 trillion is required annually from 2015–2030 to bridge the infrastructure-financing gap in developing countries. Some estimates indicate that sub-Saharan Africa alone requires up to $93 billion annually until 2020 to finance this gap.[2] Closing the gap will require both public and private sector investment in infrastructure. However, for the last two decades LICs have only attracted 25% of infrastructure financing on the continent.[3] In addition, renewed rising debt levels pose a risk to infrastructure financing in LICs as they rapidly approach debt ceilings prohibiting future borrowing.

This briefing complements the findings of the ADF final report of the mid-term review of the ADF-13 and the working group on 'Innovative approaches for the ADF-14'.[4] Among its recommendations are suggestions on implementing co-financing approaches, improving project preparation and improving private sector participation.

The ADF requires additional capital contributions every three years from donors, which are generated through replenishment meetings. Lesotho and Senegal have been invited to participate in the ADF-14 replenishment meeting in November 2016. They are used as case studies to highlight the challenges they face in dealing with the ADF and funding their infrastructure needs.

LIC DEBT SUSTAINABILITY LEVELS

Concerns around LIC debt sustainability present a challenge in mobilising finance for infrastructure. Despite successful debt restructuring efforts by MDBs, following the 2008 financial crisis LIC indebtedness slowly began to grow. This is due to a reduction in concessional debt, lower growth rates and higher primary deficits,[5] and is compounded by LIC use of non-concessional loans at higher interest rates. Moreover, the commodities slump exposes how vulnerable LICs are to returning to unmanageable debt levels.

Against the backdrop of tighter fiscal conditions governing donor support, there is pressure on donors to move from grants to loans with hardened terms. The ADF-13 report therefore encourages the ADF to work closely with LICs to increase their capacity to mobilise domestic resources and co-ordinate with other MDBs when assessing the overall debt sustainability of countries.[6] Closer co-ordination can ensure that all MDBs have a better understanding of LICs' financing needs, especially since the ADF is best positioned to service LICs. The new approach of rating countries according to their debt vulnerability and determining how much concessional finance they can obtain based on individual debt levels allows the ADF to conduct realistic debt sustainability analyses (DSAs). This provides RMCs with the flexibility to access specified levels of non-concessional financing, while also ensuring long-term debt sustainability.[7] In this way the ADF should be able to improve its services to RMCs and ensure efficient usage of their internal resources when undertaking DSAs.

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Challenges encountered in undertaking DSAs for the Debt Sustainability Framework, which is used by the ADF to inform its financing to LICs, particularly in terms of grant eligibility, expose the need to balance debt levels against development concerns. The DSAs have been remodelled to reflect linkages between public investment and growth, and show greater flexibility towards public enterprise debt and the use of remittances.[8] This is a positive step that should assist the ADF in assessing RMCs' debt levels more accurately and responding more effectively to requests for debt management assistance.[9]

However, there is a limit to what the AfDB/ADF can achieve without the co-operation of recipient RMCs themselves. The ADF's capacity to implement substantial debt management initiatives remains constrained[10] and African countries also need to find solutions towards reducing their own debts.

This can be done by:

- effectively mobilising domestic revenue;
- implementing debt management strategies and general fiscal policies that enable growth;[11]
- establishing maximum debt levels that can be incorporated into the long-term ADF financing framework to ensure timeous repayment of debts; and
- strengthening domestic capacities to undertake independent DSAs.[12]

ISSUES WITH ADF PROCESSES

The country case studies highlight specific concerns around ADF lending. In Lesotho, concerns centred on the insufficient involvement of the private sector and civil society in the selection and justification of country strategy paper (CSP) projects, which many felt is the sole purview of government officials. Private–public sector relations in Lesotho are also strained. In contrast, the Senegalese case study noted that consultations were sufficient.[13]

Both case studies highlight lengthy project preparation and implementation as a challenge, which they see as being at least partly due to the ADF's internal processes (in addition to national capacity challenges), as well as frustrations with the limited financing perceived to be available. Both countries want access to both ADF and ADB funds, which the ADF is trying to make available through increasing options for countries to achieve 'blend' status where they can access both concessional and non-concessional finance. However, Senegal and Lesotho expressed frustration with the eligibility requirements and their inability to access ADB funds.

PRIVATE SECTOR FINANCING MECHANISMS

In its 12th and 13th replenishments, the ADF introduced three new mechanisms to mobilise additional private sector financing for LICs to target its financing constraints. These are: Partial Risk Guarantees (PRGs), which guarantee against political risk; Partial Credit Guarantees (PCGs), which guarantee against debt service default; and a Private Sector Credit Enhancement Facility (PSF), which provides credit enhancement to specific LIC projects.

In an ADF-14 working group established to consider innovative modes of finance mobilisation, one option presented was to extend PSF coverage to other financial institutions that are co-financing private sector projects so they can also take advantage of the PSF's credit lines.[14] Co-financing can increase the effectiveness of lending by spreading the risk, and ADF replenishment funds alone are often only able to cover one project in its entirety over the three-year cycle.[15]

Although these three programmes are relatively new, their uptake has been low. There seems to be little awareness or understanding of these private sector mechanisms and initiatives. The Senegalese case study reveals that country officials believe that these mechanisms fall under the AfDB's commercial window and are therefore not accessible to LICs.[16] This shows a clear information gap, resulting in the lack of utilisation of resources available to assist countries.

PROJECT PREPARATION

Project preparation is crucially important as a component of infrastructure projects. Private financiers are often reluctant to invest in this phase as profits are not guaranteed. Project Preparation Facilities (PPFs) can support several steps in the project preparation process, such as legal and regulatory framework assistance, design and implementation of feasibility studies, and project design.

The Senegalese case study shows that the Senegalese government struggles with project feasibility studies, while its own efforts to start a national project preparation facility were unsuccessful due to insufficient funds. This predicament highlights not only the lack of available PPF funds but also the inability of national governments to instil confidence in investors and project financiers that they are able to implement successful projects.[17]

A 2014 review of the ADF's own PPF (established in 2000) resulted in an increase of available funding and harmonised guidelines with other PPFs.[18] However, the amount of funds available is still low: only $12.87 million, with the individual funding limit increased to $1 million per project. The PPF does not seem to be a priority of the fund, given its small capital base and the fact that its review came only 14 years after its establishment.

PUBLIC–PRIVATE PARTNERSHIPS

Another important aspect of attracting private finance is facilitating the structure of the contractual arrangement, which is often a public–private partnership (PPP).

However, experiences from Lesotho highlight that challenges remain in implementing PPPs in LIC countries. With the Queen Mamohato Memorial Hospital PPP, the government ended up shouldering a disproportionately large cost burden, and relations between the public and private sector partners became strained. Without contract management and monitoring capacity, the government did not have any recourse against its private partner. This lack of broad government capacity was the biggest risk to the project's long-term success. The AfDB's Lesotho CSP states that the ADF in particular will focus on leveraging ADF resources for more co-financing and private sector mobilisation of funds for PPPs as one if its five CSP priorities.

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SUGGESTIONS FOR THE ADF-14

Looking to the ADF-14 and beyond, consultations with LICs have highlighted ways in which the ADF can improve its effectiveness. The ADF needs to engage with RMCs more effectively to ensure better communication and a common understanding of what acceptable debt levels are, through training, regular reporting and monitoring. The ADF should use country ratings and country-specific analysis towards concessionality to better reflect nuances among developing countries, based on each country's specific public financial management profile, its debt vulnerability and country-specific DSAs. It should also continue to explore mechanisms to streamline project approval and disbursement processes, by ensuring the continuity of AfDB Project Management Unit involvement throughout projects and working with local government to improve project monitoring and evaluation. Increasing countries' ability to access non-concessional ADB funds is crucial, including providing more comprehensive information on how they can comply with the requirements.

LICs must be made aware of the new private sector mobilisation initiatives. The information should be available at the AfDB's regional offices, with clarity on LICs' eligibility, and promoted to LICs Adding co-financing mechanisms for other donors to the PSF is also crucial. However, it is important that the ADF prioritises pro-poor impacts in the design and monitoring of projects, and balances this with ensuring financial viability. It can take the lead in establishing standardised processes to measure developmental benefits when selecting projects and monitoring impacts, which is lacking among DFIs.

The ADF should increase concessional funding towards the project preparation phase, particularly social, environmental and feasibility studies. This could be explored through revitalising its existing project preparation facility, which should focus on mechanisms of cost recovery,[19] which typically acts as a bottleneck for the funding of early project preparation. There should be increased efforts to direct LIC countries to the resources that are available to assist project preparation. Governments can attract PPF support by demonstrating unified, cross-sectoral support, mobilising popular support among civil society, and demonstrating a willingness to devote significant funds in accordance with their capacity. This unified support offsets political uncertainty, which is a major risk factor for investment.

The high PPP failure rates on the continent underscore the need for the AfDB to address capacity gaps in PPP implementation and ensure that the public sector does not bear all the costs. The Lesotho CSP suggestion to increase ADF funds towards private finance mobilisation and co-financing for PPPs should be considered, and implemented more widely across LICs exploring PPPs. The softer issues of facilitating understanding and good relationships between public and private actors engaging in a contract must also not be neglected.

ENDNOTES

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19 Possible mechanisms for PPF cost recovery are discussed in more detail in Chaponda T, Nikore M & M Chennells, *op. cit*.

GEGAfrica has been funded by UK aid from the UK government; however, the views expressed do not necessarily reflect the UK government's official policies.

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