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OPERATIONALISING THE SADC REGIONAL DEVELOPMENT FUND

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EXECUTIVE SUMMARY

Infrastructure development, as an enabler of economic growth and catalyst for poverty alleviation, is an integral part of the economic development agenda of most African countries. New estimates by the African Development Bank suggest that the continent's infrastructure needs amount to $130–$170 billion a year, with an annual financing gap of between $67.6 and $107.5 billion. In Southern Africa there has been ongoing discussion about establishing an infrastructure financing mechanism to support the region's ambitious industrialisation plans. In 2017 SADC decided to operationalise the long-anticipated SADC Regional Development Fund (RDF). This briefing examines the need for and potential role of the SADC RDF in addressing SADC's infrastructure needs. It considers the focus placed on infrastructure development in SADC in various global, continental and regional infrastructure plans and initiatives, and analyses the implementation of these plans. The challenges at each stage of the infrastructure pipeline in SADC are explored, drawing on current financing mechanisms.

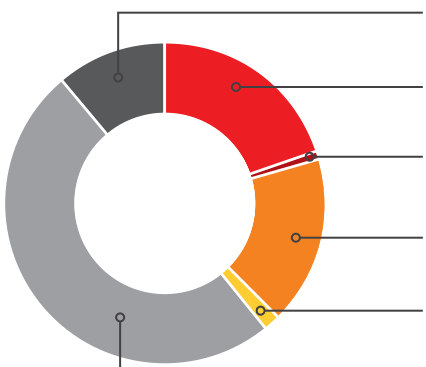
POLICY RECOMMENDATIONS

1. The SADC PPDF should be incorporated into the RDF, using its human resources structures and expertise to counter the costs of establishing a new regional structure.
2. The project preparation component should be the main vehicle for member state contributions in the RDF, to shift from ICP funding to members' contributions. This will enable greater regional control of PPDF decision-making.
3. At the national DFI level there should be a focus on regional capacity-building initiatives that support greater member state ownership and participation.
4. Financing should support continuing reviews and restructuring of the RIDMP, to remove unfeasible projects and support the refinement and de-risking of projects with real potential and that are aligned to the RISR.
5. The impact of public investment on growth can be enhanced by implementing policies that foster efficient public investment. Regionally, member states should review infrastructure and industrial strategies and continue to harmonise legislative and regulatory initiatives, as well as regional planning.

INTRODUCTION

Infrastructure development, as an enabler of economic growth and catalyst for poverty alleviation, is integral to the economic development agenda in Africa. In SADC, infrastructure development remains a critical component of the region's wider socio-economic development strategy. SADC's response to the challenges encountered in regional infrastructure development, industrialisation and economic growth and development has been to adopt the SADC Regional Infrastructure Development Master Plan (RIDMP) in 2012 and the SADC Industrialisation Strategy and Roadmap in 2015. The latter aims to increase the share of manufacturing value addition, industrial employment and use of technology to boost regional economic growth to 7% per year from the average 4% growth per year achieved since 2000. The RIDMP 2012 earmarks an estimated $500 billion for regional or regionally strategic infrastructure projects, in three five-year intervals.[2]

FIGURE 1 RIDMP FINANCIAL REQUIREMENTS



Source: SADC, 'Regional Infrastructure Development Master Plan: Executive Summary August 2012', https://www.google.com/search?client=safari&rls=en&q=,+%E2%80%98Regional+Infrastructure+Development+Master+Plan:+Executive+Summary+August+2012%E2%80%99&ie=UTF-8&oe=UTF-8, accessed 1 July 2018

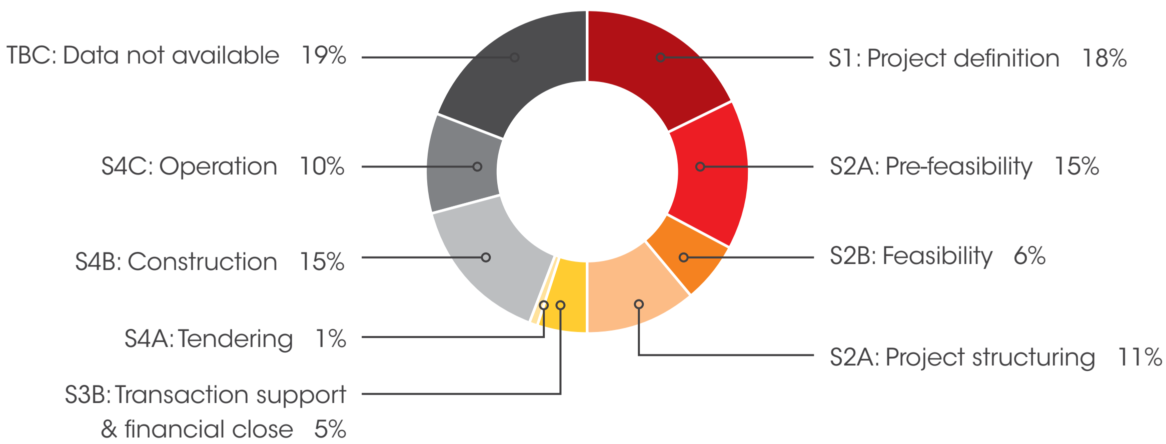
The establishment of the Regional Development Fund (RDF) to provide seed funding for SADC's ambitious infrastructure plans has been on the cards since the signing of the SADC Treaty in 1992, but a firm decision to launch and operationalise the long-anticipated SADC RDF was only taken in 2017. To accelerate the operationalisation of SADC's regional industrialisation and infrastructure development strategies, there is a need to improve regional resource mobilisation within SADC, especially at the very early project preparation phase, given a consistent finding that too few bankable projects are coming through the infrastructure pipeline. However, the establishment of a new resource mobilisation structure without due consideration of the focus, potential cost, sustainability and ability of member states to contribute to such a fund presents several challenges. This policy briefing explores the key areas requiring member states' urgent attention to operationalise the RDF by drawing on best practice examples, as well as instruments and initiatives already in place in the region.[3]

OVERVIEW OF INFRASTRUCTURE FINANCING CHALLENGES

The infrastructure financing deficit in the region is well known, and the importance of addressing it to drive regional growth and development is well understood.[4] However, methods of tackling the financing deficit have been hotly debated over the past decade. While analysts broadly agree that additional financing is needed to implement the RIDMP and SADC's Industrial Strategy, there is also strong evidence that the infrastructure deficit is primarily attributable to a dearth of bankable projects, caused by a financing gap in the early project development and project preparation stages.[5] According to the Development Bank of Southern Africa (DBSA), 'in 2009 and 2010, a total of $55 billion was available to spend on projects in the region but was not disbursed due to gaps in project preparation and delivery'.[6]

An analysis of SADC's regional Programme for Infrastructure Development in Africa (PIDA)[7] projects support this assertion, as shown in Figure 2. Projects that are still at project definition phase constitute 18% of the total. In absolute terms, 15 projects are in this phase, 13 (87%) of which have been in this phase for more than five years. In addition, project definition has the longest lead times within the project life cycle. Of the 81 SADC PIDA infrastructure projects, only 11% are at the project structuring stage. This is 10% less than the number of projects at the pre-feasibility and feasibility stages. Conversely, fewer projects pass the

FIGURE 2 STAGES OF SADC PIDA INFRASTRUCTURE PROJECTS



Source: AU, Virtual PIDA Information Centre, 'Project stages and key milestones', http://www.au-pida.org/project-stages-and-key-milestones/, accessed 19 March 2018

project structuring stage; 5% are in the transaction support and financial closing stage with 1% at tendering stage. As expected, beyond the tendering stage project turnover increases, as indicated by the 15% of projects that are at the construction stage and the 10% at the operation stage. This confirms that the bottlenecks that cause the infrastructure deficit are typically at the project preparation stages (stages S1–S3a).

While project preparation is most commonly associated with standard feasibility studies such as environmental impact assessments and economic feasibility studies, the full project preparation process starts much earlier and is more comprehensive. Indeed, project preparation can take a decade or more to complete.

Project development and preparation bottlenecks

SADC's infrastructure challenges begin at the earliest stages of project development, with the RIDMP. Stakeholder consultations highlighted that a major flaw of the RIDMP is the arbitrary way in which projects are put forward. They are not meaningfully conceptualised and several can more accurately be labelled as 'ideas' rather than fully-fledged projects. This is partly the result of overly politicised processes (ie, projects are prioritised because of the political agendas of specific administrations) that stymie proper due diligence.[8] Projects are also not chosen with the view of supporting SADC's industrialisation and developmental agenda, and what constitutes a 'regional' project is not clearly defined. The criteria for the RIDMP include economically viable projects that are either cross-border or national projects with regional impact; however, how one defines regional impact, as well as the prioritisation within these criteria, leaves room for interpretation.[9]

Project conceptualisation deficiencies in RIDMP projects are also in large part the result of capacity and coordination challenges at the project definition phase leading up to pre-feasibility. Member states often lack the capacity to prepare projects to the point where they can apply for feasibility funding (eg, the ability to prepare terms of reference or options analyses). There is therefore a distinct need for greater technical assistance and training initiatives for officials at the national level.[10] These challenges are compounded by the diverse international cooperating partner (ICP) presence in the region – each with its own set of conditionalities, policies and processes. ICPs traditionally undertake the project development process when they are funding projects, which lessens opportunities for national capacity development.[11]

Lack of capacity in member states also means that many projects do not have dedicated project sponsors (national or regional) that can facilitate the organic development of a project towards implementation. This exacerbates the above challenges and handicaps the project championing necessary to work effectively across departments and institutions, generating buy-in for projects and guiding them through the various development phases.[12] These challenges are magnified in cross-border SADC priority projects, where coordination challenges between government departments extend across national boundaries and where a much wider array of interests must be considered. Additionally, it is more difficult to find project sponsors to drive these projects when they are perceived to provide little direct national benefit.[13]

Regional projects also require some level of regulatory harmonisation across borders. SADC countries have diverse regulatory agencies and laws governing different aspects of infrastructure development such as public–private partnerships (PPPs), regulations for utilities and dispute resolution. These differences can cause conflict and delays throughout a cross-border project's life cycle and increase risks for financiers, which may be exacerbated if potential tensions are not dealt with comprehensively both in project-level contractual agreements and at a cross-border regulatory level.[14]

Financing the gaps

The project development and preparation needs highlighted above (such as the need for greater capacity within government departments to develop projects) present a unique dilemma, as they consist of both 'softer' and longer-term challenges. These activities are often unattractive to financiers as they do not generate tangible financial returns in the short run. In addition, they target the early project stages where there is a higher risk of project non-completion.

This is especially the case with infrastructure projects that do not automatically generate high investment returns (such as in the water and sanitation sector), especially where the 'user pays' principle is questionable.[15] Often, cross-border projects are unattractive to financiers owing to the higher transaction costs of dealing with multiple jurisdictions and the coordination challenges indicated earlier.[16] This underscores the need for more member state public finance support for early stage activities, specifically in the water and public transport sectors, as well as cross-border projects.

Additionally, most member states have seen declines in their fiscal space to finance or take on risk for cross-border projects. For example, many struggle to raise public funds for their own domestic infrastructure and for national economic infrastructure projects. While the majority of member states reached their fiscal budget targets in 2008, budget deficits have gradually increased since then as a result of the global financial crisis's impact on trade and investment between the region and its major trading partners – especially the EU, the US and China. Since 2011 public debt, including foreign-based or external debt, has gradually been increasing across the region.[17] This also raises important concerns about member states' ability to contribute $120 million in seed funding for the RDF.[18] The level of contributions will likely be skewed and responsibility will likely rest with a few members, as arguably none of the SADC member states, including South Africa, is wealthy enough to make sufficient redistributive contributions to a SADC RDF. This calls into question the real commitment and buy-in to a functional regional fund.

Beyond seed contributions, the need for RDF replenishments must also be considered. Various mechanisms for cost recovery (including success fees, redeemable grants, revolving funds and equity stakes) are possible.[19] An analysis of existing cost-recovery mechanisms globally should be an urgent priority for the RDF in order to proactively adopt appropriate structures to achieve its objective of financial sustainability.

Currently, there is still a reliance on highly fragmented ICP funding (both direct and through project preparation facilities) for the early stages of most regionally significant projects. This slows down their development because of onerous bureaucratic requirements and prevents certain strategic projects from getting off the ground, owing to ICPs' differing objectives.[20]

The changing nature and unpredictable future landscape of overseas development aid should motivate member states to begin to contribute to regional infrastructure development. However, there is also a need to materially improve coordination among external funding mechanisms. While the ICA[21] has clearly identified this need and created the Project Preparation Facilities

Network (PPFN) to target it, the PPFN has lost momentum.

IMPLICATIONS FOR THE RDF

Concerns regarding the establishment of a new regional structure

The challenges encountered in building new institutions are significant – especially since these are compounded when establishing a regional public institution. As noted earlier, not all countries are equally able to contribute to the RDF. While the proposed funding structure recognises this in terms of the different contribution requirements for member states based on the size of their respective economies, it is difficult to ensure that all member states make some contribution, even when the terms are flexible. The decision on whether to include some form of sanction for members that do not meet their contributions adds additional complications, as strategic regional projects may still traverse the territory of non-contributing countries, raising important free-rider considerations. Hence, a cautionary approach is needed when establishing a separate and new institution, with more consistent and committed support from member states for regional resource mobilisation.

Instead of concentrating on project financing, this briefing supports the view that member state contributions to regional infrastructure development (a minimum of $120 million under the proposed RDF) must support early project stages. Furthermore, given that early project development and preparation support for cross-border projects face the biggest financing gaps, it is critical that the RDF prioritises preparation and pre-preparation support over project finance. Otherwise it will struggle to disburse funds, as there will not be a sufficiently bankable pipeline to finance. The minimum of $120 million is small compared to the financing requirements of regional megaprojects, further supporting the notion that such funds could have greater impact in supporting earlier stage activities that would unlock future investment. From this perspective it is important to reflect on existing early project preparation facilities in the region and the challenges they experience in terms of regional support.

SADC has a Project Preparation and Development Fund (PPDF), hosted by the DBSA, which has focused on addressing early stage support. This instrument will be absorbed into the proposed RDF,[22] allowing its existing expertise and structures to be leveraged. However, the PPDF is fully funded by ICPs. As a result, it faces many bureaucratic challenges, and in certain quarters there is a perception that it is not serving the interests of the region. Some stakeholders also noted that its location in the DBSA creates an impression of South African bias. To change these perceptions, it is crucial that member states contribute substantial resources to the PPDF and the RDF in order to enable a more representative regional structure and decision-making process. Importantly, cost-recovery mechanisms should be a key priority to ensure the sustainability of the institution. Furthermore, while ICPs still have a critical role to play in offering much-needed concessional finance in the region, if member states were to increase their public contributions they would be better positioned to influence the direction of infrastructure financing so that it meets the region's most pressing needs.

Strategies for early stage support

The creation of a new institution, and even a significant injection of regional infrastructure financing from member states, will arguably have suboptimal impact if it is not directed at effective programmes and interventions that target the most pressing bottlenecks. More specifically, there is a need for funding to support capacity building in the early project stages.

Grant financing for project definition and pre-feasibility studies will not be forthcoming if the relevant institutions do not have the capacity to undertake these studies effectively. The PPDF currently has a capacity-building window that is significantly underfunded.[23] This highlights the importance of prioritising resource mobilisation for national capacity building as a key focus of the RDF.

CONCLUSION

This briefing recognises the urgent need for enhanced regional infrastructure development to fulfil the objectives of the RIDMP, as well as the crucial role that member state finances must play in this process. With regard to the establishment of an RDF, the authors strongly motivate for the new instrument to draw heavily on existing structures and resources in order to minimise additional costs for already fiscally constrained member states. Most importantly, RDF resources should focus on the area of greatest need, namely capacity building at the project development and preparation stages.

ENDNOTES

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2 Wentworth L, 'PERISA Case Study 2: Financing Infrastructure', SAIIA & ECDPM (European Centre for Development Policy Management), August 2013, https://www.saiia.org.za/special-publications-series/452-perisa-case-study-2-infrastructure-financing-of-infrastructure-by-lesley-wentworth/file, accessed 3 April 2018.

3 See the GEG-Africa Discussion Paper *SADC Regional Development Fund: Operationalisation Imminent* (forthcoming), which provides an in-depth political economy context in which infrastructure projects are developed in the region.

4 Foster V & C Briceño-Garmendia, 'Africa's Infrastructure: A Time for Transformation'. Washington DC: World Bank, 2010; Gutman J, Sy A & S Chattopadhyay, 'Financing African Infrastructure: Can the World Deliver?'. Washington DC: Global Economy and Development at Brookings, March 2015.

5 A total of 69% of projects are at the early stages of project development. See AU, Virtual PIDA Information Centre, 'Project stages and key milestones', http://www.au-pida.org/project-stages-and-key-milestones/, accessed 19 March 2018.

6 DBSA (Development Bank of Southern Africa), 'DBSA infrastructure financing investment in SA', Presentation, Gallagher Estate, Midrand, 1 October 2015, http://namibiacommercialoffice.org.za/wp-content/uploads/2015/12/DBSA-Infrastructure-Investme-in-Africa-Gallagher-Estate-Midrand.pdf, accessed 3 April 2018.

7 PIDA is the AU's continental infrastructure development strategy, which includes priority regional projects from each of the regional economic communities, including SADC. SADC's PIDA projects are broadly aligned to its RIDMP projects, although there are some differences.

8 Personal interview, DFI (development finance institution) representative A, Johannesburg, 13 March 2018; personal interview, DFI representative B; Johannesburg, 7 March 2018; telephonic interview, REC (regional economic community) representative, 5 March 2018.

9 Telephonic interview, REC representative, *op. cit*.

10 Personal interview, DFI representative A, *op. cit*.; Danso H & B Samuels, 'Private Sector Project Developers Scaling Investable Infrastructure in Africa: Benchmarking Project Development Practices to Mobilize Private Capital', *Africa Investor*, May 2017.

11 Personal interview, DFI representative A, *op. cit*.

12 Personal interview, African regional institution representative, Johannesburg, 23 February 2018; personal interview, DFI representative A, *op. cit*.

13 Personal interview, DFI representative A, *op. cit*.; personal interview, DFI representative B, *op. cit*.; personal interview, African regional institution representative, *op. cit*.; Chaponda T, Nikore M & M Chennells, 'Effective Project Preparation for Africa's Infrastructure Development'. Abidjan: ICA (Infrastructure Consortium for Africa), November 2014; Danso H & B Samuels, *op. cit*.

14 Chaponda T, Nikore M & M Chennells, *op. cit*.

15 Personal interview, DFI representative B, *op. cit*.

16 Chaponda T, Nikore M & M Chennells, *op. cit*.; personal interview, DFI representative A, *op. cit*.; personal interview, DFI representative B, *op. cit*.; telephonic interview, REC representative, *op. cit*.; personal interview, African regional institution representative, *op. cit*.

17 This period saw the global financial crisis manifest in Africa, along with a slump in commodity prices and a food crisis resulting from severe droughts in many African countries.

18 The current proposed funding mechanism requires member states to contribute a fixed percentage towards operationalising the RDF, based on the size of their economy.

19 Chaponda T, Nikore M & M Chennells, *op. cit*.

20 *Ibid*.

21 The ICA is a multi-stakeholder initiative comprising bilateral donors, multilateral agencies and African institutions, formed with the objective of increasing investment in Africa. It primarily facilitates dialogue between stakeholders and produces knowledge products.

22 Telephonic interview, REC representative, *op. cit*.

23 Personal interview, DFI representative A, *op. cit*.

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