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Workshop On Development Finance Institutions Support to Infrastructure Development In SADC and COMESA

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CONCEPT NOTE

I Background

As part of its mandate to provide advisory services and technical assistance to member States, Regional Economic Communities (RECs), Universities and other institutions, the ECA Office in Southern Africa (ECA-SA), which covers fifteen SADC Member States, is already providing technical assistance to SADC and COMESA Member States, *inter-alia* in infrastructure and services. ECA recognizes that infrastructure and services are a key precondition for and enabler of private sector development and trade. Economic integration in Africa is hampered by the lack of sound infrastructure. Poor infrastructure prevents the rapid movement of goods and people in the continent and raises transport costs. Africa's transport costs are around double those for a typical Asian country. It is estimated that inadequate infrastructure is holding Africa's economic growth per capita back by 2% each year and reducing firms' productivity by as much as 40 percent.

Among the objectives of infrastructure development is to enhance regional integration, which will in turn create a wider economic space for the movement of goods and services without tariff and non-tariff barriers.

II Context and Justification

In order for the SADC and COMESA sub-regions to become more competitive, or realize their productive potential, massive improvements in infrastructure are needed. New evidence suggests that Africa's current infrastructure investment needs are about twice as large as those estimated by the Blair Commission for Africa in 2005, which estimated the continent's needs at $20 billion a year. The more recent Africa Infrastructure Country Diagnostic (AICD) study carried out by the World Bank on behalf of the Infrastructure Consortium for Africa, shows annual infrastructure investment needs in Africa to be in the region of $40 billion per year, with maintenance and operating costs of the same magnitude. Despite the fact that Africa is spending much more on infrastructure today, the funding gap remains huge. The largest deficit is to be found in the power sector. Only one in four Africans has access to electricity. Some 30 African countries are currently experiencing regular blackouts due to power shortages. Firms struggle to cope with the costs of installing their own back-up generators − these typically cost three to four times as much as electricity from the national grid.

Africa has traditionally depended on official development assistance to meet its infrastructure needs. A growing share of the region's infrastructure finance now comes from nontraditional sources. Leading this trend are non-OECD financiers, mainly China, India, and Arab countries. While Arab funds have been operating in Africa for decades, China and India began to step up their involvement in the early 2000s. Flows from these non-OECD sources are now broadly comparable to traditional development assistance. The largest flows have gone to power — especially hydropower — and rail transport. Annual financing commitments by these non-OECD financiers jumped from less than $1 billion prior to 2003 to about $8 billion in 2006.

However, Sub-Saharan Africa receives only a small share of private investment in infrastructure. Reasons for this include the low creditworthiness of most African countries − which hampers their ability to secure project finance, low numbers of bankable projects, the limits of local financial markets and the high risk profiles typical of infrastructure projects. Infrastructure projects involving private participation are often financed through a mix of equity and nonrecourse debt.[1] Africa has been less successful in attracting nonrecourse bank debt relative to private investment in infrastructure than other developing regions. Limited access to such debt can severely damage an economy's ability to attract private investment in infrastructure. It has been even less successful in raising project finance in capital markets through project bonds. Whether or not the region can attract more private foreign currency funding for infrastructure will depend in part on their ability to reduce foreign exchange risks. In some countries, the situation is less bleak because local capital markets show good potential. For example, South African projects raised most bonds financing from currency issues in local capital markets.

Recent studies show that three related sets of factors limit Africa's ability to attract both foreign and local private finance, especially long-term debt finance, for infrastructure. Firstly, most African countries have low or nonexistent sovereign credit ratings. Only 16 of 48 countries have foreign currency debt ratings and only 4 of those have ratings of BB – or higher that provide relatively broad access to financial markets. The countries that have obtained (or have an estimated) a foreign currency debt rating of at least BB – represent only 43 percent of regional gross national income (GNI) − and this share is dominated by South Africa. For most African countries, foreign commercial lending is therefore difficult to access and typically limited to short-term transactions.

[1] Debt contracted by the project company without recourse to sponsors. Project sponsors rarely finance infrastructure projects through equity alone or assume project debt fully on their balance sheets.

The ability of infrastructure projects to attract long-term foreign currency lending has depended on a mix of factors that mitigate risk − the ability to generate foreign currency revenues and strong support by official (bilateral or multilateral) agencies.

Secondly, most local financial markets have limited capacity to finance infrastructure projects. Only South Africa has domestic banks and a local capital market capable of consistently providing local currency financing for infrastructure projects on suitable terms and in significant amounts. In other African countries local long-term financing has been limited, and infrastructure projects require substantial credit enhancement such as through guarantees, provided mostly by official agencies, to attract local currency debt.

Thirdly, compared with projects in many other sectors, those in infrastructure tend to have longer payback and build-out periods and to be more susceptible to political and regulatory interference, which increase the regulatory risk such investments may be facing.

The above factors characterize infrastructure projects with private participation in Africa – the projects have typically been small relative to those in other regions, and many have been financed entirely with equity. Projects with faster payback and shorter-term debt such as in telecommunications have been favoured over those that require long payback periods and long-term financing in order to guarantee services at affordable prices e.g. toll roads.

In recent years local banks in Africa have shown interest in providing local currency loans to infrastructure projects. But these loans have required significant risk mitigation. The biggest constraint on the ability of African banks − except for those in South Africa –to increase funding for infrastructure projects is their difficulty in reliably funding themselves over the long term. Some infrastructure projects in Africa (mostly in telecommunications) have been able to attract long-term local currency funding. However, similar to foreign lenders, local currency debt providers have often required risk mitigation from official agencies. Recent local currency financings outside South Africa include such transactions for telecommunications projects in Kenya and Uganda.

The challenge facing the SADC and COMESA regions is how to increase infrastructure project finance and minimize the need for risk mitigation from official agencies. A further challenge is how to leverage the services of the Infrastructure Consortium for Africa (ICA) in tapping infrastructure finance. Whilst the ICA is not a financing agency, it acts as a platform to catalyze donor and private sector financing of infrastructure projects and programmes.

Early in 2009, the largest multilateral investors and lenders in Africa pledged to provide an additional US$15 billion to promote trade, strengthen the financial sector, and increase lending for infrastructure, agribusiness and small and medium enterprises in the region that are affected by the global economic slowdown. The institutions participating in the initiative are the African Development Bank Group, the Agence Française de Développement Group, the Development Bank of Southern Africa, the European Investment Bank, the German Financial Cooperation, the International Islamic Trade Finance Corporation and the World Bank Group.

The initiative recognizes that pooling resources and expertise will enable governments and institutions to increase lending and investments, promote dialogue, and use a diverse range of instruments to more effectively respond to the crisis and address longer-term structural issues that have traditionally hampered Africa's economic growth.

It is against this backdrop that ECA-SA proposes to organize a workshop on Development finance institutions' support to infrastructure development in SADC and COMESA.

III Relationship to UNECA Multi-Year Programme with SADC and COMESA

Financing of infrastructure development is an activity within the SADC-UNECA-SA Multi-year programme. UNECA-SA also has a collaborative framework with COMESA on infrastructure though not in the sense of a multi-rear programme.

IV Scope and Objectives of the Workshop

The background document for the multi-stakeholder Workshop will;

(i) Review and identify and critically evaluate constraints and challenges faced at both national and sub regional levels in financing infrastructure development programmes and projects to ensure that efforts are on course to attaining regional integration in the SADC and COMESA regions;

(ii) Review existing and setting up of the local financial institutions for the financing infrastructure development in SADC and COMESA;

(iii) Propose how existing collaboration among financial institutions in Africa can be enhanced to ensure greater access to infrastructure finance;

(iv) Propose institutional structures/systems required to be in place for implementing, monitoring and evaluating financial support to infrastructure in SADC and COMESA.

The deliberations of the multi-stakeholder Workshop will be facilitated by discussants.

V Activities to be undertaken

The project activities will include;

- Preparation of the background document for the Workshop
- Organizing the Workshop including identifying participants, communication, arranging all logistics and facilities; and
- Preparing a report of the Workshop and distributing the documents to participants and other stakeholders.

VI Partnerships/Key Stakeholders

ECA-SA will collaborate with the national development banks in the two sub-regions, AfDB, DBSA, SADC and COMESA Secretariats, member States and the Trade, Finance and Economic Development Division (TFED) and the NEPAD and Regional Integration and Infrastructure Division (NRID) at ECA Headquarters in organizing the Workshop and implementation of the program on financing infrastructure development.

VII Expected Outcomes

The outcome of the workshop will be a programme implementation framework with short, medium and long-term milestones to accelerate sourcing finance for infrastructure development in SADC and COMESA. The report will contain recommendations to address the challenges, a proposed implementation framework developed with suggested benchmarks, performance indicators and a monitoring mechanism to track adherence to commitments by all stakeholders will be the major output.

This Workshop will enhance the capacity of the finance institutions to manage and coordinate regional integration initiatives through effectively addressing the current financial challenges for infrastructure development and also to be institutionally prepared to exploit the benefits of regional integration.

VIII Participants

The participants at the Workshop will be drawn from a mix of representatives of key regional and international financial institutions including DBSA, AfDB, World Bank, SADC, COMESA PTA Bank, government officials, civil society organizations and other development partners from Southern Africa.

IX Dates and Venue

The Workshop, to be hosted in collaboration with SADC and COMESA, is scheduled to take place in December 2009 in Lusaka, Zambia.