



Think 20 Turkey

Infrastructure Financing and Sustainable Development¹

Sustainable development and infrastructure availability are intrinsically interlinked. Multiple studies have shown that infrastructure is a prerequisite for inclusive and sustainable growth and for poverty reduction. Yet there is a large shortfall in infrastructure financing globally, and this is particularly acute in developing countries given the urgency of their sustainable development needs. In order to address what could be termed as a market failure in identification and financing of infrastructure deficits, a concert of policies and stakeholder inputs are required. The G20 has focused increasing attention on infrastructure investment but there is room to give even greater prominence and urgency to this agenda, and greater emphasis on how to improve the sustainability of these investments..

Of particular promise is the potential to tap long-term institutional investors. Institutional investors include pension funds, insurance companies and Sovereign Wealth Funds, which possess assets estimated in the order of \$110 trillion yet invest only a small proportion in infrastructure and negligible amounts in emerging economies (Table 1).

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Moreover, while there are a number of long term investment funds like the Government Pension Fund of Norway (USD 860 billion) and California’s public pensions fund CALPERS (USD 296 billion) that have adopted proactive policies towards sustainability linked financing, few are invested in developing countries where the deficits are the largest.

Table 1: Asset Allocation of Institutional Investors

Type of Investors/Asset Allocation	Assets Under Management (USD Trillion)	Current Investment in Infrastructure	Current Investment in Emerging Economies
OECD Institutional Investors	80	1%	Up to 10%
Emerging Market Institutional Investors	5	<1%	70-80%
Sovereign Wealth Funds	4	2%	30-50%
Other Global Institutional Capital	20	1%	Up to 10%

Source: Georg Inderst and Fiona Stewart, "Institutional Investment in Infrastructure in Emerging Markets and Developing Economies," Public-Private Infrastructure Advisory Facility (March 2014): 32

In addition to the large potential of reprioritised institutional investments, there are three prominent factors in the current global policy and market environment that make for a favourable context. First historically low long-term interest rates and the decline in oil prices have helped to augment fiscal space and improve the affordability of infrastructure investments. In particular there is scope to benefit from the reduced subsidy burden in the case on oil importing countries. For instance, the OECD estimates that fossil fuel subsidies today account for around USD 544 billion annually. Second, international financial institutions such as the World Bank and the regional development banks are looking at ways to scale up infrastructure financing, and new institutions are being established with a specific focus on infrastructure financing (such as the Asian Infrastructure Investment Bank and the BRICS’ New Development Bank). Third, given that capacity to think about sustainability linked financing is limited – a number of stakeholders have begun to recognize that capacity of finance professionals to sieve investments through a sustainability lens needs to be created.

The size of the global financing requirement is often cited as an additional USD 70 trillion by 2030. The United Nation’s Environment Programme estimates that around USD 1 trillion is needed by way of additional investments to make new infrastructure ‘green’ until 2030. In the G20 context this points towards the importance of developing a coherent long term strategy to incentivise a more robust sustainability-oriented infrastructure framework’. The pattern of

infrastructure growth can be made more sustainable, through integration of best practices in urban planning, transportation and energy efficiency. The following multipronged framework could serve as a starting point for G20 efforts to play an important direct and catalytic role in addressing pervasive infrastructure deficits in a more sustainable way:

- Implement country structural reform commitments, as embodied in growth plans. Twenty seven per cent of the G20's two per cent growth target is expected to come from direct investment and infrastructure measures.
- Follow through on the commitment to establish the Global Infrastructure Hub in Sydney, to develop a knowledge-sharing platform, address data gaps, and develop a consolidated database of infrastructure projects connected to national databases, to help match potential investors with projects. It is important that it makes demonstrable progress in 2015 and delivers tangible outcomes to leaders by the Antalya Summit. Goals for 2015 should be for the consolidated database of infrastructure projects to be made accessible to G20 members, reports of firm steps in the development of the knowledge-sharing platform and network of those involved in infrastructure projects, and for leaders to be presented with clear, albeit preliminary, examples in which the Hub has matched investors with appropriate projects.
- Place a greater focus on sustainability in bank lending. The banking sector plays a critical role in financing infrastructure especially in the preparation and construction phases. Total assets for banks globally amount to over USD 139 trillion. Indeed nearly all institutional lending towards the sector is through banks in countries with nascent capital markets such as India.
- Examine mechanisms to address commercial gaps such as partial risk guarantees, lines of credit or early-stage investment through public budgets, which can attract greater flows of private finance into Greenfield projects that are typically perceived as 'high risk', particularly those in developing countries. Multilateral development finance institutions are well placed to mitigate such risks and crowd in private investments. Non-concessional lending by the public sector can leverage private finance up to 3-6 times with the leverage ratio in the case of concessional lending and grants as high as 8-10. New institutions such as the Asian Infrastructure Investment Bank and the New Development Bank would be well suited to supplementing the existing flows towards infrastructure by leveraging concessional and non-concessional lending. In addition, multilateral development finance institutions could be asked to support transparency towards building a 'robust and liquid market' of sustainable infrastructure investments.
- Place renewed emphasis on building the skill sets to evaluate data through sustainability-linked risk metrics, as well as improving project management capacities. There are a number of factors that are extraneous to the financial system including accuracy and predictability of certain data – like resource data and performance data of various projects. The existing commercial and technological ecosystem has made lenders risk averse, in an economy where rapid credit expansion is required for growth. The unpredictability compounds 'risks' of the financial ecosystem.

- Examine the effectiveness of investment frameworks such as strategic sustainable investing and sustainable and responsible investing, which rely on environmental, social and corporate governance analyses in order to generate long-term sustainable returns. According to the US sustainable investing framework, one-sixth of assets under management (~\$6.5 trillion) in the United States were invested using the sustainable and responsible investing strategy. Such analyses and investment frameworks can be replicated at scale in other parts of the world as well. G20 policy makers could also sponsor a comparative study of the constraints to outward investment in infrastructure imposed by G20 members themselves on their pension, insurance and sovereign wealth funds.
- Focus on innovation in the financial ecosystem that ensures 'sustainability' is a parameter at the project execution level, and particularly in the public sector institutions that account for over 60 per cent (\$500-550 billion) of the total infrastructure financing in developing economies. For instance, a consortium of banks recently released the Green Bond Principles – a set of voluntary guidelines – in order to set common standards and ensure transparency towards building a robust and liquid market.
- Play a leadership role through country actions and in global discussions such as the Addis Financing for Development Conference, which includes sustainable infrastructure as one of its central pillars. As a forward looking body the G20 should also sponsor research on areas/issues such as addressing gaps in investment planning and project preparation; enhancing the role of the multilateral development banks including through better risk mitigation instruments; promoting sustainable infrastructure as an asset class for long-term institutional investors; and mechanisms/platforms for sharing good practices, experience and lessons in infrastructure public-private partnerships among G20 members.

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