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# Three compelling reasons why the G20's plan for an infrastructure asset class is fundamentally flawed

By Jesse Griffiths and María José Romero • July 2018

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All opinions are Eurodad's alone, and all errors and omissions are the responsibility of the authors.

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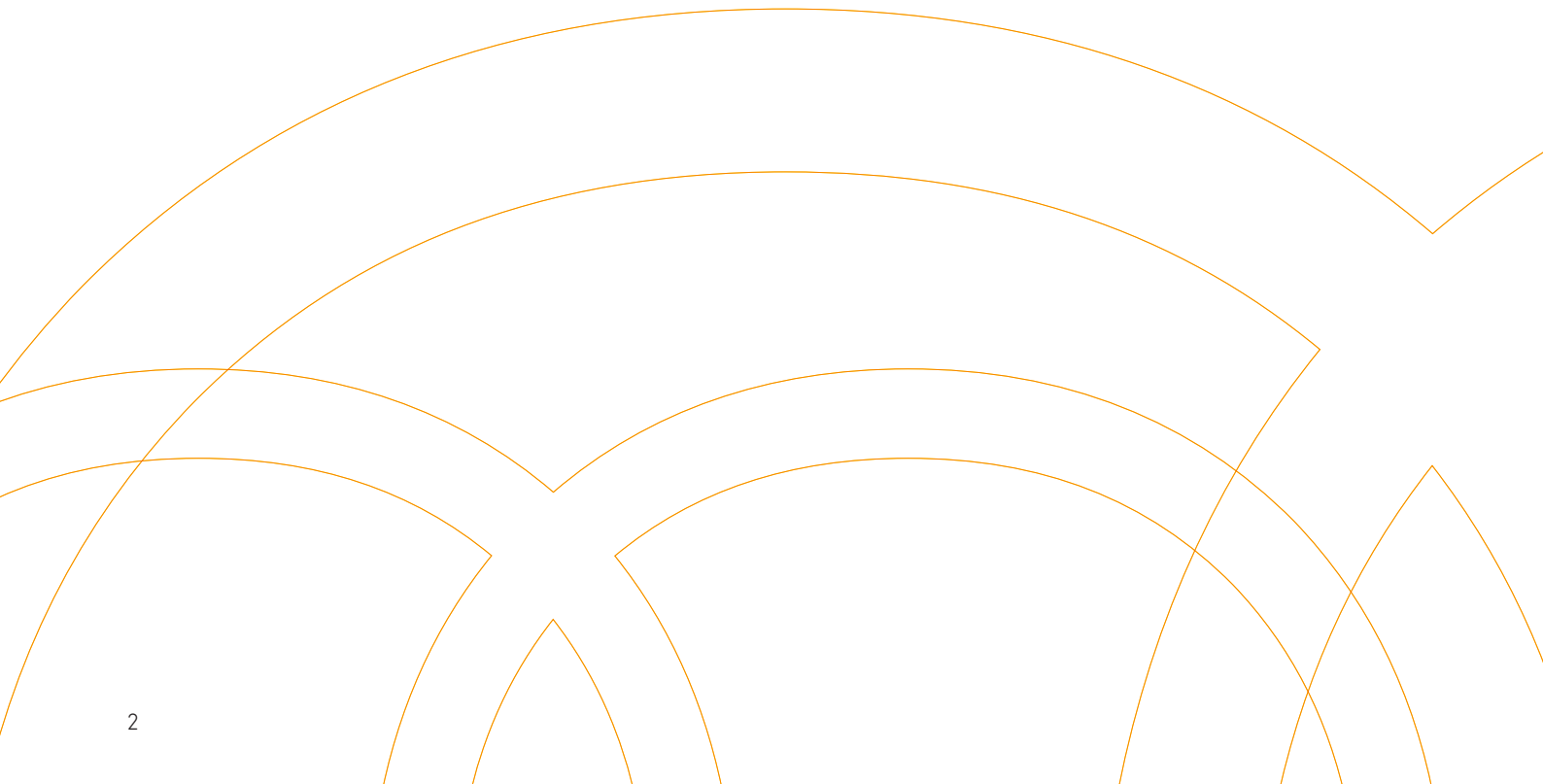


# Contents

# Executive Summary

Few doubt the need for significant global investment in sustainable infrastructure. Without better social and economic infrastructure, such as hospitals, schools, railways and sanitation, the prospect of achieving the Sustainable Development Goals (SDGs) looks increasingly remote.

Enter the G20 with a plan to develop an 'infrastructure asset class'. An asset class is a group of tradable securities or investments – for example equities or bonds. Transforming infrastructure into a tradable asset class would mean repackaging money invested in an infrastructure project into a number of standardised financial instruments which are easy to buy and sell, and which provide an attractive revenue stream for institutional investors, such as pension funds, life insurance and sovereign wealth funds.

Echoing the World Bank's mantra of 'private finance first', the G20 *Roadmap to Infrastructure as an Asset Class* takes as its starting point the assumption that only private capital, particularly from institutional investors, can fill the infrastructure investment gap. Developing an infrastructure asset class, the G20 argues, will help to unlock the trillions of pension and insurance dollars currently sitting in equities, bonds, hedge funds and other investments. It sounds plausible – all you have to do is make infrastructure less risky and more profitable, and investors will fall over themselves to finance schools, hospitals, roads and other essential services.

But there is a snag. Infrastructure projects are inherently risky and frequently unprofitable, which makes them unattractive to investors. The G20's response to that is to 'de-risk' the investment. But the risk rarely just disappears – someone has to take responsibility for underwriting it when a project hits unforeseen problems, overruns or fails to generate the expected number of paying customers. The G20's proposal is disingenuous - what would happen in practice is that the risk is transferred to the public purse, with potential negative impacts on citizens.

There are many reasons why an infrastructure asset class is a bad idea - not least because it assumes that infrastructure investments are simply another type of tradable asset. It ignores the uncomfortable fact that they are physical, concrete buildings, bridges, clinics or water pipes which millions of people rely on in their everyday lives.

This Eurodad briefing focuses on three main reasons why the G20 Roadmap is fundamentally flawed – and just as importantly, offers practical, tried-and-tested alternatives.

Firstly, the G20 plan ignores the main issue of how to increase and improve public investment. Historically, there are good reasons why infrastructure projects in developing countries have been overwhelmingly financed through public investment. It is difficult to persuade private investors to invest in infrastructure, there are extremely limited opportunities for purely commercial infrastructure projects and most require significant public investment by default.

Privately-financed infrastructure often ends up costing the public purse in the shape of bail-outs, subsidies or risk guarantees, as countless examples of failed Public-Private Partnerships (PPPs) can testify. Perhaps most importantly, the infrastructure needed in order to 'leave no-one behind' – such as water, sanitation or rural roads – are the very projects which are least likely to attract private investors. Moreover, improving the quality of infrastructure is key, and should be considered as a high priority, rather than channeling more money into infrastructure in countries with poor track records.

The second reason is that creating an asset class to attract institutional investors will often end up hurting the public purse. The direct and indirect costs of developing an infrastructure asset class are enormous and will inevitably fall on the public sector, and on citizens. The G20's definition of risk covers just about every aspect of a project – construction, completion, currency, revenue and demand fluctuation, environmental, political and regulatory. To turn projects into attractive and safe assets that can be bought and sold by investors usually means transferring this risk to the public sector. When projects do run into trouble, it is the public sector which picks up the extra costs. Additional burdens would come from subsidising – or 'blending' – private investments with public funds and from introducing standard 'plug and play' contracts - good for investors but a threat for accountability, transparency, environmental and social standards.

Thirdly, the push to develop an infrastructure asset class is a huge leap in the dark. Private finance for infrastructure has fallen in recent years, despite the G20's efforts to promote it, and the current level of institutional investor investment in developing country infrastructure is miniscule, according to the World Bank. The G20's plans are unlikely to work because of the fundamental contradiction between private investors' need to earn substantial returns and the generally low returns of infrastructure investment in developing countries. They are especially unsuitable for low-income countries - the very ones which need infrastructure investment most - and they might encourage socially and environmentally damaging 'mega-projects'.

If the G20 is serious about increasing and improving investment in infrastructure, it should stop putting private finance first and start focusing on how to improve and deliver publicly financed infrastructure. Private and institutional investors are putting pressure on the G20 to help them maximise returns during a continuing global economic slump, but creating an asset class is not the way to ensure that essential infrastructure gets built in those developing countries which need it most.

# Background

There is little doubt that investment in sustainable infrastructure must be significantly ramped up if we are to achieve the Sustainable Development Goals (SDGs). Growing economies need 'economic infrastructure', such as railways, roads and ports, sanitation, communication networks and energy grids, as well as 'social infrastructure' including schools and hospitals. Sustainable infrastructure can support the SDGs, promote environmental stability and encourage inclusive growth.[1]

However, badly designed and poorly implemented infrastructure projects can damage the environment, displace populations, lead to human rights abuses and lock countries into a high-carbon future. They can also create excessive fiscal burdens on the public purse, which in turn can lead to cuts in government spending. Many countries have suffered a history of 'white elephant' infrastructure projects stemming from corruption, lack of transparency and poor monitoring – all of which undermine democratic accountability.

This briefing critiques the G20's promotion of one way of financing infrastructure – the development of an asset class – arguing that it will not help to fund the 'right type' of infrastructure while avoiding the pitfalls.

In recent years, the World Bank Group (WBG) and others have argued that levels of infrastructure investment are too low, and that this cannot be fixed by traditional financing methods. Instead, "reinvigorating the supply of infrastructure within the developing world requires supplementing traditional sources of official finance with new resources of equity and debt finance."[2] To this end, the WBG has been promoting a 'private finance first' approach (see Box 1). This 'Cascade' approach, as it is known, encourages private financiers by 'de-risking' infrastructure investment. This means changing the policy and regulatory environment to create more favourable conditions for private investors while providing subsidies, guarantees and various other risk-mitigation instruments through public institutions. While the 'cascade' approach is currently focused on infrastructure, the WBG expects to expand it to other sectors, such as finance, education, health and agribusiness.

Taking their cue from the WBG, the G20 has been promoting similar ideas. Infrastructure was put on the its agenda under the 2010 Korean presidency, and was a major theme under the Australian G20 in 2014, when the G20 established the Global Infrastructure Hub. 'Infrastructure for development' is a priority under Argentina's current presidency. In March 2018, G20 Finance Ministers agreed in their communiqué that mobilising additional private capital was needed to meet global infrastructure needs. "To achieve this," they said, "we agree to promote the necessary conditions to help develop [economic] infrastructure as an asset class."[3]

**Box 1:** Sustainable infrastructure finance through a Cascade approach


Source: WBG (2017) 'Forward look – A vision for the World Bank Group in 2030. Progress and challenges'

An asset class is a group of tradable securities or investments - for example equities or bonds. Transforming infrastructure into a tradable asset class would mean repackaging money invested in an infrastructure project into a number of standardised financial instruments which are easy to buy and sell, and which provide an attractive revenue stream.[4] The argument – set out in the G20's *Roadmap to Infrastructure as an Asset Class*[5] and endorsed by G20 Finance Ministers – is that "private savings in the hands of institutional investors [such as pension or insurance funds] are currently at an all-time high [of] $80 trillion in assets under management" and that 'harnessing' this large pool of cash can help fill the infrastructure investment gap.

Infrastructure assets such as shares in infrastructure companies, government infrastructure bonds and specialist infrastructure investment funds are by no means new. However, the concept of grouping financial infrastructure assets together to form a distinct class is relatively recent.[6] The promotion of a tradable infrastructure asset class can be seen as part of a drive by multilateral institutions such as WBG to attract private investors to *specific* projects, as well as to infrastructure development in general.

Both the G20 Roadmap and the WBG cascade approach are attempts to present private capital - particularly from institutional investors – as the solution to the perceived infrastructure financing gap. The Roadmap aims to "address common barriers to the emergence of infrastructure as an asset class, including the heterogeneous nature of infrastructure assets, the lack of a critical mass of bankable projects and insufficient data to track asset performance." It proposes two solutions to promote greater standardisation:

A. 'Improved project development' includes developing standardised contracts and financial models, improving project preparation and providing better data.

B. 'Improved investment environment' promotes financial engineering and regulation change to reduce risks for institutional investors.

The G20 has set up seven work-streams to ease the way forward for an infrastructure asset class.[7] These are:

(i) Contractual standardisation;

(ii) Financial standardization;

(iii) Project preparation;

(iv) Bridging the data gap;

(v) Financial engineering, risk allocation and mitigation;

(vi) Regulatory frameworks and capital markets; and

(vii) Quality infrastructure.

Although none of the workstreams is truly new, the combination of them all, and the G20 and WBG coordinated push, are new features. This agenda – if successful in all workstreams simultaneously – would represent a major global shift in how infrastructure has been financed up until now. Unfortunately, as argued below, there are three compelling reasons why the plan is fundamentally flawed.

This Eurodad briefing aims to advance the ongoing debate on infrastructure financing by focusing on the G20 Roadmap's specific proposals, in the context of the broader discussion about developing an infrastructure asset class.

## Reason 1: The G20 plan ignores the main issue: how to increase and improve the quality of public investment

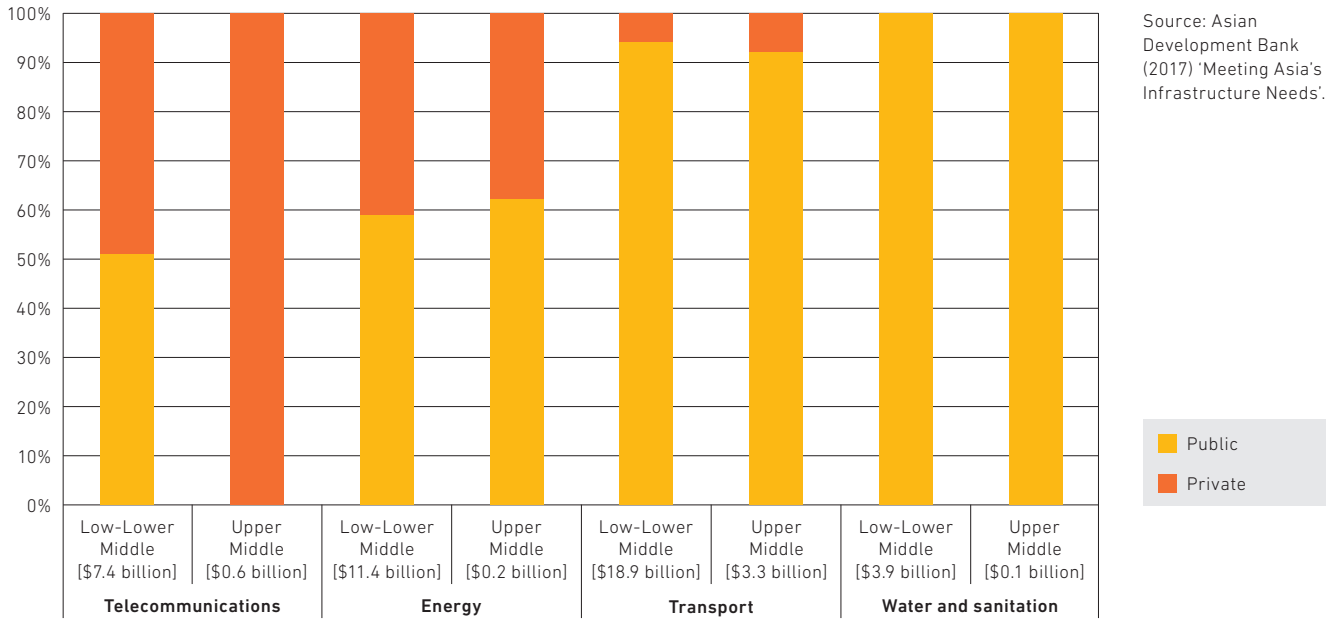
**Historically, infrastructure projects in developing countries have been almost exclusively financed through public investment.** A previous World Bank background paper for the G20 found that, in developing countries, "...private capital has contributed between 15 and 20 per cent of total investments in infrastructure"[8] – meaning that public investment has been 80 to 85 per cent of the total. Private investment is even lower in some countries and regions with fast economic growth[9] – for example, one study found that "in China, almost all infrastructure financing is undertaken by the public sector, with private financing as a proportion of GDP close to zero."[10] In Asia as a whole, the Asian Development Bank found that "The public sector currently finances around 92% of the region's infrastructure investment."[11]

**There are very good reasons why it is difficult to persuade private investors to invest in infrastructure.** The International Monetary Fund (IMF) itself acknowledges that public financing is normally the preferred option, arguing that:

- Infrastructure investments are often large, capital-intensive, 'natural monopolies';
- They tend to have significant up-front costs, with the returns only apparent over many years or even decades; and
- The positive social outcomes are often more important than the returns generated for a private operator.[12]

**Opportunities for purely commercial infrastructure projects are limited and most require significant public investment by default.** Rural roads and sewage, for example, would not provide attractive returns for a private investor, especially in developing countries – meaning there is no commercially viable model for delivering them. As the Inter-Agency Task Force (IATF) 2018 report on Financing for Development says: "For example, investments in ecosystems will largely be publicly financed due to the public good nature of the sector [... and ...] the use of private finance is more challenging in areas where equity considerations and large financing gaps reduce profit prospects, such as water."[13] Figure 1 shows that water and sanitation infrastructure investment in Asia in 2011 was entirely publicly financed, and transport more than 90 percent. Energy had a higher proportion of private financing, but was still mainly funded publicly. The only sector with a majority of private finance investment was telecommunications, and even then only in upper-middle income countries.

**Figure 1**
Public and private investment in infrastructure in Asia, by income group, 2011




Source: Asian Development Bank (2017) 'Meeting Asia's Infrastructure Needs'.

**Public-Private Partnerships (PPPs) – heavily promoted by the World Bank[14] and others – may actually saddle the public sector with significant costs.** The Organisation for Economic Cooperation and Development (OECD) defines PPPs as "arrangements whereby the private sector provides infrastructure assets and services that traditionally have been provided by government… [which] … should involve the transfer of risk."[15] There are two PPP funding models:

- User-funded PPPs, where a private partner charges the public a fee for using the facility, sometimes subsidised by government or local authorities.
- Government-funded PPPs, where a private sector company builds and runs infrastructure and receives regular payments by the public partner based on the level of service provided.

Both models can – and often do – ultimately weigh heavily on the public purse: government-funded PPPs rely heavily on public expenditure, while even user-funded PPPs may entail costs for the government through subsidies. PPPs can lead to high public costs for infrastructure in three main ways:[16]

- Higher direct costs from higher interest rates (the cost of capital), a high expected rate of return for the private operator, and higher construction costs.
- Higher indirect costs from limited competition and costs of negotiating complex contracts, including high fees from consultancy firms, and renegotiating of contracts – the IMF estimates that more than half of all PPPs are renegotiated.[17]
- Hidden costs, either because of accounting methods that keep PPPs off the government's books, or because of high levels of contingent liabilities.

For these reasons, and many others, Eurodad has repeatedly called on the World Bank and others to stop promoting PPPs until they are radically reformed. PPPs should be included in national accounts, i.e. they should be registered as a government debt, rather than being off balance sheet; and budgeted transparently, so as to fairly compare them to alternative options. The cost-benefit analysis that supports the decision to go for a PPP, and the contracts, guarantees and contingent liabilities must be fully disclosed.[18] Unfortunately, experience shows that mobilising private capital for PPPs often results in high public costs, and unless this lesson is learned, a similar outcome for the new infrastructure asset class seems inevitable.

**Encouraging private investment in challenging infrastructure sectors often entails significant public costs in the shape of subsidies or risk guarantees.** Major public investment is often necessary in order to attract private investment in infrastructure sectors with limited commercial returns, either to offset the risks of long term, uncertain projects, or to ensure that the benefits reach the whole population, not just those who can afford them. In Latin America, for example, the World Bank has noted that "while PPPs account for about 40 per cent of Latin America's infrastructure investments, they depend heavily on government support: about a third of their financing comes from public sources, and about half of all deals receive some type of government guarantee. In other words, constrained public finance also means constrained private finance for infrastructure."[19]

**Public subsidies are inevitable to meet the SDGs' pledge to 'leave no one behind'.** The SDGs include many commitments which require physical infrastructure such as clean water and sanitation (SDG6), affordable and clean energy (SDG7), and health centres and hospitals in urban and rural areas (SDG3). It is clear that universal access in many developing countries will only come about with significant public investment – for example, the World Bank's State of Electricity Access Report notes that "in Africa, unsubsidized connection costs often exceed the country's monthly income per person, and households have to pay these plus fees for inspection and application, security deposits, internal wiring, and equipment costs."[20]

**There is no evidence that 'traditional' funding sources cannot fill the 'infrastructure investment gap.'** Analysis of the 'investment gap' in global infrastructure financing comes mainly from a series of papers by the McKinsey Global Institute, the latest of which estimates that "the world needs to invest about 3.8 per cent of GDP, or an average of $3.3 trillion a year, in economic infrastructure just to support expected rates of growth [and] emerging economies account for some 60 per cent of that need. But if the current trajectory … continues, the world will fall short by roughly 11 per cent, or $350 billion a year."[21] In global terms, therefore, these figures do not suggest that a major change is needed, but rather a relatively modest increase from 3.8 to 4.2 per cent of global GDP. However, the report goes on to quote the UN Conference on Trade and Development (UNCTAD), which estimates – also partly on the basis of McKinsey data – an additional US$1.1 trillion per year of infrastructure investment is needed to meet the SDGs.[22] Although not insignificant, that would raise the requirement to only around five per cent of global GDP.

**Several countries already spend significantly more than McKinsey's estimate.** For example China – where infrastructure is largely publicly financed – invested an average of around 8.8 per cent of GDP between 2008 and 2013. McKinsey's own data suggests Chinese spending is significantly more than necessary to fill their domestic infrastructure gap between 2016 and 2030. China's challenge is the quality, not the quantity, of its infrastructure investment, which undermines the argument that traditional sources of investment are inadequate for the scale of the task. As McKinsey itself notes, public finance and direct corporate investments makes up about three-quarters of private finance, and "...the vast majority of infrastructure will likely continue to be financed by the public and corporate sectors."[23] Despite this evidence to the contrary, the G20 Roadmap assumes that the infrastructure gap cannot be filled by traditional forms of investment, and argues that "Given the magnitude of the infrastructure gap, the G20 must adopt a new collaborative approach to crowd in private capital in order to harness the large pool of private savings looking for long-term investment."[24]

**It is clear that the scale of the infrastructure financing gap is being used by financial institutions, and the governments backing them, to justify political choices.** Research suggests the World Bank's policy response has often been to promote an expanded role for private capital in financing development projects, rather than increasing and strengthening the public financing of development. This trend may be driven by wealthy institutional investors seeking stable and profitable returns.[25] Developing countries would have significantly more money that they could spend on infrastructure if rich nations met their Official Development Assistance (ODA) commitments – just five countries met the 0.7 per cent of GNI target in 2017.[26] Public infrastructure investment would be even further increased if steps were taken to tackle illicit financial flows and tax havens effectively. Developing countries are losing very large amounts of development finance due to multinational corporations taking advantage of the current global tax system. UNCTAD estimated in 2015 that one type of corporate tax avoidance alone is costing developing countries around US$100 billion per year, meaning that the total loss can be assumed to be significantly higher.[27] This is why the call for a UN global tax body to combat international tax dodging remains a top priority of developing countries and civil society campaigners.

Faced with these rather powerful arguments, some World Bank researchers concluded in a recent paper on infrastructure funding and financing: "by making public finance more efficient, some reforms symmetrically reduce the need for private finance, showing that strong public sectors with an ability to raise taxes and spend efficiently are clearly an effective solution to infrastructure finance."[28]

**Priority should be given to improving the quality of infrastructure, rather than channelling more money into infrastructure in countries with poor track records.** McKinsey estimates that "Up to 38 per cent of global infrastructure investment is not spent effectively".[29] Furthermore, the G20's assumption that improved project design will somehow solve infrastructure problems in many countries is bordering on the naïve and fails to take into account the deep-seated political, economic or capacity problems which often arise. Attempting to radically redesign the fundraising model is not likely to address these problems, and indeed may exacerbate them by increasing complexity whilst reducing transparency and accountability.

Finally, it is worth stressing that infrastructure as an asset class does not help address the fundamental problem of the funding source – as opposed to the financing mechanism – of infrastructure. As we shall see, mechanisms that attract private financing can enable projects to get built, but they do not necessarily solve the problem of who funds the operating costs and repayments to lenders and investors, and liabilities should things go wrong or take longer than planned. These are costs which can often end up falling on the public purse. Although these problems occur in both public and private sector investments, touting an infrastructure asset class as a solution to the financing gap ignores them.

If the G20 is truly committed to delivering more and better infrastructure services, it must put delivering and improving public financing of infrastructure centre stage. It must take actions at international level to support higher levels of public investment in developing countries, including stemming public revenue losses by clamping down on tax dodging; dealing with unsustainable debts through a debt resolution mechanism; meeting ODA commitments; and getting behind new sources of public financing such as the UN's proposal for annual reserve assets for developing countries.

## Reason 2: It is likely to prove very costly for the public purse, and for citizens

**The direct and indirect costs of developing an infrastructure asset class are enormous.** These costs will fall on the public sector – and therefore on the citizens who pay for it through taxes and who benefit from it through services. As the G20 Roadmap notes, "The viability of infrastructure as an asset class requires that these risks are addressed, mitigated and *allocated to relevant stakeholders*" (emphasis added). There are several reasons why allocating some risks to the public sector and citizens could result in significant financial and other problems.

**'De-risking' for the private sector in order to generate more attractive returns for private investors could mean transferring some of the risks to the public sector.** One way to 'de-risk' is through a public sector guarantee that a project will be completed even if the private sector fails. PPPs commonly include public sector guarantees which, if triggered, increase the already high cost of private financing.

According to the G20 Roadmap, de-risking is "an adequate diversification of financial instruments [which] provides a variety of tools which, alone or combined, have the potential to de-risk infrastructure assets." 'De-risking' is highly misleading in this context. It is of course possible to 'de-risk' investments by improving their quality, but the G20's risk list covers just about every aspect of a project, many of which are difficult to reduce, including "construction, completion, currency, revenue stability, environmental, and demand fluctuation. Other risks arise as a result of a project's jurisdiction, including risks stemming from the macroeconomic, political and regulatory environment."

**Many of these risks are unavoidable – in fact the G20 Roadmap itself admits they can only be mitigated and allocated to "relevant stakeholders."** In other words, in order to make an investment attractive to institutional investors, others have to accept these risks. Some investors may take a gamble by taking on the more risky slices of a project, but all too often, it falls to the public sector or a public institutions such as multilateral development banks (MDBs) to guarantee them.[30] Of course, guarantees are not always called in, but when projects do run into trouble, it is the public sector which has to pick up the pieces – especially since high public expectation and political considerations make it difficult for public authorities to abandon infrastructure projects once underway.

Finally, it is worth noting that highlighting foreign exchange risks as being of "particular importance"[31] suggests the G20's aim is to mobilise international or foreign private capital investment in infrastructure.

**Reducing risk for private investors by subsidising – or 'blending' – their investment with public funds is another potential problem.** The Roadmap says that "mechanisms such as blended finance can also provide a base to effectively crowd-in private funding and enhance risk mitigation." Blending combines concessional public finance or development aid with non-concessional private finance. However, several problems arise from this effective subsidising of commercial companies engaged in development-related work.[32]

Firstly, there's the opportunity cost - without an overall increase in aid or other concessional public finance, blending means less concessional public finance for public services or other essential help for people living in poverty. As a recent Eurodad paper argued,[33] the commercial imperative that must accompany blended aid makes it unlikely to help achieve the SDG pledge of leaving no-one behind.

Secondly, the theory that blending encourages the private sector to be more development-friendly is unproven in practice - it is very hard to measure whether the same outcomes would not have happened anyway. A 2016 evaluation of European Union blending between 2007 and 2014 found that in almost half of the cases examined, blending added no clear value.

Thirdly, it is likely that local development needs will come second to the interests of the private sector in donor countries. The OECD has yet to agree on mitigating the risk that blending will lead to an increase in tied aid (the use of aid to subsidise firms in the donor country), a practice that is widely recognised as bad for development effectiveness.

**Guaranteeing revenue from infrastructure asset class bonds could create extra public sector debt.** In theory, bonds would be repaid using income from a project, but because infrastructure projects often take a long time to complete, repayments would need to start well before income begins to flow. In addition, many projects such as rural roads, water or sanitation will yield little or no commercial income, leaving the state to pick up the bill for repayments.

**The G20 proposals are likely to shift the risks and costs onto the public sector and infrastructure users.** Standard contracts may be good for the private sector, but could threaten infrastructure quality by reducing essential public oversight and weakening environmental and social standards. "Greater standardisation of contracts and documentation in the bidding and procurement stages of an infrastructure project life cycle" may sound sensible or even innocuous. But standard contracts governing multi-year infrastructure investments will necessitate assigning the many risks and costs of changes that will arise during the lifetime of the project, and cautious institutional investors will look to the public sector take on these risks.

Again, PPPs should serve as a warning. The World Bank's attempts to standardise PPP contracts – which are supposed to balance risks, rights and responsibilities carefully between the public and private sectors – have, according to a recent legal analysis, resulted in "proposals which are often skewed to favour private interests to the prejudice of the public entities that are ostensibly the beneficiaries of the projects and services being contracted for."[34] Furthermore, legal analysis of the 2017 Edition of the Guidance on PPP Contractual Provisions, concludes that "the Guidance does not take an equitable approach to balancing public and private interests (...) the Guidance neglects the long-term and legitimate interest of developing countries. As a result, the World Bank Group's client countries and their citizens are potentially ill-served by the Guidance."[35]

**The current focus on standardisation included in the G20 Roadmap panders to the longstanding demands of private investors.** The 2016 McKinsey Global Institute report[36] stresses that "capital markets for infrastructure assets remain relatively complex, non-standardized, and illiquid," and argues that limited standardisation increases transaction costs. By the same token, following the February 2018 G20 Infrastructure Financing Seminar, the CEO of the Global Infrastructure Hub made clear that standardisation means "the creation of plug-and-play contracts, documentation and risk allocation for public-private infrastructure transactions." Significantly, he added: "If we want to scale-up private infrastructure investment, we have to move to standardised products," which in his view "reduces barriers to entry and cuts costs."[37]

Ultimately, the goal of creating an asset class is to create safe, high-return products for institutional investors, while the tasks of planning, implementing, assessing and mitigating social and environmental costs, and dealing with unforeseen problems, will fall to others. To ensure that the tradable assets produced are seen as safe by investors will require strong guarantees that risks will be underwritten by the public sector, and that revenue streams (returns on assets) will be guaranteed even if the project meets major difficulties.

**Furthermore, private infrastructure investment frequently lacks transparency and accountability.** Firstly, infrastructure as an asset class requires standardised investment products which bundle multiple infrastructure assets with unknown risks, often involve offshore structures and vehicles, and bias risk and return in favour of investors. Financial products are engineered to disconnect investment performance and return, thus guaranteeing investors a healthy return regardless of the performance of the investment asset.

Secondly, democratic accountability is undermined because many layers separate the asset manager from the citizens who pay road tolls or water tariffs. According to one analysis, "much of the $3 trillion plus that is invested by private investors in infrastructure is one step or more removed from direct holdings in actual bricks and mortar."[38]

Thirdly, most asset managers and investment funds lack the ability or desire to ensure that the products they trade support sustainable development and climate goals. Institutional investors - who have a duty to protect their clients' interests - often view government rules to protect the public interest as obstructive.[39]

**Lack of transparency and public scrutiny of deals regulated by commercial and competition laws can tend to foster corruption.** PPP projects are especially vulnerable. In Australia, for example, an Independent Commission Against Corruption found that ministers at the state level unlawfully interfered with a decision on a water PPP with the aim of siphoning off AUS$60m of state money to one of the ministers, his family, and associates. In Brazil the construction giant Odebrecht paid bribes to government officials in countries throughout Latin America. The Economist revealed in early 2017 that the main method for the company to win contracts was to make low bids and "then corruptly secure big increases in costs through addenda – in some cases when the ink on the contract was barely dry". According to the report, 22 contract addenda caused the cost of a PPP road linking Brazil and Peru to rise from US$800 million to US$2.3 billion.[40]

**Creating an asset class for infrastructure could trigger macro-economic risks including increased likelihood of financial crises, and a shift of investment from other sectors.** Focusing the financing of infrastructure on creating asset classes for international capital markets makes it vulnerable to damaging financial crises and increases the likelihood of such crises. As the 2018 IATF report said: "Developing this asset class has to be done with care, as it is creating liquid instruments on illiquid assets. This could attract investors with short-term investment horizons, with the potential of creating short-term bubbles that could impede rather than help long-term sustainable development. Indeed, many of the financial market crises over the past 25 years involved some form of mis-pricing of liquidity."[41]

**The G20 should learn from the experience of trying to use PPPs to attract private finance to infrastructure.** An operational note released by the World Bank in 2014[42] lists many different examples where the performance of PPP projects reflects macroeconomic crises. In the late 1990s, several Asian countries suffered from the regional financial crisis which transformed PPP contingent liabilities into immediate obligations. According to the World Bank's note "all PPP road projects in countries affected by macroeconomic crisis (Greece, Portugal, and Spain recently, and previously Malaysia and Mexico) simultaneously suffered demand challenges (and faced bankruptcy risk) creating a systemic risk". An economic crisis can reduce demand for a PPP service (the so-called 'demand challenge'), which in turn causes a knock-on effect in the public sector. An additional unintended consequence of creating an attractive, risk-free infrastructure asset class could be that institutional investors shift large amounts of capital from other sectors, but thus far the G20 has not assessed the trade-off of such a shift.

**It is not hard to work out what may really lie behind the G20's push for an asset class for infrastructure.** One of the G20's priorities is economic and employment growth through trade and investment, especially in the context of the financial crisis and bank bailouts. The G20 also faces pressure from institutional investors who have seen low returns from traditional assets for many years, and who are keen for governments to create higher yielding alternatives whilst relieving them of the risk burden. According to the World Economic Forum (WEF), institutional investors holding trillions of dollars under management and seeking a diversified portfolio of infrastructure assets with attractive returns, have exerted pressure to several launch infrastructure funds. As the WEF argues, institutional investors believe "infrastructure project risk-return profiles present an attractive alternative investment – especially with real fixed income returns being near zero in the wake of the global financial crisis."[43]

**The G20 should pause its radical plans for reinventing infrastructure financing and consider whether private financiers are really interested in delivering infrastructure which 'leaves no one behind'.** Poorly thought-out policies will not only hinder Agenda 2030, but could actually undermine the SDGs. As Alexander rightly warns, attracting private investors through financing vehicles "can create vast inequalities as they could privatize gain and socialize loss on a massive scale."[44]

## Reason 3: An infrastructure asset class would be a dangerous leap in the dark

**The push to develop an asset class for infrastructure is a huge leap in the dark as private investors, have not been increasing their investments in developing countries' infrastructure.** Despite the G20's energetic championing of private investment in infrastructure for nearly a decade, "private participation in infrastructure has fallen each year since the Addis Agenda was adopted in 2015" according to the IATF report.[45] The Center for Global Development (CGD), using the World Bank's own figures, suggests that infrastructure investment with private participation fell from US$211 billion in 2012 to US$76 billion in 2016.[46]

**In fact, institutional investors are currently tiny players in infrastructure financing.** As Figure 2 shows, infrastructure investment by pension funds in the seven largest markets is currently close to zero. According to the IATF, "investment in infrastructure still represents less than 3 per cent of pension fund assets, with the majority in advanced economies,"[47] while a 2018 World Bank report reveals "...the contribution of institutional investors is miniscule, at only 0.67 per cent of the total global PPI [private participation in infrastructure] investment (comprising 0.4 per cent of the total debt and 1.3 per cent of the total equity)."[48] When it comes to insurance companies, a recent World Bank blog reported that "insurance companies still allocate less than 2.5 percent of assets under management to infrastructure investment."[49]

A 2018 report from the Overseas Development Institute (ODI) explains that "most traditional institutional investors have a strong bias towards fixed-income securities (55-60 per cent of investments), frequently government bonds and other highly rated, low-yield, long-term bonds, with most of the remaining assets allocated to publicly traded equities." Security of investment is paramount: "the great majority (87 per cent) is invested in high-income countries, while only 11 per cent is directed toward upper-middle income countries and very little to other markets."

**There are very good reasons why institutional investors don't put money into infrastructure.** According to the World Bank the "Challenges to institutional investor flows to infrastructure"[50] include:

a. Lack of a 'sizeable' project pipeline;
b. Limited resources for setting up specialised infrastructure teams;
c. High risk/low returns;
d. Challenges due to the inherent nature of infrastructure projects: projects do not yield returns during the construction phase; etc.
e. Differing mandates and lower risk appetite of institutional investors;
f. Unpleasant past experiences;
g. Information asymmetry.

Against this, the IATF points out that institutional investors favour liquid assets which are easy to buy and sell, and are subject to fewer government regulations.[51]

**The G20's plans are unlikely to work because of the fundamental contradiction between private investors' need to maximise profits and the generally low returns of infrastructure investment.** Reliable data on the actual performance of investments is hard to come by, and returns vary widely according to country, sector, timing and the way a deal is structured. Nonetheless, analysis suggests that targets are fairly ambitious. According to the Preqin infrastructure database of private equity, infrastructure funds typically target an average net return of 15.8 per cent (12 per cent for developed markets and 19.3 per cent for emerging markets) – although the returns in Africa are expected to be far higher at 30 per cent.[52] The reality, however, is that developing countries find it difficult to develop a pipeline of projects to provide investors with attractive risk-adjusted returns over the project life cycle without creating a heavy burden on the public purse. Getting an attractive credit rating on a bond guaranteed by an infrastructure project, for example, could itself increase the cost of the project.

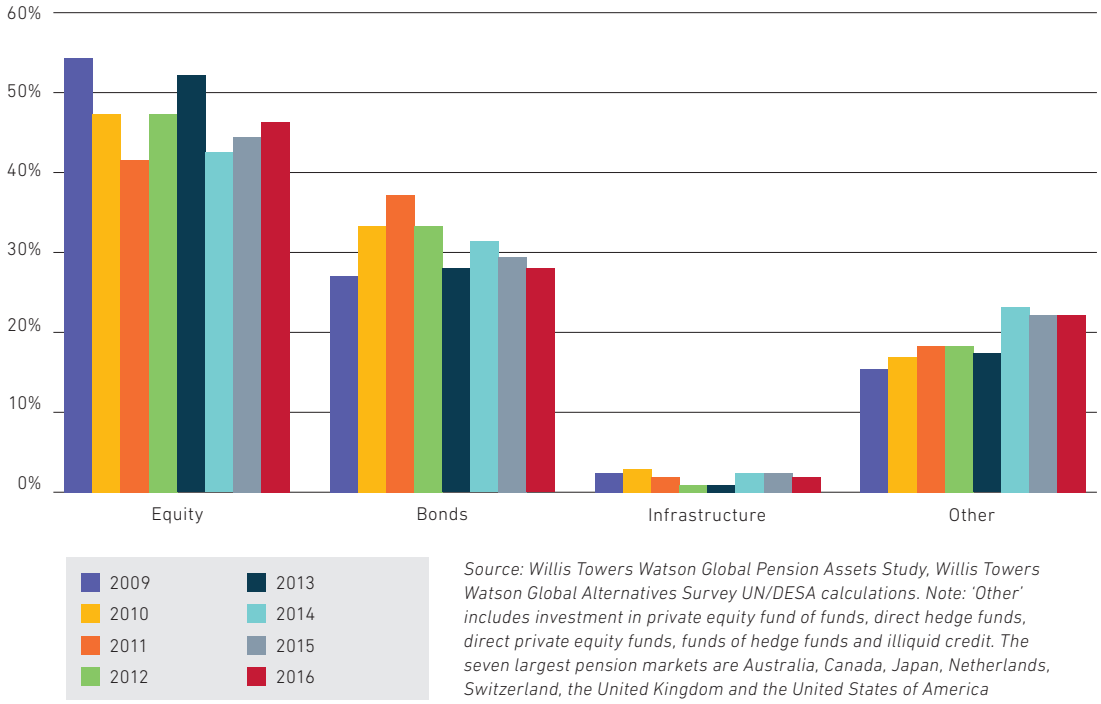
**The G20's agenda is unsuitable for low-income countries where capital markets tend to be small, and banks provide the majority of non-firm private financing.** The Roadmap notes that "steps to ensure that domestic capital markets are deep and liquid will also support the development of infrastructure as an asset class." Though the World Bank has promoted the development of capital markets, it recognises that the poorer the country, the smaller the capital market.[53] Institutional investors such as pension and insurance funds also tend to be far smaller in developing countries, and as Figure 3 shows, low-income countries have very low levels of assets as a share of GDP.

**The G20's solutions are therefore unsuitable for fragile and low-income nations which face the biggest infrastructure financing gap**, because these are precisely the countries where international private capital is least likely to invest. The most profitable projects – especially telecommunications – will always attract private investment, but desperately-needed water and sanitation infrastructure struggles to attract any private money at all. A 2015 World Bank working paper points out that "only 24 out of the world's poorest 56 countries had a single infrastructure project with private investment in the five years between 2011 and 2015, and one country (Laos) accounted for one third of the total."[54]

**The G20's drive to mobilise private investment encourages major regional infrastructure plans, and 'mega-projects' that can be socially and environmentally damaging.**[55] Given their size and complexity, mega-projects tend to be financed by foreign private investors, to the exclusion of domestic players, and there are concerns that corridors of mega-infrastructure projects exacerbate regional inequalities. Evidence suggests that many infrastructure projects currently being financed favour specific regions and geographic areas by "agglomerating" cheap labour and capital.[56]

**Figure 2**

Pension fund asset allocation as an aggregate of the seven largest pension markets, 2009-2016 (percentage)

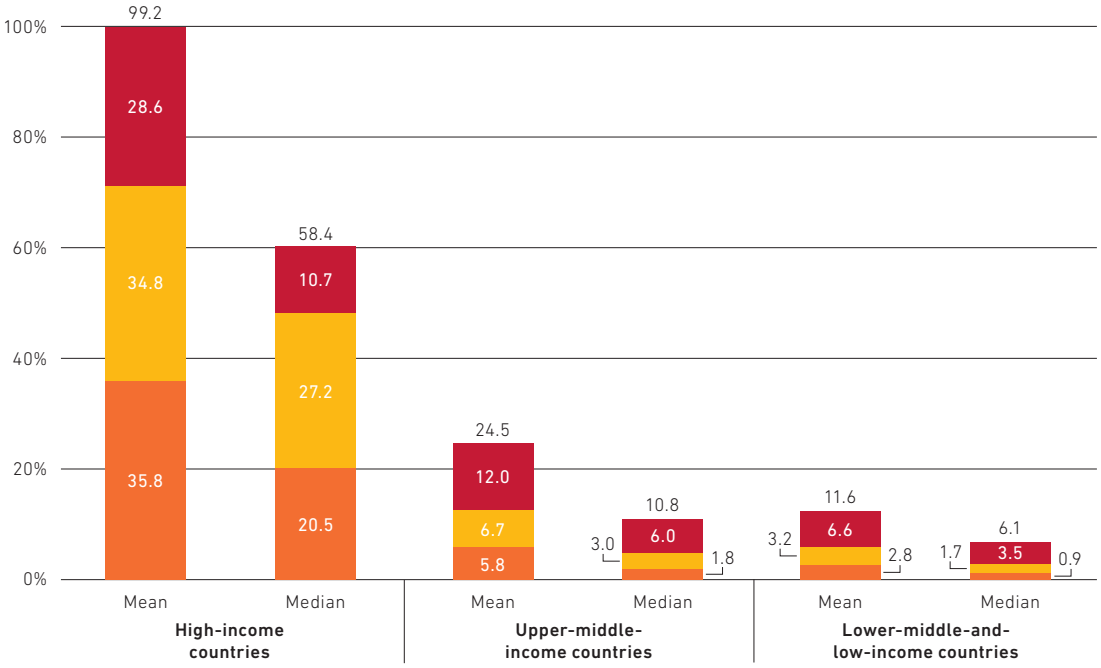



Source: IATF, "Financing for Development: Progress and Prospects 2018. Report of the Inter-Agency Task Force on Financing for Development."

*Source: Willis Towers Watson Global Pension Assets Study, Willis Towers Watson Global Alternatives Survey UN/DESA calculations. Note: 'Other' includes investment in private equity fund of funds, direct hedge funds, direct private equity funds, funds of hedge funds and illiquid credit. The seven largest pension markets are Australia, Canada, Japan, Netherlands, Switzerland, the United Kingdom and the United States of America*

**Figure 3**

Institutional investor assets by country income group, 2000-11 (% of GDP)




Source: World Bank Group, "Global Financial Development Report 2015/2016: Long-Term Finance"

*Source: World Development Indicators (database), World Bank, Washington, DC, http://data.worldbank.org/data-catalog/world-development-indicators; and Global Financial Development Database, World Bank, Washington, DC, http://data.worldbank.org/data-catalog/global-financial-development*

# Conclusion

If the G20 is serious about increasing and improving investment in infrastructure, then it needs to stop putting private finance first and start focusing on how to improve and deliver publicly financed infrastructure. Creating an asset class is not the way to ensure that essential infrastructure gets built in those developing countries which need it most. The G20 must resist the Siren calls of private investors who are concerned more about profit than 'leaving no-one behind'.

This Eurodad briefing presents a compelling case for the G20 to rethink its infrastructure financing proposals, and offers three key critiques of the G20's approach. Firstly, it ignores the main issue of how to increase and improve the quality of public investment. Secondly, it is likely to prove very costly for the public purse, and thus will have a negative impact on citizens. Finally, an infrastructure asset class would be a leap in the dark - an unnecessary, extremely difficult, and potentially dangerous development which will not deliver for the world's poorest and most vulnerable.

Public financing is less costly and more accountable, but it is also being starved of funds because of a lack of action at international level. Clamping down on losses of public resources through tax dodging, dealing with unsustainable debts through a debt workout mechanism, increasing levels of international concessional resources including through meeting ODA commitments and creating new sources of public financing would all be a better contribution to bridging the global infrastructure gap and thus achieving the SDGs.

Transparency and accountability must be radically improved to avoid the damage caused by badly designed or implemented infrastructure. Climate change must be taken seriously – which means meeting longstanding commitments to properly finance adaptation and mitigation in developing countries and discouraging investment in carbon-based infrastructure projects. Recognising that the 'infrastructure financing gap' is in fact a public financing gap, and that no amount of wishful thinking will allow private financing to replace public financing for critical kinds of infrastructure, would be the logical place to start.

[The G20] needs to stop putting private finance first and start focusing on how to improve and deliver publicly financed infrastructure

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