G20 AND BRICS UPDATE E-NEWSLETTER

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Dueling Visions: Civil Society and the G20

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Introduction
Inequality and Growth: What does the G20 Know?
Nancy Alexander, Heinrich Böll Foundation - North America

Could global growth be stunted by the fact that almost half of the world’s wealth is owned by less than 1% of the population? In other words, the wealth of 85 people is equivalent to that of half of humanity (3.5 billion people), as described by Oxfam International’s report, Working for the Few: Political Capture and Inequality.

The Pope, Barack Obama, the World Economic Forum (WEF) and the IMF decry inequality. The WEF climbed on the bandwagon, declaring that extreme inequality is a top global risk; the IMF endorsed redistributive policies, stating that they seem to have helped support “faster and more durable growth.” But, in fact, the lack of such policies can destroy economies. Nevertheless, the G20 (and the institutions it controls) not only ignore the need for redistributive policies, it actively promotes policies that exacerbate inequality, as this issue of the "G20- BRICS Update" describes.

The G20 is producing too many reports and too little progress. But, to its credit, it is trying to curb the tax avoidance and evasion which rob developing countries of over $1 trillion per year. At the 2013 G20 Summit, Leaders committed to automatically exchange tax information with each other by the end of 2015, but it will take mighty political will to implement this commitment and related ones.

The authors in this issue identify dynamics that foster inequality: suppression of returns to labor; speculation in risky infrastructure assets; trade and financial liberalization; and mega-project development. In her article, “The Global Social Crisis: the Labour 20 Challenges the G20 to Respond,” Sharan Burrow, General Secretary, International Trade Union Confederation (ITUC), calls on the G20 to resume the kinds of economic stimuli that produced a 5% global growth rate in 2010.

Ironically, the G20 aims to raise its collective GDP by more than 2 per cent above the current trajectory for the next 5 years. But, since the 2010 growth rate was 2% higher than the 2013 growth rate of 3%, the G20 could resume its stimulus policies and help get people back to work. Burrow identifies the approaches which can reverse the rise in global unemployment, now at more than 202 million, and to begin to fill the 55 million jobs gap in G20 countries.

In his article, “If You Build It, Will They Come? [If the G20 Helps Build Platforms for Trading Infrastructure Assets, Will Investors Care?]” Manuel F. Montes, Senior Advisor on Finance and Development, the South Centre states that decades of financial deregulation have made it impossible for developing countries to receive the long-term funding for infrastructure they need. Now, instead of re-regulating finance, as it should do, the G20 is intervening in markets in an effort to mobilize investment of pension funds in infrastructure assets in emerging and developing countries. Montes warns labor unions about the safety of their pension funds in such ventures and warns governments of G20 schemes which could result in speculators using this new “asset class” to earn excessive profits at their expense.

In her article, “What will it Take? Achieving sustainable industrialization in the BRICS and other developing countries,” Jayati Ghosh, Professor of Economics, Jawaharlal Nehru University (India), identifies flaws in the current growth model: the impact of financial liberalization; the obsession with export-oriented growth model; and inadequate attention to ecological imbalances. She contrasts this model (which fails to produce adequate employment growth, among other things) with the potential for a different set of policies aimed at “sustainable industrialization.”

In his article, “High Ambitions, High Risks: the Programme for Infrastructure Development in Africa (PIDA),” Mzukisi Qobo, Senior Lecturer and Deputy Director, Centre for the Study of Governance Innovation, University of Pretoria describes how PIDA is developing continental infrastructure, especially in energy, transport, and water sectors estimated at US$360 billion up to 2040. These mega-projects provide a destination for rising infrastructure finance from external actors, such as the World Bank (see page 2); new institutions, including the BRICS Bank; and countries, such as China and India. Qobo concludes that PIDA could become a “bane for the continent,” if it fails to create and nurture the governance mechanisms to ensure that infrastructure projects are undertaken with greater sensitivity to the environment and social inclusivity.

If, as the World Bank claims, Africa’s infrastructure funding gap is $93 billion per year until 2020, then the G20 should take note: the continent’s recovery of an estimated $50 billion per year in illicit financial flows would go a long way toward filling that gap.
Focus of April 2014 Communiques and Reports on Infrastructure Financing

For a thorough analysis of the communiques of the G20, G24 and governance bodies of the IMF-World Bank, see the work of the the Bretton Woods Project.

A report entitled “Optimizing World Bank Group Resources and Supporting Infrastructure Financing,” which is attached to the Communiqué of G20 Finance Ministers and Central Bank Governors describes several avenues through which the World Bank Group will expand its support for infrastructure, including: a) Measures that will enable World Bank to nearly double its annual lending capacity for middle-income countries (including for infrastructure financing) from $15 billion to as much as $28 billion per year. The Bank’s lending capacity (the total loans on its balance sheet) will increase by $100 billion in the next decade, to roughly $300 billion. b) Expansion of the Global Infrastructure Fund (a fund of the Asset Management Corporation (AMC) of the International Finance Corporation (IFC)) to support $18 billion in infrastructure investment over five years. c) Launching a Global Infrastructure Facility (GIF) which would leverage additional financing for infrastructure, and actively seek partnerships with other multilateral and national development banks as well as donors, sovereign wealth funds and the private sector. The Bank’s new GIF would contribute, over time, to the creation of a new asset class for long term investors like pension funds. Governance arrangements, which are still under discussion, will “allow financial partners to provide guidance to the platform.”

The communiqué of the Group of 24 takes note of “the proposal to establish the Global Infrastructure Facility as a constructive contribution to overcoming the gaps and constraints in infrastructure financing and project development.” It states that, “The ultimate proposal must ensure adequate and broader participation of recipient countries and the availability of additional resources, together with sufficient flexibility to meet diverse infrastructure finance needs.” It adds that “given the large and critical financing needs in LICs, particularly for infrastructure, we emphasize the importance of adopting a flexible and non-intrusive operational framework” for the IMF’s policy on debt limits. The communiqué expresses concern that the IMF has not yet completed its review of this policy.

The Communiqué of the G20 Finance Ministers and Central Bank Governors calls for “country specific and collective actions” in the G20’s growth strategies, which should include “a set of leading practices to promote and prioritize quality investment, particularly in infrastructure...[and] improve our investment climates and develop approaches to better leverage private sector involvement...” An addendum to the Communiqué includes links to seven reports that were delivered to the Ministers; these relate to World Bank infrastructure finance (see above), pooling institutional investment capital; guidelines for debt management; financial reform; regulation of OTC derivatives; competition; and a report from the G20’s anti-corruption working group.

The Australian G20 Development Agenda states that, in 2014, the development agenda will be an extension of the G20’s broader growth agenda. While the three main priorities of the G20 Development Working Group are Infrastructure, Domestic Resource Mobilization, and Financial Inclusion/Remittances, it will also address Food Security and Human Resource Development.
G20 Leaders face a critical choice in 2014. They can opt for “more of the same,” risking stagnation, rising unemployment, which is on the verge to becoming structural, and a deeper social crisis. Or, they can start over and deal a collective hand of cards that foresees job centered investment – namely, investment in:

- infrastructure;
- the green economy;
- the care economy to promote women’s participation;
- scaling up apprenticeships to drive inclusion and improved skills for young people; and
- social protection floors to both avert growing social despair and boost aggregate demand.

If this sounds familiar, it is and it worked. At the Washington and London G20 Summits in 2008 and 2009, respectively, Leaders took collective action. As a result, in 2010, global growth was at 5% and, at the OECD Ministerial meeting in May of that year, it was billed as the ‘the green shoots of recovery’. At that point, growth in the BRICS was the global adrenalin and optimism was on the rise.

Just one month later, in June 2010, the G20 Leaders “split the deck” and Europe opted for austerity at any cost, while the U.S. favoured employment-centered growth and the emerging economies went their own ways. The resulting global slump in demand for goods and services cut global growth to a level barely above 3%. Meanwhile, historic levels of unemployment turned into a structural social crisis.

The evidence for this negative trend continues to pile up. The OECD in its “Society at a Glance” publication this year confirms that “despite a gradually improving global economy, medium-term fiscal consolidation in many countries will pose challenges for tackling the social fallout from the crisis.” Rising inequality, especially for the most vulnerable, prevents social cohesion. To stop the widening of social gaps and to bolster confidence, governments must urgently boost levels of public expenditures in order to counteract these trends.

Our own ITUC polling tells us that almost 1 in 2 people have direct experience of unemployment or reduced working hours for themselves or members of their families in the past two years. 78% say their wages have stagnated or fallen behind the cost of living.

“Society at a Glance” highlights the impact of the crisis and of austerity policies by showing that the “number of people living in households without any income from work has doubled in Greece, Ireland and Spain, and risen by 20% or more in Estonia, Italy, Latvia, Portugal, Slovenia and the United States”. In stark contrast to high-income earners, households with lower incomes in Eurozone crisis countries suffered terribly during the economic downturn and did not meaningfully benefit from the recent recovery either. The most worrisome trend is that more and more young people are at risk of poverty. Meanwhile, in 23 countries, there is a rise in the share of people struggling to afford enough food to feed their families.

There is more: recently, the IMF admitted that it underestimated the negative multiplier impact of fiscal consolidation on growth. Its officials even agreed with the OECD’s evidence of rising inequality, while the ILO has chalked IMF data sets.

Enough is enough. Our own ITUC polling tells us that almost 1 in 2 people have direct experience of unemployment or reduced working hours for themselves or members of their families in the past two years. 78% say their wages have stagnated or fallen behind the cost of living. It is obvious that neither austerity nor government reliance on individualism works.

So, will the G20 blaze a path out of this social crisis in 2014?
In February 2014, the G20 Finance Ministers in Canberra, Australia committed to “ambitious but realistic policies […] to lift our collective GDP by more than 2 per cent above the trajectory implied by current policies over the coming 5 years”. This is supposed to be achieved by concrete actions across the G20, including increasing investment and lifting employment and participation.

However, the reality is that Australia has refused to continue the successful dialogue between labour and finance ministers initiated under the Russian Presidency last year.

These actions are critical to reverse the rise in global unemployment, now at more than 202 million, and to begin to fill the 55 million jobs gap in G20 countries through policies focused on quality job creation.

Labour ministers need to assert themselves and call for a joint G20 Labour-Finance ministerial meeting. Also, in April, when the G20’s Employment Task Force (ETF) meets at the OECD, its representatives must set forth an ambitious agenda in support of job centered growth.

This agenda requires the following:

• Integration of policy: coherent policy packages that coordinate macroeconomic, financial, and labour market policies;

• Investment: more productive private sector investment will need to be underpinned by pro-growth macro policies and desperately needed increases in public infrastructure spending;

• Inequality reduction: rising inequality is bad for growth – we need strong wage floors and strengthened collective bargaining to stop the slide in the labour share of total income;

• Inclusion through Active Labour Market Policies: strengthened worker rights should foster the formalization of informal employment. Policies should ensure youth guarantees; better childcare and elder care to facilitate participation in the workforce (especially for women); enhanced dialogue with social partners; improved worker safety; and the implementation of Social Protection Floors.

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Labour and business representatives at the G20 level understood this. In 2013, the Labour-20 and the Business-20 reached a common understanding in support of investment in infrastructure, including enabling green infrastructure to create jobs. They also released an agreement to scale up quality apprenticeships.

Furthermore, the B20 and L20 are joining forces in regard to the need to formalise businesses and workplaces in the growing informal sector.

Through the lens of the global workforce, the picture is bleak. Of an estimated 2.9 billion workers, 60% are employed in the formal sector. However, more than 50% of them find themselves in increasingly precarious or vulnerable employment. Then there are the 40% of all workers (primarily women and young people) who live in desperation in the informal sector, lacking all forms of protection. This is the state of globalisation, which is ignored by those, who solely focus on growth figures and profit.

Beyond the immediate jobs crisis, the current global economic model is driving inequality that in itself constitutes a risk to continued growth. It is time for a different approach, when ILO figures demonstrate that the number of people covered by collective bargaining has declined by 2/3 from 2000 to 2010; when protests are erupting in many nations, where the minimum wage does not enable people to pay for basic necessities; and when more than 75% of people have few, if any, social protection.

Such an approach requires political will. Will we see it from G20 Leaders at the Brisbane Summit in November 2014?

If the follow-up on financial regulation is any indication, we will be extremely disappointed. Speculation is greater than before the crisis and the ‘too big to fail’ banks remain untouched. High frequency trading has been labeled ‘insider trading’ with no move in sight to ban computer-generated speculation. The financial sector has thrown millions of dollars into lobbying in order to prevent real regulatory reform and to ensure that the proposed financial transactions tax in Europe is watered down.

The G20 Leaders Summit in Brisbane is looming, and with it, hopes for a turning point. However, despite the undeniable urgency, the Leaders’ agenda is missing critical elements: climate action; funding for social protection floors for the poorest countries; ways to strengthen collective bargaining; and minimum wage mechanisms.

Without urgent action, there is a high risk that world leaders and their finance ministers will ignore the social crisis and the lack of decent jobs.

Is there the political will to restore collective action and promote quality job creation, sustainable growth and a fair distribution of income? The jury is out on this.

\footnote{2 The Labour 20 (L20) represents the voice of workers through their trade unions to the G20. It is convened by the International Trade Union Confederation (ITUC) and the Trade Union Advisory Committee to the OECD (TUAC) and in 2014 is working with the Australian Council of Trade Unions (ACTU) as national hosts.}
This publication compiles articles by a leading representative of each G20 “engagement partner”: business, civil society, labor, think tank and youth groups (B20, C20, L20, T20, Y20), who shares their perspectives on the G20’s 2014 agenda. In opening comments, the Australian Sherpa Heather Smith emphasizes the importance of dialogue with each of these groups to achieve the desired G20 goals. These are: 1) economic growth and job creation and 2) resilience of the global economy to future shocks.

To these ends, the G20 is addressing nine priorities, which appear in a diagram here. The complexity of these issues leaves room for wide interpretation by the satellite groups. The B20 Sherpa, Robert Milliner, emphasizes that strong economies rely on a profitable private sector. He calls for better financial regulation, better skills, and free trade. He also calls for business leaders to assist governments in creating a favorable business environment that will foster sustainable growth and job creation. It is assumed that such a benevolent environment will attract private investment in infrastructure.

The T20 author (Mike Callaghan) calls for more effective and coherent growth strategies by G20 countries which can increase needed infrastructure spending; ensure macro stability, keep markets open, liberalize trade; and promote efficient labor and product markets. In addition, the T20 calls for progress in tackling tax evasion and avoidance, eliminating fossil fuel subsidies and supporting the UN in addressing climate change. It takes the view that the G20’s Development Working Group should focus on financing for development in order to reduce inequality and boost economic growth through empowerment of small and medium-sized businesses.

The L20 author (Sharan Burrow) states that global recovery requires rising demand, but that without progress in addressing unemployment and inequality, meaningful recovery cannot materialize. She calls for growth strategies that emphasize job creation (including jobs in the care economy and investment in skills) as well as responsible investment (including green infrastructure and technology), and tax and financial reform. Burrow highlights conspicuously missing elements of the G20 agenda, including climate change.

The C20 author (Tim Costello) asserts that “‘burning platform’ under today’s G20 is growing inequality.” One way that the G20 can restore the confidence of business and civil society is through “unflinching action to reduce tax base erosion, profit shifting and other forms of tax leakage, including corruption. Governments cannot fulfill their social contracts without effective reform in this area.” Economic resilience is not achieved by a favorable business environment alone, but also by investments in education and health. Social infrastructure has to be promoted alongside economic infrastructure in order to spread the benefits of growth more widely.

The Y20 author (Holly Ransom) stressed the importance of tackling youth unemployment and raising the stature of the Y20 group as thought leaders.

Despite their different interpretation of several aspects of the G20 agenda, what unites the satellite groups is their call on the G20 to finally move beyond action plans and actually deliver on its commitments.
Is Infrastructure Investment a Win-Win Solution?

The face of it, the highly touted global effort to mobilize significant financing from pension funds for infrastructure investment in developing countries is a proverbial win-win.

Even as developed economies expected to be in the doldrums for perhaps a decade, developing countries have been estimated to require as much as an additional trillion dollars per year (doubling the current level of spending) in (non-energy) infrastructure in the coming decade. Clean energy investments could absorb about half a trillion more.

Infrastructure investment is important for development. Properly planned construction creates employment for the poor, facilitates new economic activities, and upgrades the quality of life in developing countries. This is potentially the first win.

The ongoing global financial crisis itself represents the possible basis for the second win. Pension funds, whose source of funding is long-term, are anxiously searching for safer ground, looking for long-term investments to “de-risk” their portfolios. To quote the first few paragraphs from a 22 March Financial Times article:

For the people in charge of the world’s largest pension plans, the past 15 years has been a Las Vegas drama in slow motion. Many of them would like nothing more than to retire from the table – and this year many of them will be close enough to break-even that they can consider doing just that.

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Retiring from the table, in this analogy, means being able to pull a lot of their pension pot out of risky assets, such as equities, which have endured two bear markets since the start of the century, and instead invest the money in safer bonds.

Unlike many investors, whose aim is to maximize returns, the managers of defined benefit pension plans have a different priority. Theirs is to make enough money to meet the promises they have made to employees, and then to sleep at night.

Given the elevated infrastructure needs from developing countries for years to come, it would seem that finding a mechanism to channel pension funds to finance such projects is a solid basis for the second win.

Indeed, it is likely that proposed new institutions are banking on this fact. This year, the World Bank is seeking to launch a Global Infrastructure Finance Facility (GIFT) and the Asian Infrastructure Investment Bank and BRICS Bank may not be far behind. Infrastructure development is a key inspiration for the proposed BRICS development bank. These new institutions (as well as existing ones that are re-orienting their businesses to promote infrastructure investment) expect to attract long-term private financing in exchange for off-setting their risks.

International labor federations have expressed support for their pensions being invested in developing country infrastructure.

If You Build It, Will They Come?1
(If the G20 Helps Build Platforms for Trading Infrastructure Assets, Will Investors Care?)

Manuel F. Montes, Senior Advisor on Finance and Development, The South Centre

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Especially since its 2012 Mexican and 2013 Russian Summits, the G20 has elevated this topic of “financing for investment” (particularly in infrastructure) to the top of its agenda. A G20 study group called for a “G20-sponsored convening of pension funds” with participation “beyond managers to include key trustees, CEOs and/or CIOs, the infrastructure fund managers that the pension funds themselves work with, as well as investment consultants and union leaders where relevant”.

G20 Illusions

Why would G20 orchestration be needed at all? In this suggested extra-market convening, have we managed to find the storied Invisible Hand in the G20? Shouldn’t market incentives be sufficient to channel pension fund resources to the infrastructure needs of developing countries?

Decades of financial deregulation have in fact made it impossible for developing countries to receive the kind of long-term funding for infrastructure they need. Financial institutions have gotten out of the business of evaluating the risks of proposed projects. Instead, they seek to “package” these projects into bonds which can be sold to savings pools, including pension funds.

Among the managers of savings pools – including pension funds – “short-termism” prevails because their performance is measured by their quarterly results. Indeed, it is not surprising that, from quarter to quarter, individual fund managers (along with their “herd” of fund managers) hop from financial asset to financial asset in an effort to maximize their returns.

A background study for the ongoing discussions in the United Nations on financing sustainable development suggests that volatility and short-termism now prevail in the financial sectors of both developed and developing countries. In its executive summary, this UN study says “In the United States, for example, the average holding period for stocks fell from about eight years in the 1960s, when investors were more long-term oriented, to approximately six months in 2010.”

This UN study suggests that “misaligned incentives, such as short-term oriented compensation packages,” . . . “present impediments to long-term stable investment.”

Decades of financial deregulation have in fact made it impossible for developing countries to receive the kind of long-term funding for infrastructure they need.

The G20 proposes that pension fund managers begin to think of infrastructure investment in developing countries as a new “asset class.” But do pension fund managers have the technical capacity to analyze the risks associated with directing their money into less liquid, more long-term infrastructure projects?

Because of limited technical capacity, much of the new pension interest in infrastructure is being channeled through private equity and hedge funds, the most agile operators in today’s financial markets. With their fee structure (four percent management and 20 percent performance fees), hedge fund managers are “licking their chops” over the “discovery” of a new “asset class.” This is fair warning to friends in labor unions about the safety of their pension savings as they try to support infrastructure investment in developing countries.

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It is also fashionable to insist that countries require an open and enabling business environment in order to attract and retain investment flows. This is a “coded” policy message calling for the removal of capital account regulations. This policy is misguided since, capital account regulations are not meant to cage in external investors or rich locals with connections to invest abroad. They are needed to maintain a sound domestic financial sector. These regulations also nurture a long-term investment climate by containing the adverse impact on national exchange and interest rates of international private mood swings and developed country policy pivots.
Towards Real Solutions to Infrastructure Under-Investment

Why is the G20’s Invisible Hand attempting to manipulate markets? It is because institutional features of today’s international financial markets obstruct the intermediation of long-term pension fund savings into long-term infrastructure projects. As long as the “regulation” of international financial markets permits short-term, asset-hopping on the part of investors, G20 efforts will fail or fall dramatically short of expectations. If the G20 builds platforms for trading infrastructure funds, the investors will not come, even if pension funds’ “key trustees, CEOs and CIOs” are called into the meeting.

Could the G20’s interest in promoting infrastructure investment be a smokescreen? One that obscures its underwhelming performance in working with the Financial Stability Board (FSB), an institution that the G20 created to redesign financial regulation? Re-regulation is needed for financial markets to make these markets, once again, assume their role in the real economy of providing upfront the money needed for long-term infrastructure investments. But, from all appearances, the FSB is not up to the job.

For developing countries, the volatility of private capital flows has been extremely costly. Developing country authorities are spending massive sums of money for the sole purpose of building their foreign exchange reserves, which protect them against volatility and fend off exchange rate appreciation (especially in the backwash of successive waves of quantitative easing). For instance, in the periods 2004-2009 and 2010-2014, developing country authorities bought an annual average of $660 billion and $643 billion respectively of developed country financial assets.

Towards Equitable Risk-Taking

If one still insists that private pension funds must invest in developing country infrastructure, what kind of public guarantees, insurance schemes, and subsidies will be required to attract them and dispel their short-term funk? How generous must these guarantees be? Will it be necessary to transfer most of the risk to public entities (i.e., taxpayers and citizens) to mobilize pension fund financing for developing country infrastructure?

It is fair to warn developing country governments that any guarantee and risk-sharing arrangements with private firms will quickly turn against them when infrastructure projects fail. Developing countries have decades of experience with debt crises. The recent experience in Spain’s only confirms, that – in the absence of equitable methods of bailing in creditors—national governments are the sole risk holders of external financing.

Inadequate money for project preparation is often cited as an explanation for inadequate infrastructure financing. Good design is important. Infrastructure investment is highly risky, but there are many ways to make it much less risky without exempting pension funds from sharing the cost when things go wrong.

How can infrastructure investment be less risky? It is crucial to minimize the currency mismatch in projects. As much as possible, projects should use foreign currency financing only to pay for imported goods and services. Relying more on domestic currency financing will require upgrading the domestic financial sector, but this is a desirable end in itself.

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If one still insists that private pension funds must invest in developing country infrastructure, what kind of public guarantees, insurance schemes, and subsidies will be required to attract them and dispel their short-term funk? How generous must these guarantees be? Will it be necessary to transfer most of the risk to public entities (i.e., taxpayers and citizens) to mobilize pension fund financing for developing country infrastructure?

It is fair to warn developing country governments that any guarantee and risk-sharing arrangements with private firms will quickly turn against them when infrastructure projects fail. Developing countries have decades of experience with debt crises. The recent experience in Spain’s only confirms, that – in the absence of equitable methods of bailing in creditors—national governments are the sole risk holders of external financing.

Inadequate money for project preparation is often cited as an explanation for inadequate infrastructure financing. Good design is important. Infrastructure investment is highly risky, but there are many ways to make it much less risky without exempting pension funds from sharing the cost when things go wrong.

How can infrastructure investment be less risky? It is crucial to minimize the currency mismatch in projects. As much as possible, projects should use foreign currency financing only to pay for imported goods and services. Relying more on domestic currency financing will require upgrading the domestic financial sector, but this is a desirable end in itself.
mitigation and adaptation in the developing countries. Development banks with capability in developing countries to undertake long-term projects can serve as effective intermediaries in this global effort.

Sound infrastructure projects are those which provide affordable services to domestic users. In the coming years, with a sluggish and uncertain international economy, serious consideration must be given to projects that are less dependent on exports and more dependent on the growth of domestic incomes. Also, climate resilient projects should have priority, since their debt financing can be repaid over the long-term.

Meanwhile, megaprojects should be avoided. While they might enjoy economies of scale, they seldom benefit the poor. Moreover, they can dislocate and damage the interests of affected communities and harm the natural environment. Project identification is recurrently successful when women prioritize investments, such as in providing water and sanitation services in low income areas.

The G20’s "Invisible Hand" attempt to manipulate markets is misguided. It is unlikely to solve the dilemma facing pension funds or usefully meet the infrastructure needs of developing countries. The G20 needs to shift its direction and face the pressing need to re-regulate international finance. Until it takes steps to do so, global financial volatility and imbalances will plague the developed and developing world and the promise of infrastructure will remain a mirage.

If the objective is to expand the scale of infrastructure investment in developing countries as a matter of development partnership, the international community could not start in a better place than to address systemic shortcomings in the global economic and financial architecture that gave rise to the current crisis. One place to accelerate this is in the current intergovernmental negotiations in the United Nations toward a strengthened and expanded Global Partnership for Development.

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1 The title is a quote from the 1989 movie “Field of Dreams” in which a farmer prophesied that, if he built a baseball diamond on his land, crowds would come to see famous, long-gone stars play the game.

2 I am extremely grateful to Nancy Alexander for comments and suggestions. I am solely responsible for all errors, opinions and analyses. Email: montes@southcentre.int.


6 In Spain, municipal governments borrowed from German, Dutch, and French banks for infrastructure and building projects. The national government had to assume this debt and its servicing when the financial crisis struck.

What will it Take?
Achieving sustainable industrialization in the BRICS and other developing countries

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In the past two decades, some developing countries such as the BRICS have emerged as major exporters and importers, as well as new sources of foreign capital flows. This is widely perceived to have significant implications for existing trade structures and patterns, as well as for global power as expressed in other ways. In particular, it means that developing countries have alternative sources of capital inflows, alternative markets other than those in the North, and even alternative channels of migration compared to the past.

Growth prospects in jeopardy

A premature celebration of this emergence may not be justified and for some countries could even be described as hubris. This is particularly so if growth expectations continue to rely on a development strategy that is unlikely to deliver sustained growth in future. There are at least three reasons why the current growth strategy may face constraints: the impact of financial liberalisation; the mercantilist obsession with export-oriented growth with adverse distributive consequences; and the inadequate attention to ecological imbalances that result from the patterns of material expansion. Growth strategies need to change towards models that focus on the potential of domestic and regional markets, not just global markets. This means increasing employment and ensuring that wages increase with productivity, along with improving the viability and incomes of micro-enterprises and self-employed workers.

Growth strategies need to change towards models that focus on the potential of domestic and regional markets, not just global markets.

Productive transformation and Employment

Until recently, the policy discussion on productive transformation in the BRICS has tended to focus on changes in per capita incomes and the structure of output, rather than on the level and composition of employment. This has been based on two assumptions: that rapid GDP growth will cause increases in aggregate employment; and that this growth will be associated with industrialisation that will cause shifts in the structure of the work force. However, neither of these assumptions can be easily accepted today, even in the more successful countries. Recent patterns of economic growth invalidate the assumption that high output growth automatically translates into rapid employment growth. This runs contrary to traditional theories that have argued that greater economic openness and integration will promote labour-intensive activities in countries with surplus labour. These theories do not take account of forces that affect growth in open economies and cause declining employment elasticities of output (the percentage change in employment associated with a one per cent change in output) in manufacturing and other sectors. In extreme cases, improvements in labour productivity can even reduce employment: thus, if the growth of output is slower than the growth of
productivity, employment will decline. Across the developing world in the past two decades, employment elasticities of output growth have generally fallen (and in some cases even turned negative) during the years when countries have opened their economies to trade and investment, even when they have had relatively rapid output growth.

**Unintended impacts of trade liberalisation**

The disappointing employment trend can be significantly attributed to the impact of trade liberalisation on the internal pattern of demand for goods and services. Since the tastes of the elites and middle classes in the emerging world are influenced by the lifestyles in the developed countries, consumption becomes more import-intensive both directly and indirectly. Also, producers in developing countries find that the pressure of external competition in both exporting and import-competing sectors requires them to adopt the labour-saving technologies developed in the North.

If the growth of output is slower than the growth of productivity, employment will decline.

Integration into global value chains may not solve the employment problem either, because the global technological trajectory is associated with significant increases in labour productivity and the emergence of global oligopolies earning high profit margins. So when poor countries open their borders to foreign capital and technology, despite their large unemployed reserve and low wages, the technology gap relative to the developed countries shrinks and labour productivity rises due to the use of capital-intensive production technologies. If production is also dominated by a few oligopolistic private producers (whether local or multinational), then one can expect high profit margins, low wages and poor working conditions, as illustrated by the spate of accidents in export-oriented garment industries in Bangladesh and Cambodia.

All global production chains are not the same; therefore, one cannot uncritically encourage integration into them. This is particularly important because of the "downsize and distribute" model that is driving more global production chain investment by multinational corporations (MNCs) to focus on shareholder value. When MNCs outsource to informal producers, there may be gains in price-competitiveness, but these can come at the cost of smaller average firm size and lower potential growth and productivity. In general, high rates of informality drive countries towards the lower, more vulnerable end of global production chains, which may not be desirable. Most crucially, demand matters, size matters - and therefore policy matters crucially, and cannot be delinked from a broader plan for national development.

Integration into global value chains may not solve the employment problem either, because the global technological trajectory is associated with significant increases in labour productivity and the emergence of global oligopolies earning high profit margins.

Many governments avoid taxing away the surplus profits of MNCs and other large businesses for fear of reducing production incentives. This diminishes the state’s capacity to spend either on employment generating projects or on social security. As a result, success on the export front may not ensure employment growth. In the less successful exporters, markets for domestic producers do not grow fast.
The BRICS’ “model”

Many governments avoid taxing away the surplus profits of MNCs and other large businesses for fear of reducing production incentives. This diminishes the state’s capacity to spend either on employment generating projects or on social security.

Consequently, greater economic openness is probably the primary cause of the growing divergence between output and employment growth. In addition, macroeconomic policies that have aimed at restricting domestic demand for stabilisation or adjustment purposes have also had adverse effects (despite the fact that conventional economists applaud the “macroeconomic prudence” of such measures). Local employment generation is inhibited by restrictive monetary policy regimes (e.g., those that target very low rates of inflation and reduce the credit access of small producers) and fiscal discipline through reduced government spending.

Regrettably, public expenditure contraction in the most recent phase of global austerity has been directed not only at the employment-intensive social sectors, such as health and education, but also at spending that directly impacts upon agriculture, which is typically a major source of livelihood.

Policies for Sustainable Industrialisation

The central challenge is to shift the bulk of workers into higher productivity activities that also offer higher remuneration and better working conditions. This requires diversification of production and consumption within the economy. Yet, it is detrimental to establish enclaves of high value creation (e.g., export processing zones) that lack strong linkages with the rest of the economy. So basing growth simply on mineral rents and other resource-based or extractive industries is not an optimal strategy. It may generate growth as long as global markets for these products continue to be buoyant, but there will not be significant positive multiplier effects domestically if the surpluses so generated are not ploughed back into investment and if the employment in these sectors does not expand fast enough. So industrialisation is essential, but that too cannot only rely on external markets, even for small economies: without generating synergies that rely on the interaction between domestic production and consumption, it is impossible to have virtuous cycles of expansion that also allow for continuous productivity increases.

Sustainable industrialisation requires industrial policies, supported by trade policies that recognise the specific circumstances and needs of individual countries. There is certainly no “one-size-fits-all” trade policy, and no single trade strategy is optimal for all developing countries over all periods. Trade policy choices depend on the level of development, the size of the domestic and potential external markets, and other factors. Also, trade and industrial policies have to be different from the industrial policies used by countries in the past. They have to be oriented towards competitive strengths and allow for the development of synergies over time. Consider the case of a mineral-exporting poor country, in which one or a couple of commodity groups account for a very large share of merchandise exports. Depending on the commodities involved this can increase vulnerability rather than provide the base for economic diversification, as the country is prone to potentially large fluctuations in demand and prices for those commodities. It is important to avoid dangers such as early exhaustion of non-renewable resources; overvalued exchange rates that undermine the competitive strengths of other tradable sectors; and damaging ecological consequences that impinge on the livelihoods of the rest of the population.

In the desired model,

• Social ownership and the common property nature of resources need to be respected and the proceeds from export success used to strengthen the rest of the economy.
• Public ownership by a democratically accountable state and taxation of net revenues will finance investment in productivity enhancement and economic diversification and provide for adequate social expenditures.
• Investment will focus on sectors such as infrastructure, ancillary industries and downstream activities such as processing and development of services that could cater to the local demand generated by the primary activity.

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STARBUCKS

Turnover: £1.2bn
Corporation tax: £0

Boycott tax evasion. #BoycottStarbucks.

Courtesy of www.alphabetics.info
cater to the local demand generated by the primary activity.

In addition, it is crucial to regulate finance to guard against financial fragility and failure and ensure that finance reaches important sectors that would otherwise be bypassed or neglected. The state needs to use the financial system to direct investment to sectors and technologies at appropriate scales of production. Equity investments and directed credit are important instruments in such state-led or state-influenced development trajectories.

It is important to nurture and encourage co-operatives, since small and micro enterprises are fundamentally unviable in a competitive environment if they cannot utilise technological and organisational economies of scale. In the developed world, recent evidence suggests that, in the current recession, there has been an increase in the numbers of cooperatives being formed.

A systematic industrial policy may continue the agricultural development process, which remains important because:

- Any process of diversification is unlikely to reduce dependence on agriculture in the short run. Agricultural growth has to be stepped up considerably to make an immediate impact on poverty and unemployment; these problems cannot be rectified in the long-run through the "trickle-down" effect of growth in the non-agricultural sectors.

- The structural change that results from a step-up in agricultural growth via an expansion of the domestic market is likely to be broad-based, resistant to external shocks, and employment-intensive in contrast to any structural change produced by an "outward-orientation" of an economy constrained by a limited domestic market.

- Agricultural growth holds the key to the provision of food-security for the domestic population. In an economy with uncertain export prospects, ensuring adequate food availability for the entire population, a crucial objective in itself, necessitates a step-up in agricultural production.

Trade and Investment Rules and the Privatization of Knowledge

The international regime must support and enable industrial policies, rather than restrict national autonomy. Trade rules and investor-friendly economic partnership agreements that reduce such autonomy are problematic.

Development is also impeded by current patterns of knowledge generation and dissemination. The privatisation of knowledge and its growing concentration, through the proliferation and enforcement of intellectual property rights, have become significant barriers to the necessary technology transfer and social recognition of traditional knowledge that are so necessary for effective realisation of the right to development. This is evident in terms of access to essential medicines and crucial technologies for food cultivation as well as industrial technologies, and the knowledge required for mitigating and adapting to climate change and associated natural disasters. National and international institutions should provide checks and balances to the privatisation of knowledge and ensure that knowledge is produced and disseminated to meet social goals. Yet such institutions are becoming more fragile and less effective as they increasingly cater to a small elite.
What is PIDA?

The Programme for Infrastructure Development in Africa (PIDA) was adopted by African Heads of State in 2012 as a strategic framework that will run through 2040, for the development of continental infrastructure (Energy, Transport, Information and Communication Technologies (ICT) and Trans-boundary Water Resources). The initiative is spearheaded by the African Union Commission (AUC), the New Partnership for Africa's Development Planning and Coordination Agency (NEPAD Agency), and the African Development Bank (AfDB). PIDA’s main purpose is to strengthen the consensus and ownership of infrastructure development continentally, regionally and nationally to help ensure subsequent successful implementation.

PIDA’s projects are estimated at US $360 billion up to 2040. For its 51 priority projects, the cost estimate stands at US$68 billion from 2012 to 2020, or US$ 7.5 billion in expenditure per year. This article describes PIDA and its relationship with external actors, including new and existing financial institutions.

Background

The African continent comes off a very low base in its growth trajectory. It is still early times to make projections about its future, but there are already signs of resurgence. This article focuses on the challenges of infrastructure as an aspect of development, and more specifically assesses the efforts undertaken by PIDA, African policymakers and external actors to overcome these challenges.

The imperative for increased infrastructure investment in the African continent is self-evident, especially if one takes at face value the proposition that infrastructure can be a catalyst for growth and an input into human capital. Moreover, poor infrastructure creates a competitive disadvantage and adversely affects growth, as it raises the transaction cost of trading across borders, among other things. It is a daunting constraint for landlocked countries, of which there are 15 in the continent. According to the African Development Bank: “Poor infrastructure accounts for 40 percent of transport costs for coastal countries, and 60 percent for landlocked countries.”

There are large-scale projects that are in the PIDA pipeline, which could have negative consequences for environment if they are not underpinned by clear policy frameworks to achieve sustainability objectives.

A major challenge is that, to get the private sector excited about investing in infrastructure, at least, two conditions have to be in place. The first is the existence of “bankable” projects; and the second is security of investment, something that is a function of a country’s legal
framework, especially its ability to enforce commercial law.

In 2012, the BRICS produced about 20% of the $71.6 trillion world output. But, the slowdown of the economic giants is striking.

In addition, infrastructure projects on the African continent require sufficient project preparation to make them bankable, at which point it becomes easier to mobilize financing. The cost of project preparation is estimated at between 3 – 3.5 percent of total project costs. Donors apply their own criteria and preferences before committing to project preparation support; these can diverge from those of the recipient country.

Importantly, throughout the project cycle (including project selection and preparation), the association between infrastructure and sustainable development should not be taken for granted. There are large-scale projects that are in the PIDA pipeline, which could have negative consequences for environment if they are not underpinned by clear policy frameworks to achieve sustainability objectives.

Features of PIDA

PIDA is a worthwhile framework to develop the critical infrastructure sectors, but making it functional will require significant capital commitment, greater coordination amongst various actors (including affected community stakeholders), and a private sector that is convinced of the viability of structure.

Commercial viability hinges on the effectiveness of public-private partnerships (PPPs). Among other things, a clear and transparent regulatory framework; good governance policies; and prevailing stability set the stage for a conducive business environment.

The core principles that guide PIDA include: an integrated vision of infrastructure sectors; regulatory and institutional frameworks; a strategic prioritisation of programmes; regional capacity for programme development and implementation; innovative financing architecture oriented to the private sector; and stronger partnerships and coordination. Harmonisation of national policies is also important if there is to be a consistent standard applied across the African continent for implementing and evaluating infrastructure projects. However, this will not be without difficulties given the weak record of institutionalization in the regional economic communities of Africa.

Nonetheless, it remains important that African governments champion greater sensitivity to environmental and social

PIDA’s Energy Ambitions and the Case of Ruzizi III

Two-thirds of Africa’s 800 million people lack access to power. For power generation, PIDA comprises 15 projects worth US$ 40 billion focused on building 12 hydropower facilities, 4 transmission projects connecting power pools, and 2 regional oil pipelines. These projects would increase the continent’s power capacity by five-fold.

An example of a promising project is the Ruzizi III hydropower project located on the Ruzizi River that flows between Lake Kivu, which borders the Democratic Republic of Congo and Rwanda, and Lake Tanganyika in Tanzania. The cost of the 145 MW plant is estimated at US$400 million – US $600 million. As is well-known, for over two decades this part of Sub-Saharan Africa has existed under a cloud of internal and cross-border tensions that took on ethnic dimensions.

This is also an area that has high poverty levels, with countries that are characterised as “least-developed.” Using low-cost renewable resources such as hydro-power and geothermal energy could go a long way in expanding energy access to citizens, but also hold promise for economic growth. It is also hoped that this form of economic cooperation over a resource that is vital for the three countries will act as a pivot for stability.

This hydropower plant generates electricity in equal portions for Rwanda, Burundi and the Democratic Republic of Congo (DRC). Like many large-scale projects, this is not without risks. One such risk is political instability, especially because the project falls within a politically sensitive area that has a history of conflict with rebel movements still roaming about. Second, there are concerns that the project could have cost inflation that may raise tariffs. If such risks materialize and the government picks up the tab, the risks of this commercial project would, effectively, be socialised.
norms in their projects, rather than having such norms imposed by donors. There is an expressed commitment by African policymakers to address the environmental and social impacts of PIDA projects, including claims that are often not substantiated, e.g., that PIDA projects will lead to reduction in green-house-gas emissions. The reality is that, since projects are undertaken at the domestic level, it is difficult to impose environmental and social measures, especially in contexts where there are no governance mechanisms (institutions or regulations) to ensure such co-benefits.

**External Actors and PIDA**

To help fund PIDA, the new Africa50 initiative, a commercially-oriented financial institution, aims to mobilize equity investments of USD 10 billion, thereby attracting USD 100 billion of local and global capital to finance and develop PIDA and related projects in the next three years. The EU, the G8, the multilateral development banks, and the G20 make constant reference to PIDA, and some offer direct financial support. Some aspects of this support include:

European Union (EU). There is a shift of emphasis in the character of EU’s developmental support to Africa more towards infrastructure, with the social sector still remaining an important dimension.

Group of 8. Commitments through the Infrastructure Consortium for Africa (ICA) have been made by the G8 countries as well as institutional members, such as the World Bank Group, the European Commission, and the European Investment Bank. ICA members have decided to focus on implementation of PIDA’s medium-term Priority Action Plan (PAP).

Group of 20. The G20 too has positioned itself for relevance on the theme of infrastructure, which has gained currency in low-income countries in Asia and Africa. A High Level Panel on Infrastructure was mandated by the G20 countries at the 2010 Seoul Summit, where Leaders adopted a development agenda under the theme of 'shared and inclusive growth,' including an infrastructure pillar. At the 2011 G20 French Summit, the Report of the High Level Panel and the MDB Action Plan were presented to Leaders. Today, under the G20 Australian Presidency, the challenge is being addressed by two G20 groups: the Infrastructure Investment Working Group and the Development Working Group (DWG).

Since the G20 High Level Panel made its recommendations, the G20 has worked to promote a strong supply of bankable projects as well as mobilize long-term institutional finance to develop infrastructure in its member countries as well as low income countries. The multilateral development banks took up an important recommendation – namely to review existing project preparation facilities (PPFs). The Australians’ Global Development Agenda states that, in 2014, the G20 will expand its assessment of PPFs. The assessment of Africa’s PPFs, entitled “Tunnel of Funds,” was concluded in 2012.

The multilateral development banks and the Panel also recommended improving the quality of data relating to infrastructure development projects and bringing project sponsors and financiers together in the way that the Sokoni platform does.

Such capacities facilitate an improved flow of information, but they may be difficult to realize if the actions of individual governments are not reliable.

**The BRICS and Infrastructure Development**

At the BRICS Summit hosted by South Africa on 26 – 27 March, 2013, Leaders promoted the creation of a BRICS development bank in order to facilitate infrastructure and sustainable development and the creation of a contingency reserve arrangement (CRA). This BRICS development bank may play a pivotal role in financing infrastructure projects in other developing countries, especially on the African continent. South Africa could possibly pressure its Summit partners to support PIDA.

The architecture of the bank is not yet clear. It is expected that the work of the BRICS development bank and the CRA will begin in earnest after the Sixth BRICS Summit in Brazil in July 2014. According to Russian officials, the Bank’s draft charter is being prepared by Brazil while Russia is drafting an intergovernmental agreement on the bank’s creation.

The bank is not intended as a substitute for the work already undertaken by the World Bank and other regional development banks. Indeed, in 2014, the World Bank will launch a Global Infrastructure Facility and regional banks will further re-orient their portfolios to finance infrastructure. Rather the proposed BRICS development bank aims to complement multilateral development banks, especially to fill in key deficiencies in infrastructure development.

It will not bode well for Africa’s development to have multiple uncoordinated or even competitive infrastructure efforts. What may compound the challenge is the fact that individual BRICS countries, such as China and India, already pursue relationships with African countries at a bilateral level, using a model that cannot be easily replicated at the regional level.

**Conclusion**

There is no doubt that the African continent requires a significant drive for infrastructure development. There is a recognition that infrastructure can in fact create conditions that could allow...
governments to tackle social and economic challenges.

Yet, if there are no policies or governance mechanisms in place (at the regional and domestic level) to ensure that infrastructure projects are undertaken with greater sensitivity to environmental and social inclusivity and that benefits are harnessed towards improving quality of life, this endeavour could very well turn out to be a bane for the continent.

1 See Table 1: PIDA stakeholders from the PIDA official site at: http://www.pidafrica.org/about_us.html


3 African Development Bank, Africa in 50 Years’ Time, p.87.


6 A detailed account of the project including technical specifications can be found here: Ruzizi III Hydropower Project., Number E. 12.1.


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