National Planning Commission (NPC), Government of Nepal, and
United Nations Economic and Social Commission for Asia and the Pacific (ESCAP)

Policy Dialogue on Infrastructure Financing Strategies for Sustainable Development in South and South-West Asia

Chair's summary

The policy dialogue on Infrastructure Financing Strategies for Sustainable Development in South and South-West Asia, organized jointly by ESCAP and the National Planning Commission, Government of Nepal, was held on 25-26 January 2017 in Kathmandu. The policy dialogue was attended by high-level officials from Ministries of Finance, Planning and Economy, as well as PPP Units, from nine different countries. The event also benefited from the expertise of experts from the private sector, representatives of multilateral development bank, central bank and securities board among other stakeholders. To support the discussions, a sub-regional study was prepared and circulated to the participants ahead of the event.

The policy dialogue was addressed by honourable Mr. Krishna Bahadur Mahara, Deputy Prime Minister and Minister of Finance and members of the National Planning Commission among other dignitaries from Nepal.

The policy dialogue observed that South and South-West Asian countries do suffer from wide infrastructure gaps and closing them require resources of huge magnitude. In addition, the region's rapid economic development and urbanization create demand for more infrastructure services and put pressure on existing assets. The participants agreed that such combination of infrastructure gaps and additional demand calls for more investments. It was also highlighted that simply building more infrastructure assets is however not going to solve the region's development challenges unless these investments are better aligned with the 2030 Agenda for Sustainable Development. This means that infrastructure development has to be inclusive, climate-friendly, resilient and forward-looking.

Participants then reviewed the possible strategies to address these financing challenges and some of the issues and key recommendations that came up in the discussion included the following:

Partnering with the private sector

The participants recognized that Governments have to effectively involve the private sector for infrastructure development, which requires creating a conducive environment for Public-Private Partnership (PPP) and a strong commitment from high-level policymakers. In this regard, country representatives presented their recent initiatives to develop enabling policy, regulatory and institutional frameworks, which can facilitate the emergence of PPP projects. Participants also exchanged best practices related to the different project phases, namely the preparation, procurement and monitoring stages. Participants also noted with interest the different tools developed by ESCAP to support countries in assessing their PPP environment, selecting the right projects for PPP and building internal capacity. Several PPP projects from the region were also presented and lessons learnt from these practical experiences. It was highlighted that public financial support is sometimes required to make some projects financially viable and instruments have been developed for this purpose (for example project preparation facility, viability gap funding and guarantee mechanisms). PPP liabilities related to government guarantees have nevertheless to be carefully assessed and monitored to ensure fiscal sustainably.

Mobilizing domestic resources

The participants discussed in this session the challenges facing the sub-region in improving the role of the public sector in infrastructure financing. It was highlighted that there is considerable scope to improve the collection of both direct and indirect taxes by raising rates, rationalizing exemptions and improving collection efficiency as South and South West Asia has one of the world's lowest tax revenue levels. Some of the political economy challenges associated with tax policy were highlighted. The participants also debated about another important area of public revenue collection and expenditure, which is the subnational/city level. This level was found critical due to the large demands being made on public services by rural-urban migration and the efficacy of various revenue generation tools at the subnational level, such as property taxes, was discussed. It was also pointed out that there are considerable new sources of public financing for countries in the sub-region emerging with the entry of new multilateral development banks such as the Asian Infrastructure Investment Bank and the New Development Bank.

Improving public expenditure efficiency for infrastructure development, including gender-responsive planning

The session benefited from the discussion of many country experiences and the participants outlined practical ways to improve the efficiency of public spending in infrastructure, which can lead to significant savings, of the magnitude of 15 to 35 percent according to different studies.[1] For instance, this could be done by enhancing project selection, ensuring adequate maintenance and optimizing the use of infrastructure assets. It was also explained that there were innovative infrastructure financing solutions in many countries but the challenge lay in converting plans into effective implementation. The participants also discussed the need to strengthen the balance sheets of State-Owned-Enterprises through the introduction of marked-based pricing strategies.

The participants also recognized that infrastructure projects cannot be assumed to deliver benefits to men and women equally and that some sectors tend to benefit more women, such as water and health, compared to road. To be successful, projects need to take into considerations gender specific needs (e.g. safety considerations, different usage patterns, etc.) and gender has to be mainstreamed in infrastructure development, for example through gender involvement and consultation. It was also pointed out that public sector policies with regard to infrastructure were increasingly taking account of sustainable development concerns in terms of both social and environmental policies.

Tapping financial markets & institutional investors

With more investments needed, the participants also noted the need to find solutions to boost the financial resources available. While the finance sector is dominated by banks, the participants highlighted that banks' long-term lending is constrained following stricter regulations, maturity mismatches and credit limits. Therefore mobilizing resources from local and foreign institutional investors, such as insurance companies and pension funds, was considered promising although capital markets remain largely underdeveloped in the sub-region. Developing such markets should thus be a priority. In this respect, it was explained that some countries are discussing with multilateral development banks the issuance by these institutions of local currency bonds in domestic and international markets. Other country initiatives were also presented such as the idea of establishing a green financial system (including green equity indexes, ratings and bonds) as

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[1] Such studies include IMF (2015), making public investment more efficient, Staff Paper, June 2015 and McKinsey & Company (2013). Infrastructure productivity: How to save $1 trillion a year. IMF paper compares the value of public capital (input) and measures of infrastructure coverage and quality (output) across countries reveals average inefficiencies in public investment processes of around 30 percent.

well as the creation of financing instruments such as infrastructure debt fund, tax free infrastructure bonds, credit enhancement schemes and Infrastructure Investment Trust that channel funds to infrastructure development. It was also mentioned that introducing credit rating system that reflects the unique nature of the infrastructure sector and aims at better risk-based pricing have the potential to open up long-term funding. The participants also recognized that regulatory limits to institutional investors might prevent them to channel their resources to long-term infrastructure projects and that reforms might be needed to address this issue.

Climate finance landscape

The session provided a comprehensive overview of the different sources of public and private climate finance sources. It highlighted the role of the development finance institutions in delivering the bulk of public climate finance, in particular, development finance institutions and their role in channeling adaptation and mitigation funding. Many national DFIs have further potential to increase their investments into the low-carbon, climate resilient transition and have the advantage that they are anchored to countries' national development planning processes and priorities.

Despite being very small in the larger picture of public international climate finance, international climate funds are an important source of grant-finance for the most vulnerable countries. Many funds are increasingly prioritizing adaptation investments. Grant finance is in extremely limited supply and should therefore be used carefully, preferably not to standalone projects but to help leverage other sources of finance. There is also a need to target grant finance to priority investments that might not otherwise receive funding, especially those that suffer from higher investment risk, or do not have sufficient revenue streams to attract private sector involvement.

The Green Climate Fund (GCF) is expected to become the main financial instrument for delivering on the Paris Agreement. The session covered the six investment criteria that the GCF has set, including to promote a paradigm shift towards low-emission and climate-resilient development. Its unique features include direct access to maximise country ownership, a designated private sector facility to catalyse private funding, and a large range of instruments including grants, debt, equity, and guarantees. The process and progress of accreditation was discussed, including its fit-for-purpose features which provides a flexible structure to respond to different needs by institutions seeking accreditation and adjusts the fiduciary requirements accordingly. For the subregion, a few strategic areas were identified. These were energy generation and access, transport, buildings and cities; and increased resilience of agriculture, infrastructure and the built environment. Examples were provided for the different financing instruments, as well as a thorough analysis of the GCF pipeline and emerging trends. The important role of country programming as an entry point to accessing the GCF funding window was emphasised, as well as the supporting role of readiness funding and the project preparation facility.

The International Finance Corporation (IFC) presented a number of innovative project financing models such as the YES Bank green bond, the China Green Finance Program (CHUEE)-Risk Sharing facility, the Kabeli Hydroelectric Project (KAHEP) Nepal-Blended finance and the weather index insurance in Sri Lanka. During FY2011 to 2015, the IFC has made climate investments of $1.3 billion. Almost half of its investments have targeted renewables or green buildings, while another quarter has been aimed at providing credit lines. Future priorities for IFC investments in the subregion were identified as cities, adaptation, green buildings, energy efficiency and renewable energy.

Role of private sector in climate finance

The role of private sector climate finance is potentially much larger than that of the public sector. This requires action on a number of avenues, including through commercial banks, central banks, the securities and exchange commissions, corporate governance, the insurance sector, institutional investors and also necessitates policy coherence and sector reform. The subregion slowly embracing different initiatives, for example, disclosure and reporting by companies of emissions in their production processes as well as in their value chains, mandatory portfolio targets for commercial banks to invest in low-carbon climate resilient projects, the emergence of sustainability indices and benchmarking to better track investments, voluntary fossil fuel divestments of large institutional portfolios and their reorientation towards more sustainable investments, etc. Green bonds are also an instrument gaining momentum in the subregion. These have been overwhelming focussed on the transport and energy sectors, but also have potential for adaptation investments. Green bonds are expected to play a crucial role in tapping into the wealth of institutional investors, such as insurance companies and pension funds. This growth needs to be supported by providing high-quality guarantees to issuers to ensure investor confidence and unlock cross-border flows. Additionally, domestic capital can be mobilized through demonstration issuance of domestic green bonds by public sector entities and banks as well as through regulatory reforms that lower restrictions on green bond investments.

Regional context of climate finance

Four countries – Cambodia, Bangladesh, Sri Lanka and Nepal – highlighted the large losses to their economies associated with climate change impact and disasters, showcased the progress they have made in developing their climate change governance systems, in mainstreaming into national development plans and budgets, novel public finance instruments employed, and highlighted areas for future work and for capacity building. All four countries have institutionalized climate change policymaking within their domestic structures, in some cases creating very high-level policy commissions that help to prioritize this agenda, review climate change investments and allocate funds to priority projects. Bangladesh presented its climate change trust fund, a funding vehicle to implement its strategic climate change policies. Nepal focused on the findings of its Climate Public Expenditure and Institutional Review (CPEIR) in 2011, which has helped to integrate the climate change agenda into its medium-term expenditure process. Nepal established climate coding and specific criteria to achieve a climate responsive budget. In fiscal year 2016-7, it allocated approximately 19 per cent of its budget to highlight relevant or relevant climate investments.

Climate finance: way forward