# How do differing contexts of fragility have an impact on private sector infrastructure investment?

*ICED Facility*

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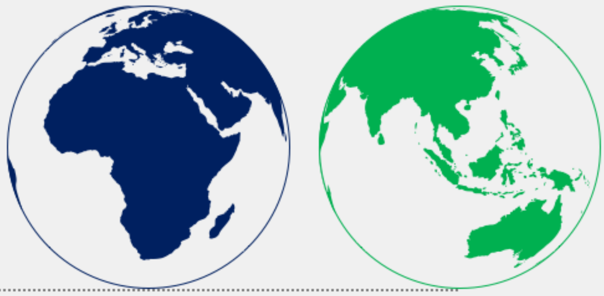
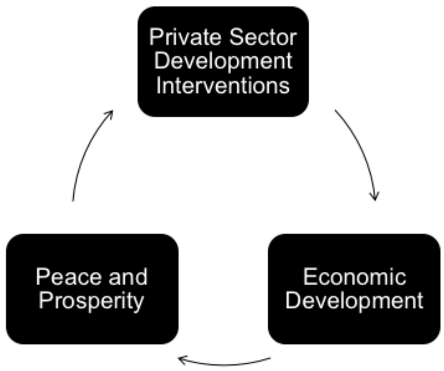


## *Conceptual Framework*

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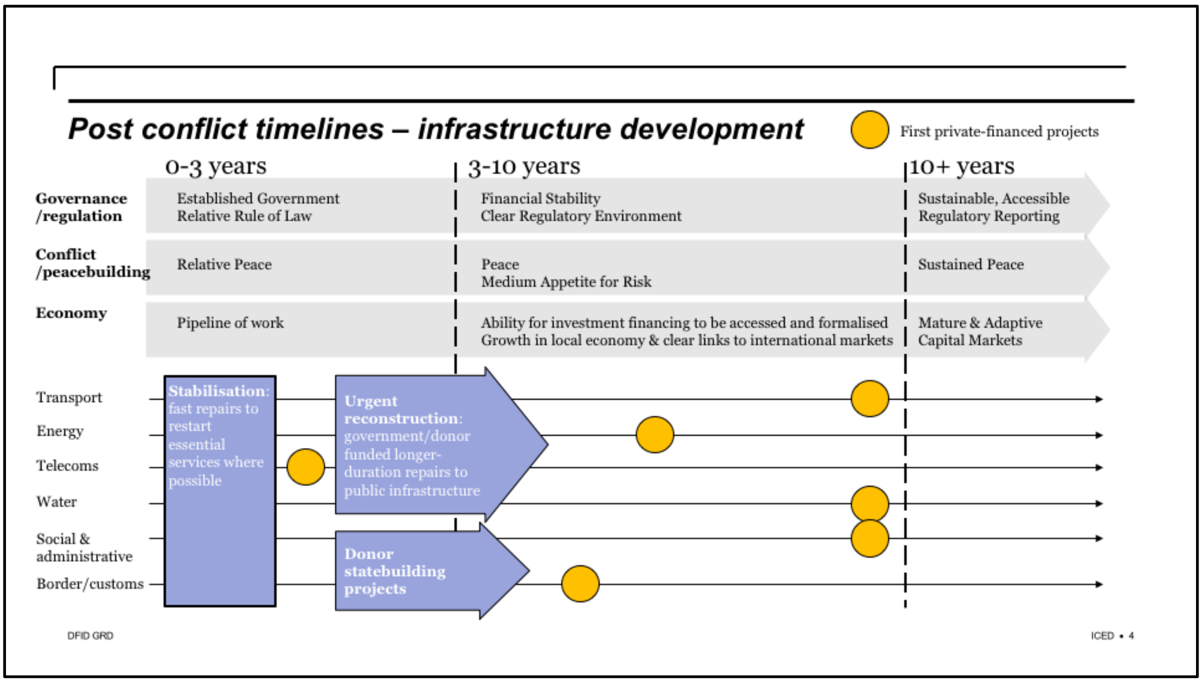
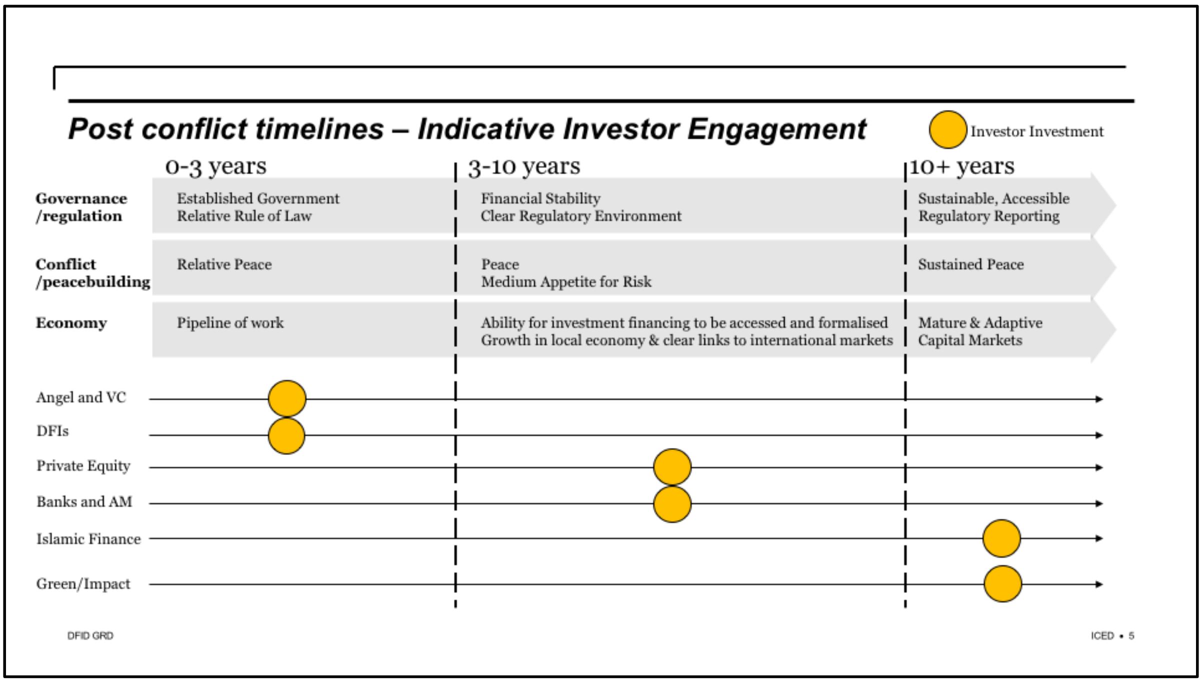
## *Broad types of conflict and fragility for infrastructure investment*

- **Post-conflict reconstruction**:
  - Immediate post-conflict (0-3 years - repairing essential services, state-building, peace-building)
  - Long-term reconstruction of major infrastructure which cannot be fixed quickly
- **Post-conflict development of <u>new</u> infrastructure**
  - Developing infrastructure and systems from a low base after a conflict ends. Basic development and reconstruction are qualitatively different challenges.
- **Building infrastructure in chronically fragile states**
  - Long-term economic mismanagement accompanied by fragility and conflict with no clear inflection date when recovery and development begins.
  - Requires specific remedies for political, regulatory, financial and conflict risk – patches for individual projects and/or initiatives promoting systemic change.
  - Includes building infrastructure to **counteract destabilisation which may lead to conflict** (e.g. Jordan, Nigeria, OPTs).



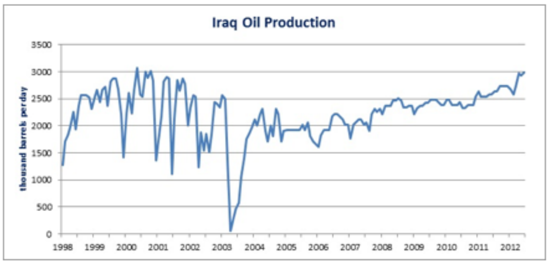

Very few modern conflicts conform to this kind of timeline. Far more common is a mixed picture where some parts of the affected country/ies and some sectors are more able to recover than others. This slide is intended to illustrate that even under ideal conditions, private-financed infrastructure projects are still some years away even after a sustained reduction in levels of violence (such as following a peace settlement).

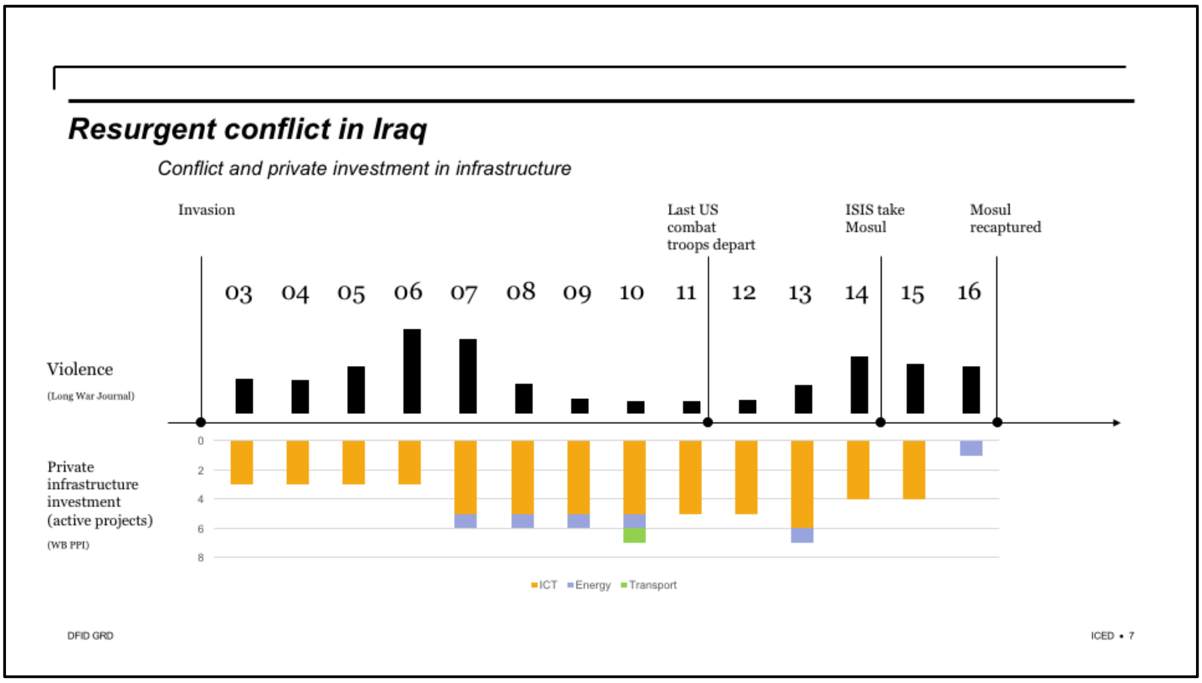



As for previous slide: this timeline expresses what is possible under an ideal situation where a conflict can be said to end at T=0. A more likely scenario is one of many much more complex conflict trajectories. The message is merely that policymakers should distinguish between investor types in early post-conflict stages, acting within the bounds of what is possible.

## ***Iraq*** *– post-conflict and resurgent conflict*

- Iraq's economy is dominated by the oil and gas industry, which has knock on effects on public finances and productivity, as hydrocarbon revenues (90% of government revenue) have been used to expand the public sector (43% of all employment, 40% of government expenditure).
- Oil production was barely affected by the resurgence in conflict in 2013 due to the government prioritisation and the ability of large private producers to mitigate conflict risks.
- In the immediate aftermath of the US invasion, there were 3 separate private investments in telecommunications networks *before the end of the year*. The re-establishment of telecoms networks in Iraq was reportedly nearly unaffected by violence, with providers citing land rights and regulatory decisions as the primary constraints. While insurgents attacked transport and electricity networks, cellphone towers were deliberately undisturbed






Note 1) the preponderance of ICT projects and very few projects in other sectors; 2) inverse relationship between projects and violence; 3) energy projects mainly in Iraqi Kurdistan, where violence levels lower. Caveats: investment data reported to WB, may be incomplete; causal relationship implied but graph alone is not strong evidence.

## ***Barriers to Investment***

FCAS are challenging markets for private sector investors and tend to lack clear and effective policy in four keys areas. The lack of clarity in this four areas makes it difficult for the country to attract sustainable investment from the private sector.

| Security and Stability | Finance and Infrastructure |
|---|---|
| Lack of security<br>Lack of macroeconomic stability (forex, interest rate, etc.)<br>Inability to ensure contract enforcement<br>Incoherent Land rights/private property law | Lack of access to affordable finance<br>Undeveloped financial markets<br>Lack of access to utilities<br>Limited transport and communication infrastructure |
| **Markets and Employment** | **Regulatory Framework** |
| Lack of functional local markets and value chains<br>Lack of access to sustainable labour force – formal and informal<br>Lack of access to skilled labour – technology gap | Incoherent tax and custom administration<br>Incoherent governance of business administration (licenses, registration) |

## *Creating an Enabling Environment for Investment*

Within each FCAS there will be varying degrees of difficulty in addressing these areas. In order to tackle the issues outlined above, donor programmes should aim for the following:

- **Analyse the drivers of fragility/conflict and incorporate into project design and implementation**
- **Empower local private sector by addressing their primary concerns**
- **Start with short, small projects and build off their success**
- **Identify sectors that have high potential for development results for country, i.e. comparative advantage**

## *Creating an Enabling Environment for Investment*

Therefore, donor engagement with FCAS should be locally informed and owned and should aid an enabling environment through the following initiatives:

| Security and Stability | Finance and Infrastructure |
|---|---|
| Supporting reconciliation efforts with conflicting parties<br>Supporting early stage investment climate reform<br>Supporting governments efforts to address expropriated land<br>Supporting to backlog of arbitration and dispute settlements | Supporting micro finance initiative to later be connected to centralised banking framework<br>Providing financial support directly to infrastructure projects along with TA<br>Supporting efforts for local currency financing of infrastructure |
| **Markets and Employment** | **Regulatory Framework** |
| Supporting short-term efforts for public financing of projects<br>Supporting an evolution from informal to formal employment<br>Supporting local enterprise and linkages with multination companies<br>Training local business to adapt to new regulations/licensing | Focusing on PEA when seeking to integrate PSD initiatives into government reforms<br>Engaging in upstream capacity building within the government<br>Encouraging the development of business associations and regular dialogue between them and the Government |

## *Creating an Enabling Environment for Investment*

The success and failures of economic development projects within FCAS has found that, in general, the following issues were present within the projects:

- **A lack of sound analysis of the capacity available for investment climate reform**
- **Lack of inclusion of local private sector in sounding out what reforms were most critical at the time and/or what kinds of technical assistance are required**
- **Poor analysis of the amount of time required – reforms for a government where many things are broken and need fixing take time. These reforms could not be achieved in 2-3 years**
- **Lack of sufficient government support for investment climate reforms**
- **Failure of design to include sustainable measures, such as enforcement of reforms**

*The Effectiveness of Private Sector Development Interventions in Fragile and Conflict-Affected Situations: Evidence from Evaluations*, IFC, World Bank Group, Development Impact Department, November 2016

## *Conclusions*

Donor programmes should focus on:

- **Restarting the functioning of government institutions and re-establishing their legitimacy**
- **Supporting locally informed and sensitive private sector engagement**
- **Ensuring that new flows of finance do not re-entrench the structural factors that lead to the country's fragility or conflict**
- **Supporting finance mechanisms and instruments that encourages local, private sector investment in infrastructure projects**

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## *Country Cases*

## **Somalia** – *chronic instability, violence and state failure*

Somalia has been in a state of active civil conflict since 1991 and an end to the conflict is beyond reach in the medium term. Tenacious governance problems make traditional donor statebuilding difficult or impossible.

What public infrastructure existed following colonial independence has been significantly degraded or destroyed. Where infrastructure and related services do exist, they are patchy and mainly provided by the private sector and NGOs, at a local level, and in urban areas. AfDB estimates that $3.8bn of infrastructure investment is needed over 10 years, of which only a small fraction is thought to be feasible under current conditions.

In this chronically unstable environment, the local private sector has developed interim solutions to infrastructure deficits. Private companies provide electricity and water in urban areas where public supply is lacking. The **telecoms** sector has been regularly cited as far back as 2005 as a success story in Africa, with a lack of regulation and low barriers to entry fostering a competitive local market in mobile communications.

However, there is a limit to the size and scope of private infrastructure provision in this environment and private services without public investment result in higher costs to consumers, braking economic growth. International investment is lacking and focuses on export infrastructure such as ports (there is also early interest in off-shore oil and gas potential). Legal and regulatory risks as well as a poor security environment prevent investments in large assets in energy, transport and other sectors. Regulation – e.g. the new Communications Act (2017) – will support investment, but the Federal Government needs to demonstrate that it can implement regulations and enforce the rule of law before significant investment will be unlocked. Such tasks are significantly harder for transport, energy and water than telecoms. "***Since telecoms operators are the first to arrive, the ability of the government to demonstrate good contractual faith and establish an appropriate regulatory framework can have a powerful demonstration effect on other investors."*** *– WB 2004*

Until Somalia's government can show that conflict is under control and governance and rule of law are improving, any investment in major infrastructure projects will come from donors and development banks. This itself will be restrained until there is evidence that Somalia can raise and competently manage sufficient revenue to support any new infrastructure. In the interim, small-scale local solutions will fill the gap. Solar energy, rural water resource management, mobile telecoms and other 'cellular' infrastructure can have a direct impact (especially social) and be supported by donors where major infrastructure is unfeasible.

## **Myanmar** – *Energy Market Reform*

Myanmar is a resource rich country, but its economy is one of the poorest and slowest growing in East Asia. The economy lacks an educated workforce and suffers from inadequate infrastructure. Railways have had few repairs since their construction, most highways are unpaved, and energy shortages are common, even in the major cities. These issues are driven by the decades of stagnation, corruption, isolation, and civil war.

Electricity is an infrastructure sector that has been identified as a development priority by the government and its development partners. Over 84% of households in rural Myanmar have no electricity connection, creating hardship, perpetuating poverty, and stalling development. The Government of Myanmar has recently sought to open its energy market and create a formalised process of contracting energy providers. Currently, only 30% of Myanmar's population is connected to the electricity grid while candles and batteries offer dim light, limited lifespans and eat up a large fraction of daily income for many rural households.

The Government of Myanmar, with the help of international partners, have developed a National Electrification Plan to provide an action plan for the sector with aim of encouraging private sector investment. Through this Plan, the Government and international donors are currently rolling out off-grid electricity services and installing solar PV systems in eight of Myanmar's states and regions, benefiting over 2,000 villages and 140,000 households.

Due to the lack of a recent track record for private sector led initiatives, it is essential for government/DFI sponsored initiatives to provide sufficient financing to decrease the risk for private sector investors. In terms of electrification, one of the primary areas that DFID programmes could offer support is by providing grant funding to cover the cost of feasibility studies for private sector investors as they being to establish a business case for investing in Myanmar's energy market. In addition, while many investor perceive Myanmar's energy sector as a growth market, to generate sizeable private sector investment in the energy sector there is still a need for continued business engagement to address governance issues that hamper private sector investment.

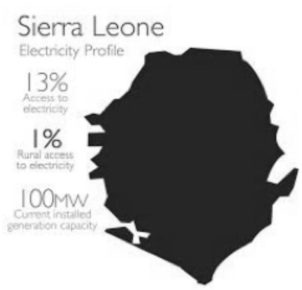
## ***Sierra Leone*** *– Power Generation after Civil War*

Sierra Leone was already one of the world's poorest countries when a devastating 11-year civil war began in 1991. The war destroyed most of the very little infrastructure that existed in the country in the late 1980s. Since the end of that war in 2002, the country has made significant progress, particularly within the extractives sector. However, roads and power generation/distribution are inadequate, plus the country struggles with low professional capacity in government, poor public financial management, governance issues, and extreme sensitivity to global economic downturns.

While Sierra Leone is considered to be more stable politically than other post-conflict, near country comparators, such as Cote d'Ivoire, Guinea and Liberia, it's level of investment still suffers from private investors perception that any investment in the country is susceptible to both micro and macro economic risk.

The chronic lack of power and poor condition of its road network have been the focus of the Government of Sierra Leone. Efforts are being made to increase the countries hydropower supply and encourage private sector investment into the country, however, due to the current constraints only relatively large private sector investors and DFIs are willing to invest in such a risky environment.

In order to address the constraints on private sector investment, capacity building and support within the local Government is necessary. The process of embedding advisors into local ministries would enable knowledge transfer and provide the Government with internal expertise when engaging with private sector investors and developers.



## **Nigeria** – *Developing Local Capital Debt Markets*

Nigeria is a fragile state that has been struggling to meet an enormous demand for the delivery of infrastructure services to the vast majority of their constituents. The country has relied on its oil production to manage it's power supply, but due to the recent devaluation of the oil price this has reduced the amount of funds that the Government has to invest in the energy sector.

The Government has sought to encourage private sector investment in the energy sector to increase the supply of energy to the local economy, however, one the primary constraints to private sector investment in Nigeria is a lack of access to finance. The lack of access to finance results in revenue shortfalls for investors and makes it impossible to make the capital investments that are required to increase energy production and distribution.

In order to tackle the lack of power supply and provide sustainable investment, access to finance, guarantees and locally financed debt, need to be enhanced. Currently, financial situation of eleven of the countries distribution companies are poor. This, coupled with their highly-leveraged balance sheets, severely constrains their ability to access commercial financing. The lack of access to finance further constrains their ability to undertake the necessary investments to increase their reliability and reduce their losses.

Programmes supporting access to guarantees, such as those currently supported by the DFID-supported Private Infrastructure Development Group, will encourage further investment in Nigeria's energy market and enhance the quality of local currency debt instrument issued by local companies and state governments. However, continued support to the Nigerian government and the energy sector will be required as the Government seeks to further mobilise private sector investment along the entire value chain with it's reforms with the Power Sector Recovery Program.

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