

# Strengthening the Role of Private Finance in Infrastructure Development in Eastern Partner Countries

KEY FINDINGS AND RECOMMENDATIONS





## **ABOUT THE REVIEW**

The review seeks to provide the countries in the Eastern Partner (EaP) region with evidence-based analysis to help them more effectively and efficiently mobilise private finance to address the twin challenges of upgrading existing infrastructures and developing new infrastructure that can underpin sustainable and inclusive growth.

To this end, the review provides a comparative assessment of investment needs and priorities, the capacity of financial systems, as well as legal and regulatory framework conditions. The results are based on a comprehensive assessment, completed by the six governments of the EaP countries between January and September 2020.





## **OVERVIEW**

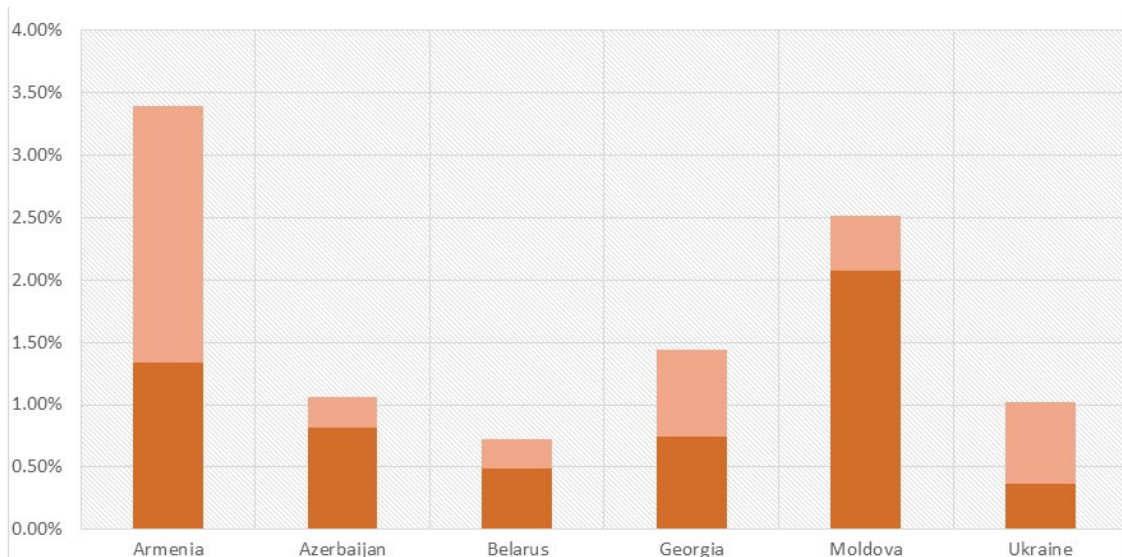
Given the scale of infrastructure investment required over the coming decades, the six Eastern Partner (EaP)\* countries, like most countries around the world, are seeking more effective ways to mobilise private finance for infrastructure development. Strengthening the role of the private sector in infrastructure offers an opportunity to scale up investment in quality infrastructure and help realise efficiency gains in infrastructure operations, but it is difficult to achieve. The complex nature of public-private interaction requires considerable attention from policy makers for defining the modalities of private involvement, reflecting fully the long-term fiscal costs and adequately sharing the associated risks between the public and private co-contractors.

\*Armenia, Azerbaijan, Belarus, Georgia, Republic of Moldova and Ukraine

## CHALLENGES

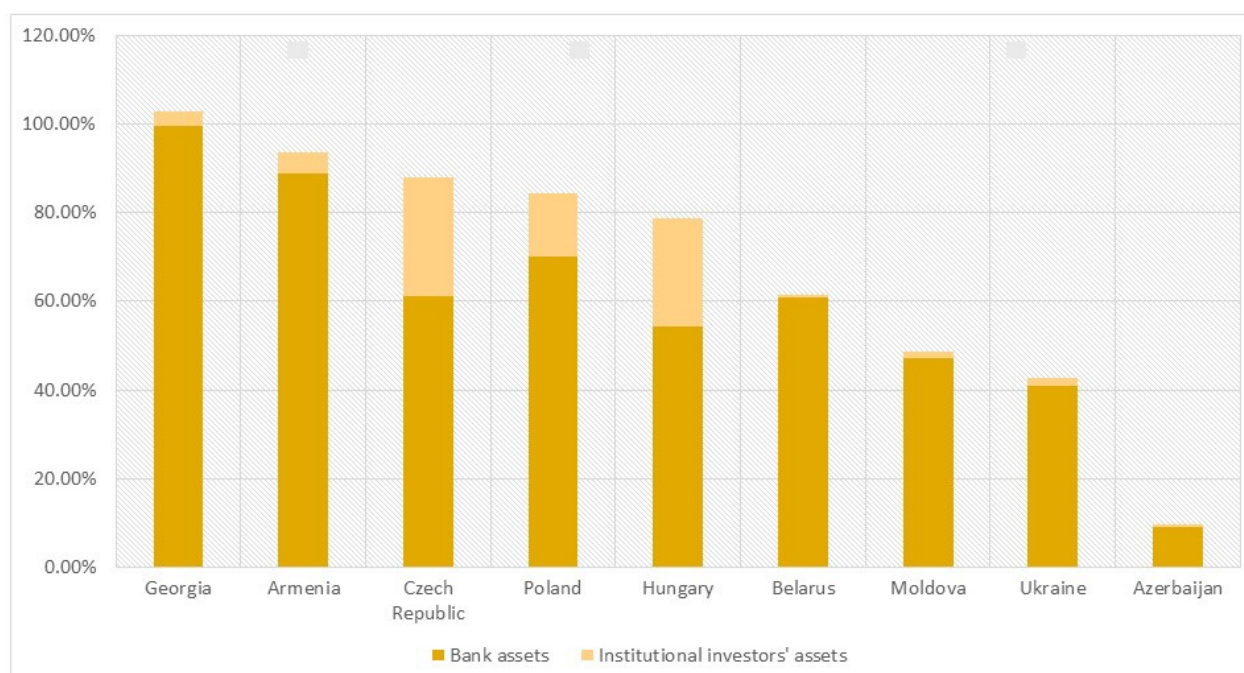
- The EaP countries will need to invest 5-7% of their annual GDP to maintain infrastructure assets and meet their future needs. Current investment levels fall short of 5% per GDP across the region, even when accounting for SOEs.
- Public budgets will not be able to bear the full burden of infrastructure investment needs, especially in the context of the Covid-19 crisis, which has put additional pressure on public finances. The crisis is also likely to complicate access to global capital markets.
- Although the EaP six have well-developed banking sectors relative to market depth, the share of private financing in infrastructure is low. The region only has access to a limited base of institutional investors, equivalent to around 5% of GDP as opposed to 20-25% in Central and Eastern Europe. Regulatory provisions still limit their direct investments into alternative assets, including infrastructure.
- Structural impediments continue to hinder private investment in infrastructure. These include restrictions on FDI in protected sectors and the lack of a level playing field between private/foreign companies or between private firms and SOEs.

**Level of infrastructure investment in EaP countries 2009-2016 annual average (% of GDP)**



*Note:* The dark orange denotes infrastructure investments by the central governments and the light orange investments with private participation. The figures do not fully reflect investments made by state-owned enterprises.  
*Source:* Adapted from (World Bank, 2019)



**Banking sector and institutional investors' assets (% of GDP) in 2019**

*Note:* Institutional investors' assets include the assets of pension funds, insurance companies, and asset management companies.

*Source:* Survey of EaP governments for institutional investors' assets, OECD calculations, IMF figures for banking sector assets.

## OPPORTUNITIES

- Private and foreign investment have boosted the development of renewable energy infrastructure across the EaP region during the past decade. Overall, since 2010, the EaP region has attracted investments close to USD 8 billion into energy infrastructure with private sector participation. EaP countries should work to continue these efforts by integrating infrastructure planning into overall greening strategies.
- The public-private partnership (PPP) frameworks are well established in EaP countries and already widely used in the transport sector. New PPP pilot projects are looking to increase their role in the development of the countries' highway, port and airport infrastructures.
- Bond markets are relatively well developed in EaP countries and the increasing provision of financial instruments like dedicated infrastructure bonds paves the way for further private participation in infrastructure projects especially as the role of domestic institutional investors continues to grow.

## INFRASTRUCTURE GOVERNANCE

Delivering high-quality infrastructure and leveraging private investment to fund it depend on a correspondingly high quality of infrastructure governance and delivery models that offer an acceptable distribution of risk-adjusted returns for public and private partners. The selection of the delivery model depends on the sector, the nature of the specific project and the type of investor. Effective infrastructure delivery models depend on the existence of clearly defined legal and regulatory framework conditions that give all stakeholders predictability and a clear understanding of their respective roles, responsibilities, rights, obligations and expectations.

Even though many EaP countries have set up legal and regulatory frameworks for PPPs, their quality varies widely in terms of preparation, procurement and contract management standards. All EaP countries have set up dedicated PPP units, although a lack of project preparation funds limits their ability to finance feasibility studies and provide information and technical assistance to potential investors.

**IMF Financial Development Index**

	All-governmental infrastructure strategy	Publicly available project pipeline	Dedicated PPP unit	Project preparation fund	National Development Bank
Armenia	Yes	In development	Yes	No	No
Azerbaijan	Yes	No	Yes	No	No
Belarus	Yes	Priority project pipeline part of the infrastructure strategy	Yes	N/A	Yes
Georgia	N/A	N/A	Yes	No	No
Moldova	No	No	Yes	No	No
Ukraine	No	Sectoral pipelines available	Yes	No	No

*Note:* The scores are on scale 0 (least developed) to 1 (most developed). The index is a relative ranking of countries on the depth, access, and efficiency of their financial institutions and markets. The score is an aggregate score that combines the separate Financial Institutions and Markets indexes.

*Source:* (IMF, 2020)



## Recommendations: INFRASTRUCTURE GOVERNANCE

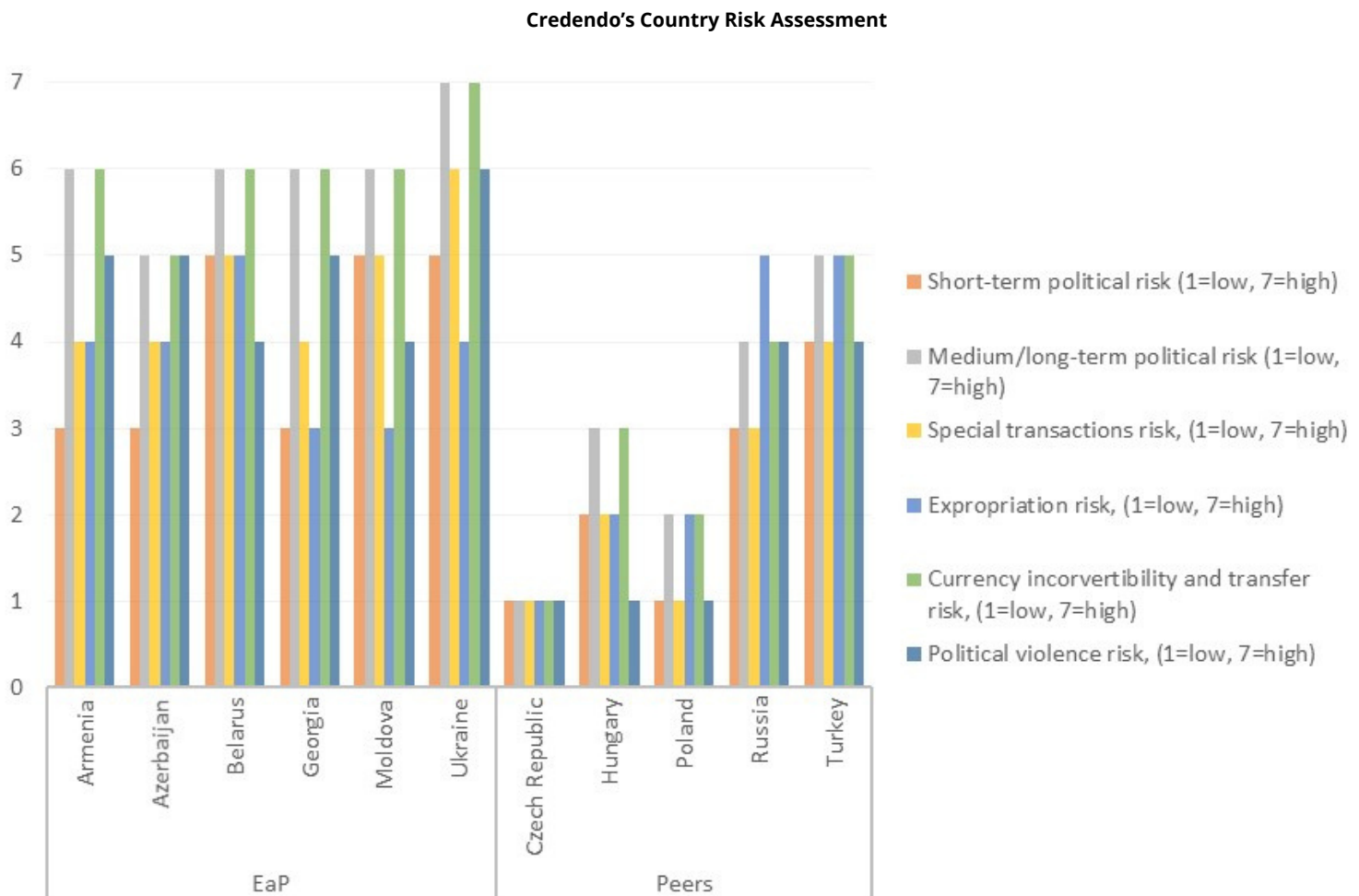
- Refine existing governance frameworks by adopting infrastructure strategies that outline an all-governmental strategic vision for the development of infrastructure across different sectors.
- Existing project pipelines could be improved by merging sectoral pipelines into a frequently updated, publicly available, interactive, central project pipeline.
- Establish project preparation funds to improve the efficiency of infrastructure planning.
- Guarantee that sufficient funding backs project pipelines.
- Ensure that infrastructure project pipelines are aligned with economic development goals and citizens' needs.
- Apply robust evaluation systems to ensure that pipeline projects represent value for money and are environmentally sustainable.
- Enhance information disclosure, data collection and sharing of best practices to improve infrastructure planning.
- Follow OECD principles on the public governance of PPPs, especially regarding the measures to maximise value.
- Plan infrastructure development holistically, following the OECD's key principles for infrastructure governance.



## RISK MITIGATION

Large infrastructure projects are intricate undertakings in any country. Risks can generally be categorised in terms of general market risks associated with infrastructure as an asset class, general country risk, and specific risks and barriers to infrastructure investment in a given country.

The EaP economies are relatively small and vulnerable to external shocks. Indeed, the COVID-19 crisis is the third major economic shock to hit the region in a little more than a decade, following the global financial crisis of 2008-09, and the sharp drops in commodity prices in 2014-15. EaP countries are vulnerable to fluctuating commodity prices, and remain undiversified, in terms of both products exported and trading partners. This creates potential interest- and exchange-rate risks for potential investors, which limits EaP countries' ability to raise long-term financing for infrastructure projects. It is critical for EaP countries to offer risk mitigation instruments, while continuing to diversify their economies and to build an enabling investment environment based on transparent market access, sound competition and strong SOE governance frameworks, as well as the rule of law and an independent judiciary.



Note: Credendo is the export credit agency of Belgium.

Source: (Credendo, 2020)

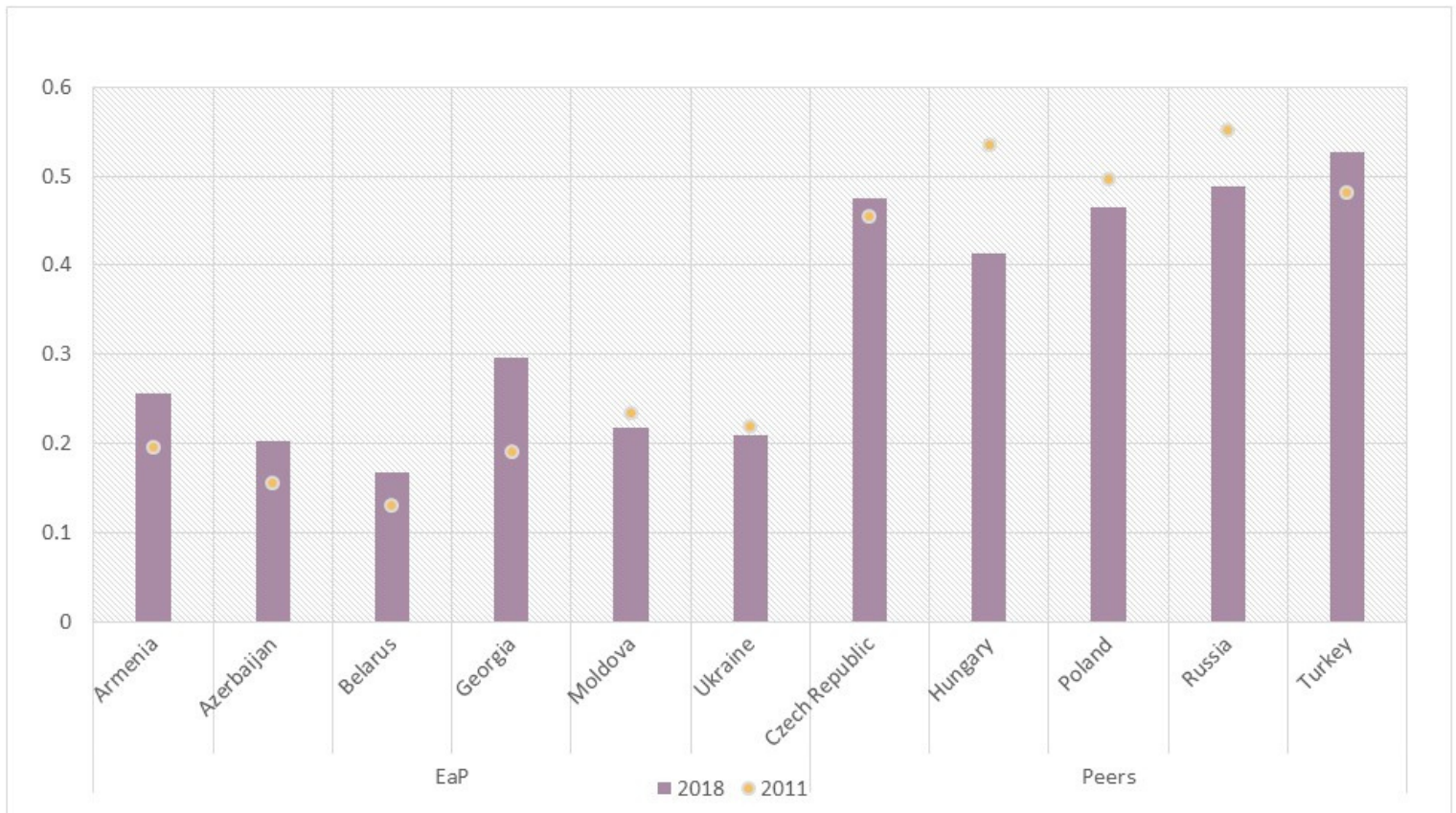
## Recommendations: RISK MITIGATION

- Support alternative infrastructure financing models through the use of financial structures and vehicles that include governmental de-risking instruments.
- Leverage the capabilities of national and multilateral development banks to de-risk projects.
- Make (quasi-)equity contributions with the aim of enhancing financing and risk profiles of infrastructure projects.
- Establish dedicated guarantee funds to support the development of PPPs.
- Set up governance frameworks for project development that enhances the judicious management of commercial, financial and legal risks.
- Alleviate currency risk by promoting local currency investments and hedging instruments.
- Promote blended finance approaches that involve the government, NDBs, MDSs or development finance institutions.
- Alleviate currency risk by promoting local currency investments and hedging instruments.

## FINANCIAL SECTOR DEVELOPMENT

The role of pension funds, insurance companies and asset management firms in the financial markets in the EaP six is still in its infancy, and financial systems remain less developed than those of their peers. Although there is some evidence that the role of institutional investors is increasing, development banks and state-owned banks in particular play a dominant role for infrastructure financing.

IMF Financial Development Index



*Note:* The scores are on scale 0 (least developed) to 1 (most developed). The index is a relative ranking of countries on the depth, access, and efficiency of their financial institutions and markets. The score is an aggregate score that combines the separate Financial Institutions and Markets indexes.

*Source:* (IMF, 2020[62])



## Recommendations: FINANCIAL SECTOR DEVELOPMENT

- Enable infrastructure project companies to list on stock exchanges.
- Support the development of capital market instruments that can mobilise private capital for equity investments in infrastructure projects.
- Set up incentives for promotion of equity investment in infrastructure.
- Establish co-financing instruments, platforms and partnerships for mobilising private capital to invest in infrastructure project equity.
- Consider government equity participation in infrastructure projects.
- Establish government infrastructure development banks or funds that can invest in the equity of infrastructure projects.
- Strengthen the enabling frameworks for syndicated lending.
- Promote the development of a domestic bond market for infrastructure financing.
- Use credit enhancement to attract bigger volumes of private debt for infrastructure projects.
- Diversify funding sources and provide public financial support to enable innovative financing approaches.
- Provide stable, transparent and long-term credible commitments to investors.
- Reallocate taxes between different levels of government to support infrastructure investment.

# OECD WORK ON INFRASTRUCTURE FINANCING

Much of the OECD's infrastructure-related work focuses on mobilising private financing for infrastructure investment. This work stream covers different financing sources and channels, and seeks to identify solutions for enabling private sector participation through diversifying financing instruments, expanding the range of risk mitigation instruments, and mobilising institutional investors, among other things. To this end, the OECD has developed a body of international guidance in these areas, including the [G20 Guidance Note on the Diversification of Financial Instruments for Infrastructure and SMEs \(2016\)](#). The OECD has also supported the priorities of the G20 and APEC through the G20 OECD Task Force on Long-term Investment. The OECD's work on infrastructure financing encompasses blended finance mechanisms and green finance, topics of increasing focus for both policymakers and investors.

## MORE INFORMATION

[www.oecd.org/eurasia/competitiveness-programme/eastern-partners/strengthening-the-role-of-private-finance-in-infrastructure-development-in-eastern-partner-countries-2019-20.htm](http://www.oecd.org/eurasia/competitiveness-programme/eastern-partners/strengthening-the-role-of-private-finance-in-infrastructure-development-in-eastern-partner-countries-2019-20.htm)

OECD's work on private infrastructure financing

[www.oecd.org/g20/topics/infrastructure/](http://www.oecd.org/g20/topics/infrastructure/)

OECD's work on Eastern Partner countries

[www.oecd.org/eurasia/competitiveness-programme/eastern-partners/](http://www.oecd.org/eurasia/competitiveness-programme/eastern-partners/)

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This work was made possible through financial support from the Ministry of Economic Development, Labour and Technology and the Ministry of Foreign Affairs of Poland.



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Labour and Technology



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of Foreign Affairs  
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