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The Development Potential of Extractives and Large Infrastructure Projects

Today, investors are showing considerable interest in large mining and infrastructure projects even in difficult places where conflict, poor governance and extreme poverty collide. Major multinationals are far less shy about investing in challenging parts of the world.

One driver of this change is the need to meet growing demand for raw materials. For example, there are 75 different minerals in every smartphone, and as the number of smartphone sales explodes, the supply of minerals has to expand. Electricity demand is also growing rapidly as countries grow and urbanize, creating new interest in hydro-projects and oil and gas exploration in remote areas.

In this context, large multinational corporations (MNCs) are recognizing that opportunities will slip away if they do not proactively originate and participate in deals. Established firms are now prepared to take on greater risk in the face of competition with firms based in emerging economies and second-tier firms from advanced countries. As Michael Farina, senior manager of strategy and analytics at General Electric International, put it, "When the team first had the opportunity to pitch the Gas-to-Power initiative internally

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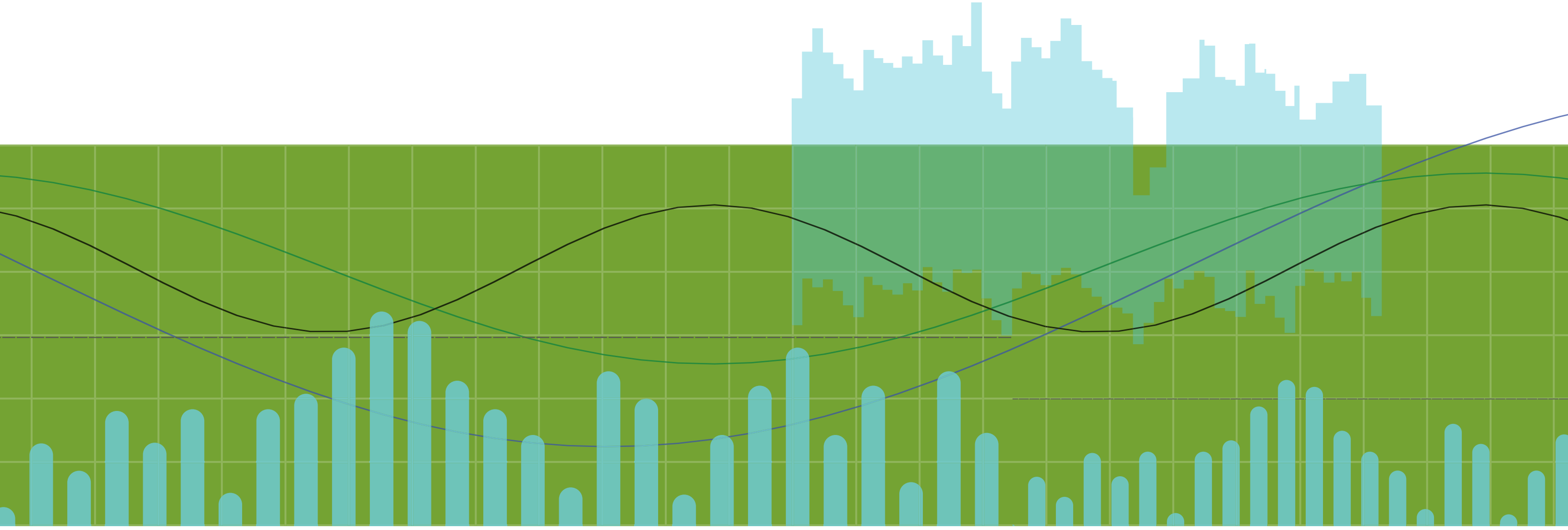
at GE, the initial reaction was 'That is hard, we're not sure we want to do that, we'd much rather just sell equipment in existing markets.' Yet, we have overcome most internal concerns and are now aggressively working on new partnerships and structures to unlock the huge potential for Gas-to-Power in emerging markets." MNCs now have people on the ground to drive deals, and they have more contacts with strong and confident local partners, sometimes from the diaspora community, who can help mitigate risks.

A second driver of change is a readiness by multilateral and bilateral aid agencies to utilize their participation in large projects as an entry-point into a dialogue with governments on specific policy reforms. This is a reversal of the traditional sequencing of donor agency processes that emphasized reforms as a prior condition for investment. Historically, there has been an insistence on the creation of a sound enabling environment for private business, involving improved governance, combating of corruption, and other elements to ease the costs of doing business. But implementing these reforms can take a long time. Many fragile states do not have the political consensus or technical capability to enact and implement reforms in an effective way. And therefore reforms have lagged, and development agencies have become disinclined to support major projects. But without major projects and tangible development progress, fragile states slipped back into conflict or economic stagnation. So a new paradigm has emerged that entails starting with a large project and using its transaction to identify the key reforms that are needed to overcome obstacles faced by the project. This transaction-driven approach has created a more focused dialogue between governments, aid agencies, businesses and civil society organizations.

Three basic questions were discussed at the roundtable. First, how do you get more, and better, deals? Second, how can you improve the development benefits that come from the sizable expansion of resources flowing to the government through such deals? Third, how can you use large deals to encourage economic diversification, capacity building and a further growth cycle? Although there was considerable optimism that global conditions for implementing large deals had improved, there was also a healthy skepticism that all the obstacles could be overcome. As some put it, there is a need to go beyond the "Kumbaya" generalities and to be grounded in the reality of what is actually going on.

GETTING MORE AND BETTER DEALS

The number of large projects in developing countries is growing. The International Finance Corporation is tracking over 20 projects that are worth more than $1 billion and could have a transformative impact in the host country. It is also monitoring some 200 public–private partnership projects in Africa alone, compared with only a handful a few years ago—although, admittedly, many of these projects will not come to fruition. So the ideas are there, but what is missing is an effective organizational structure to bring deals to the finish line.



Organizing Deals

Deals do not happen without "boots on the ground." The roundtable participants frequently returned to this theme. Although there was considerable discussion of the need to standardize contracts and procedures, all agreed that this had to be considered and modified to suit the local context. The "boots" usually need to be on several feet. Thus, development agencies need dedicated staff in the field. Businesses need their own deal drivers, either within a country or regionally. And international nongovernmental organizations (INGOs) need to engage with local civil society organizations.

However, large projects are complex and thus require an organizational structure that brings together many different disciplines, skill sets and partners. Some referred to this as the "systems integrator," a function that requires its own dedicated staff and funding if it is to become institutionalized to deal with more than one project. The systems integrator role is often neglected, but without it a series of large transactions are unlikely to get off the ground.

A practical example of the systems integrator approach is the creation of Power Africa, a platform that organizes U.S. government agencies into a whole-of-government approach to address electricity supply issues in selected countries in Africa. It has been able to break through bureaucratic obstacles that previously prevented the U.S. government from deploying all the instruments at its disposal to solve a problem—grants, guarantees, technical assistance and even diplomatic support for the governments in recipient countries. Power Africa acts like a secretariat for all government agencies where ideas can be exchanged, people can grow to trust one another, transaction teams can be identified, and policies can be developed that different agencies with different perspectives and operating procedures can live with. Because it works in difficult environments, the Power Africa team often works in a way that makes people uncomfortable, but that keeps them focused on moving a specific transaction along.

Other organizations are moving in the same direction. The European Investment Bank has implemented an idea to have four-person "deal teams" for large projects to play a similar coordination function within the agency.

There was a lively discussion about the role that international NGOs could play in this process. Several examples were described of new ways in which INGOs are forming partnerships with MNCs to help them resolve issues pertaining to conflict, local community development and other

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aspects of sustainable development, like water pollution. INGOs have traded staff members with MNCs as a way of forging stronger partnerships and relationships. But successful partnerships will require a new INGO mindset, a switch away from the traditional areas of service delivery and on bringing to light community and local civil society grievances. Instead, INGOs offer platforms for more proactive engagement and broker solutions to disputes between companies and local communities.

Some government development agencies are actively promoting these new forms of partnerships between NGOs and MNCs, believing that when MNCs understand priorities at the local level they can integrate these into project design and mitigate risk. One roundtable participant suggested that a working group among NGOs to derive best practices on community consultations would be useful. Another participant proposed that more foundations and aid agencies support new types of NGO partnerships. Yet another admitted that if a fragile state became a focus country for his program it would keep him up at night.

Some sectors, like mines and minerals, are more advanced in setting up institutional structures to exchange information, set standards and engage in partnerships. The International Council on Mining and Minerals has taken a progressive stance to shed the image of the exploitative mining company. The new Canadian International Institute for Extractive Industries and Development could become a world-class center for information sharing and academic study. But other sectors are less progressive. The roundtable participants commented on the pushback by oil companies against Dodd-Frank regulations requiring transparency in payments and contracts. There are no global knowledge-sharing platforms for large infrastructure projects, although several regional ones exist. (After the roundtable, the G-20 announced the formation of a Global Infrastructure Initiative and a Global Infrastructure Hub to promote knowledge-sharing, address data gaps and provide model documentation.)

Structuring Deals

Deals require people with many different skills. First

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is an understanding of the complex structure of a large deal. Knowing which capital player should sit in which chair is critical. The second needed skill is subject matter expertise, especially when addressing regulatory issues, design issues or prospects for local content sourcing and procurement. Third, multistakeholder negotiations need to be conducted, with all parties feeling they can have a fair outcome. But the stakeholders in a deal of course go beyond the principal investors to also include local communities and, in the case of infrastructure, the consumers of the service. The deal driver must be perceived as an honest broker. Fourth, there needs to be an understanding of the specific market realities of operating in a given geographical region. Where conflict is an issue, conflict assessments can be useful tools. But local knowledge—whether embedded in local partners or explicitly commissioned in expert studies—is crucial.

Most participants subscribed to the view that there was plenty of capital for large deals, but wondered about specific types of capital. Some argued that project preparation is a natural niche for aid agencies. Costs can be recouped from project sponsors when a deal is closed. Some emphasized the development of a project prospectus as a critical initial step. Some governments may need financing to acquire a share of the equity. Aid agencies also need to provide more guarantees and other forms of financial incentives, but to manage these with care to avoid charges of corporate subsidies, especially on unsolicited bid projects.

Roundtable participants were split in terms of whether sovereign wealth funds represent a likely source of capital for infrastructure projects, and what the implications might be. Mostly, sovereign wealth funds were thought to follow similar objectives to other types of private capital, namely, maximizing risk-adjusted returns to their shareholders. But it was clear that these organizations take into account political considerations in various ways, which results in considerable heterogeneity. Their appetite for investing in infrastructure

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in developing countries might be higher if there was an arrangement that pooled several projects, to diversify risk, but such a structure is not yet on the horizon. Proximity makes a difference, so the establishment of an infrastructure asset class might first take off at home, generating a benchmark against which riskier investments in fragile states could be assessed.

Considerable emphasis was placed on capacity building as something that needed to be embedded in the structure of a large deal. Large MNCs have their own universities or certification courses to build local capacity for the project itself, including for engineers, suppliers and the like. Also crucial, but harder to accomplish, is capacity building for government officials, in order to be able to staff regulatory agencies or ministries' planning and strategy units. Scholarship programs to bring government officials to universities in developed countries are less used in the United States than in the past, but one participant asked if it would be possible to link private universities with companies in a scaled-up system of capacity building. A difficulty that was noted is that trained staff members may be rotated, or even leave government. One participant asked if there were opportunities for creating specialized, semiautonomous public agencies as a way of retaining trained staff.

Community Consultations

There was a consensus that community consultations should be conceived of as part of the core business practices of companies, rather than as part of their corporate social responsibilities. Of course, there are benefits to be gained from delivery of local services (schools, clinics) that respond to local priorities, but the larger gains accrue from a shared value perspective. Examples were provided of how professionally run consultations can defuse local conflicts, or create solutions to environmental hazards such as water pollution. But these kinds of consultations require independent, third-party intermediation, and they work best when local civil society bodies are in turn well organized. Development organizations and foundations could be well placed to support such processes.

IMPROVING THE DEVELOPMENT BENEFITS FROM LARGER PUBLIC REVENUES

The roundtable participants agreed that a good use of the royalties, taxes and fees paid by large extractive and infrastructure projects is the desired "home-run" outcome. But they also concluded that in many fragile environments, the transparency and accountability of public expenditure systems could not be expected. Governance is a key challenge.

There is no easy answer on governance. Several participants noted a preference for small-scale engagements in countries with poor governance, but acknowledged that any large project inevitably must engage with governments. There was great support for transparency on what is paid as well as on contracts, but the participants also noted that it is governments rather than companies that oppose greater transparency. The degree of leverage that companies actually have was hotly debated. In

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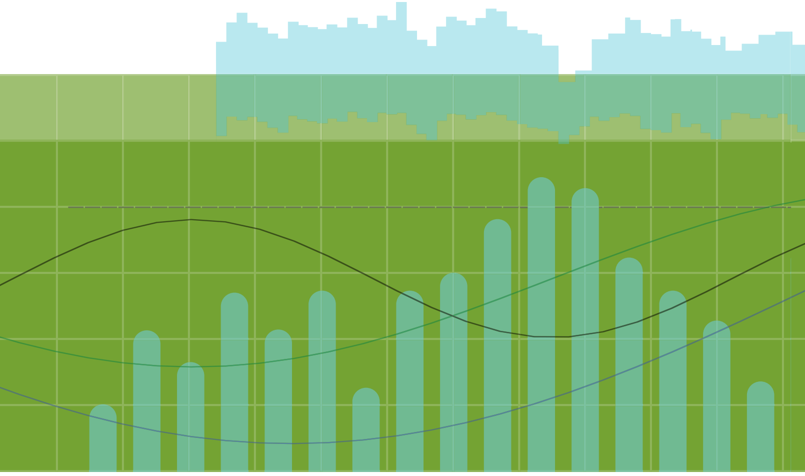
a competitive environment, companies may not have much leeway but to acquiesce to government wishes. But in a context where they have specific skills and expertise to bring to a project, there may be more scope for taking a tougher stance.

The role of policies in advanced countries to encourage companies to do the right thing was also highlighted, with acknowledgment that the United States had been the first country to introduce anticorruption practices, which were later rolled out to all the countries that belong to the Organization for Economic Cooperation and Development in the 1997 Convention on Combating Bribery. Participants commented on the importance of China adopting similar legislation. The greater transparency on payments and contracts required by Dodd-Frank was applauded, but its final status is still in doubt, with various court cases pending.

When governments are left to pursue corruption cases themselves, the proceedings tend to be long, drawn-out affairs. This makes companies very reluctant to consider undertaking projects in countries with poor governance. But if there were a global public–private partnership to investigate corruption in a quick and professional fashion, it could defuse the situation. This would operate in the same way as off-shore dispute resolution mechanisms and other contractual agreements that isolate companies from legal jurisdiction in host countries.

The participants agreed on the desirability of introducing better public expenditure management systems, but they debated how this could be done and institutionalized. There are great pressures on governments to provide instant benefits to their citizens or local communities upon the announcement of a large deal. The creation of sovereign wealth funds (as in Nigeria) and the use of licensing systems to avoid "Gold Rush" excesses were recommended as ways to manage resource rents.

Managing people's expectations is not easy. They expect jobs and other benefits. Often, there is a tendency to exaggerate the size of the resource rents, making the problem worse. Political leaders



have to manage the politics; most large deals must have the go-ahead from the head of government. But projects can also be designed to bring about quick results in some instances.

One suggestion was to use cash transfers more aggressively. The process of cash transfers has become easier, with biometric identification cards now being issued in many countries, including fragile states. Early results from randomized control trials are positive in terms of development impact. An advantage of the new technologies available is that they provide a digital audit trail and have far lower overheads. This, in turn, serves to reduce petty corruption.

Another option is to tie resources explicitly to various forms of poverty reduction programs, as in the case of the priority poverty programs identified for funding in the Laos Nam Theun 2 hydropower project that was the subject of a briefing note for the roundtable. Some participants argued that agricultural programs should be given special attention, given that they provided direct vehicles for achieving inclusive growth. Others argued for structuring resource rents into off-take guarantees for infrastructure projects.

Given the long time frames from project announcement to the flow of cash and benefits to the government, there is a need for complementary projects that can provide benefits quickly. Development agencies are able to provide these kinds of projects, and they can also provide considerable technical assistance in modernizing public expenditure management systems. But to make these systems stick, to prevent unrestricted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increases in the size of civil service salaries and other administrative expenses, governments also need to be accountable to their citizens. The roundtable started off with debates on the role of national and sector plans and strategies as vehicles for formalizing people's expectations as to exactly what they could expect in terms of service delivery and other development opportunities. Governments that use national plans to establish a social development compact with their citizens are more likely to prioritize revenue and spending management and to be realistic about the revenues flowing from large projects. Indeed, improving revenue and expenditure management is one of the five priority development areas identified by the g7+ group of fragile countries.

ECONOMIC DIVERSIFICATION

The direct benefits to economic diversification from a large project tend to be small. One brief written to clarify the roundtable discussions—Diversifying Growth in Light of Economic Complexity by Muhammed Yildirim—indicated that spillovers of capabilities from mining to other sectors are very small. There is some employment opportunity associated with large projects, but even this may be driven out by new technology. For example, the roundtable participants heard about remote-controlled vehicles replacing truck drivers at major mines. Large infrastructure, like hydropower, often produces electricity that is largely exported and thus does not benefit local industry. So is there any realistic chance of achieving a transformative impact through these projects?

One source of optimism is the commitment of a new generation of CEOs in major multinationals to be development actors, not just project sponsors. The 17 major mining firms appear committed to this. Shareholder emphasis on sustainability as a risk management tool also matters. Large projects can increasingly engage with multiple stakeholders on the basis of the concept of shared value.

For many MNCs, shared value means providing jobs and local content provisions. There is a significant emphasis on training, capacity building, and management skills, but these are all geared toward providing a corps of local employees for the project. Scale has not yet been achieved. Nor has the complementary training and capacity building of government ministries and regulators. Even civil society organizations need staff members who have a new outlook on solving problems.

Some local content can be generated in countries with a sufficient local market size. The willingness of MNCs is there. Localization can help develop true local partners, an important ingredient in project success. But in smaller countries, or more remote localities, the scope for local content goes down. Government then must provide the connectivity to regional or global markets in order to create diversification opportunities.

One initiative with promise is paying more attention to local financial intermediaries. Roundtable participants noted that even in fragile areas there was a nascent private sector with established traders and markets. But these lacked access to finance. Building up local financial intermediaries, who could then lend to small-scale traders and entrepreneurs, was proposed as a useful way of encouraging some economic diversification in a local area.

Similarly, there was strong support for community development programs in areas where large projects were located. These could be intermediated by civil society organizations, by local banks or by community-driven development programs sponsored by government or development agencies. And there would be an added benefit if funding were made available to accelerate the market penetration of products with a significant social impact. The roundtable participants heard about the rapid scaling up of solar lights and solar charging stations. Linking social entrepreneurs with large projects could create a bridge between the large contributions to national development through revenues and the needed smaller contribution to local development to provide fairness and create social harmony through the project.

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