High-level Forum on Balancing Infrastructure Investments with Debt Sustainability

Nur-Sultan, Kazakhstan; 15 May 2019

I. Introduction

1. On 15 May, the Asian Development Bank (ADB), International Monetary Fund (IMF), and the World Bank jointly organized a high-level CAREC forum in Nur-Sultan, Kazakhstan to discuss infrastructure financing needs, fiscal constraints, debt sustainability, and the need for more private sector involvement in infrastructure financing. Central bank governors, ministers, and high-level attendees from CAREC countries (Attachment 1: List of Participants) participated in three panel sessions (Attachment 2: Program). The forum discussed how to balance infrastructure investment needs with debt sustainability in the CAREC region.

2. Mr. Ruslan Dalenov, Minister of National Economy of Kazakhstan, shared in his opening remarks that Kazakhstan maintains a strong demand for infrastructure financing. To meet the demand, Kazakhstan will attract both internal and external financing, as well as private investments. Mr. Dalenov reported that Kazakhstan adopted the State Program on Transport Development "Nurly Zhol" (bright path) in 2015 to support the economy and develop modern transport and logistics infrastructure. He noted that during the implementation period of the Program from 2015 to 2018, Kazakhstan built and reconstructed around 2,400 kilometers of national roads. The program was funded by the Republican Budget, the National Fund, and loans from international financial organizations. Mr. Dalenov reported that growth of investments in fixed assets from 16.4% in 2018 to 19.4% of GDP by 2025 is envisaged as one of the key national indicators in the Strategic Development Plan of the country until 2025.

3. Mr. Erbolat Dossaev, Governor of the National Bank of Kazakhstan, thanked ADB, IMF, and the World Bank for organizing the forum to discuss macroeconomic policies for economic and financial stability, in his opening remarks. Mr. Dossaev appreciated the support to Kazakhstan through the CAREC program, especially in terms of infrastructure investments for CAREC transport corridors connecting Western Europe with East Asia through Kazakhstan. Mr. Dossaev reported that the National Bank of Kazakhstan is working towards more sustainable infrastructure financing by further developing stock market instruments, leasing facilities, and tools for equity financing and venture capital investments.

4. Mr. Shixin Chen, ADB Vice President, appreciated in his welcome remarks that the macroeconomic policy dialogue under the CAREC Program has gained momentum since the adoption of CAREC Strategy 2030. Mr. Chen shared that there are two key aspects to balancing infrastructure investments with debt sustainability. The first is the continued importance of infrastructure investments to promote growth, create employment, and reduce poverty. The second is that such investments have to be undertaken in a way in which macroeconomic stability is protected through responsible debt and fiscal management policies. He further stated that the forum's theme is topical since on the one hand, high quality infrastructure investments can help raise debt repayment capacities of our developing member countries, but on the other hand, debt-financed low-quality investments with minimal rates of economic return can lead to suboptimal outcomes and rising debt sustainability problems. Mr. Chen further highlighted that with the opening up of the CAREC region and improving relationships among neighboring countries, major new infrastructure projects of regional significance in the hydropower, rail, and

port connectivity sectors are being discussed. The financing needs of such mega projects are very large and require well-structured financing solutions, involving private financiers, public-private partnerships (PPPs), and long-term institutional investors.

5. Mr. Jihad Azour, Director of the IMF Middle East and Central Asia Department, mentioned in his opening remarks the importance of infrastructure for regional cooperation and integration. Mr. Azour shared results of a 2018 IMF study on the Caucasus and Central Asia on the link between regional integration and economic growth. He also shared that IMF is working on an infrastructure toolkit, which can support Ministries of Finance and Economy in decision making processes for prudent infrastructure investments.

6. Ms. Lilia Burunciuc, Regional Director of the Central Asia Region at the World Bank reiterated the importance transport and energy connectivity in the CAREC region. CAREC member countries still require investments in key infrastructure assets that have not undergone modernization since Soviet times. Ms. Burunciuc also stressed the importance of combining connectivity infrastructure investments with trade reforms. She mentioned the example of the impact of investments under the Belt and Road Initiative, which is also being driven by soft components, and not just hard infrastructure projects alone.

7. Mr. Werner Liepach, Director General of ADB’s Central and West Asia Department, introduced the agenda and stressed the importance of balancing infrastructure financing with debt sustainability at a time when a substantial infrastructure financing gap in the CAREC region remains, debt levels are rising, and fiscal space is reducing. Mr. Liepach suggested that new ways of financing crucial infrastructure have to evolve, with stronger involvement—both in terms of financing and risks—of the private sector. He mentioned that infrastructure alone cannot drive economic growth, and this is particularly true for regional infrastructure. Without trade reforms to ensure a fast, inexpensive, and low-risk trade across borders, regional infrastructure will not deliver the desired development impact. And without flourishing intra-regional trade, the region cannot develop its full potential in terms of diversification of exports and specialization. Regional value chains are gaining more significance while global trade regimes are challenged. In this context, Mr. Liepach highlighted the relevance of the CAREC platform to promote regional infrastructure development, and outlined the need to undertake concrete steps to ease trade across borders, harmonize custom procedures, and build strong relationships and trust to facilitate stronger regional integration.

II. Panel Discussions

8. The first panel session discussed the magnitude of infrastructure gaps and how to prioritize infrastructure investments in the CAREC region. After an ADB presentation “CAREC Infrastructure Financing for Growth and Regional Connectivity” (Attachment 3), the magnitude of infrastructure gaps in the CAREC region were discussed and critical regional infrastructure projects and reforms identified to capitalize on the improving economic cooperation prospects in CAREC. Infrastructure needs in CAREC remain large but equally important is to accompany these investments with the right reforms to maximize economic returns of infrastructure assets. Consequently, when investment priorities are developed, necessary structural and trade-related and logistics-related reforms would need to be factored in, which can be challenging, especially when it comes to regional infrastructure that involves more than one country.

9. The panel stressed the importance of considering the inclusive growth impact and climate change when selecting and designing public investments. It also discussed that when it comes to financing and managing key infrastructure, state-owned enterprises play an important

role and their corporate governance and debt management capacities have to be further developed for them to properly play their important role as public investment vehicles. Discussants highlighted the growing role of technology and artificial intelligence in strengthening regional cooperation and connectivity, and noted that in the sector of telecommunications, major investments are also required to benefit from technological advancements to improve digital connectivity and access to key utility services.

10. The second panel discussed how to find the right balance between needed infrastructure investments and long-term fiscal sustainability following an IMF presentation on "Infrastructure Gaps, Growth, Financing, and Public Debt—Clarifying the Linkages" (Attachment 4). The discussions focused around two aspects: effective debt management and carefully selecting and prioritizing feasible projects to close the infrastructure gap and add such assets on the governments' balance sheet. Panelists also noted the importance of reforms to maximize the economic returns on infrastructure investments. Closing reform gaps in the financial sector, streamlining government revenues, strengthening transparency, and enabling environment for private sector development can yield significant development impacts.

11. The panel stated that for sustainably financing infrastructure investments, debt management is critical because of the strong role of public expenditures, especially for large infrastructure projects, and the potential for fiscal risks through contingent liabilities. Panelist reported that in order to mitigate these risks, some CAREC countries have adopted debt to GDP thresholds and related ceilings to contain debt overhangs, while also introducing higher standards for financial reporting of SOEs. In addition, to contain public debt, the panel noted that new and innovative ways of infrastructure financing can be developed. This includes making use of guarantees to support CAREC countries' access to capital markets. The second aspect is related to selecting the best projects to drive inclusive economic growth but also to comply with high standards of operational feasibility, environmental, and social safeguards. Panelists highlighted that this can only be guaranteed by following due process through transparent procurement, proper feasibility studies, and effective provisioning for maintenance and operation costs. Countries should not rush into new infrastructure investments without due diligence and attention to economic, financial and environmental feasibilities of projects.

12. Panelists highlighted the importance of prudent infrastructure investment under the CAREC program. Through CAREC alone, close to $34 billion of infrastructure investments have been mobilized since 2001. In addition to the governments' contribution of $7.8 billion, ADB has financed $12.5 billion, the World Bank $7.4 billion, Islamic Development Bank $1.7 billion, European Bank for Reconstruction and Development $1.6 billion, and other cofinanciers have financed $2.7 billion. Most of the investments have been undertaken in the transport sector with (75%), followed by energy (23%). Discussants cautioned that investments must be undertaken in a way in which growth-enhancing impacts are ensured and macroeconomic stability is protected through responsible debt and fiscal management policies. Thus, while infrastructure investments can improve potential economic growth and improve national debt repayment capacities, investments with low or even negative rates of economic return can also lead to unsustainable debt levels and can trigger a spiral of lower sovereign credit ratings and higher debt service commitments as well as contingent liabilities.

13. The third session discussed how the private sector can be brought in more strongly to finance infrastructure investments. The World Bank presented on "Financing Infrastructure: PPPs and Capital Markets" (Attachment 5). Panelists agreed that to alleviate public infrastructure financing constraints, the private sector must be facilitated to play a larger role to close remaining infrastructure gaps. PPPs, although still a niche instrument, can be a financially

advantageous alternative to traditional public procurement if the price of transferring risks to the private sector according to risk preferences and management capabilities is lower than the higher cost of finance of private sector investments. Due to the private sector's advantages in the management of key risks, CAREC governments are increasingly turning to the private sector to explore PPPs as a means of developing and managing critical infrastructure.

14. However, discussants cautioned that international experience has identified many reasons why PPPs might not lead to the projected benefits, such as inadequate legal and institutional frameworks, overly ambitous assumptions about future income streams and inaccurate estimates of the price of risk transfers from the public to the private sector. Support from the public sector continues to be needed to ensure bankability of PPPs through viability gap funding and other modalities. The panel discussed how to attract domestic and foreign investments into infrastructure projects and concluded that PPPs can become a powerful tool, if used in the right way. Well-designed PPPs can ease the burden on public finances and shift risks to the private sector, but poorly-designed ones pose substantial fiscal and governance risks.

15. Panelists mentioned that among the main impediments to private sector investments in long-gestation infrastructure projects is the lack of availability for long-term finance in the domestic market. In the banking sector in CAREC countries, vulnerabilities, exposed particularly after the global financial crisis, persist. Panel members found that financial sector stresses in the region have deep-rooted structural causes, including lack of competition, weak governance, segmentation of the credit market, and weak regulation and supervision. Measures to strengthen the banking system should be complemented by efforts to further develop capital markets which remain weak and nascent in many CAREC countries, including securities market infrastructure and regulation and supervision mechanisms. It was noted that capital markets can provide alternative channels for firms to access long-term capital for infrastructure investments. Hence, for domestic private investors to play a stronger role in infrastructure financing, accelerated reforms of banking sector and capital markets would need to be pursued in CAREC countries, to provide access to long-term local currency financing and to undertake appropriate financial structuring of large infrastructure projects.

III. Closing Session

16. Mr. Sabit Khakimzhanov, Director of Financial Stability Department of the National Bank of Kazakhstan, thanked all participants for coming to Nur-Sultan, Kazakhstan and summarized the discussions during the forum.

17. Mr. Werner Liepach thanked all participants for their active participation and appreciated the rich deliberations during the panel sessions which will contribute to planning and policy making on the important matters of meeting infrastructure financing requirements while maintaining adequate fiscal frameworks. The outcomes of the forum will be reported at the CAREC senior officials meeting in June 2019 and at the CAREC ministerial conference in November 2019 in Tashkent.