G20 BRASIL 2024

BUILDING A JUST WORLD
AND A SUSTAINABLE PLANET

1st Finance and Central Bank Deputies (FCBD) Meeting

SESSION VI: SUSTAINABLE AND INCLUSIVE INFRASTRUCTURE AND THE PRIORITIES FOR THE IWG IN 2024

KEY OBJECTIVES:

- present the Brazilian priorities for the Infrastructure Working Group in 2024;
- consider challenges; and
- seek members' views on the proposed priorities.

Brasília, December 2023

I. OUTLOOK AND STRATEGIC VISION

The global economy continues to recover from the pandemic amid ongoing geopolitical tensions. Against a background of disruptions in energy and food markets due to conflict and substantial monetary tightening measures aimed at mitigating historically high inflation rates, economic activity is decelerating in several countries. Growth is likely to remain sluggish and uneven in the medium term, contributing to widening disparities. Climate-related events worldwide are pressing for a more sustainable development model and a just energy transition.

In this environment, infrastructure investments have a significant impact on global economic growth, through multiple supply and demand-side channels. Investments in energy, telecommunications, and transportation networks have a direct impact on economic expansion, as all forms of infrastructure represent essential inputs in the production of goods and services. Furthermore, infrastructure can enhance productivity, facilitate the physical mobility of people and products, and advance the objectives of the Paris Agreement.

The Brazilian G20 Presidency recognizes the importance of infrastructure investment to transform societies, reduce inequalities, and contribute to long-term economic growth. Under this assumption, infrastructure is regarded as a fundamental catalyst for the endeavor of "building a just world and a sustainable planet."

Four main priorities will be addressed by the IWG: (1) Financing Climate-Resilient Infrastructure; (2) Linking Infrastructure and Poverty Reduction; (3) Mitigating Exchange Rate Risks; and (4) Building Cross- Border Infrastructure.

Under the Brazilian G20 Presidency, the IWG will work on these four priorities, while ensuring continuity with previous IWG deliverables, such as the G20 Principles for Quality Infrastructure Investment (QII).

II. PRIORITIES FOR THE INFRASTRUCTURE WORKING GROUP

Priority 1: Financing Climate-Resilient Infrastructure

All types of infrastructure are susceptible to the consequences of climate change, which might cause relevant economic losses. According to the International Monetary Fund (IMF), direct damage from climate disasters added up to $1.3 trillion over the past decade. While some of these losses result directly from extreme weather events, such as floods in large cities, a sizable portion of economic losses are due to the disruptions that these events cause on infrastructure networks, such as transportation, electricity, and telecommunications. In this scenario, the impacts of climate change tend to be felt more acutely in low- and middle-income countries.

The social and economic consequences of climate change highlight the importance of resilient infrastructure to protect lives, livelihoods, and support economic conditions. Ensuring that infrastructure is resilient to climate change will help reduce losses and the indirect costs of disruption. For many countries, resilient infrastructure also plays an essential role in meeting national development aspirations in line with the Sustainable Development Goals (SDGs).

From the standpoint of both public and private investors, creating climate-resilient infrastructure makes sense as it improves reliability, improves asset life, and protects asset returns. To achieve this goal, existing infrastructure must be managed differently, and new infrastructure must be planned, designed, built, and operated considering the possibility of extreme weather events. Creating resilient infrastructure also requires a precise assessment of risk exposure, with a clear identification of vulnerabilities and the costs of making infrastructure more resilient. This assessment is especially relevant for low-income countries, since it is hard to justify the additional investment required to make infrastructure climate resilient to uncertain events.

Resilience and maintenance of infrastructure assets were discussed by the IWG during the Italian G20 Presidency in 2021, and the Brazilian Presidency will build on this work, developing the specific perspective of climate risk. During the Brazilian Presidency, the work of the IWG will be focused on answering two main questions:

First, how can risk assessment mechanisms be implemented by countries more fully, and encouraged among infrastructure operators to achieve more climate-resilient infrastructure systems? This includes how they can help understand priorities, financing needs and benefits (avoided costs) of climate-resilient infrastructure.

Second, what are the options available for financing climate-resilient infrastructure systems? This can explore issues including the relationship with risk-sharing arrangements and climate finance.

The Brazilian Presidency will encourage discussion and exchange of best practices to help G20 countries adapt to climate change by considering financing solutions to build new climate-resilient infrastructure and retrofit existing infrastructure.

Priority 2: Linking Infrastructure and Poverty Reduction

According to the World Bank, nearly half of the global population lives on less than US$6.85 per person per day. Poverty reduction is one of the greatest concerns for both developed and developing countries, and the Brazilian Presidency is committed to working towards a more equitable and prosperous world. With this goal in mind, in 2024 the Brazilian Presidency will be discussing the contribution of infrastructure investment and infrastructure services to poverty reduction. Specifically, the next cycle of IWG meetings will explore how infrastructure can be used to correct market failures and promote well-being in the parts of the world most in need.

The topic has been addressed by the IWG in previous Presidencies, with relevant and productive discussions. The Italian Presidency brought up the issue of "infrastructure for social inclusion", while "social inclusion and subnational disparities" was addressed during the Indonesian presidency. Similar work was undertaken on "inclusive cities" under the Indian presidency, with important recommendations for the design and execution of infrastructures that promote the inclusion of low-income groups in urban areas.

Inclusive infrastructure can be considered from two different perspectives, both relevant and challenging. The first emphasizes the supply side of infrastructure services, with attention to investments, strategies, and interventions on infrastructure assets. The supply perspective addresses potential areas of improvement in the infrastructure delivery space, from planning to construction and maintenance, to increase the availability of assets for firms and households.

Bearing in mind the overarching goal of fighting poverty, the Brazilian Presidency will draw more attention to a second perspective, which emphasizes the demand side of infrastructure. Here the key assumption is that service provision, or inclusiveness, is the final goal of infrastructure investment. From the service perspective, provision of infrastructure and poverty reduction will be considered under two different criteria:

First, access. To effectively contribute to poverty reduction, infrastructure services must be available to all citizens, regardless of income level.

Second, affordability. Infrastructure services might be accessible and of good quality, but they cannot address poverty issues if they are not affordable to all citizens.

In summary, in 2024, the IWG will discuss policies and financing solutions to offer infrastructure that is more accessible and affordable to all. The Brazilian Presidency will build on the work of the Indian Presidency, exploring ways to ensure universal access to essential infrastructure services in urban areas, with special attention to the effectiveness of public subsidies.

Priority 3: Mitigating Exchange Rate Risks

Emerging Markets and Developing Economies typically have substantial infrastructure investment deficits, ranging from 1% to 4% of their annual GDP expenditures. The complexity of infrastructure projects helps explain a portion of this gap. These projects typically involve multiple risks, take a long time to complete, and have significant costs. To secure financing, projects frequently require complex funding arrangements with the participation of public and private institutions in the multiple stages of project development and execution.

The challenges of financing infrastructure projects are more intensely felt in the developing world, where capital markets tend to be underdeveloped and few alternatives to infrastructure project financing exist. As a result, public and private agents tend to rely on a limited number of funding options.

This scenario could be improved if investors had easier access to international financial markets, which frequently offer financing alternatives that better match the needs of infrastructure projects, including longer maturities and lower interest rates. Nevertheless, access to international capital is seldom attractive to investors from developing countries.

Multiple factors explain why emerging markets have limited access to international financing. Exchange rate risk is frequently mentioned as one of the most relevant, arising when investors have their debts denominated in a foreign currency and their assets and/or future project incomes are denominated in a local currency. As a result, to avoid these risks, investors may avoid debts in foreign currencies or price them with excessive risk premia.

Exchange rate risk also affects publicly funded infrastructure projects. For the same reasons highlighted above, public agents may avoid incurring debt in foreign currencies, or they might have to pay excessive rates, which reduces the existing funding alternatives for public infrastructure projects. The same holds true for public-private partnerships.

In summary, the Brazilian Presidency will build on the previous work on "infrastructure as an asset class", conducted during the Argentinian Presidency, to discuss the topic of exchange rate risk in financing infrastructure projects. Under this priority, the Brazilian Presidency plans to explore best practices and recommendations to mitigate this risk. Furthermore, the IWG will also examine how projects can be customized or adjusted to address this issue, as well as the role of MDBs in the provision of solutions and financial instruments to make infrastructure financing in foreign currencies less risky and more attractive to EMDEs and international financial markets.

Priority 4: Building Cross-Border Infrastructure

Cross-border infrastructure is at the center of debates on prosperity, poverty reduction, and economic growth. Roads, bridges, communication networks, and transmission lines in border regions create market opportunities and determine the way people live, move, and work. They also have an important effect on the efficiency of public services in these regions, especially those aimed at reducing poverty and providing better living standards.

Cross-border infrastructure is also intricately linked to trade. Countries with good border infrastructure are better connected to global value chains and are more efficient in promoting regional cooperation and economic integration initiatives with neighboring countries.

Cross-border infrastructure influences the living costs and the general productivity of economies. Energy supply, the availability of internet connection, and structures for the flow of goods and services affect production costs and impact the income and living standards of citizens. In other words, countries are more prosperous and more efficient if they have structures that allow for the connection and interaction with economic agents living in other countries.

Cross-border infrastructure is considered a cost-effective option for advancing climate-related goals. However, building cross-border infrastructure is a complex endeavor. The timing of investments is relevant since one country`s investment depends on the investment decisions of others. To make matters harder, incentives to creating common infrastructure are asymmetric. Coordination challenges may affect not only initial political decisions but the whole life cycle of infrastructure projects, from design to execution, to maintenance.

Building common infrastructure requires policy coordination. Norms and standards for the flow of goods and services, which occasionally require negotiation between the authorities of neighboring countries, including subnational entities, have a significant impact on the effectiveness of cross-border infrastructure. In some cases, these negotiations must occur before construction work is initiated to avoid the risk of obsolete or inadequate infrastructure.

Finally, the financing of common infrastructure implies another layer of complexity. Countries financing the largest sections of projects might not gain the most from them. Shared infrastructure can be sometimes financed through joint financing mechanisms, but coordination, in these cases, is also challenging since countries must negotiate together and agree to the financial conditions related to the lifecycle of the infrastructure projects. In 2024, IWG members will be encouraged to share experiences and analyze best practices for mobilizing finance for joint projects. Members will assess alternatives for multi-level financing, available funding, new financial mechanisms, and ways to engage the private sector. Special attention will be given to the role of MDBs.

III. PLANNED DELIVERABLES

- A report with case studies from G20 member countries, showcasing strategies to financing and investing in climate-resilient infrastructure, including recommendations on possible policy actions for G20 member countries to support the financing of climate-resilient infrastructure.

- A report with tactics and initiatives to achieve universal access to essential urban infrastructure services, emphasizing poverty-reducing policies that increase affordability.

- A strategic and practical guidance note highlighting best practices to mitigate foreign exchange risk in infrastructure projects, featuring recommendations to increase the attractiveness of national infrastructure projects to foreign investors.

- Stocktaking of best practices for carrying out and financing cross-border infrastructure projects. The paper will highlight the role of MDBs in mobilizing stakeholders and in structuring and financing such projects.

IV. QUESTIONS FOR DISCUSSSION

1. What are the Deputies' views on the priorities proposed by the Brazilian Presidency for the Infrastructure Working Group?

2. What are the Deputies' views on current global challenges affecting infrastructure projects?

3. Do Deputies have policy suggestions to boost international cooperation on the priorities proposed by the Brazilian Presidency?

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