GOVERNANCE FOR DEVELOPMENT

Can “Resource Financed Infrastructure” Fix the Natural Resource Curse?

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In Africa, estimates indicate that an annual investment of $93 billion is required to address the continent’s basic infrastructure needs – more than double the current level of investment.

The lack of productive investment of resource revenues, with spending of these revenues often heavily tilted towards consumption, is a critical component of the so-called resource curse, the observation that countries rich in natural resources frequently have slow long-term growth. Following oil or mineral discoveries, as the expectation of increased wealth spreads, pressures to spend typically become hard for politicians to resist, public sector salaries go through the roof, wasteful spending increases, corruption may flourish, hidden foreign bank accounts may be established, and the number of unproductive “white elephant” projects grows.

How can resource-rich countries ensure that a large share of oil, gas, and mining revenues are used for productive investment rather than excessive or wasteful consumption?

“Resource financed infrastructure”, or RFI contracting, represents a commitment mechanism that enables ministers to ensure that future decision makers devote a sensible proportion of resource revenues to the accumulation of assets. Unlike resource-backed lending or sovereign bond issuances, RFI connects government revenues from resource extraction directly to infrastructure investment. RFI thereby serves to countervail barriers to international capital markets, and to bypass capacity constraints that governments face when required to implement large infrastructure projects. Another reason that existing versions of RFI transactions have been seen as attractive by governments may be that the RFI type of transaction is perceived as an opportunity to provide fast returns to citizens while decision makers are still in office. Since mines and oil fields take a long time to develop, the infrastructure could be in use long before the extractive project is generating revenue or turning a profit.

A recent World Bank Study, comprising an in-depth study of RFI by global project finance specialists Hunton & Williams LLP, and comments by some of the most internationally respected development economists and policy makers, debates the merits, challenges, and risks of the RFI approach. This analytical approach to RFI seeks to formalize the relationship between (a) the government’s future revenue stream from the resource component, and (b) a non-recourse loan, from the resource developer's lender or another financial institution, to the government for the purchase of infrastructure. The loan is paid down with the committed future government revenues from the oil or mineral extraction, as part of the established fiscal regime. Loan disbursements for the infrastructure component are paid directly to the construction company to cover construction costs. The key to RFI is creating the non-recourse link, by a special loan mechanism, between the committed future resource revenues and the current infrastructure financing.

Despite its potential benefits, RFI also brings significant risks and challenges. Early deals approximating an RFI structure have generally been concluded on a non-competitive basis, with little transparency or attention to structuring the transaction as a true financing model. This has brought up questions related to the valuation of the deals – how much infrastructure now for a certain amount of oil or minerals in the future? There have also been concerns with regard to the quality of the completed infrastructure, as well as regarding capacity for operation and maintenance – issues that in a mature RFI deal would be addressed through careful contracting, due diligence exercises, and independent third-party construction supervision.

So, can RFI contracting contribute to fixing the resource curse? Contributors to our study argue that “it depends.” As Wells points out, RFI deals should be evaluated like any other business arrangement, and carefully compared to alternative ways of obtaining returns from natural resources or financing

infrastructure. Understood in that way, and with appropriate safeguards and procedures for implementation, RFI contracting may have the potential to be an important tool for countries struggling to escape that old curse.

What do you think? Tell us in the comments.

Comments

Very interesting concept. At

SUBMITTED BY RAJIV SONDHI ON SAT, 10/04/2014 - 08:26

Very interesting concept. At the conceptual level this makes sense to me. An attractive feature of this concept is that both future revenue streams (derived from natural resources) and scale of infrastructure financing needed (generally large size and long term) have potentially a matching tenor. A key hurdle to operationalizing this concept would be political. You have mentioned the political pressures that often prevent wise use of such revenues and encourage profligacy. The same political pressures may also discourage political leadership to make long term contractual commitments needed to make RFI bankable deals. Perhaps one way to mitigate this would be to package technical assistance into what might otherwise be only a banking transaction: i.e. apart from financing, also put on the table a technology package to help the governments pursue extraction of the natural resources, and move them higher up on the value chain.

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