



G20 MONITOR

Infrastructure, tax, energy

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OVERVIEW

MIKE CALLAGHAN¹

This issue of the Monitor focuses on the role of the G20 in infrastructure, tax and energy governance. There is also a note on trade.

INFRASTRUCTURE

I have an article with reflections from the *Financial Flows and Infrastructure Financing* conference held in Sydney on 20-21 March 2014. The conference was co-hosted by the Reserve Bank of Australia, the Lowy Institute and the Productivity Commission. The conference topic was chosen because Australia has prioritised infrastructure during its period as G20 chair.

There have been a vast range of issues raised around infrastructure investment, and many were canvassed during the conference. My paper therefore proposes there would be value in the G20 identifying the basic building blocks that are required if infrastructure investment is going to contribute to lifting long-term economic growth and creating jobs. I suggest that the core issue is project selection, namely, identifying infrastructure projects with the greatest social benefits. This issue is currently not given much prominence in the G20 agenda.

Daniela Strube's paper focuses on the role of the multilateral development banks in helping developing countries lift their infrastructure investment. Most of the issues associated with increasing infrastructure investment are domestic. But ensuring that the multilateral development banks are as effective as possible in assisting developing countries meet their infrastructure needs is an 'international' aspect of the infrastructure agenda worthy of the G20's attention.

Susan Harris Rimmer's article examines the link between the G20's infrastructure and development agendas. She notes that finding complementarity between these agenda items is particularly important in 2014, given Prime Minister Abbott's claim that he wants to be known as the 'infrastructure prime minister'. Harris Rimmer notes that while increasing infrastructure investment is crucial for lifting growth prospects in developing countries, the challenge facing the G20 is to make infrastructure investment and implementation truly pro-poor.

¹ Director, G20 Studies Centre, Lowy Institute for International Policy.

TAX AND DEVELOPMENT

Claire Spoons and Serena Lillywhite's paper focuses on the link between the G20's priority to combat base erosion and profit shifting and its objective to promote development. They highlight that one of the most practical steps the G20 could take to increase the domestic revenue raising capacity of developing countries would be to support the disclosure of tax payments made by corporate entities on a country-by-country basis.

ENERGY GOVERNANCE

Hugh Jorgensen's paper emphasises the need for enhanced global energy governance and suggests that this is an issue that should be on the agenda for G20 leaders. He points out that while the G20 currently has a number of energy issues on its work program, it has not adequately addressed the prior need for a revision of the global energy governance system itself. Specifically, one outcome that could come from the Brisbane G20 Summit is the acknowledgement of the need for a global forum that explicitly focuses on energy challenges, and that brings together all the major countries that will most heavily rely upon global energy markets in the twenty-first century on an equal basis.

TRADE

Shinichi Kitajima provides a brief update on developments in the global trading system and highlights the role that the G20 can play in promoting trade liberalisation. He notes that the meeting of G20 trade ministers in July 2014 will occur during a crucial period, as July is also the deadline for WTO members to pledge to implement the trade facilitation agenda adopted at the Bali meeting of trade ministers last year.

G20 AND INFRASTRUCTURE: FOCUSING ON THE FUNDAMENTALS

MIKE CALLAGHAN¹

INTRODUCTION

On 20-21 March 2014, the Reserve Bank of Australia, Productivity Commission and Lowy Institute jointly hosted a conference titled *Financial Flows and Infrastructure Financing*.² The topic was selected because of the priority that Australia has placed on infrastructure as an agenda item during its term as G20 chair in 2014.

This paper contains reflections on the conference and suggestions for what the G20's priorities should be in seeking to increase infrastructure investment. Australia has said its main focus is to increase the proportion of private sector capital in infrastructure investment. However an important outcome from the conference is that the most fundamental task should be ensuring that the 'right' infrastructure projects are selected. The importance of project selection currently does not receive much attention within the G20, where the focus is largely on how to tap private sector capital flows, particularly pension funds. But ensuring that the right infrastructure projects are selected is more important than the question of how they will be financed. Identifying and selecting the right infrastructure projects is a challenging task. As such, the G20 should designate appropriate project selection as the foundation stone of its infrastructure agenda.

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THE CONTEXT: G20 AND INFRASTRUCTURE

Infrastructure has been identified by Australia as a priority for the G20 in 2014. The Prime Minister noted in a speech at the start of Australia's G20 presidency: "as an infrastructure prime minister, my hope as G20 host is to bring policy-makers, financiers and builders together to identify practical ways of increasing long-term infrastructure financing".³

But infrastructure is not a new priority for the G20. At previous G20 summits, leaders have endorsed the importance of infrastructure

¹ Director, G20 Studies Centre. Lowy Institute for International Policy.

² The draft conference papers are available at <http://www.rba.gov.au/publications/confs/2014/index.html>. The Reserve Bank of Australia will be publishing the conference papers and a summary of the discussions in July 2014.

³ Tony Abbott, "Prime Minister's Address to the World Economic Forum, Davos, Switzerland," 23 January 2014, Available at: <http://www.pm.gov.au/media/2014-01-23/address-world-economic-forum-davos-switzerland-0>.

investment to growth and jobs and have committed to lift infrastructure investment. For example:

- At the Seoul Summit in 2010, as part of the *Multi-Year Action Plan on Development*, leaders said they were committed to overcoming obstacles to infrastructure investment, developing project pipelines, improving capacity and facilitating increased finance for infrastructure investment.⁴
- Prior to the Cannes Summit in 2011, a high-level panel was established to identify measures to scale up and diversify sources of financing for infrastructure, make projects bankable and enhance knowledge by sharing skills with low-income countries.⁵
- At the Los Cabos Summit in 2012, leaders emphasised that infrastructure is critical for sustained economic growth, poverty reduction and job creation. They noted that while public financing of infrastructure development projects remained critical, it should be complemented by private sector investment.⁶
- At the St Petersburg Summit in 2013, leaders re-emphasised the key role of long-term investment, particularly in infrastructure, and committed to put in place the conditions that would promote financing for infrastructure investment, including mobilising private investment.⁷

The challenge for Australia is to move beyond the rhetoric of emphasising the importance of infrastructure investment and deliver on the Prime Minister's commitment that under his watch the G20 will deliver tangible outcomes. Indeed, with G20 leaders regularly emphasising the importance of infrastructure investment, it is curious that the top infrastructure priority of the B20 for the Brisbane Summit is that there needs to be a "strong affirmation of the critical importance of infrastructure and investment as a key part of the G20 vision".⁸ Infrastructure is already an established part of the G20 agenda.

The narrative painted by Australia so far is that there is a worldwide infrastructure gap that cannot be totally financed by the public sector, particularly given that many countries are constrained by high public

There is, however, no shortage of private capital available to finance infrastructure – the central challenge is to unlock this private capital, particularly pension funds, so that it can be used to lift infrastructure investment.

⁴ G20, "Annex II to G20 Leader's Communique: Multi-Year Action Plan on Development," (Seoul 2010).

⁵ "Cannes Summit Final Declaration - Building Our Common Future: Renewed Collective Action for the Benefit of All," 2011, Available at: <http://www.g20.utoronto.ca/2011/2011-cannes-communique-111104-en.html>.

⁶ "G-20 Leaders Los Cabos Declaration," 2012, Available at: <http://www.g20.utoronto.ca/2012/2012-0619-loscabos.html>.

⁷ "G20 Leaders' Declaration, St Petersburg," (6 September 2013) Available at: <http://www.g20.utoronto.ca/2013/2013-0906-declaration.html>.

⁸ G20 Studies Centre, *G20 Monitor No.9: Perspectives from Business, Civil Society, Labour, Think Tanks and Youth* (Sydney: Lowy Institute for International Policy, 2014).

debt levels. There is, however, no shortage of private capital available to finance infrastructure – the central challenge is to unlock this private capital, particularly pension funds, so that it can be used to lift infrastructure investment. As Prime Minister Abbott stated “it should be easier to get big new road, rail, pipe and dam infrastructure off the ground and we can do that through attracting more private capital”.⁹ Similarly, the Australian Treasurer, Joe Hockey, said that the centrepiece of the G20 agenda under the Australian chair would be “to undertake domestic reforms that tangibly improve the investment environment and so unlock private sector investment, particularly in the area of infrastructure”.¹⁰

THE NEED TO FOCUS ON THE FUNDAMENTALS – PROJECT SELECTION

Focusing on the financing of infrastructure investment, particularly boosting private sector investment, raises a wide range of issues. As Treasurer Hockey outlined, an important task for all countries is to improve their domestic investment climate. This involves ensuring macroeconomic and political stability and providing certainty for investors in such areas as regulation, taxation, accounting and governance. With the aim to lift private sector involvement, attention inevitably turns to the role of public-private partnerships (PPPs) and the contractual challenges of dealing with the range of risks associated with the construction and operation of infrastructure projects.

Another dimension of infrastructure financing is the impact of post-crisis regulatory initiatives on the traditional project financiers, particularly in the construction phase, namely commercial banks. Banks are facing credit constraints as part of new regulatory requirements and their investment horizon has been shortened. This leads to the importance of developing capital markets, particularly in developing countries. Multilateral development banks can make a significant contribution to the establishment of such markets, both as a source of infrastructure finance for developing countries and also through the provision of technical assistance and capacity building.

From the business perspective, the B20 appear to be focusing on ‘transaction’ issues associated with infrastructure financing. For example, they have identified the need for a stock of long-term ‘bankable’ infrastructure projects (which will encourage institutional investors to develop the skills to analyse investment projects), the standardisation of the process and materials for the preparation of

⁹ Ibid.

¹⁰ Joe Hockey, “Australia’s Role in Strengthening International Consultation and Cooperation, Address to the Lowy Institute,” 6 February 2014, Available at: <http://jbh.ministers.treasury.gov.au/speech/001-2014/>.

projects, and time limits on regulatory and environmental assessment processes.¹¹

All of these elements are relevant to increasing infrastructure investment and the G20 has launched initiatives dealing with most of them. But it makes for a crowded agenda and there has been little effort by the G20 to prioritise its efforts. While the cost of bidding for a PPP may be high, it is not clear that high bidding costs and a lack of standardisation of processes, materials and documentation for infrastructure projects – as called for by the B20 – are key impediments to increased infrastructure investment. If the G20 is going to deliver tangible outcomes on this issue in 2014, the first task should be to prioritise its efforts and identify the fundamental areas where it can boost infrastructure investment that contributes to supporting long-term economic growth. In this context, the main observation from the *Financial Flows and Infrastructure Financing* conference is that the top priority of the G20 should be to ensure that the ‘right’ infrastructure projects are selected. Specifically, too much attention is presently being focused on how infrastructure can be financed, rather than ensuring that the funds are being channelled towards supporting the most appropriate projects.

This was a key point in a paper presented to the conference by Poole, Toohey and Harris.¹² They noted that the focus on project financing options presumes that a decision has already been made as to whether investment is the best use of limited resources. Specifically, they point out “given that the source of financing itself cannot fundamentally alter the economics of a project, a necessary first step is ensuring that good projects, that is ones that generate net social benefits, are chosen”. In a similar vein, the main conclusion from the paper by Galetovic, Engel and Fischer is that in selecting infrastructure projects, the financing is irrelevant.¹³

Bertrand Badre from the World Bank recently made a similar point in observing that the promotion of infrastructure investment necessarily requires more than money.¹⁴ Badre observes that some countries generate massive growth benefits from their infrastructure spending, while others hardly see a return. The lesson Badre draws is that

...it is not clear that high bidding costs and a lack of standardisation of processes, materials and documentation for infrastructure projects – as called for by the B20 – are key impediments to increased infrastructure investment.

¹¹ Ibid.

¹² Emily Poole, Carl Toohey, and Peter Harris, “Public Infrastructure: A Framework for Decision Making” (paper presented at the Financial Flows and Infrastructure Financing conference, Sydney, Reserve Bank of Australia, 20-21 March 2014). Available at: <http://www.rba.gov.au/publications/confs/2014/pdf/harris-toohey-poole.pdf>.

¹³ Alexander Galetovic, Eduardo Engel, and Ronald Fischer, “Finance and Public-Private Partnerships” (paper presented at the Financial Flows and Infrastructure Financing conference, Sydney, Reserve Bank of Australia, 20-21 March 2014). Available at: <http://www.rba.gov.au/publications/confs/2014/pdf/engel-fischer-galetovic.pdf>.

¹⁴ Bertrand Badré, “Infrastructure Unbound,” Project Syndicate, 26 March 2014, Available at: <http://www.project-syndicate.org/commentary/bertrand-badre-cautions-that-money-is-not-enough-in-meeting-countries--public-investment-needs>.

...governments must pay more attention to the selection, quality and management of infrastructure projects as well as to the quality of the underlying investment environment.

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The importance of project selection is fundamental, but many countries do not have adequate processes in place to ensure optimal selection. Moreover, emphasising the need to rapidly close the large global investment gap, along with suggestions from the B20 that governments should set specific targets for lifting infrastructure spending, runs the danger of excessively emphasising quantity over quality in the pursuit of infrastructure investment. The same concerns arise when an increase in infrastructure spending is used for demand management purposes and as a way to boost short-term economic growth. In these circumstances it is more likely that governments will build 'bridges to nowhere'. There are 'white elephant' infrastructure projects in most countries and the quest to lift infrastructure investment, be it publically or privately financed, cannot be at the expense of rigorous processes to ensure that the highest value projects are selected.

This was the key point in the Australian Productivity Commission's recent draft report on public infrastructure.¹⁵ The overall message in the report is the need for a comprehensive overhaul of processes in the assessment and development of public infrastructure projects. As the Productivity Commission notes, without reforms, more spending will simply increase the cost of infrastructure to users, taxpayers, and the community generally and lead to the provision of wasted infrastructure.¹⁶ While the Productivity Commission's draft report refers to Australia, the conclusions are likely to be relevant to many G20 countries.

One of the factors that works against the selection of the right infrastructure projects is the tendency for governments to select projects for political reasons or because they are popular rather than because they generate the highest net social returns. This was captured by Henry Ergas when he noted

"The incentive in political decision-making leads to an undue emphasis on 'ribbon cutting' opportunities, generally associated with very major ('mega') projects, at the expense of periodic maintenance and of small-scale 'de-bottlenecking' options that could postpone or even avoid the need for more costly asset expansions".

¹⁵ Productivity Commission, "Public Infrastructure, Draft Inquiry Report," (Canberra, March 2014) Available at: http://www.pc.gov.au/__data/assets/pdf_file/0007/134674/infrastructure-draft-volume1.pdf.

¹⁶ Ibid.

BETTER PRICING OF INFRASTRUCTURE SERVICES

The comment from Ergas raises another factor working against the selection of the most appropriate projects, and that is the failure to use existing infrastructure as effectively as possible. In many respects this comes down to poor pricing and regulatory policies by governments. For example, as noted in the conference paper by Winston, the way to deal with road congestion is not to build more roads.¹⁷ It will require the use of congestion charges, so as to encourage the use of existing roads more efficiently, along with better urban planning. The failure to properly price the services from infrastructure not only results in their inefficient use, it also represents a barrier to increased private sector financing.

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The good news is that the ability to better price the services from infrastructure, so that they are used more efficiently and are thus more attractive candidates for private financing, is being facilitated with advances in technology. An obvious example is how technology can allow the application of congestion charges without disrupting journeys. Winston outlines many other examples where technology is allowing the more efficient use of infrastructure. This includes weigh-in-motion technology that can monitor the contribution to road damage caused by trucks, and satellite-based air traffic control systems that can improve the efficiency of airports over older radar systems. He also raises the fundamental question as to why these new technologies are not being applied universally, and why governments continue with policies that result in the inefficient use of existing infrastructure, thereby impeding new investment. In the US context, Winston says that some of the factors working against the uptake of new technologies include agency limitations, a bias towards the status quo, regulatory constraints and political factors – such as the electorate not wanting to pay tolls or higher charges. No doubt these or similar factors are at work in other G20 countries, suggesting that one of the most important public policy challenges that governments face is to change community attitudes so that infrastructure can be used more efficiently.

ARE GOVERNMENTS THE PROBLEM?

Governments generally take the lead role in infrastructure development. This is often to ensure equitable access to infrastructure services (such as providing services to those who are not able to pay), to counter market failures (that occur when not enough of the good or service is being provided or natural monopolies have arisen), or for historical and cultural reasons. But as noted, governments can be the main

¹⁷ Clifford Winston, "The Private Sector's Potential to Improve Public Transportation Infrastructure: With and without Privatization" (paper presented at the Financial Flows and Infrastructure Financing conference, Sydney, Reserve Bank of Australia, 20-21 March 2014). Available at: <http://www.rba.gov.au/publications/confs/2014/pdf/winston.pdf>.

The cost-benefit assessment for infrastructure has to be broad and take into account social, distributional and environmental considerations. These are ultimately matters for which governments have to take responsibility.

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impediment to the efficient use of existing infrastructure and political influences can result in inferior infrastructure investments.

The B20's response to pressures that result in governments selecting less efficient infrastructure projects is to recommend that "G20 governments and business jointly develop long-term bankable infrastructure plans for each country, supported by objective, independent assessments of national priorities, and freed from the uncertainties of the political cycle".¹⁸ While such a recommendation from the business community is understandable, and Australia has a degree of independent assessment over infrastructure investments through the operations of Infrastructure Australia, it is questionable whether it will gain much traction among G20 countries. The recommendation effectively says that governments cannot be trusted with infrastructure planning and project selection and that the direct involvement of business in the planning process would result in better outcomes.

As noted, a range of factors account for why governments have historically being largely responsible for the provision of infrastructure. These cannot be ignored. Moreover the cost-benefit analysis associated with selecting infrastructure projects is different from the financial analysis of investment undertaken by firms. The cost-benefit assessment for infrastructure has to be broad and take into account social, distributional and environmental considerations. These are ultimately matters for which governments have to take responsibility. In addition, when the B20 says that the infrastructure selection process has to be freed from the 'uncertainties of the political cycle', this could also be interpreted as saying that it should not form part of the accountability process of a democratic political system.

The key requirement to improve infrastructure planning and project selection is transparency. In many respects it does not matter who undertakes project assessments, provided all the factors taken into account in making a decision are fully disclosed and available for public scrutiny. It would be a notable achievement if G20 countries committed to make the selection of infrastructure projects fully transparent, for this would help not only improve the quantity but also the quality of infrastructure investments.

CAUTION WITH PPPS

The overall flavour from the conference papers and discussion on the use of PPPs was 'be careful'; PPPs are not a magic bullet for increasing infrastructure investment. Engel, Fisher and Galetovic conclude in their paper that whether a PPP makes sense depends almost exclusively on the economic characteristics of the infrastructure, not on the way it is

¹⁸ Ibid.

financed or funded. PPPs can work when objective performance standards can be written into a contract between the public authority and the private firm. The authors also argue that the notion that PPPs liberate public funds for other investments is a mirage, for PPPs affect the inter-temporal public budget in much the same way as the public provision of infrastructure. PPPs do not free up government resources per se. One of the main advantages of PPPs from the government perspective is that they allow investments while keeping future obligations off balance sheets and outside parliamentary control.

In terms of the decision to use private financing through a PPP, the questions that need to be assessed are whether it would result in lower production costs, better maintenance, and a higher level of service than if the investment was financed totally by public funds. This comes back to the basic point that the G20's focus should be on the selection, design and characteristics of infrastructure investment, rather than just on how it is financed.

CONCLUSION

In past summits, G20 leaders have said that infrastructure investment was critical for growth and was a priority. Australia has nominated infrastructure financing, particularly the involvement of the private sector, as a priority for the G20 in 2014. The danger is that this can lead to a crowded agenda, with various aspects of infrastructure financing being pursued. There would be value in the G20 identifying the basic building blocks that are necessary if increased infrastructure investment is going to contribute to lifting long-term growth and creating jobs. And the most basic building block is appropriate project selection. Notwithstanding its importance, it does not appear to have thus far been given a prominent role in the G20's work on infrastructure investment. The focus has been on the financing of infrastructure. However, the selection of infrastructure projects is as important, if not more important, than the funding and financing arrangements used to deliver them.

It is hoped that the comprehensive growth strategies that G20 governments will be presenting at the Brisbane Summit will include requirements and reforms that ensure the most appropriate infrastructure projects are selected. And the core component of these reforms should be complete transparency over the factors that are taken into account in the project selection process.

MULTILATERAL DEVELOPMENT BANKS, THE G20 AND INFRASTRUCTURE INVESTMENT

DANIELA STRUBE¹

...as infrastructure investment is largely a domestic policy issue, the question often raised in the context of processes like the G20 is how international summits can actually contribute to lifting infrastructure investment.

INTRODUCTION

The world is facing a significant global infrastructure gap. The consulting firm McKinsey & Company estimates that in the period to 2030, USD 57 trillion, or 3.5 per cent of global GDP, is required to support projected GDP growth.² This represents a surge of almost 60 per cent over the USD 36 trillion that has been spent since 1995.³ These are monumental figures. However, as infrastructure investment is largely a domestic policy issue, the question often raised in the context of processes like the G20 is how international summits can actually contribute to lifting infrastructure investment. This paper suggests that strengthening the multilateral development banks (MDBs) and thereby enabling them to play a significant role in supporting infrastructure investment in developing countries constitutes a clear international dimension of infrastructure investment. This is one area where the G20 may be able to use its political impetus to make a valuable contribution.

There have been a number of attempts to quantify the impact of infrastructure on growth. The World Bank's *Infrastructure Strategy Update FY2012-2015* finds that a 10 per cent expansion in infrastructure investment correlates with a 1 per cent increase in growth.⁴ The credibility of any such analysis is limited by endemic problems related to modelling, measurement, data availability, heterogeneity and most importantly, establishing causation. However, economic theory is very clear on the existence of a positive relationship between infrastructure and economic growth and there is an overwhelming consensus on this issue in the economics profession.⁵ Moreover, more recently,

¹ Research Fellow, G20 Studies Centre, Lowy Institute for International Policy.

² McKinsey Global Institute, "Infrastructure Productivity: How to Save \$1 Trillion a Year," (January 2013) Available at: http://www.mckinsey.com/insights/engineering_construction/infrastructure_productivity.

³ Ibid.

⁴ World Bank Group, *Infrastructure Strategy Update FY2012-2015*, (Washington DC, 2011) Available at: <http://siteresources.worldbank.org/INTINFRA/Resources/Transformationthroughinfrastructure.pdf>.

⁵ David Aschauer, "Is Public Expenditure Productive?," *Journal of Monetary Economics* 23 (1989); Luis Servén, "Infrastructure and Growth," (World Bank, January 2010)

infrastructure has been associated with important benefits for equality and social development.⁶

The Australian G20 presidency has identified infrastructure and investment as a priority for the G20 in 2014.⁷ This primarily stems from the concern that sub-optimal infrastructure endowments may significantly undermine growth prospects for the global economy. The global financial crisis and its negative implications for business activity and public budgets have raised additional concerns about the likelihood of the world being able to effectively address the global infrastructure gap, especially regarding the significant investment needs in developing countries. For example, European banks have historically been a main source of infrastructure finance, but are now facing significant consolidation challenges.⁸ More generally, fiscal pressures in advanced countries are also likely to have contributed to a trend of further reductions in bilateral official development assistance that could have been directed to supporting infrastructure investment.⁹ Since these traditional actors (advanced countries' banks and aid budgets) are severely constrained, multilateral development banks have been called upon to further strengthen their role in infrastructure investment.¹⁰ This paper looks at how and why the G20 might catalyse a greater role for the MDBs.

Available at:

<http://econ.worldbank.org/WBSITE/EXTERNAL/EXTDEC/EXTRESEARCH/0,,contentMDK:22629797~pagePK:64165401~piPK:64165026~theSitePK:469382~isCURL:Y,00.html>.

⁶ United Nations Human Settlements Programme, "Infrastructure for Economic Development and Poverty Reduction in Africa," (Nairobi, 2012) Available at: <http://www.uncsd2012.org/content/documents/UN-HabitatReport.pdf>.

⁷ Department of the Prime Minister and Cabinet, "G20 2014: Overview of Australia's Presidency," (Canberra, 20 January 2014) Available at: https://www.g20.org/sites/default/files/g20_resources/library/G20Australia2014conceptpaper.pdf.

⁸ World Bank Group, "Financing for Development Post-2015," (Washington DC, October 2013) Available at:

<http://www.worldbank.org/content/dam/Worldbank/document/Poverty%20documents/WB-PREM%20financing-for-development-pub-10-11-13web.pdf>.

⁹ OECD Newsroom, "Aid to Poor Countries Slips Further as Governments Tighten Budgets," OECD, 3 April 2013, Available at:

<http://www.oecd.org/newsroom/aidtopoorcountriesslipsfurtherasgovernmentstightenbudgets.htm>.

¹⁰ In this article, the term 'multilateral development banks' is used to refer to the World Bank Group, the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development and the Inter-American Development Bank. Sub-regional development banks are not explicitly included under this definition.

'Additionality' is the key test to determine how and where the MDBs can meaningfully contribute to promoting infrastructure investment.

ADDITIONALITY

Promoting infrastructure investment has traditionally been a core role of the MDBs. However, over the last two decades, infrastructure has become relatively smaller as a component within their operations, as their mandates have expanded into other areas such as health and education. Given this broader set of priorities, it is all the more important that the MDBs' engagement in fostering infrastructure investment is as efficient and effective as possible. 'Additionality' is the key test to determine how and where the MDBs can meaningfully contribute to promoting infrastructure investment. Within the context of this paper, additionality refers to the critical hurdle of determining whether a project would have gone ahead without MDB involvement.

MDBs provide various dimensions of additionality in the area of infrastructure investment. Financial additionality covers their ability to attract funding from other sources based on the official 'stamp of approval' that MDB involvement in a project implies. This is often referred to as the MDBs' 'core' catalytic role.¹¹ Policy additionality refers to the MDBs' indirect role in fostering infrastructure investment by addressing the underlying investment conditions within a given market, for example by providing technical assistance in areas such as capital market development, governance and regulation.¹² In some instances, this 'indirect' catalytic role may prove to be even more important than their financial contribution.¹³ Other related dimensions of additionality include demonstration additionality (demonstrating potential success by supporting 'first-mover' projects), design additionality (in project design and implementation) and selection additionality (through improved project selection on the basis of strict governance and accountability standards).¹⁴ Lastly, MDBs also provide additionalities within the dimension of political economy – MDBs may serve as a 'scapegoat' for

¹¹ A variety of factors is attributed to creating this financial additionality, including the MDB's solid finances and in particular their preferred creditor status, their long-standing technical expertise in countries all over the world, their long-term outlook and their strict adherence to governance and project standards in project selection and implementation. These advantages also may allow MDBs to secure better financing terms, such as lower rates and longer maturities, for a project. See: Willem Buiter and Steven Fries, "What Should the Multilateral Development Banks Do" (paper presented at the Annual World Bank Conference on Development Economics - Europe, June 2001). Available at:

<http://www.ebrd.com/downloads/research/economics/workingpapers/wp0074.pdf>; Jeff Chelsky, Claire Morel, and Mabruk Kabir, *Investment Financing in the Wake of the Crisis: The Role of Multilateral Development Banks*, World Bank Economic Premise, no. 121 (2013).

¹² *Investment Financing in the Wake of the Crisis: The Role of Multilateral Development Banks*.

¹³ Jeff Chelsky and Claire Morel, "Official-Sector Non-Concessional Long-Term Financing: The Role of Multilateral Development Banks" (paper presented at the Finance Ministers and Central Bank Governors meeting, Moscow, 15-16 February 2013).

¹⁴ Chelsky, Morel, and Kabir, *Investment Financing in the Wake of the Crisis: The Role of Multilateral Development Banks*.

politically sensitive decisions that are associated with a project.¹⁵ Alternatively, MDB conditionality may provide borrower countries with a justification for the need for reform, while an MDB's reputation as an 'honest broker' may help foster policy change that ultimately contributes to improving investment environments.

ADDITIONALITY AS A CRITERIA FOR MDB ASSISTANCE

Additionality is not only crucial in evaluating the rationale for the MDB's specific activities in infrastructure investment, it is also useful in determining who should receive assistance from the MDBs.

Emerging economies are increasingly able to draw upon alternatives to the traditional MDBs while financing their investment needs. With growth in both their economies and their savings, they now have a much greater ability to access international financial markets and pay off remaining debt to the MDBs. In addition, emerging economies are also increasingly active in setting up entirely new organisations to complement the traditional MDBs, such as the proposed BRICS bank and the new Asian Infrastructure Investment Bank.¹⁶ The latter's official launch may take place as early as the APEC meeting in China in November 2014.¹⁷ Such developments are a testimony to the emerging economies' willingness and ability to create alternatives to financing agencies that have historically been dominated by Western or developed country interests.

The financial weight of these new actors is already substantial. In 2011, concessional funding from emerging economies to low-income countries (USD 12-15 billion) was at a similar level to the funding allocated by donors in the Organisation for Economic Development's Development Assistance Committee (OECD-DAC) towards official development assistance (ODA) (USD 16-17 billion).¹⁸ China is the most important player among emerging economy donors.¹⁹ China also has a particular focus on funding infrastructure projects.²⁰ Other non-traditional partners include private philanthropy and vertical funds. In 2012, private donors

Additionality is not only crucial in evaluating the rationale for the MDB's specific activities in infrastructure investment, it is also useful in determining who should receive assistance from the MDBs.

¹⁵ Rebecca M. Nelsen, "Multilateral Development Banks: Overview and Issues for Congress," (Washington DC: Congressional Research Service, 8 November 2013) Available at: <https://www.fas.org/sgp/crs/row/R41170.pdf>.

¹⁶ Banyan, "An Asian Infrastructure Bank," *The Economist*, 2013, Available at: <http://www.economist.com/blogs/analects/2013/10/asian-infrastructure-bank-1>.

¹⁷ Andrew Elek, "The Potential Role of the Asian Infrastructure Investment Bank," East Asia Forum, 11 February 2014, Available at: <http://www.eastasiaforum.org/2014/02/11/the-potential-role-of-the-asian-infrastructure-investment-bank/>.

¹⁸ World Bank Group, "Financing for Development Post-2015."

¹⁹ Ibid.

²⁰ Ibid.

In 2012, private donors provided funds amounting to about half (USD 60-70 billion) of the combined ODA of the OECD-DAC members.

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provided funds amounting to about half (USD 60-70 billion) of the combined ODA of the OECD-DAC members.²¹

Infrastructure-specific data conveys a similar picture. 2006 data from the Public-Private Infrastructure Advisory Facility shows that more than a third of total infrastructure financing comes from non-traditional partners (USD 8 billion).²² This is of a similar magnitude to the level of private investment and it is significantly greater than traditional concessional infrastructure financing (USD 5 billion). For sub-Saharan Africa, the World Bank also emphasises the significant role played by non-traditional financing sources. Average infrastructure capital expenditure between 2001 and 2006 by the private sector is equal with public sector spending (at USD 9.4 billion).²³ ODA adds another USD 3.6 billion, while non-OECD financiers provided USD 2.5 billion over the same period.²⁴ It can be expected that emerging economies will further gain in importance as funding sources, even if this is only due to an increase in their relative share of global wealth. Growth in emerging markets will, *ceteris paribus*, expand their share in global development funding for infrastructure.²⁵

However, with the emergence of new actors comes the risk of fragmentation of assistance. Different donors tend to focus on different types of infrastructure or financing arrangements. Non-traditional partners tend to focus on investments in power and transport while private sector engagement has been primarily in telecommunications infrastructure.²⁶ The public sector, including MDBs, often focuses on areas that are less attractive to private and non-traditional financiers. It remains to be seen whether emerging country-led funding organisations will provide a similarly broad coverage of projects.

Despite taking on new responsibilities as lenders of investment finance, major emerging economies have also remained active customers of the MDBs. This is evident in Figure 1, which shows that more than three-quarters of MDB funding goes to middle-income countries.²⁷ Low-income countries do not get significantly more assistance than high-income countries. Among middle-income countries, there is also a slight bias towards upper middle-income countries, which receive more than 40 per

²¹ Ibid.

²² Ibid.

²³ Vivien Foster and Cecilia Briceño-Garmendia, "Africa's Infrastructure: A Time for Transformation," (Washington DC: Agence Française de Développement and the World Bank, 2010) Available at: http://siteresources.worldbank.org/INTAFRICA/Resources/aicd_overview_english_no-embargo.pdf.

²⁴ Ibid.

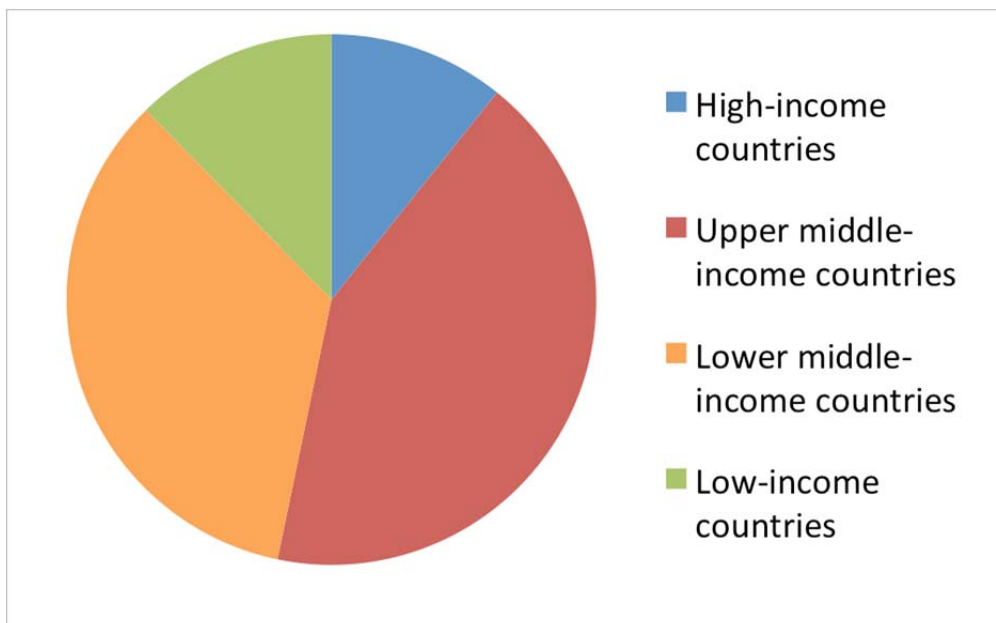
²⁵ World Bank Group, "Financing for Development Post-2015."

²⁶ Ibid.

²⁷ Figure 1 is based on the author's own calculations on the basis of the FY 2013 data provided in: Nelsen, "Multilateral Development Banks: Overview and Issues for Congress." The figures for the ADB include assistance from the Asian Development Fund.

cent of overall assistance. The breakdown for the individual MDBs is shown in Figure 2.²⁸ Even the International Development Association (IDA), the concessional funding arm of the World Bank, commits less than half of its funding to low-income countries. The rest is given to lower middle-income countries. The African Development Bank (AfDB) is the MDB that is most active in working with low-income countries (LICs), but it still commits less than 20 per cent of its investment to the poorest countries.

Figure 1: Recipients of MDB financial assistance



²⁸ Figure 2 is based on the author's own calculations on the basis of the FY 2013 data provided in: *ibid.* The figures for the ADB include assistance from the Asian Development Fund.

Figure 1: Recipients of MDB financial assistance

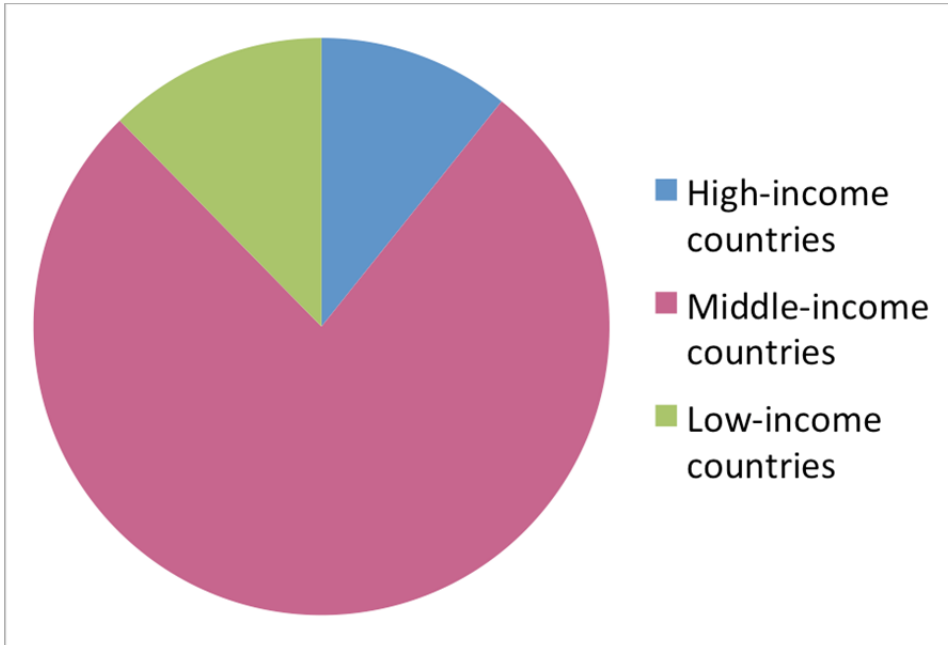


Figure 2: Recipients of MDB financial assistance – institutional breakdown

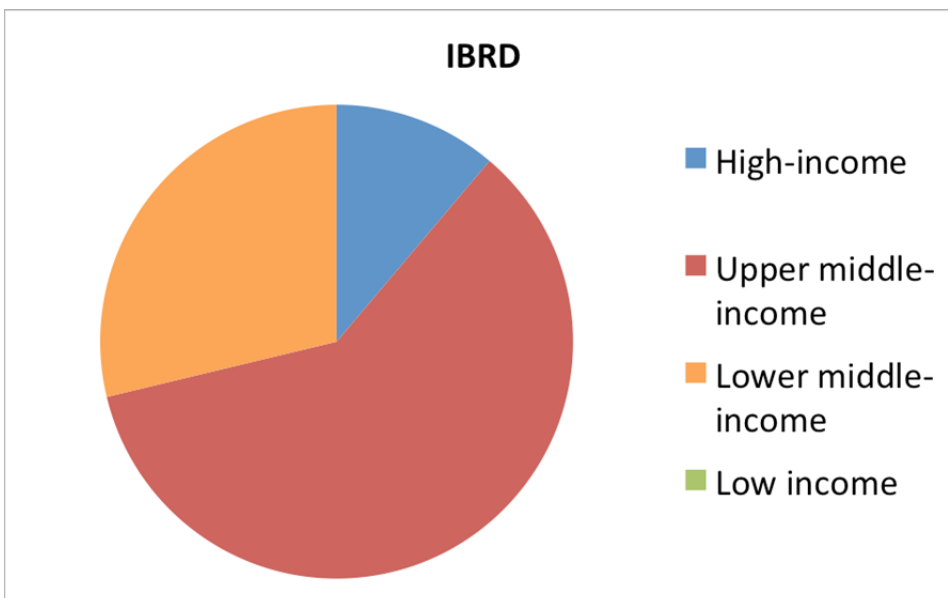


Figure 2: Recipients of MDB financial assistance – institutional breakdown

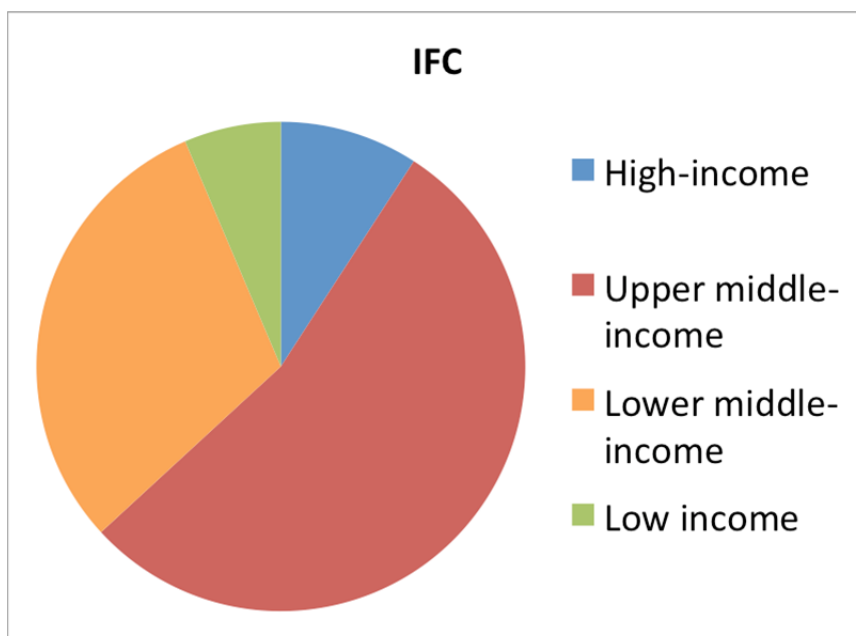
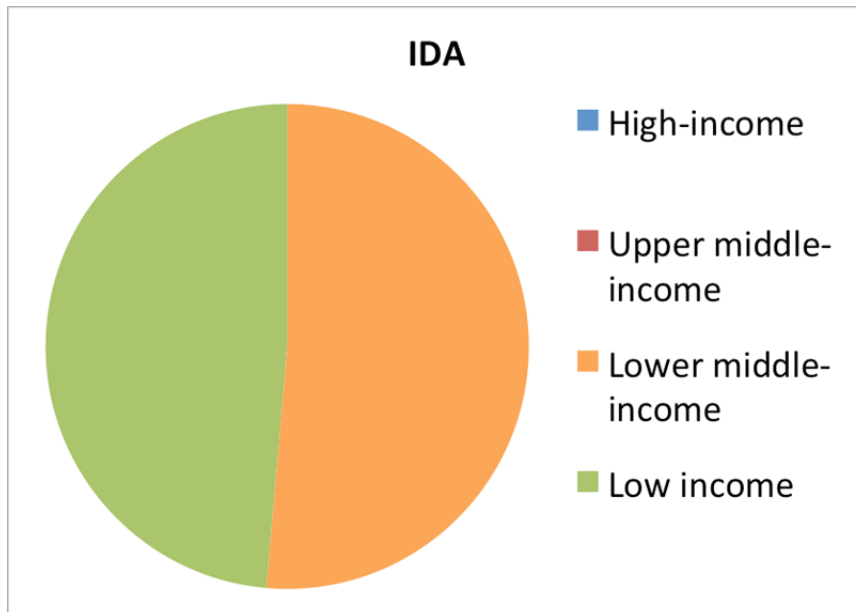


Figure 2: Recipients of MDB financial assistance – institutional breakdown

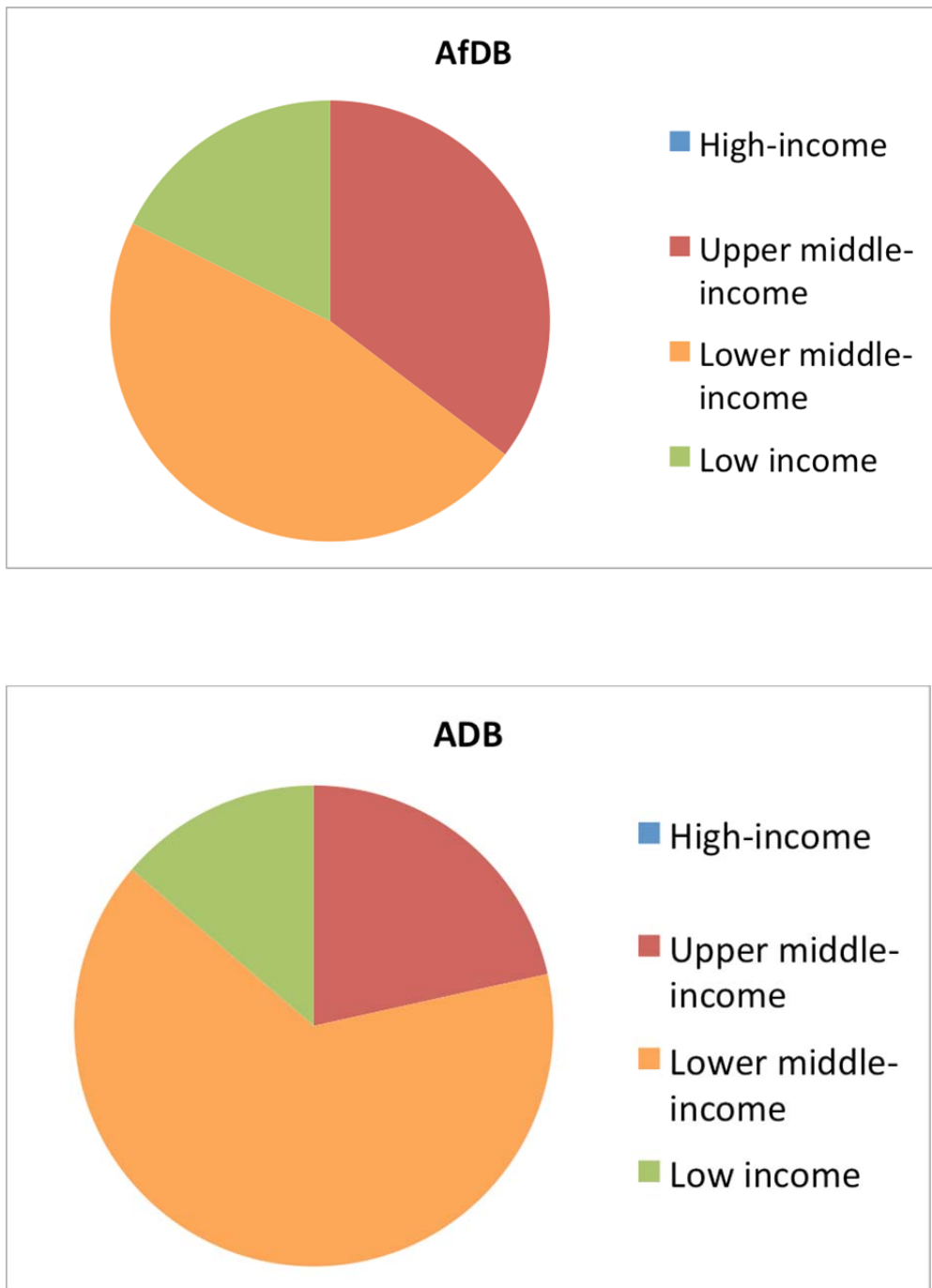
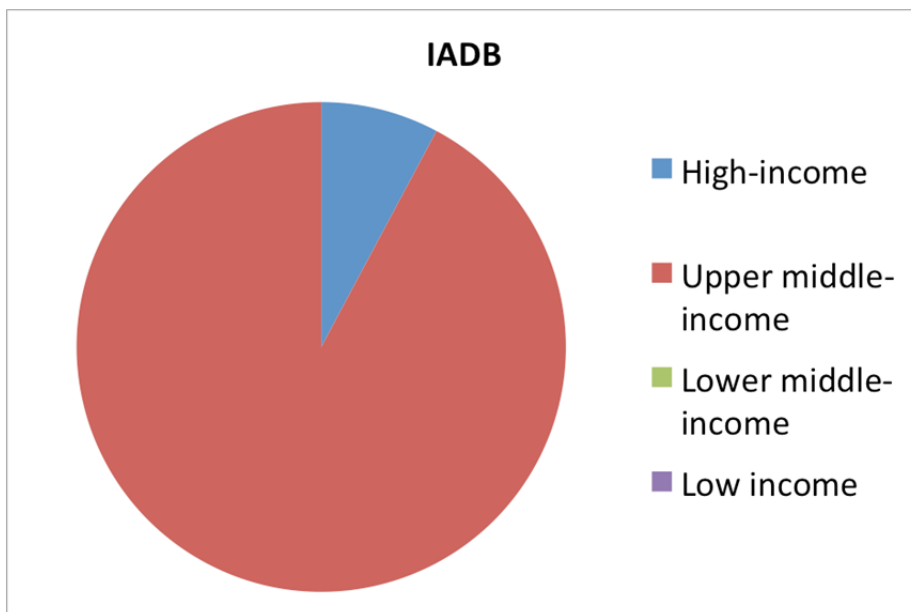
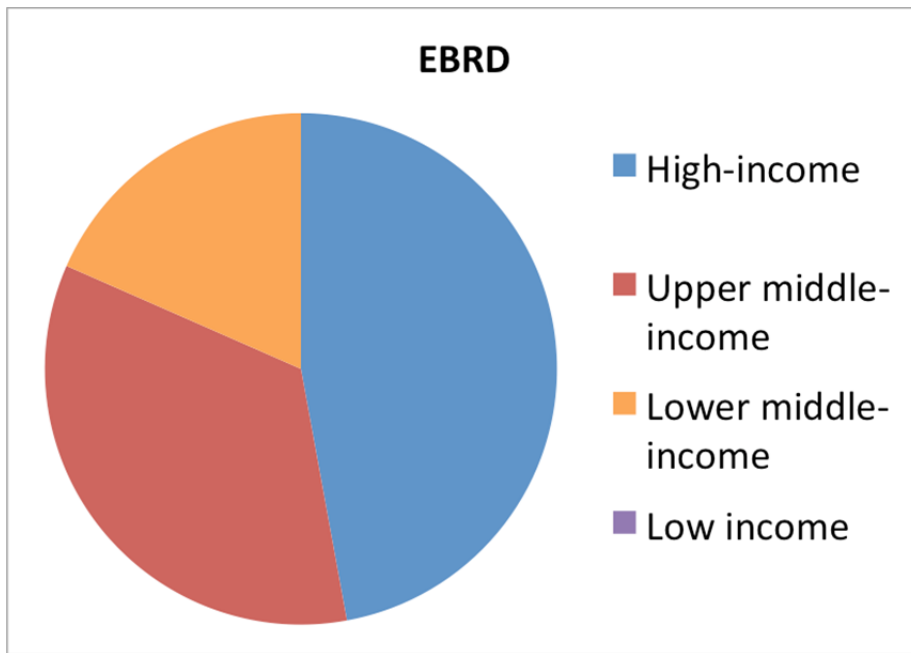


Figure 2: Recipients of MDB financial assistance – institutional breakdown



Intense debate has been sparked over whether MDBs should continue to lend to emerging countries, especially those with access to private capital markets and significant reserves, such as Brazil and China.

The BRICS receive a significant share of MDB funding. In fact, Brazil (USD 6552 million), China (USD 4399 million), India (USD 4309 million) and Russia (USD 4226), respectively represent the four countries that receive the largest amount of MDB assistance. Only the IDA and the AfDB do not have a BRICS nation as their top recipient of assistance.²⁹ Intense debate has been sparked over whether MDBs should continue to lend to emerging countries, especially those with access to private capital markets and significant reserves, such as Brazil and China. As emerging economies are such significant MDB borrowers, this is not just a matter of principle, but also has important implications for the resources available to MDBs.

However, for some emerging economies, access to private capital markets is limited. Only about 20 middle-income countries have appropriate access to private capital markets at the national level. This excludes subnational governments as well as the rest of the developing world. While private participation in infrastructure has never been higher than in FY2010 (USD 160 billion), LICs have received virtually none of these flows. This clearly supports the case for MDB lending to be primarily channelled towards LICs, while some emerging countries that have extensive government reserves and/or access to private capital markets may not require additional financial support to address potential infrastructure gaps.

ADDITIONALITY AND THE MDBS AS CATALYSTS FOR REFORM

In the aftermath of the global financial crisis, developed countries have been unwilling to support the growth of the MDBs' balance sheets.³⁰ This has led to greater efforts from MDBs to leverage investment from the private sector, in the spirit of their 'core catalytic role'.³¹ This is mentioned as a key concern in the World Bank's *Infrastructure Strategy Update FY2012-2015*.³²

The benefits from including the private sector in MDB infrastructure projects are evident. In addition to financial contributions, the private

²⁹ Based on the author's own calculations on the basis of the FY 2013 data provided in: *ibid.*

³⁰ Johannes F. Linn, "Realizing the Potential of the Multilateral Development Banks," The Brookings Institution, September 2013, Available at: <http://www.brookings.edu/research/articles/2013/09/multilateral-development-banks-linn>.

³¹ World Bank Group, "Financing for Development Post-2015."

³² *Infrastructure Strategy Update FY2012-2015*.

sector will bring an efficiency focus and an entrepreneurial mind-set to the table. Involving domestic companies can also contribute to private sector development in the host country. At the same time, the evidence regarding private-public partnerships (PPPs) is mixed.³³ PPPs are complex instruments, to the extent that countries with weak administrative capacities may not be able to implement them effectively even with technical assistance from MDBs.³⁴ PPPs are also prone to information asymmetries which may cause moral hazard.³⁵ The World Bank acknowledges the problems inherent in PPPs in terms of their complexity, as well as the associated difficulty of making a sizeable positive social impact through the use of PPPs.³⁶

It is therefore important that, while generally promoting private sector involvement where appropriate, MDBs do not have a 'PPP bias' for every project. They should remain neutral prior to a project assessment and not presume to know the best financing and implementation arrangements for that project. Private sector development is a desirable secondary goal and should be promoted wherever it is an efficient approach, but it should not supersede the MDBs' preoccupation with value for money. Given these intrinsic challenges associated with private investment in some areas of infrastructure, it is doubtful that it is sufficient to address the infrastructure gap in developing countries in the absence of public involvement.

A more dedicated commitment to innovative financing, so as to increase the productivity of existing resources, may be a promising solution to the funding dilemma. Guillermo Perry is among those who argue that the MDBs have a tendency to be overly risk-averse and conservative in their uptake of financial innovation.³⁷ Two major areas should be prioritised in addressing this issue: the provision of guarantees/risk mitigation and the development of local currency markets.

Private sector development is a desirable secondary goal and should be promoted wherever it is an efficient approach, but it should not supersede the MDBs' preoccupation with value for money.

³³ OECD and International Transport Forum, "Better Regulation of Public-Private Partnerships for Transport Infrastructure: Summary and Conclusions," ITF Round Tables, No. 151 (2013); Clive Harris, *Private Participation in Infrastructure in Developing Countries: Trends, Impacts, and Policy Lessons* (Washington: World Bank Publications, 2003); Antonio Estache and Caroline Philippe, "The Impact of Private Participation in Infrastructure in Developing Countries: Taking Stock of About 20 Years of Experience," ECARES working paper 2012-043 (2012).

³⁴ Stephen Grenville, "Financing for Infrastructure - What Contribution Can the G20 Make?," in *G20 Monitor No. 6: Infrastructure, Anti-Corruption, Energy and the G20* (Sydney: Lowy Institute for International Policy, 2013); Maria Monica Wihardja, "Looking at G20 Initiatives on Infrastructure Investment from a Developing Country's Perspective: Indonesia," in *G20 Monitor No. 6: Tax, Infrastructure, Anti-Corruption, Energy and the G20* (Sydney: Lowy Institute for International Policy, 2013).

³⁵ See for example Dennis De Clerck, Erik Demeulemeester, and Willy Herroelen, "Public Private Partnerships: Look before You Leap into Marriage," *Review of Business and Economic Literature* 57, no. 3 (2012).

³⁶ World Bank Group, *Infrastructure Strategy Update FY2012-2015*.

³⁷ Guillermo Perry, *Beyond Lending: How Multilateral Banks Can Help Developing Countries Manage Volatility* (Washington: Centre for Global Development, 2009).

Risk mitigation is the most obvious instrument for MDB involvement. It highlights the principle of crowding in other (private sector) resources and, most importantly, specifically targets the economic problem of excessive non-commercial risk that constrains infrastructure investment in many emerging market and developing economies (EMDEs). MDB assistance should particularly focus on projects where the viability gap is caused by non-commercial risks. First-loss guarantees can also be of particular value. If an equity tranche is included in the deal, the issuer can also participate in the upside risk of the project.³⁸ MDBs, such as the World Bank with its Multilateral Investment Guarantee Agency (MIGA), are active in the area of risk mitigation, but they are in a position to pursue a more aggressive strategy and take on more risks in this area.³⁹

Strengthening local currency markets is important, because insufficient market depth represents a level of elevated risk to global investment decision-makers that are otherwise more familiar with, and biased in favour of, advanced markets.

The World Bank has recently proposed additional efforts to address these shortcomings by creating exposure exchange agreements between the International Bank for Reconstruction and Development and MIGA as well as with regional MDBs. This is designed to reduce concentration risk, and in turn possibly lead to an increase in the productivity of agency resources.⁴⁰ In the context of the proposed Global Infrastructure Facility, the Bank has also committed to working towards the establishment of a new investment asset class for long-term investors such as institutional investors.⁴¹ The International Finance Corporation is extending its efforts in the area of managing third-party capital funds, specifically targeting institutional and non-bank investors.⁴²

The other area where the potential additionality of MDBs is under-utilised is in local currency markets. Strengthening local currency markets is important, because insufficient market depth represents a level of elevated risk to global investment decision-makers that are otherwise more familiar with, and biased in favour of, advanced markets. Despite increasingly strong fundamentals in EMDEs, both investors from advanced economies and EMDEs themselves seem reluctant to pursue opportunities in these markets.

The MDBs have recently increased their efforts in this area. Examples include the Currency Exchange Fund (TCX), the Global Emerging Markets Local Currency Bond Program (Gemloc) and the Efficient

³⁸ World Bank Group, "Financing for Development Post-2015."

³⁹ 43% of all MIGA guarantees in the FY 2011 were for infrastructure projects. See: *Infrastructure Strategy Update FY2012-2015*.

⁴⁰ World Bank Group Staff, "Optimizing World Bank Group Resources and Supporting Infrastructure Financing" (paper presented at the G20 Finance Ministers and Central Bank Governors meeting, Washington DC, World Bank, 14 April 2014). Available at: https://www.g20.org/sites/default/files/g20_resources/library/Optimizing%20World%20Bank%20Group%20Resources%20and%20Supporting%20Infrastructure%20Financing.pdf.

⁴¹ Ibid.

⁴² Ibid.

Securities Markets Institutional Development (ESMID) Africa program. However, given the continuing lack of market depth in EMDEs and the fact that the MDBs are well placed to deal with this policy area, more effort is required. The viability of local currency bond markets (LCBMs) is fundamentally defined by macroeconomic conditions and political credibility.⁴³ Broader MDB efforts in the areas of governance and macroeconomic stabilisation are therefore complementary to initiatives for promoting LCBMs.

The G20 has also taken steps towards promoting local currency markets by commissioning the development of a Common Diagnostic Framework (CDF) on local currency bond markets.⁴⁴ However, follow-up on the CDF has been weak and not a policy priority of the G20. Hence, progress in this area has not been consistent and the topic needs revitalising within the G20.

The MDBs have been advised to consider a range of other instruments. These include developing global markets of debt instruments funded by diaspora communities, such as diaspora bonds, and further developing output-based aid programs, with a view to increasing positive project spillovers to the community.⁴⁵ A more progressive approach to incorporating suitable innovative financial instruments into mainstream MDB activity may 'buy' the MDBs some time to consider necessary adjustments to their mandate and governance structure. Recent experience with IMF reform has shown that even small changes in this area may take years to materialise. The global infrastructure gap, however, requires a strong and immediate response. Opportunities that are created by financial innovation may therefore be hard to ignore.

ADDITIONALITY AND THE MDBS' PROVISION OF TECHNICAL ASSISTANCE

Given the political difficulties in obtaining additional funding for financial assistance, the MDBs' policy and technical assistance function may grow in importance. The case for policy and technical assistance is based on the assumption that improving the business and regulatory environment in assisted countries will indirectly foster stronger infrastructure investment. This line of argument is sound and should be further investigated. However, the MDBs' technical assistance services also face a range of challenges.

⁴³ World Bank Group, "Financing for Development Post-2015."

⁴⁴ IMF et al., "Local Currency Bond Markets - a Diagnostic Framework," (July 2013) Available at: <http://www.oecd.org/g20/topics/financing-for-investment/Local-Currency-Bond-Markets-Diagnostic-Framework-2013.pdf>.

⁴⁵ Perry, *Beyond Lending: How Multilateral Banks Can Help Developing Countries Manage Volatility*; World Bank Group, "Financing for Development Post-2015"; *Infrastructure Strategy Update FY2012-2015*.

MDBs such as the World Bank are now acknowledging the limitations of this 'trickle down' view, and point to the importance of explicitly considering the impact of infrastructure on the poor.

The potential benefits of climate change mitigation and adaptation lie predominately in the future, but they are important. In addition to environmental and equity concerns, economic arguments...support the case for large-scale investment in climate change mitigation and adaptation.

First, there must be adequate recognition and accommodation by the MDBs of the local non-economic (chiefly social and environmental) dimensions of infrastructure. Infrastructure investment should not only target growth. It cannot necessarily be assumed that all members of the community will benefit equally – or even at all – from an infrastructure project without any dedicated effort to promote a broad sharing of the gains. The assumption of the existence of automatic 'trickle down' effects from major infrastructure projects has rightly been criticised by civil society.⁴⁶ MDBs such as the World Bank are now acknowledging the limitations of this 'trickle down' view, and point to the importance of explicitly considering the impact of infrastructure on the poor.⁴⁷ In addition to fostering economic growth, infrastructure investment should explicitly be designed to positively contribute to reducing inequality and promoting sustainability. At the very least, it should not be the source of, nor exacerbate, any undue negative impacts on communities and the environment. Moreover, there is no escaping the reality that people's infrastructure needs differ according to socioeconomic characteristics (for example income and degree of urbanisation).⁴⁸ The interests of marginalised groups thus need to be protected appropriately. The MDBs' work is based on an array of standards that have been put in place to make sure that social and environmental impacts are carefully monitored. This area should be further strengthened and remain a core concern of broader MDB involvement in infrastructure investment.

In addition, particular efforts will be required to address the implications of climate change on infrastructure investment. The time-inconsistency problem that is endemic to infrastructure in general is even more pronounced for investments in infrastructure that aim to take climate change into account and foster sustainability. The potential benefits of climate change mitigation and adaptation lie predominately in the future, but they are important. In addition to environmental and equity concerns, economic arguments (for example related to efficiency gains from technology-driven investment, market expansion and development, reduced extreme weather-related losses etc.) support the case for large-scale investment in climate change mitigation and adaptation.

Globally, these upfront costs for addressing climate change are monumental. It is estimated that by 2020, USD 100-200 billion will be required annually in global mitigation investments to limit the concentration of greenhouse gases in the atmosphere to 450ppm.⁴⁹

⁴⁶ Peter Bosshard, "Infrastructure for Whom? A Critique of the Infrastructure Strategies of the Group of 20 and the World Bank," (Berkeley, May 2012) Available at: http://www.internationalrivers.org/files/attached-files/infrastructure_for_whom_report.pdf.

⁴⁷ World Bank Group, *Infrastructure Strategy Update FY2012-2015*.

⁴⁸ Bosshard, "Infrastructure for Whom? A Critique of the Infrastructure Strategies of the Group of 20 and the World Bank."

⁴⁹ Amar Bhattacharya, Mattia Romani, and Nicholas Stern, "Infrastructure for Development: Meeting the Challenge," (Grantham Research Institute on Climate

Furthermore, adaptation will cost an additional USD 70-100 billion globally per year.⁵⁰ While the MDBs' contribution to climate change mitigation and adaptation in developing countries should involve a financial assistance component, an even greater contribution may be in providing technical assistance in this area, in particular in relation to their infrastructure investment programs. The MDBs are active in both climate change and infrastructure financing. They are therefore well placed to combine their expertise in these two areas and provide guidance on sustainable infrastructure investment.

The MDBs have recently made progress in accounting for the social and environmental dimensions of their engagement in infrastructure investment. The World Bank's *Infrastructure Strategy Update FY2012-2015* specifically highlights the need to explore "co-benefits between infrastructure and environment [... and] inclusive development".⁵¹ In addition, the World Bank commits to strengthen its 'transformational engagement' by increasing its efforts in the areas of knowledge management, cooperation with other actors, and pooling of expertise and resources.⁵²

CONCLUSION

The MDBs can make a major contribution to reducing the global infrastructure gap, provided their actions begin with the principle of additionality. Lending should be concentrated on low- and lower middle-income countries that lack other funding options. In terms of both financial and technical assistance, additionality needs to be strengthened. The MDBs can increase the productivity of their lending by further reinforcing recent efforts to more strongly embrace financial innovation. The MDBs' technical assistance will benefit from a stronger integration between the infrastructure agenda and efforts to combat climate change and promote inclusive development. Given the enormous challenges in terms of infrastructure investment, in particular in developing countries, an efficient and effective MDB system is of utmost importance. The G20 can be instrumental in providing political impetus to this reform process, chiefly by aiming to strengthen the catalytic role of the MDBs in promoting productive and sustainable infrastructure investment.

The MDBs can make a major contribution to reducing the global infrastructure gap, provided their actions begin with the principle of additionality.

Change and the Environment Centre for Climate Change Economics and Policy, June 2012).

⁵⁰ Ibid.

⁵¹ World Bank Group, *Infrastructure Strategy Update FY2012-2015*.

⁵² Ibid.

LINKING DEVELOPMENT ACTIONS TO GROWTH: DEBATING INFRASTRUCTURE INVESTMENT

SUSAN HARRIS RIMMER¹

WHAT HAS HAPPENED TO DATE?

My key recommendation from a previous Think20 paper focused on the status of development issues within G20 actions and debates, and their relationship to broader questions of accountability and the legitimacy of the G20 as a forum.² Recommendation 1 reads:

At least, do no harm. The Development Working Group should explicitly monitor the economic implications of G20 core actions in fiscal, financial, trade, exchange rate and environmental policies for non-G20 countries, especially low-income countries.

This piece assesses how this recommendation is playing out in 2014 in relation to financing infrastructure investment, a key priority of Australia as G20 chair.³

WHAT IS AUSTRALIA'S APPROACH TO THE G20 DEVELOPMENT AGENDA?

As the host nation for the 2014 G20 meeting, Australia has been explicit that focusing on development is fundamental to the G20's growth mandate. Australia has sought to consider the impact of the G20 agenda as a whole on developing countries *by linking development actions to growth*. As the government's overview of its priorities for the 2014 G20 agenda notes, "[e]merging market and developing economies contribute around three quarters of global growth".⁴ Prime Minister Abbott has

¹ Director of Studies, Asia Pacific College of Diplomacy, The Australian National University.

² Susan Harris Rimmer, "Coherence and Humility: Development Priorities for the G20," in *G20 Monitor No. 5: Development and the G20* (Sydney: Lowy Institute for International Policy, 2013). Available at: http://www.lowyinstitute.org/files/g20_monitor_the_g20_and_development_.pdf.

³ Australian G20 Presidency, "Investment and Infrastructure," 2014, Available at: https://www.g20.org/g20_priorities/g20_2014_agenda/investment_and_infrastructure.

⁴ *Ibid.*

focused on the development aspects of trade, specifically “working together on practical actions to remove obstacles to trade and enhance countries’ ability to participate in global value chains through domestic reform”. Treasurer Joe Hockey has lauded the OECD Base Erosion and Profit Shifting agenda as a way of increasing domestic budgets for developing and developed countries. So far, however, the political leaders have been muted in their public references to development issues.

The challenge for the Brisbane Summit will be working out how best to identify and achieve practical actions to help developing countries, particularly low-income countries. This will involve working with these countries through outreach activities, and elevating certain issues that relate to development to the leaders’ level if that is strategically required. Australia has prioritised three development issues for the Development Working Group (DWG) to work on. The first is ‘creating conditions for developing countries to attract infrastructure investment’. The other two issues are strengthening tax systems, and improving access to financial services and the associated benefits from a reduction in the costs of transferring remittances home.

CREATING CONDITIONS FOR DEVELOPING COUNTRIES TO ATTRACT INFRASTRUCTURE INVESTMENT

The DWG will examine potential implications for LICs from the work of the former G20 Study Group on Financing for Investment, as well as strengthen coordination between the DWG and the new Infrastructure and Investment Working Group (IIWG), co-chaired by Germany, Indonesia and Mexico. Leaders in St Petersburg also endorsed the work plan prepared by the G20 Study Group on Financing for Investment and called for particular attention to be given to ways to improve public-private partnership (PPP) arrangements.⁵

The design/risk issues for investment in infrastructure for development outcomes is clearly an area of the development agenda that has the potential to be placed on the leadership track negotiations by Australia’s ‘infrastructure prime minister’ Mr Tony Abbott. However, the issues around how to increase private investment are difficult to navigate, as shown by the recent G20 report *Practical Solutions and Models for Addressing Obstacles to Institutional Investment in Infrastructure in Developing Countries*.⁶ This debate comes in the context of more

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⁵ G20, “G20 Workplan on Financing for Investment: Study Group’s Findings and Ways Forward,” (St Petersburg: G20 Study Group on Financing for Investment, July 2013) Available at: <http://en.g20russia.ru/news/20130906/782776427.html>.

⁶ World Bank Group Staff, “Practical Solutions and Models for Addressing Obstacles to Institutional Investment in Infrastructure in Developing Countries” (paper presented at

participation and consideration of the role and responsibilities of business in international development, as well as the dominance of economic diplomacy.⁷

WHERE DOES THE INFRASTRUCTURE INVESTMENT FIT INTO THIS DEVELOPMENT FRAMEWORK?

Is infrastructure investment in large part a development issue under this approach? Most development experts agree there is an underinvestment in pro-poor infrastructure globally, and certainly in G20 countries.⁸ The OECD estimates global infrastructure requirements to 2030 to be around USD 50 trillion.⁹ The International Energy Agency also estimated that adapting to and mitigating the effects of climate change over the next 40 years out to 2050 will require around USD 45 trillion or around USD 1 trillion a year.¹⁰

Focusing on infrastructure investment for macroeconomic growth can, but does not automatically, benefit people living in extreme poverty.

In some cases though, infrastructure that opens access to markets or social infrastructure can improve the lives of poor people. The consequences of a lack of investment fall most heavily on the poor, such as the almost 900 million people in the world who do not have access to clean, safe drinking water, or the 2.6 billion living without basic sanitation. The question is how to make such infrastructure investment and implementation truly pro-poor. Focusing on infrastructure investment for macroeconomic growth can, but does not automatically, benefit people living in extreme poverty, as they can be affected by displacement, environmental damage or by being forced to pay more for basic services.

There is the larger issue too, of capital flowing 'up-hill' from emerging markets to developed economies, instead of "connecting the surplus savings of developed countries with the high social-return infrastructure investment opportunities in emerging markets".¹¹ Linked to this idea is

the Investment and Infrastructure Working Group, January 2014). Available at: https://www.g20.org/sites/default/files/g20_resources/library/WBG%20IIWG%20Practical%20Solutions%20and%20Models%20Institutional%20Investors%20EMDEs.pdf.

⁷ Margaret Callan and Robin Davies, "When Business Meets Aid: Analysing Public-Private Partnerships for International Development," (April 2013).

⁸ Ifzal Ali and Ernesto M. Pernia, "Infrastructure and Poverty Reduction - What Is the Connection?," ERD Policy Brief Series, no. 13 (2003).

⁹ OECD, "The Role of Banks, Equity Markets and Institutional Investors in Long-Term Financing for Growth and Development: Report for G20 Leaders," 15-16 February 2013, Available at: <http://www.oecd.org/pensions/private-pensions/G20reportLTFinancingForGrowthRussianPresidency2013.pdf>.

¹⁰ Ibid.

¹¹ As examined by Daniela Strube and Stephen Grenville: G20 Studies Centre, *G20 Monitor No. 6: Tax, Infrastructure, Anti-Corruption, Energy and the G20*, (Sydney, 2014) Available at: <http://www.lowyinstitute.org/publications/tax-infrastructure-anti-corruption-energy-and-g20>.

the OECD's urging of nations to promote 'patient, productive and engaged' capital when investing in infrastructure.

WHAT MORE IS REQUIRED BEFORE THE BRISBANE SUMMIT?

Australia needs to use its outreach program to talk to LICs about the possible prioritisation of infrastructure investment within the G20 agenda. Australia also needs to open debates about the issue of public-private partnerships, as such partnerships raise significant concerns for many development, human rights and anti-corruption commentators. A key debate for Brisbane will be how to finance and handle issues of risk in a way that meets the developmental infrastructure needs of states and also safeguards vulnerable communities. One think tank report calls this a 'responsible' approach.¹² The role of the multilateral development banks and the hard-won learning about the role of safeguards will be crucial to the success of this agenda.

A report from the Heinrich Böll Stiftung on responsible investment in infrastructure asks:

What kind of infrastructure is necessary and where? For whose benefit? How should the cost/benefits of infrastructure proposals be assessed? How will proposed infrastructure affect the planet's carbon footprint? How can investment be brought into underserved countries, or continents, such as Africa? How should infrastructure finance be generated? Are PPPs the right modality for infrastructure development?¹³

These seem like the right questions, and the best way to test them is to ask LICs and civil society about how to proceed in particular contexts, bearing in mind the 'do no harm' approach.

¹² Nancy Alexander, "Responsible Investment in Infrastructure: Recommendations for the G20," (Washington DC: Heinrich Böll Foundation North America, 2013) Available at: http://www.boell.org/downloads/Responsible_Investment_in_Infrastructure.pdf.

¹³ *Ibid.*

RECOMMENDATIONS¹⁴

- At least, do no harm. The Development Working Group should explicitly monitor the economic implications of G20 core actions in fiscal, financial, trade, exchange rate and environmental policies for non-G20 countries, especially low-income countries.
- A development pillar/column should be added to the mutual assessment framework.
- The G20's future lies in the 'beyond aid' agenda (trade facilitation, labour mobility, gender equality, climate finance, migration, technology etc.), and the aim should be policy coherence for development.
- The greatest leadership challenge in 2013-2014 for all global governance actors is the achievement of the Millennium Development Goals and making sure something decent comes next.
- Leaders declarations in St Petersburg, Brisbane and Istanbul need to speak to inclusive growth and acknowledge poverty and inequality challenges within the G20.
- G20 is not a credible development actor without paying serious attention to gender equality issues. The new Development Action Plan and Mutual Assessment Plan must be informed by serious gender analysis and indicators.

¹⁴ These recommendations are taken from: Susan Harris Rimmer, "The G20 and Its Outreach: New Measures of Accountability, Legitimacy and Success," in *Think20 Papers 2014: Policy Recommendations for the Brisbane G20 Summit*, ed. Mike Callaghan and Hugh Jorgensen (Sydney: Lowy Institute for International Policy, 2013).

FAIR TAX FOR SHARED GROWTH: HOW TAX AND TRANSPARENCY REFORMS CAN HELP ACHIEVE G20 GROWTH AND DEVELOPMENT GOALS

CLAIRE SPOORS AND SERENA LILLYWHITE¹

INTRODUCTION

Today, the poorest half of the world's population owns less than the richest 85 people in the world, and inequality is growing, according to a recent Oxfam report. *Working for the Few*, which captured the zeitgeist at the World Economic Forum in Davos in January, also showed that the gap between rich and poor is growing globally, and in all but four G20 member countries.² Since then, the International Monetary Fund, in two strongly worded reports, has identified inequality as a growing risk to the G20's overarching objective for 2014 – economic growth.³ The Fund states:

It would still be a mistake to focus on growth and let inequality take care of itself, not only because inequality may be ethically undesirable but also because the resulting growth may be low and unsustainable.⁴

...the poorest half of the world's population owns less than the richest 85 people in the world, and inequality is growing...

To achieve its goal of driving strong, sustainable and balanced growth across developed and developing economies, the G20 needs to note this growing trend and respond. Australia, the 2014 G20 President,

¹ Claire Spoor and Serena Lillywhite jointly prepared this paper as representatives of Oxfam Australia and Publish What you Pay Australia. For more information on Oxfam Australia and Publish What You Pay Australia, visit www.oxfam.org.au and www.pwypaustralia.org.

² Ricardo Fuentes-Nieva and Nick Galasso, "Working for the Few: Political Capture and Economic Inequality," (Oxford: Oxfam International, January 2014) Available at: <http://www.oxfam.org/sites/www.oxfam.org/files/bp-working-for-few-political-capture-economic-inequality-200114-en.pdf>.

³ David Lipton, "Fiscal Policy and Income Inequality. Address to the Peterson Institute for International Economics," (Washington DC, International Monetary Fund, 13 March 2014). Available at: <https://www.imf.org/external/np/speeches/2014/031314.htm>.

⁴ Jonathon D. Ostry, Andrew Berg, and Charalambos G. Tsangarides, "IMF Discussion Note: Redistribution, Inequality, and Growth," (Washington DC: International Monetary Fund, 2014). Available at: <http://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf>.

should particularly take note as our region is far from immune. On the contrary, a recent study from the Asian Development Bank should serve as a reminder that despite regional growth, these development challenges remain prevalent in the Asia Pacific region, such that in order to achieve regional development and growth targets, inequality must be addressed:

For Asia and the Pacific, where stellar growth is being challenged by still pervasive poverty and rising inequality, inclusive growth must be more than just a highly desirable but rather vague goal: it is an imperative for achieving sustained and equitable growth.⁵

A major contributor to increasing inequality is the broken international tax regime. The problem, in G20 parlance, is base erosion and profit shifting (BEPS). High levels of tax dodging by multinationals and wealthy individuals are draining away revenues from national budgets and creating a division between those who pay their taxes and those who have the means to avoid them. The Australian Government's inclusion of international tax reform as a priority issue for its 2014 presidency of the G20 forum is welcome. Although the issue was first flagged at the 2009 London Summit, it seems that it was not until budgets in industrialised economies reached breaking point that there has been a sufficient appetite to stop the haemorrhaging of tax revenue through clever accounting. Addressing tax avoidance, promoting international tax transparency and ensuring that developing countries benefit from the G20's tax agenda, particularly in relation to information sharing, are the focus areas for this priority.

Transparency is essential if tax avoidance, tax evasion and money laundering are going to be addressed, and to ensure developing countries benefit from international tax system reform. The interconnectedness of the world's economies facilitates the circumvention of national tax jurisdictions by multinational companies. One of the most practical reforms to address this issue is to require business entities to disclose country-by-country information pertaining to their tax contributions. This will help ensure that companies pay their fair share of tax where value is created and real economic activities occur. In short, companies need to pay tax in the country where they conduct their business. Anything less than this will deprive developing and industrialised countries alike of much needed tax revenue.

In purely financial terms, some multinationals feel it makes good business sense to minimise their tax bill. This is done by artificially transferring profits to shell companies in secrecy jurisdictions with low or

...the erosion of tax bases, which provide the infrastructure and labour skills that multinationals rely on, is not sustainable for the corporate sector or for society...

⁵ ADB, "Adb's Support for Inclusive Growth," (Manila: ADB, March 2014) Available at: http://www.adb.org/sites/default/files/tes-ig_0.pdf.

nominal tax rates, where companies are neither resident nor conduct business. Yet the erosion of tax bases, which provide the infrastructure and labour skills that multinationals rely on, is not sustainable for the corporate sector or for society – G20 governments, Oxfam and the International Monetary Fund agree on this point. It is also unfair on small businesses and ordinary citizens who pay their dues and increasingly shoulder the tax burden.

The OECD has found that on average multinationals pay 5 per cent in corporate tax while small companies pay around 30 per cent.⁶ This non-productive competitive advantage that multinationals gain over small companies by dodging their tax liabilities distorts the market.

IMPACT OF BEPS ON DEVELOPING COUNTRIES

Tax avoidance by digital brands in developed countries has recently captured global headlines. However, the shifting of profits by multinational companies out of developing and least developed countries is even more pernicious, and is a prominent factor undermining prospects for stable global economic growth.⁷ The OECD states that, “[m]ultinational enterprises (MNEs) are being accused of dodging taxes worldwide and in particular in developing countries, where tax revenue is critical to foster long-term development”.⁸

When profit shifting is combined with other illicit financial flows, such as the looting of public assets, the impact is devastating. In 2011, the revenue lost to developing countries was valued at just under USD 1 trillion.⁹ Approximately half of these illicit flows from developing countries are attributable to profit shifting by multinationals.¹⁰ This represents a loss of tax revenues of around USD 100 billion,¹¹ which could have paid

⁶ OECD, “Addressing Base Erosion and Profit Shifting,” (Paris, 12 February 2013).

⁷ Petr Janský and Alex Prats, “Multinational Corporations and the Profit-Shifting Lure of Tax Havens,” (March 2012) Available at: <http://www.christianaid.org.uk/images/ca-op-9-multinational-corporations-tax-havens-march-2013.pdf>; Clemens Fuest and Nadine Riedel, “Tax Evasion and Tax Avoidance in Developing Countries: The Role of International Profit Shifting” (paper presented at the The Dynamics of Illicit Flows from Developing Countries conference, Washington DC, 2009). Available at: http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Working_Papers/Series_10/WP1012.pdf.

⁸ “Tax Evasion and Tax Avoidance in Developing Countries: The Role of International Profit Shifting.”

⁹ Dev Kar and Devon Cartwright-Smith, “Illicit Financial Flows from Developing Countries: 2002-2006,” (Washington DC: Global Financial Integrity, April 2009) Available at: <http://www.gfintegrity.org/storage/gfip/executive%20-%20final%20version%201-5-09.pdf>.

¹⁰ Raymond W. Baker, *Capitalism's Achilles Heel: Dirty Money and How to Renew the Free-Market System* (Hoboken: John Wiley and Sons, 2005).

¹¹ Ann Hollingshead, “The Implied Tax Revenue Loss from Trade Mispricing,” (Washington DC: Global Financial Integrity, 2010) Available at:

A large number of developing countries are reliant, sometimes solely, on the extractives sector for revenue.

for the provision of basic school education in poor countries four times over.¹² The impact of this lost revenue is compounded by the fact that developing countries are more reliant on corporate tax than developed countries that can tap other tax sources such as personal income tax.¹³

A large number of developing countries are reliant, sometimes solely, on the extractives sector for revenue. This is particularly true in sub-Saharan Africa, where in 2011 exports of oil, gas and minerals were worth USD 382 billion, nearly eight times the value of international aid to the continent.¹⁴ Unfortunately, many resource-rich developing countries remain trapped in poverty and do not benefit from their natural resource wealth. The secrecy and corruption that often surround deals facilitates profit shifting and illicit financial flows. This paradox, known as the 'resource curse', sees two-thirds of the world's poorest people living in resource-rich countries.

An alleged example of this is the case of the mining and commodities conglomerate, Glencore (now GlencoreXstrata) and its dealings in Zambia. According to a leaked Grant Thornton audit report, Glencore engaged in profit shifting when selling copper from its Mopani mine to Switzerland at below market prices.¹⁵ The report also found that the company had artificially increased its costs, which meant Glencore was able to report overall losses and pay minimal or no corporation tax in Zambia, a country where almost two-thirds of the population live below the poverty line.¹⁶

If a country like Zambia cannot harness its finite natural resource wealth (as well as revenues from other major sectors such as agriculture), its prospects for the development of a healthy, skilled and productive population, and the economic flow-on effects from such development, are greatly diminished. The status quo, which sees the country remain

http://www.gfintegrity.org/storage/gfip/documents/reports/implied%20tax%20revenue%20loss%20report_final.pdf.

¹² UNESCO, "Schooling for Millions of Children Jeopardized by Reductions in Aid," (Paris, June 2013) Available at: http://unesdoc.unesco.org/images/0022/002211/221129E.pdf?utm_source=News+Alert+10%2F6%2F13+-+New+figures+on+children+out+of+school+and+aid+to+education&utm_campaign=News+Alert+June+2013&utm_medium=email.

¹³ Sizeable tax contributors, such as foreign companies, across sub-Saharan Africa, for example, typically constitute less than 5 per cent of all taxpayers, yet generally contribute three-quarters of all tax revenue, see: International Tax Dialogue, "Revenue Administration in Sub-Saharan Africa," (2010) Available at: <http://www.itdweb.org/documents/AfricaStudy.pdf>.

¹⁴ See the WTO Statistics Database: stat.wto.org and OECD Stat Extracts: stats.oecd.org

¹⁵ Grant Thornton and ECON Pöyry, "Pilot Audit Report – Mopani Copper Mines PLC," (2010) Available at: http://www.letemps.ch/rw/Le_Temps/Quotidien/2011/02/09/Economie/ImagesWeb/Audit%20Glencore%20Mopani.pdf.

¹⁶ World Bank, "Data: Zambia," 2014, Available at: <http://data.worldbank.org/country/zambia>.

dependent on aid, is clearly not the optimum outcome, not least as stretched budgets in donor countries mean aid budgets are shrinking. It certainly does not fit with the G20's objective of delivering strong, sustainable and balanced growth across developed and developing economies.

Clearly it would be preferable for developing countries to mobilise and manage their resource revenues effectively to achieve sustainable growth. This would enable current aid commitments to deliver broader benefits beyond supplementing missing tax revenues. The governments of industrialised countries with big resource sectors, such as Australia, must play an active leadership role. Advanced economies need to ensure the multinationals headquartered in their countries are not engaged in tax avoidance, tax evasion or corruption, particularly in developing countries.

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EXTRACTIVE INDUSTRY TRANSPARENCY

In response to this challenge, the United States and European Union have introduced legislation that requires oil, gas and mining companies to publish what they pay governments in the countries where they operate, at both a country and project level. These jurisdictions cover two-thirds of the global extractive industry market. If the other G20 nations with large extractive markets followed their lead and introduced similar legislation, a truly global standard for extractive industry transparency would emerge.

The Africa Progress Panel (chaired by former United Nations Secretary General, Kofi Annan and which includes Michel Camdessus, former Managing Director of the International Monetary Fund and Robert Rubin, former Secretary of the United States Treasury) argues that transparency in the extractives sector is essential to ensure resource-rich countries harness their natural wealth for development. In its Africa Progress Report 2013, *Equity in Extractives: Stewarding Africa's Natural Resources for All*, the Panel's number one recommendation states that:

All countries should embrace and enforce the project-by-project disclosure standards embodied in the US Dodd-Frank Act and comparable EU legislation, applying them to all extractive industry companies listed on their stock exchanges. It is vital that Australia, Canada and China, as major players in Africa, actively support the emerging global consensus on disclosure. It is time to go beyond the current patchwork of initiatives to a global common standard.¹⁷

¹⁷ Africa Progress Panel, "Equity in Extractives: Stewarding Africa's Natural Resources for All," (2013).

Since publication of the Panel's report, the Canadian Government has committed to establish a mandatory reporting standard for extractive companies by April 2015.¹⁸ This will be consistent with the legislation in the United States and European Union. The decision is endorsed by the country's mining industry. It should also be noted that since 2010, the Hong Kong Stock Exchange has required prospective oil, gas and mining companies to disclose payments to governments in their listing applications.

The benefits of a global common standard for extractive industry transparency would help:

- Ensure extractive companies' activities lead to sustainable economic development in resource-rich countries by enabling citizens to hold their governments to account for the collection and spending of revenues
- Offset aid dependency in resource-rich countries and address fundamental causes of poverty and inequality
- Combat corruption in resource-rich countries and foster more stable operating environments for companies
- Reduce the reporting burden on companies that are listed on markets in multiple jurisdictions
- Ensure a level playing field for all extractive companies issuing shares on international markets
- Assist investors with risk assessment when making decisions to invest in extractive projects.

Further, major players in the extractives sector see a fundamental benefit of payment transparency in helping establish and maintain social license with the local communities where they operate.

Further, major players in the extractives sector see a fundamental benefit of payment transparency in helping establish and maintain social license with the local communities where they operate. Without this, companies risk significant losses due to project delays, project shutdowns, damage to assets, and in the worst-case scenario, human rights violations and loss of life.

Companies such as Statoil and Tullow Oil,¹⁹ those represented by the Mining Association of Canada and the Prospectors & Developers Association of Canada (which worked with civil society to develop a

¹⁸ Natural Resources Canada, "Minister Oliver Reinforces Harper Government's Support for the Mining Industry," 3 March 2014, Available at: www.nrncan.gc.ca/media-room/news-release/2014/15563.

¹⁹ Statoil, "2013 Sustainability Report," (2014) Available at: http://www.statoil.com/no/InvestorCentre/AnnualReport/AnnualReport2013/Documents/DownloadCentreFiles/01_KeyDownloads/SustainabilityReport.pdf; Tullow Oil PLC, "Tullow Oil PLC 2013 Annual Report & Accounts," (2014).

framework for disclosure),²⁰ and B20 members, Rio Tinto and BHP Billiton, have called for the harmonisation of payment disclosure requirements across markets.²¹ In its recent *Taxes Paid* report Rio Tinto stated that “governments should work together to adopt a consistent global approach” with regards to mandatory disclosure.²²

International investors with USD 5.8 trillion in assets under management and investors in Australia with over AUD 2 trillion in assets under management also support harmonisation.²³ Investors recognise that it will enable them to compare and evaluate extractive companies, using the same type and level of information, across global markets. Due to cross listing, a number of companies listed on the Australian Securities Exchange (ASX), worth over AUD 300 billion in market capitalisation, will be required to disclose either under the United States, European Union or forthcoming Canadian legislation. If Australia does not keep up, there will be an asymmetry with regards to information disclosed by ASX extractive industry issuers.²⁴

Australia, as a major global extractive industry player and also President of the G20 for 2014, is presented with the perfect opportunity to progress the global movement towards greater harmonisation and the development of a global standard. Extractive industry transparency is already on the agenda of the G20 Anti-Corruption Working Group and

If Australia does not keep up, there will be an asymmetry with regards to information disclosed by ASX extractive industry issuers.

²⁰ Publish What You Pay Canada et al., “Recommendations on Mandatory Disclosure of Payments from Canadian Mining Companies to Governments,” (16 January 2014) Available at: http://www.pwyp.ca/images/M_images/Working_Group_Transparency_Recommendations_Eng.pdf.

²¹ Sam Walsh, “Rio Tinto Spoke at the Closing Plenary of the Pre-G8 Summit on Trade Tax and Transparency, Lancaster House, London,” 15 June 2013, Available at: http://www.riotinto.com/documents/G8_event_Closing_plenary-Sam_Walsh_Rio_Tinto.pdf; Graham Kerr, “Letter from BHP Billiton Group CFO Graham Kerr to Mary Jo White, Chair of the Securities and Exchange Commission,” 15 October 2013, Available at: <http://www.sec.gov/comments/df-title-xv/resource-extraction-issuers/resourceextractionissuers-13.pdf>.

²² Rio Tinto, “Taxes Paid in 2013: A Report on the Economic Contribution Made by Rio Tinto to Public Finances,” (March 2014) Available at: http://www.riotinto.com/documents/RT_taxes_paid_in_2013.pdf.

²³ Jacob de Wit, Steve Waygood, and Matthias Beer, “Investor Letter to the Director General of Natural Resources Canada,” 14 August 2013, Available at: <http://www.revenuewatch.org/sites/default/files/NRCan%20Joint%20Investor%20Letter%20-%208-14-2013.PDF>; Ann Byrne, “Letter from Ann Byrne, CEO of the Australian Council of Super Investors, to the Regulatory and Public Policy Department at the Australian Stock Exchange Limited,” 27 January 2012, Available at: http://www.acsi.org.au/images/stories/subs_pres_speeches/12%20Submission%20to%20ASX%20Listing%20Rules%20Review%20Paper.pdf; Martin Codina, “Australian Implementation of Extractive Industries Transparency Initiative: A Letter from Martin Codina, Director of Policy at the Financial Services Council to Diane Lewis, Head of the ASX Corporate Governance Council Secretariat,” 29 September 2011, Available at: http://www.fsc.org.au/downloads/file/SubmissionsFile/2011_0928_LettertoAustSecuritiesExchangereAustralianImplementationofExtractiveIndustriesTransparencyInitiative.pdf.

²⁴ Publish What You Pay Australia, “Australia: An Uneven Playing Field: Extractive Transparency on the ASX 200,” (May 2013) Available at: <http://publishwhatyoupay.org/sites/publishwhatyoupay.org/files/ASX.pdf>.

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there is clear crossover with the mandates of the Development Working Group and the Finance Track with respect to domestic resource mobilisation, facilitating investment and tax reform.²⁵

THE OECD PLAN

The G20-endorsed tax reform effort, overseen by the Finance Track, is led by the OECD via its 15-point *Action Plan on Base Erosion and Profit Shifting*. The Action Plan contains important elements for fixing the broken tax system so it is fit for purpose. However, it is regrettable that developing countries were not involved in developing the plan from the outset, and as such, have not been meaningfully engaged in the process.

The lack of capacity within developing country tax authorities is a key barrier to ensuring developing countries benefit from the outcomes of the BEPS project and the parallel discussion on automatic exchange of tax information. To illustrate this point, it has been calculated that more than 650,000 additional tax officials would need to be employed in sub-Saharan African countries for the region to have the same tax officials to population ratio as the OECD average.²⁶

The OECD's mandate to establish requirements for multinationals to disclose key financial information on their activities, profits and taxes paid, seems limited thus far to information to be submitted to tax authorities. However, public disclosure of information pertaining to multinational entities (not individuals) – country-by-country breakdown of number of employees, physical assets, sales, profits and taxes due and paid – is likely to have a greater impact on tackling base erosion and profit shifting and at a lower cost. This level of transparency would assist developing countries where tax authorities' capacity is lacking.

The primary benefit of country-by-country reporting is the deterrent effect it would have on multinationals to pursue aggressive profit shifting and tax avoidance schemes. It would help restore the reputations of

²⁵ The voluntary Extractive Industries Transparency Initiative (the EITI), which is often confused with mandatory disclosure, also forms part of the discussion in the Anti-Corruption Working Group with regards to the extractives sector. Clare Short, the Chair of the EITI and former UK minister, along with the Publish What You Pay international civil society network, views the two mechanisms as complementary measures, as mandatory disclosure will lead to the provision of timely and easily comparable data that can be utilised by the multi-stakeholder groups that oversee the EITI process. It will also apply to those countries that currently lack the political will to implement the initiative. The United States, British, French and Italian governments have committed to implementing the EITI in addition to introducing mandatory disclosure requirements for extractive companies. For more, see: EITI, "Clare Short: Disclosure Requirements Complement Eiti," 21 August 2012, Available at: <http://eiti.org/news-events/clare-short-disclosure-requirements-complement-eiti#>.

²⁶ Claire Kumar, "Africa Rising? Inequalities and the Essential Role of Fair Taxation," (Christian Aid and the Tax Justice Network Africa, February 2014) Available at: <http://www.christianaid.org.uk/images/Africa-tax-and-inequality-report-Feb2014.pdf>.

companies at the centre of recent tax dodging scandals and assist investors with risk assessment. Beyond enhanced corporate accountability, an additional benefit of this level of disclosure is greater government accountability for the use of tax revenues for essential services.

This type of disclosure would complement the United States' and European Union's requirements for extractive industry transparency, which are limited to countries of operation and not countries where companies have legal entities for the purpose of avoiding tax.

To crack down on broader illicit financial flows, public registers of the beneficial owners behind corporate structures is urgently needed. Without this, untaxed profits and other illicit finances will continue to be moved 'offshore'. The British Government has made a commitment to establish such registers for companies and in March 2014, members of the European Parliament voted in support of the creation of public registries of beneficial owners for companies, trusts and other corporate entities.²⁷ Cost/benefit analyses for the United Kingdom and European Union have shown that such registries are cost effective and would assist with law enforcement, asset recovery and financial sector due diligence requirements.²⁸

CONCLUSION

Australia, as the G20 President this year, has a responsibility to drive the reforms that will deliver the well-functioning domestic and international tax systems that are integral to strengthening industrialised economies. But these reforms are also critical to achieving sustainable economic and human development in developing and least developed countries. The G20 presidency is a rare and time-bound opportunity to influence the process guiding these reforms to ensure they help address poverty and inequality globally and within Asia and the Pacific where, despite high growth, 790 million people live on less than USD 1.25 a day and 1.6 billion on less than USD 2 a day.²⁹

Transparency of taxes and other payments to governments will help ensure domestic resources, essential for securing access to universal

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²⁷ Innovation & Skills Department for Business and The Prime Minister's Office, "Public Register to Boost Company Transparency," 31 October 2013, Available at: <https://www.gov.uk/government/news/public-register-to-boost-company-transparency>; European Parliament, "Parliament toughens up anti-money laundering rules," 11 March 2014, Available at www.europarl.europa.eu/news/en/news-room/content/20140307IPR38110/html/Parliament-toughens-up-anti-money-laundering-rules.

²⁸ John Howell and Co Ltd, "Costs of beneficial ownership declarations," April 2013, Available at: www.globalwitness.org/howell.

²⁹ ADB, "ADB's Support for Inclusive Growth."

services for all citizens, are retained and mobilised in the countries where the wealth is generated. It will help reduce inequality, reduce dependency on aid donors and achieve stronger, better-balanced and more sustainable economic growth.

In particular, Australia needs to harness its influence as a global mining power, and its desire as G20 President to draw out synergies across the G20 agenda, to boost international momentum toward a global standard for transparency in the extractives sector.

POLICY RECOMMENDATIONS FOR THE G20

- Ensure that *all* developing countries participate in the OECD-led Base Erosion and Profit Shifting process on an equal footing, and are supported in implementing measures to stem their losses from international tax avoidance and illicit financial flows that deprive governments of badly needed revenues.
- Promote worldwide tax transparency (public country-by-country reporting) by requiring multinational enterprises to publish for each country in which they operate: a breakdown of their employees, physical assets, sales, profits and taxes due and paid so as to assess whether they pay their fair share of taxes.
- Support the development of a global transparency standard for the extractive industries and adopt legislation that requires oil, gas and mining companies to publish payments made to governments on a country-by-country and project-by-project basis, consistent with United States and European Union legislation.
- Implement a multilateral system for exchanging tax information on an automatic basis, which would include developing countries from the start with non-reciprocal commitments (no obligation to send information until they have the capacity to do so).
- Adopt national public registries of owners of companies, trusts and foundations to reveal who is the ultimate owner of these assets and to tackle tax avoidance, tax evasion and illicit financial flows.

THE G20 AND THE GLOBAL ENERGY GOVERNANCE GAP: A CASE FOR LEADERS

HUGH JORGENSEN¹

INTRODUCTION

Modern societies depend upon power sockets and petrol pumps to function. As such, a concern of all countries is to have secure and stable access to energy supplies. In addition, overcoming 'energy poverty' is central to promoting economic development and reducing poverty. Energy markets are, however, not always efficient and domestic priorities often mean that international externalities exist. This is clearly evident in the contribution that major emitter energy policies are making to climate change. International cooperation is required if: nations are to have secure access to reliable sources of energy; the world's poor are to have access to modern forms of energy; and the impact of increased energy consumption on ecosystems and the climate is to be minimised. But the framework for such international cooperation is seriously lacking. The 'global energy governance system' in 2014 is fragmented, byzantine, inflexible to new energy problems and does not adequately bring together the needs of major emerging markets and the OECD countries.

Furthermore, with 1.3 billion people in the world currently lacking access to electricity, 2.6 billion people still reliant on burning traditional biomass for cooking, a projected global population increase from 7 billion to 8.7 billion between 2012-2035, and the encroaching risk of greenhouse gas emission-induced climate change, the current global energy governance system leaves much to be desired.² To paraphrase an anonymous Gaelic policy-maker: if the goal is to achieve sensible and responsive global energy governance for all, then "you would not start from here". Yet getting from 'here' to an energy governance framework fit for the twenty-first century will only happen if world leaders from major energy producer and consumer countries can reach a common understanding on why such an outcome is politically desirable, how their citizens would benefit, and what they can actually do to assist. This is an issue that should be addressed by the G20 if it truly is the pre-eminent forum for

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¹ Research Associate, G20 Studies Centre, Lowy Institute for International Policy.

² IEA, *World Energy Outlook 2013*, (Paris, 2013); IPCC, "Summary for Policymakers. Climate Change 2013: The Physical Science Basis. Working Group I Contribution to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change," 2013, Available at: http://www.climatechange2013.org/images/uploads/WGIAR5-SPM_Approved27Sep2013.pdf.

international economic cooperation. In broad strokes, this paper outlines a political case for reforming global energy governance.

Evidently, the politics of energy varies widely from country to country and is heavily influenced by each country's ability to access energy import or export markets. As such, although much has been written on which key global energy governance institutions are in need of an update and why – and this paper does address the need for modernisation of the International Energy Agency (IEA) – this paper's main objective is to synthesise why multilateral energy governance is a problem in particular need of *political attention from domestically elected leaders*.³ In outlining the complex and emergent challenges inherent within the current 'global energy matrix', the paper then proceeds to argue that from the perspective of both leaders and their citizens, a more coherent system is a desirable global public good worthy of pursuit. The final section briefly considers the role of 'leader to leader' cooperation as a catalyst of institutional reform, and how this might be practically applied to the world of energy governance.

WHICH CURRENT AND FUTURE ENERGY GOVERNANCE GAPS REQUIRE ATTENTION?

On a day-to-day basis, the majority of citizens are realistically less concerned with where power is sourced from, so much as they are with whether something happens when they hit the 'on switch' or turn the ignition key. As such, a simple way to approach the question of 'which energy governance gaps are most in need of multilateral attention?' is to begin with an acknowledgment of how human beings actually use energy resources at the final point of consumption, and how this usage is dependent upon cross-border arrangements. Telecommunications, manufacturing, driving, heating and cooking are just a handful of practices that are affected by, or reliant upon, energy commodities that exist within a global market. By extension, the purview of policy-makers is to meet their citizens' daily demands for access to a secure, cost-effective and relatively price-stable supply of energy for the purpose of facilitating activity in the commercial, industrial, transportation and residential sectors.⁴ Of note, 'cost-effective' does not necessarily mean 'cheapest' – depending upon the degree of domestic political concern, 'cost-effective' also captures energy policies that have factored in some or all of the cost of negative externalities like long-term environmental

³ For comprehensive overviews of contemporary global energy governance issues, see the papers contained within the September 2011 'special issue' of *Global Policy: Global Energy Governance*, and also Thijs Van de Graaf, *The Politics and Institutions of Global Energy Governance* (Palgrave Macmillan, 2013).

⁴ US Energy Information Administration, "How Much Energy Is Consumed in the World by Each Sector?," 20 November 2013, Available at: <http://www.eia.gov/tools/faqs/faq.cfm?id=447&t=1>.

degradation, and pollution that diminishes the overall quality of life and health of citizens.

However, although societies gain from sound energy policies, more energy governance does not automatically equate with better governance. Any investigation that aims to improve the global energy governance system must carefully define those cross-border policy problems which no process or institution has an adequate mandate to engage with – or even any mandate at all. Even then, the demarcation of an energy governance gap does not automatically necessitate a multilateral response, as there may be alternative and more effective unilateral or bilateral ways of minimising the risks associated with that gap. Energy policy, both domestic and multilateral, is ultimately useful insofar as it actually facilitates beneficial social and economic activity. The goal should be to prioritise work on policy blind spots where political leaders can act in concert to add genuine value. If policy-makers respond positively to one of the following questions, then they should have an incentive to engage with strengthening multilateral energy governance:

- Are the energy or foreign policies of foreign states impeding, or have the potential to interrupt, domestic supply and access to global energy markets?
- Are the energy policies of foreign countries producing negative environmental externalities for the domestic population?
- Is negotiation with one or more countries on energy policy necessary for the prevention or minimisation of further detrimental outcomes?

On all three questions, multilateral energy institutions can add value – in providing technical support, a venue, and a general framework for conducting negotiations about resolving or preventing, current and future cross-border energy dilemmas. Multilateral bodies like the IEA and the International Renewable Energy Agency (IRENA) already play an important role in assisting policy-makers to think strategically about how the medium- and long-term outlook for domestic and international energy markets will affect their ability to meet their citizens' daily expectations. Indeed, before looking specifically at how multilateral energy governance itself can be strengthened, it is worth outlining several major challenges that would benefit from enhanced international cooperation.

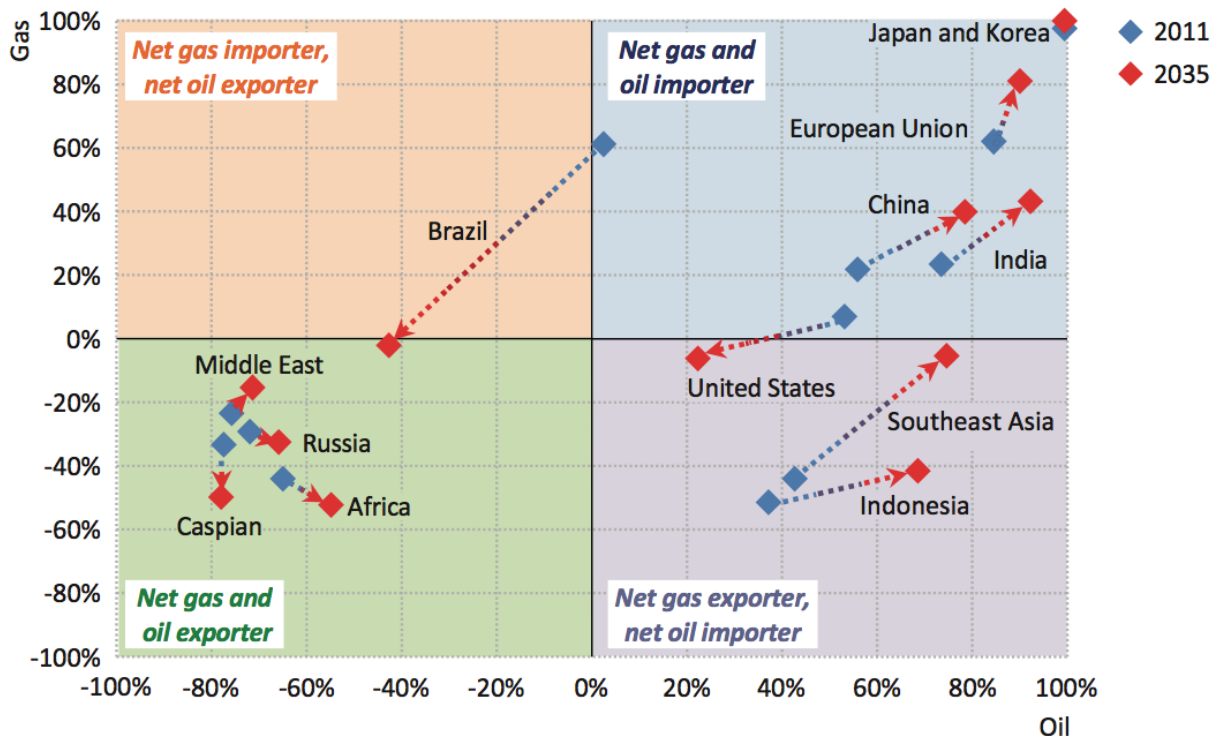
Perhaps the most unsurprising of the IEA's projections is the forecast increase in population-fuelled energy consumption that is already underway in non-OECD countries. The IEA predicts that non-OECD countries will account for over 90 per cent of the growth in energy demand between 2011-2035, chiefly driven by changing economic and

...more energy governance does not automatically equate with better governance.

...major oil and gas importers are on track to become exporters, major exporters are anticipated to consume more, and many smaller players will further disrupt energy supply and demand channels as their market influence grows over time.

demographic circumstances.⁵ Graph 1 and Table 1 below highlight the transformative impact this growth in energy consumption from non-OECD countries will have on the global energy system: major oil and gas importers are on track to become exporters, major exporters are anticipated to consume more, and many smaller players will further disrupt energy supply and demand channels as their market influence grows over time.⁶ For prominent energy governance actors like the IEA and the Organization of the Petroleum Exporting Countries (OPEC), originally composed of the world's major oil importers and exporters respectively, their mandates and membership are becoming increasingly misaligned with the nature of actual global energy challenges.

Graph 1⁷: Net oil and gas import/export shares in selected regions under the IEA's New Policies Scenario



⁵ IEA, *World Energy Outlook 2013*.

⁶ Graph 1 is taken from is taken from the IEA's *World Energy Outlook 2013*. Table 1 is also derived from data contained within the IEA's *World Energy Outlook 2013*, however, unless specified, the data has been converted into standard exajoules.

⁷ Note from page 77 of IEA, *World Energy Outlook 2013*: "Import shares for each fuel are calculated as net imports divided by primary demand. Export shares are calculated as net exports divided by production. A negative number indicates net exports. Southeast Asia, i.e. the ASEAN region, includes Indonesia."

Table 1: Global primary energy demand and energy related CO₂ emissions under the IEA's three different policy scenarios

	Past	Current	New Policies		Current Policies		450 Scenario	
	2000	2011	2020	2035	2020	2035	2020	2035
Coal (in exajoules)	106	158	176	185	188	228	156	106
Oil	153	172	187	195	190	213	179	150
Gas	87	117	137	172	140	183	132	141
Nuclear	28	28	37	47	36	43	39	64
Hydro	9	13	16	21	16	20	17	23
Bioenergy*	43	54	63	77	62	72	64	92
Other Renewables	3	5	13	30	12	22	14	49
Fossil Fuel Total	346	447	500	553	518	624	466	396
Total energy demand	422	547	629	728	643	781	599	624
Fossil Fuel per percentage of total	80%	82%	80%	76%	80%	80%	78%	64%
Non-OECD share of total**	45%	57%	61%	66%	61%	66%	60%	64%
CO₂ emissions (Gt)	23.7	31.2	34.6	37.2	36.1	43.1	31.7	21.6

* includes traditional and modern biomass uses

** excludes international bunkers

Although the rise of the non-OECD energy consumers is chiefly being driven by major emerging economies like China and India, the energy footprint of Southeast Asian and Middle Eastern economies will also expand. China's total electricity capacity doubled between 2005 and 2010, and in December 2013, China officially replaced the United States as the world's largest net importer of oil, ending a reign stretching back to the 1970s.⁸ Between 2011-2025, China will account for 37 per cent of the growth in energy demand, and 18 per cent between 2025-2035, while India will account for 14 per cent, and 26 per cent respectively. Indeed, India will replace China as the world's largest coal importer by around 2020. Meanwhile, the Middle East will be the second largest gas consumer by 2020, and will replace Europe as the third largest 'bloc' consumer of oil by 2035 (China and the United States split first and second place).⁹ Conversely, by 2030 sub-Saharan Africa, sadly, is projected to see an increase in the number of people without access to modern energy services from 600 to 645 million, which will approximately constitute two-thirds of everyone in the world without

⁸ Ed Crooks and Lucy Hornby, "The New Gas Guzzler: China Has Overtaken the Us as the World's Top Oil Importer," *Financial Times*, 9 October 2013; Daniel Yergin, *The Quest* (New York: Penguin Books, 2013).

⁹ IEA, *World Energy Outlook 2013*.

access to an electricity grid.¹⁰ Clearly, maximising the social and political gains from these shifts in global energy consumption will depend upon advanced policy planning, as the expansion of already existing networks of energy production and distribution will require new capital-intensive projects that typically involve long lead-in times, and a semblance of future regulatory certainty.¹¹

Other emergent factors and risks that threaten to undermine existing modes of energy governance include changing patterns of industrialisation, power generation and distribution; volatility of energy pricing; as well as disruptive technological innovation within the energy sector, as typified by the falling cost of renewable power generation technologies,¹² and the new means of tapping previously inaccessible shale, coal seam and tight gas (hydraulic fracturing – colloquially known as ‘fracking’).¹³ For example, the forecast rise of non-OECD countries as major energy players is all the more remarkable in light of the most recent – and optimistic – projections from the US Energy Information Administration (EIA) that suggests new drilling techniques might mean net oil imports to the United States could fall to zero by as early as 2037.¹⁴

...the most ‘diabolical’ cross-border policy challenge calling out for improved multilateral energy governance is climate change.

However, while demographic and technological developments will have significant ramifications for the combination of resources that constitute the global energy supply, the most ‘diabolical’ cross-border policy challenge calling out for improved multilateral energy governance is climate change. Climate change evokes dilemmas associated with both free-rider and ‘tragedy of the commons’ problems – chiefly in terms of the lack of accountability individual countries face for producing harmful greenhouse gases that diminish the quality of life within other jurisdictions.

Yet if policy-makers accept the need to counter the high probability risk that climate change poses to the planet’s liveability, as strongly advised by the Intergovernmental Panel on Climate Change’s (IPCC’s) Fifth Assessment Report (AR5), then a major decarbonisation of energy production is required, as is preparation for the social and economic changes that such a shift would necessitate. How well political leaders are able to cooperate on balancing the liveability of the planet with

¹⁰ Ibid.

¹¹ Van de Graaf, *The Politics and Institutions of Global Energy Governance*.

¹² IRENA Secretariat, “Renewable Power Generation Costs in 2012: An Overview,” (Bonn: IRENA, 2012) Available at: http://costing.irena.org/media/2769/Overview_Renewable-Power-Generation-Costs-in-2012.pdf.

¹³ IEA, *World Energy Outlook 2013*.

¹⁴ The EIA notes this is under the most optimistic, and therefore not the most likely, scenario. See: U.S. Energy Information Administration, “Annual Energy Outlook 2014 with Projections to 2040,” (April 2014) Available at: [http://www.eia.gov/forecasts/aeo/pdf/0383\(2014\).pdf](http://www.eia.gov/forecasts/aeo/pdf/0383(2014).pdf).

meeting the energy demands of their citizens will thus have a formative influence on future energy policies.

The IEA paints three scenarios that are broadly based around differing combinations of policy preferences with regards to sustainable energy. Specifically, the scenarios point to the variety of ways in which carbon emissions will likely be affected by the policy incentives politicians put in place for the usage of fossil fuels, renewables, nuclear and other alternatives. The exajoules expended per year under each of the three scenarios, projected out to 2035, as well as the total amount of CO₂ emissions in gigatonnes, are listed above in Table 1.

Factoring in global population growth, the IEA's 2013 energy outlook finds that if current energy policies are left untouched between 2011-2035, fossil fuel sources (coal, oil and gas) will still account for around 80 per cent of global energy production, equating to an absolute increase in yearly fossil fuel usage from 450 to 620 exajoules. Evidently, 'business as usual' policies will, unsurprisingly, probably result in a similar proportional breakdown of energy production to the present, albeit with greater absolute demand for every resource. Alternatively, if the major emitters opt for the tentative and mild emission-reducing policies touted under the IEA's 'new policies scenario', then we can anticipate a slight decline in fossil fuels as an energy input, driven by a decline in market share for coal of around four points, as well as an increased role for renewables. This would see an increase in annual energy-related CO₂ emissions of 20 per cent over 2011 levels (37.2 Gt over 31. Gt per year), versus the 40 per cent rise projected under 'current policies' (to 43.1 Gt per year). However, the 'new policies' scenario will still see global demand for yearly energy resources increasing by an additional 40 exajoules, with demand for oil increasing by 13 per cent, coal by 17 per cent, natural gas by 48 per cent, nuclear by 66 per cent, and renewables by 77 per cent. The third IEA projection is the '450 scenario', where governments actually implement the necessary policies to give the planet at least a 50 per cent chance of limiting the global temperature increase to no more than 2 degrees celsius by 2100.¹⁵

Regardless of which scenario proves most accurate, policy-makers will have to prepare for a substantial transformation in global energy markets, and have the flexibility to accommodate unexpected deviations from these projected trends and any associated impact in their own jurisdiction. Countries that produce or rely on any one of the resources listed above, and that are adequately prepared for an expansion or reduction in output or consumption of those resources, will be less

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¹⁵ The 450 figure refers to the implicit need to have the concentration of greenhouse gases stabilising at 450 parts per million of CO₂ in the atmosphere by 2100, see: IEA, *World Energy Outlook 2013*. It is worth noting that under IRENA's projections, renewable energy is forecast to play a larger role in the energy mix, even under its own version of the 'current policies' scenario, see: IRENA Secretariat, "Renewable Power Generation Costs in 2012: An Overview."

susceptible to market shocks than those that resign themselves to more reactive short-term policies. More broadly, the risk of shocks to the supply and demand of energy markets, new (gas) and old (oil), be they gluts or shortages, must also be taken into account, so that policy-makers can establish prevention plans, or at least minimise the fallout, from any shocks to energy access. Recent tensions between Russia and Ukraine point to the growing importance of effective governance within the field of gas market supply.

STRENGTHENING MULTILATERAL ENERGY GOVERNANCE – WHAT'S IN IT FOR LEADERS?

Global governance exists where the policy preferences of individual states overlap, and an agreement can be reached on how to cooperatively pursue these 'overlapping' shared objectives. Needless to say, as the preferences that states bring into the global energy governance sphere are born at the domestic political economy level, finding such common objectives is not easy. This is not least because the position of each state varies widely according to the relative power balance between politicians, industry lobby groups and other stakeholders, as well as other factors like population, geographical location and geological endowment.¹⁶ Moreover, as the previous section outlined, the major multilateral energy bodies are no longer as neatly composed of 'importers' or 'exporters' as they were at the time of their creation. Thus, with members of the IEA transitioning to the status of energy 'exporter', OPEC countries playing a much larger role as energy consumers, and the emergence of major emerging economies that are not fully-fledged members of either, there is a growing incentive for states to distil the increasingly outdated network of institutions that make up the current global energy governance system into a system that is better aligned with the energy challenges of the twenty-first century.

Specifically, in order to minimise the risk of market disruption due to misinformation, the major energy players have a strong incentive to devise an institution that, at a minimum, allows for continual dialogue and negotiation around shared future energy dilemmas, as well as the mutual dissemination of domestic information and data. It is an anachronism that no policy-making agency currently brings together all of the major or future energy players within the one room, on an equal basis, for the specific purpose of strengthening cooperation on energy. Although there are many more objectives that deserve multilateral attention, bringing together all major energy players should be an obvious starting point.

It is an anachronism that no policy-making agency currently brings together all of the major or future energy players within the one room, on an equal basis, for the specific purpose of strengthening cooperation on energy.

¹⁶ Van de Graaf, *The Politics and Institutions of Global Energy Governance*.

On face value, the membership of the International Energy Forum (IEF), which brings together 87 countries that “account for around 90 per cent of world oil and gas supply and demand”, suggests it could serve as a future central institution of global energy governance.¹⁷ The IEF has been fundamental to the establishment of the Joint Organisations Data Initiative on oil (JODI-Oil) and more recently, JODI-Gas, both of which have added to transparency in each commodity’s respective market. However, to date, the IEF has principally operated as a forum for high-level networking for energy ministers, and is much less fully formed as a governance institution when compared to the IEA. Given the low level of interest in establishing a treaty-based ‘World Energy Organisation’,¹⁸ this leaves the IEA as the best-placed energy-focused institution for being elevated into a role that can cope with the aforementioned energy challenges.

To date, the IEA’s efforts to work more closely with major emerging economies have been positive, but minimal. On face value, this is unsurprising, as the major energy consuming industrialised countries have relied upon the IEA as a locus for coordinating their efforts against interruptions in energy supply since the 1970s. Indeed, the IEA was established under the broad objective of coordinating policy practices between OECD states that would bolster price and supply stability in global energy markets. There is also no denying that a key inspiration for the agency was for it to serve as a counterbalance against the growing influence of OPEC in the mid-1970s. Rather than allowing the global energy market to break down into a ‘noodle bowl’ of bilateral agreements between major consumer countries and OPEC, the IEA was tasked in 1974 with facilitating harmonisation between the energy policies of major Western countries. The IEA was tasked with ensuring that any OPEC-induced rise in the price of oil would not lead to a repeat of the zero-sum ‘competitive stockpiling’ that had led to the economic dislocation of the early 1970s.

Notably, this led to the establishment of strategic oil reserves within IEA member states, of up to 90 days worth of consumption, to be deployed in the event of any future sudden shortage. These stockpiles have been utilised on three occasions: the Gulf crisis in 1990-1991, during Hurricane Katrina in 2005, and during the Libyan crisis in 2011 that shook the oil market. However, while the IEA’s treaty-based origin as an offshoot of the OECD made initial sense, the continued restriction of IEA membership to OECD members that meet certain democratic and market economy criteria, now serves as an institutional legacy that in fact impedes the IEA’s future vitality as a global energy governance actor.

¹⁷ International Energy Forum, “Member Countries,” May 2014, Available at: <http://www.ief.org/about-ief/organisation/member-countries.aspx>.

¹⁸ David Cameron, “Governance for Growth: Building Consensus for the Future,” (London, November 2011).

...without an active push for IEA reform from current member states, major emerging economies like Brazil, Russia, India, China and South Africa (the 'BRICS') may push for an alternative model.

Thus, if the current membership of the IEA wishes to preserve the relative influence of the institution, then the forum must become more inclusive of emerging markets, and less anchored to its traditional concentration on oil and gas commodities. The November 2013 declaration from the non-OECD energy ministers of Brazil, India, China, Indonesia, Russia and South Africa¹⁹ that welcomed closer cooperation with the IEA via an 'association' was an important step, but it also indirectly highlighted the sizeable hurdles that must be overcome before these 'partner' countries have comparable influence within the IEA to its current OECD-only membership. Such a shift requires a political impetus – without an active push for IEA reform from current member states, major emerging economies like Brazil, Russia, India, China and South Africa (the 'BRICS') may push for an alternative model where the OECD members play a smaller role than they otherwise might in a renewed IEA.

Another major reason for elevating the IEA's role is that, historical political legacies aside, it has greatly expanded the scope of its mission since its foundation, and is now well placed to form the basis of an inclusive model of mutually beneficial cooperation that works in the interests of both OECD and non-OECD states. In particular, the IEA's advanced functional capacity means it is now the primary multilateral agency for advising its member states on:

- The outlook for oil and gas markets
- The latest compilations of international energy data
- Coordinating 'emergency preparedness and the use of emergency stocks'
- Promoting best-practice energy policies²⁰

Both OECD and non-OECD states alike would have much to gain from stronger data collection and dissemination around their respective access to, and need for, energy resources. Although China and India have some way to go in terms of willingness or capacity to accurately capture and disclose their domestic energy data, the IEA should nevertheless abandon its own artificial and out-dated barriers that pre-

¹⁹ IEA, "Joint Declaration by the IEA and Brazil, China, India, Indonesia, Russia and South Africa on the Occasion of the 2013 Ministerial Meeting Expressing Mutual Interest in Pursuing an Association," (Paris, 2013).

²⁰ Energy Research Institute National Development and Reform Commission and Grantham Institute for Climate Change, "Consultation Draft Report: Global Energy Governance Reform and China's Participation," (February 2014) Available at: <https://workspace.imperial.ac.uk/climatechange/Public/pdfs/Global%20Energy%20Governance%20Reform%20and%20China%27s%20Participation.pdf>.

emptively negate such an outcome – primarily, the restriction of IEA membership to only OECD countries. It is also true that the IEA has other attributes that, without sufficient planning, could be weakened by bringing in BRICS, but valuable functions such as the 90-day oil reserve agreement could still operate with or without the newer members' involvement, as the stockpiling requirement could be turned into a final, but not entry-phase criterion of IEA membership. Yet whatever the negotiated requirements for IEA membership ultimately look like, the agency's future relevance, and its primary position in global energy governance, depends upon a more inclusive shift away from the status quo.

WHICH LEADERS?

So far, this paper has outlined some of the major future energy challenges, and offered a proposition on how multilateral energy governance might begin to meet them. This leaves the question of 'who' – who can apply a disruptive force that jolts the global energy governance system out of its current state of twentieth century inertia? As this paper has dealt with policy challenges that cross state boundaries, it is clear that any strengthening of multilateral energy governance will require the endorsement and support of actors that have the authority and mandate to engage (or disengage) in multilateral cooperation. That is, the political executives of states.

Inclusive change will not come simply because the secretariats of the IEA, IRENA or IPCC recommend it. Also, as outlined earlier, few if any bilateral relationships are capable of meaningfully tackling global climate change, meeting future global energy demands or ending energy poverty. The possible exception here might be a US-China 'G2', as the participation of both countries will be essential to the future success of any major multilateral initiative. However, although it would be greatly welcomed, it is not clear that reform of the IEA is going to be a major international priority for the United States without external encouragement (one need only look at its delay on passing IMF reform), or that the agency will receive public support from China – a current non-member.

Realistically, in the post-global financial crisis era, only one global governance body has demonstrated the potential to catalyse the kind of reform that is required – the Group of Twenty (G20). Indeed, a major contribution of the G20 has been in advancing governance reform in the International Financial Institutions (IFIs) in a way that recognises the ongoing and expected future redistribution of global economic power and wealth. In particular, the G20 has successfully managed to oversee an expansion in both the mandate and membership of the Financial Stability

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Forum – now the Financial Stability Board.²¹ It has also been a central political conduit for promoting IMF quota reform, and it has boosted the status of anti-corruption initiatives such as the United Nations Convention against Corruption.²² The G20 has also strengthened the level of collaboration between major economic institutions such as the IMF, World Bank and OECD. Arguably, the G20 leaders should spend much more of their time strategically thinking about how to galvanise reform in other institutions than in attempting to directly tackle complex issues from within the G20 – something that is particularly true for global energy governance.

Although this paper began by linking the act of turning on a power switch to the high-level world of global energy governance, there is no denying that conveying the need to address the challenges listed above to the broader public will not be easy. However, the key advantage of the G20 is that it brings together the leaders from twenty major economies, on the basis that they have the greatest agential capacity to navigate through the tensions that arise between domestic political concerns and the gains to be made from realising global public goods. A stronger system of global multilateral energy governance is such a global public good – it is clearly necessary if risks like future shortages of energy supply, climate change and energy poverty are to be overcome, or even addressed.

While the G20 currently has a number of energy issues on its work program, it has not adequately addressed the prior need for a revision of the global energy governance system itself.

While the G20 currently has a number of energy issues on its work program, it has not adequately addressed the prior need for a revision of the global energy governance system itself. This must be the first step. Specifically, one outcome from the forthcoming Brisbane G20 Summit should be the explicit acknowledgement of the need for a global forum that focuses on energy challenges, and brings together all the major countries that will most heavily rely upon global energy markets in the twenty-first century, on an equal basis. This should be followed by a work plan that focuses on elevating the IEA to fill this role. As outlined, the IEA is the best-placed institution for being elevated into this role. Yet this reform will only happen if it is catalysed from a sufficiently influential group of political leaders. It is well within the G20 leaders' capacity to claim the political credit for being that group.

²¹ G20 Studies Centre, *G20 Monitor No. 4: Financial Regulation and the G20*, (Sydney: Lowy Institute for International Policy, 2014) Available at: <http://www.lowyinstitute.org/publications/financial-regulation-and-g20>.

²² Hugh Jorgensen, "Hard Graft: The G20 and Anti-Corruption," in *G20 Monitor No. 6: Tax, Infrastructure, Anti-Corruption, Energy and the G20* (Sydney: Lowy Institute for International Policy, 2013).

A PATH BEYOND BALI

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THE EXPECTATION FOR THE ROLE OF THE WTO AFTER THE 9TH WTO MINISTERIAL CONFERENCE

The 9th WTO Ministerial Conference that took place in Bali, Indonesia, in December 2013 brought a pleasant surprise to all those promoting global trade liberalisation. With the WTO having faced an impasse for many years, it finally experienced a breakthrough, even if it was only a small trigger. As a result, expectations regarding the role of the WTO as an international organisation that promotes global trade liberalisation have recovered. We should certainly take advantage of this momentum built after the Bali Agreement, and in this regard, the role of Director General Azevedo is crucial. Efforts to formulate the Doha Round Work Program under the leadership of Director General Azevedo should be fully supported, in order to not lose the momentum post-Bali.

At the same time, various regional trade agreements are being negotiated, such as the Trans-Pacific Partnership (TPP) and Transatlantic Trade and Investment Partnership (TTIP). While the multilateral trade negotiation under the WTO has been revived, efforts to promote these regional trade agreements (RTAs) should also be maintained. Achieving successes in RTAs in line with the WTO framework is essential, since the RTAs and multilateral trade negotiations under the WTO should be complementary. For instance, in Japan's case, Japan continues to put great importance on the multilateral trade negotiations under the WTO while enhancing various RTAs such as the TPP, Japan-European Union Economic Partnership Agreement (EPA), Regional Comprehensive Economic Partnership, and many other bilateral EPAs.

In this regard, July 2014 marks an important milestone in trade negotiations. First, the G20 Trade Ministers' Meeting will be held in Sydney on 19 July. This meeting is expected to enhance coordination among the G20 members on free trade and to build momentum towards the G20 Brisbane Summit in November. It is important for all the G20 member countries, both developed and emerging countries alike, to show their commitment towards trade liberalisation, especially in the fight against protectionism. Second, July is also a critical time in the WTO process, since it is the deadline month in which developing countries have to make a pledge in line with the trade facilitation agreement. Therefore, July is an important moment for all of us to reaffirm our

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commitment and determination and to ensure there is a follow-up process to the Bali meeting.

COMPREHENSIVE GROWTH STRATEGIES AND TRADE

One of the major goals of this year's G20 process is to develop and achieve a 'Comprehensive Growth Strategy', and trade is an essential factor to promote economic growth. Recently, the issue of global value chains (GVCs) has drawn attention as an important element that promotes economic growth. GVCs are seen as game changers that have brought about a closer and better-linked world. To ensure global economic growth, efforts to develop GVCs should be further enhanced. Towards this end, Japan is focusing on a concept of 'cold chains'. This is based on an idea that it is essential to provide support for developing countries to build thorough value chains, from food production to market distribution. 'Cold chains' are especially important in places such as Africa, where a lack of infrastructure to transport agricultural products leads to a large amount of food loss. As a result, Japan considers it is necessary to provide assistance in infrastructure, including 'cold chains', which enable agricultural products to be refrigerated and prevent food loss. Building such infrastructure is an essential part of GVCs, and we need to strengthen our cooperation in this respect.

FIGHT AGAINST PROTECTIONISM

Last but not least, our fight against protectionism continues to be a significant outcome of the G20. We agreed at the G20 St Petersburg Summit last year to 'extend until the end of 2016 our standstill commitment' and 'reaffirm commitment to roll back new protectionist measures'. But without implementing our agreement and maintaining our commitment, we cannot ensure trade liberalisation at a global level. By constantly reminding ourselves of this agreement, it deters us from taking any further protectionist measures.

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Daniela Strube is a Research Fellow with the G20 Studies Centre at the Lowy Institute. Her work focuses on contributing to distinctive perspectives and critical analysis on the role of the G20 in global economic governance, in particular against the background of the Australian G20 presidency in 2014. She completed her PhD in Economics researching how macroeconomic models and analysis can better reflect local economic development conditions. A large part of her research has been conducted as a visiting researcher at the London School of Economics and the Australian National University. She also holds a Master's degree in Economics from the College of Europe, Belgium, and a Bachelor's degree in Economics from the University of Maastricht, Netherlands. Her graduate and doctoral studies were sponsored by several awards and scholarships from leading European funding organisations. Daniela has previously worked for the European Commission and the German federal government on issues relating to telecommunications regulation, research policy as well as development cooperation and economic development policy.

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