



Letter of 25 April 2014 from the Minister for Foreign Trade and Development Cooperation to the House of Representatives on a new instrument for infrastructure development

I submitted Carnegie Consult Investment Advisory Services' report on its review of the Facility for Infrastructure Development (ORIO) to the House on 8 November 2013.¹ This present letter considers the future of ORIO, taking account of the recommendations made by the Policy and Operations Evaluation Department (IOB) in its review of Dutch private sector development policy.² The IOB concluded that Dutch efforts in the field of infrastructure development could be more relevant to development. Carnegie Consult found that ORIO was complex and unpredictable and paid little attention to the non-grant financing component and coherence with other programmes.

I have therefore decided to end the ORIO programme. Current projects will be completed but in spring 2015 I will launch a new public infrastructure programme: the Developmentally Relevant Infrastructure Investment Vehicle (DRIVE). The key features of the new programme will be development relevance founded on focus and coherence, flexibility in the project cycle and concessional financing for the entire project.

This letter briefly explains the importance of infrastructure development in low- and middle-income countries. It then looks at the performance of ORIO and the feedback received from Dutch embassies in a number of target countries. It closes by introducing the new DRIVE programme.

Importance of infrastructure development

As set out in *A World to Gain*,³ I am seeking a combination of aid, trade and investment to reduce poverty, promote inclusive growth and increase the success of Dutch firms in international markets. In a letter to parliament entitled *Business for Development*⁴ I explained that a good business climate is a key precondition for the emergence of a private sector that enables effective entrepreneurship, foreign trade and investment and facilitates inclusive growth so that people in low- and middle-income countries could provide for themselves. And a good business climate depends in part on efficient and accessible infrastructure. My focus on infrastructure development in low- and middle-income countries is intended to help create a business climate that promotes private sector development and, by extension, jobs in low- and middle-income countries.

¹ Carnegie Consult Investment Advisory Services, 14 October 2013, *ORIO Review, Final report*. See: <http://www.rijksoverheid.nl/documenten-en-publicaties/kamerstukken/2013/11/08/aanbiedingsbrief-bij-rapport-over-de-review-van-het-programma-ontwikkelingsrelevante-infrastructuurontwikkeling-orio.html>.

² IOB, 2014. *Op zoek naar focus en effectiviteit: Beleidsdoorlichting van het Nederlandse beleid voor Private Sector Ontwikkeling in ontwikkelingslanden 2005 – 2012* [Searching for focus and effectiveness: Review of Dutch policy on private sector development in developing countries 2005-2012].

³ House of Representatives, 33625, no. 1, 5 April 2013, letter to parliament, *A World to Gain*.

⁴ House of Representatives, 33625, no. 38, 30 September 2013, letter to parliament, *Business for Development*.

In its review of Dutch private sector development policy, the IOB cited several studies that highlighted the strong ties between infrastructure and growth, trade, private investment and private sector development.⁵ A study by Calderón and Servén, for example, found that investment in infrastructure could boost annual economic growth by an additional 2.5%. The studies cited by the IOB concluded that access to good infrastructure reduced income disparities. Better infrastructure improves access to education and health care, cuts production and transaction costs and increases labour market participation. Infrastructure also enables developing countries to take the step from a raw material economy to more local processing, diversification and development.⁶

The funds available for infrastructure still fall well short of the demand. Low- and middle-income countries are financing more infrastructure from their own budgets. The IOB also found that traditional donors and new donors such as China had considerably increased their funding of infrastructure in recent years. Bhattacharya, Romani and Stern nevertheless concluded that additional investments of at least USD 1,000 billion per year were necessary to meet the demand for infrastructure from low- and middle-income countries.⁷ The World Bank calculated that the annual financing deficit for infrastructure in Africa was USD 31 billion.⁸

I believe the Netherlands can add value mainly in the development and implementation of medium-sized public infrastructure projects in specific areas like private sector development, water and food security. Low- and middle-income countries often turn to the Netherlands for advice, know-how and sustainable technology in these areas. The Netherlands also has expertise in public-private infrastructure investments. The Netherlands supports both bilateral and multilateral infrastructure development programmes. These programmes not only finance public infrastructure directly but also use public funds as a lever to attract private investments in high-risk but commercially viable projects. Together, the programmes cover the entire project cycle from development to construction, use and maintenance.

Review of ORIO

The ORIO programme has revealed the enormous global demand for new or rehabilitated infrastructure. ORIO has assessed 500 project applications. Sixty-seven projects are being developed or implemented in Africa, Asia, Latin America and Eastern Europe.

⁵ IOB, 2014, *Op zoek naar focus en effectiviteit: Beleidsdoorlichting van het Nederlandse beleid voor Private Sector Ontwikkeling in ontwikkelingslanden 2005 – 2012* [Searching for focus and effectiveness: Review of Dutch policy on private sector development in developing countries 2005-2012]. The report refers to the following sources: Hulten, 1996, Esfahani and Ramirez, 2003, Calderón and Servén, 2004, Willoughby, 2004, Fay et al., 2005, Lederman, Maloney and Servén, 2005, Asiedu, 2006, Ndulu, 2006, WSP IMC, 2007, Calderón, 2009, Foster and Briceno-Garmendia, 2010, World Bank, 2010, Ferro et al., 2011.

⁶ Amar Bhattacharya, Mattia Romani and Nicholas Stern, 2012, *Infrastructure for Development: meeting the challenge*.

⁷ *Idem*.

⁸ World Bank, 2010, *Africa's Infrastructure: A Time for Transformation*.

The beneficiaries note, however, that the programme does not work as well as it could. The recipient countries' appreciation of the ORIO programme is reflected in the reports from our local embassies. The embassies indicate, though, that the system is complicated and inconsistent with the approach taken by other donors, chiefly because ORIO includes both the project development phase and the implementation phase. A deliberate decision was taken to include and consider the development phase in order to help countries meet the great demand for well-developed infrastructure projects. This can however lead to unnecessary bureaucracy and the duplication of project assessments. Project approval, followed by a grant agreement with the recipient country, is required in both the development and the implementation phase.

A common complaint is that the distinction drawn between the development phase and the implementation phase creates uncertainty about project financing. A decision on whether ORIO will co-finance implementation is not taken until a relatively late stage, when the project has been fully worked out. The recipient country is by then expected to have secured the non-grant financing. This has proven difficult in practice. Countries usually arrange the non-grant financing only when the Dutch contribution to the implementation phase has been secured. This delays implementation and creates great uncertainty. The target countries of several ongoing projects have been unable to arrange satisfactory non-grant financing. This throws project implementation into doubt. Many countries prefer the donor to offer a financing package that covers a project's costs in full, which ORIO does not.

Another common complaint is that the ORIO programme's distinction between the development phase and the implementation phase does not make optimal use of the development and innovative strengths of potential Dutch contractors. The inclusion of a development phase leads to consultants being primarily responsible for project development. Project implementers do not make an entrance until a project has been worked out in detail and the contract has been awarded through an international tender procedure. This leaves implementers little scope to use innovative technical solutions in the further development of the project. As a result, optimal use is not made of Dutch know-how and expertise, even though many countries turn to the Netherlands precisely for its expertise.

The ORIO review therefore recommended making fundamental changes to the programme to make better use of the development and innovative strengths of Dutch businesses. The programme should be refocused on the implementation phase. The development phase should be separated from the implementation phase. The review also recommended full project financing on a concessional basis. This will address the problem of lack of non-grant financing. The implementing organisation, the Netherlands Enterprise Agency (RVO.nl), must also have more expertise in the fields of infrastructure, financing and tendering to enable it to provide expert guidance at every stage of a project.

DRIVE

Given the experience with ORIO, the IOB's conclusions on the importance of infrastructure development and the ORIO review's conclusions, I have decided to end the ORIO programme. In early 2015, I will launch a new programme known as the Developmentally Relevant Infrastructure Investment Vehicle (DRIVE). Its key features will be development relevance, flexibility and concessional financing for the entire project. One objective is to actively involve the Dutch business

community. I intend to encourage this involvement by inviting tenders for projects at the earliest possible stage. I will also allow local authorities to submit projects that have already been worked out with or without the business community. Decisions on project implementation will in future coincide with project selection. Projects will therefore no longer be assessed twice as at present. Finally, complete concessional financing will increase the certainty of financing.

Development relevance

Development relevance is at the heart of DRIVE. I fully accept the IOB's conclusion that infrastructure development efforts should focus more sharply on the development impact. Both the IOB and the ORIO review recommended that the development impact be increased by improving the cohesion between private sector programmes and infrastructure development programmes. I therefore intend to increase joint programming by means of a more focused, integrated and proactive approach in the countries selected:

- DRIVE will concentrate on the least developed countries and the transitional countries on the private sector development and Dutch Good Growth Fund country list.⁹ We will increase the DRIVE effort in these countries.
- DRIVE will focus on private sector development, as well as priorities in the field of food security, water and sexual and reproductive health and rights (SRHR) and my goal relating to climate relevant investment.¹⁰
- RVO.nl will run the programme and act as a broker by identifying projects in the countries targeted by DRIVE. It will consult local authorities, the Dutch embassy, NGOs, other donors and businesses present. It will also take account of Dutch initiatives in the priority areas. In that respect DRIVE will no longer function as a scheme, but rather as a fund. RVO.nl will work flexibly and ensure that it has the right expertise in the fields of infrastructure, financing and procurement.
- The potential development impact of a project will be clearly established at an early stage in the process. Where possible, projects will refer to national priorities and plans and coherence with other Dutch initiatives.
- Projects will be ranked by development relevance and quality. They will no longer be selected on a first-come, first-served basis.

All projects must satisfy the requirements of International Corporate Social Responsibility (ICSR) and, especially, the OECD Guidelines and the IFC Performance Standards, as explained in the letter to parliament, *Business for Development*.¹¹

Flexible project cycle

I endorse the ORIO review's recommendation to make better use of the development capacity of Dutch businesses at project level:

⁹ DRIVE, like ORIO, is not open to the countries where the Netherlands, for political reasons, works with the private sector and civil society but not with the government. This is periodically reviewed.

¹⁰ House of Representatives, 33625, no. 60, 13 November 2013. Letter to parliament on international climate financing in developing countries.

¹¹ *Idem*.

- DRIVE will not include a separate development phase before project implementation. DRIVE will consider project applications from countries at various stages of development. If a project is selected, it will be for the full implementation of the project. A project's scope, development relevance and cost must be known before it is assessed and selected.
- Any further project development requirements will be determined during project selection with a view to the call for tenders.
- Project contracts will be awarded as early as possible in the project cycle on the basis of the most economically advantageous bid. This means that selection will be based not on lowest price but on the best price/quality ratio, with account being taken of ICSR requirements. Tenders will be accepted on the basis of concept design rather than detailed design¹² as is often the case at present with ORIO. Design and build contracts or design, build and maintenance contracts will be the preferred contractual arrangement.
- The possibility of accommodating unsolicited proposals in the context of tendering procedures will be examined so that a company can suggest solutions to an infrastructural challenge at an early stage without the risk of a competitor stealing its ideas.
- I will make the recipient country responsible for the project application and project development but will not lose sight of the fact that good project development is an important factor in infrastructure development. Under the DRIVE umbrella I will therefore create a technical assistance facility to help countries that do not have the capacity necessary to formulate and put forward good projects. Technical assistance will be provided in the form of advice and capacity building, for example to identify and formulate projects (feasibility studies). Assistance can also be provided to work out projects after their selection and to prepare for and assist in the tender procedure. This will ensure that the tender procedure complies with ICSR requirements and the projects satisfy the highest quality standards.

Concessional financing for the entire project

The ORIO review found that there was a need for a financing instrument that held out the prospect of full project financing at an early stage.

- I will therefore use DRIVE grants to soften loan conditions for project financing. The aim is to finance projects in full.
- RVO.nl, which will run the programme, will help countries find and take out loans with financial institutions that cover all project costs. DRIVE will cover some costs, such as interest expenses and the premium for the export credit insurance underpinning the loan.
- Where necessary least developed countries may also be eligible for funding to meet concessionality requirements under international agreements on debt sustainability.
- Where possible DRIVE will also finance public-private projects in which the public DRIVE investment attracts private financing. This will be easier if DRIVE itself grants loans or provides risk capital for an infrastructure project. I will examine whether this will be feasible in the future.

¹² FIDIC terminology (see fidic.org).

There will be no new round of project proposals for ORIO in 2014. The programme is closed to new applications. I will use the remainder of 2014 to develop the new DRIVE programme, the associated administrative rules for publication in the Government Gazette and programme instructions. I will launch the new DRIVE programme in early 2015.