

Beyond Avoidance: AIFFP's journey to strengthen E&S

Abstract

Pacific governments and businesses can face difficult choices about safeguards conditionalities on infrastructure loans. On the one hand, cheap or fast projects may be especially attractive due to economic recovery and social stability drivers, but present larger environmental and social sustainability (ESS) risks and costs. On the other hand, established partner safeguards may reduce environment and social (E&S) risks upfront but at the cost of complex management and reporting processes for already under-resourced agencies. In this context, the Australian Infrastructure Financing Facility for the Pacific (AIFFP) was announced in 2019 with a mandate to work with the Pacific to drive higher quality infrastructure outcomes. AIFFP loans must satisfy DFAT requirements, IFC Performance Standards, and Equator Principles, while being responsive to Pacific realities. In its 3 years of operation, AIFFP has sought to apply these Safeguards Policies in ways which enable good projects by applying proportionate and considered approaches to risk assessment and mitigation throughout the project cycle, rather than those that disable good projects through rigid policy application resulting in disproportionate caution and restrictive controls. In this paper, we reflect on our iterative efforts to improve projects through attention to IFC PS and EP4 considerations over the lifecycle of projects in a way that works with the realities of the context, the actors, and the resources available. While avoidance is at the top of the mitigation hierarchy, risk is ever present and unavoidable for actors in Pacific infrastructure and should be utilised for spurring innovation and improvement in E&S management rather than as a roadblock to investment and development.

Introduction

Launched in 2019, the AIFFP partners with Pacific governments and the private sector to design high impact, safeguarded projects and enable their delivery through up to AUD3 billion in loan financing and up to AUD1 billion in grants. This paper documents AIFFP's approach to working with Pacific countries on infrastructure financing:

- which meets the highest international environmental and social (E&S) standards, applied in ways which allow borrower country systems to lead;
- that uses adaptive management, allowing investment design to shift as institutional, capacity, and technical needs arise or become apparent;
- where regional articulations of quality are paramount, and adapted to local conditions; and
- where quality contractors are in place, managed, and *supported* to deliver value for money outcomes.

This paper rejects the notion that infrastructure financing in the Pacific presents a 'choice' between higher or lower environmental and social standards, costs, and complexity. Such a view is at the expense of deeper attention to factors that may be more important in explaining risk in this unique context. It is also to underestimate the central role of (i) contracts, (ii) contractors and (iii) partnerships in upholding national and international standards employed to manage and deliver the works, and the central principle of adaptive management. The paper concludes by drawing recommendations from AIFFP's experience for the practical interpretation and application of safeguards in the Pacific.

The Pacific Context

General statements about the Pacific Island Countries (PICs) are unavoidable in a paper this brief, but they can cause problems, both when reasoning from experience in other regions and countries and also when discussing the Pacific Islands as a group. In many ways the region demonstrates more exceptions than conformities (Brown 2006). At a high-level, however, PICs do commonly exhibit difficult economic geography, including: remoteness from major international economic centres; internal dispersion within countries; incredibly small size by most key measures (such as population, land, and GDP); dependence on a narrow set of uncertain income sources, notably commodities, aid, remittances, and tourism; and high vulnerability to major natural disasters and the effects of climate change.

Accordingly, the PICs are an especially complex place to finance and deliver large infrastructure. The term 'Pacific Paradox' emerged in the early 2000s, partly in recognition of the relative lack of success of development projects over decades (Toatu, 2002). For example, ADB internal evaluation in the late 1990s showed the ADB project failure rate was twice as high in the Pacific islands as in the Bank's overall lending (ADB 1998). Only half of ADB's projects in the Pacific were "generally successful", and 22 percent were assessed as complete failures (ADB, 1996). The Pacific Paradox persists: only half of the ADB's projects recently completed in the Pacific have been considered a 'success' (ADB, 2020). The World Bank faces similar problems (Wood & Otor, 2019). Australian aid projects are also evaluated to be less effective in the Pacific than elsewhere in the world. (Wood, Otor & Dornan, 2020)

Other finance partners to the Pacific have encountered similar challenges, though perhaps for different reasons, with some prominent recent infrastructure projects:

- being built to inadequate standards for the environmental and climate conditions (particularly harsh in the Pacific);
- having a significantly shorter useful life (and lower value) than was designed/ scoped;
- not being able to be maintained due to insufficient complementary investment; and/or
- delivering benefits that are inequitably distributed.

Safeguards in Focus

Separate review and assessment by the World Bank, ADB and DFAT indicate that the most common root causes of unsuccessful projects include inadequate initial diagnostics and project design, insufficient implementation support and monitoring, weak government ownership, and thin capacity of implementing agencies. However, increasingly prominent among the wide range of factors which correlate with project failure in the Pacific are environmental and social safeguard policies ('safeguards'), which have emerged as a major focus of development actor attention.

E&S considerations in Pacific infrastructure financing are characterised by perceived gaps and tensions between the international Development Assistance Committee (DAC) standards and approaches of traditional MDBs on the one hand, and emerging non-traditional financing institutions which are less legalistic and more reliant on country systems on the other. While such a characterisation is heavily reductive of nuance, the respective 'approaches' to safeguards are nonetheless underpinned by distinct philosophy and practices toward development assistance and cooperation. Borrower countries are considered to face a choice about whether to partner with partners who (i) apply legacy MDB standards which avoid environmental and social risk at almost any cost or (ii) rely on national standards and avoid the high upfront cost and complexity of international safeguards approaches.

Unfortunately, neither approach has been designed primarily to strengthen stability, security, and citizen prosperity in Pacific Island countries. Critics of the first approach argue that external and technocratic safeguard standards and principles are imposed by MDBs not primarily to manage project risks but to avoid reputational risk to the institution from activists and members from wealthier, non-borrower countries. Critics of the second approach argue that new financiers rely on sometimes very-weak national standards primarily to avoid the real costs and complexity associated with delivering quality infrastructure. In so doing, they reallocate technical and financial debt elsewhere, where complicated re-works are required to remedy poor construction.

In both cases, environmental and social risk avoidance appears to be framed and approached primarily in terms of sovereignty, with both approaches claiming to support the borrower country's best interests and understood in terms of rational choice incentives. However, neither approach addresses the core developmental problem facing environmental and social oversight in the Pacific – weak legal frameworks and implementation capacity to adequately manage environmental and social risk, which can result in real and irreversible impacts to communities and ecosystems.

The Integration Frontier: Investment Solutions to Safeguard Challenges in the Pacific

Below we present three examples of AIFFP's approach to infrastructure challenges in the Pacific which rejects the false dichotomy of *avoidance of risk* versus *avoidance of complexity*. The case studies illustrate the AIFFP approach of shifting thinking and practice towards achieving proportionate safeguarding using existing systems or through innovating within those systems through focused attention on (i) contracts, (ii) contractors and (iii) partnerships.

Palau Solar: The AIFFP provided a USD 22 million financing package to a private sector developer for the purpose of building a 15.28 MWp solar voltaic facility and 12.9MWh battery energy storage system (BESS) located on Babeldaob in Palau. When complete, it will be among the largest hybrid facilities of its kind in the Pacific and generate over 20 per cent of Palau's energy needs.

Contracts & Contractors - Working with an Equator Principles Financial Institution (EPFI), Export Finance Australia, AIFFP has an obligation to enable Independent Environment and Social Consultants (IESC) compliance review of its loans. While an IESC can, to some, be conceived as a rigid compliance audit function, IESCs delivered numerous benefits and ultimate

improvements to AIFFP investments. In an example of highly effective post-financial close support, the IESC was utilised to undertake a review of Contractor EMPs and monitoring plans and propose recommendations and examples for use by the existing EHS personnel with minimal additional training requirements. By going beyond the compliance/non-compliance binary and recognising the opportunity to work *with* the proponent and contractor to develop the monitoring strategy, AIFFP were able to drive operational efficiency gains in the project, improve environmental monitoring, and strengthen the implementation relationships.

Partnerships - Following standard procurement policy and process, a solar module manufacturer was chosen based on competitive pricing, warranty coverages, and quality to withstand the environmental conditions in Palau, such as typhoons. A comprehensive due-diligence assessment conducted by AIFFP found that the proposed provider of the plant's solar modules was procuring polysilicon from factories suspected of using forced labour, however, meaning the project could breach Australia's Modern Slavery Act (2018). As a result, and at the request of the AIFFP, the client collaboratively initiated a second procurement to source a new supplier which could demonstrate its supply chain was not exposed to modern slavery. These actions not only ensured that the AIFFP's investment would do-no-harm, but also contributed to measurable improvements in global labour conditions by removing significant Pacific market demand for the exposed forced-labour-exposed polysilicon products. Although the new supplier's technology had a higher unit cost, a careful lifecycle analysis demonstrated that the new modules would satisfy all operational and production requirements. The outcome demonstrates how close, collaborative partnerships can lead to strengthened projects in the Pacific.

PNG Laitim Hauslain Project: AIFFP is supporting PNG Power Limited (PPL) to expand the distribution grid in Lae and East New Britain. The *Laitim Hauslain* Project will connect an additional 30,000 to 40,000 households, as well as schools and clinics to the electricity grid for the first time, thus improving the living standards of up to 200,000 people and increasing PPL's existing customer base by up to 25%.

Contracts & Contractors - Following AIFFP's commissioning of a local labour assessment to understand and plan around technical capabilities in-country to carry out the works, AIFFP targeted the procurement for all contracts to favour local companies through a tailored scoring approach. This labour market assessment is also helping PPL and AIFFP to plan and sequence capacity development needs with the project procurement plan and gender, disability and social inclusion action plan, with tailored training scheduled at appropriate points in procurement, from bid preparation support to upgrading of technical certifications. Besides assessing existing local technical capacity, the assessment also identified opportunities to grow local contractor capacity.

Partnerships - PPL's development partners apply a range of E&S policies and frameworks which, while complementary and broadly consistent, can complicate PPL's management of risk. Given the scale and scope of the current and expected partnership, AIFFP agreed to assist PPL in the development of a comprehensive fit-for purpose organisation-wide Environmental and Social Management System (ESMS). The PPL ESMS was designed as a modular framework which can easily accommodate additional inputs and thematic 'modules' from PPL and partners as and when risks or opportunities emerge. It also allows for progressive capacity building of PPL's environment and social staff and management in real world scenarios.

PNG Ports: In partnership with PNG Ports Corporation Limited (PNGPCL), AIFFP is financing a AUD621.4 million investment to repair and upgrade key ports around the country. This AIFFP flagship investment will transform Lae Port to be the key trans-shipment port servicing the Highlands, surrounding areas and the wider Pacific, and upgrade wharves to benefit remote local communities, increasing their access to transport, trade and services.

Contracts & Contractors – The Pacific infrastructure space has long been characterised by market distortions in procurement due to artificially low pricing (the 'high cost of cheap projects'). In response, AIFFP worked with PNGPCL to provide genuine choice of quality contractors, ensuring safeguards and impact issues in design and build contracts are not displaced by lowest-

cost considerations. AIFFP is the first sovereign lender in PNG to support a state-owned enterprise (SoE) partner to establish a local content target. This includes a strong contractual enforcement mechanism through which a minimum target of 30% local expenditure on local content is mandatory. Scoring for construction tenders also provides weighting for the inclusion of local contractors.

Partnerships - The AIFFP investment is supporting the partial implementation of the PNG Ports 30-year Master Plan. As part of this long-term partnership, AIFFP identified several ways that it could support PNGPCL in furthering its institutional E&S aspirations while laying the foundations of strong safeguards approach to each Port investment. For example, AIFFP worked with PNGPCL to undertake a Sectoral Environmental and Social Assessment (SESA) of the Master Plan which provided the framework to promote sustainable and resilient development at the project ports by embedding sound environmental management within implementation, reducing duplication and cost.

As part of the project, PNGPCL invested for the first time in a dedicated Safeguards team with appropriately skilled personnel, supported by on-call specialist support and a dedicated budget. By going beyond individual project risk, AIFFP support has demonstrably led to a strengthening of safeguard culture in PNG Ports.

Learnings and Recommendations

Many of the key decisions made in Pacific infrastructure financing and delivery are made in the belief that either international or national safeguard standards and systems are the best way to manage risk while enabling successful projects. The Pacific experience suggests that they are not. Neither international or national systems focus on national capacity or quality standards. Nor do they contain guidance to ensure that infrastructure is built well, serves its purpose for many years, and brings real opportunities for local business and people.

AIFFP was established to ensure that infrastructure financing would deliver for the people where the infrastructure is built, and for the people who ultimately use and pay for it. That means (i) contracting in ways which support value for money outcomes in works bid evaluations, (ii) strengthening national and quality contractors' ability to compete and (iii) treating clients as equal partners, meeting them where they are and working with them over time to succeed.

AIFFP remains the 'youngest' major infrastructure financing partner for PICs, having commenced operations only in late 2019. In its short life, factors complicating quality infrastructure outcomes in the Pacific have been compounded by the COVID-19 pandemic and economic contraction, inflationary and global supply chain challenges, and sharpening geopolitical and climate change pressures. These and other challenges remain. However, the evidence presented in this paper indicates that AIFFP's 'contracts, contractors and partnerships' approach to safeguards – which is deeply collaborative, adaptive and responsive – puts AIFFP in a strong position to respond to emerging risks across the life of infrastructure assets, and emerge as a preferred infrastructure partner for Pacific Island countries.

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