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# Asia's Infrastructure Challenge


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## Project Chambers Lunch

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Thank you Tim for that generous introduction, and for this opportunity to address an important and fascinating topic to this distinguished and knowledgeable audience.

♦Maybe none of us needed the dreadful and tragic pictures of the damage wrought across the central Philippines two weeks ago by the Haiyan super-typhoon to remind us of the paucity and horrendous vulnerability of infrastructure across much of our Asia-Pacific region, but the illustration could not have been more graphic.

Even in the best of circumstances, the Philippines has one of the least developed and most vulnerable infrastructures in the world. Decades of poverty, government indebtedness, and low tax revenues have meant little has been spent on roads, railways, power grids, drinking water, and sewerage systems. Overlay this with an average of 20 typhoons a year – most of them thankfully not as savage as Typhoon Haiyan – add to this frequent other natural disasters, and it is easy to see why the Philippine economy from an infrastructure viewpoint is one of the most challenged in our region.

But the Philippines is of course not alone. Put on one side affluent societies like Hong Kong, Singapore and Korea with strong infrastructures that help underpin keen competitiveness, and many of East Asia's economies have poorly-developed infrastructures that inhibit economic activity, hamper efficiency, and make it tough for even the most creative of entrepreneurs to be competitive.

Let me show some World Bank slides to demonstrate this, starting with ♦road development, then ♦rail density, ♦electricity production, ♦ internet connectivity – and ♦hospital beds.

The infrastructure deficit in all areas is clear to see.

The♦ World Economic Forum has developed indices to map this, and needless to say, many of our Asian economies lag far behind the developed world shown in the bar at the bottom of the slide. And even those with reasonably-developed infrastructure face challenges to repair and update in order to sustain competiveness.

The only good thing I can find in this is that it should provide some marvelous business opportunities for many of you in this room today!

♦Quite famously, the Tokyo-based Asian Development Bank Institute in 2009 published a study that estimated the Asia region needed to spend US$8 trillion on infrastructure in the decade to 2020. This number has been widely quoted ever since as a striking measure of the scale of the region's challenge, with costs focused mainly on energy and transport.

♦Since then, HSBC has upped estimates to US$11 trillion, with ♦keenest shortages (marked by the hot red areas) in ♦Indonesia and the ♦Philippines. But these estimates of infrastructure spending needs, daunting as they may be, are likely to be significant underestimates, because they focus on just four broad sectors – energy, transport, water and telecoms, and exclude infrastructure that many of us would regard as indispensable – like spending on schools, hospitals and health systems, or ♦on building the new cities that are going to be needed in the coming decades to meet the strong urbanization trend when emerging Asia is forecast to grow its city population by 650 million people.

Nor does the number include the investment needed to tackle severe environmental pollution, or to mitigate climate change.

A recent World Bank study estimates that if we include urbanization needs, we need to lift current infrastructure-spending worldwide of around US$900 billion by at least US$1 trillion a year – to between US$1.8 trillion and US$2.3 trillion a year in total. This study says East Asia will account for half of this, and energy will be the largest component

♦ As people pour over these huge numbers, a single message is very clear: these needs cannot be met by governments alone. Private sector engagement is critically important.

And if the private sector is to be drawn effectively into the challenge of meeting these essential future infrastructure needs, whether through one form of Public Private Partnership (PPP) or another, many distinct challenges need to be faced. Projects need to be structured in a way that promises reasonable returns on investment. Legal certainties need to be in place for contracts that may have a life of 20 or 30 years. Risks unique to long-gestation infrastructure projects that are serving social rather than purely commercial needs must to be satisfactorily mitigated.

♦ In the short time we have here today, I am going to try to summarise what I think are some of the key challenges that we face. I am going to build a picture based on the many initiatives we have undertaken in the APEC Business Advisory Council (or ABAC), of which I have been a long standing member representing Hong Kong.

But first, perhaps some examples of the scale and nature of the challenges we face.
♦And let me pull up some more World Bank data to help focus our thoughts, comparing adequacy of infrastructure in many forms – hospital beds, safe water, roads, rail networks, power, and internet access.

♦The Philippines illustrates the challenges clearly. Investment has for decades been inadequate in all areas of basic infrastructure – energy, water, roads, air transport, and rail. A number of internationally publicized negative experiences – like the delays in building the new Terminal 3 at Manila's international airport, and cost overruns and delays in the Manila urban rail system – have intimidated many potential international investors.

Less publicized however are a number of successful projects, in ♦building toll roads, ♦power plants and ♦water utility privatization. In the Manila Water project, for example, 4 million homes have been given access to piped water, lifting water coverage from 49% to 94% of the community. ♦And the dilapidated North Luzon Expressway has been revitalized under a BOT put in place in 2003. Many of these PPP projects have been coordinated by the 60-strong technical staff in the PPP Centre under the National Economic and Development Authority.

♦Commendably in the recent past, the Philippine Government has brought the balance of payments back under control, and greatly reduced debt, improving the local investment climate. Much work is being done to improve the legal and regulatory environment for investors.

But more needs to be done in the Philippines, as in several of the region's economies, to develop local capital markets, including long term bond instruments. An important part of this would be through development of the life insurance industry, to harness savings more effectively including those of the many hard working Filipinos overseas, whose remittances totaled some US$21 billion last year. Properly harnessed, these could both provide retirement security and play an important part in funding infrastructure projects.

♦As the largest ASEAN economy by far, Indonesia has in many ways flourished over the past 10 years, boosted by strong demand for its key commodities – though the past year has been more difficult. However, for infrastructure the country has been something of a laggard. You can see from the chart that the infrastructure "deficit" is such large. A number of measures are under way to improve performance going forward, and the government's infrastructure-spending in the past year has been lifted by 25%.

♦Still the government in Jakarta faces huge challenges in this vast country of 17,000 islands: coordination between ministries is poor; ability to develop pipelines of bankable infrastructure projects remains limited; land acquisition remains a key problem, as does inconsistency in the workings of the legal system and local regulations.

There are hopes that a recently created PPP unit in the Ministry of Finance will help. The potential benefits from infrastructure spending to Indonesia's economy and the quality of life of its people are huge. It has been estimated that excellent infrastructure could raise Indonesia's growth rate from 6% to 8%. It would increase the country's competitiveness, and attractiveness as a production base and would spread jobs and wealth to more remote parts of the country.

♦The scale challenges faced by China hold us all in awe. ♦The government is committed to build 100 new cities of a million people or more by 2020 – on top of the 220 that exist already. Compare that with the UK that has two cities with a population of 1 million or more, and the US, which has just 9 cities over one million people, and it is quickly clear that China is creating – and responding to – infrastructure-building challenges never before confronted. They are in the process of ♦ building 16,000 kms of high-speed railway line, ♦ and 160 new airports.

♦Mass transit systems operating in leading cities like Beijing, Shanghai, Shenzhen or Guangzhou now match the best in the world, and are expected to double in size by 2020, but in most of China's cities of between 5-10 million people, even where local mass transit systems already exist, they are skeletal compared with cities like Tokyo, New York or London, and will in future need to be expanded hugely. ♦Compare Chengdu's system with Tokyo's for example. It looks small today but by 2020 it is planned to have 291 kilometers of subway lines, close to the 310 million of Tokyo.

♦ Thailand has invested quite aggressively to meet its basic infrastructure needs, and was the first in the region to draft specific PPP laws, but the ADB still estimates it will need to spend $173 billion on infrastructure in the period to 2020. Perhaps the most interesting part of this is its pivotal role in driving regional integration in the Greater Mekong Area. ♦An East-West corridor has been built connecting the south of newly-emerging Myanmar across Thailand and into Laos and central Vietnam. A North-South corridor linking Central Myanmar with south China and the north of Vietnam is close to completion. And a southern economic corridor now links the centre of Thailand with Cambodia and the south of Vietnam.

♦In ABAC, recognizing the critical importance of infrastructure development to the economies of our region, we have for many years been concerned about the challenges linked with drawing private sector investors into such long-gestation infrastructure projects.

Three years ago we won support for a brief and refreshingly clear document setting out "Non-Binding Investment Principles" – a set of guidelines to policymakers on what needs to be in place if an economy is to be successful in attracting foreign investment. Our message from the business community to APEC governments was clear: it is up to you whether you adopt these principles or not, but if you do you will find it easier to attract foreign investment.

But these initiatives were aimed at the general challenge of attracting foreign investment. Over the past three or four years, more and more of our attention has been focused on the imperative of improving our infrastructure – both connectivity within our economies, and in improving the linkages between our economies.

Three years ago, the APEC Business Advisory Council launched an initiative jointly with global institutions like the World Bank and the Asian Development Bank called the Asia Pacific Infrastructure Partnership. Nowadays, we tend to call it APIP, as we are very fond of acronyms in ABAC. This is a task force of private sector infrastructure experts that has grown today to be more than 70-people strong – with several of those on the Task Force based here in Hong Kong.

Having set up the APIP Task Force, we then told the region's governments that members of this task force would make themselves available to meet in confidential circumstances with officials to talk about their infrastructure-building challenges, and suggest from our experience what they will need to do if they want to build successfully a stream of viable projects.

We cannot of course force the Task Force on anyone. But if a government wants to meet, we make ourselves available. The Task Force met in 2011 with top-level teams, mainly from finance ministries, from Mexico, Peru and the Philippines. In 2012 the Task Force met with governments from Vietnam and Indonesia. This year, we have engaged with Thailand, the Philippines for the second time, and on December 2, we meet for the second time with officials from Indonesia.

Because the meetings are totally confidential, they can be full and frank. No Task Force member is selling any product or service. He or she is participating simply to help government officials discover the practical challenges private sector participants face when they consider joining a PPP. The results appear to have been greatly appreciated.

While availability of finance remains a key factor, it is by no means the only constraint, and often not the main one. Our key findings have been♦:

- A lack of capacity to prepare bankable projects that can provide a robust pipeline, as well as capacity for policy reforms and planning
- A need to understand risks better, which parties are best able to take on which risks in which sectors, and how best to allocate these risks among public, private, multilateral, and other relevant institutions
- A need to have a transparent and efficient legal and regulatory environment that can reduce risks to the minimum possible
- A need for mechanisms to mitigate risks that the private sector cannot cover
- A lack of long term local currency finance
- A need for a more coordinated and coherent public sector approach to PPPs, and
- A need for credible and creditworthy partners and public counterparties.

♦Outside ABAC, the ADB, working with the Economist Intelligence Unit, has developed a very interesting "tool" called the Asia Infrascope, which uses similar factors to evaluate a country's capacity to undertake sustainable PPP projects. It bases its tool on five criteria: the legal and regulatory framework, the institutional framework; operational maturity of institutions responsible for infrastructure; the local investment climate; and an economy's financial facilities.

While the region's economies generally have considerable room to improve, the research team gave Indonesia and the Philippines some marks for their recent efforts to improve the regulatory and institutional environment

♦Inside ABAC, we have developed an "Enablers of Infrastructure Investment Checklist" – a self-help tool for officials to help them check their readiness to manage substantial private sector investment in infrastructure projects. This focuses on four key areas: augmenting government project planning and coordination mechanisms; building a strong financial environment; developing a robust framework for PPPs; and creating a strong environment for attracting foreign investment.

♦This tool, along with the APIP, was endorsed last month by APEC Leaders meeting in Bali, and will form part of APEC's broader efforts to drive infrastructure investment, under a new Multi-year Plan on Infrastructure Development. They have endorsed the creation of a PPP Expert Advisory Panel and a pilot PPP Centre in Indonesia. Our APIP Task Force will dovetail into this. The main aim is to create capabilities to develop robust pipelines of bankable infrastructure projects.

As Beijing takes over the mantle of leading APEC in 2014, there is no question that the infrastructure development priorities set by Indonesia this year will be forcefully pursued. And looking out further to Manila's chairmanship of APEC in 2015, it is clear that the infrastructure imperative will be maintained.

♦As our officials gird their loins to develop these plans, and aggressively build our under-developed infrastructure, a key challenge will be to engage the private sector effectively. I have given you a few ideas and would turn now to all of you experts in this room. ♦What are your own thoughts on the challenges we face as we consider rolling up sleeves to participate in long-gestation infrastructure projects? How do we most valuably and effectively signal to governments the changes needed to facilitate private sector involvement in this difficult but essential area?

I thank you for the chance to set the scene here today, and look forward to questions, and any ideas you have to take forward initiatives in this very important area.

Thank you.

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