LAUNCH OF THE INFRASTRUCTURE FINANCING FOR SUSTAINABLE DEVELOPMENT IN ASIA AND THE PACIFIC BOOK

Tientip Subhanij
Ningbo, China
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• This book proposes a strategic shift in infrastructure financing for Asia and the Pacific
  • It builds on the question “What is the current landscape?” to consider “What can we do differently?”

• The public sector is – and will remain – the largest player in infrastructure investment
  • Government intervention: is it about quantity or quality of investment?

• How to get the private sector more involved in infrastructure development
  • Sources of finance: Bank or bond (non-bank) financing?
  • Public incentives: Traditional or innovative?

• Geographic challenges hamper the success of infrastructure implementation
  • Cross-border projects: Shifting from a national focus to regional cooperation
  • Countries with special needs: shifting from ‘One size fits all’ to bespoke solutions to unique challenges
A holistic approach is necessary

- **The investment needs of Asia-Pacific in infrastructure are significant**
  - ESCAP estimates that an additional US$1.5 trillion per year is required in the developing countries of Asia and the Pacific to meet the 2030 Agenda
  - And this includes US$900 billion per year on infrastructure investment

- **Focusing on harnessing additional financial resources is not enough**
  - Improved strategic planning, allocation and management of existing and planned infrastructure investment is vital. ‘More bangs for the buck’

- **Adopting a holistic approach has the potential to:**
  - Unlock considerable efficiency gains
  - Reduce redundancies of effort
  - Provide a more conducive – and less risky – enabling environment for investors and financiers
Three pillars for infrastructure financing strategies

**Achievement of the SDGs**
- **Inclusiveness** – infrastructure that ensures universal access to basic services
- **Sustainability** – infrastructure that meets the needs of the present without compromising the ability of future generations to meet their own needs
- **Resilience** – infrastructure that protects citizens and economic assets

**Public sector support**
- Ensure the appropriate selection and implementation of infrastructure projects
- Expend public financial resources in the most efficient, equitable and impactful manner possible

**Private sector engagement**
- Reduce business risks and uncertainties typically found in infrastructure projects
- Develop and diversity financial market and instruments
- Provide an attractive value proposition / risk-adjusted rates of return
Public spending on infrastructure: a tight-rope walk for planners
Improving the effectiveness and efficiency of project implementation

- The implementation of large public infrastructure projects has frequently been marred by substantial cost over-runs and/or benefit shortfalls.

- Reasons attributed to this include:
  - Adverse and unforeseeable events (‘bad luck’)
  - Projects’ complexity
  - Ad hoc revisions in the scope and design of the project
  - Opposition of stakeholders

- Improvements in the public sector’s effectiveness and efficiency should derive two objectives:
  - Implementation of sustainable infrastructure projects
  - Increased participation of the private sector in infrastructure projects
The need for up-stream institutions

- When planning infrastructure development nationally, a lack of coherence across sectors and government levels is often observed.

- Policy-makers should consider new upstream institutions under the form of a national commission / council, with the potential to:
  
  - Facilitate the flow of quality information and analysis
  - Identify and reduce social and environmental risks
  - Maximize the efficiency of project implementation
  - Ensure consistency between national-level policies and implementation at the regional and local levels
The challenge of bringing the market to infrastructure investment
Bond markets still not harnessed in Asia-Pacific

- Bonds can play an important role in complementing bank loans, given their comparative advantages:
  - Fewer maturity and currency mismatches
  - Particularly good fit with the operation phase of infrastructure

- However, bond financing remains limited in Asia-Pacific, where bank loans still dominate:
  - Insufficient sovereign credit risk ratings to help benchmark
  - Under-developed capital markets

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Sources of funding for infrastructure finance, 2018

- Bank Loans
- Bonds
- Equity
- DFI Loans

Source: IJ Global database
Two groups of policies to encourage bond infrastructure financing

Ensuring a robust and enabling macroeconomic environment

- Macro-economic stability
  - Avoid inflation and currency fluctuations
- Supportive financial markets
  - A robust banking sector is essential for the development of bond markets
- Effective legal and regulatory framework
  - Ensure the enforceability of obligations
  - Provide a suitable level of protection of investors’ rights

Strengthening bond market structure, intermediaries and architecture

- Deepening the sovereign bond market
  - Facilitate the development of corporate and project-specific bonds
- Widening the investor base
  - Engage institutional investors
- Diversifying financial instruments
  - Islamic finance, green bonds, blended finance
- Increasing market liquidity
How can capital markets support the achievement of the 2030 Agenda?

**Prudent approach to capital market development**
- Consider the potential risks of rapid financial sector liberalization on macroeconomic growth and stability
- Getting the balance right

**Bonds for sustainable development**
- Bonds that are used to support socio-economic development and environmental sustainability
  - Green bonds
  - Blue bonds
  - Social impact bonds

**Environmental, social and governance (ESG) factors**
- Mainstreaming ESG factors into investment research
- ESG reporting in securities exchanges
Harnessing positive indirect effects in local economies

- **‘Externality effects’**: positive socio-economic benefits that accrue outside the target area of the infrastructure investment and its direct service provision

- **The availability of new public goods in the area surrounding a new infrastructure project indirectly stimulates:**
  - New uses of land (office buildings, housing, manufacturing plants, etc.)
  - Increased employment (new businesses, restaurants, residents, etc.)

- **These spill-over effects, in turn, are expected to trigger**
  - Tax revenue increases
  - Land value increases in the periphery and adjacent areas
Harnessing externalities to incentivize private sector participation in infrastructure

- If the private sector is expected to share the **risks** of infrastructure development, they should also be given an opportunity to share in the **benefits**
- Governments can use some of the incremental tax revenues to give long-term subsidy schemes to private investors
  - Ensures increased rates of return
  - Indexes the economic benefits of the project to its successful design, construction and operation, thereby motivating efficiency

Source: ESCAP
For some less developed countries the needs are great and the resources slim.
Cross-border infrastructure is fundamental, but comes with additional challenges

- ‘Development of seamless connectivity’ is a pillar of the Bangkok Declaration on Regional Economic Cooperation and Integration (RECI)

- Cross-border infrastructure is a pre-requisite for a greater and freer movement of people, goods, energy and information, but exhibit additional risks that must be recognized and addressed:
  - Large investment requirements and lengthy maturation cycles
  - Differing or opaque rationales, and greater political risks
  - Potentially greater foreign currency liabilities
  - Differences in regulatory and policy frameworks
  - Institutional capacity and coordination issues
  - Differing technical standards
Regional initiatives have the potential to mitigate these challenges

**Belt and Road Initiative**

- Largest initiative, covering countries in Asia, Africa and Europe
- Constitutes a channel for countries to access MDB and DFI financing
- Establishes long-term commitments that reduce political risks
- Addresses environmental concerns through the BRI Green Investment Principles

**Infrastructure Financing and PPP Network of Asia and the Pacific**

- Platform for dialogue and homogenization of policies and objectives
- Promotes cooperation in the identification and prioritization of cross-border infrastructure projects
- Aims at improving the institutional capacity of member states
- Engages with the private sector to secure additional sources of finance
LLDCs and SIDS face additional challenges regarding infrastructure finance

- Landlocked developing countries (LLDCs) and small island developing States (SIDS) exhibit the **highest investment needs** and yet have the **largest financing gaps**

- They share some common challenges, such as:
  - Sub-optimal economic performances
  - Less favorable investment climates
  - Administrative obstacles and institutional capacity constraints
  - High transport and logistics costs

Source: ESCAP, Economic and Social Survey of Asia and the Pacific 2019
Unique challenges demand different policy actions

### Landlocked developing countries

**Geographic & demographic conditions**
- Typically mountainous and topographically unfavorable
- Costly access to foreign markets, other than immediate neighbors

**Fiscal and current account balance deficits**
- Crucially constrains infrastructure financing capacity

**The way forward**
- Fiscal and financial incentives to attract FDI
- Strengthening PPPs

### Small island developing States

**High construction & maintenance costs of infrastructure projects**
- Lack of economies of scale
- Necessity of importing materials and capital goods

**Natural disasters and climate change**
- Raise the costs of investment
- Decrease the expected future incomes

**The way forward**
- Deepening fiscal capacity and efficiency
- Regional cooperation to raise and manage climate change funds
CONCLUSION

• This book proposed adopting a more strategic and holistic approach to infrastructure financing ...

• ... one that encourages policy-makers to embrace a mindset change, away from a traditional focus on *spending more*, and towards a strategic goal of *spending better* ...

• ... with the SDGs as a guiding compass.

• ESCAP has played a key role in addressing these issues, including:
  • Infrastructure Financing and PPP Network for Asia and the Pacific
  • Sovereign bond market development
  • Mainstreaming climate finance into policy-makers’ agendas