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INFRASTRUCTURE

+ Lifting-The-Barriers Roundtable

Preliminary Paper

ERIA

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About CARI

The CIMB ASEAN Research Institute (CARI) was established in 2011 as a member of CIMB Group. CARI prides itself on being the first independent, transnational research institute dedicated solely to the advancement and acceleration of the ASEAN integration agenda. CARI was designed to pursue research and to promote thought leadership in support of an integrated ASEAN Community. CARI seeks pragmatic solutions and policy recommendations to address challenges in ASEAN integration and connectivity. CARI's headquarters is located in Kuala Lumpur but the institute has a regional presence.

ASEAN
BUSINESS
CLUB

About ASEAN Business Club

A fully private sector driven initiative of ASEAN's leading businesses coming together to support economic integration while providing a platform for networking. The ABC creates an avenue for ASEAN's businesses to engage with global regional leaders. The club's vision is ASEAN: Open for Business.

ERIA

About the Economic Research Institute for ASEAN and East Asia (ERIA)

The Economic Research Institute for ASEAN and East Asia (ERIA) is an international organisation established by a formal agreement among 16 heads of government at the 3rd East Asia Summit in Singapore on 21 November 2007. ERIA works closely with the ASEAN Secretariat, and researchers and research institutes from East Asia to provide intellectual and analytical research and policy recommendations. ERIA aims to (i) facilitate ASEAN Economic Community building, (ii) support ASEAN's role as the driver of region-wide economic integration, (iii) contribute to narrowing the development gaps in East Asia, and (iv) nurture a greater sense of community in East Asia. Another key ERIA objective is capacity building aimed at strengthening policy research capacities in less developed countries.

ERIA research covers a wide range of policy areas, such as trade and investment, globalisation, development of small and medium enterprises (SME), human resource and infrastructure development, and energy issues.

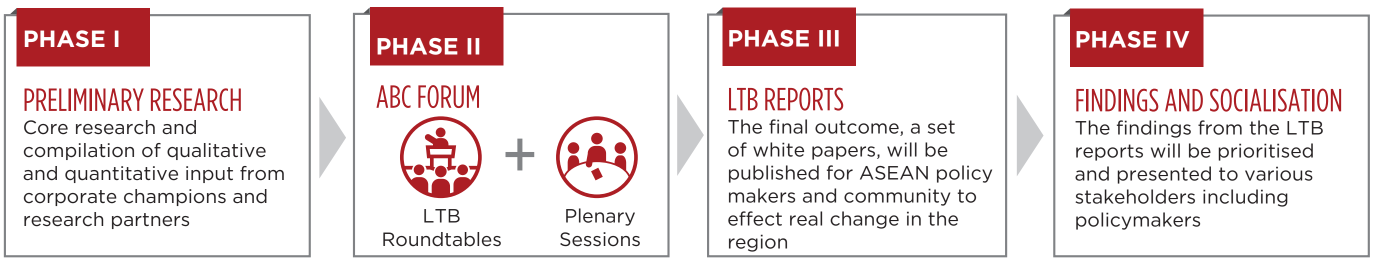
PREFACE

The Lifting-The-Barriers Initiative (LTBI) is a year-long research exercise designed in conjunction with the ASEAN Business Club (ABC) Forum. The overall objective is to conduct sector based research with the purpose of identifying bottlenecks and barriers to trade and ASEAN economic integration.

The LTBI in 2013 and 2014 have yielded 13 reports for 11 sectors, namely 1) Financial Services, 2) Capital Markets, 3) Connectivity, 4) Aviation, 5) Infrastructure, Power and Utilities, 6) Healthcare, 7) Legal and Tax, 8) Automotive and manufacturing, 9) Minerals, Oil and Gas, 10) Retail, 11) Food and Beverage Industry. The LTBI 2015 continues to highlight five key sectors covered in 2013 and 2014, with the addition of the tourism sector which is one of the twelve priority integration sectors (PIS) of the ASEAN Economic Community Blueprint.

The Lifting-The-Barriers reports have been widely referred to by ASEAN policy makers and stakeholders. The ASEAN Chair of 2015, the Right Honourable Prime Minister Dato' Sri Najib Razak, publicly cited the LTB reports as being a useful guide for Malaysia's stocktake exercise to identify the gaps between ASEAN aspirations and the reality in the business sector, in anticipation of the pronouncement of the ASEAN Economic Community later this year.

The LTBI has four phases, each playing a unique role in helping achieve the wider objective. Details of the initiatives are:



Phase I:
Phase I of the LTBI involves core research and seeks to identify the existing barriers in each sector to assist in understanding the challenges faced by different segments of the industry. We also study the AEC obligations and impacts on businesses and the industry as a whole.

Phase II:
Phase II convenes around the sector based "Lifting-The-Barriers Roundtables" at the ABC Forum. The roundtables serve as a platform for different stakeholders to deliberate on the future of their sector and of ASEAN as a region.

Phase III:
Phase III consists of the production of the final outcome of this exercise, the Lifting-The-Barriers Reports, white papers delivered to the relevant regulatory bodies to effect real change and accelerate ASEAN integration efforts. This phase will consolidate materials from Phase I and Phase II. The Reports summarise the industrial insights and ideas discussed at the Roundtables.

Phase IV:
Phase IV is the socialisation of key findings from the LTBI. This phase involves the distribution and presentation of the key findings to the relevant regulatory bodies as well as to other industry stakeholders. The 2014 LTB Reports were distributed to over 1000 companies and corporate entities as well as presented to various ASEAN government bodies and institutions.

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1. LANDSCAPE OF INFRASTRUCTURE AND FINANCING SOURCES IN ASEAN

A. Sources of Financing

The demand for quality infrastructure is huge in ASEAN region where economic growth has been robust. It is projected that ASEAN economies need to invest over US$60 billion a year in infrastructure until 2020 to support and maintain the region's high economic growth[1]. However, infrastructure supply in ASEAN economies remains low relative to the needs. Except Singapore that ranks in the third position in the world, the majority of states in the region are struggling with low quality infrastructure. Infrastructure investment has mainly been funded by sovereign resources with some variations of mix financing such as subsidised semi private facilities, backed up by user fees, or supplemented by foreign aid. These traditional sources still cannot fulfil the whole demand for infrastructure investment.

Particularly after the severed Asian crisis in 1998 and later in times of global crisis in 2008, many governments' fiscal space has narrowed due to expansionary stimulus packages to offset the impact of the crisis. With current development of strong US economy, appreciation of US Dollar against all other currencies, and anticipated higher interest rates in the US, many emerging countries including those in Asia are struggling to cope with capital flight and maintain monetary stabilisation. This condition puts pressure on public fiscal space.

In addition, Official Development Aid (ODA) will likely decline for many countries that have achieved medium income status. Infrastructure projects are also competing for donor's funds with social sectors and projects with direct poverty alleviation impact. Therefore, with the rapidly rising demand the infrastructure deficit is expected to widen in most of the member countries. The majority of ASEAN member states, except Singapore and Malaysia, could only feed less than half of estimated demand.

One of the market instruments to channel funds into the business is through utilisation of capital markets. ASEAN's bond markets vary in size and have developed at different rates but are mostly dominated by government bonds. There is no specific information on the size of the portion of this fund that goes into infrastructure.

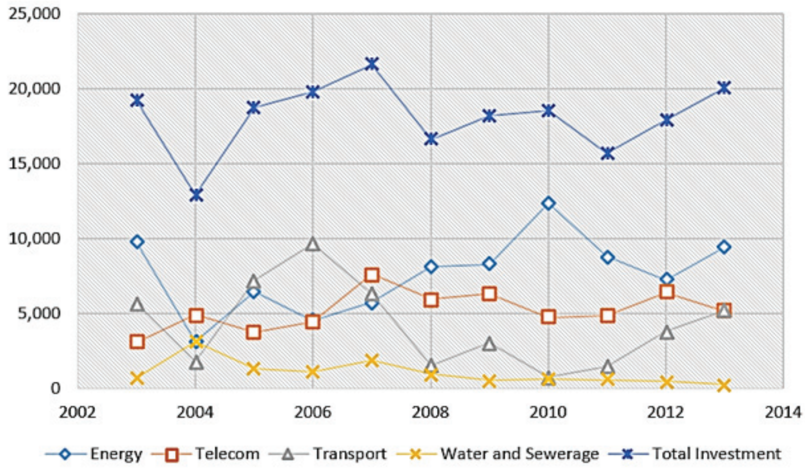
Description	Indonesia	Malaysia	Philippines	Singapore	Thailand	Vietnam
Q4 2014 Market Size (US$ Billion)	Total = 123 Gov= 106 Corp= 18	Total = 316 Gov= 185 Corp= 131	Total = 104 Gov= 87 Corp= 17	Total = 241 Gov= 147 Corp= 95	Total = 282 Gov= 211 Corp= 70	Total = 41 Gov= 40 Corp= 0.6
YoY Growth (%)	Total = 14.8 Gov= 17.7 Corp= 0.3	Total = 1.1 Gov= 1.4 Corp= 0.7	Total = 4.8 Gov= 1.2 Corp= 27.6	Total = (1.1) Gov= (2.1) Corp= 0.5	Total = 2.3 Gov= (1.1) Corp= 14.1	Total = 41.2 Gov= 42.5 Corp= (10.9)

Source: http://asianbondsonline.adb.org/documents/abm_mar_2015.pdf

Private financing participation is also expected to increase through Public Private Partnership (PPP) schemes, equity participation, and privatisation. However, since the majority of infrastructure projects falls into the category of non-commercial business, they attract limited private financing.

The rate of PPP implementation remains slow in Asia and, in particular, in ASEAN countries. The dollar amount of PPP infrastructure projects that came to financial close, in fact, declined significantly after the Asian crisis and has not recovered. In 1997, private participation in infrastructure in the East Asia and Pacific Region amounted to US$36 billion[2]. After the crisis, the amount fell to a little over US$10 billion in 1998. Although it recovered to US$20 billion by 2000, the amount has since been fluctuating between US$10-20 billion. A large part of this are investments in China and Thailand.

Table 1. Private Participation Investment in East Asia & Pacific (US$ million)



Source: PPIAF and The World

Regional Sources of Financing

In the light of enhancing regional cooperation and regional resilience, several initiatives have been developed in the region including those related with financial supply and channelling. Among those are Asia Bond Fund (ABF), Asian Bond Markets Initiative (ABMI), ASEAN Infrastructure Fund (AIF, subsidiary of ADB), and the latest one: China-led Asia Infrastructure Investment Bank (AIIB).

The ABF was created in 2003 as an initiative of the Bank for International Settlements (BIS) to foster regional cooperation, promote intra-regional investment and capital market development. The ABF has achieved its early objectives including withholding tax reforms, the liberalisation of foreign exchange rules and reduction in cross-border settlement risk. Nevertheless, challenges remain including improvement in both debt and liquidity with the development of repo markets, the adoption of derivatives trading and opening the market to non-resident investors (Bank for International Settlements, 2011).

The ABMI was established to prevent resurgence of financial crisis and to promote growth. It would reduce the risks of dual mismatch in the term structure and currency in financing activities through harmonisation and integration in Asia Bond Market, aiming at strengthening regional capital market and channelling savings into the East Asia region. The ABMI was introduced in 2005 by ASEAN+3 with the support of the Asian Development Bank.

The ABMI in its early years adopted a supply side perspective with the objective of improving depth and diversification of offers. The market doubled in size between 2007 and 2013. The future development of the ABMI market includes a strategy to increase the volume of infrastructure securities, which will offer several advantages unavailable with foreign-sourced project finance, including better diversification of project risk and investor liquidity[3].

Asian Infrastructure Investment Bank (AIIB) is a soon to be established financial institution that will focus on financing infrastructure in Asia. It was led by China's initiative in 2013, and till the date, almost 60 countries are committed to be founder of the bank. The AIIB is expected to operate by the end of 2015 with estimated capital of US$100 billion. It will significantly increase the financial supply for infrastructure investment in the region.

Infrastructure Financing Paradox[4]

- The World Bank estimates that approximately US$800 billion is being invested annually in infrastructure in developing countries (of which 40 percent goes to East Asia and Pacific), with about US$600 billion/year financed from government budgets; the remainder comes from the multilateral development banks (MDBs) (about US$40 billion/year) and from private sector investments (about US$160 billion/year).
- To maintain annual economic growth at 5 percent, the current annual infrastructure investment will need to double over the next 10 years.
- The Bank estimates a 'gap' of roughly US$1 trillion/year by year 2020. This is the gap that cannot be met by government budgets or by the MDBs.
- At the same time, there are massive supplies of surplus capital -- global savings currently amount to US$17 trillion -- with investors looking for long-term stable returns: this is the 'infrastructure paradox'. A similar paradox exists in ASEAN countries, too, where both savings rates and foreign reserves are high.

B. Existing and future infra projects/needs among ASEAN countries

Types of infrastructure projects needed in ASEAN:

Infrastructure	Countries	Remarks
Power, Roads, Railway, Telecom, Water and sanitation (Watsan)	All	- Lack of supply in Cambodia, Indonesia, Laos, Philippines, Myanmar, Vietnam. - Response to Growth in Brunei, Malaysia, Singapore and Thailand. - Cross-border projects: SKRL[5] , APG[6] , AHN[7], TAGP[8]
Urban transportation	All	Types of facilities/projects and size depend on the development stage of the urban areas.
Seaport	High demand in archipelagic and maritime-hub countries: Indonesia, Philippines, Thailand, Malaysia, Vietnam.	Potential demand from Myanmar (esp. Dawei Port).
Airport	All except Singapore (on-going The Jewel project) and Brunei (just completed)	

Indonesia estimates that during the period of the current administration (2015-2019) it needs approx. of US$500 billion to build the necessary infrastructure in the country . Some estimates and compilation made by KPMG (2014) indicate that Myanmar needs US$320 billion by 2030, Thailand needs US$105 billion between 2013-2020, Malaysia needs US$100 billion between 2013-2020, Vietnam needs US$170 billion between 2013-2020, Cambodia needs US$12-16 billion between 2013-2022, and Philippines needs US$110 billion.

2. BARRIERS

The gap between infrastructure demand and supply is usually attributed to the lack of financing. It is indeed true, but the problems lie beyond the adequate financial supply. The data of global savings show there is larger potential supply than the estimated demand for infrastructure investment. The question of what is going wrong has led to the identification of critical points of the bottleneck. Of course the first thing to match is the need for long-term investment portfolio vis-à-vis the attractive projects offered. There are problems of finding good projects on the pipeline, the channelling barriers, as well as refinancing the project's subsequent terms or expansion. Among the identified barriers, the following three issues (regulatory, market, and operational) are typically found in emerging economies:

- Poor regulatory system causes lack of private confidence, inefficiencies, delayed project implementation, weak government support, and public challenges. Regulatory issues: conflicting regulations, poor investment planning, unclear investment procedures, changing tax regime, barriers for foreign investors, repatriation issues, barriers for foreign workers, irrelevant objectives in investment regulation.

- Market issues in emerging economies: underdeveloped capital market, lack of viable attractive projects, costly transaction, lack of market instruments to manage portfolio risk, barriers for investment in- and outflows.

- Operational issues: inadequate local partners, unarranged flows of deal, lack of capability, high cost economies (high cost of logistic, labour, and input), the absence of arbitration facility, weak contract enforcement.

3. RECOMMENDATIONS

For Public Sector:

- Improve capacity of people who decide, design, and run public procurement.
- Increase allocated funds for project development in order to have well prepared projects that are ready to offer. It will decrease premium risks perceived by potential investors and help the procedures run smoothly and unbiased.
- Improve regulatory system and enforcement, with focus on enhancing efficiency, streamlining the process, and having rationale objectives.
- Develop market and cooperate with foreign markets if needed.
- Secure the investors' confidence by showing credibility and willingness to reach a mutually benefit agreement.

For Private sector:

- Invest in capacity building and technology/innovation transfer especially for local experts/partners; in the long term growing market will benefit private sector.
- Adopt environmentally friendly technology to sustain the development and gain local appreciation.
- Understand local regulatory framework and talk to government on inputs to improve the system.

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[1] In 2009 dollar. Asian Development Bank 2009.

[2] Data are from the World Bank and PPIAF, and uses figures for East Asia and Pacific countries.

[3] Financing ASEAN Connectivity (Zen & Regan, 2013) http://www.eria.org/publications/research_project_reports/FY2013/No.15.html

[4] Moving MPAC Forward: Strengthening Public-Private Partnership, Improving Project Portfolio and in Search of Practical Financing schemes (Shishido, Sugiyama & Zen, 2013)

[5] Singapore Kunming Rail Link

[6] ASEAN Power Grid

[7] ASEAN Highway Network

[8] Trans-ASEAN Gas Pipeline

[9] JICA-Bappenas (2013, unpublished)

[10] An overview of infrastructure opportunities in ASEAN

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