stars insights: 20 March 2017

Infrastructure services play key role to solve Asia's connectivity conundrum

Further to the discussions held at the 4th stars Singapore symposium in February 2017, **Jordan Schwartz, Director of the World Bank's Infrastructure & Urban Development Hub in Singapore**, provided his insights into Asia's infrastructure challenges in an exclusive interview with David Erne, Director Asia at stars.

Erne: Asia's subpar infrastructure is a major roadblock to its further economic growth. Every year, US$1 trillion in infrastructure investment is needed to maintain Asia's rapid urbanization. In which sectors do you identify the biggest infrastructure deficits?

Schwartz: In terms of volumes needed for investment and share dollar amounts, the energy sector is a perennial winner. However, these large demand figures are easily misunderstood. They generally come from growth convergence analysis or from a simple multiplier that relates capital accumulation to GDP growth. They are not price sensitive and they are not country-specific. In other words, it will cost a lot to keep up with energy demand, which is a multiplier of income growth, but consumers generally pay cost recovery tariffs for power—or something close to cost recovery. In those countries where governments are willing and able to cover the cost of system expansion through tariffs and other user fees, then financing the investments are not so difficult. That is why the majority of East Asia Pacific’s private investment in infrastructure goes into the power sector... and why the financing of mobile telephony has not been a problem. People pay those bills and governments have less difficulty allowing the public utilities or the private providers to cover those costs. The harder struggle is finding the resources to pay for basic urban services—water, sanitation, mass transit, solid waste—where there is very little in the region in the way of cost recovery from users and where metropolitan authorities do not have access to capital markets themselves. Costs of financing big, heavy inter-urban transport systems—roads, highways, rail infrastructure—are also hard to lay at the feet of users. For dollar-earning assets, like container port terminals and airports, financing should not be as difficult. Of course, if a government insists on running its infrastructure inefficiently, then finding outside financing will continue to be difficult. Even those infrastructure assets where excludability is easier (i.e., they don’t exhibit public good character traits), where there are few externalities (i.e., there aren’t major environmental or social liabilities associated with the investments) and where affordability and equity concerns are not paramount, end up dependent on constant government support if the tariffs are too low or the operations of the utilities and authorities are inefficient.

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Across the region, what kind of infrastructure needs to be improved most urgently to pave the way for further development?

I'd say there are two buckets of urgent needs in the infrastructure space for the emerging markets of the region. For the archipelagos, island states and land-locked countries of the region, the infrastructure of connectivity is crying out for more investment. However, it's not just about pouring cement, building roads and dredging shipping channels. The services *over* that infrastructure—terminal operations, trucking, third party logistics, customs and border management and trade facilitation—have to be competitive and efficient, or the economic returns on the connectivity infrastructure are never achieved. The rules and regulations that bind the infrastructure to the services also have to favor commerce and the free flow of goods and people. This means cabotage restrictions, open skies, cross-border trucking reciprocity, and regional power trade all have to be governed within a regional regime and regulated with a commitment to collective action. Individual nations that overly protect their domestic constituents in trade, transport, energy and ICT services end up losing the benefits of scale economies. We all learned about Prisoner's Dilemma in grad school… well, it plays out every day in the regulations of the physical movements of goods, people, services and capital.

Beyond the big network investments of connectivity, urban services in much of the region are also struggling to keep up with GDP growth, urbanization, ageing and a growing middle class. This is particularly the case for household water connectivity, sanitation, wastewater treatment and mass transit systems of all sorts. In those countries, such as Singapore, that have reached cost recovery tariffs and have relatively efficient public service providers, capital has not been a problem. However, much of the region has urban water tariffs at about 10-20% of cost recovery, as an example, and little mechanism for financing big urban transport systems. And most of the region's municipalities can't access bond markets on the back of their own resources. In this scenario, central and regional governments will have to step up with major financing to close the growing demand gap or they will have to reconsider the revenue base of these services as well as the functioning of their SOEs and public utilities if they want them to access capital markets themselves.

On their own, governments cannot supply the total amount of funds needed for infrastructure investment. For the time being, however, levels of private participation in infrastructure in Asia are low. What can be done for PPPs to gain more traction?

In fact, the private sector does not fund infrastructure. It might *finance* infrastructure—indirectly through capital markets or directly by securitizing revenue streams from users through private investments or PPP structures—but it does not pay for infrastructure. Only users or tax payers pay for infrastructure. So, the question for the region is whether tax payers—through transfers, subsidies, or public investments—or consumers—through tariffs, tolls and user fees—can be asked to provide the underlying payments that will allow for more diverse forms of financing of infrastructure. PPPs offer an approach to the procurement of services that often combines public and private financing in order to share risk according to each party's comparative advantage. Even in these cases, however, government balance sheets are still on the hook for the contingent liabilities associated with future payments. We turn to the private sector to make smart investment decisions, and to bring efficiency in service delivery, and, in that way, increase the likelihood of access to outside capital. Still, there's no free lunch; someone has to pay for the services.

Frustrated by the existing MDBs dominated by the United States and Japan - and enabled by holding the world's biggest foreign-exchange reserves - China is building its alternative architecture to develop infrastructure and boost connectivity in Asia and beyond. Given the sheer size of Asia's infrastructure deficit, are those new institutions like the AIIB welcome additions which will complement existing frameworks or do they rather pose a risk of unlevelling the playing field?

Looking at the emerging safeguards, procurement framework and operating guidelines, we are pleased to see that the AIIB is evolving very much into an open and collaborative member of the multilateral development bank community. In fact, the agreement between the institutions, and the closeness of the working models, have allowed the World Bank to work together with the AIIB from the outset in developing its rules of the game and in identifying projects for joint-support as AIIB finds its feet. Over the months and years to come, I have no doubt that the AIIB will build out its own brand of expertise, obtain a credit rating, access capital markets and develop its own approach to development finance. The majority shareholders of both institutions are the same and so it should not be too much of a surprise that they share the same sensibilities and goals.

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