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Asian infrastructure no longer faces a funding gap, but a confidence gap. In these circumstances, argues Robert Bestani[1] multilateral institutions should view themselves as more than simple sources of capital.

Ruling the Rooster

With the celebration of the Chinese New Year, Asia has now ushered in the Year of the Rooster. This seems altogether fitting. As if on cue, the countries of Asia are again focusing in on their immense infrastructure needs and trying to come to grips with how to deal with them. Several countries across Asia including India, Indonesia and Thailand have announced massive new infrastructure programs. Collectively, it is estimated that the countries of Asia will need between $250 billion to $300 billion per year, for each of the next ten years, for infrastructure spending alone. That figure was calculated before the tragic 2004 tsunami.

Even in those countries that have not announced brash new programs, there is a renewed emphasis on infrastructure. The level of discussion about such spending has picked up dramatically in a very short period of time. As a result, after a long ten-year hiatus, the World Bank has also announced it is seeking to return back to financing infrastructure projects. The Asian Development Bank, which never left the field, has stepped up its commitment to the field, with particular emphasis on private sector investments.

The challenge ahead

The need for these infrastructure programs is clear. But so too is the realization that governments cannot undertake them alone. Most of the governments in the region are either borrowed up to the hilt or have learned the painful lessons of the 1997 financial crash. As a result, numerous countries deliberately put off large scale expenditure programs for as long as possible, but are now looking for new ways to finance the needed expenditures. Without exception, they are thinking anew about how to engage the private sector.

One of the key problems with this strategy is, however, the very strong reluctance of the private sector to jump back into such investments. The American and European firms that were once at the heart of such projects were badly burned and will not readily return. The next wave of infrastructure programs will undoubtedly rely on a much smaller group of regional players. Arguably, they know Asia far better than their predecessors. But they too are being very cautious.

Unfortunately, the core problems that plagued former investors have not gone away. The single biggest problem is regulatory risk; that governments in the emerging countries have continued to renegotiate contracts after the fact. Some 80% of projects from the 1990s had their contracts forcibly renegotiated two or three years after inception. Given the rigidities of project financings, there is no way that a project sponsor can renegotiate their secondary contracts. As such, they are then forced to absorb the higher costs or the lower margins imposed on them. Not only does this impact the project in question, but it also impacts on the parent company's appetite for projects across Asia.

So the problems of the past persist. Unless they can be solved, progress with these various infrastructure programs will be elusive.

Last year the ADB published in Euromoney's Project Finance Yearbook an article entitled "The New Key to Finance in Asia" which spelled out the Bank's abilities to help with this.[2] In that article, we made the point that the ADB's unique position gives it the ability to help stave off capricious government intervention and to help improve the regulatory environment.

So how have we done?

Quite simply – very well. The reader can be forgiven for skepticism as to the objectivity of this self-authored report card. Fortunately, it is based on the market reaction, which is what gives us the confidence to repeat such a claim. Indeed, we believe that the approach we have taken is one that strongly suggests a new methodology for all of our sister multilaterals around the world.

Two examples among many can help us make the point.[3] A number of years ago, the ADB helped finance a power project in one of our constituent countries. Though this was a textbook example of a sound power project, the country's new government recently approached the sponsor with the insistence that they renegotiate the underlying tariff. Though they viewed us principally as a lender, the sponsor came to the ADB and sought our assistance asking if there was anything we could do. We responded that assisting them in such matters is exactly what we should be doing. We worked with the government and have successfully held off a renegotiation.

The ADB is in a position to do this because of what the Bank represents. In effect, the ADB speaks with the authority of the international community. The request that the government not pursue its initial renegotiation demand is coming not just from a private interest but from the 63 nations that make up the Bank's membership.

In another instance, we worked to help clear the way for a regional sponsor and solve one of its major problems with the community. After years of difficulty the ADB successfully "certified" the compliance issues of a particular project, which dramatically cleared the road for the progress of that particular project. While this was satisfying in and of itself, what came next was music to our ears. Some months after we concluded the initial transaction the company came to visit us. They had read that we had supported a transaction is a third country and although they had not intended to invest in that country, the ADB's presence was enough for them to ask for a significant equity participation.

The multilaterals' new role

This is exactly the role that the multilaterals should be playing. To date, all of these organizations have principally viewed themselves as sources of money. That approach reflects the original founding purpose of these banks. The lack of investment funds was the major problem holding off development in the post-war period. When the ADB was created in 1966 there was a 30% gap between what was needed and what was available[4]. But the times have now changed. Unlike the early days when these institutions were formed, there is now and enormous quantity of money in markets. It is estimated that there is currently between $3 trillion and $5 trillion of surplus cash waiting for productive investments.

Today's problem is no longer a funding gap; it is a confidence gap. Between the demand for investment and the supply of funds, this critical element is missing. Its absence is suffocating the needed investment activity. Without confidence, the required equity (and debt) for new infrastructure investment is not, and will not be, accessible.

Hand in hand with that equity investment, of course, goes the necessary technical and managerial expertise to actually get projects off the ground. Most of the large international companies that provided critically important leadership for infrastructure projects of all types in the 1990s have left the international scene. Their experiences in Asia (and other emerging countries around the world) were almost universally bad, and the majority of sponsors have retreated to their home countries to recover their financial health.

Thus the risk-reward equation is out of balance. The Asian Development Bank can help, and is helping, to restore that balance. By being an advocate for companies across Asia, the ADB can go a very long way to helping restore the confidence levels needed to make investors, both domestic and foreign, feel comfortable taking on the commercial risks in the emerging countries of Asia.

But not only can we be the advocate for companies in the short term, we can be the advocate for a whole variety of industries such as the power, water, transportation, banking and other sectors. In many countries what is critically missing is the longer term regulatory environment needed for effective good governance. The ADB regularly uses its technical capabilities and broad Asian perspective to advocate reforms which will strengthen the longer term enabling environment for future investment. As an honest broker we typically get much closer to the regulatory thinking and decision making of our constituent countries. We can and do work closely with them to help design regulatory frameworks.

What is new in this approach is two factors. First, it is a view that money is no longer the core product of the multilaterals. As noted earlier the money shortage that once existed has long since passed and we are now in a position of surplus cash. We are increasingly seeing ourselves not so much as a provider of funds but an enabler to promote investment and capital market financing. In a sense, we are moving from playing the role of a commercial bank to functioning more as an investment bank. We can more effectively help countries access the capital markets; instead of providing funds, we can help channel funds in from the capital markets. It is hard to argue with the notion that if the multilaterals do not make this shift they will suffer the same fate that the commercial banks have in the last thirty years as they have been excluded from working in the capital markets.

Secondly, we are acting as a bridge between the public and private sectors. All too often, there is very little dialogue between these two sectors of society. By being the conduit between the two, we can use our honest broker status to facilitate a greater dialogue and understanding between the two. It is critical that the public sector knows what the private sector is thinking, just as much as it is critical that the private sector knows what the public sector is thinking. The common denominator across all the countries that have achieved real success in their development efforts in the last forty years is a healthy partnership between the public and private sectors. The ADB can help inform and facilitate this dialogue. To the extent that we are successful in this endeavour it also helps us with our first task of facilitating investment.

Our success to date in these undertakings leads us to believe that this should be the major role for us – and all the multilateral development banks going forward. To be the provider of a commodity in a market where there is a major oversupply of that commodity is not a recipe for success. But no other institution can provide the sort of advocacy that the ADB and our sister organizations provide. In this we have a unique capability.

In the end, the requirement will be for the multilaterals to take on a broader product role making them much more akin to 0the "universal banks" which incorporate both commercial and investment banking roles. The smaller and less developed countries will still need the lending capabilities of the multilaterals. In some cases the larger countries may also need those capabilities. But they will place greater reliance on those services which will require the enabling function of risk mitigation and capital market intermediation.

Conclusion

In sum, we are highly confident that the future is looking very promising for the success of infrastructure projects in the region. Asia is the fastest growing area of the planet and promises to remain so for the foreseeable future. There are numerous examples of countries that have performed virtual miracles of development. One only needs to remember where Japan, Korea, Malaysia, Singapore Taiwan, and other countries were forty years ago to appreciate what the future can hold for those countries that have lagged behind.

But, there is a great deal of work to be done. Infrastructure construction is the foundation of economic development and the emerging countries of Asia recognize this. The renewed emphasis on this across Asia is not a coincidence. The conditions which have been keeping investors away for the last seven or eight years are lifting and a new dawn is emerging in this, the Year of the Rooster.

Footnotes:

1 Robert Bestani is the Director General of the Private Sector Department at the Asian Development Bank. He is a career banker with extensive experience in corporate finance as well as management consulting and has repeatedly served in senior government positions. He is a member of the Council on Foreign Relations.

2 http://adb.org/PrivateSector/Finance/publications.asp

3 Discretion would dictate that we not publicly identify the involved parties.

4 A Bank for Half the World (The Story of the Asian Development Bank 1966-1996), Dick Wilson. Pg 3.

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Tom Nelthorpe
Editor
Project Finance Magazine / Renewable Finance
Euromoney Institutional Investor
225 Park Avenue South
New York, NY 10003, USA
Email: tnelthorpe@euromoneyny.com
Tel: + 1 212 224 3554
Fax: +1 212 224 3488
Website: **http://www.projectfinancemagazine.com**