Infrastructure and the Financial Crisis in EAP

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Outline of Presentation

Part A. **Impact of the Crisis on Infrastructure in EAP**

Part B. **How Have Governments Responded?**

Part C. **Informing Policy through a Rapid Diagnostics Exercise**

Part D. **Infrastructure Development During the Crisis and Beyond**

Part A. Impact of the Crisis on Infrastructure in EAP

Preliminary assessment of the impacts

- Growth slowing across EAP, but remains higher than anywhere else in the world. Impacts have varied across the region:
  - China and Vietnam have fared better than other countries
  - Indonesia’s slowdown has been delayed and moderate
  - Mongolia has seen a large impact due to the slump in metal prices

- Difficulties in raising finance for infrastructure. Impacts via capital markets on financing for PPPs and SOEs
  - New projects being tendered and brought to financial close, but at slower pace
  - Projects continue to show the impact of the higher cost of financing, delays and cancelations
  - Reduced liquidity and credit from commercial banks
  - Shorter term of loans and increased demand for equity
  - Increase in demands for risk bearing from lenders
  - Flight to quality

Preliminary assessment of the impacts (Contd.)

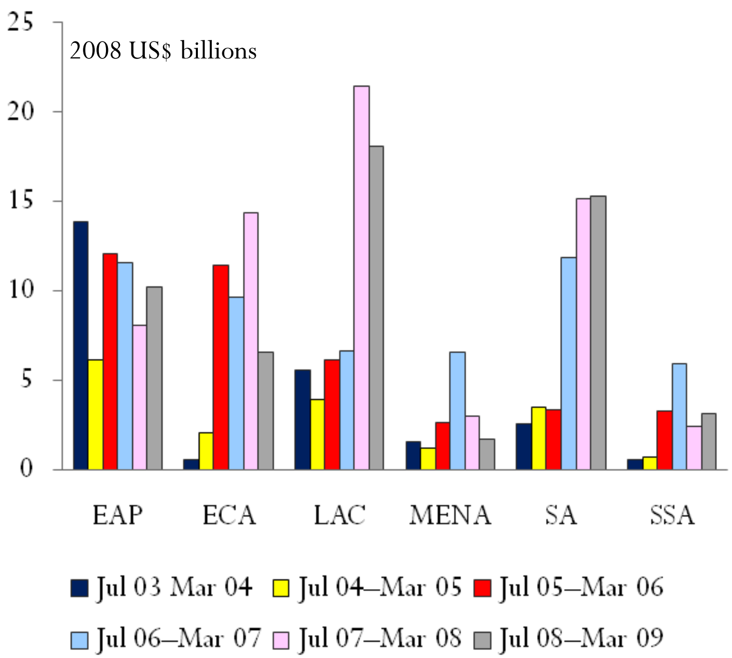
- Lack of broad-based frameworks to leverage private financing into infrastructure
  - Lack of well-developed pipeline of bankable PPPs
  - Limited financing models for infrastructure

- Crisis has thrown into sharper relief long-term policy/structural impediments to closing infrastructure gaps
  - Implementation capacities in government and in some countries the construction industry
  - Incomplete or inadequate sector policy and regulatory frameworks

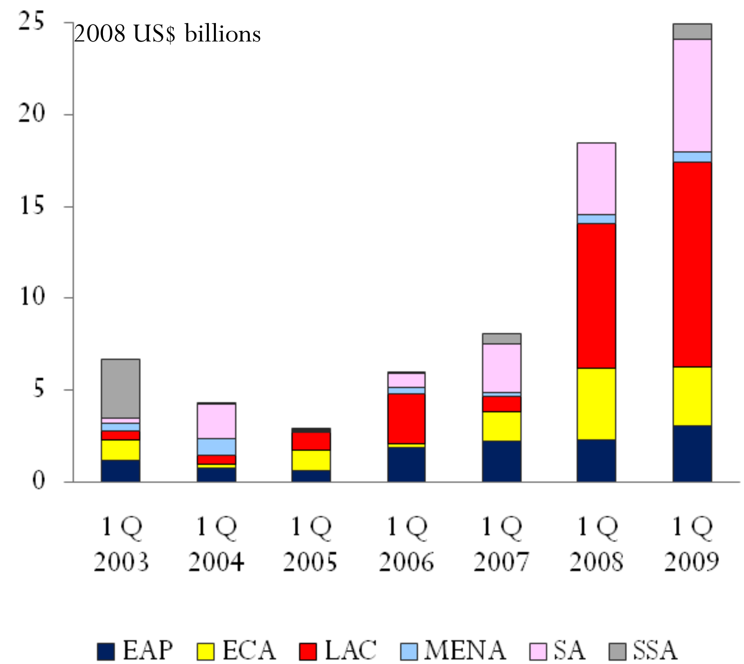
- As a result, there is evidence of financing and implementation gaps in sectors and countries across the region

That said, private investment in infrastructure in Asia has held up relatively better than elsewhere

Investment commitments to private infrastructure projects reaching closure in developing countries by region, Jul 2003–Mar 2009



Investment commitments to private infrastructure projects reaching closure in developing countries by region in the first quarter, 2003–2009

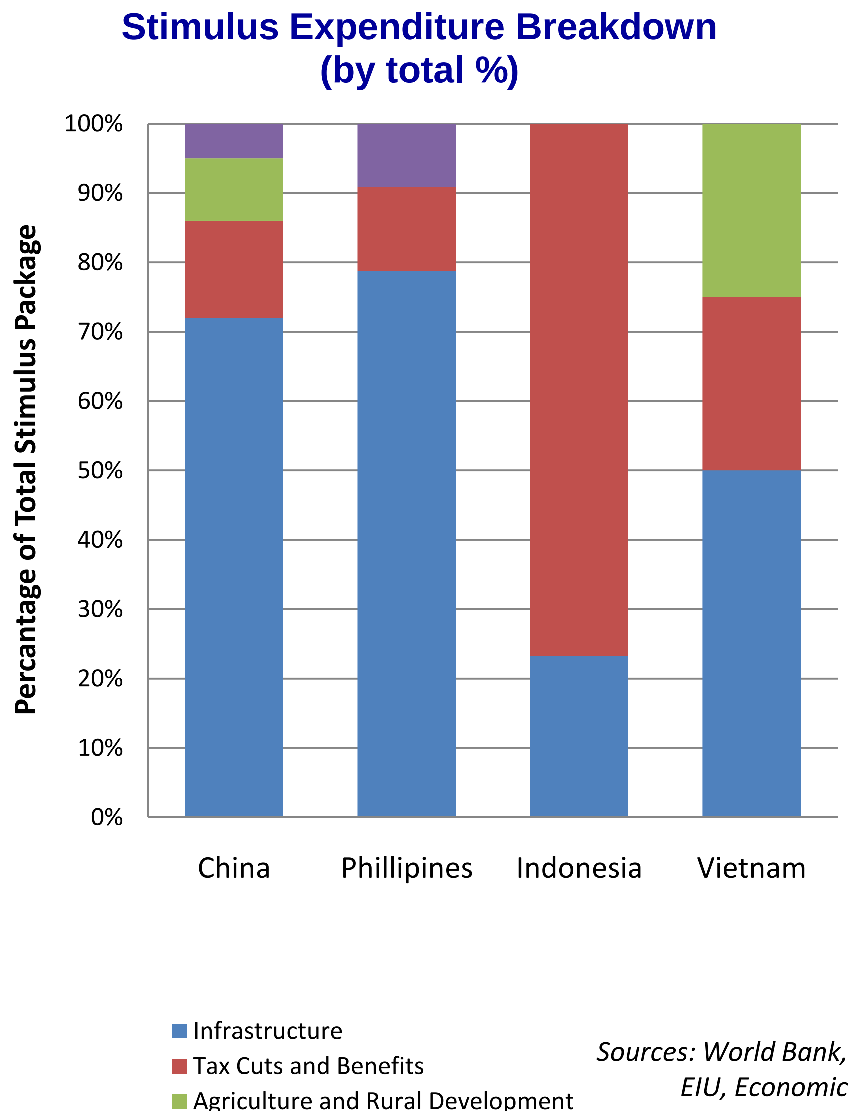


Source: World Bank and PPIAF, PPI Project and Impact of the crisis on PPI databases.

Part B. How have Governments Responded?

Several countries in East Asia have announced stimulus packages, with wide variations

- Only China's is greater than the output gap from lower growth
- There are big differences in composition – Indonesia focused more on tax cuts (reflecting implementation difficulties)
- Some are largely notional – Philippines appears to be repackaged spending



Sources: World Bank, EIU, Economic Observer

EAP enters this crisis in better shape – but not all countries have fiscal space for increased spending

Infrastructure Expenditures		Fiscal Space: Low	Fiscal Space: Moderate	Fiscal Space: Large
	High > 7% of GDP	Vietnam		China
	Medium > 3% of GDP	Lao PDR Mongolia	Indonesia	Thailand
	Low <= 3% of GDP	Cambodia		Phillipines
		Low	Moderate	Large
		Fiscal Space		

Sources: Izvorski, Fiscal Space and Fiscal Stimulus in East Asia and the Pacific (DRAFT), World Bank, March 2009; EIU; UN Future Forum

Part C. Informing Policy through a Rapid Diagnostics Exercise

Diagnostics exercise underway to provide strategic policy advice tailored to needs of governments

- What role can infrastructure have in providing fiscal stimulus and a safety net for the poor/crisis impacted?
  - What is the implementation capacity of government and of construction industry
  - That is the inventory of infrastructure projects the country is already committed to
  - What is the impact of spending by different types of infrastructure projects

- How has the crisis altered investment priorities in infrastructure sectors?
  - How has the crisis impacted the demand for infrastructure services
  - What is the available resource envelope for infrastructure taking into account planned spending on “fiscal stimulus”

- Diagnostics work underway in Vietnam, Philippines, Indonesia, Mongolia
  - Preliminary results available
  - Complete set of results expected in the September – November 2009 timeframe

Preliminary results of diagnostics work

- Vietnam
  - Large financing gaps in infrastructure sectors, ranging from US$200 m a year in water & sanitation to US$1 billion a year in expressways
  - Challenges in raising finance; GOV plans to access local bond markets but has received very little response
- Philippines
  - Indication of lags between planned and actual infrastructure spending, with low disbursements expected from principal infrastructure agencies
  - Concern that such lags would reduce the effectiveness of counter-cyclical infrastructure spending
- Mongolia
  - Impact of crisis very substantial; economic growth expected to slow down sharply
  - Substantial compression in spending on infrastructure

Vietnam

- Estimated investment needs to cope with demand
  - Energy. US$800 m to complete investment pipeline over next 2 yrs
  - Transport. US$1 b a year in expressways alone
  - Water and sanitation. US$200 m a year in basic urban and rural WSS infrastructure
- Funding issues
  - Government plans to raise $1.2bn from local markets but first issue received very little response
  - Financial markets cannot provide financing for e.g. expressways under existing models

Philippines

- Fiscal stimulus not as large as might seem at first glance
- In both nominal and real terms, the total budget of two key infrastructure agencies DPWH and DOTC in 2009 is lower than in 2007 when government wanted to catch up on infrastructure spending after many years of expenditure compression
- There are concerns that the lag between the recognition of the need for fiscal stimulus and the actual infrastructure spending would reduce the effectiveness of counter-cyclical infrastructure spending
- Cash disbursements for infrastructure of the two principal infrastructure agencies is expected to be low, around 1.5% of GDP in 2009
- Capital expenditures of the two water companies in Manila in 2009 are expected to be lower than in 2008, with a recovery after 2009

Mongolia

- Impacts of crisis very substantial
  - from a 2.9 percent of GDP surplus in 2007 to a 5.0 percent of GDP deficit in 2008)
  - Export proceeds are expected to fall by one third (about US$800 million) this year
  - Economic growth is projected to slow down sharply—it would fall from 8.9 percent in 2008 to a projected 2.7 percent in 2009

- Substantial compression in spending on infrastructure, including both investment and O&M
  - Diagnostic will focus on immediate priorities and identify possible new areas for support
  - Focus should remain on improving policy and approach for mining infrastructure and revenues

Part D. Infrastructure Development during the Crisis and Beyond

During the crisis, governments will feel the pressure to provide more support to get private financing

- Region can learn from what other governments are doing to get projects to financial closure
  - Strengthening their PPP framework
  - Revisiting Risk Allocation
  - Supplementing private financing with government or public sector debt e.g. extending term of loans
  - Providing more grant-based or other support

But countries must carefully consider ways of effectively combining multiple sources of infrastructure financing …

- The financial crisis notwithstanding, East Asia's infrastructure needs are large and increasing
- There are multiple sources of infrastructure finance, all of which will be needed
  - Public Sector. Incl. budget funding, government bonds, State Owned Commercial Banks; but need to create fiscal space, and build implementation capacity
  - International Donors. Traditionally played a small role in most (but not all) of the region
    - New donor roles being highlighted in the context of the crisis, including providing client-responsive analytic and advisory support, and establishing project preparation facilities
    - Scope for additional grant funding in some cases
  - Private Sector. Great potential, but relative progress in East Asia has stalled since 1997 crisis

… and address institutional and governance issues that go beyond the current financial crisis

- There is a need to leverage private sector financing for infrastructure. It is critical to establish market-oriented institutional frameworks
  - strong sector policies
  - greater capacity in government
  - well-designed PPP projects

- Improve infrastructure governance

- Parallel "greening" of infrastructure – climate change, mitigation and adaptation

The Three Parts of Infrastructure Governance

National Policy Framework

- Macroeconomic conditions
- Fiscal space
- Institutional framework
- Financing framework
- Legal basis of regulatory arrangements

Enabling Environment at Sector level

- Sector-specific laws and decrees
- Funding through taxpayers vs. by users?
- Bundling vs. unbundling of networks
- Pricing and subsidy rules
- Policies toward technology and industries supporting specific infrastructure services

Management of Service Provision requires focusing on process issues

- Is there coordination within the sector, with key economic ministries, and among different tiers of government?
- Are there well-established methods for ensuring transparency and participation of stakeholders?
- Are service providers accountable to users and shareholders?