

With the support of the Government of Japan



# OECD-ASEAN Training on Investment Policy Making

## Module 5

*Promoting private investment in  
infrastructure*

12-14 June 2013, Da Nang





**1. The role of infrastructure in the economy and current infrastructure challenges**

2. The OECD Principles for Private Participation in Infrastructure



# Why infrastructure matters?

---

## ***Two important reasons***

- Important intermediate good for manufacturing and service industries
- Final good for consumption: improves quality of life

## ***Lack of adequate infrastructure***

- Hinders market participation
- Limits competition which can lead to monopolistic pricing, particularly in rural areas
- Limits ability to participate in educational opportunities
- Creates barriers to adequate health care



# Why infrastructure matters?

## EXAMPLE

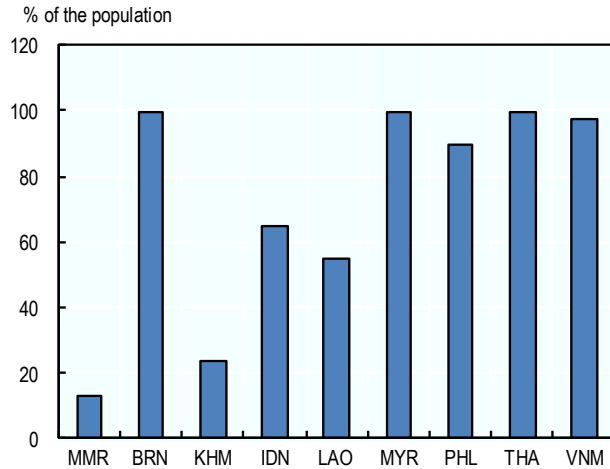
### *Impact of infrastructure on trade costs*

- Trade costs are reflected not only in direct monetary outlays, but also in indirect expenses such as time and uncertainties
- 20 days is a typical trans-Pacific shipping time
- Each additional day spent in transport reduces the probability that the US will source from that country by 1-1.5%

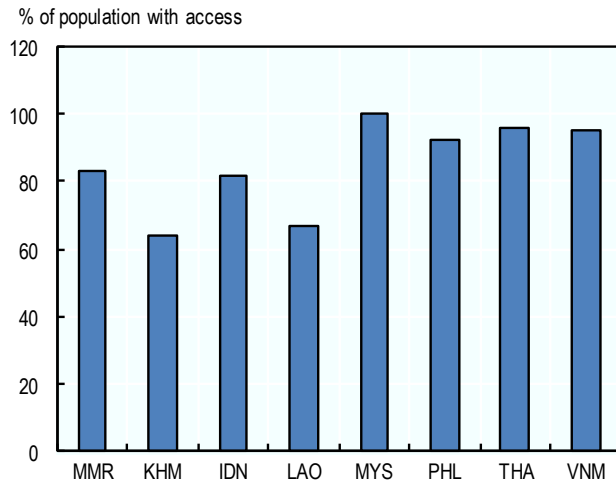


# Infrastructure needs are large and diverge considerably across countries in the region

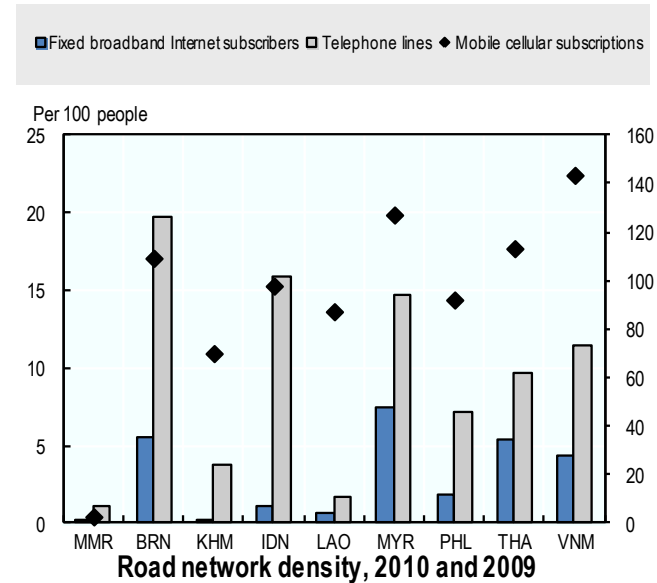
**Access to electricity, 2009**



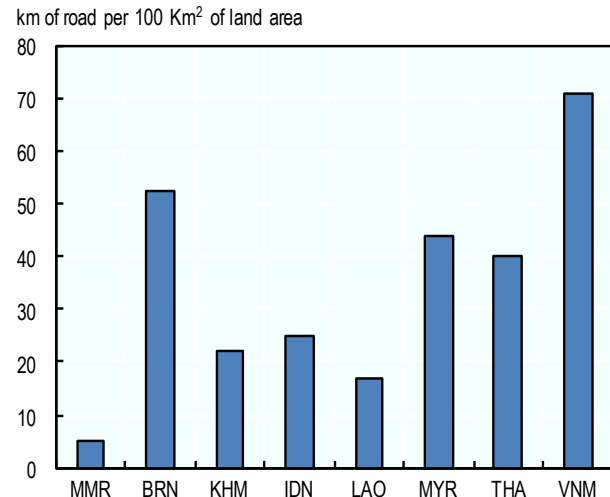
**Access to improved water source, 2009**



**Access to ICT per 100 people, 2011**



**Road network density, 2010 and 2009**

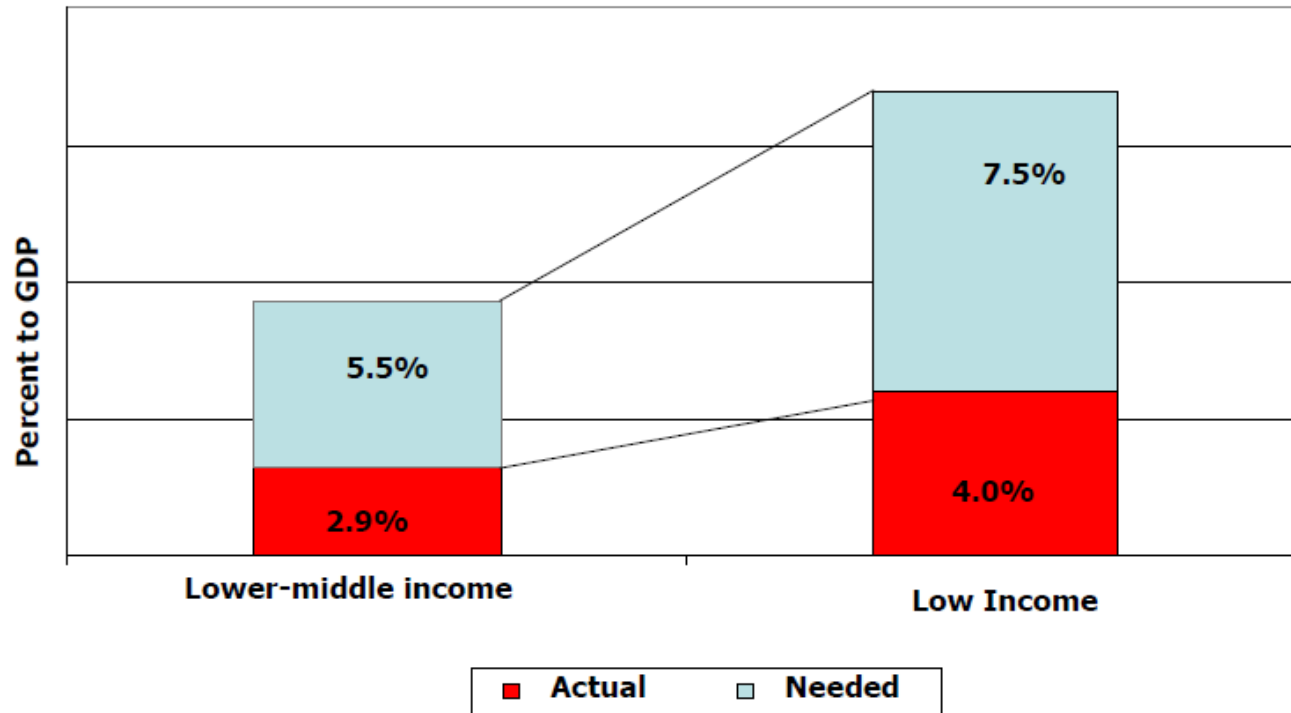




# ...and infrastructure investment falls short of needs

## Infrastructure investment gap in Asia

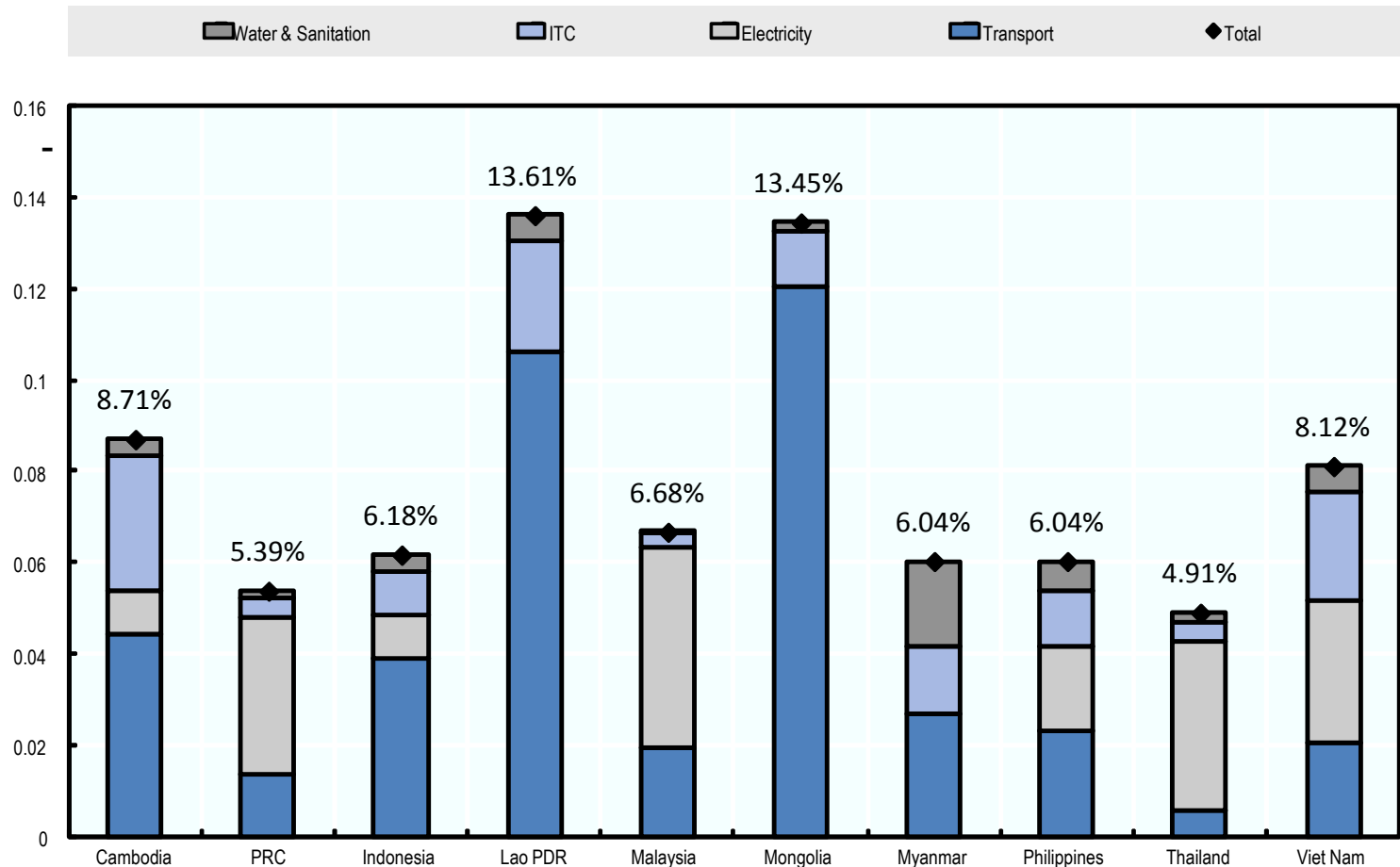
Annual Expenditures on Infrastructure as Share of 2003 GDP  
(Actual versus Needed 2003)





# Infrastructure investment needed is quite significant in East and Southeast Asia

## Investment needs as a percentage of estimated GDP 2010-2020





# Large share of investment is needed in new capacity

Country / Sub region	% of Total Asian Investment Need	Estimated Investment Needs (US\$ millions)	Investments as Percentage of Total		Total Investment per Year	Total Investment per Capita (US\$)	2008 GDP Per Capita (Constant 2000 US\$)
			New Capacity	Maintenance			
<b>East and Southeast Asia</b>	<b>66.553%</b>	<b>5,472,327</b>	<b>71%</b>	<b>29%</b>	<b>497,484</b>	<b>2,886</b>	<b>1,765</b>
Cambodia	0.163%	13,364	51%	49%	1,215	918	511
PRC	53.118%	4,367,642	72%	28%	397,058	3,297	1,965
Indonesia	5.476%	450,304	70%	30%	40,937	1,981	1,087
Lao PDR	0.138%	11,375	56%	44%	1,034	1,833	475
Malaysia	2.287%	188,084	79%	21%	17,099	6,962	5,151
Mongolia	0.122%	10,069	37%	63%	915	3,812	735
Myanmar	0.264%	21,698	56%	44%	1,973	438	-
Philippines	1.546%	127,122	53%	47%	11,557	1,407	1,225
Thailand	2.103%	172,907	72%	28%	15,719	2,566	2,640
Viet Nam	1.335%	109,761	53%	47%	9,978	1,273	647

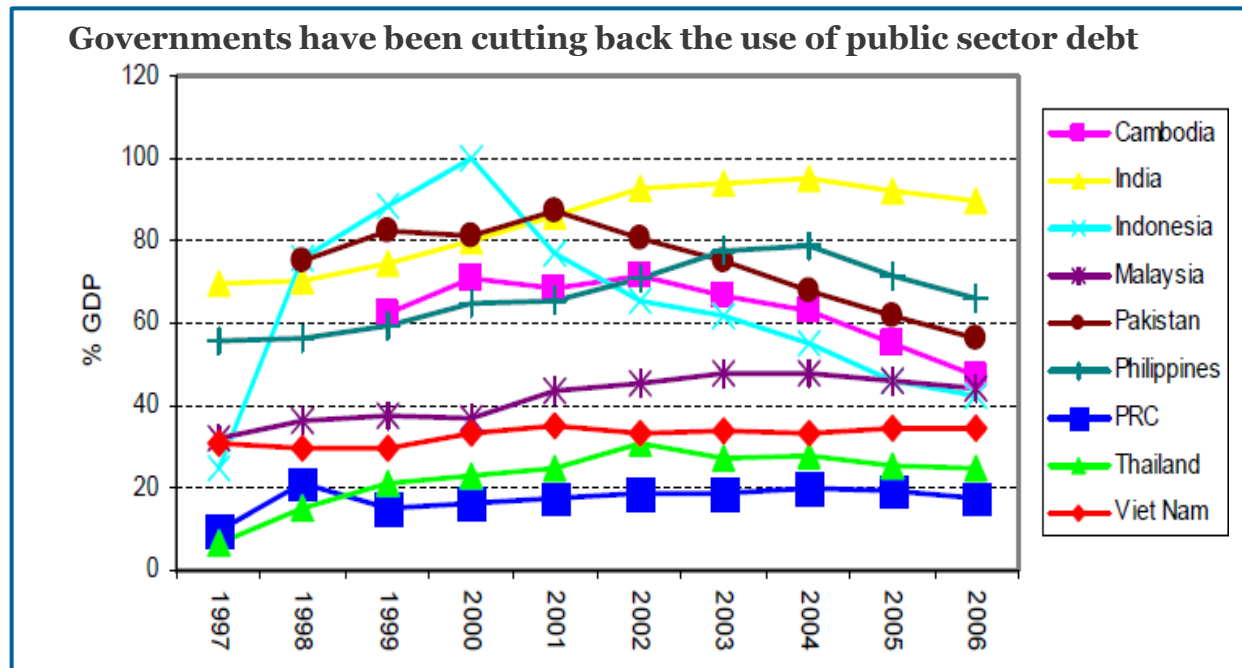
- Demand is likely to grow faster than the increase in infrastructure networks
  - Rapid GDP growth and urbanization
  - Creating new demand for infrastructure & competitiveness





# Meeting infrastructure demand requires broadening sources of financing

- Actual investment is likely to be less than half the amount needed: mobilized from
  - **Public sector**
    - Fiscal constraints
  - **International donors**
- Donor assistance is a finite resource and can best be used to help catalyze broader sources of funding
  - **Private sector**





# There is a need for stronger private participation in infrastructure

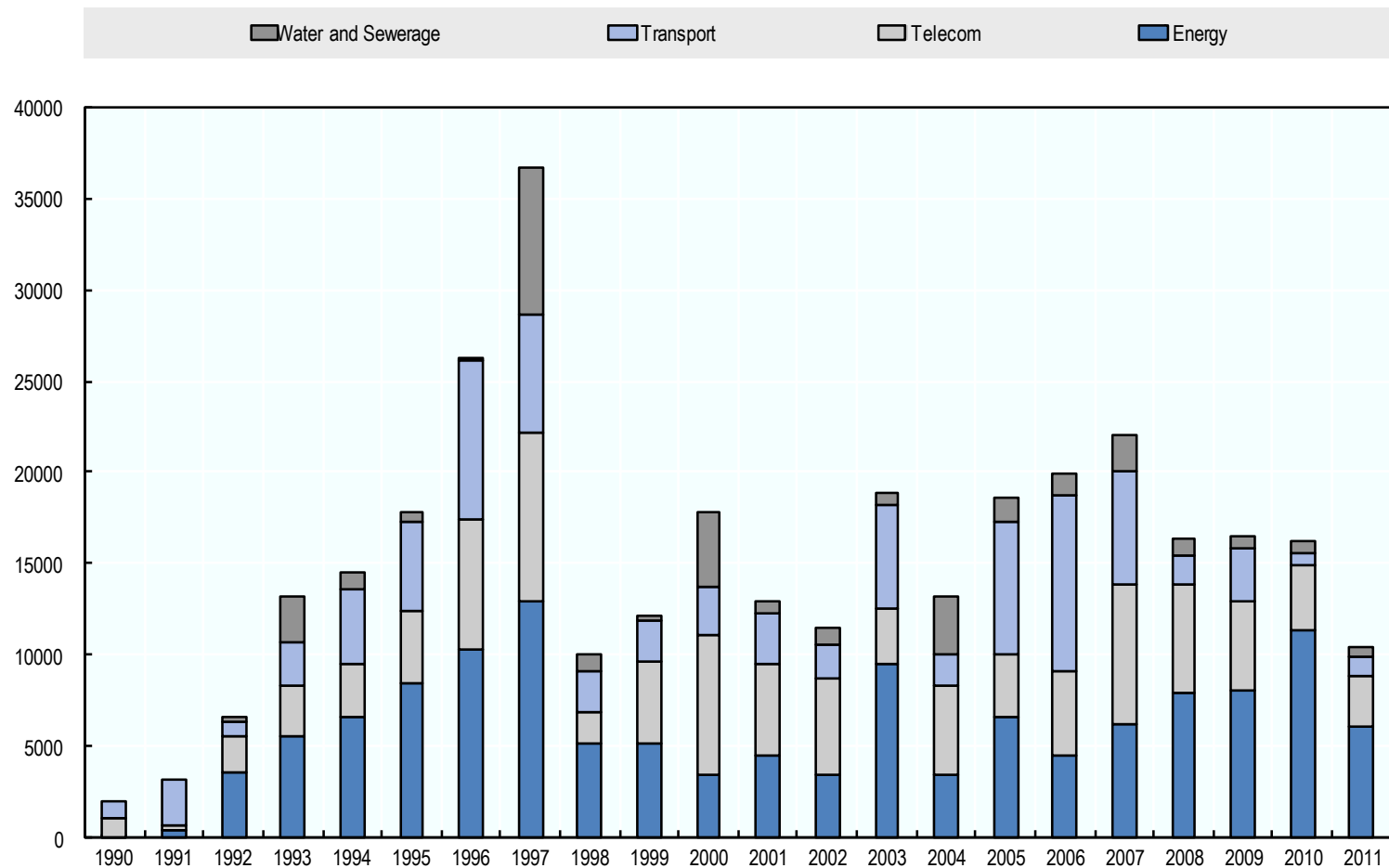
---

- **Worldwide infrastructure needs exceed what can be funded by the public purse**
  - In OECD countries: ageing basic infrastructure
  - In developing countries: a need to step up efforts to meet development goals.
  
- **Private participation brings efficiency gains**
  - Tapping the technological and managerial expertise of the private sector
  - Competition, wherever feasible, brings market discipline
  - Better allocation of risks



# Private sector investment in infrastructure in East Asia & Pacific

## Investment commitments in infrastructure projects in EAP, by sector, 1990-2011



Source: World Bank PPIAF database. Obs: Projects include management or lease contracts, concessions, greenfield projects, and divestitures. The database contains almost 5,000 projects dating from 1984 to 2011.



# However, attracting private investment in infrastructure faces many challenges

---

- **A number of private participation in infrastructure projects in the past have failed**
  - Often the main cause was not project specific, but short-comings in investment environments, capacities and attitudes
- **Related to the nature of infrastructure projects:**
  - Customers fear that firms will use their market power (natural monopoly) to overcharge
  - Firms fear that government will use their regulatory power to prevent firms from covering their costs
- **Governments remain central to the delivery of infrastructure services, either as providers or enablers**
  - No actor can replace government weakness in policy formulation, regulation and risk management.



1. The role of infrastructure in the economy and current infrastructure challenges

**2. The OECD Principles for Private Participation in Infrastructure**



# The OECD Principles for Private Investment in Infrastructure

---

- **Demand for clearer forms of public support and risk sharing arrangements**
  - High level cancellations: less risk taking parties
  - Important needs and competition for financing (across countries and across sectors) & financial crisis >>> more selective investors
- **Advice on how to avoid the mistakes of the past**
  - Synthesising a large body of analysis and case examples
  - Offering recommendations of best practices, agreed among a variety of experts and policy communities to help governments work with private sector partners
- **The process for developing the Principles**
  - Developed by the Investment Committee in co-operation with other OECD bodies
  - Consultation with a broad group of public and private sector experts from OECD and non-OECD countries, as well as from NGOs
  - Approved by the OECD Council on 20 March 2007
  - Specific applications to water & sanitation and to the energy sector



# The 5 areas of the OECD Principles

---

- **1. Deciding on public or private provision of infrastructure Services**
  - Informed & calculated choice, project financial sustainability, tailor-made model, preserving fiscal discipline
- **2. Enhancing the enabling institutional environment**
  - Enabling environment, corruption, competition, access to financial market
- **3. Goals, strategies and capacities at all levels**
  - Consultation, empowerment of authorities, clear and broadly understood objectives & strategies, cross-jurisdiction cooperation
- **4. Making the public-private co-operation work**
  - Communication, disclosure of information, fair & transparent contract awarding, output-based, regulatory bodies, renegotiations, dispute resolution
- **5. Encouraging responsible business conduct**
  - Responsible business conduct, good faith & commitment, corruption, communication, responsibility for social consequences



# Example 1: Deciding on public or private provision of infrastructure services – *Principle 1*

*Principle 1: The choice by public authorities between public and private provision should be based on cost-benefit analysis taking into account all alternative modes of delivery, the full system of infrastructure provision, and the projected financial and non-financial costs and benefits over the project lifecycle.*

## ***Why private participation?***

- Private operators can bring much needed-capital, relieving public budgets
- And also an entrepreneurial and results-driven approach to infrastructure
- Superior performance is not straightforward...depends on incentives created by regulation and competition
- Some activities, ownership is largely unrelated to performance

## ***Benefits of public provision***

- Access to cheaper funding depending on government's credit condition
- Co-ordination of infrastructure facilities
- ...but the public agencies or SOEs are more prone to political influence, which may hinder performance





# Example 1 (*cont.*): Deciding on public or private provision of infrastructure services – *Principle 1*

---

## ***Cost-benefit analysis should be a guiding policy principle***

- Limited resources requires prioritising investments
  - How much, where to allocate financing and how to deliver?
- Cost benefit analysis
  - *Value for Money*: The best available outcome after taking account of all benefits, costs and risks over the whole life of the project
  - Not the lowest price - Qualitative and quantitative approaches to assess a range of project outcomes in addition to price
- Taking into account alternatives: the Public Sector Comparator
  - A benchmark to ensure the procurement method gives the best Value for Money
  - Functions as a cost benchmark
  - Based on public sector financing and coordination of delivery



## Example 1 (*cont.*): Deciding on public or private provision of infrastructure services – *Principle 1*

---

### ***What type of projects are normally suitable for private sector participation?***

- Large projects to justify transaction costs which can be as high as 3% of bid costs compared to 1% for traditional procurement
- Need to be able to clearly define the outputs
- There is a need for a competitive private sector that can bid and credibly supply the service
- Need to be able to demonstrate that value for money is being achieved
- Risks need to be allocated, based on the principle that the party who assumes the risk is in the best position to manage that risk

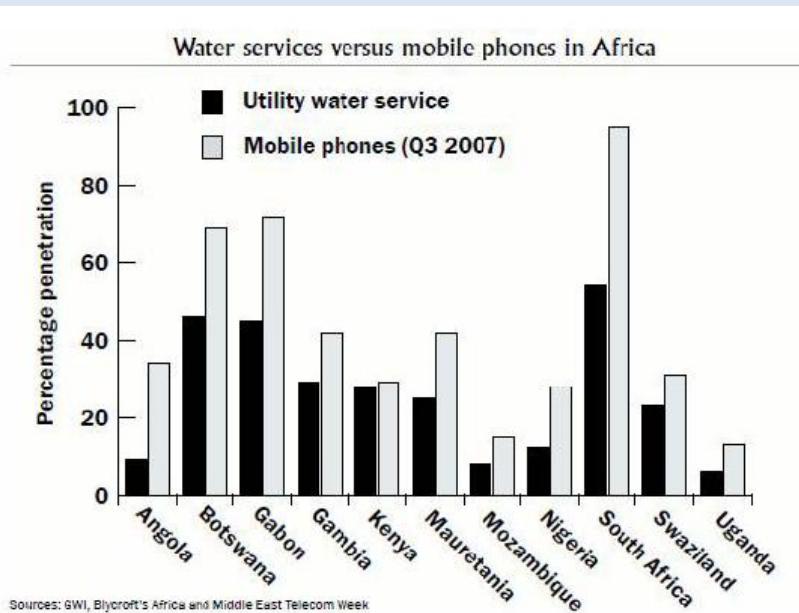


## Example 2: Deciding on public or private provision of infrastructure services – *Principle 2*

*Principle 2: No infrastructure project should be embarked upon without assessing the degree to which its costs can be recovered from end users and, in case of shortfalls, what other sources of finance can be mobilised.*

***Cash-flow is essential: the problem is paying for the service and not financing it***

### EXAMPLE



Source: Global Water Intelligence 2008 Vol 9 Issue 5 May

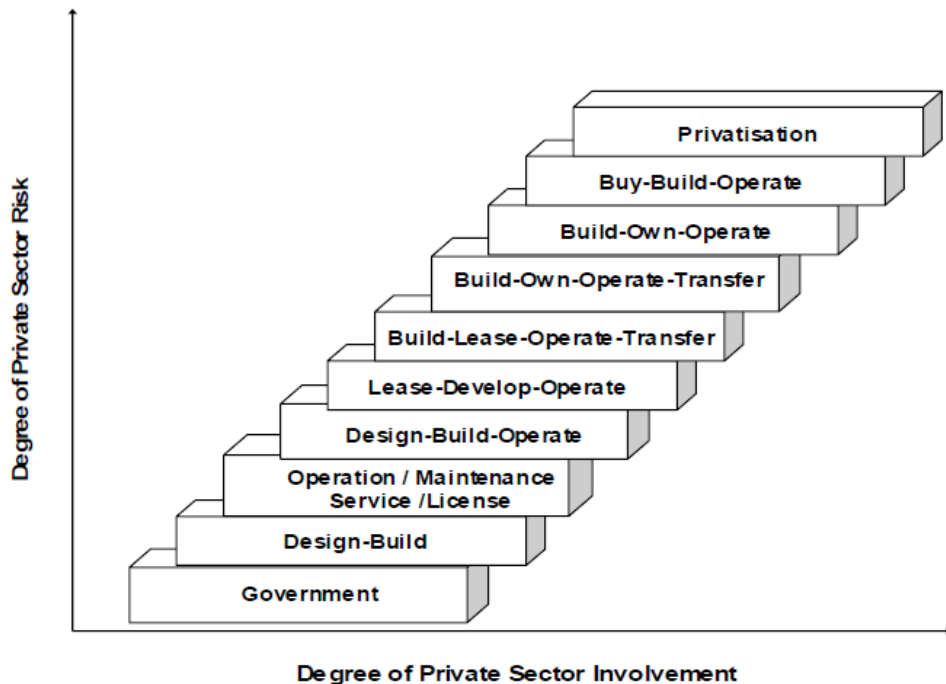
- Pricing determines demand and incentives to supply the services
- Cost-covering price is the basis for realistically assessing the affordability of a project
- Allows determining an optimal level of subsidisation
- Subsidies often poorly target the most needed and fail to reach the poor
- But if needed, should be tied to efficiency and performance



# Example 3: Deciding on public or private provision of infrastructure services – *Principle 3*

*Principle 3: The allocation of risk between private parties and the public sector will be largely determined by the chosen model of private sector involvement, including the allocation of responsibilities. The selection of a particular model and an associated allocation of risk should be based upon an assessment of the public interest.*

## ***Allocation is determined by the model chosen of private participation***



- **Risks should be allocated to the party best capable of managing them**
- There is a continuum of risk-sharing arrangement possibilities
- Risk/Return: governments might feel tempted to shift as much as risk possible to the private sector..
- ...but this must balance against the price the private sector will require to bear those risks



## Example 3: Deciding on public or private provision of infrastructure services – *Principle 3*

---

### *Many risks are involved in infrastructure projects*

- **Construction risks:** relate to design problems, building cost overrun and project delays
- **Financial risks:** variability in interest rates, exchange rate and other factors affecting financing costs
- **Availability risks:** relate to continuity and quality of service provided and in turn depend on “availability” of an asset
- **Demand risks:** relate to ongoing need for the service
- **Residual value risk:** relate to future market price of assets
- **Technology risks**
- **Non-commercial objective risks**
- **Political risks**



## Example 4. Enhancing the enabling institutional environment – *Principle 7*

*Principle 7: The benefits of private sector participation in infrastructure are enhanced by efforts to create a competitive environment, including by subjecting activities to appropriate commercial pressures, dismantling unnecessary barriers to entry and implementing and enforcing adequate competition laws*

### ***When feasible competition should be pursued in infrastructure activities***

- Expose competitive activities to competition and subject monopoly activities to regulation
- Unbundling infrastructure activities
  - Vertical: separating upstream and downstream segment
  - Horizontal: allowing more than one provider
- How to ensure competition
  - Competition in the market
  - Competition for the market
  - Regulated natural monopoly activities – prices are set by the regulator



## Example 4 (cont.): Enhancing the enabling institutional environment – *Principle 7*

### ***Examples of Market Structure Reforms***

Sector	Reform	Country examples
Power	Separating generation from transmission and creating competition in generation	Argentina, Australia, Colombia, New Zealand, United Kingdom
	Permitting free entry in generation	The countries above plus the United States
Gas	Separating production and supply from transmission and distribution	Argentina, Colombia, Mexico
	Permitting free entry in gas transmission	Chile, Germany, New Zealand
Telecommunications	Separating local from long-distance service	Argentina, Hong Kong, United States
	Permitting free entry in basic services	Australia, Chile, New Zealand, United Kingdom
Rail	Separating infrastructure (track) from rolling stock	Sweden, United Kingdom
	Separating railway lines by geographical region	Argentina, Mexico



# Example 5. Goals, strategies and capacities at all levels – *Principles 9, 10*

*Principle 9: Public authorities should ensure adequate consultation with end-users and other stakeholders including prior to the initiation of an infrastructure project*

*Principle 10: Authorities responsible for private-operated infrastructure projects should have the capacity to manage the commercial processes involved and to partner on an equal basis with the private sector counterparts*

## ***Authorities should improve their ability to deliver***

- Clear communication with stakeholders to convey realistic expectations of what the private sector can achieve and ensure communities' interest are preserved
  - Particularly when subsidy cuts and shifting to price covering levels are expected
- Ensure public authorities have the capacity to partner or service the private sector
  - Often, they lack planning and implementation capacity
  - Governments should focus in ensuring appropriate staff and training is available
  - Costs of doing so should be included in the overall project design
- PPP units – Successful ones:
  - Staff with a mix of expertise - Attached cross-sectoral ministry (treasury or finance ministry) - High-level political support for the PPP programme





## Example 6. Making the public-private co-operation work – *Principle 13*

*Principle 13: To optimise the involvement of the private sector, public authorities should communicate clearly the objectives of their infrastructure policies and they should put in place mechanisms for consultations between the public and private partners regarding these objectives as well as individual projects*

### ***Clear communication of public sector expectations is essential to best gain from private-sector participation in infrastructure***

- Public sector expectations of the performance of infrastructure providers should be, to the greatest extent possible, specified:
  - in terms of the services to be provided to the public
  - the pricing methods that may be applied to them
- Output-based specifications of objectives are easier to verify, more relevant to stakeholders and encourage greater efficiency and flexibility than other arrangements
- Granting private sector participants the freedom to meet the end-users needs in the way they deem most efficient also, from their perspective, removes a number of risk factors
- Regular and timely consultations help to mitigate problems that may arise and facilitate creating trust between the public and private partners



# Example 7. Making the public-private co-operation work – *Principle 17*

*Principle 17: Regulation of infrastructure services needs to be entrusted to specialised public authorities that are competent, well-resourced and shielded from undue influence by the parties to infrastructure contracts*

## **Creating a credible regulatory environment**

- Independent regulatory bodies, adequately staffed and with clear responsibilities and powers, to ensure regulatory coherence overtime
  - Independence from political pressure: to be able to undertake necessary unpopular measures, such as tariff increase in response to rising costs for instance
  - Independence from operators: to avoid measures to the detriment of competitors or new entrants
- Accountable for their decisions to avoid opportunism, corruption and inefficiencies
  - E.g., independent auditing of regulators performance, justify decisions, publicize
- Transparent and predictable, with rules and agreements accessible to the public
- Respect for precedent decisions



## Concluding...

---

- ***1. Deciding on public or private provision of infrastructure Services***
- ***2. Enhancing the enabling institutional environment***
- ***3. Goals, strategies and capacities at all levels***
- ***4. Making the public-private co-operation work***
- ***5. Encouraging responsible business conduct***



---

# Thank you

Fernando Mistura

Policy Analyst

Investment Division, OECD

2, rue André-Pascal

75775 Paris Cedex 16, France

Tel. 33 (0) 1 45 24 83 68

[fernando.mistura@oecd.org](mailto:fernando.mistura@oecd.org)

PFI : [www.oecd.org/daf/investment/pfi](http://www.oecd.org/daf/investment/pfi)

PFI Toolkit: [www.oecd.org/investment/pfitoolkit](http://www.oecd.org/investment/pfitoolkit)

Investment Policy Reviews: [www.oecd.org/daf/investment/countryreviews](http://www.oecd.org/daf/investment/countryreviews)

