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ASEAN Public-Private Partnerships: Models, Legal and Financial Structures to Boost Italian Investments

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The ASEAN Region's steady growth over the past three decades has arisen from many well-concerted, farsighted policies, resulting in the planning and development of critical national and cross-border infrastructure. Nevertheless, despite their rapid infrastructure development, most ASEAN Member States still lack fundamental electricity, transport, water and sanitation facilities. The Asian Development Bank estimated that an annual **US$ 1.7 trillion** investment will be necessary across ASEAN in the period 2016-2030 to eradicate poverty and spur the bloc's regional competitiveness. A key factor in attracting domestic as well as foreign direct investment, infrastructure is the solid foundation upon which developing nations build long-term economic resilience.

Developing economies in the ASEAN Economic Community (AEC) greatly rely on off-balance sheet financing to cope with rising **infrastructural needs** amidst fiscal deficits. Policymakers are increasingly shaping the Region's legislative framework so as to stimulate private participation in state undertakings and to benefit from the private sector's expertise and resources, thus bridging the gap between governments' budgets and projected infrastructure investment needs. To this end, **Public-Private Partnerships (PPP)** are long-term contractual arrangements between governments and the private sector for the delivery of infrastructure assets, where the latter agrees to design, build, finance and operate public facilities.

The ASEAN Region is a fast-paced, key global economy

1. The region is ranked third in the world in population, fifth in GDP and fourth in trade value. **ASEAN's GDP is one of the world's fastest growing**. The region's economic outlook remains strong, with regional GDP growth forecast at 5.2% for 2019. Financial sector stability in the region is also improving, with bigger assets, solid capital adequacy, and higher profitability of financial institutions. However, monetary policy normalization in major economies has resulted in bouts of capital outflows, leading to currency depreciation in some economies in the region.[1]

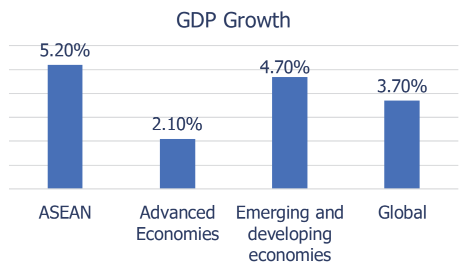

***Figure 1.** ASEAN GDP Growth forecast for 2019.*
(Source: The European House – Ambrosetti and Mahanakorn Partners Group elaboration on OECD, data, 2019)

2. Recent data shows that global trade remains resilient, with average monthly growth in 2018 still higher than in previous years. However, trade outlook indicators point to a moderation in the near-term. On the other hand, **Foreign Direct Investments (FDI)** to ASEAN in 2017, increased by 11.6%, to stand at US$133.8 billion. Of the total FDI inflows, 19.9% came from within the region, followed by the EU (18.3%), Japan (9.9%), and China (8.4%). FDI to services sectors accounted for 65.8% of total FDI, or $90 billion.[2]

3. For over three decades, the ASEAN region has thrived and pursued a path of economic development, becoming one of the world's most attractive regions for FDIs. Critical infrastructure development and connectivity in ASEAN is of paramount importance, which led to the ASEAN Economic Community (AEC) member countries ratifying the **ASEAN Principles for Public-Private Partnership Frameworks**, on the occasion of the 25th ASEAN Summit in Nay Pyi Taw, Myanmar, on 12 November 2014. The Principles outline best practice guidelines for creating a transparent and efficient regulatory environment for infrastructure investment, and address issues related to cross-border regional infrastructure projects.

4. By leveraging off-balance sheet financing provided by the private sector, PPPs are a means for governments to meet ASEAN infrastructure needs, estimated by the Asian Development Bank (ADB) to be US$ 60 billion per annum[3]. **Private Participation in Infra-structure (PPI)** enhances existing public capacity in delivering **economic infra-structures** (such as transport, power, telecommunication, water and sanitation) and **social infrastructures** (such as health and education). Effective infrastructure makes

[1] Source: OECD, "Economic Outlook for Southeast Asia, China and India, 2019".
[2] The ASEAN Economic Integration Brief (AEIB), 2018.
[3] Source: Asian Development Bank (ADB), 2018.

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transport more cost-efficient, fosters competitiveness with a positive impact on investment and trade flows, and the integration within global and regional value chains.

5. The vast majority of PPIs in ASEAN are **greenfield**, which account for three quarters of the total number of PPP projects (US$195 billion, 74.47%) followed by **brownfield** (US$45 billion, 17.48%), **divestitures** (US$21 billion, 8.01%) and a marginal quantity of **manage-ment and lease** contracts (US$110 million, 0.04%)[4].

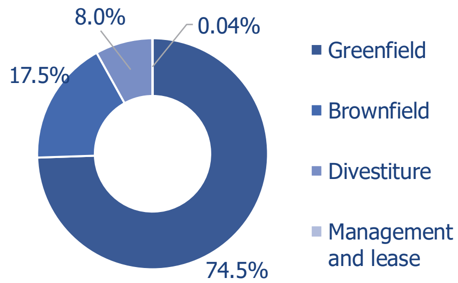

Figure 2. *Type of PPIs in ASEAN between 1990-2018. (Source: The European House – Ambrosetti and Mahanakorn Partners Group elaboration on World Bank data, 2019)*

6. In terms of **project size**, ASEAN PPIs appear to have followed a uniform distribution in the past three decades, being inelastic of the investment amount for projects exceeding US$100 million. 4.63% of the total number of projects completed between 1990-2018 required an investment per project not exceeding US $100 million (for a total investment amount of US $12 billion), 26.53% of the PPIs required an investment between US$100-US$500 million (for a total of US$69 billion), 25.72% of the PPIs required an investment between US$500-US$1,000 million (for a total of US$67 billion), 19.11% of the PPIs required an investment between US$1-2 billion (for a total investment amount of US$50 billion) and 24.01% of the PPIs required an investment exceeding US$2 billion (for a total investment amount of US$63 billion)[5].

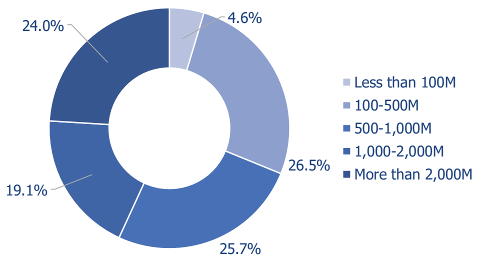

Figure 3. *ASEAN Project Size in US$ between 1990- 2018. (Source: The European House – Ambrosetti and Mahanakorn Partners Group elaboration on World Bank data, 2019)*

7. The number of PPP projects in developing Asia has risen by a compounded annual growth rate of 11% and, in aggregate, the number of PPPs in developing Asia accounts for half of all PPPs in the World's emerging and developing economies[6]. PPPs have extensively gained ground in Southeast Asia, predominatly in the relatively larger economies of Indonesia, Malaysia, the Philippines, Thailand and Vietnam[7]. PPPs in ASEAN exceeded US$261 billion in 1990-2018, distributed as follows: 1.60% in Cambodia, 25.62% in Indonesia, 6.83% in Lao PDR, 19.79% in Malaysia, 1.51% in Myanmar, 21.72% in the Philippines, 15.94% in Thailand and 6.99% in Vietnam[8].

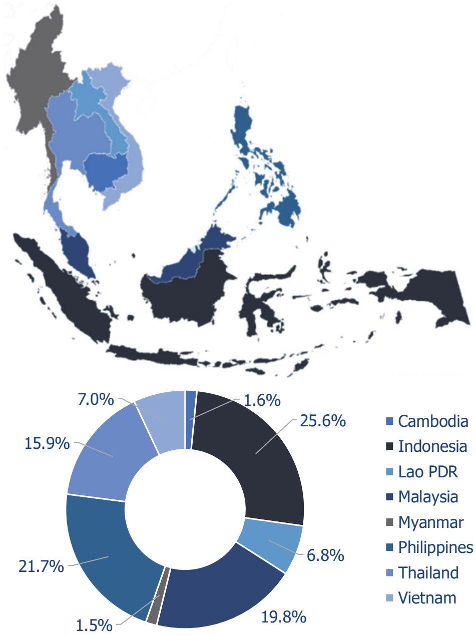

Figure 4. *Total investment distribution in US$ in ASEAN between 1990-2018. (Source: The European House – Ambrosetti and Mahanakorn Partners Group elaboration on World Bank data, 2019)*

8. Statistics on PPPs by sector in ASEAN over the past three decades point to a high incidence of electricity generation projects, which have accounted for 64.31% of the **total number of PPP projects** in the Region, followed by roads (10.25%), water and sewerage (8.12%), ports (6.66%), ICT (5.19%) railways (2.26%), airports (1.73%) and natural gas (1.46%). Thailand leads the ASEAN Region for the number of PPPs completed between 1990-2018, with 171 projects, followed by the Philippines (149), Indonesia (136), Malaysia (108), Vietnam (107), Lao PDR (32), Cambodia (29) and Myanmar (13)[9].

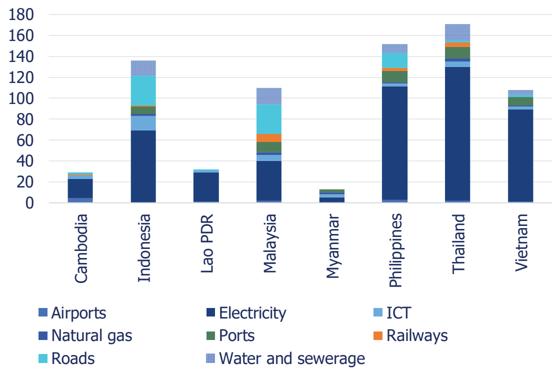

Figure 5. *PPP Project Count in ASEAN by Subsector between 1990-2018. (Source: The European House – Ambrosetti and Mahanakorn Partners Group elaboration on World Bank data, 2019)*

[4] Source: World Bank Group, 2019.
[5] Source: IBID, 2019.
[6] Source: Asian Development Bank (ADB), 2019.
[7] Source: IBID, 2019.
[8] Source: World Bank Group, 2019.
[9] Source: World Bank Group, 2019.

9. In terms of **infrastructure investment in PPPs** by sector, electricity generation projects have reached the staggering amount of US$164.87 billion (62.91% of the total amount invested in PPPs in ASEAN over the same period), while investments in water and sewerage amounted to US$21.81 billion (8.32%), roads to US $20.95 billion (7.99%), railways to US$20.65 billion (7.88%), ICT to US$15.60 billion (5.95%), ports to US $8.34 billion (3.18%), natural gas to US$5.87 billion (2.24%) and airports to US$4 billion (1.53%)[10].

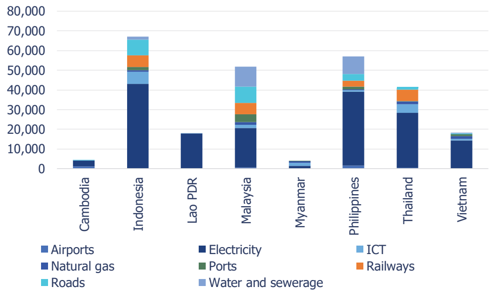

Figure 6. *Infrastructure investment in PPPs in million US$ by subsector between 1990-2018. (Source: The European House – Ambrosetti and Mahanakorn Partners Group elaboration on World Bank data, 2019)*

Cross-border PPP projects planned to increase connectivity and regional competitiveness in ASEAN

10. As indicated in paragraph 3, the **ASEAN Principles for Public-Private Partnership Frameworks** were developed in 2014 to provide useful guidelines to undertake cross-border, regional infrastructure projects. The Principles comprise four main areas:

- policy and organizational framework for private participation;
- project selection, development and implementation;
- affordability and budget transparency;
- transnational infrastructure connectivity.

The Principles, developed with the assistance of the OECD, cover various models of Private Participation in Infrastructure, ranging from management, lease and services contracts, traditional PPPs, concession agreements, as well public divestiture of existing assets[11].

11. In the wake of the acceptance of the Principles, the legislative apparatuses of ASEAN member states have worked towards shaping a **harmonized PPP regulatory landscape**. Thailand, for instance, has updated and upgraded its laws to provide for a swifter and more cost-effective process[12]. The PPP Fast Track is founded upon four pillars:

- **Facilitation** of processes for investors, with a substantial reduction of red tape and easier access to funds;
- **Alignment** of the PPP projects being proposed with each country's development plan;
- **Streamlining** applications by curtailing procedures into a clear and concise processes;
- Increased **transparency** and a more efficient dialogue between private investors and contracting authorities.

12. The importance of regional connectivity was further highlighted at the **36th ASEAN Ministers on Energy Meeting** on 29 October 2018, which laid out a roadmap for the energy generation and distribution industry in ASEAN, in keeping with the Region's top priorities. Deliverables include:

- a more cohesive and structured collaboration between ASEAN and the International Renewable Energy Agency (IRENA), with the aim of assisting ASEAN in upgrading its green energy capacity and long-term sustainability;
- a Gas Advocacy White Paper, with key recommendations in furtherance of the consumption of natural gas through a connected **common gas market**;
- a study on the development of green building codes for ASEAN; and
- the ratification of the initiative on the Capacity Building Roadmap on Energy Investment and Financing[13].

13. **Smart City** projects in ASEAN are increasingly being developed and financed with PPP arrangements. The rising importance of eco-friendly living and an environmentally sustainable future has prompted governments to incentivize private investment in smart city projects, rolling out legislation aimed at spurring infrastructural and economic development, consistent with the tenets of the Industry 4.0[14]. ASEAN Leaders convened at the 32nd ASEAN Summit on 28 April 2018, where they established the **ASEAN Smart Cities Network** (ASCN). The goal of the ASCN is to provide the ten ASEAN Member States (AMS) with a platform to achieve smart and sustainable urban development. The ASCN stipulates that "smart cities development cuts across many sectors such as transport, water quality, energy, health care, education, public services, data, and information and communications technology (ICT)".[15]

14. The necessity for seamless connectivity in ASEAN was articulated in the **ASEAN Master Plan for Connectivity** (AMPC), whose compelling vision is "to achieve a seamlessly and comprehensively connected and integrated ASEAN that will promote competitiveness, inclusiveness, and a greater sense of community."[16] The AMPC outlines strategic objectives[17] and an action plan to be implemented across five main areas, namely: (i) Sustainable Infrastructure, (ii) Digital Innovation, (iii) Seamless Logistics, (iv) Regulatory Excellence, and (v) People Mobility.

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[10] Source: IBID, 2019.

[11] Source: ASEAN, "ASEAN Economic Integration Brief, 2018".

[12] Source: Ministry of Transport of Thailand, ASEAN PPP Summit, 2018.

[13] Source: ASEAN, "ASEAN Economic Integration Brief, 2018".

[14] For instance, The Eastern Special Development Zone Act B.E. 2561, promulgated in Thailand in 2018.

[15] Source: ASEAN, "ASEAN Smart Cities Network, 2018".

[16] Source: Master Plan on ASEAN Connectivity 2025.

[17] Physical, institutional and people-to-people connectivity.

Structured Finance for PPP Projects in the ASEAN Region

15. The ADB estimates that developing Asia—including China, India and the ASEAN bloc—is in need of heftier infrastructure financing to be regularly mobilized each year to maintain its growth momentum. According to an ADB study on a sample of 25 developing Asian countries, infrastructure requirements would call for aggregate spending of US$22.6 trillion (or US$26.2 trillion, factoring in climate mitigation), non-inflation-adjusted, between 2016-2030, in transport, power, telecommunication, and urban water and sanitation. Infrastructure investments in 2016-2018 fell significantly short of ADB's estimate and over 90% of infrastructure development funding in the region was derived from government spending. While more public funds could be raised through **fiscal and monetary reforms** or reorienting budget allocations, bridging circa 40% of the estimated investment gap in 2016–2020, private sector infrastructure investments would still have the lion's share in infrastructure financing.

16. ASEAN governments have long under-stood that, in order to attract FDIs, PPP projects need to meet international bankability criteria and present clear-cut contingent risk mitigation mechanisms. An extensive infrastructure greatly contributes to an economy's attractiveness and spurs investment in other areas. Infrastructure investments in ASEAN are increasingly financed by private proponents in PPP arrangements, which are best suited to manage risks, thus enabling governments to mobilize long-term financing from private sources for public infrastructure.

17. **Project finance transactions** in ASEAN present multi-layered complexities and are tackled by a wide array of structures. It is common practice for private project proponents and sponsors to set up a **Special Purpose Vehicle** (SPV), to finance the cost of a PPP project through a combination of equity and debt. Developing economies, such as those of most ASEAN member states, require a reasonable **Debt-to-Equity Ratio** to not incur over-indebtedness. Planning a PPP project correctly from outset—from a legal and financial standpoint, with the structuring of adequate credit enhancement—is imperative, inasmuch as the cost of capital is directly correlated with the project's downside risk, which, in turn, is inversely correlated with the host country's credit rating.

18. Sources of PPP project financing are:

- **Equity**: representing financial resources provided by the SPV's shareholders in return for an ownership interest. It may range between 10%-30% of capitalization.

- **Hybrid**: such as mezzanine finance, subordinated loans, convertible bonds and preferred stock, characterized by an equity-like feature and bridging between equity and debt. It may range between 0%-20% of capitalization.

- **Debt**: accounting for the largest portion of infrastructure finance, provided by a multitude of instruments such as loans, project bonds, ABS, ETFs, sukuk finance (e.g. in Malaysia). It may range between 60%-90% of capitalization.