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Discussion Paper

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MOBILIZING PRIVATE CAPITAL FLOWS FOR INFRASTRUCTURE DEVELOPMENT IN ASIA AND THE PACIFIC

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Discussion Paper

Macroeconomic Policy and Financing for Development Division

Mobilising Private Capital Flows for Infrastructure Development in Asia and the Pacific

by

Rajiv Biswas

March 2016

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Abstract

The infrastructure financing needs for the developing Asia-Pacific region are estimated to be in the range of USD 700 billion to USD 800 billion per year over the next decade. With many Asian governments struggling with high levels of government debt as well as large fiscal deficits, their capacity to finance such large annual infrastructure spending is being severely stretched. Private capital flows will need to play an important role in filling the infrastructure financing gap. However private capital investment flows into infrastructure have been constrained by considerable hurdles. Asian governments will need to work together with the international financial institutions and multilateral development banks in order to create new innovative approaches that will help to boost private capital flows into Asia-Pacific infrastructure.

***Keywords**:* Asia, infrastructure, economic development, REITs, AIIB.

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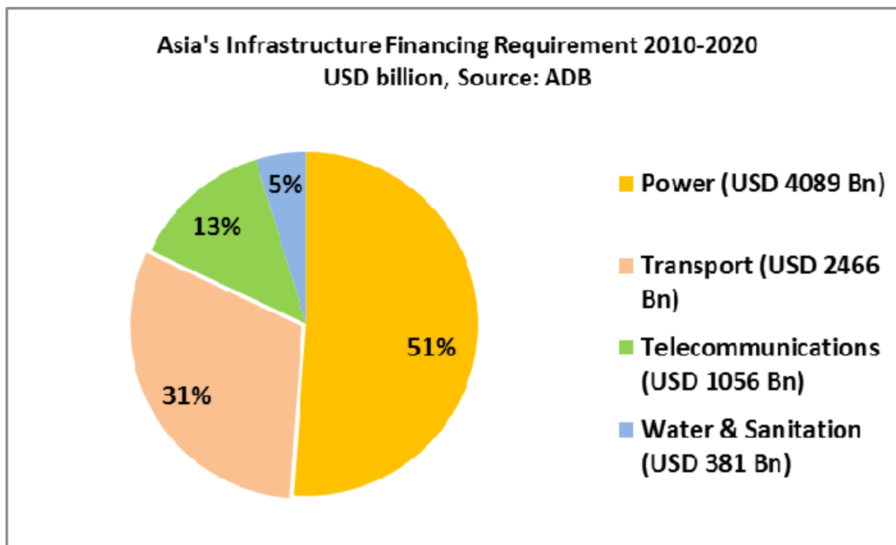
I. The Infrastructure Challenge in the Asia-Pacific

A. Asia's infrastructure financing requirement

The infrastructure financing requirements of the developing Asia-Pacific region has been estimated at USD 8 trillion for the 2010-2020 period, according to estimates by the Asian Development Bank. Of this total, an estimated 68% is required for new capacity expansion, with 32% needed for replacing and maintaining existing infrastructure. (Asian Development Bank, Infrastructure for a Seamless Asia.) This amounts to an annual infrastructure financing requirement of around USD 700 billion to USD 800 billion per year for the developing Asia-Pacific region.

According to the Asian Development Bank's assessment, the largest share of infrastructure financing is required for the power sector, at around USD 4.1 trillion, or 51% of the total infrastructure financing requirement. The second largest infrastructure financing requirement is for the transport sector, at around USD 2.5 trillion, or 31% of the total.



Due to the large infrastructure funding requirements of the Asia-Pacific region over the next decade, national governments will not have sufficient fiscal resources to fund all of the required infrastructure investment. Therefore a key economic priority for the governments of the Asia-Pacific region is to co-ordinate strategic initiatives to boost international investment and private capital flows to meet this infrastructure funding gap.

A number of high level initiatives have already been launched in 2014 and 2015 that will play an important role in addressing the infrastructure financing gap.

China has led a number of new initiatives to increase infrastructure financing in the Asia-Pacific region (Biswas, R., "*Reshaping the financial architecture for development finance: the new development banks*", London School of Economics Working Paper, Global South Unit, February 2015). Through the creation of the Asian Infrastructure Investment Bank (AIIB), the Silk Road Fund and the New Development Bank (NDB),

significant new infrastructure funding has been mobilized from the public sector that can help to also attract new private sector infrastructure financing through project co-financing.

The AIIB has an initial authorized capital of USD 100 billion, with initial subscribed capital of USD 50 billion, and has commenced operations with planned initial lending to commence during 2016. The Silk Road Fund, with planned capital of USD 40 billion, also has a mandate to invest in infrastructure projects in Asia, and is already operational. The New Development Bank, which was created by the five BRICS countries as founding members, has initial capital of USD 50 billion. Therefore the combined impact of these three new infrastructure financing organisations could provide more than USD 100 billion in funding.

The NDB, AIIB and Silk Road Fund combined have the potential to significantly increase the total multilateral financing available for infrastructure development in the medium-term, and will also give developing countries a greater voice in governing global development in the next decade and beyond.

While these initial capital for the AIIB and NDB will be provided by the member governments of each fund as public financing for infrastructure development, these new funds will also help to crowd-in additional public and private infrastructure financing flows through .co-financing of major infrastructure projects with state-owned development banks as well as with private sector finance.

Japan, which already has played an important role for decades as a source of official development assistance for Asia, has also launched a major new initiative to provide USD 110 billion in development aid for developing countries in the Asia-Pacific.

Therefore these new infrastructure financing initiatives are creating considerable positive momentum for significant additional multilateral and bilateral infrastructure financing flows for developing countries in the Asia-Pacific region. However, despite the major new infrastructure financing commitments by China, Japan and other governments worldwide, public sector resources cannot fully fund these large-scale infrastructure financing requirements. Private sector financing will also need to play an important role in achieving these infrastructure financing targets. A key challenge continues to be mobilizing private capital flows for developing countries.

While the pool of assets held in pension funds, life insurance funds and other collective investment vehicles globally is very large, there are significant obstacles that limit the amount of assets that are invested in infrastructure assets in developing countries. These obstacles include a wide range of issues, including regulatory restrictions on asset allocation by certain types of funds such as pension funds and life insurance funds into infrastructure as an asset class, as well as factors such as the higher risk profile and lack of liquidity in infrastructure investments in many emerging markets. Often investment funds in developed countries also have restrictive mandates that limit their ability to invest in sub-investment grade assets, which significantly restricts the number of developing countries that they can invest in.

Therefore finding new solutions that will unlock the vast global pool of private savings that can be allocated to infrastructure financing in developing countries is a key public

policy priority in order to boost private capital flows to finance economic development.

II. Boosting Private Capital Flows for Infrastructure Finance

A. Liberalizing regulatory restrictions on pension funds and insurance funds

While investment in the infrastructure asset class has become increasingly acceptable as part of the investment strategy of large global asset managers such as pension funds and insurance funds, there are often regulatory restrictions by governments on the ability of pension funds to invest in such assets.

Many countries do not allow direct investment in real estate or infrastructure by their pension funds, although indirect investment in real estate or infrastructure through listed vehicles is often permitted. In the Asia-Pacific region, Hong Kong, Japan, Thailand and Pakistan do not allow their pension funds to make direct investments in the real estate sector. South Korea does not allow defined benefit pension funds to make direct investments in real estate, but does permit such pension funds to invest in retail investment funds (OECD, 2015). While Hong Kong does not permit its pension funds to invest directly in real estate, they can invest indirectly through bonds and shares of property companies and through approved Real Estate Investment Trusts (REITs). Similarly Thailand does not allow its pension funds to invest directly in real estate but does allow investment indirectly through REITs and infrastructure trusts.

Therefore a review of such regulatory restrictions by governments needs to be undertaken in order to assess whether it is possible to allow a small share of total pension fund assets to be invested in the infrastructure asset class. This is a matter for individual governments to undertake such a review and consider whether a small proportion of total asset allocation can be allowed into infrastructure assets. Similar reviews would be needed for insurance funds where government regulations restrict their ability to invest in infrastructure.

Large pools of financial assets are held in global pension funds and insurance funds. According to estimates by the OECD, the total pension fund assets held in OECD countries in both public and private sector funds amounted to around USD 25 trillion at the end of 2014. According to Willis Towers Watson, the total pool of assets held by the world's 300 largest pension funds amounted to USD 15 trillion in 2014.

Therefore if a small proportion of these total pension fund assets can be unlocked for infrastructure investment, it could potentially provide a significant new source of capital for infrastructure financing. As many investment funds prefer to invest through liquid instruments that are listed on stock markets rather than taking direct equity stakes in projects, the liberalization of regulatory restrictions on pension funds and insurance funds to invest in infrastructure also needs to be accompanied by development of the real estate investment trust and infrastructure investment trust legislation in emerging Asian countries, where such infrastructure investment vehicles do not already exist.

While the first step in reviewing pension fund regulations can be taken at a national level in order to liberalise investment rules regarding investment into domestic infrastructure assets, a broader and more co-ordinated international approach to allowing pension

funds and insurance funds to invest in international infrastructure assets would also be a important aspect of such liberalization measures, to allow pension funds worldwide to invest in infrastructure projects internationally, not just in their domestic economy.

Large Asia-Pacific pension funds		
Name of fund	**Country**	**Estimated assets**
Government Pension Investment Fund	Japan	USD 1.1 trillion
National Pension Fund	South Korea	USD 430 billion
Central Provident Fund	Singapore	USD 207 billion
Local Government Pension Fund	Japan	USD 195 billion
National Social Security Fund	China	USD 247 billion
Employees Provident Fund	Malaysia	USD 184 billion
Employees Provident Fund	India	USD 80 billion
Australian Super	Australia	USD 70 billion
National Public Service	Japan	USD 68 billion
Colonial First State	Australia	USD 50 billion
Public School Employees	Japan	USD 49 billion
QSuper	Australia	USD 45 billion
BT Retirement Wrap	Australia	USD 40 billion
AMP Superannuation	Australia	USD 40 billion
Retail Employees Super Trust	Australia	USD 30 billion
Retirement Fund KWAP	Malaysia	USD 31 billion
Government Pension Fund	Thailand	USD 22 billion
Government Service Insurance	Philippines	USD 21 billion
New Zealand Super Fund	New Zealand	USD 20 billion
NTT	Japan	USD 19 billion
Fujitsu	Japan	USD 18 billion
Social Insurance Funds	Vietnam	USD 17 billion
Mizuho	Japan	USD 17 billion
Hitachi	Japan	USD 14 billion

Sources: Willis Towers Watson 2015 survey; Australian Prudential Regulation Authority.

Note: Pension fund figures shown are approximate values based on 2014-15 surveys, and are subject to significant

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