Source: Project Finance International {Main}
Edition:
Country: UK
Date: Wednesday 22, October 2014
Page: 47,48
Area: 664 sq. cm
Circulation: Pub Stmt 2421 Fortnightly
Ad data: page rate £4,000.00, scc rate £0.00
Phone: 020 7369 7616
Keyword: Berwin Leighton Paisner

PLUGGING THE GAP – THREE NEW PLAYERS

GIVEN THE EVIDENT NEED FOR NEW INFRASTRUCTURE, DRIVEN BY ASIA'S CONTINUED POPULATION AND ECONOMIC GROWTH, BUSINESSES AND GOVERNMENTS ALIKE WILL BE ENCOURAGED BY THE EMERGENCE OF THREE NEW ASIAN FUNDING SOURCES. BY NOMITA NAIR AND ROBERT GROSS, PARTNERS, PROJECT FINANCE, AT BERWIN LEIGHTON PAISNER LLP.

Numerous studies have shown that Asia has sizeable infrastructure investment needs, principally due to the region's rapidly expanding population and exponential economic growth. Asian nations have started to propose infrastructure projects and schemes to meet these demands.

In 2014, India and Indonesia – two of Asia's most populous countries – went to the polls, and infrastructure was high on the agenda. The Indian government's plans, revealed during its July 2014 budget, include: (i) a US$6.2bn investment in National Highways Authority of India and state roads; (ii) a green energy corridor project to facilitate transmission of renewable energy nationwide; and (iii) an "infrastructure business trust" – a new investment vehicle that will assist cash-starved infrastructure developers with raising long-term financing through a range of tax incentives.

Indonesia's new president, Joko Widodo, proposed 2,000km of new roads, rural electrification and 10 airports and 10 seaports in his manifesto.

Given this evident need, driven by Asia's continued population and economic growth, businesses and governments alike will be encouraged by the emergence of three new funding sources: the BRICS New Development Bank, the Asian Infrastructure Investment Bank and the smaller but strategically important SAARC Development Bank. All announced within the last year, these institutions will be important players in supporting future infrastructure investment in the region.

Current funding sources

Although there are numerous funding sources for infrastructure projects, national government budgets have traditionally been the largest source. It has been estimated that public funding of infrastructure in emerging markets accounts for as much as 70% of infrastructure financing, with 20% coming from the private sector and the remaining 10% being financed by multilateral and bilateral agencies[1].

Apart from government budgets, the remaining funding sources can be categorised broadly as: (i) commercial banks; (ii) export credit agencies; (iii) bilateral aid agencies; (iv) multilateral development banks (such as the World Bank and the Asian Development Bank, or ADB); (v) sovereign wealth funds; (vi) capital markets; and (vii) private equity and other funds (eg, infrastructure funds).

Since the 1997–98 Asian financial crisis, Asian leaders have worked towards creating greater regional financial co-operation and integration. These initiatives include the Asian Bond Markets Initiative and the Asian Bond Fund, both established in 2003 to promote bond market development in the region, as well as the ASEAN Infrastructure Fund, set up in 2011 to mobilise financial resources within ASEAN and support regional infrastructure development.

However, apart from the ADB and the World Bank, there are few institutions that offer credible resources to tackle this mammoth infrastructure challenge. It thus comes as a welcome relief that three new sources of financing for developing countries have been announced recently.

BRICS New Development Bank

The most developed of these is the BRICS New Development Bank (NDB) and Contingent Reserve Arrangement (CRA), which were officially established on July 15 2014 at the sixth BRICS summit in Brazil. The NDB will finance infrastructure and sustainable development projects (much like the World Bank) in BRICS (Brazil, Russia, India, China and South Africa) and other emerging economies. It will do this by: (i) supporting public or private projects through loans, guarantees, equity participation and other financial

Source: Project Finance International {Main}
Edition:
Country: UK
Date: Wednesday 22, October 2014
Page: 47,48
Area: 664 sq. cm
Circulation: Pub Stmt 2421 Fortnightly
Ad data: page rate £4,000.00, scc rate £0.00
Phone: 020 7369 7616
Keyword: Berwin Leighton Paisner

instruments; (ii) co-operating with international organisations, national development banks and other financial entities; and (iii) providing technical assistance for projects to be supported by it.

The BRICS are the founding members of the NDB but it is open to any member state of the United Nations. It is designed to have an initial subscribed capital of US$50bn (contributed equally by and distributed equally among the founding members) and an initial authorised capital of US$100bn.

Notably, despite differences in size between the BRICS economies (eg, China's economy is 28 times the size of South Africa's), voting rights and governance have been split equally among

> Apart from ADB and World Bank, there are few institutions that offer credible resources to tackle this mammoth infrastructure challenge

Source: Project Finance International {Main}
Edition:
Country: UK
Date: Wednesday 22, October 2014
Page: 47,48
Area: 664 sq. cm
Circulation: Pub Stmt 2421 Fortnightly
Ad data: page rate £4,000.00, scc rate £0.00
Phone: 020 7369 7616
Keyword: Berwin Leighton Paisner

the founding members. Further to that, the NDB's first president is from India, the inaugural chairman of the board of directors from Brazil and the inaugural chairman of the board of governors from Russia, while its headquarters are in Shanghai and the first regional office in Johannesburg. The parliament of each BRICS must ratify the NDB's creation, with the first lending activities expected to occur in 2016.

The CRA will provide assistance to BRICS in financial difficulty (much like the International Monetary Fund, or IMF) and further strengthen financial stability through liquidity and precautionary instruments. However, unlike the IMF, the CRA is not a fund but a number of bilateral promises between its members to make foreign reserves available to other members in need.

The initial total committed resources of the CRA will be US$100bn, with Brazil, India and Russia each committing US$18bn, China committing US$41bn and South Africa committing US$5bn. The members can request to access committed resources at any time, subject to maximum access limits equal to a multiple of their individual commitments (Brazil, India and Russia each having a multiple of 1, China having a multiple of 0.5 and South Africa having a multiple of 2). Voting rights are distributed among the members according to the relative size of individual commitments, with China having the largest voting right (39.5%).

It has not been disclosed which currencies will be used to disburse development funding (through the NBD) and provide financial assistance (through the CRA). However, commentators have suggested that these will primarily be the renminbi, given China's size within the BRICS.

Asian Infrastructure Investment Bank

In addition to China's involvement with the NDB, Chinese President Xi Jinping proposed the establishment of the Asian Infrastructure Investment Bank (AIIB) in October 2013. The AIIB is meant to act as a new multilateral bank with the mandate to finance cross-border infrastructure projects in Asia, in order to promote regional connectivity and economic co-operation. To-date, 21 countries in the region have shown interest in becoming founding members of the AIIB, with an inter-governmental memorandum of understanding to be signed between the founders by the end of 2014.

The AIIB's structure, operational workings and other key details are unconfirmed, as is the bank's paid-up capital, with media reports suggesting that this will be anywhere between US$50bn and US$100bn. It is likely that the products it will offer will include project financing, trade financing, crisis liquidity and risk cover programmes.

However, China has confirmed that the AIIB: (i) will be less bureaucratic than the ADB and will be more infrastructure focused; and (ii) will have zero-tolerance of corruption. China is also reported as wanting the AIIB to acquire and maintain its own AAA rating as soon as possible, as opposed to relying on an underwriting of its capacity to borrow at AAA rates from international capital markets.

It is expected that among the AIIB's first few projects will be the financing of a direct rail link from Beijing to Baghdad, as part of developing a "silk road" economic belt and seaborne route. The "silk road" plans (which are named after the ancient mercantile routes through which China shipped its silk and tea to the West as early as the Han dynasty, in 206 BC to 220 AD) are expected to boost China's trade and investment ties with a number of countries.

SAARC Development Bank

On a slightly smaller scale, but still politically strategic, the member countries of the South Asian Association for Regional Co-operation (SAARC) – namely Afghanistan, Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka – have expressed their desire to establish a SAARC Development Bank (SDB).

Spearheaded by Indian Prime Minister Narendra Modi, the members are likely to formally give the SDB the green light at the 18th SAARC Summit in Nepal in November 2014. Although these countries represent some of the poorest nations in the world and those in most desperate need of infrastructure investment, it is hoped that such an initiative will pave the way towards greater trade connectivity and closer regional integration between these neighbours. There is limited information available on the SDB, but it is understood that the bank will be able to look to multilaterals and other institutions for sources of capital in addition to contributions from its member countries.

Source: Project Finance International {Main}
Edition:
Country: UK
Date: Wednesday 22, October 2014
Page: 47,48
Area: 664 sq. cm
Circulation: Pub Stmt 2421 Fortnightly
Ad data: page rate £4,000.00, scc rate £0.00
Phone: 020 7369 7616
Keyword: Berwin Leighton Paisner

What does the future hold?

It remains to be seen how the NDB, AIIB and SDB will help to stimulate increased levels of infrastructure investment in Asia to meet the demands set out above. Many commentators have said that these banks represent a South-South or Act East paradigm shift – a move by emerging economic powers such as China and India from the US and European dominated IMF and World Bank.

However, many Asian infrastructure developers have for years lamented the lack of "good bankable projects", and the lack of available funding sources is only one of the reasons to account for this. If these new financial institutions are to truly succeed, host governments must also recognise that sound project fundamentals remain essential.

The NDB, AIIB and SDB are banks to watch in the coming years, promising greater cross-border investment, trade and connectivity in the region and closer economic and political ties between their respective member countries. ■

Footnote

1 - Delmon, J., (2011) 'International Project Finance and PPPs: A Legal Guide to Key Growth Markets'

300376950 - CHRGID - xxT745-1 - 91662527