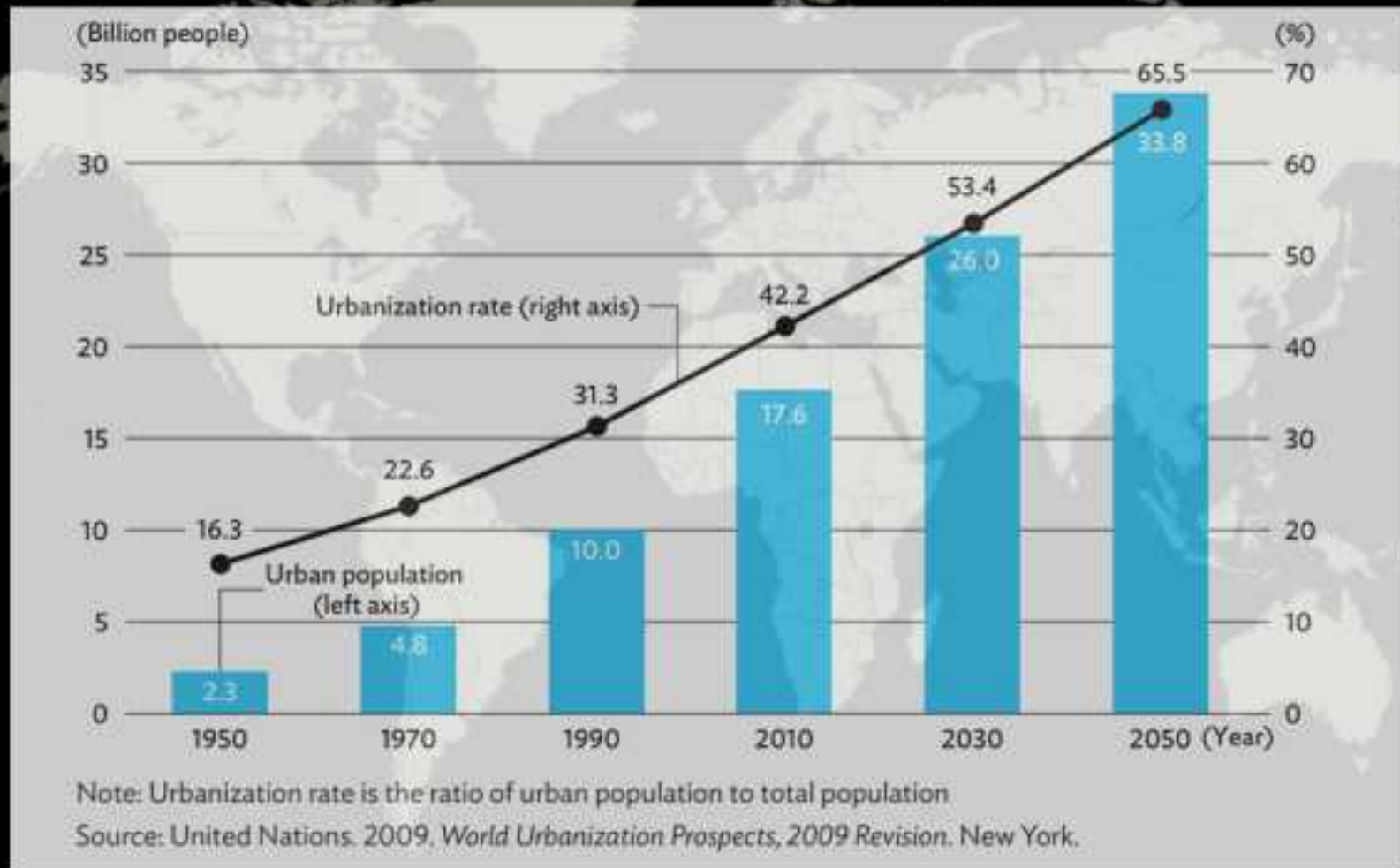


ISSUES AND CHALLENGES IN MOBILIZATION OF
PRIVATE SECTOR FUNDS ON INFRASTRUCTURE
INVESTMENT

Riznaldi Akbar
31 October 2023

URBAN POPULATION AND URBAN POPULATION RATE IN ASIA



Infrastructure Investment and Economic Growth

Infrastructure in Transportation increases Economic Growth

Bidirectional Causal Relationship between Infrastructure in Electricity and Economic Growth

Publicly financed projects may not produce a positive effect on economic growth due to corruption, poor maintenance, and cost overruns.

Sometimes, short-term impacts of the infrastructure investment can negatively affect output due to the crowding out of private investment in the short run.

Evidence from Central Asian Countries



Impacts vary across economies and different sectors of the economy



Struggle to attain higher economic growth even with various reforms



High account deficits restrict government from undertaking any long-term infrastructure investment.



From a policy perspective, Central Asian countries should improve private participation in infrastructure (PPI) in all sectors to promote infrastructure.

Challenges in Providing Infrastructure

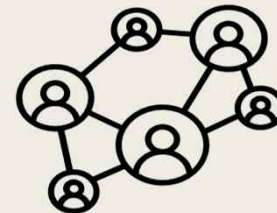
■ Government

1. Poor Project Selection
2. Poor Infrastructure Maintenance
3. Inefficient Pricing
4. Poor Institutional Design/Corruption
5. Inefficient Renegotiation Process








■ Private Sector

1. Territorial and Institutional Fragmentation
2. Limited involvement of local stakeholders
3. Inadequate Governance Frameworks
4. Patchy financial management
5. Uncertainties in the economic and political environment



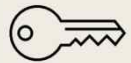
Benefits of Private Participation in Infrastructure

-  Budgetary Certainty
-  Innovation and Technology
-  Timely and Cost-Efficient Project Delivery
-  Local Economic Development
-  Transfer of Skills and Expertise

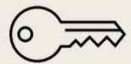
RISKS RELATED TO INFRASTRUCTURE BUSINESS

Phase in which risk occurs	Risk Type
All Phases	Political Risk
	Economic Risk
	Natural Disaster
Construction	Land Acquisition
	Construction
	Completion
Operation and Management	Operational Risk
	Discontinuation Risk

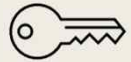
How can Government Unlock Private Participation?



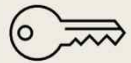
High Level of Freedom from Corruption



The Better Rule of Law



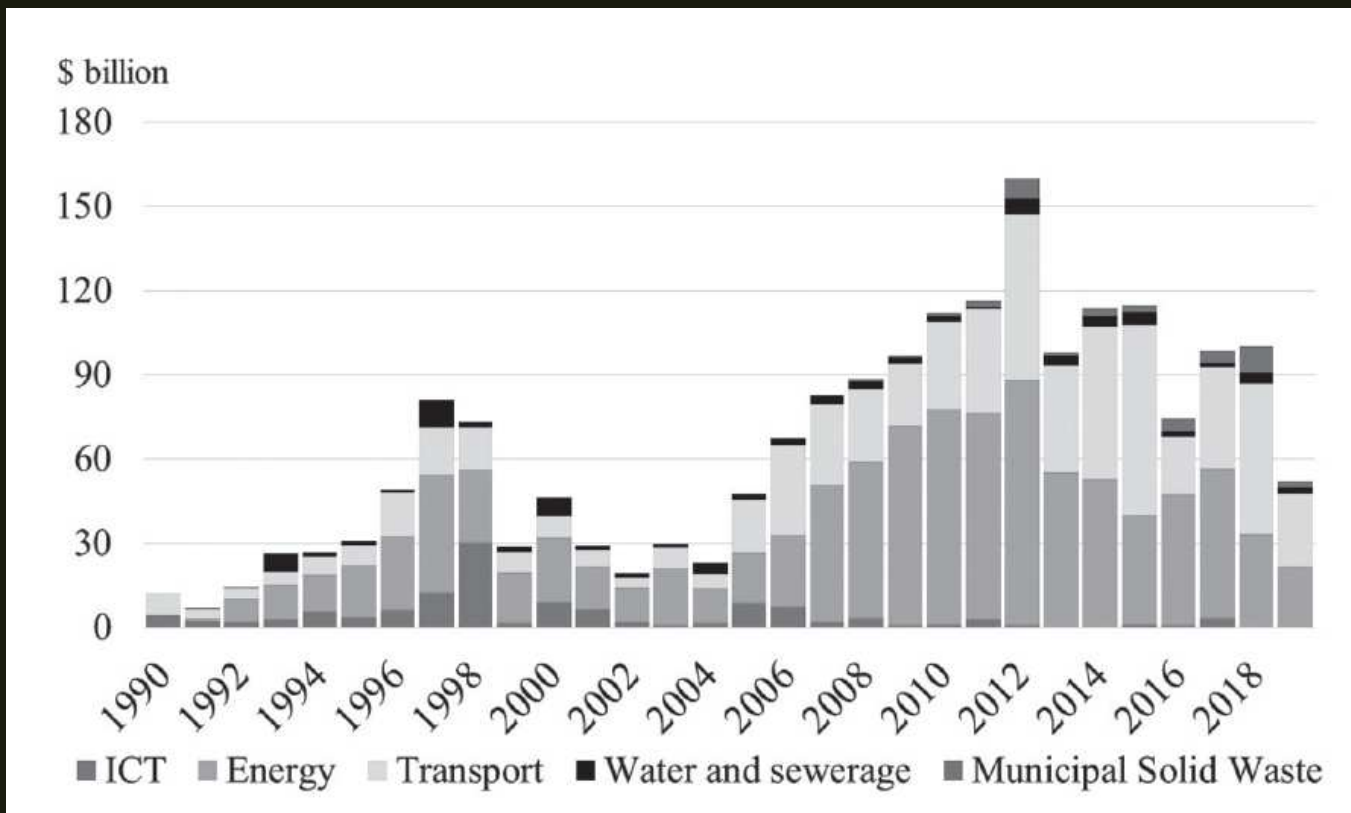
The Better Quality of Regulations



A Lower Number of Court Disputes

Institutional Framework and Political Economy are the keys

Private Investments in Developing Countries.



Subtle private investment in the water sector, particularly in developing economies.

Challenges:

1. high uncertainty
2. low financial viability
3. high fixed cost
4. long-term initial investment
5. long payback periods
6. low rates of return

Note: ICT = Information and Communication Technology

Source: Government Initiatives to Unlock Private Participation in Infrastructure: Lessons from Indonesia's Public-Private Partnership in the Water Sector (Febrio Kacaribu,* Yohanna M.L. Gultom, Nauli A. Desdiani, and Syahda Sabrina, 2023)

Story of Batam's Clean Water Infrastructure (Indonesia)

Keys to success: Strong Political Will and High Tariff

- Water is generally not competitive compared to other public infrastructure due to its large sunk costs, large economies of scale and low returns.
- Government of Indonesia (Gol) initiated private participation in water projects in 1995
- A successful concession for clean water supply in Batam
- Gol expanded PPPs in water infrastructure but faced setbacks due to economic crises and legal framework inadequacies.
- Business-to-Business (B2B) partnerships: unlike PPP contract, the B2B mechanism is omitted from the government support and/or guarantee.

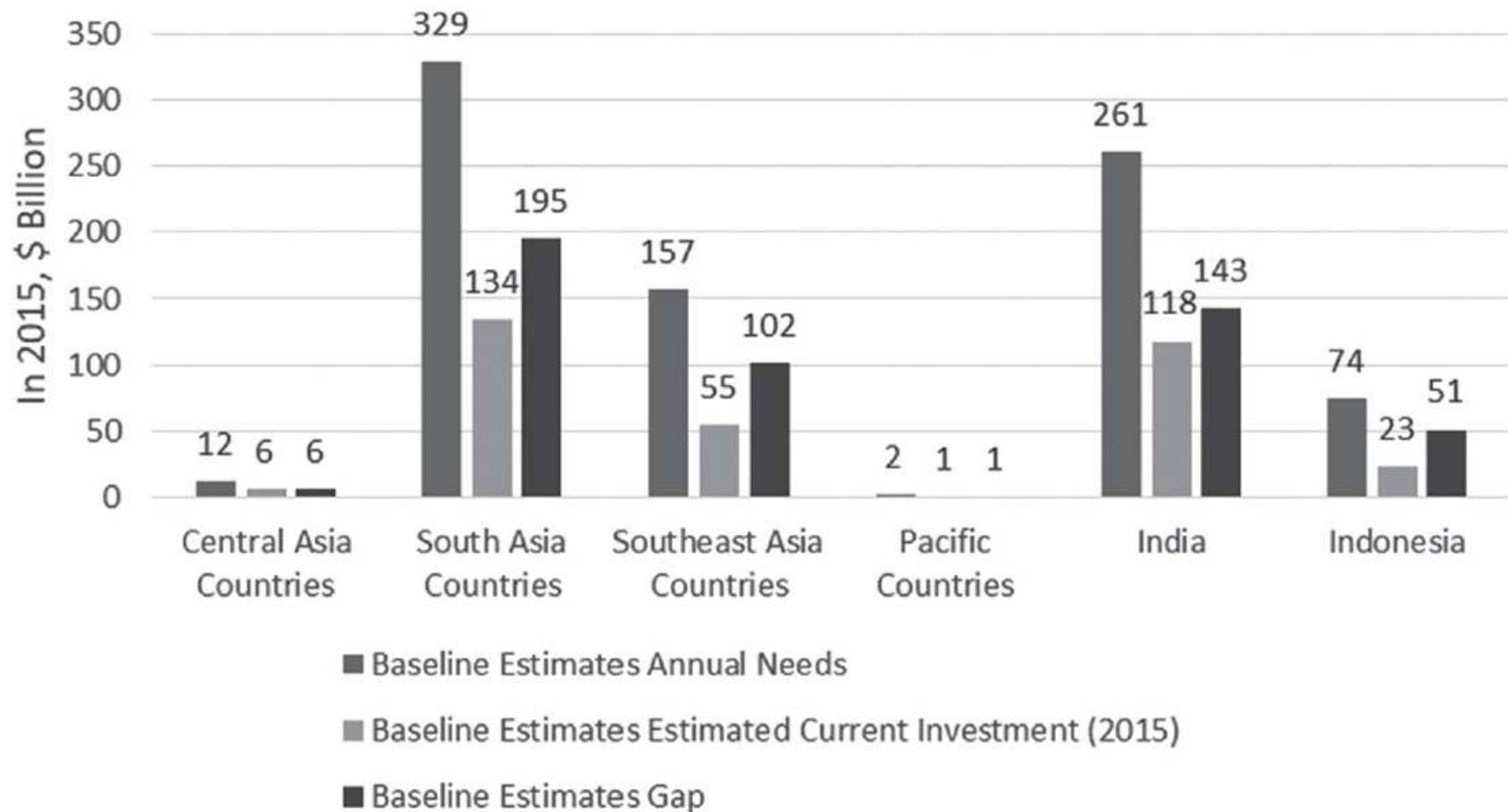
When the sound institutional framework alone is still inadequate ...

Government Supports are Crucial.

Examples from Batam's Clean Water Infrastructure (Indonesia)

- Gol offers assurances to minimize financial risks.
- Government support boosts the economic viability of projects, resulting in higher returns on investment.
- In Asia, the utilization of government assistance is often driven by political motives.

Infrastructure Investments and Gaps, 2016-2030



Source: ADB Data Library

Case Study: A PPP Model for Sustainable Infrastructure Investment in Delhi

Problem: Land acquisition delays projects and reduces the rate of return for private investors.



Challenges: landowners' reluctance to sell due to conflicts of interest and high compensation demands.

Similar Situation: a project of high-speed railway linking Narita got delayed due to the opposition of a few landowners who did not want to sell their land.

Possible Solutions:

- Value capture policy framework
- Development-based and tax-based value capture methods
- The Delhi Land Pooling (DLP) policy

Benefits of Land Pooling

- Land pooling can expedite cooperation between local agencies and landowners.
- It is a cheaper alternative that generates high revenue.

Land Trust and Spillover Effects

- Land trusts managed by trust banks allow landowners to retain property ownership while transferring title to a trustee.
- Spillover tax revenue results from increased economic activities near infrastructure projects.

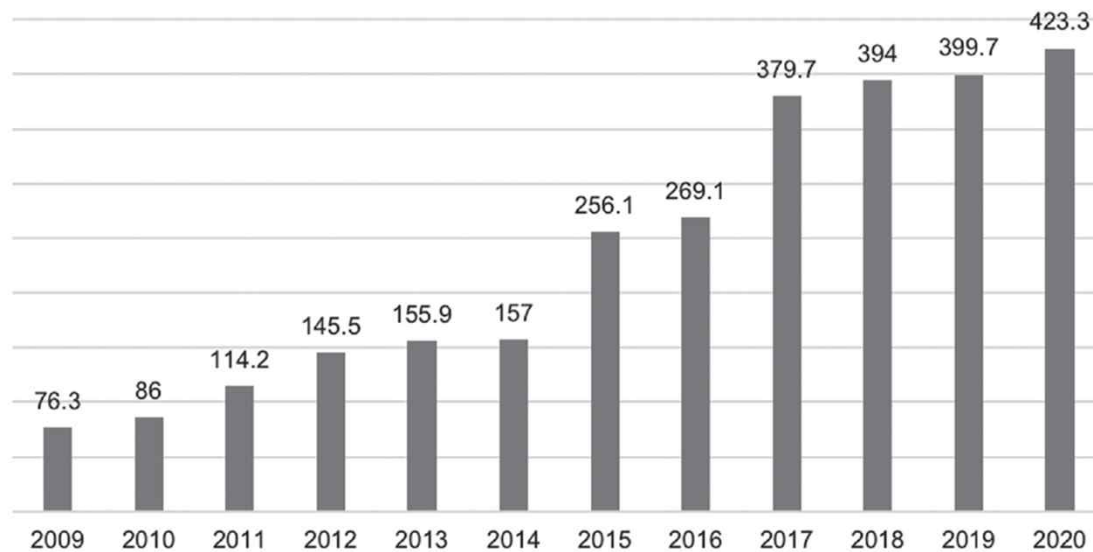
Case Study: Delhi, India

- Value capture policy framework involves monetization of land to create a sustainable model for infrastructure development.
- Land pooling, leveraging increased land value, is a key method to attract private investment.
- Key Findings from comparative analysis of multiple districts using land-pooling:
 - *Lack of flexibility in plot/house sizes deters landowners.*
 - *Efficient profit sharing and equal partnership rights between stakeholders are essential.*
 - *Development-based value capture is preferred over taxes/fees.*

Tax incentives

- a means to attract private investment in infrastructure
- The rapid growth of the population urged the need for infrastructure to support the basic needs of living, such as water treatment, energy, education, and healthcare.
- To meet infrastructure needs, developing Asia will need to invest \$1.7 trillion each year from 2016 to 2030 (ADB 2017), which is generally grouped into energy, transportation, telecommunications, water, and sanitation.
- However, the current level of investment is not sufficient, with a financing gap equal to 2.4% of gross domestic product (GDP) from 2016 to 2020. Unfortunately, the gap is wider for low to lower middle-income economies, which can be around 5.6% of projected GDP (ADB 2017)

Infrastructure Spending (Rp trillion)



Note: 2019 is an estimation while 2020 is the budgeted amount
Source: Ministry of Finance, Indonesia

From 2014 to 2020, infrastructure spending increased by almost triple from Rp157 trillion (\$10.7 billion) to Rp423.3 trillion (\$28.7 billion), with average annual growth of 11.8%.

Case Study: Indonesia

Indonesian Context:

- Indonesia faces unequal development across regions, especially regarding infrastructure access and quality.
- The mid-term development plan for 2020-2024 emphasizes basic, economic, and urban infrastructure.
- Due to fiscal limitations, there's a need to increase private sector involvement through tax incentives.

Tax Incentives:

- Various tax incentives include tax holidays, reduced tax rates, value-added tax (VAT) exemption, and investment allowance.
- Tax incentives have been found to have a positive impact on attracting foreign direct investment (FDI), especially in developing countries which are less capable of offering financial incentives up front.

Case Study: Indonesia

Tax holiday

- introduced in 1967 and has been amended over the years for simplicity and flexibility.
- A "mini tax holiday" approach has been introduced for more effectiveness.
- Initial tax holiday in 2011 had limited outcome while the 2018 tax holiday was more effective.

Tax allowance

- Reduced net taxable income, withholding tax rates, extended tax loss carryforward periods
- Reforms involved digitization and acceleration of the administrative process, clarification of eligibilities, and expansion of eligible infrastructure-related sectors.
- Amount of foregone tax revenue decreased; Utilization of tax allowance increased

VAT exemption for residential buildings

- Indonesia has VAT for any consumption of taxable goods at 10%.
- The government provides VAT exemption for certain types of residences following the certain criteria.

Five Major Institutional Challenges



Aligning Legal and Regulatory Frameworks



Developing Effective Governance



Managing Social Consequences & Promoting Environmental Sustainability



Engaging the Private Sector



Engaging Regional and International Institutions

Conclusion and Policy Recommendations

- Tax incentives are a vital tool in motivating private sector participation in infrastructure development.
- Simplifying and ensuring administrative clarity in tax incentives is crucial
 - *The government should broaden the range of infrastructure sectors eligible for tax incentives.*
 - *Small-scale investors should also qualify for tax allowances.*
- Increase involvement to improve infrastructure performance, efficiency, and reduce the fiscal burden on public budgets.
- Increase private sector participation in infrastructure development and suggest a “simplified and direct institutional framework” to enhance land pooling efficiency.



THANK YOU

