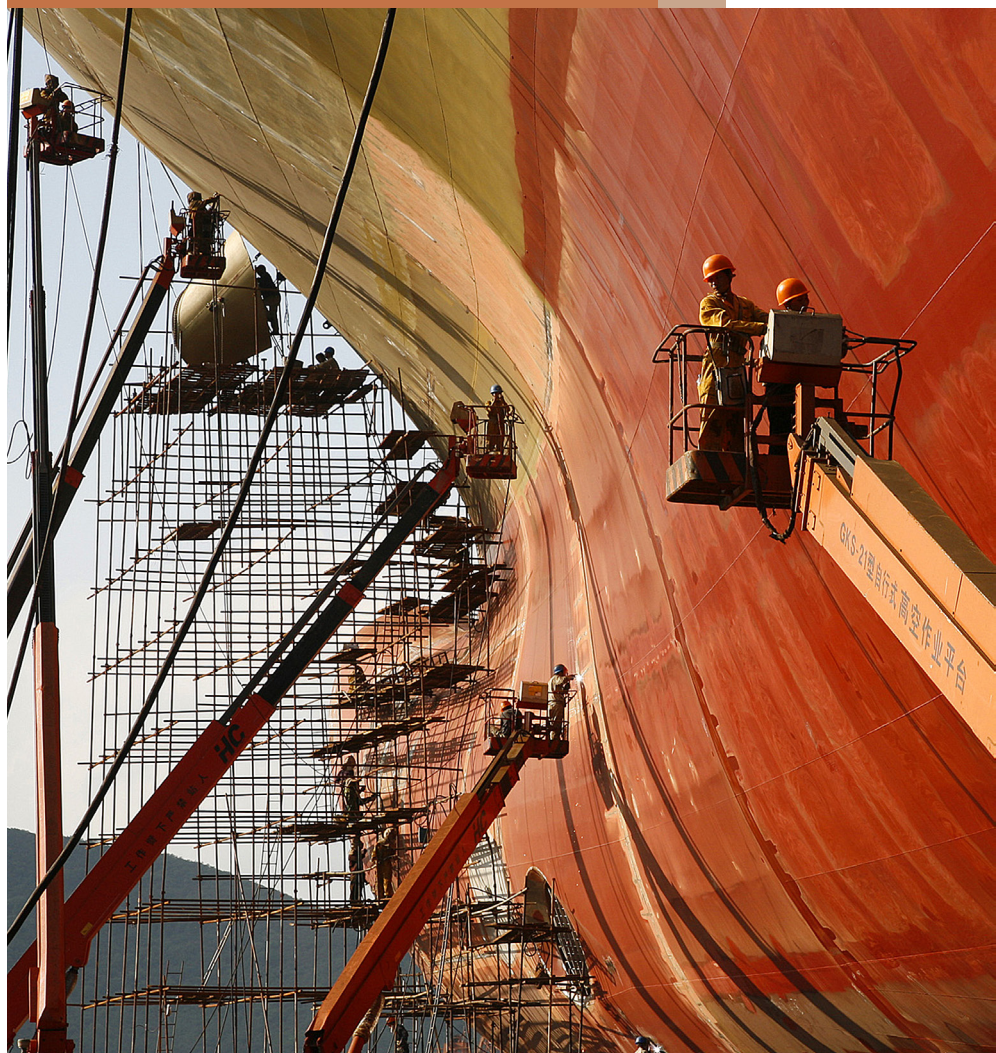


Foundations of the future

*What is holding back
business investment in
Asia? And what can be done
to remove these obstacles?*

2013



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About the report

'Foundations of the future' is a report prepared for the APEC Business Advisory Council (ABAC) by PwC in its capacity as the Knowledge Partner of the APEC CEO Summit 2013. This report explores some of the major impediments faced by businesses investing in the Asia Pacific region, particularly around infrastructure. It examines the central role governments can play in easing these barriers and facilitate the freer flow of capital for economic growth.

The report's content draws upon the views and insights of CEOs and business leaders with operations spanning Asia Pacific. PwC developed this report with the support of the Economist Intelligence Unit (EIU) who conducted research and in-depth interviews for this paper.

We would like to thank all interviewees for their time and insights.

September 2013

Interviewees, in alphabetical order:

Johan Bastin, CEO, CapAsia

Michael Deegan, national infrastructure coordinator, Australian Government

Paul Graham, CEO, Asia Pacific, Middle East and Africa, DHL Supply Chain

Benoit Henry, CEO, Asia Pacific, commercial tyres, Continental

Lars Rasmussen, CEO, Asia Pacific, Moog

Mark Rathbone, APAC leader, capital projects and infrastructure, PwC

Greg Slater, global head of trade and competition policy, Intel

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Tan Sri Dr Francis Yeoh, group MD, YTL

1. Introduction

The science of understanding how an economy grows is complex and hotly debated. But one ingredient that everyone agrees is necessary is fixed capital investment. Unless an economy builds roads, factories, and schools, it is hard for that economy to grow.

Fixed capital investment can come from the government or the private sector, but in most countries in Asia it is the latter that contributes the greatest share. In Thailand, for example, 73% of all fixed capital investment – the sort that goes into physical assets, like ports and computers and office blocks – comes from private sources. In India, the figure is 74%, while in the Philippines it is 80%.¹

The implications are two-fold. First, governments are not investing enough in building their nations' fixed assets and infrastructure. There is a substantial deficit in inherently public sector infrastructure – the type that doesn't offer strong returns to the private sector and often needs government subsidy to be viable. For example, across the emerging markets in Asia, most economies lack efficient transports networks, power supply and distribution, water supply and distribution.

And second, if governments continue to under-invest, they need to create an environment that attracts even more investment from the private sector. Governments must create the right conditions for businesses to feel confident about deploying their capital in new projects over long time periods.

Given that much of Asia today has relatively low levels of income, the region has a pressing need to pursue rapid economic growth. It needs to attract the necessary fixed-capital investment to support economic development and rising prosperity. But is the region doing enough to attract this private capital?

This paper looks at the investment landscape for private business in the Asia-Pacific region.² By talking to CEOs from a range of sectors, it gathers opinions about what factors are preventing businesses from investing. Further, it assesses what could be changed in order to reduce these barriers and obstacles. The paper looks at the general investment climate, and then focuses on two issues in particular: infrastructure, and the evolving network of free-trade deals.

¹ World Bank national accounts data for 2009, the latest year available

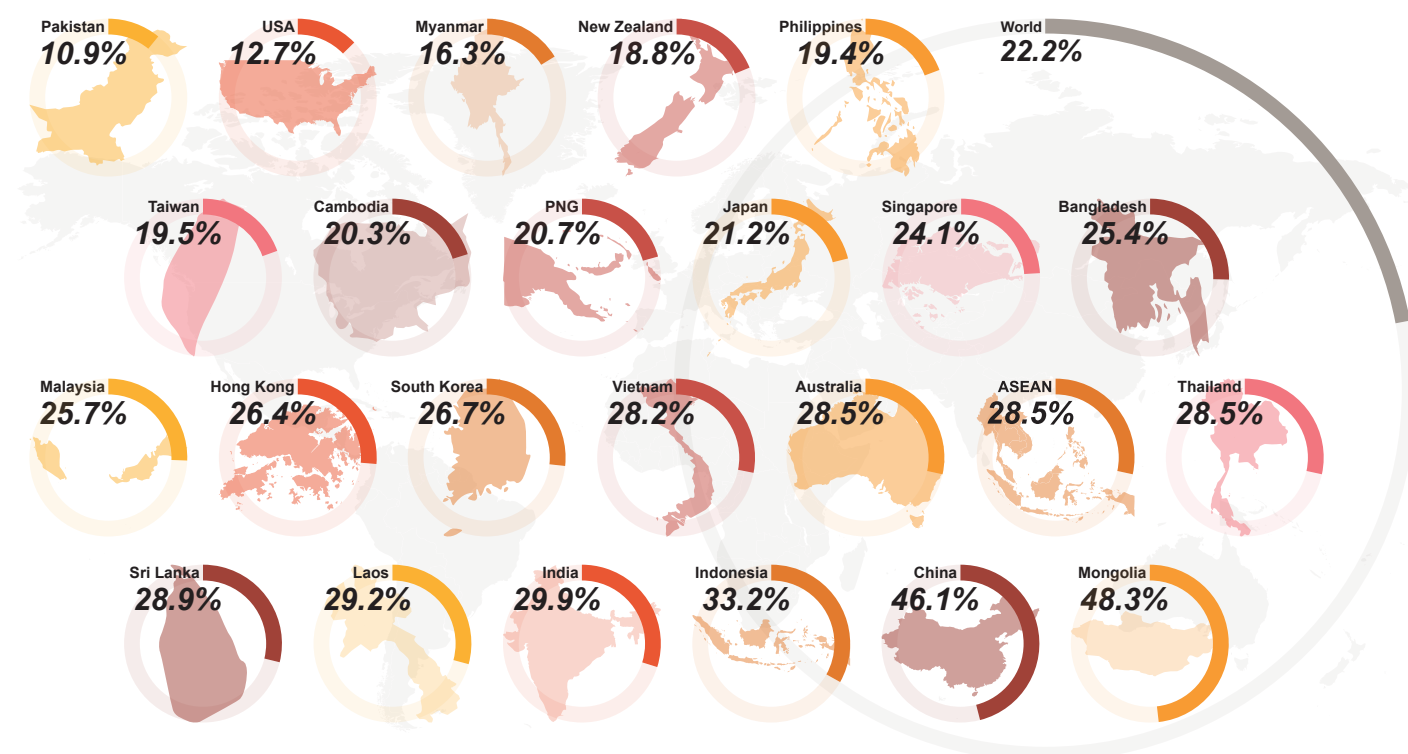
² In this report “Asia” and “the Asia-Pacific region” refer to the following economies: Australia, Bangladesh, Brunei, Cambodia, China, Hong Kong, India, Indonesia, Japan, Laos, Malaysia, Mongolia, Myanmar, New Zealand, Pakistan, Papua New Guinea, Philippines, Singapore, South Korea, Sri Lanka, Taiwan, Thailand, Vietnam

2. The quantity and quality of business investment

Although the picture varies, many countries in the Asia-Pacific region are already attracting lots of business investment. Asia is well known for having high rates of saving, and these savings are being used to invest in assets such as new infrastructure, houses and factories.

In 2012, total fixed-capital investment (public and private sector) accounted for 22% of the global economy. In Asia, most economies had an investment ratio that was above this global average. In Mongolia, for example, investment made up almost 50% of the economy, thanks in large part to its mining boom. (See chart 1.) In China, fixed asset investment was 45% of GDP. (China is a little different from many Asian countries in that half of this substantial investment comes from the government and half from the private sector.)

Chart 1: Fixed capital investment as a share of GDP (%), 2012*



*Figures rounded to the nearest tenth.

Source: Economist Intelligence Unit

“High rates of investment tell only part of the story, though. As well as the quantity of investment, it is important to consider its quality.”

Emerging economies that are building their infrastructure, cities and industrial base for the first time need to have higher investment ratios than developed economies. While some of emerging Asia is attracting this needed investment, it is painfully clear that some countries are not. In Pakistan, for example, total investment in fixed assets only amounts to 12% of GDP. In Cambodia it is only 20%. Some observers argue that India, with an investment ratio of 30% of GDP, won't achieve its full potential until this is closer to 35%.

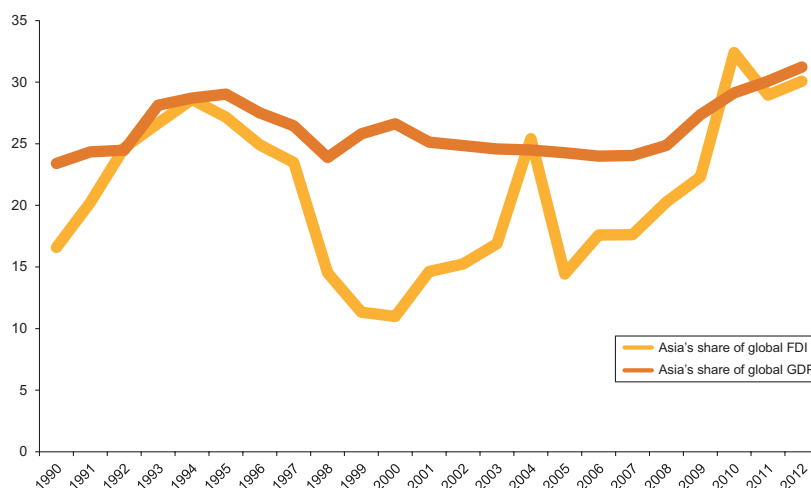
High rates of investment tell only part of the story, though. As well as the quantity of investment, it is important to consider its quality. Is the investment going into the most productive parts of the economy? Is it creating the sort of assets that a country most needs for its future?

In Indonesia, for example, the headline investment ratio of 34% of GDP looks impressive. But a lot of this investment is going into building high-end apartments and real estate, and very little is going into the infrastructure that is needed to allow for continued and sustainable economic growth. For Indonesia to enjoy high rates of growth in the future, it needs to put money into transport networks, power stations and other utilities. In China, commentators have long argued that some of the country's investment is creating too much capacity in certain industries such as steel. In countries like China and Indonesia, policymakers need to examine why some parts of the economy are attracting too much investment and other parts too little.

Flirting with foreigners

A different window onto the investment picture in Asia comes from looking at inflows of foreign direct investment (FDI). High levels of FDI suggest that a country is an attractive place for companies to put their money. Chart 2 (below) compares the Asia-Pacific region's share of the global economy with its share of global FDI. During the 1990s, the region was attracting FDI in proportion to its share of the world economy. After the Asian Financial Crisis of 1997 and 1998 FDI flows dropped markedly, but more recently they have recovered. In 2012, Asia accounted for 32% of the global economy and 30% of global FDI.

Chart 2: Global share of gross domestic product and foreign direct investment (%) for Asia



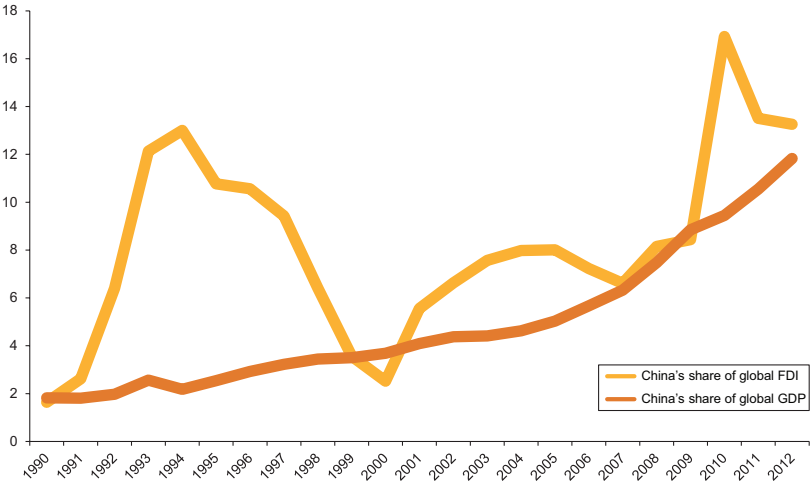
GDP and FDI measured in US\$ at market exchange rates
Source: Economist Intelligence Unit

While this picture looks reasonable, the region should arguably be attracting more. Asia is the fastest-growing part of the global economy, which suggests that foreign businesses should be investing in the region today in anticipation of all the future growth to come.

Behind the headline figures, it's clear that some parts of the region are outperforming in their ability to attract FDI. In particular, the countries of the Association of South-east Asian Nations (ASEAN) and China are outperforming. However, other parts, notably Japan and India, are underperforming. (See charts 3, 4, 5 and 6, below.)

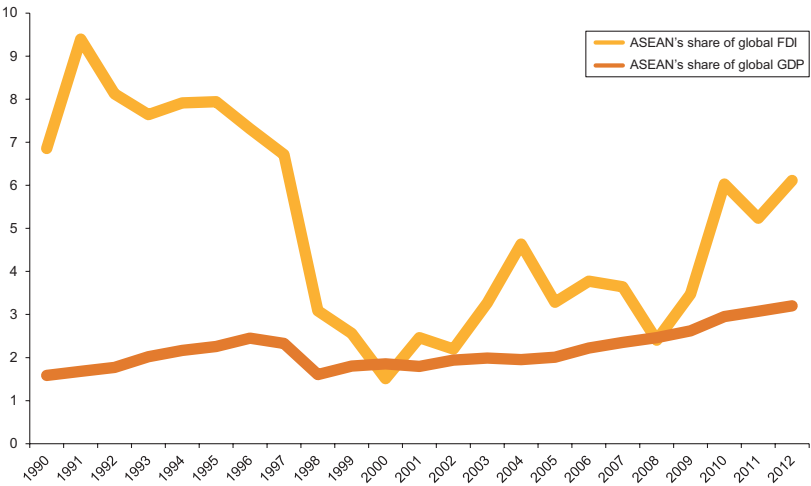
The reasons behind underperformance or outperformance in attracting FDI vary depending on the country. However, investors clearly favour certain kinds of investment environment over others, as the next chapter explains.

Chart 3: Global share of gross domestic product and foreign direct investment (%) for China



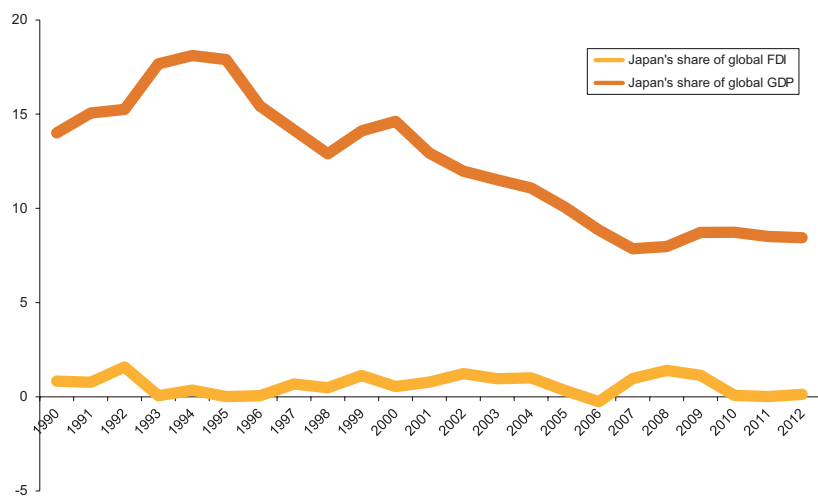
GDP and FDI measured in US\$, at market exchange rates
Source: Economist Intelligence Unit

Chart 4: Global share of gross domestic product and foreign direct investment (%) for the Association of South-east Asian Nations (ASEAN)



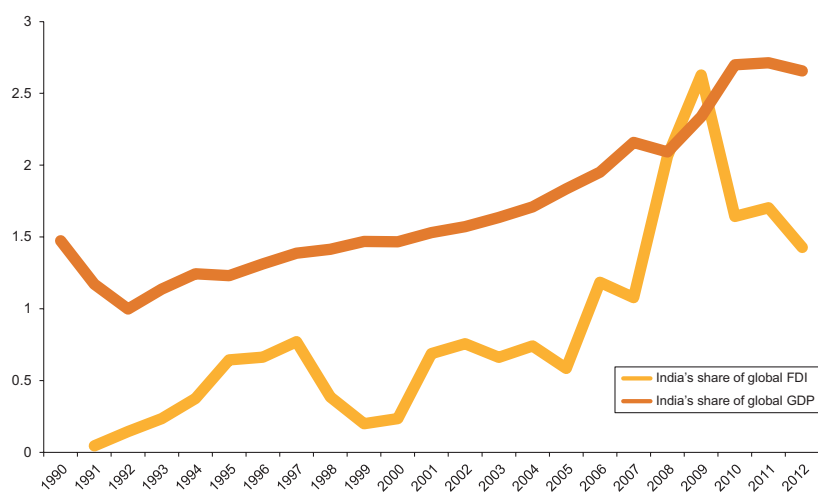
GDP and FDI measured in US\$, at market exchange rates
Source: Economist Intelligence Unit

Chart 5: Global share of gross domestic product and foreign direct investment (%) for Japan



GDP and FDI measured in US\$, at market exchange rates
Source: Economist Intelligence Unit

Chart 6: Global share of gross domestic product and foreign direct investment (%) for India



GDP and FDI measured in US\$, at market exchange rates
Source: Economist Intelligence Unit

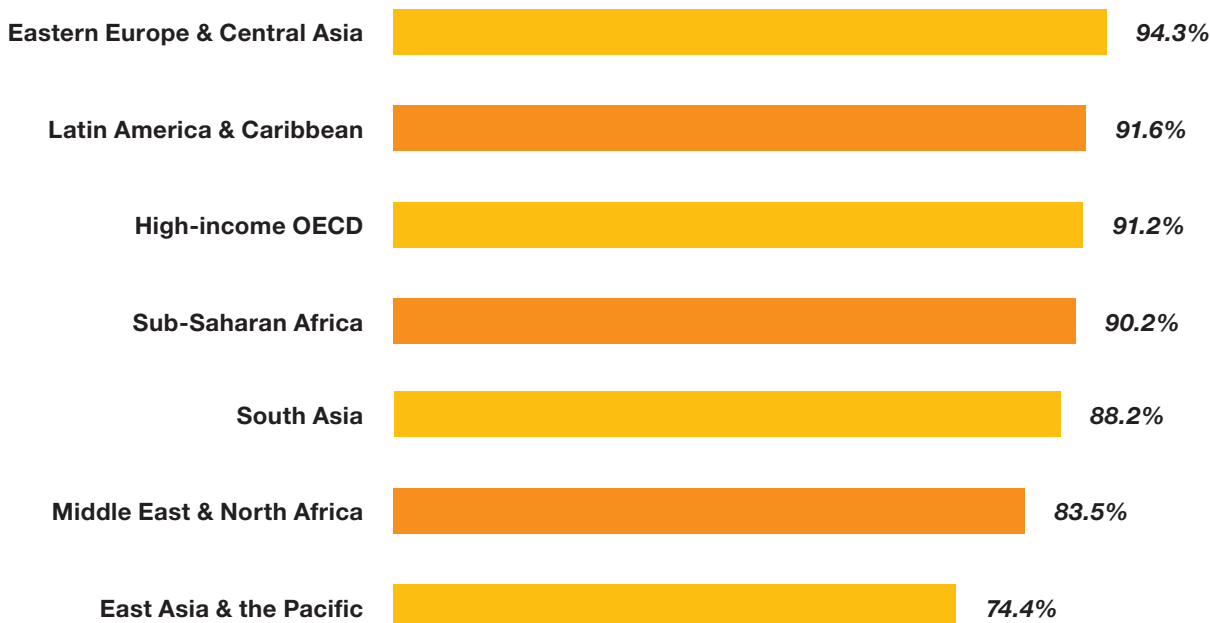
3. Attracting and repelling investors

When a company makes an investment in a new market many factors feed into the decision. Some of these factors are beyond the reach of policymakers. For example, the size of a domestic population, the presence of natural resources and the geographic location are important considerations that governments have little control over.

But many other areas can be addressed. The first barrier that companies face is whether they are even allowed to invest. All countries have some degree of restrictions around foreign ownership of certain industries. However, Asia has much higher foreign restrictions than the rest of the world.


A study by the World Bank looked at 31 different industrial sectors and calculated the average ownership allowed by foreign investors in different countries.³ The nations of East Asia and the Pacific have significantly higher restrictions than everywhere else in the globe. (See chart 7, below.) The same report also shows that 50% of all countries in East Asia require foreign firms to obtain approval before making an investment in light manufacturing. In Latin America and Eastern Europe, by contrast, not a single country requires such approvals.

Chart 7: Average % ownership of companies allowed by foreign investors across 31 sectors



Source: World Bank

³ “Investing across Borders 2010”, World Bank



Assuming that companies are allowed to invest, they then look at many other factors. The quality of macroeconomic management is important. Investors prefer countries with a stable currency, low inflation and steady GDP growth, and they are put off by too much volatility. The political system must be equally stable. Just as important are the supply of workers with the right skills, the presence of good infrastructure, the character of the regulatory environment, the reliability of the legal system and the level of transparency in the market.

“Like most companies, when we think about a location for a new investment, we have a set of screens,” says Greg Slater, global director of trade and competition policy at Intel, a US semiconductor manufacturer. “One of the most important screens is the availability of the right sort of workers. A lot of countries are rejected because the human capital isn’t right.”

At Moog, a US engineering group that makes motors and motion control devices, the most important screen is economic stability. “In order to invest, we have to be sure that the economy is being well managed,” says Lars Rasmussen, the firm’s CEO for the Asia Pacific region. “Our operations in India this year have been hurt by the falling rupee.” (From January to July 2013 the rupee fell by more than 11% against the US dollar.)

Just as important is the protection of intellectual property (IP). “We are in a position where we don’t want to share our IP with anybody,” stresses Mr Rasmussen. “That’s part of the reason why we haven’t invested in manufacturing in China.”

Digging up the playing field and shifting the goal posts

At Continental, a German automotive and tyre group, the company’s truck tyre division has also avoided China, but for different reasons. “When we look for places to invest, we have to feel we can be competitive,” explains Benoit Henry, Asia Pacific CEO of the truck tyre business. “We look for a level playing field for competition.”

In China, Mr Henry feels the playing field does not allow his firm to compete effectively. In part, this is because many of his competitors are state-owned enterprises (SOEs), and as such they operate with different goals and priorities. “For SOEs, their primary goal is to create employment, and tyre manufacturing is very labour-intensive,” explains Mr Henry. “Making profits for them is a secondary consideration, so they charge prices that are hard to compete with, while we are a company that is focused on earning reasonable profits.”

The issue of free and fair competition is not limited only to China. CEOs report that many parts of Asia operate with conditions where local companies have considerable advantages over foreign investors, through both official regulations and unofficial arrangements of patronage, cronyism and discrimination. While such conditions support local companies in the short run, they are likely to harm a country and its economic development in the long run by promoting inefficiency.

In some cases, the lack of a level playing field takes on a different character, whereby companies are forced to invest if they want to do business. “Some countries in Asia are creating conditionality around market access based on locating investment in those countries,” notes Mr Slater at Intel. “This is not sensible. It’s not good policy to force companies to invest. It’s much better to attract them to invest.”

Ruing rules and bemoaning bureaucracy

Gripes around bureaucracy and regulation are also commonplace among CEOs. If business rules are too onerous or unclear, if paying taxes is too complicated, and if governments create unnecessary licensing procedures and paperwork, then businesses are less likely to invest.

One frustrating form of bureaucracy for many companies comes from restrictions around what activities they are able to engage in. Companies that sell industrial equipment, for example, often want to provide financial services to their clients but are prevented from doing so because these activities are considered the preserve of banks.

DHL Supply Chain, a German-owned logistics business, has encountered these issues in Indonesia with some of its pharmaceutical clients. As well as shipping drugs into the country for these customers, and storing them in its warehouses, DHL wants to provide other services such as repackaging the drugs with local labels and distributing them to pharmacies. However, activities such as these are considered the domain of drug manufacturers, which requires a different set of operating licenses and requirements for DHL.

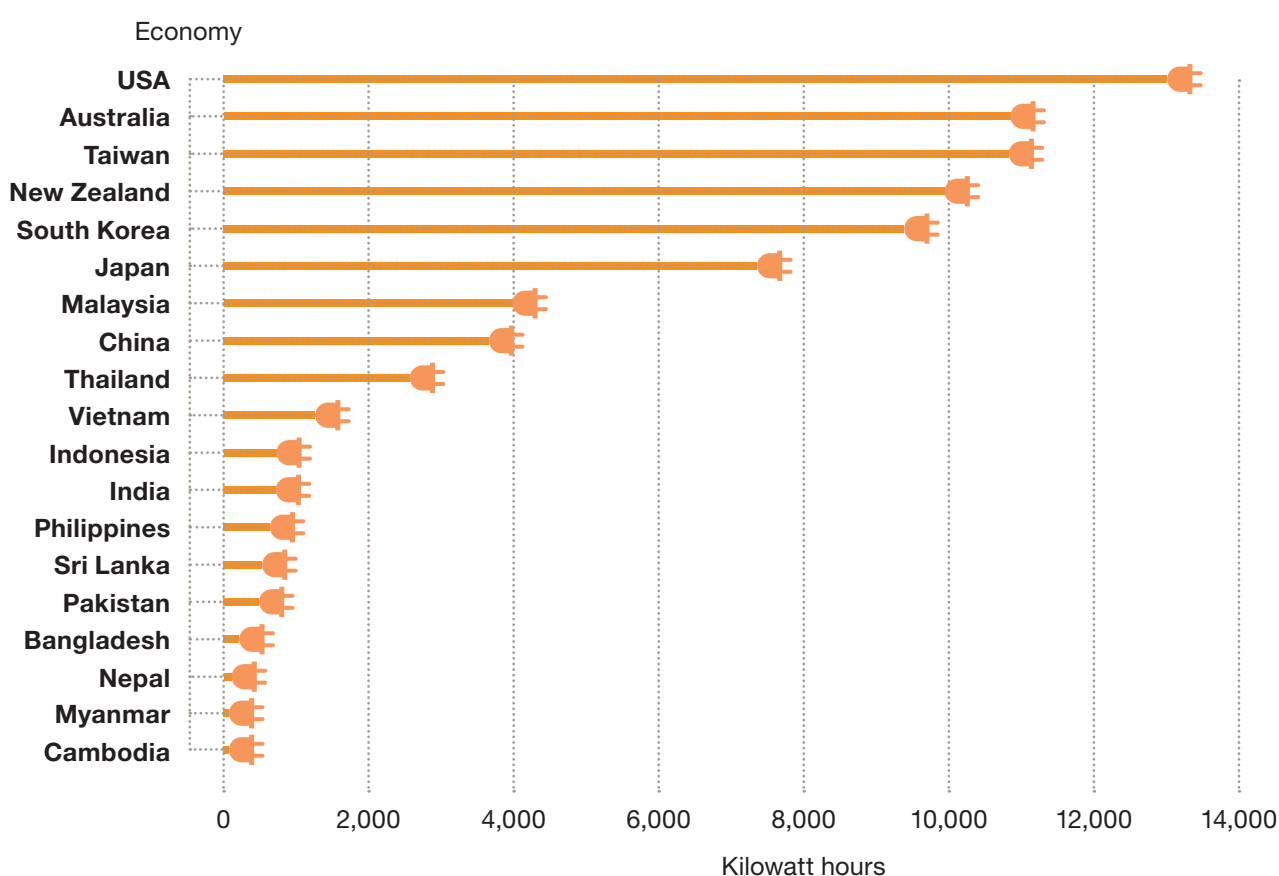
“The authorities have very rigid definitions of what sectors companies can operate in and sometimes that prevents us from providing some of the services that we would like to offer,” says Paul Graham, CEO for the Asia Pacific, Middle East and Africa at DHL Supply Chain.

4. Infrastructure frustrations

Of all the different types of business investment, arguably the most important is money that goes into infrastructure. Power, transport, communications, water and sanitation are the foundations upon which an economy grows. Unless these crucial elements are in place, countries are unlikely to attract any other types of investment – there is no point building a factory in a country that has no electricity to power the machines or no roads to transport the goods.

And yet, despite the self-evident importance of infrastructure, the Asia-Pacific region has been seriously under-investing in these assets. Economic growth has been running at a faster speed than new investment in infrastructure, and many parts of emerging Asia now struggle with gridlocked roads, clogged ports, unreliable power, and unsafe water. Comparing levels of infrastructure across the region shows how far behind many countries are. (See charts 8, 9, 10, and 11, below.)

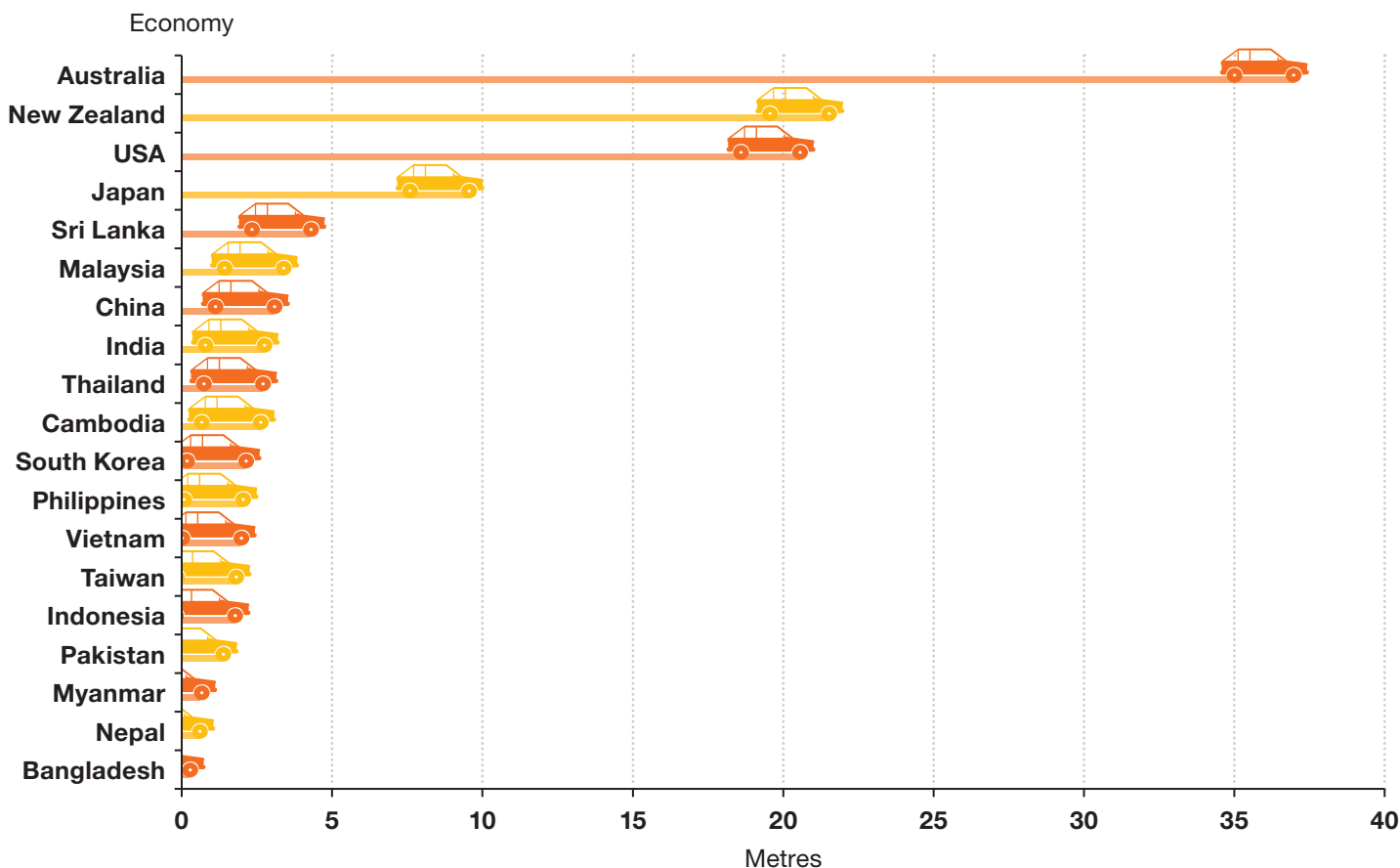
Chart 8: Electricity production per capital (in kilowatt hours)



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Data is for latest available year

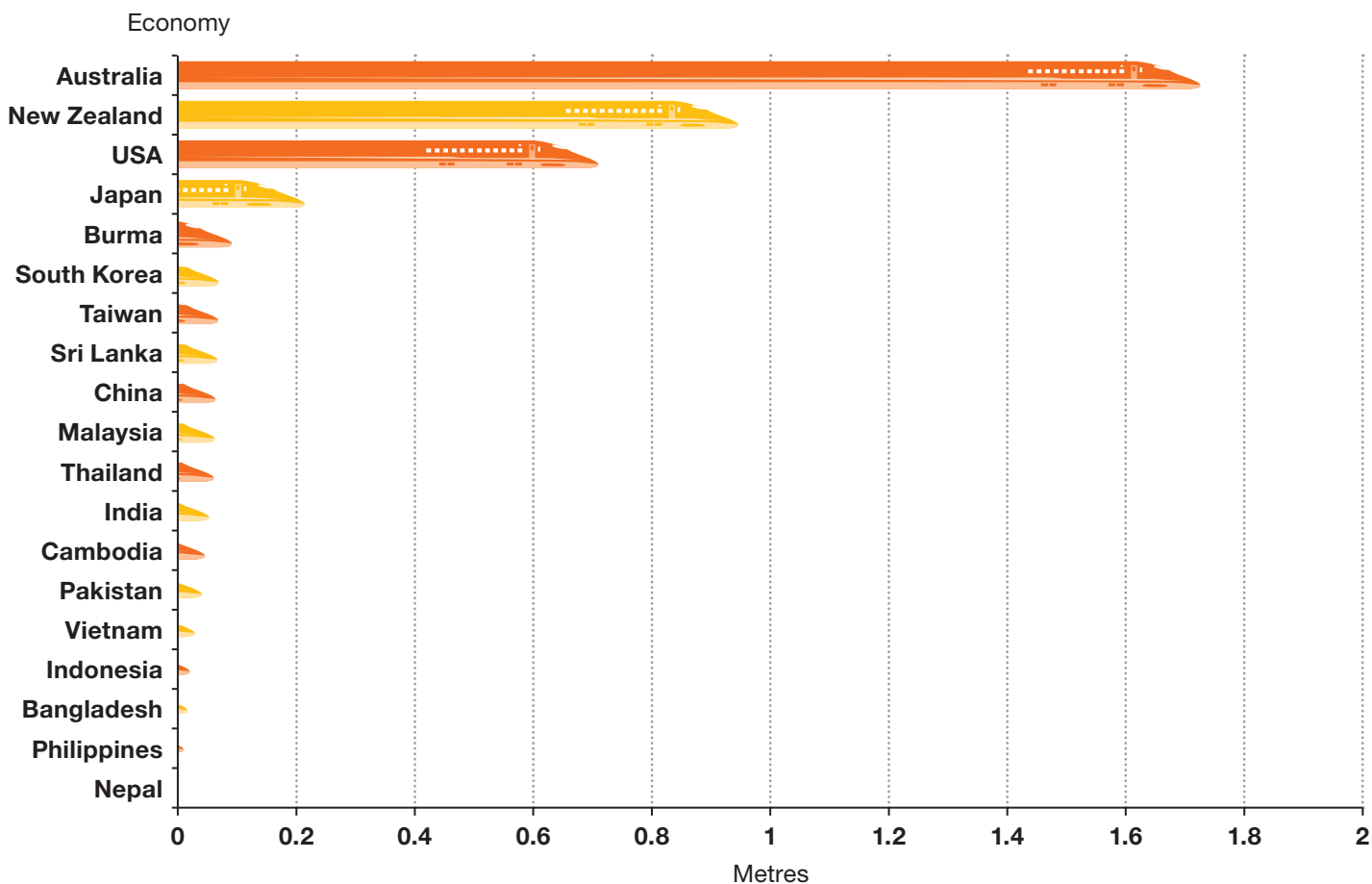
Source: Economist Intelligence Unit & CIA World Factbook

Chart 9: Road per capita (in metres)



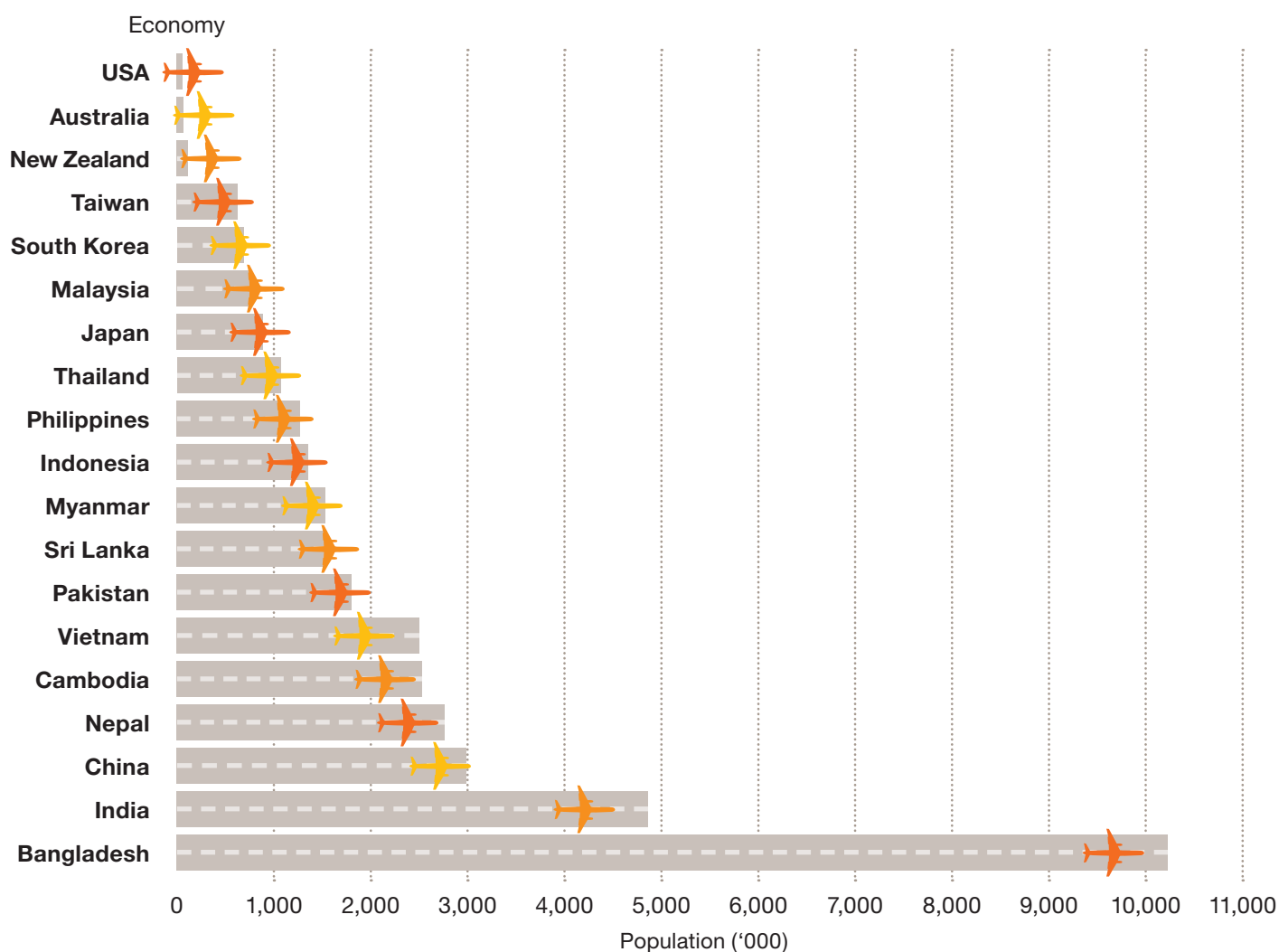
Source: Economist Intelligence Unit & CIA World Factbook

Chart 10: Metres of railway per capita



Source: Economist Intelligence Unit & CIA World Factbook

Chart 11: Population per airport with a paved runway



Source: Economist Intelligence Unit & CIA World Factbook

While these issues are most serious in the emerging economies of Asia, the developed economies have their own issues too. In Japan, for example, rebuilding infrastructure after the Fukushima earthquake and tsunami in 2011 will cost around US\$200bn. And given the country's reluctance to rely so heavily on nuclear power in the aftermath of the disaster, even more investment will be needed in building new sources of electricity. More generally, Japan built much of its infrastructure during the 1960s and '70s, and these assets are starting to age and need upgrading.

The Asia Development Bank estimates that the region needs to invest between US\$8trn and US\$9trn in infrastructure between 2010 and 2020. This is the amount of investment needed to keep the region's economies growing at current rates. If this investment doesn't materialise, the region will not be able to grow so quickly, thereby slowing the rate at which incomes rise.

"Infrastructure is the elephant in the room in Asia," says Francis Yeoh, group MD of YTL, a Malaysian conglomerate with interests ranging from cement and construction to power, water and hotels. "In Asia, we need infrastructure to drive our economic growth, but governments are not doing anything to create the conditions that will encourage the investment we need."

Indeed, looking at the level of investment going into infrastructure, it's clear that many parts of Asia are seriously under-investing. At a global level, investment in infrastructure is equal to 3.8% of GDP.⁴ Some countries in Asia are investing at a higher rate than this, for example Vietnam, where infrastructure investment is equal to 10% of GDP⁵, and China, where it comes to 8.5% of GDP.⁶ However, many other parts of the region are investing at a much lower rate than the global average. In Indonesia, infrastructure investment is equal to just 3.2% of GDP.⁷ In the Philippines it comes to 2.7% of GDP.⁸ Given that these are emerging economies with giant infrastructure needs, these rates of investment are much too low.

⁴ McKinsey Global Institute

⁵ World Bank

⁶ McKinsey Global Institute

⁷ World Bank

⁸ World Bank

City capital

So why are Asian economies under-investing in infrastructure? Might it be a lack of capital? Typically, governments are the largest contributors to infrastructure investment around the world. In Asia, some governments do face fiscal constraints and lack the money to invest in infrastructure, notably the lower-income countries such as Indonesia, India, the Philippines, Cambodia, Myanmar, and Laos. However, while public-sector capital may be limited in some places, private-sector capital is certainly not constrained.

“There is a huge amount of capital in the market,” observes Johan Bastin, CEO of CapAsia, a Singapore-based fund manager looking to invest in infrastructure projects in Asia. As well as funds such as Mr Bastin’s, private sector sources of capital also include pension funds, private equity groups and banks, as well as operators and constructors of infrastructure themselves. “In some markets there are issues on debt financing for infrastructure because you can’t get long-enough maturities,” adds Mr Bastin, “but this is improving.”

Clearly, while public capital may be constrained in certain countries in Asia, private capital is readily available. So what is holding back private investors? Why is business so hesitant to get involved in Asia’s infrastructure opportunities?

One of the primary concerns among investors is a lack of trust in the regulatory and legal regimes in many countries. At present, the frameworks that govern infrastructure are obscure, unreliable, difficult to navigate and constantly changing. As such, investors do not have confidence that their investments will be safe and well-governed over long time horizons.

“There is nothing more local than infrastructure,” observes Mr Bastin. “Because everything is local, you need to have trust in the government and trust in the economy and the market that things won’t go wrong.” Whereas a manufacturer might be able to unplug its machines and move to a new country with relative ease, the owner of a port or a railway has no such option.

In addition to weak regulatory and legal environments, investors cite many other barriers to investment. Infrastructure projects in Asia are often poorly prepared, with insufficient feasibility studies, which in turn leads to unviable commercial terms being offered to investors. Often the risk allocation between the public sector and the private sector is inequitable. For example, governments sometimes expect the private sector to acquire the land needed for an infrastructure project, when this is almost always best done by governments, especially for investments in roads and railways.

It would be simple enough to address this issue if governments were to look at what is best practice for allocating risk in other markets and then structure their own projects along similar lines. However, certain adjustments would still be needed in terms of the risk/reward profile of these projects. The weaker regulatory and legal environment in many emerging markets makes them inherently more risky than similar opportunities

in more developed markets. As such, governments must recognise the need to shoulder a higher level of risk, and perhaps also recognise the need to boost potential returns through subsidies, in order to attract global capital.

Building bridges to investors so investors can build bridges

“What we need in Asia is coherence and transparency. We need a coherent regulatory regime for infrastructure and transparent processes,” says Dr Yeoh at YTL. “Countries like the UK, Australia and Singapore have world-class regulatory regimes. Everyone competes on a level playing field, with guaranteed prices and fair returns for owners and operators of infrastructure, and guaranteed service levels for consumers and users of infrastructure. The regulations are perfectly transparent. There is certainty and clarity, which is what investors are looking for.”

In contrast, notes Dr Yeoh, some countries in Asia are plagued with cronyism, corruption and nepotism. “Infrastructure does get built, but the process is slow and inefficient, there is little competition, and the costs [of building infrastructure] are much higher,” he says.

Dr Yeoh, and other investors like him, have a wishlist of things they would like to see improved. For a start, they believe regulators of infrastructure must be truly independent of politics. At present, they argue, regulators often come and go whenever there is a new election, which means the regulators can’t be relied upon.

Investors call for a deepening of the capabilities of government departments to procure infrastructure. At present, projects are put in front of investors with little or no preparation, such as commissioning feasibility studies or analysing what sort of prices users will pay to use the infrastructure, and whether or not government subsidies are needed to make the projects viable.

Investors want to see more transparency around bidding for infrastructure projects, with clear processes and well-defined steps. They want more certainty around how infrastructure projects will be governed, such as the frequency and character of pricing reviews by the regulator. An important part of this certainty is the use of standardised legal contracts, which is common practice in mature infrastructure markets, but not yet the case in much of Asia. Investors also want a level playing field, where local and foreign capital are treated equally and the opportunities for corruption are removed.

Many investors also believe that governments must be prepared to offer longer concessions for infrastructure projects. Because incomes in many parts of Asia are low the prices charged to users are also low, which means it can take a long time to earn a proper return on an investment. At present, the length of infrastructure concessions is often too short to earn a decent return.

5. Noodle bowl indigestion

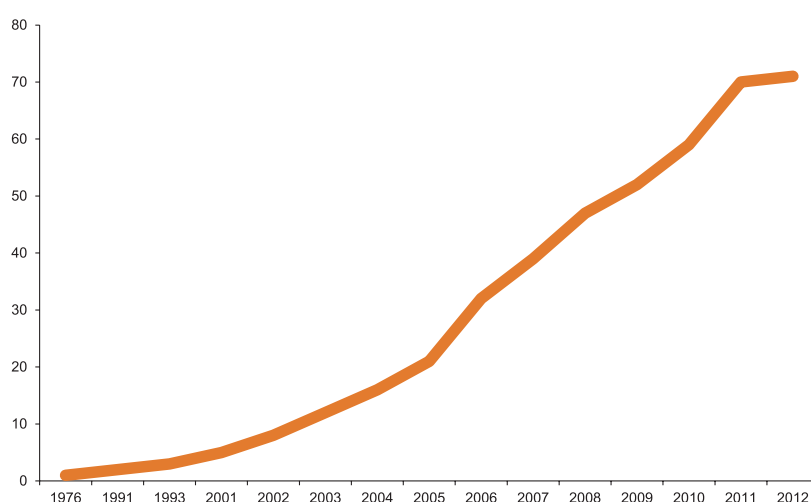
Cross-border investment is tightly linked with cross-border trade of goods and services. Over the past five decades the value of cross-border trade around the world has risen sharply, fuelled by progress in reducing barriers to international business. Between 1950 and 2010 the volume of global trade grew by an average of 6% a year, nearly twice the rate of GDP growth.

Much of this progress was achieved on a multilateral basis under the General Agreement on Tariffs & Trade (GATT), which ran from 1947 to 1994, and then from 1995 under the World Trade Organisation (WTO), which replaced GATT. However, while these multilateral agreements achieved a great deal at first, progress more recently has ground to a halt. With 159 member countries in the WTO, all with their own vested interests, countries have found trying to negotiate a new trading landscape to be cumbersome, unwieldy and increasingly impossible.

And yet, countries recognise the benefits that come from pursuing free trade and the opportunities it creates for attracting foreign investment. As such, many nations have turned away from multilateral trade negotiations and have focused instead on arrangements that are easier to set up, notably bilateral trade deals between two countries, or else regional deals between a handful of neighbours.

Asia has responded eagerly to this new trade landscape. In 2001 the region had set up only five free trade agreements (FTAs), including the ASEAN Free Trade Area, which was established in 1991. However, by 2012 that number had risen to 71. (See chart 12, below.) A further 84 FTAs are in negotiation by Asian nations.⁹

Chart 12: Number of concluded free trade agreements in Asia, 1976 to 2012



Source: East-West Center

⁹ Patterns of Free Trade Areas in Asia, Masahiro Kawai and Ganeshan Wignaraja, East-West Center, 2013

While these smaller-scale trade deals undoubtedly reduce the barriers to cross-border investment, they also create headaches. One of the biggest issues is complexity. When countries operate with one global set of trade rules, understanding them is relatively easy. But when a picture emerges like that in Asia, often dubbed “a noodle bowl”, then many firms, especially smaller ones, struggle to understand what is allowed and how they should respond.

“The proliferation of trade deals makes it difficult for companies to keep up with what is going on,” says Mr Graham at DHL Supply Chain. “We need a real commitment to harmonise trade agreements at an APAC level, but progress doesn’t seem to be happening fast enough.”

Given that costs are rising rapidly in Asia, especially those for labour, Mr Graham believes that reducing the friction of cross-border trade is one way that Asia can stay competitive against emerging centres of manufacturing in other places such as Africa. Friction comes not only from trade barriers and the complexity of trade agreements, but also from inefficient customs.

“Customs procedures are still challenging in much of Asia and are hampering regional connectivity,” notes Mr Graham. “Even shipping goods from Malaysia to Singapore can take 14 hours to clear customs for a 20-minute drive.” Elsewhere in the region, Mr Graham notes that customs documentation is still highly bureaucratic and paper-based. “The processes involved in shipping goods across borders open up opportunities for middle men to get involved, which adds cost and complexity.”

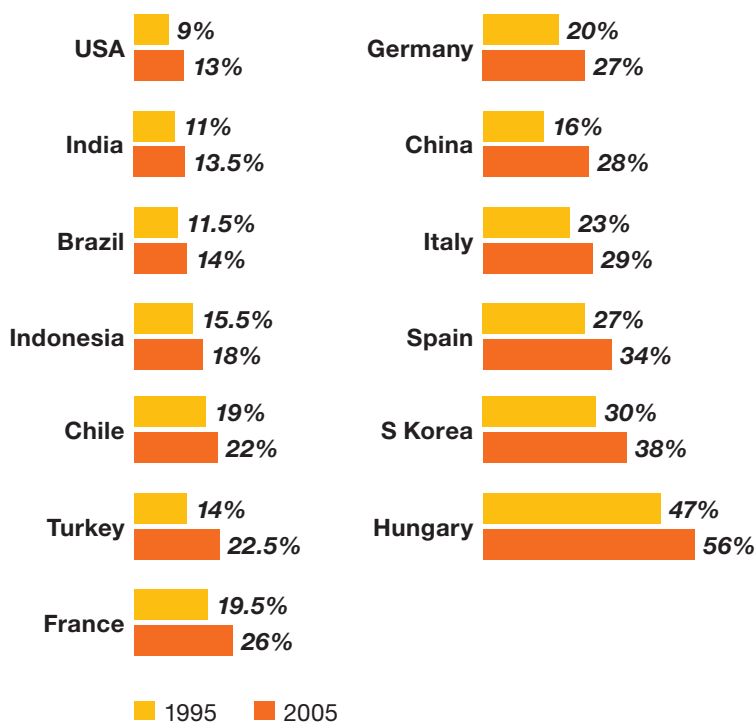
Cross-border? Furious-border?

The proliferation of trade deals isn’t the only issue that CEOs find frustrating. Just as significant is the fact that many of the FTAs being negotiated today are backward-looking and designed for an obsolete model of business. In particular, they fail to recognise the dramatic fragmentation of supply chains in recent decades.

In the past, manufacturing of a particular product was largely done from start to finish in just one country, with the finished products then shipped across borders. Free-trade deals were designed around this view of manufacturing and concentrated on the treatment of finished goods.

But these days, thanks to improvements in information and communications technologies, manufacturing processes have been broken up into ever smaller, more discrete parts, with each individual process in the manufacturing chain located in the country where it can be done most cost-effectively. The result is that the share of finished goods in cross-border trade has fallen markedly, whereas the share of parts and components has risen sharply. (See chart 13, below.)

Chart 13: The import content of exports (%)



Source: World Economic Forum

The old generation of FTAs is not equipped to deal with this new situation. For a start, components might flow across multiple borders during the manufacturing chain before they reach their final market. While tariffs have come down sharply over the past few years, they still add up if incurred every time a part crosses a border during the production process. Another issue concerns so-called “rules of origin” (ROO). These are the regulations that govern where a product was made, and thereby whether it is subject to tariffs, quotas and the like. Given that products these days are made from parts sourced from all over the globe, understanding and interpreting ROO has become extremely challenging.

Losing the service game

Another issue that needs addressing with FTAs is the cross-border provision of services. Most trade deals today are heavily focused on products and tend to ignore services. Yet services make up an ever growing piece of the global economy. In high-income countries, services account for 73% of GDP; in middle-income countries, they make up 53% of the economy; and in low-income countries they represent 45% of economic activity.¹⁰ As countries in Asia get richer, they will find the need to liberalise services ever more pressing.

This is especially true given that services are increasingly tradeable across borders. Thanks to new IT and communication technologies, companies can increasingly set up global value chains in services industries. Product design, logistics services, finance, telecommunications, business process outsourcing, IT system management and many other types of activity are being organised on an international basis. Unless countries start to open their borders to cross-border service provision, they risk losing out on a growing flow of investment dollars that is building these global service industries.

One of the barriers standing in the way of cross-border services (and hence blocking cross-border business investment) are rules around data flows, and what sort of information is permitted to be sent from one country to another. “Most FTAs today do not have robust e-commerce provisions,” notes Mr Slater at Intel.

His company, for example, has 10,000 suppliers and hundreds of customers all over the globe, not to mention countless internal divisions within Intel itself. All these various entities need to communicate with each other, sending contracts, orders and information that are the lifeblood of the company.

“Cross-border data flows are critical to any global company these days. We want to be able to run our company on a truly global basis without having to incur taxes on the goods and services that make up our value chain, or having to put certain functions in certain places,” says Mr Slater. “We need trade deals that address issues such as trade-secret protection, encryption and cross-border data flows. We need trade deals that keep pace with the changing character of globalisation and the changing character of technology.”

One ray of light, he adds, could be the Trans Pacific Partnership, a trade deal being negotiated between 12 countries around the Pacific Ocean, including the United States. The TPP, argues Mr Slater, is a truly forward-looking trade deal that promises to address many of the shortcomings of current FTAs. That’s good news for business. But unless and until other governments can adopt a similar approach they will be restricting the ability of companies to invest in the best way possible.

¹⁰ “Investing across Borders 2010”, World Bank

6. Conclusion

No country has the perfect investment conditions. Companies will always find something that could be improved. But when it comes to attracting business investment, many countries in Asia are still not getting even the basics right, like providing reliable electricity, let alone tackling harder issues such as crafting trade rules for cross-border e-commerce.

Perhaps some parts of the region feel that they do not need to try. After all, Asia is the fastest-growing part of the global economy. Global businesses want to be in the region to position themselves for rising wealth and opportunity. Perhaps some countries feel that businesses will invest come what may.

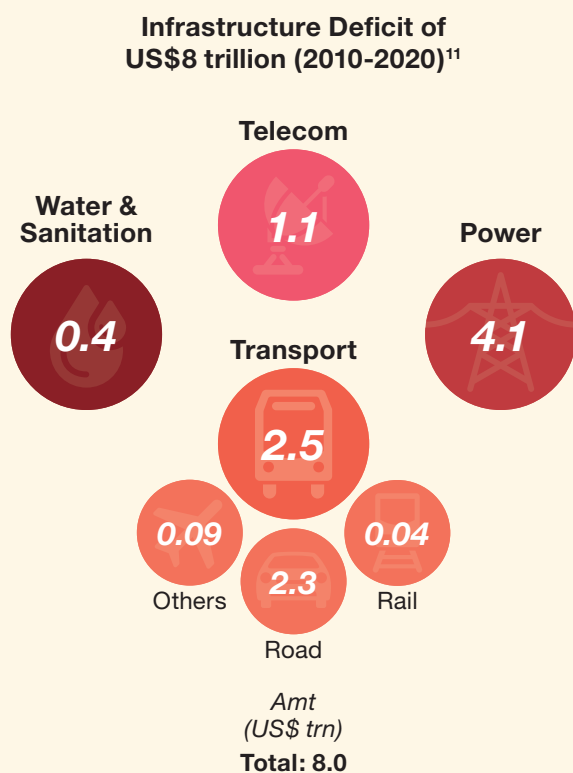
But such a view would be mistaken, for Asia's future will certainly be more challenging than its recent past. Regional growth in the 2000s was driven by strong demand for Asia's exports in Europe and the US, where consumer spending was fuelled by rising debt. Following the financial crisis, that debt-engine in the West has stalled and Asia has relied much more on domestic demand for its growth. And yet, much of the domestic demand within Asia has also been fuelled by debt. Some of the debt has grown up on the back of hot capital inflows from the West where central banks have been flooding their economies with cheap money. But more significantly, Asia itself has been running loose monetary policy, especially in China.

These ultra-supportive conditions are unlikely to last – either in the West or in Asia – and the region will have to work harder for its growth in future. The competition to attract business investment will increase – both regionally and globally. Those countries that can compete most effectively in attracting investment will have the greatest protection against an uncertain future.

The PwC Perspective:

The governments of emerging economies across Asia need to recognise that each is competing with the other for necessary capital (financial and human) from the private sector. This capital will flow to the projects and markets that are most attractive to the investor – risk profile, return, ease of doing business, security of investment.

The graphic below illustrates the extent of infrastructure needs across Asia. It also highlights the sources of potential capital available for investment and the barriers inhibiting this investment from flowing into critical infrastructure.



Investment Barrier

- Poor project preparation
- Legal & regulatory framework
- Poorly defined and unstructured procurement processes
- Haphazard pipeline management
- Risk allocation and commercial structure
- Lack of institutional capacity
- Imbalance between risk and reward
- Election cycles
- Planning and investment horizons
- FTA frameworks
- Lack of effective co-ordination across government ministries/agencies
- Lack of investment subsidy in certain jurisdictions

Supply of Capital

- Government
- Multi-laterals
- Commercial banks
- Private sector
 - Infrastructure funds
 - Pension funds
 - Strategic investors
 - Constructors
 - Operators
- Others (eg export credit agencies)

As a starting point, regional governments need to address the basic barriers to investment that are highlighted within this paper. Spending more time and attention affecting pragmatic change to legal and regulatory frameworks, preparing implementable projects and recognising the need to structure commercially viable opportunities will allow an easier flow of much needed capital into Asia's weak infrastructure stock.

In parallel, governments should seek to implement broader policy initiatives that will improve the attractiveness of an economy to investors:

- Harmonisation of free trade agreements with a shift towards multilateral agreements and away from bilateral agreements. In conjunction with this, existing agreements should be updated to better reflect the contribution of services to GDP growth;
- Incentivise and prioritise the development of foundational infrastructure (roads, railways, utilities, airports, etc) which will unlock and spur growth in other sectors of the economy; and
- Strengthen efforts to unlock private sector capital and channel this towards the development of critical economic infrastructure. Governments can do this by working to develop and facilitate financial products that are suited to investment in long-term infrastructure assets.

The actions required by governments in Asia to tackle the infrastructure deficits that they face can seem insurmountable and indeed are, without doubt, significant. However, with clear and committed policymaking, governments will be able to develop a track record of successful project implementation. These efforts can only help to build traction among private sector financiers, and create the conditions necessary to reducing critical infrastructure deficits and spur faster growth in the wider economy.

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¹¹ Adapted from ADB/ADB (2009) and Bhattacharyay (2010)

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HK-20130801-3