THE ADVISORY GROUP ON APEC FINANCIAL SYSTEM CAPACITY-BUILDING

A Public-Private Sector Initiative

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Meeting Paper 4-B
Asia Pacific Infrastructure Partnership (APIP) Dialogue with the Government of the Kingdom of Thailand

22 February 2013, Bangkok, Thailand

Office of the Advisory Group Chair

PURPOSE For information.

ISSUE Report of the APIP Dialogue with the Government of Thailand

BACKGROUND This dialogue was hosted by the Government of the Kingdom of Thailand on 22 February 2013 at the Ministry of Finance in Bangkok. It was preceded by a preparatory meeting of the APIP panel sponsored by the Thai Bankers' Association. The dialogue was attended by key senior officials from the Thai Government led by Deputy Prime Minister and Minister of Finance Kittiratt Na-Ranong, experts from multilateral development institutions and members of the APIP private sector panel.

PROPOSAL N.A.

DECISION POINT Note the report of the dialogue.

Asia-Pacific Economic Cooperation

ABAC

Asia Pacific Infrastructure Partnership (APIP) Dialogue with the Government of the Kingdom of Thailand

22 February 2013 * 3:00 pm – 5:30 pm
Ministry of Finance, Bangkok, Thailand

CONFERENCE REPORT

BACKGROUND

In 2010, the APEC Business Advisory Council (ABAC) proposed a regional structure to enable governments and the private sector to frankly and objectively discuss complex matters related to infrastructure finance and enhance understanding of the issues and risks they face. This structure, the Asia-Pacific Infrastructure Partnership (APIP), would involve key officials, experts from multilateral development banks, and senior private sector infrastructure experts and practitioners. The APEC Finance Ministers endorsed this proposal at their meeting in Honolulu in 2011. A number of dialogues have been held with various governments – the governments of Mexico and Peru on 24 August 2011 in Lima, the Philippine Government on 5 October 2011 and on 23 January 2013 in Manila, the Vietnamese Government on 20 July 2012 in Hanoi and the Indonesian Government on 22 October 2012 in Jakarta.

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As in previous ones, this dialogue was designed to help address the problem of information asymmetry between public and private sectors. This problem is seen as posing a challenge to closing the gap between the public sector's priorities and aspirations, on the one hand, and the constraints on the private sector's engagement in infrastructure finance, on the other. Through private, frank and open discussions, the dialogue sought to bring these issues to light and to help both the public and private sectors to effectively deal with them while enhancing their collaboration.

INTRODUCTION

Thailand is an important market in the region, given its large population, economic position (the 2nd largest economy in ASEAN), strategic geographical location and history of rapid economic development. The government has declared its intention to focus on further promoting inclusive and sustainable growth and competitiveness. In line with this objective, the government is moving to reduce the corporate income tax and provide tax incentives for companies establishing their regional operating headquarters in Thailand, and to seek legal reforms to improve public sector governance.

Infrastructure is an important pillar of Thailand's development strategy. The ADB Institute estimates Thailand's infrastructure investment needs for the period 2010-2020 at US$172.9 billion, of which 72 percent will be for new capacity.[1] With 99 percent of households having access to electricity supply, Thailand has a well-developed energy infrastructure, and ranks relatively high in global competitiveness rankings with respect to sea and air transport infrastructure.[2] Much still needs to be done in the land transportation sector, particularly the economy's road and rail network, as well as in the communication sector.[3]

Consequently, the government plans to devote around 65 percent of its US$72.1 billion budget for improvement of basic infrastructure for the period 2012-2020 to land transportation.[4] Thailand's plans for developing land transport infrastructure focus on road, rail and mass transit networks connecting major cities and economic zones. The government is also pursuing the expansion of connectivity with other economies within the Greater Mekong Sub-region (GMS) through the development of border areas to serve as economic gateways to these neighboring economies, expansion of its major air and sea ports and collaboration on key developments projects.

In the energy sector, Thailand plans to allocate 22 percent of this total budget to seeking and developing new sources of energy, particularly in collaboration with Myanmar. Other plans focus on providing high-speed internet services to cover the whole territory and the development of the Government Information Network, as well as the expansion of the water supply in rural areas and economic zones and waste water management.

CREATING AN ENVIRONMENT FOR EXPANDED INFRASTRUCTURE PPP

To achieve these goals, the government needs to address a number of challenges. For many years now, the government has been able to allocate less than a quarter of its annual budgets to long-term investment. For the current year, only 18.7 percent of the total budget is allocated to investment. With a public debt to GDP ratio of 43.9 percent, Thailand is looking to raise more financing for infrastructure from the private sector. The following describes the key challenges and steps being undertaken to provide a favorable environment for greater private sector involvement in Public-Private Partnerships (PPPs).

1. Reform of the PPP legal framework

A new PPP law (the Private Investment in State Undertaking or PISU Bill) which was in the process of being finalized at the time of the dialogue, once enacted, will replace the existing law (Private Participation in State Undertaking Act B.E. 2535 or PPSU), which has been in effect since 1992.[5] Thailand was the first economy in the region to introduce a PPP law, but it now needs to be updated. The PPSU involves a lengthy consideration process that could prolong the

[1] Biswa Nath Bhattacharyay, ***Estimating Demand for Infrastructure in Energy, Transport, Telecommunications, Water and Sanitation in Asia and the Pacific: 2010-2020*** [ADBI Working Paper No. 248], September 2010, p. 12.

[2] Laem Chabang Port was ranked 19th by the Review of Maritime Transport 2007 and the air transport infrastructure quality was ranked 26th by the WEF Global Competitiveness Report 2009-2010.

[3] The IMD World Competitiveness Yearbook 2010 ranked Thailand 43rd and 42nd among 133 economies in terms of road and rail density, respectively.

[4] Data from the National Economic and Social Development Board, Thailand.

[5] The bill was approved by the Cabinet on 3 May 2010, approved by the House of Representatives with amendments by the Senate on 31 January and submitted to His Majesty the King for signature on 4 February.

initiation of a PPP project to as much as two years. It does not provide sufficiently clear definitions, robust governing arrangements and provisions for amendment and renewal of agreements.

The PISU bill represents a significant improvement over the PPSU Act in that it will provide clearer directions, a more robust institutional structure, streamlined procedures, a clearer time frame and stronger public sector support for projects. Its development was guided by three principles: standardization, facilitation and transparency. Key features are:

- *PPP Master Plan (Strategic Plan on Private Investment in State Undertaking)*: This 5-year plan is intended to identify, prioritize, synchronize and coordinate medium-term projects from all relevant ministries to help avoid overspending and strengthen coordination. It is also intended to be a key instrument of the government in more effectively formulating its fiscal budget and strategic investment plans and in providing information to potential investors about investment opportunities. Minimum components of the Master Plan include (a) investment policies governing public undertakings and the categories and types of undertakings appropriate for private investment; (b) objectives for private investment and the operational timeframe; (c) investment forecasts for both public and private sectors; and (d) prioritization and sequencing of undertakings that are appropriate for private investment.
- *PPP Policy Committee (Committee on Private Investment in State Undertaking) and Secretariat*: The committee is a body intended to promote consistency and comprehensiveness in setting the direction and priorities for PPP and Thailand's development. Key mandates of the Committee include preparation of the PPP Master Plan, approval of PPP project principles, proposing financial measures or PPP guidelines to the Cabinet, approval of non-bidding procedures, defining criteria for PPP projects with valuation under the legal threshold and issuance of rulings and interpretations of the PISU Act. It includes 17 members[6] and is chaired by the Prime Minister. The Director-General of the State Enterprise Policy Office (SEPO), who is an ex-officio member, is the Secretary of the Committee, with SEPO serving as the secretariat and central PPP agency.
- *Streamlined procedures*: A project needs to be submitted to the Cabinet in only one stage, instead of two as in the previous law. The PPP Policy Committee undertakes the project principle approval, thus reducing the workload of the Cabinet.
- *Clear time frame for project consideration*: Time limits are set for each stage of the project consideration process, with a maximum 210 days for qualified projects.
- *Standard contract terms and guidelines on post-contract management of projects*: These will be developed to ensure project continuity and enhance confidence of both the public and private sectors.
- *More flexible provision for project valuation*: This will introduce greater managerial flexibility compared to current arrangements where the investment value threshold is set at THB 1 billion. Instead of setting the threshold through promulgation of a royal decree, it will be set through ministerial regulations together with a guideline governing projects valued below the threshold.
- *Project Development Fund (PDF)*: This will be a financial facility to support the formulation of the PPP Master Plan and assist project agencies in the development of project proposals compatible with the Plan, including the hiring of advisors for feasibility studies and the

[6] These include – aside from the Prime Minister (Chair), Finance Minister (Vice-Chair) and the Director General of SEPO – the Permanent Secretary of the Ministry of Finance, the Secretary General of the Council of State, the Secretary General of the National Economic and Social Development Board, the Directors General of the Budget Bureau, Comptrollers' General Department and the Public Debt Management Office, the Attorney General and 7 expert members appointed by the Cabinet.

drafting of contracts. The PDF is designed to be a sustainable revolving facility, with initial funding sourced from the government budget and subsequent revenues derived from document, evaluation and signature fees to be paid by project agencies, in addition to subsidies or annual appropriations.

- *Improved transparency and integrity of the process*: Among the key measures are the establishment of a pool of pre-screened experts for the Selection and Monitoring Committees, the prohibition of members of these and the PPP committees from serving private contracting parties after their terms in office, the formulation of disqualification criteria for advisors and contractors and the establishment of a PPP project database incorporating ongoing projects initiated under both the previous and the new PPP laws.

Market participants and observers see the new PPP law as a milestone and a major improvement that will make it more attractive for the private sector to participate in PPP projects. Sound and effective implementation of this law is seen as taking Thailand to the next level of its infrastructure development.

2. Effectively allocating risks between public and private sectors

An important element of successful PPP projects is finding a suitable allocation of risks between the public and private sectors. There is no single formula for risk allocation, and risks vary depending on the economic sector, the size of the project, the project cycle, the business model used and the number of parties that are involved. For example, project risks typically increase during the construction phase where construction and financial risks are dominant considerations, peak during start-up as delay, refinancing and traffic risks increase, and decrease substantially through the operation phase.

A deeper understanding of which risks the different parties can more effectively manage, allocating each risk to the party best suited to manage or minimize it, and defining this clearly in agreements can help government attract more private sector participation in infrastructure project. In certain PPP projects, for example, design, construction, performance, operation and management risks may be allocated to the private sector, while demand, off-taker and legislative/regulatory risks would be taken by the public sector and risks arising from interest and currency fluctuations, pricing structure and unforeseen events could be shared by both.

The government could consider different risk allocations for different stages of market development for infrastructure projects, where it takes certain risks, e.g., demand and off-taker risks, where there is a strong social element that may make it difficult to charge market tariffs, during the early stages of market development or in the case of pioneer projects, to attract private sector participation. Government can reduce its role over time as the market develops, more successful projects emerge and the private sector feels more comfortable in assuming these risks.

With respect to projects that are not yet bankable, viability gap financing (VGF) can provide a very transparent way for government to enable private sector participation, particularly by providing the additional support that can make a project bankable. The new law is neutral with respect to this and does not have a specific provision for VGF, but the government is open to the possibility of its introduction, if proposed by the PPP Policy Committee. Multilateral agencies are willing to work with the government in moving forward with VGF and a guarantee fund.

3. Building strong and credible public institutions

The power sector in Thailand has been successful in developing well-executed PPP projects and is a model case for other emerging economies. Key to this success has been the credibility of the Electricity Generating Authority of Thailand (EGAT), the public enterprise in charge of electricity generation. Strong and clear government support for EGAT enacted into law provides a stable environment for projects to be developed. Its creditworthiness has facilitated the engagement of commercial banks and export credit agencies to provide financing. The currency composition of the tariff structure (half in local currency and half in US dollars) provides a natural hedge that encourages contractors to use local products.

Arrangements in the power sector cannot simply be replicated in other sectors due to their different characteristics. For example, adopting the same approach in the transportation sector with respect to ridership risks may not be sustainable. Nevertheless, the experience of EGAT underscores key features that public utilities must have for successful PPP projects: credibility, good credit, the authority to make decisions and capacity. How this successful experience can be applied in other sectors will need to be considered by the new central PPP body to be created under the new law.

4. Building capacity for planning and implementation

Capacity building is important in two areas: (a) long-term planning in infrastructure and (b) undertaking transactions.

Developing capacity for long-term planning

Developing capacity for long-term planning in infrastructure is important to promote private sector participation, given the long-term horizon of infrastructure investment. A key issue is the capacity of government planners to deal with complexity, which legislation cannot capture and must be dealt with during actual planning. In the same way that the fate of a tree is determined at the time of planting, the success of an infrastructure project depends on the clarity of the project's objectives and key performance indicators at the outset.

Examples of areas where government officials could benefit from improved capacity include the following: (a) design of infrastructure to meet changing needs over time; (b) facilitating the transfer of knowledge across projects and the emergence of learning organizations through planning; (c) effective management of time, resources and collaboration of stakeholders in complex environments; (d) leadership in multi-disciplinary infrastructure planning for the whole economy; (e) deeper understanding of how infrastructure systems are affected by such factors as changes in land use and population density; and (f) developing evidence-based approaches in ensuring that infrastructure design meet government objectives.

Developing capacity to undertake transactions

As the new law goes into effect and new projects emerge, officials will need to develop their capacity to effectively undertake transactions. On-the-job training is an approach that could be suited for this purpose, such as in the building up of teams working on selected initial projects in particular sectors, and learning how to replicate successful deals within the same sectors. These efforts can be complemented by learning through seminars on key issues such as risk allocation between public and private sectors that are being made available by private and public institutions.

FINANCING CROSS-BORDER INFRASTRUCTURE

Being in the center of the GMS, Thailand stands to greatly benefit from growing integration of the grouping's economies. The importance of physical connectivity to the GMS' development and integration puts cross-border infrastructure and the development of sub-regional transport and logistics network among the priority issues not only for Thailand, but for ASEAN as well. These form part of Thailand's infrastructure development plan.

In line with the corridor approach to sub-regional development adopted after the establishment of the GMS in 1992, a network of three economic corridors is currently under development, which includes various areas within Thailand:

- The *East-West Economic Corridor (EWEC)* connects Southern Myanmar, Central Thailand, Southern Laos and Central Vietnam.
- The *North-South Economic Corridor (NSEC)* connects Central Myanmar, Northwest and Central Thailand, Northern Laos, Southern China and Northern Vietnam.
- The *Southern Economic Corridor (SEC)* connects Central Thailand, Western and Central Cambodia and Southern Vietnam.

Thailand has constructed and financed various roads and expressways, bridges and railroads within these corridors. One of the key projects forming part of the SEC is the Dawei development project in Myanmar. Located on the coast of Southern Myanmar, Dawei is a deep sea port that has significant potential to be developed as part of an overland route that can link the Indian Ocean and Andaman Sea to the Gulf of Thailand (through a road to Thailand's Laem Chabang port) and to the South China Sea (through roads to Quy Nhon and Vung Tao in Vietnam). The route passes through several key cities: Bangkok, Sisophon, Siem Reap, Phnom Penh and Ho Chi Minh City.

The governments of Thailand and Myanmar signed a memorandum of understanding on the development of the Dawei special economic zone and related areas in July 2012. They established a joint mechanism headed by the Thai Deputy Prime Minister and Myanmar's Vice President to address issues related to construction, industry and business development, power and energy, community development, rules and regulations, and financing. Several priority projects have been identified, including a toll road, deep sea port, industrial estate, power plant, water supply and waste water system, telecommunications facilities, community development and relocation, and railway.

Projects related to the development of the special economic zone and deep sea port have been identified, and investment costs for the first two phases have been estimated at US$6.776 billion. To attract greater private sector participation, a new Special Economic Zone (SEZ) law is being prepared that will further improve tax incentives and extend their application from investors only (as in the existing law) to developers as well. It will also provide for longer initial land use period, allow full foreign ownership of foreign direct invested projects, establish a one stop center in each zone and guarantee against expropriation of properties with the SEZ.

On the financing side, a special purpose vehicle (SPV) is being set up, which will also be the center of decision-making and control over investment, concession rights and management in companies it invests in. The business units will consist of special purpose companies (SPCs) that will seek to attract private and state owned companies as strategic investors to build infrastructure (port, road and power, water and telecommunications facilities) and provide services.

To promote the long-term sustainability and efficiency of cross-border projects such as the Dawei project, it would be important to strengthen and develop coordination among relevant agencies in the different economies involved, particularly in the building of physical infrastructure, the development of common standards such as for design and safety, and ensuring the maintenance of infrastructure through the adoption of a life cycle value cost framework for infrastructure projects that will provide better estimates of financing requirements. Relevant legal reform measures to address multiple country risks involved in cross-border projects need to be identified to provide a better environment for greater private and multilateral engagement.

Building planning capacity assumes an even greater importance in the case of cross-border infrastructure projects. Regional-level capacity building initiatives using a best practice planning approach that can look at existing land use and transportation systems can help promote greater understanding of synergies and significantly reduce information asymmetry. Improved planning capacity will help address long-term risks and provide better access to debt markets at lower cost to finance projects.

The Ministry of Finance and Ministry of Transport are working closely together in developing cross-border infrastructure. Ongoing discussions are being undertaken on such issues as appropriate business structures, financing mechanisms and currencies to be used. Experiences of emerging markets, including those of Eastern Europe during the transition from socialism and its economic integration with the West, as well as those of Thailand in obtaining access to finance with the assistance of Japan during the early days of its market development, will be useful in finding creative solutions to issues surrounding cross-border infrastructure in the GMS. The Dawei project, along with other major cross-border infrastructure initiatives being undertaken in the GMS, promises to be a transformational experience for Thailand and its neighbors in Southeast Asia. Providing an environment that will attract private financing for these projects will entail significant reforms and capacity building efforts that need to be coordinated at the regional level, which will take time to bear fruit. Governments in the region are aware, however, that they need to continue moving ahead in order to make progress in achieving their growth objectives, even as they continue to grapple with such issues as harmonizing standards and developing capacity. The challenge they face is finding the balance between speed and caution to let them move forward both rapidly and sustainably.

THE WAY FORWARD

The dialogue concluded with a deeper appreciation on the part of participants from the private sector and multilateral institutions of the significant progress that Thailand has made with the passing of its new PPP law and of the great potential of the cross-border infrastructure projects in the GMS, particularly the Dawei development project, in further promoting connectivity and creating new business opportunities throughout Southeast Asia. Thai government officials gained a greater understanding of the private sector's views on key considerations that are important to promote and facilitate greater private sector engagement in Thai infrastructure, particularly with respect to risk allocation, credibility of public sector institutions and capacity to undertake long-term planning and transactions.

The enactment of Thailand's new PPP law is an important milestone, but it is just the beginning of a process. As Thailand unveils new domestic and cross-border projects that will be open to private sector participation, the private sector will be closely watching how the new law is implemented and how the government further builds up its capacity to provide a conducive environment for PPPs. The Deputy Prime Minister invited the APIP to continue providing valuable advice to the government as it moves forward with its infrastructure development agenda and encouraged the private sector to look at the emerging opportunities.

The Acting APIP Chair reiterated APIP's commitment to collaborate with the Thai government in promoting greater private sector engagement to provide cost-effective, high-quality and efficient infrastructure for the economy's continued rapid growth and development. It is expected that future follow-up dialogues, as well as continued efforts by institutions and experts affiliated with APIP to help Thailand further build its capacity for long-term planning and implementing its PPP strategy, will provide opportunities for APIP to contribute significantly to the expansion of private sector infrastructure in Thailand and in the broader region in the years ahead.

This report was compiled by Dr. Julius Caesar Parreñas, Co-Coordinator, Asia-Pacific Infrastructure Partnership (jc_parrenas@mufg.jp).

ANNEX

Asia-Pacific Infrastructure Partnership
Dialogue with the Government of the Kingdom of Thailand

22 February 2012
3:00 PM – 5:30 PM
Vayupak I Room, Ground Floor, Ministry of Finance Building
Bangkok, Thailand

PROGRAM

(*As of 20 February 2013*)

14:30 – 14:45	**Arrival of APIP Private Sector Panel Members and MDB Partner Institution Representatives**
15:00 – 15:15	**Welcome Remarks and Introductory Overview of Current Plans and Future Directions of Thailand's Infrastructure Development** The Hon. Kittiratt Na-Ranong *Minister of Finance, Kingdom of Thailand*
15:15 – 15:30	**Welcome Remarks and Introduction of APIP** Mr. Yoshihiro Watanabe *Acting APIP Chair, ABAC Member and Advisor, The Bank of Tokyo-Mitsubishi UFJ, Ltd.*
15:30 – 17:15	**Discussions on Agenda Items** *Jointly moderated by the Hon. Kittiratt Na-Ranong and Mr. Yoshihiro Watanabe* 1. Guidelines for efficient and integral PPP development projects 2. Appropriate financial structure of PPP projects to enhance connectivity in the Greater Mekong sub-region
17:15 – 17:25	**Conclusions and Next Steps** Mr. Yoshihiro Watanabe *Acting APIP Chair, ABAC Member and Advisor, The Bank of Tokyo-Mitsubishi UFJ, Ltd.*
17:25 – 17:30	**Closing Remarks** The Hon. Kittiratt Na-Ranong *Minister of Finance, Kingdom of Thailand*
17:30	**End**