

Enhancing Private Investment in Infrastructure and Access to Capital

The APEC Voluntary Investment Projects and the Infrastructure Investment Initiative

In our inaugural report, we proposed APEC Voluntary Investment Projects (AVIP's) as an approach to investment liberalization. Under this scheme, economies would encourage selected projects by voluntarily applying enhanced investment protection to them. We committed to develop a list of specific investment principles to facilitate the implementation of AVIP's. In this report, we have further developed this concept to apply to infrastructure investment, taking the following into consideration:

- The AVIP concept responds to the need for pragmatism and flexibility in accommodating the different levels of economic development among APEC economies. It also reflects the urgency of taking steps towards the goal of full investment liberalization. However, AVIP should be seen as part of a spectrum that also includes sectoral and sub-sectoral approaches, as stepping stones towards full investment liberalization.
- In projects requiring large injections of private capital, such as infrastructure development, the absence of effective investment protection means higher financing cost, even if partly mitigated by measures such as letters of comfort. AVIP principles can enable projects to equal or exceed the sovereign ratings ceiling. While the current environment may not be as favorable to the inflow of necessary private capital as desired, AVIP can provide a framework of principles that will have immediate and decisive effects on these investment flows.
- The urgent need for large-scale infrastructure development in the region justifies a sectoral approach to investment liberalization for infrastructure, applying principles similar to those used for AVIP on a sectoral basis.
- The advantage of this approach is that, even if participating economies are not yet in a position to commit themselves to across-the-board investment liberalization, they can pledge to provide enhanced investment protection for selected projects, subsectors, or sectors as they are able. This allows these economies the flexibility to embrace investment liberalization while taking into account their different levels of readiness. Once economies commit to AVIP/III projects, these projects will be accorded full application of the AVIP/III principles.

Recommendation

APEC economies should make possible a sectoral approach to investment liberalization for infrastructure through an Infrastructure Investment Initiative (III), which applies certain investment protection principles on a sectoral basis to infrastructure projects.

It must be emphasized that AVIP and III are designed to further ABAC's wider goal of investment liberalization. Their application needs to be consistent with this objective and with the principle of open regionalism. These schemes are not meant to benefit solely a select group of investors- whether an individual company or companies for a single economy or group of economies. Tendering should be open to all on a fair and equal basis, and award procedures should be open and transparent. Without these caveats we recognize that AVIP and III could be misused to distort investment flows rather than to facilitate them.

Infrastructure Investment Initiative (III): Investment Protection Principles

The following principles can be incorporated into future infrastructure contracts to enhance infrastructure investment in the region:

Investors (private investors, multilateral institutions and/or investor economies) shall:

- encourage the strengthening of existing export/ investment insurance systems against non-commercial risks to facilitate investment flows into infrastructure;
- recognize the importance of investor behavior in facilitating the acceptance of foreign investment in infrastructure; and
- encourage the removal of regulatory and institutional barriers to capital exports for infrastructure development.

Host economies shall:

- treat foreign investors in infrastructure throughout the life of their investment in an equivalent manner to domestic infrastructure investors, except as otherwise defined before the start of project investment and financing;
- accord most-favored-nation treatment to foreign investors in infrastructure throughout the life of their investment;
- give infrastructure investors equal access to domestic markets and resources, subject to limited and specific exceptions that should be defined before the start of project investment and financing;
- not change the terms of project investment agreements without the mutual agreement of both parties;
- avoid double taxation related to foreign infrastructure investment;
- ensure the free and prompt repatriation of infrastructure investment-related funds and the convertibility of currency;
- permit the temporary entry and sojourn of key foreign technical and managerial personnel for the purpose of engaging in infrastructure development;
- not use performance requirements that distort or limit expansion of infrastructure investment;
- not require more information from an enterprise belonging to a foreign project investor than is required from locally-owned enterprises;
- not expropriate foreign investment in infrastructure or take measures that have a similar effect;

- ensure prompt settlement of disputes involving infrastructure investment through consultation, negotiation, and international arbitration between the parties;
- not relax health, safety, and environmental regulations as a false incentive to encourage foreign investment in infrastructure; and
- make all laws, regulations, administrative guidelines and policies pertaining specifically to infrastructure investment in their economies publicly available in a prompt, transparent and readily accessible manner.

Model contract provisions carrying out the above items are set forth by way of example in Appendix 2.

SME Finance Roundtables

In our previous report, we proposed the holding of SME Finance Roundtables to address the growth and export financing needs of SME's, with the recommendations from these exercises to be reinforced by government policy. We recognize the initiatives to date in convening such Roundtables, including the September APEC-wide meeting of export credit agencies in Ottawa, Canada and submit follow-up recommendations based on the following considerations:

- Export development financing for SME's will become even more critical as trade liberalization leads to more intense competition. Attention must therefore be focused on the needs of established SME's that are actual or potential exporters.
- While present financing mechanisms are inadequate, there is yet no clear sense of the range of instruments and approaches needed to address existing constraints. In addition, financing fora often restrict their focus to issues surrounding start-up finance and do not address the fundamental issue of the restrictive attitude of financial institutions to SME's.
- As reviews of present practices demonstrate, a deregulated, competitive financial services market that provides a wider range of domestic and foreign funding sources can improve the availability and cost of financing for SME's.
- Removing barriers to finance continues to be the highest priority for SME's, recognizing in particular the difficulties facing specific groups (for example, women and youth) and reflecting the Economic Leaders' vision of full participation of those group.

Recommendations

APEC and its member economies should reinforce the continued holding of SME Finance Roundtables, where key issues are discussed and best practices can be identified and shared.

APEC should prioritize liberalization in financial services in the context of assistance to SME's.

Key Issues for SME Finance Roundtables

- Access to a full range of financing options, such as:
 - operating lines of credit

- project financing
- export financing instruments
- venture capital
- Comparative cost of available capital
- Development of an effective and efficient credit guarantee system
- Improvement of skills of financial institutions' staff, particularly in evaluation of SME credit applications
- Barriers to finance for SME entrepreneurs

Promoting Capital Market Development

In our 1996 Report, we indicated our intention to look at the issue of capital market development and submit recommendations on this issue. The following considerations reflect our assessment of the situation in this area:

- The APEC Finance Ministers this year emphasized the increasingly prominent role that capital markets play in emerging economies, channeling savings and investment of individuals and enterprises to their most productive use. These burgeoning capital markets are helping assess and price risk more accurately, increasing the availability of credit and lowering costs. Increasing the liquidity and efficiency of capital markets will thus be important for economic growth.
- While the specific needs for capital market development vary among economies, certain critical elements are always necessary for capital markets to facilitate growth. Among these are transparent regulations and laws, independent and technically proficient rating agencies, and modern clearing and settlement systems.
- Financial markets that are conducive to growth provide investors and business with a better range of financial services from insurance companies, bank, securities firms and other diversified financial companies. Limiting the range of financial services deters the flow of capital to its most productive use and stifles innovation and growth.
- APEC economies can better address the financing needs of SME's, improve access to finance for consumers, and more effectively finance large infrastructure projects by facilitating the developments of markets for asset-backed securities. Currently, there is insufficient understanding of asset-backed technologies and the impediments to their use in the APEC region.

Facilitating Economic Growth through Capital Markets: Critical Elements

1. Addressing currency instability

Currency instability can impede capital market development and the process of liberalization within APEC. Because of the growing interrelationships among APEC economies, currency instability in one economy affects all APEC economies. Therefore, the problem of currency instability should be addressed through cooperation within APEC. Such cooperation should include the following steps:

- developing transparent and timely national economics statistics to provide early warning of macroeconomic imbalances that could lead to currency instability;
- cooperation among finance ministers to comment on the macroeconomic policies of any economy that is following policies likely to lead to instability;
- cooperation in developing and enforcing rules against market manipulators; and
- cooperation in developing and administering appropriate adjustment funds and programs, together with the IMF/World Bank and other multilateral entities.

2. Promoting regulation and transparency

Efficient capitals markets can only develop with a legal framework that operates on fair rules and allows all participants access to material information. In order to support growth, securities markets must meet several goals, which include:

- protecting investor;
- assuring disclosure of information by issuers;
- creating secondary markets with an efficient pricing mechanism; and
- establishing a process for introducing new products.

Without these elements, active primary and secondary markets cannot be established. In addition, the process of rulemaking should allow advance notice of rule changes and provide opportunity for comment by interested parties, whether domestic, or foreign. A corporate and a commercial legal system (including bankruptcy law) that establishes the rights of creditors and shareholders, and thus offers predictability and stability, should be given high priority. The enforcement of commercial contracts is also an important area for improvement.

The globalization of markets has prompted a movement regulatory harmonization among economies. The design of such a regulatory structure requires input from among those already working in this area. Several groups, including the International Organization of Securities Commission (IOSCO) and the Council of Securities Regulators of Americas, are already working on regulatory cooperation and the sharing of information. These efforts will assist in incorporating into local law best practices which have proven their worth in other markets.

3. Establishing modern clearing and settlement systems

A modern clearing and settlement system with a centralized depository is a key component of developing a secondary market for securities. More specifically, a secondary market encourages initial investment and capital formation and provides the critical pricing mechanism for new security offerings. Systems that involve physical delivery or create extensive delays increase risk in the system, deter investor in participation, reduce market liquidity. Although economies have developed systems based on their own history and practices, the recommendations of the Group of Thirty on common standards and practices for clearing and settlement form the basis from systems which will lower risk and reduce costs. These recommendations should thus be a guide to the development of enhanced regional clearance and settlement systems.

4. Developing understandable and harmonized accounting and disclosure standards

Information is a crucial ingredient for investor confidence and participation. Building long-term investor participation depends on transparent financial information based on clear accounting rules and full disclosure of material information. Lax accounting and disclosure standards impede capital formation by damaging the credibility of an economy's capital market and reducing participation in it. In such a market, investors will demand a "risk premium" as the price of participation to compensate for the higher risk. Use of recognized accounting standards attracts investors and enhances the ability to tap debt and equity markets for new capital.

ABAC supports the efforts of the International Accounting Standards Committee and the IOSCO to develop international accounting standards, scheduled for completion by the turn of the century. Uniform accounting standards will strengthen disclosure and enhance comparability among companies and countries, thereby increasing the ability of companies using these standards to access foreign capital through listing in developed markets.

5. Broadening the local investor base

The development of a local institutional and retail investor base should be a key objective. A regulatory system that is perceived as fair to all investors is crucial in promoting investments in an economy's debt and equity markets. Foreign exchange convertibility, simple regulatory requirements for the introduction of new products, and the timely release of economic data must also be considered in a strategy for building a domestic investor base. Collective investment vehicles, such as mutual funds, offer investors professional management, and may be a useful tool in expanding the individual investor's presence in the market. A national retirement savings system, depending on its design, can be a powerful mechanism for broadening the base of domestic investment.

6. Liberalizing rules for foreign financial services firms

Emerging economies in the region have taken steps, although at an uneven pace, to reduce barriers to foreign financial services firms. As economies increasingly turn to the global securities markets to meet a portion of their capital needs, foreign financial services firms are helping to channel both foreign and domestic savings to these markets.

Non-resident financial services firms face many barriers, which include: · Prohibitions and limitations on establishing and licensing of commercial presence; · Restrictions on foreign exchange transactions; · Investment limitations on stock purchases; · Lengthy and difficult approval for new products; and · Arbitrary and non-transparent promulgation of new rules.

Considering the significant contribution of foreign financial services firms to the development of emerging markets, APEC should address these barriers. ABAC is ready to assist the Finance Ministers in liberalizing financial services on a priority basis.

Recommendations

The Economic Leaders should endorse the adoption by APEC of steps that will help capital markets facilitate economic growth, specifically, addressing currency instability, promoting regulation and transparency, establishing modern clearing and settlement systems, developing understandable and harmonized

accounting standards and disclosure, broadening the local investor base, and liberalizing foreign access.

The Economic Leaders should endorse public-private sector cooperation to facilitate the development of markets for asset-backed securities in the region.

ABAC in Action: The Asset-Backed Securities Roadshow

In 1997, ABAC provided leadership in public-private cooperation to examine innovative financial technologies, by organizing a roadshow in several developing economies to discuss asset-backed securities with government and private sector representatives. The audience included finance ministry officials, bankers, prospective issuers, potential users of asset-backed financing, and prospective investors in asset-backed securities in the APEC economies. ABAC undertook, as part of the roadshow, an examination of the legal and regulatory structure in each economy, with a view to developing the market for asset-backed securities.

ABAC intends to submit to the Economic Leaders a description of the current environment for asset-backed securities in all the APEC economies, summarize the conclusions from the roadshow, and provide concrete recommendations for facilitating the development of asset-backed financing. ABAC will also participate in the Malaysian Roundtable on asset-backed financing scheduled next year. ABAC believes that the information gathered during its roadshows will enhance the level of discussion and knowledge during the roundtable.

Cooperation Among Stock Exchanges

Stock exchanges play a very important role in the growth of equity markets in the region. For this reason, we have examined various ways to promote their development.

Recommendations

APEC Stock Exchange should cooperate in developing rules, listing requirements and surveillance mechanisms that increase investor confidence and further the development of equity markets in the APEC region.

An APEC Roundtable of Stock Exchanges should meet with regulators and finance officials from each economy.

APEC economies should establish an APEC Association of Stock Exchanges (AASE) as a framework to accomplish cooperation.

Where practical, APEC economies' stock exchanges and regulatory authorities should be encouraged to facilitate trading in SME equities.

Taxation Issues

In our report last year, we identified taxation issues as an area of future work. We believed that the issues of double taxation and withholding and professional services taxes should be addressed in a uniform manner, and to the greatest extent possible, through bilateral tax treaties.

Recommendation

APEC should set the goal of 2010 as a target date when consistent bilateral treaties should be executed and effective between 153 pairs of APEC economies. APEC economies should announce their individual targets for arriving at bilateral tax treaties in their IAPS.