

Economic Growth and FDI

FDI and PPPs Experiences in the People's Republic of China

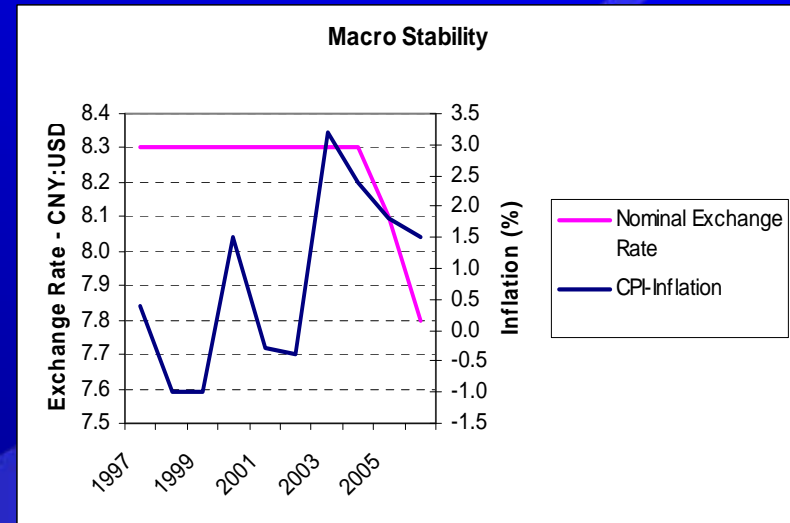
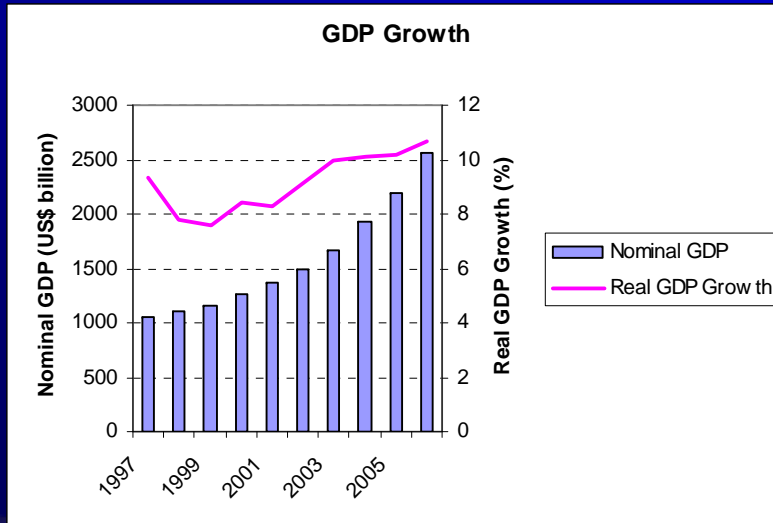
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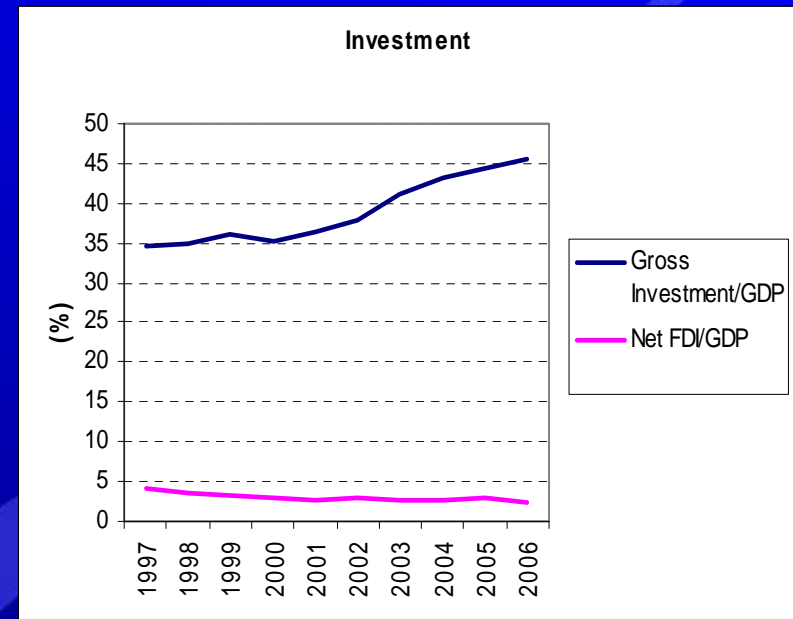
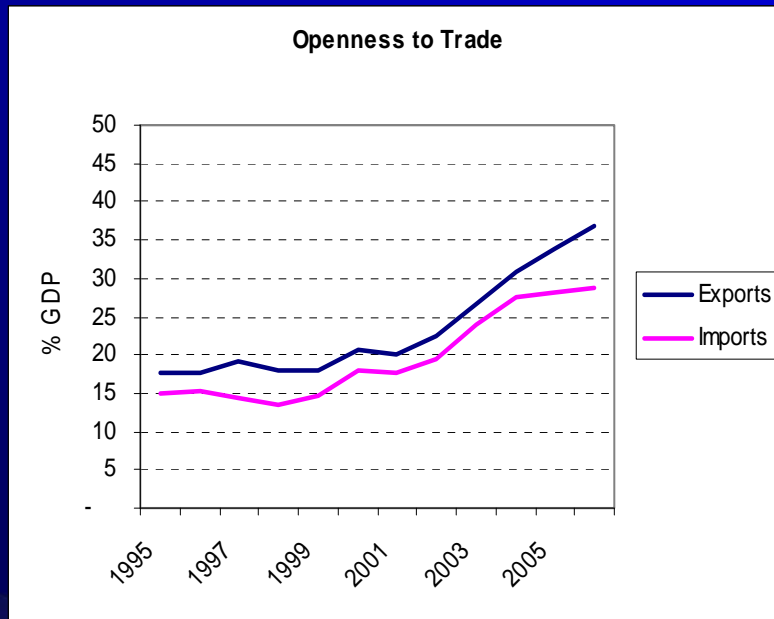
The logo of the Asian Development Bank (ADB), consisting of the letters 'ADB' in a white serif font on a dark green square background.

In the early 1970s the PRC began benefiting from economic liberalization under its “open door” policy. It has been growing rapidly for more than a decade in a relatively stable environment.



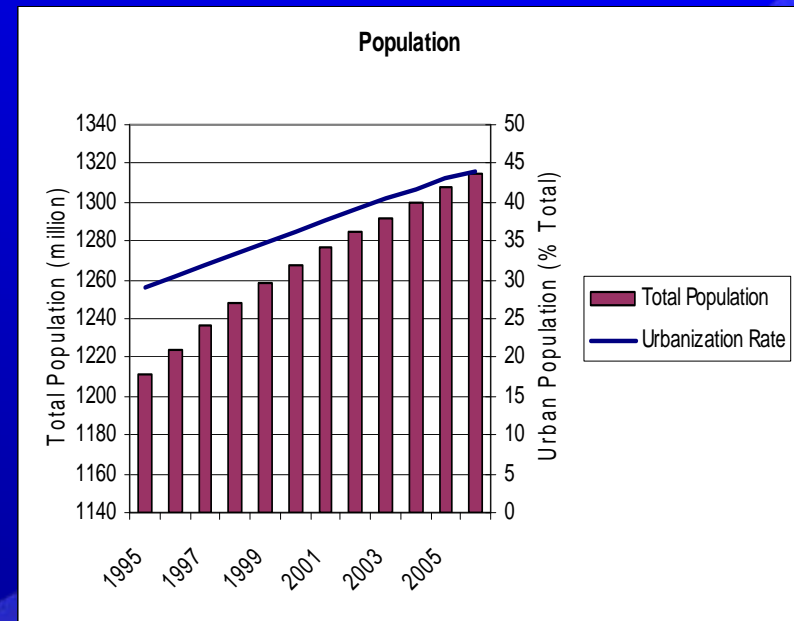
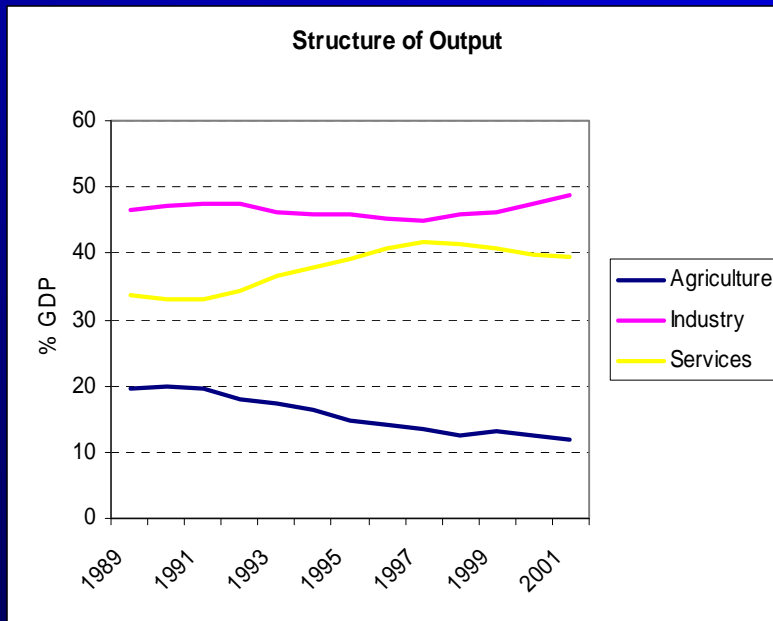
Source: *Key Indicators*, 2007, ADB

The economy has become increasingly open since WTO accession in 2002. Investment has been very high and mainly sourced domestically. Net foreign investment as a percentage of GDP has been falling gradually.



Source: *Key Indicators*, 2007, ADB

Like the rest of Asia, industrialization and a high rate of urbanization have led to a sustained rise in incomes and they are key drivers of investment, especially in infrastructure

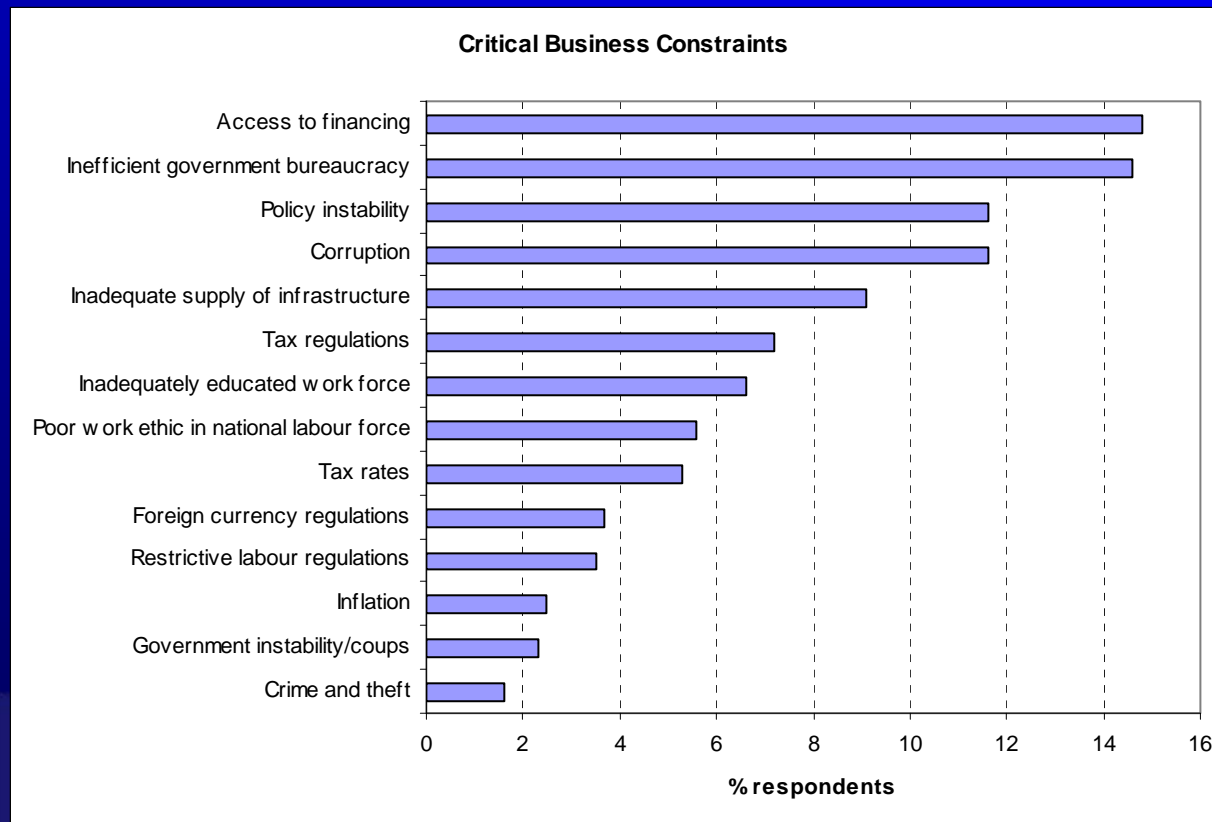


Source: *Key Indicators*, 2007, ADB

Infrastructure investment in the PRC has played a central role in the country's development program

- Infrastructure investment rate is the highest in Asia, being in the order of 15%-20% of GDP per annum
- Impacts have been significant and, between 1990 and 2000, the road network increased by 63% and generating capacity by 136%
- Many people see PRC's investment in infrastructure as being one of the main drivers of its sustained high growth rates
- Investment in infrastructure has been sourced primarily via state-owned enterprises (SOEs) at national and provincial levels

The high levels of investment have paid off in the sense private firms do not see infrastructure as a dominant constraint, although it is still a critical issue



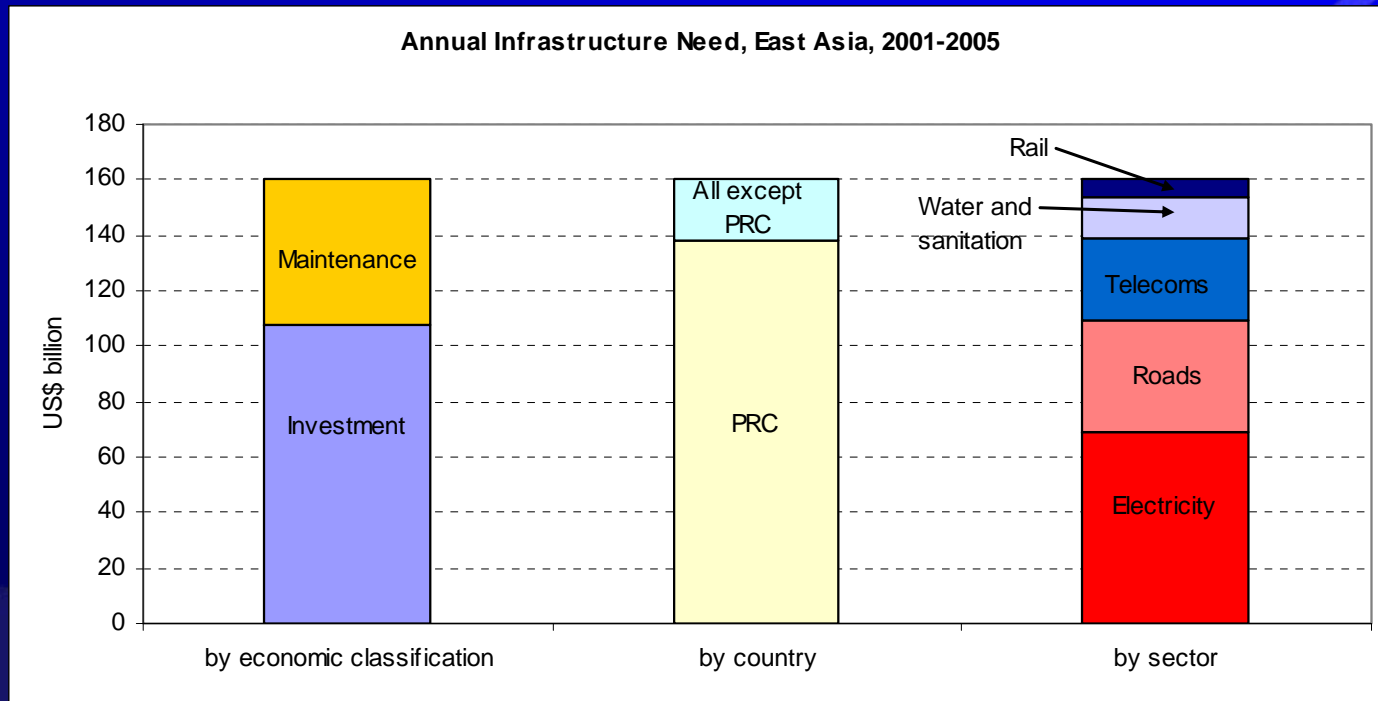
Source: *World Competitiveness Report, 2007*

While PRC has some of the highest quality infrastructure in East Asia, standards are still far below OECD averages

Indicators	PRC	East Asia and Pacific Average	Lower middle income Countries	OECD Average
Gross National Income per capita, Atlas method (current US\$)	1,290	1,640	1,828	33,470
Access to electricity (% of population)	99	63	77	-
Electric power consumption (kilowatt hour per capita)	987	971	1,204	8,769
Improved water source (% of population with access)	77	74	84	99
Improved sanitation facilities (% of population with access)	44	58	71	-
Total telephone subscribers (per 100 inhabitants)	49	22	33	

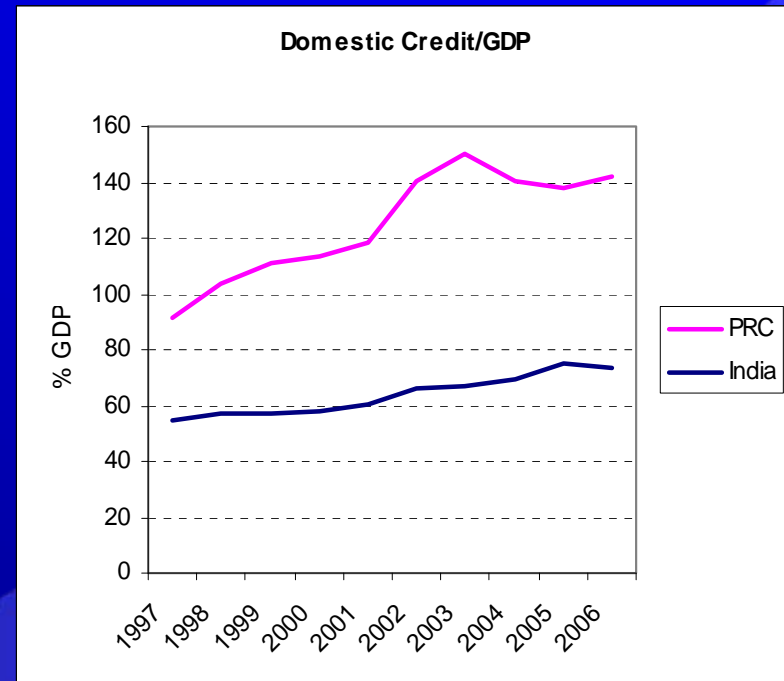
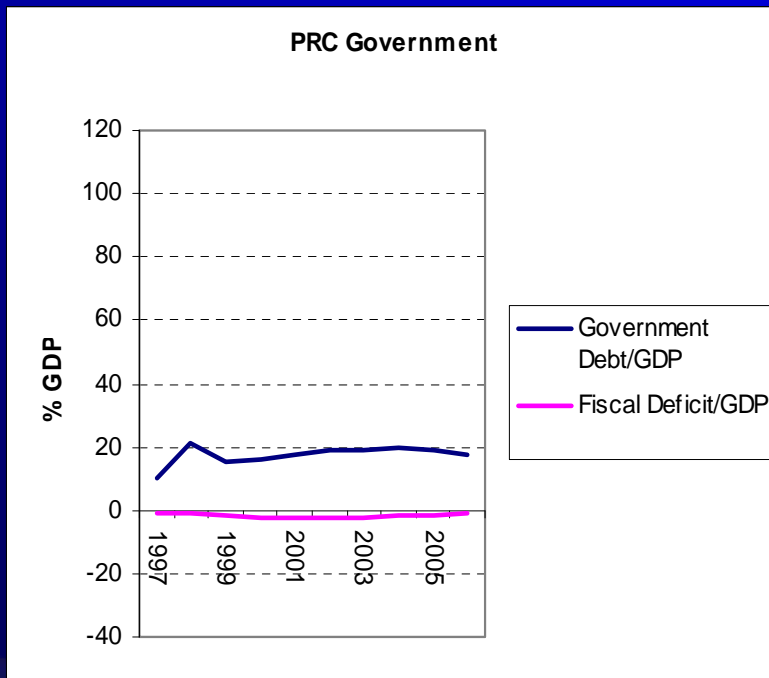
Source: PPIAF

IFIs recently estimated that PRC will require annual investment of \$160 billion pa for infrastructure and indicated that most of this funding would be needed in the power sector



Source: *Connecting East Asia*, ADB, World Bank, JBIC

Government has made limited use of direct debt, and typically financed infrastructure projects through SOEs that benefit from high domestic savings, controlled interest rates, and directed lending policies



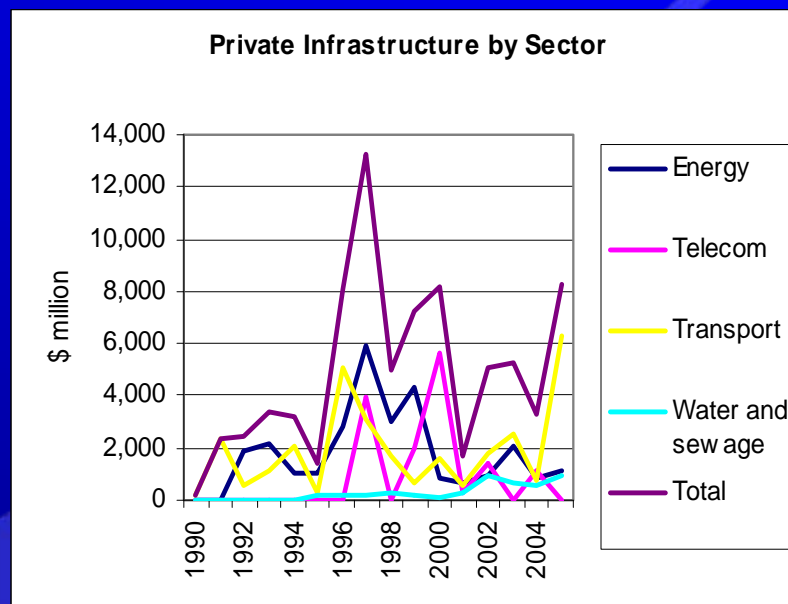
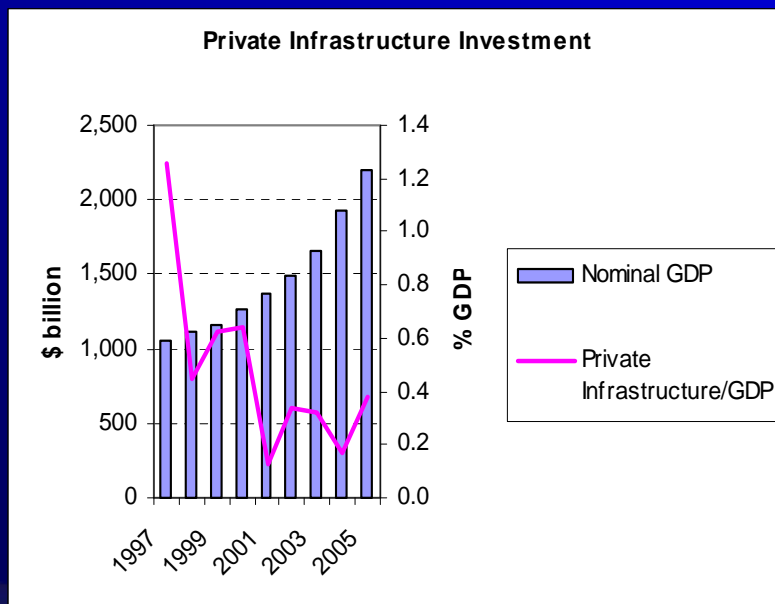
Source: IMF International Financial Statistics

There are enormous opportunities for private infrastructure but they have not yet been realized

The National Development and Reform Commission has retained centralized control of planning while decentralizing responsibility for provision to local governments.

- **Private sector** only recognized legally after 1999 when the constitution was amended
- **Privatization** of strategic assets has been limited
- The high level of political risk and lack of certainty on **tariff regulation** has discouraged private infrastructure investment
- **SOEs** encouraged to tap into high levels of private domestic savings, often on a negotiated rather than competitive basis
- Focus has been on **accessing funds** rather than increasing efficiency, creating potential for local monopolies
- **Directed lending** has created potential concerns about over-capacity, and non-performing loans

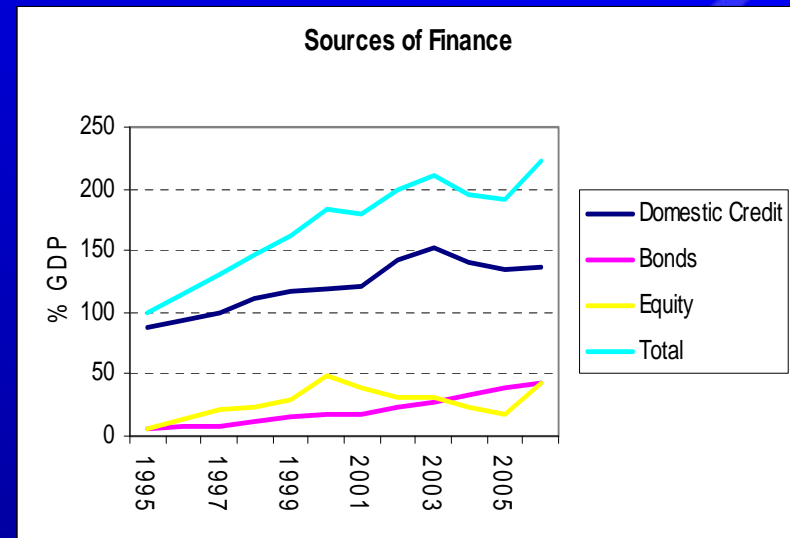
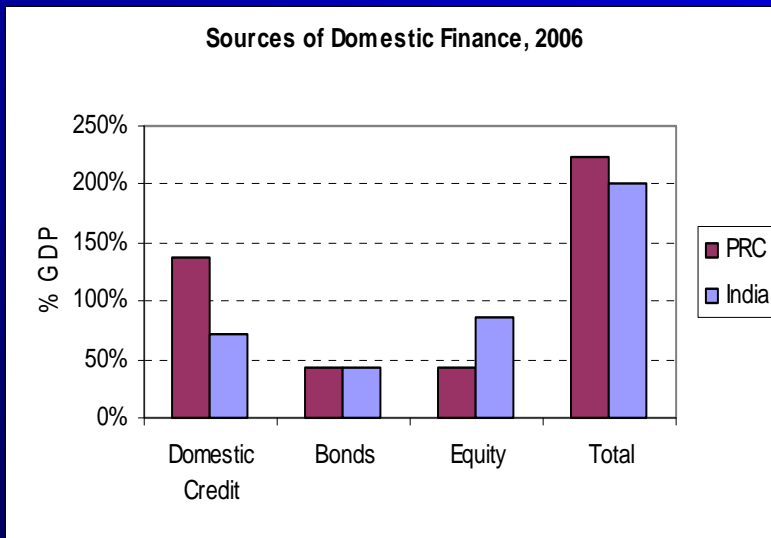
As a result, private investment in PRC infrastructure was only about \$8.6 billion in 2005. This investment was mainly in transport, compared to the rest of Asia, which tends to focus on telecoms followed by power



Source: PPIAF

Similar to the rest of Asia, private investment is primarily greenfield and it has not occurred in the context of comprehensive sector reform

Private firms have difficulty accessing bank finance and capital markets are not yet an important feature of the economy, although they are growing



Source: *Asianbondsonline*

Foreign private equity and debt have not been a major source of finance and the global credit crunch further reduces potential

Absolute levels of FDI are high compared to the rest of the world, but it is mainly concentrated in manufacturing in Special Economic Zones and Open Coastal Cities and net FDI is flattening off

- PRC has been the **largest recipient of FDI** since 1989 and it is forecast to remain the case for 2007 and 2008 (IIF)¹
- FDI dominated by investors from neighboring countries and **linked to trade**
- Despite high levels of FDI, **private investment in infrastructure** was only estimated to be 0.4% of GDP in 2005 (PPIAF/ADB)
- Low levels of foreign private infrastructure investment reflect weaknesses in the **enabling environment** in both the infrastructure and financial sectors
- Foreign investors increasingly focusing on **specialist niches** such as eco friendly energy
- A new development is Macquarie's recent purchase of an 81% interest in the **Hua Nan Expressway**, an urban tollroad in Guangzhou, which is something of a first for a Private Equity Fund (APER)

To date competitive private infrastructure has not been significant. These circumstances may be starting to change, but the enabling environment for PPPs will need to be strengthened to realize full benefits.

- There is a need to put in place a **centralized PPP procurement agency** with standardized legal framework
- **Tariffs** need to consistently reflect full costs of operation and capital
- **Power sector** needs independent regulators, corporatization and transparent competitive opportunities for private sector to participate
- **Transport** would benefit from an equivalent agency such as NHAI (India) which has independent sources of revenue for a credit rated fund
- **Water and local roads** would benefit from pooled municipal funds/institutions
- **Local currency financing is key** due to concerns about exchange rate movements
- **Financial sector**, including both bank lending and bond markets, corporate and municipal, need further strengthening
- There is potential for **credit enhancement agencies** such as LGU Guarantee Corporation set up in the Philippines with ADB assistance
- **ADB** has financed power and water facilities, and investigating opportunities for providing local currency finance, including indirect mechanisms such as political and credit guarantees to support project bonds