

# FINANCING SUSTAINABLE INFRASTRUCTURE IN ASEAN

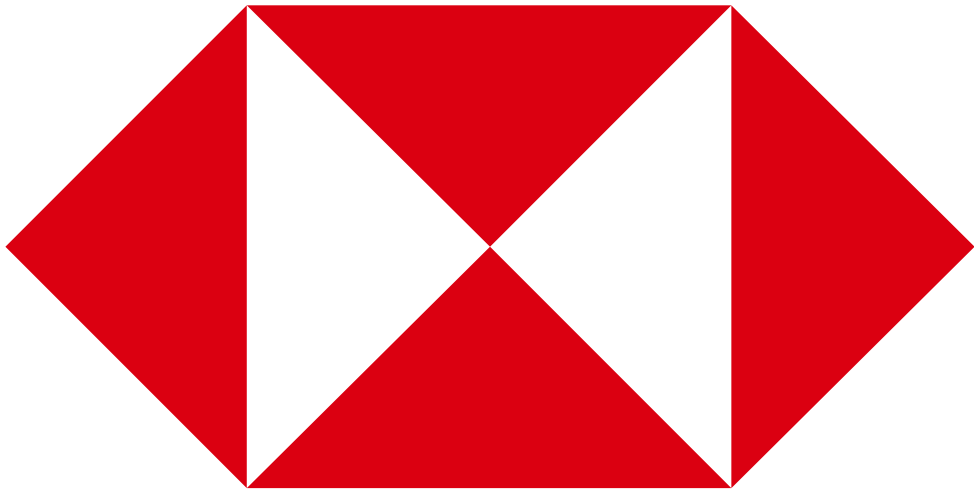
Seizing the Moment: Opportunity to Curb Climate Change and Promote Growth

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## **FINANCING SUSTAINABLE INFRASTRUCTURE IN ASEAN**

### **Seizing the Moment: Opportunity to Curb Climate Change and Promote Growth**

#### **Introduction**

**ASEAN has made impressive progress over the years in advancing economic prosperity.** Millions have been lifted out of poverty and the region has weathered the Asian financial crisis of 1997 and the global economic crisis of 2008-2009. ASEAN's combined GDP of US\$3 trillion<sup>i</sup> positions it as a global economic power akin to the United Kingdom, France, and India. Across the region there are opportunities for increased economic prosperity driven by urbanisation, demographics, integration and technology. These impressive accomplishments are underpinned by the region's formidable workforce and the emergence of a more prosperous middle class. However, the demographic window to push growth across many ASEAN markets is closing. And growing challenges such as climate change are placing increased strain on economies weighing on long-term forecasts. Policy and infrastructure gaps are also holding back the region's ability to respond and reach its full potential. ASEAN member states must act now to maximise the growth impact driven by their current demographic dividend and take decisive steps to address infrastructure gaps to ensure long-term prosperity.

**ASEAN and its individual member states should act decisively to deepen integration, maximise growth and ensure long-term opportunity.** The launch of the ASEAN Economic Community in 2015 and its aims to foster a single market, increase competitiveness, support inclusive, sustainable growth and further integrate the region into the global economy is exactly what's needed. While regional integration has brought immense prosperity to millions, variations in financial, economic, trade and regulatory systems, and capital and exchange controls, continue to impede growth and increase disparities in the economic and social status of individual markets. Addressing these "policy gaps" through liberalisation of trade, integration of capital markets and standardisation of legal and regulatory frameworks will be necessary to increase the ease of doing business.

**Significant gaps in infrastructure also exist, reducing the productive capacity of ASEAN's workforce and increasing the cost of doing business.** For example, driven by infrastructure issues, logistics costs represented about 9 percent of GDP in Germany and 12 percent in Brazil in 2016, while they stood at 21 percent of GDP in Vietnam and 26 percent in Indonesia<sup>ii</sup>. While the average number of hours that a commuter spends in traffic per year in Bangkok and Jakarta is estimated to be 64 and 63 hours respectively<sup>iii</sup>. More significant is the associated

economic cost of congestion. In the case of Indonesia, the total time-related cost of commuting in Indonesian cities is currently estimated at IDR 498 trillion (US\$37 billion) per year and could increase by over 41 percent in 2020<sup>iv</sup>.

**A rapidly changing climate represents an unprecedented and urgent threat as well as opportunity to economies and societies in ASEAN.** Southeast Asia is expected to be disproportionately affected by climate change: the Asian Development Bank forecasts that climate change could reduce the region's gross domestic product (GDP) by 11 percent by the end of the century if left unaddressed.<sup>v</sup> Tackling climate change is an imperative to avoid economic and environmental harm. But the challenge also represents a tremendous opportunity associated with the transition to a low carbon economy and positioning ASEAN as a leader in sustainability. This transition will contribute to unlocking the full potential of ASEAN's workforce by increasing demands for green skills and creating new green jobs and industries. It will also support the development of cutting-edge clean energy technologies such as batteries and photovoltaics, putting ASEAN at the forefront of research and advanced manufacturing in some of the leading industries in the 21st century. ASEAN countries are already taking bold action in this direction: last year Malaysia set the goal to increase the share of its electricity generated from renewable sources to 20% by 2030,<sup>vi</sup> this year Indonesia announced it will adjust its fiscal policies to incentivise the production of environmentally friendly vehicles,<sup>vii</sup> and Vietnam is working to complete several mega solar power plant projects later this year.<sup>viii</sup>

**Investment in sustainable infrastructure can help ASEAN to meet the challenge of climate change and realise the benefits of transitioning to a low carbon economy, as well as close gaps that are holding back long-term growth.** An estimated US\$100 trillion of investment is needed in new sustainable infrastructure globally over the next 15 years – including financing for clean energy infrastructure, sustainable transport, energy efficiency and waste management – to meet the 'well below 2 Degrees' global temperature goal in the Paris Climate Agreement.<sup>ix</sup> This coincides with the growing demand for infrastructure in ASEAN already to support continued urbanisation and development. Over the next 50 years a new global urban system is being set in train, with 15 of the large metropolitan-cities over 10,000,000 people expected to be in Asia. This means establishing more connected trade routes, advanced mobility, and digital connectivity in urban hubs in Asia. Infrastructure investments can enable ASEAN countries to mitigate and adapt to the challenges of climate change, transition to a lower carbon economy and promote growth. These investments can also contribute to meeting ASEAN countries' Nationally Determined Contributions under the Paris Climate Agreement.

**Private sector financing has a critical role to play in making sustainable infrastructure a reality in ASEAN.** Public financing is absolutely vital, but is not sufficient to meet ASEAN's overall infrastructure needs. The Asian Development Bank (ADB) has highlighted that even if reforms were carried out by governments in the region with regards to public finances, the public sector could cover less than 50% of the total investment required.<sup>x</sup> To fill this gap, ASEAN member states must take steps to promote greater private sector participation in infrastructure



financing. Private sector engagement can also help ASEAN to mobilise know-how and technology to increase the efficiency and productivity of infrastructure and create long-term assets to match the investment needs of its societies.

**The region has already taken important initial steps to unlock private sector financing through creation of the ASEAN Green Bond Standards.** The launch of the ASEAN Green Bond Standards in November 2017 by the ASEAN Capital Markets Forum created a common framework to promote the growth of a new green asset class while enhancing transparency, consistency and uniformity of new issuance. This was followed more recently by the launch of the ASEAN Social Bond Standards and ASEAN Sustainability Bond Standards in October 2018. Global issuance in the green, social and sustainability bond market has already reached US\$53 billion so far in 2019 (more than the total issuance for all of 2015) and is on track to easily surpass last year's total.<sup>xi</sup> This growing investor demand matched with new frameworks is helping to boost private sector and government-led sustainability efforts. Indonesia, for instance, is already moving forward with mobilising new financing: in 2018 the country launched a dual tranche Green Sukuk, representing the first international green offering by a government in Asia. The proceeds of this and future offerings will be allocated to projects identified as having climate change benefits.

**Financing for sustainable infrastructure is particularly critical for ASEAN's rapidly growing urban areas.** About 90 million people are predicted to migrate to urban areas in ASEAN between 2015 and 2030, placing unprecedented strain on existing infrastructure and challenging many cities to construct new infrastructure to keep up with growing demand.<sup>xii</sup> By making the choice to prioritise sustainable infrastructure, ASEAN member states can support rapid urbanisation, aid regional efforts to tackle climate change, and make an important contribution towards achieving the vision of the ASEAN Smart Cities Network (ASCN), which aims to promote smart and sustainable development in key cities, including by catalysing bankable projects with the private sector and securing funding from external partners. A variety of regional and international partners are already working within the region to support sustainable infrastructure development in urban areas. The Belt and Road Initiative (BRI), as one example, is expected to pivot towards investing in urban infrastructure development in addition to its original focus on energy and transport. The World Wide Fund for Nature (WWF) has released a series of principles and recommended actions to guide future BRI investments to ensure that sustainability is fully integrated into new projects, which could be leveraged to support ASEAN's sustainable urbanisation efforts.<sup>xiii</sup> The Asian Development Bank has also set out in its Urban Operational Plan 2012-2020 an approach for urban development and investments that prioritises environmental sustainability.<sup>xiv</sup>

This paper outlines 3 opportunities that ASEAN could consider as part of broader efforts to unlock financing for sustainable infrastructure, accelerate regional efforts to tackle climate change and support economic growth:

- Launching a "Doing Sustainable Infrastructure Report"

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- Creating an ASEAN Urban Infrastructure Network
  - Developing an ASEAN Blended Finance Toolbox

### **Launching a “Doing Sustainable Infrastructure Report”**

Much progress has been made already in ASEAN member states to attract investment and foster enabling environments for sustainable infrastructure. But to date there is no single, standardised, validated and dedicated report that governments, international organisations, development banks and the private sector can rely on to evaluate progress and identify opportunities for further improvements in the ASEAN region. This knowledge gap prevents ASEAN member states from fully highlighting their achievements with potential investors and hinders sustained, coordinated action within each market and across the region to make headway in improving the investment environment.

ASEAN could support the development of a new infrastructure-focused report in collaboration with the international community that would fill this knowledge gap and help member states to showcase their accomplishments, enhance policy frameworks and guide capacity building efforts. Such a report would increase the confidence of investors and help identify common objectives that governments, development partners and the private sector can collaborate on to improve the enabling environment for sustainable infrastructure.

**Recommendation 1:** *Partner with the international community (e.g. the Asian Development Bank, the AIIB and the WBG) to develop an annual ASEAN “Doing Sustainable Infrastructure Report.” This initiative could build on and complement efforts advanced under the G20’s Global Infrastructure Hub, such as the InfraCompass tool. Such a report could be designed to support the efforts of member states by including:*

- *a checklist of best practices that countries and cities can consider to better enable financing of sustainable infrastructure. This could incorporate and operationalise the Principles for Quality Infrastructure proposed by the Japanese G20 Presidency for adoption later this year;*
- *annual progress reports on ASEAN member states’ investment environments and efforts to promote financing for sustainable infrastructure; and*
- *recommendations on ways to increase financing for sustainable infrastructure based on key metrics and feedback from public stakeholders in government, international organisations, and the private sector.*

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**Creating an ASEAN Urban Infrastructure Network**

ASEAN's growing cities are natural focal points for sustainable infrastructure investment. This is logical given the World Bank's 2009 World Development Report, and numerous others, show that the rise in living standards in lower income countries is correlated with urbanisation: cities reduce poverty, they don't cause it. But one of the main impediments to channeling capital towards sustainable infrastructure projects in cities is the lack of capacity at municipal levels. Successful infrastructure efforts often have champions at the city-level that are experts in infrastructure and public procurement and can advance projects from conception to completion. However, many municipalities have limited experience in preparing bankable project proposals, developing MoUs and entering into agreements with the private sector, or familiarity with credit enhancement tools that are often needed to attract sustainable private sector financing.

Several ASEAN cities and member states are already leading the way through local-level efforts and partnerships with the international community. For example, Quezon City in the Philippines is collaborating with the C40 Cities Finance Facility to develop solar power as part of the Philippines' efforts to build resilience to extreme weather events and increase clean, renewable energy generation. As part of the ASEAN Smart Cities Network cities such as Battambang, Siem Reap, Kuching, Kota Kinabalu and Mandalay are interested in turning their cities into clean, green and liveable communities with sustainable waste management.

There is a pressing need to expand these efforts regionally to maximise their impact and build broader awareness across more cities and towns. Such an initiative could augment these existing efforts or be included as a component of the ASEAN Smart Cities Network to promote sustainable development in key urban centres.

***Recommendation 2:*** *Building off ASEAN's Smart Cities Network launched in 2018, ASEAN could develop an ASEAN Urban Infrastructure Network to provide capacity building for municipal, procurement and other public sector leaders so that they are better equipped to work with the private sector and develop bankable sustainable infrastructure projects. Such an initiative could include:*

- *the development of toolkits (e.g. templates, models, other resources) for officials to leverage when developing sustainable infrastructure projects;*
- *in-person or online training for officials on key topics in sustainable infrastructure, leveraging existing initiatives and training programs; and*
- *an annual Smart Cities Infrastructure Leaders Forum for officials from across ASEAN to connect and share best practices.*

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**Developing an ASEAN Blended Finance Toolbox**

ASEAN is not short of sustainable infrastructure opportunities, but is often short of sufficient financing to support these projects. A key barrier for financing is the lack of opportunities that are defined as investment grade by credit rating agencies. International pension funds, asset managers, insurance companies and Sovereign Wealth Funds can be key sources of financing for ASEAN and help to rapidly scale up infrastructure efforts, but will be largely unable to participate in these opportunities unless the risk return profile of potential investments is altered.

Large scale infrastructure projects in ASEAN often involve a variety of risks that prevent private sector investment. These include risks related to the design and construction phases of a project, post-construction payment and the policy environment. So long as these risks remain unaddressed, it will remain challenging for ASEAN to attract sufficient capital to combat climate change and meet growing infrastructure demands.

One solution to overcome this challenge is blended finance, which shares these risks between the private sector and public sector. By reducing the risk profile of sustainable infrastructure projects, blended finance can allow investors to participate in financing projects that they would not otherwise be able to. While some infrastructure projects in ASEAN have already benefited from the use of these instruments to unlock financing, the lack of a standardised approach prevents blended finance from achieving scale, limiting its impact.

ASEAN could address this in a number of ways, focusing on standardisation; securitisation and an ASEAN-focused facility or programmatic approach.

***Recommendation 3:*** ASEAN member states, in partnership with development banks and the private sector, can:

- *develop an ASEAN Blended Finance Toolbox to standardise instruments that address common risks associated with sustainable infrastructure projects and meet the investment requirements of different sources of financing;*
- *work with the industry and development banks to introduce a blended finance approach to structured finance in order to crowd in a wider class of investors looking for long term returns; and*
- *work with international and national development banks to establish ASEAN focused facilities and programmes for blending, including developing the capacity to carry out the financial engineering successfully.*

**ENDS**



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<sup>ii</sup> World Bank, Connecting to Compete - The Logistics Performance Index and Its Indicators, 2016; Export.gov, Brazil - Transportation Infrastructure, August 2017; Biinform, Vietnam Logistics Market Report, January 2017; Jakarta Globe, ‘Indonesia Logistics Costs Can Match Asian Peers in Two Decades’, March 2016

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<sup>iv</sup> “Rethinking urban mobility in Indonesia”, AlphaBeta, May 2017,  
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<sup>v</sup> Asian Development Bank “Climate Change Losses for Southeast Asia Well Above Previous Estimate”, December 2015 <https://www.adb.org/news/climate-change-losses-southeast-asia-well-above-previous-estimate-adb>

<sup>vi</sup> The Edge Markets “Malaysia sets new goal of 20% clean energy generation by 2030”, September 2018  
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<sup>viii</sup> Nikkei Asian Review “ASEAN’s largest solar plant planned in Vietnam”, June 2018  
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<sup>x</sup> Asian Development Bank, “Meeting Asia’s Infrastructure Needs”, 2017

<sup>xi</sup> HSBC Green, Social, Sustainability Bond database (note: based on Dealogic, CBI, Bloomberg as of 15 March 2019)

<sup>xii</sup> McKinsey Global Institute “Southeast Asia at the Crossroads”, November 2014  
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<sup>xiv</sup> Asian Development Bank “Urban Operational Plan 2012-2020”, 2013  
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