The Philippines: Infrastructure Opportunities and Challenges

Many countries in ASEAN, while boasting rapid growth and rising income on improving economic fundamentals, desperately need to upgrade their infrastructure to provide the backbone for long-term economic growth. This is particularly relevant for the fastest-growing major economy in ASEAN, the Philippines, which has been under-investing in the country's infrastructure for many years. To correct this, President Duterte, who took office in June 2016, has made infrastructure development his prime policy pledge.

Infrastructure Needs and Development Priorities

The dire traffic congestion in many parts of the capital Manila is just one highly visible example of past under-investment in the infrastructure of the Philippines. Spending on infrastructure accounted for only 2-3% of the country's GDP under the previous Aquino administration. As infrastructure depreciates and requires continual maintenance, this level of investment has not been sufficient to upgrade or raise the quality of existing infrastructure. This has meant that the quality of the country's infrastructure has failed to keep up with the rising income and expectations of Filipinos.

President Duterte has made infrastructure improvements a prime development priority in his "*Dutertenomics*" economic strategy. The "*Build, Build, Build*" programme is at the centre of his *Socio-economic Agenda*. The idea is that infrastructure projects will increase the productive capacity of the economy, create jobs, increase incomes and ultimately reduce poverty. The government aims to raise infrastructure spending to 5% of GDP by the end of 2017, and further increase it to 7% of GDP over 2018 and 2019. Public infrastructure spending is targeted to reach PHP8-9 trillion (about US$180 billion) during the period 2017-2022.

Transport Infrastructure as Priority

The bulk of the Philippines' economic activity is centred in Luzon, the largest and most highly populated island in the archipelago that makes up the country. Transport infrastructure is not only poor in the rural areas outside central and southern Luzon, it is also inadequate in the island's urban areas. Metro Manila, the region centred on the capital, suffers from congested road, sea and air traffic; while in Manila itself, one of the world's most densely populated cities, the metro rail transit system is poorly maintained and does not have the capacity to serve the swelling population. It takes three to four hours to travel by car from Manila's international airport to downtown Makati City, longer than it takes to fly from Manila to some ASEAN cities in mainland Southeast Asia.

The poor transport facilities in the Philippines hinder utilities provision and economic development. This is why the majority of the priority projects in the *Build Build Build* programme are ones involving transport infrastructure, such as national roads, regional airports, ports, freight facilities and railways. Many of projects are located in central and southern Luzon, but attention is also being given to Mindanao in the south, the poorest region of the country. The table below lists the flagship projects under the *Build Build Build* initiative.

Key Infrastructure Projects of the Philippines

Category	Projects
Highways	Luzon Spine Expressway Network
	Tarlac-Pangasinan-La Union Expressway
	NLEX-SLEX Connector Road
	Cavite-Laguna Expressway
	Central Luzon Link Expressway
	Bacolod Economic Highway
	Metro Cebu Expressway
	Panguil Bay Bridge
	Mindanao Development Road Network
	Davao City By-pass
Airports	New Bohol (Panglao) Airport
	Mactan Cebu International Airport
	Bicol International Airport
Railways	PNR North Railway (Manila-Clark)
	PNR South Railway (Manila-Bicol)
	Mindanao Railway
	Mega Manila Subway
	MRT Line 7
	LRT 1 Cavite Extension
	LRT Line 2 East Extension
Ports	Cavite Gateway Terminal
	Port Modernisation Project

Source: Philippine Infrastructure Transparency Portal

The *New Clark City* development, a comprehensive urban development project which is envisioned to turn the successful *Clark Economic Zone* into a new township housing more than one million people, is another key project. The government is planning to strengthen the zone's productive capacity further while developing the *New Clark City*, with new transport and logistics infrastructure projects including a new terminal building at the *Clark International Airport*, the Subic-Clark cargo railway and a bus-based mass transit system. The *New Clark City* is a large-scale development that is expected to take over 40 years to complete. Highways and public transport linking the *New Clark City* to Metro Manila, utilities, community facilities, commercial and residential land use will also be developed in the new township.

Widening Funding Sources Required to Support the Ambitious Program

Supported by robust economic growth and development funding, the Philippines is now more capable of financing infrastructure projects than it has been in the past. International development funding from the *Asian Development Bank (ADB)* and *Japan*

International Cooperation Agency (JICA) has been granted to the country for infrastructure development. China's *Belt and Road Initiative* *(BRI)* and the establishment of the *Asian Infrastructure Investment Bank (AIIB)*, of which the Philippines is a member, will also open up new funding sources for infrastructure projects in the country. Furthermore, President Duterte is now pursuing closer economic co operation with China, opening a host of opportunities for Chinese companies to participate in infrastructure projects in the Philippines.

In spite of this enhanced ability to fund public projects, President Duterte's infrastructure investment targets remain highly ambitious. A considerable amount of the financing is expected to be met by borrowing, with the Philippine government prepared to run bigger fiscal deficits, rising from 2% to 3% of GDP.

To widen funding for the infrastructure program, it will be necessary for the Philippines to engage with investors both locally and internationally. Yet the *ADB* has recognised that the Philippine capital market and non-bank finance are not resilient enough to gauge financing risk. The country must also broaden access to infrastructure finance and investment funds to deliver financially feasible and sustainable projects.

Capacity Building in Project Development

In addition to concerns over funding, the Philippines suffers from insufficient capacity to build and operate viable and sustainable projects. Both the government and industry need better infrastructure services. On the government side, technical assistance in feasibility studies, public expenditure management, organisational management, public services management and financial modelling should be better engaged. The efficiency and reliability of built infrastructure, whether constructed or managed by the government or by private companies, remains poor. While the *Private Public Partnership (PPP)* model is more prevalently adopted in many ASEAN countries, it is still somewhat new to the country.

On the industry side, professional services such as project development, transaction advice and technical feasibility studies are not readily available locally. The skills, organisation and mobilisation of Filipino construction workers are not up to the standards of their ASEAN counterparts in countries such as Malaysia and Thailand. There is a considerable service gap, which means that the Philippines may require greater involvement of foreign companies with the skill sets needed for the country's bold infrastructure plan.

Institutional Framework for Private Sector Participation in Infrastructure Projects

In the past, private sector involvement in the Philippines' priority infrastructure projects has been minimal. The current Philippine government recognises the importance of engaging the private sector in financing and operating infrastructure facilities, but it is far from well practised in infrastructure development, and the bulk of infrastructure projects still adopt the traditional procurement model.

Nonetheless, the Philippines is now taking a keen interest in promoting the use of *PPP*. The *Public Private Partnership Unit (PPPU)* is currently tasked with optimising the institutional framework for adoption of the *PPP* model. Current procedures involve numerous government departments and agencies, and there is no clear guideline as to which government unit serves as the key contact for any individual infrastructure project.

The *PPPU* is in charge of drafting such guidelines and deciding which body will work with consultants on developing *PPP* projects.

Although it is showing a greater intention to explore the *PPP* model, the Philippine government still seems more inclined to build the physical infrastructure itself and allow private companies to operate and manage the facilities afterwards. The government is keen to apply this model to the construction of transport facilities, including airports, railways and ports. The Build-Operate-Transfer (BOT) is another preferred model for education facilities and transport and water infrastructure, in which ownership of the built facilities and infrastructure will eventually be transferred back to the government.

Foreign companies should also be aware that they are not allowed to take full ownership of any infrastructure project in the Philippines. The local-foreign ownership ratio of 6:4 applies in all sectors related to infrastructure development. In any case, local partners are considered to be crucial as infrastructure projects involve regular contacts with local parties and government agencies. It would be very difficult for foreign businesses to deal with these parties by themselves, without support from Philippine partners with direct local contact and on-the-ground knowledge. However, collaboration opportunities abound in the Philippines as local companies often lack the technical capability to take up large-scale and/or complex infrastructure projects, and they are willing to partner with foreign firms able to bridge the gaps with specialised construction skills and expertise.

Business Opportunities and Risk for Hong Kong

Hong Kong as the One-shop Services Platform

With local capital and expertise insufficient to underwrite the ambitious infrastructure programme in the Philippines, there is ample room for foreign participation in infrastructure projects in this country.

To this end, Hong Kong companies are in a strong position to offer professional and technical services to Filipino project owners. Hong Kong has seasoned construction and infrastructure professionals in master planning, transport planning, engineering consulting, architectural design and financial modelling, and they have years of experience in undertaking these projects in Southeast Asia. Hong Kong companies also have a world-renowned track record of success in managing and maintaining ports, airports and railway system, and have been exporting such management expertise to other parts of the world. Practical knowledge and proven best practises in adhering to budget in the construction and management of infrastructure projects can be introduced to the Philippines. Management, operation and human resources training that Hong Kong can provide will be a good fit with the Philippines' service gap in their infrastructure development. As Asia's financial centre, Hong Kong can also serve as the platform for the Philippines to gain access to a deeper fund pool and multi-currency syndicated loans.

President Duterte's diplomatic pivot towards China since 2016 is conducive for deepening economic cooperation. Chinese enterprises are expected to be keen to take up infrastructure projects in the Philippines, and as Hong Kong is the world's largest offshore RMB centre, mainland enterprises can use Hong Kong as a platform to seek opportunities and invest overseas, particularly in Southeast Asia.

An Emerging Market with Institutional Risks and Challenges

Like many other developing countries in need of continual economic reform and institutional development of their public administration capacity, the Philippines can be a challenging market for project owners and their foreign partners. This is especially the case in dealing with infrastructure projects, which involve government regulations, funding and interfaces with numerous agencies and departments.

Compared with four other major ASEAN countries, the ease of doing business of the Philippines is ranked the lowest. The business operation environment there is notably more challenging than the more mature ASEAN economies like Malaysia and Thailand. The Philippines ranks especially low in the areas of dealing with construction permits, getting credit and enforcing contracts. Difficulties in these areas will certainly pose great challenges and risks to those taking part in infrastructure projects.

EODB 2017 Rankings of ASEAN-5

	Philippines	Malaysia	Thailand	Vietnam	Indonesia
Overall Rank (out of 190)	**99**	**22**	**46**	**82**	**91**
Starting a Business	171	112	78	121	151
Dealing with Construction Permits	85	13	42	24	116
Paying Taxes	115	61	109	167	104
Getting Credit	118	20	82	32	62
Trading Across Borders	95	60	56	93	108
Getting Electricity	22	8	37	96	49
Enforcing Contracts	136	42	51	69	166

Source: World Bank

As infrastructure projects, especially the larger ones, may take a long time to complete. There are also clear risks associated with policy changes on the one hand, and bureaucracy and red tape on the other. Furthermore, the government still lacks the public administration capacity to develop and manage infrastructure projects well.

As discussed before, an infrastructure project in the Philippines will involve intricate procedures and many government agencies and departments, each taking part in a specific part of the process without a centralised agency or a good coordination mechanism. This will be further complicated by the fact that the government is very cautious in spending public money, while being reluctant to explore unconventional funding sources. As a result, debates and delays in signing off project funding in Congress and working departments often occur.

In recognition of difficulties that project owners face when dealing with government agencies and departments, the Duterte government is taking steps towards reform. As well as cracking down on corruption and reforming the bureaucracy, President Duterte has taken a strong interest in pushing project delivery, smoothing the path for infrastructure project owners. However it will take time for the bureaucratic system to adjust and improve. In the meantime, with foreign companies limited to assuming minority stakes in infrastructure projects, Hong Kong businesses can mitigate or avoid major investment risks by not taking substantial stakes in these projects, aiming mostly to act as services providers to local companies, or partnering with local companies and focussing on delivering technical services.

Summary

The Philippines has launched an ambitious programme of infrastructure projects to help fuel the country's economic development. Given the country's deficiencies in finance provision and services expertise in trying to carry out such an intensive programme in such a tight timeline, there are good opportunities for foreign businesses to fill the funding and services supply gaps. However, Hong Kong businesses should be aware of the challenging business operation environment in the Philippines. Partnering with local companies and/or serving as services providers will be the practical way for foreign businesses to explore the Philippine market whilst mitigating risks.

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