Financing Development Projects: Public-Private Partnerships and a New Perspective on Financing Options

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At the OECD/DAC Tidewater Meeting
Penha Longa, Portugal
24-26 June 2001

Ladies and Gentlemen, good afternoon. I am delighted to be with you today on the occasion of the first Tidewater meeting of this century. We have the opportunity at this forum to discuss different approaches to globalization and the financing of development projects that can rapidly reduce poverty and promote sustainable development. I thank the organizers of this conference for having invited me here.

Today, I would like to focus on two approaches: first, the important role of public-private partnerships in foreign direct investment and enterprise development, and what governments should do to promote such partnerships; and second, the different roles that domestic resources, private external capital flows, and official development assistance play in financing development projects.

But first, I will give a very brief overview of how we at the Asian Development Bank view the current economic situation and investment requirements in Asia and the Pacific.

Current Economic Situation in Asia

In 2000, ADB’s developing member countries continued to recover from the Asian financial crisis of 1997/98. Their strong performance reflected the favorable external environment through most of 2000, expansive macroeconomic policies, competitive exchange rates, and varying degrees of progress in financial and corporate restructuring. Higher oil prices toward the end of the year had different effects on different countries, but on balance, were negative factors for growth.

GDP growth for the region was over 7 percent for the whole of 2000, up from just over 6.5 percent in 1999, although the pace slowed during the second half of 2000. Domestic demand strengthened in a number of economies compared with the preceding two years. Singapore and Hong Kong, China led the continued strong performance of the region, with economic growth of about 10 percent in both these economies in 2000. In Indonesia, Philippines, and Thailand, the recovery remained somewhat fragile due to incomplete structural reforms, political uncertainty, and generally weak private investment. Growth in the
People's Republic of China and India, where the impact of the Asian crisis was more limited, continued at a rapid pace primarily due to strong domestic demand and buoyant export performance. Prospects for 2001 are less optimistic. From the 7 percent GDP growth of 2000, growth in the Asia-Pacific region is expected to come down to 5.3 percent in 2001. The anticipated slowdown reflects a sharp deceleration of export growth to single-digit levels in 2001. Private consumption is expected to moderate in 2001 as the income effects from the export sectors spread during the year. Monetary policy is generally expected to be accommodative and fiscal policy will be constrained by the need to reduce fiscal deficits in some countries.

**Investment Requirements in the Asia-Pacific Region**

With population growing at 60 million a year, and the rapid urbanization of the Asia-Pacific region (17 of the world's 19 megacities are in Asia), a major challenge looms in infrastructure development. While the crisis gave rise to excess capacity in some infrastructure sectors, such as power, the share of infrastructure as a percentage of regional GDP is expected to rise from 4 to 7 percent in the next few years. Even assuming better demand management and operating efficiency, rapid urbanization and the rise of megacities will continue to place considerable pressure on infrastructure across Asia. Clearly, the region offers new markets and investment opportunities, diversification, and returns. But this means huge financing requirements. Private capital flows are key. There was a time when official capital flows to developing countries were twice as high as private capital flows - about US$50 billion official flows against $25 billion private flows in the early 80s. Now, developing countries receive $300 billion from private sources compared with about $60 billion from official flows. However, more than 80 percent of private capital flows into the world's emerging markets go to only 12 countries - and just 5 of them are in the Asia-Pacific region. Clearly, the challenge to ADB is to facilitate the flow of private capital into the region, and to do this in a way that benefits not just a few but all our developing member countries. There have been some reports recently that capital flows into the region, overall, have slowed down. In this situation, an institution such as ADB has a key role to play in attracting private capital into the region. One way to do this is through public-private partnerships.

**Public-Private Partnerships**

Clearly, the provision of infrastructure is not a matter for the public sector alone, with its limited finances and entrepreneurial skills. Nor is it a task to be undertaken by the private sector on its own, although there has sometimes been a perception that the private sector can "do it all." The reality is that the private sector has limited capacity to influence policy, enact laws, and regulate markets. In short, only through a combined effort - a public-private partnership - can the infrastructure challenge be met. We believe that the public and private sectors should complement each other in the overall development effort. Government efforts to form partnerships with the private sector will lower the risks and costs associated with investments,
particularly for infrastructure projects. ADB can help identify the risks and costs associated with the present business environment, and support the development of workable public-private partnerships. The role of government in risk mitigation is crucial for projects in a sector newly opened to private investment. Care must be exercised, however, in judging where the government's development function should cease and market mechanisms and institutions should take on the usual project risks, and where continued support to encourage project financing is still warranted.

**The Government and The Private Sector**

First, a few words about the role of the government versus the role of the private sector. The private sector is usually able to bear project risks — construction, technical, operating, and investment/commercial risks. But in many developing Asian countries, this is difficult because of the weak institutional framework and the poor track record of government in providing the required support. At the same time, the private sector has not always fully appreciated social concerns such as project impacts on the poor and the environment as well as issues of resettlement and governance.

In these circumstances, what contributions can governments make?

First, they can maintain macroeconomic stability and promote appropriate structural policies.

Second, we would like to see governments create the necessary enabling environment for private sector involvement, including the legal regulatory framework, competitive mechanisms, model agreements, standard pricing formulations, and the setting of tariffs. Governments need to foster domestic capital markets as a source of long-term, reasonably-priced local currency funding. Government regulation is also required to make infrastructure affordable to the poor and, further, to give poor people access to project design and bidding documents.

Third, we would like to see governments create investment opportunities for the private sector, mainly by privatizing public enterprises that can be more efficiently run by the private sector. Many public sector corporations represent a drain on government coffers, with the government running the risk of throwing good money after bad. Privatizing such corporations in a responsible and prudent manner would clearly bring fiscal benefits to governments, allowing them to fund socially relevant, pro-poor programs. But public-private partnerships alone cannot do the job and need to be complemented by domestic resources, foreign private funds, and official development assistance. This leads me to the next theme of this paper - a new perspective on financing development projects.

**Financing Development Projects: A New Perspective**

[Recent Developments - A New Environment] We do not now detect the anxiety about Asia's future that was so prevalent 12 months ago. At the Asian Development Bank, we are optimistic about Asia's prospects - although we are not complacent. On the social front, real wages and employment levels are rising, although employment is still below pre-crisis levels because many of Asia's
problems remain. Three key areas of resource mobilization in the post-crisis era merit particular attention:

i. domestic resource mobilization via the capital markets,

ii. resource mobilization through the private sector, and

iii. resource mobilization through international financial institutions (or IFIs).

[Domestic Resource Mobilization via Capital Markets.] Before the crisis, Asia was home to many banks and banking groups, but sound banking practices were often absent. When the banking system came under stress during the crisis, no alternative form of financial intermediation was available. The absence of well-developed capital markets made emerging market economies fragile and more dramatically exposed to economic crises and exchange rate fluctuations than the more industrialized economies. Hence, in Asia the banking crisis triggered a full-fledged financial sector crisis, with a major impact on growth, and an increase in poverty. Another lesson from the crisis was the need to address the demand for capital market instruments. Insurance market liberalization, pension fund and social security reform, and so on, are measures that create demand for capital market instruments, which can play a key role in developing the market. Governments can influence the supply of such marketable instruments through their borrowing and debt management policies as well as transparency and disclosure policies that inspire confidence in markets and issuers.

We at ADB support this approach as we believe that capital market projects have a significant catalytic impact in channeling foreign and domestic capital to productive sectors of the economy. ADB has participated in many capital market programs designed to develop local markets; and in a number of capital market transactions, including offshore, country and regional funds, and, more recently, specialized funds such as the Thailand SME Investment and Restructuring Fund. The Thai fund will invest in small and medium-sized enterprises to spur entrepreneurial development in the country. We are investing in this fund together with the Japan Bank for International Cooperation (JBIC), KfW of Germany, and the State Street Global Advisors Inc. of the United States.

Let me turn now to a second and increasingly important source of development financing -- the private sector.

[Mobilizing Resources through the Private Sector.] Asia was a huge success story in the area of resource mobilization, responding to globalization and absorbing private flows - until the crisis. Since then, there has been renewed appreciation of the role of the private sector as an engine of growth and a necessary ingredient in helping to reduce poverty. On the other hand, while market-led growth and the benefits of private sector development offer promise, they are certainly not a panacea. They pose major challenges to government, which needs to change in response. If government does not promote good corporate governance, privatization will not bear fruit, nor will private sector development bring
broad-based growth. If government ignores safety nets and society's needs, growth is unlikely to be equitable. Corruption and lack of transparency are issues that need to be addressed. And there needs to be equitable access to education, credit, and land ownership, to ensure that market-led growth offers solutions for the socially excluded. So, while resource mobilization through the private sector is important, the role of government remains equally critical.

But, as I said we cannot ignore the increasing important role of the private sector in mobilizing financial resources for development. At ADB, we have adopted a Private Sector Development Strategy designed to provide a coherent framework within which to promote the private sector to support growth and reduce poverty. Under the strategy, ADB will utilize the capabilities of both its public and private sector operations to develop a synergy between the two and deliver solutions to problems that impede private sector growth in ADB's developing member countries.

Let me now turn to the international institutions themselves. The international finance institutions (or IFIs) have a significant role to play in mobilizing resources in post-crisis Asia. However, the role of the IFIs has been evolving since they were first set up to function as reconstruction agencies. The second phase of IFI development came with their transformation into "project banks." The third phase started in the 1980s with the transition from "project banks" to "policy banks" focusing on policy reforms.

We are now in the fourth phase, brought on by the realization among IFIs that, to remain relevant to their member countries, they need to act as catalysts promoting private sector capital flows. 

**ADB's Private Sector Development Strategy** stresses this role of facilitating private sector capital flows. The strategy has two main thrusts. First, lending and policy advice to create a sound enabling environment for domestic and foreign private sector investment. Second, wearing its private sector hat, a direct role for ADB in financing selected private sector projects. In our goal to be more responsive to the financial needs of both governments and the private sector to increase the flow of resources, we are developing credit enhancements through guarantees for private sector projects that will cover risks that the private sector cannot easily absorb or manage on its own. Mitigating these risks can make a crucial difference in mobilizing debt funding for private sector projects. ADB has recently launched its political risk guarantee program, or what we call PRG, designed to facilitate commercial cofinancing by covering specifically defined sovereign or political risks. I am happy to report that we have recently approved three projects with PRGs: two in the power sector - one in Bangladesh and the other in Sri Lanka; as well as a trade finance project in Pakistan to boost the country’s exports. These projects might not have come about, had the risks not been mitigated with the ADB's assistance.

In short, it is not just the amount of lending by a development bank that matters - although that is very important - but also the bank's role in mobilizing resources,
leveraging relationships, and continually developing financial instruments that are responsive to client needs. For example, at ADB we are now examining the feasibility of providing guarantees for local currency financing to further boost the level of long-term, reasonably-priced local currency available domestically for project finance in our developing member countries. We are forming partnerships, not only with the private sector but, increasingly, with other players concerned with development - foundations, nongovernment organizations, and civil society. Ideas count, and development banks can play a major role in generating the ideas and establishing the coalitions that mobilize resources for developing countries. The IFIs will not just be lenders, but increasingly, partners with their clients, helping to share good practices and adapt ideas to local needs. Increasingly, generating such ideas and mobilizing resources will be the IFIs' most powerful roles.

Conclusion
Globalization poses a huge challenge to the private sector and to Asia's developing countries. Resource mobilization through capital markets, through the private sector, and with assistance from international agencies will be crucial. The Asian currency crisis has highlighted the importance of managing capital flows well; it demonstrated the new dimension these capital flows can take; and it focussed our attention on the evolving roles of IFIs, governments, and the private sector. ADB is committed to helping to craft solutions to the challenges that lie ahead.
Thank you and a very pleasant day to you all.

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