

THE ADB'S PRIVATE SECTOR OPERATIONS¹

By Violeta Q. Perez-Corral²

Introduction

In the past two decades, two global trends have emerged. First is the increasing privatization of state enterprises in such areas as infrastructure, economic production and distribution. According to the 1994 World Development Report (World Bank), in 1994 alone, there were 81 publicly offered privatizations worldwide, and 28 of them (worth US\$11.7 billion) were sales by Asia-Pacific governments. Telecommunications and power alone accounted for 86.5% of all infrastructure privatizations in 1988-92.

Second, private financial flows has overtaken official development assistance (ODA) as the primary source of development financing for Southern countries. Private capital flows (in the form of foreign direct and portfolio investment) are now thrice the level of ODA, surpassing ODA in 1991 and is steadily growing at a rapid pace. Their growth has been led by foreign direct and portfolio investment. In 1986, private flows totaled US\$ 19.9 billion; this increased to US\$ 113.2 billion in 1993.

In 1994, private capital flows reached a staggering \$ 172.9 billion, as compared to official flows of \$54.5 billion. Globally, private flows are heavily concentrated in East Asia (\$30 billion, 1990-92 average) and Latin America (\$20 billion, 1990-92 average). Five countries -- Argentina, China, Malaysia, Mexico and Thailand -- absorbed more than half of all foreign direct investment flows to developing countries in 1989-1993. China is the largest such recipient in the whole world.

Along with these trends, developing member countries (DMCs) of the Asian Development Bank (ADB) have increasingly opened to the private sector areas which were the traditional domain of the public sector, such as power, urban transportation and water and sanitation sectors.

Private Sector Strategy

Hard-pressed to find a niche for ADB in the overall "development" financing arena, ADB strategists have come up with a new approach to promote private sector development in the Asia Pacific region. The new strategy places more and more emphasis on the role of the private sector and merely assigns a regulatory role to governments.

The ADB's Board of Governors in their speeches at the May 1995 Annual Meeting do not speak with one voice vis-a-vis the relative role of the private and public sectors in development. The positions range from those very supportive of the private sector role (India: *"ADB has to catalyze private investment by providing financial support from OCR and by 'guarantee structure' which can act as a 'comfort' to investors"*), to cautious (Indonesia: *"ADB should determine how it can best complement the private sector, but risk must be properly allocated between the parties"*), to outright rejection (Denmark: *"ADB is a development Bank and not a commercial Bank; Private sector and free market are not magic words which solve all the problems; Commitments to the Copenhagen Social Summit must be a guiding principle for ADB as well"*). (See Table 1)

Despite these unresolved issues, however, within the Bank's Board of Governors, the ADB set in

¹ Presented at the *Third NGO Regional Consultation on ADB Policies and Issues*, 25-28 April 1996, UP Bahay Kalinaw, Quezon City, Philippines. [Organized by the NGO Working Group on the ADB].

² The author is Program Officer in charge of the ANGOC's program on multilateral development banks.

place a redefined private sector and cofinancing strategy which places a greater role on the private sector in development efforts.

In June 1995, three main thrusts were identified: (1) sharper country focus; (2) greater attention to the needs for physical and financial infrastructure in developing member countries (DMCs); and (3) sustained access of DMCs to international loans and capital markets. The Private Sector Group (PSG) at the ADB, created in June 1995 during the Bank's reorganization, has focused on five key activities: (a) Infrastructure Investment; (b) Capital Markets; (c) Privatization; (d) Large, complex industrial deals; (e) AFIC: small projects, manufacturing and commercial deals

The new Private Sector Strategy also includes improving the policy environment for the private sector and provides for direct investment in private sector firms in its DMCs. These changes often require legislation and strengthening of the regulatory and supervisory agencies involved.

Cumulative private sector operations (PSO) of the ADB (1986-1995) totaled \$1.2 billion, concentrated in 10 countries -- Bangladesh, PRC, India, Indonesia, Malaysia, Nepal, Pakistan, Philippines, Thailand, Sri Lanka. On an annual basis, private sector operations peaked in 1987, followed by 1995, 1989.

Relative proportion of private sector loans by country (1983-95) -- Pakistan (26%), Philippines (20%), India (19%), PRC (6%), Thailand (5%), Bangladesh (5%), Nepal (3%), Sri Lanka (<1%).

Cofinancing and Guarantee Operations

The Bank's redefined cofinancing strategy, approved in April 1995, aims to mobilize additional private capital for DMCs and to continue to promote official cofinancing. Priority sectors are infrastructure and finance. This policy states that --

- ♣ the use of guarantees will be expanded and a sovereign risk (political risk) guarantee instrument will be introduced;
- ♣ official cofinancing and the targeting of concessional development assistance to ADF-only countries will be emphasized;
- ♣ parallel term-loans for projects in investment-grade DMCs will be promoted;
- ♣ documentation and fee structure for market-sourced cofinancing arranged under the Bank's Complementary Financing Scheme (CFS) will be improved;
- ♣ proactive arrangement of export credit cofinancing will be made.

In 1995, cofinancing from all sources amounted to \$2.5 billion, which was 45% of the Bank's total lending for the year. The amount represented a 58% increase over that of the previous year. In other words, for every US dollar lent by the Bank, 45 cents was mobilized through the cofinancing function. Hence, the cofinancing/Bank's own lending ratio is 1.16:1 in 1995. (Please refer to Figure 2 on cumulative ADB co-financing, 1970-93.)

Cofinancing operations focus on traditional infrastructure projects, with the energy sector receiving the biggest share of cofinancing (50%), followed by transport and communications (16%) and agriculture and agro-industry (15%). The largest cofinancing transaction was for a power generation and transmission project in the Philippines (\$523 million). Pakistan received \$3895 million for its national drainage problem and Thailand \$300 million for a regional road.

Official cofinancing reached a historical record of \$2.2 billion (\$1.3 billion from bilateral agencies and \$900 million from multilateral institutions), and accounted for 89% of total cofinancing. Japan continues to be the main source of official cofinancing. OECF and Japan Export Import Bank cofinancing amounted to \$1 billion for 9 projects. The World Bank supported the Bank's projects with \$771 million. The largest cofinanciers of the ADB are: JEXIM Bank, OECF, WB and the European Investment Bank (EIB).

Cofinancing from commercial sources amounted to \$216 million (13% of total cofinancing) for four projects, employing cofinancing modalities such as: CFS, parallel loan and guarantee-supported financing. Commercial cofinancing was arranged for two public sector projects: (a) a parallel syndicated loan for \$55 million for an energy project in PRC; (b) Bank' s partial credit guarantee to partly finance the Northern Luzon Transmission and Generation Project. This latter transaction marked the beginning of efforts by the Bank to introduce high-quality infrastructural debt to institutional investors in the bond markets.

The Banks' Private Sector Lending Record

It should be noted that the Bank has traditionally financed small and medium-scale enterprises in the private sector through credit lines to development finance institutions (DFIs) either guaranteed by or channeled through DMC governments. In 1983, however, private sector lending has shifted dramatically with a program of direct assistance, without government guarantee, to the private sector.

Following is a chronology of ADB' s policy on private sector lending without government guarantee:

1983: *Direct assistance to private sector.* The ADB has responded to private sector thrusts in its DMCs with a program of direct assistance, without government guarantee to the private sector.

1986: *Direct lending without government guarantee.* ADB introduced direct lending to private enterprises and financial institutions without government guarantees. These loans are provided on terms comparable to similar loans from commercial sources.

1987: *India – polyester fiber project.* The Bank gave a loan of \$16 million for a polyester fiber project in India in 1987, the first private sector investment in the country.

1989: A *Private Sector Department* was created to act as the focal point of private sector activities in the Bank.

AFIC. Regionally, the Bank made an equity investment of \$35 million in AFIC (Asian Finance and Investment Corporation), a regional investment company created by the bank and other private financial institutions within and outside the region. AFIC is an independent private sector entity which complements the Bank' s support for private enterprises. ADB is AFIC' s largest shareholder, holding some 30% of its paid-up capital of about \$115.5 million. AFIC provides loans, equity investments, syndication of financial packages, underwriting, guarantees, leasing, administration of trust funds, and business advisory services.

Philippines - private power generation. The Bank supported the Philippines' first private sector venture in the power generation sector. Hopewell Energy (Philippines) Corporation will operate the scheme under the BOT (build, operate, transfer) scheme for 12 years before handing it over to the National Power Corporation.

Nepal – cotton spinning mill. The first private sector in Nepal without government guarantee is a \$4 million equity and loan to Jyoti Spinning Mills Ltd. to set up a modern cotton spinning mill.

Thailand – BOT transport project. The Bank also financed Thailand' s first BOT project-- the Bangkok Expressway Co. Ltd -- which is a 37-km multi-lane toll expressway to ease Bangkok' s severe traffic congestion. It is one of developing Asia' s most ambitious infrastructure venture undertaken by the private sector, totaling over \$1 billion. Bank investment was \$40 million (\$10 million in equity and \$30 million in loan).

1990: The Board approved an increase in the existing ceiling of \$375 million for private sector investments without government guarantee to \$1 billion up to end 1992.

Laos, Sri Lanka – capital market development. Two financial sector loans were given to Lao PDR and Sri Lanka to help develop their capital markets. The Lao PDR loan was intended to assist the government in establishing and developing a "sound and responsive" banking system through the introduction of market-oriented interest rates, among others. The loan to Sri Lanka is to support policy reforms and institutional strengthening in the finance sector and accelerate the shift of productive assets from the public to the private sector, including the privatization of the National Development Bank of Sri Lanka.

Laos, Indonesia, Tonga – privatization of state-owned enterprises. The Bank also approved TAs (Technical Assistance) related to the privatization of government-owned corporations in Indonesia, Lao PDR and Tonga.

1991: Nineteen investment projects were approved totaling \$215 million (\$28 million in equity investments and \$187 million in loans without government guarantee). Another \$280 million was approved, with government guarantee, for onlending to productive enterprises, including funding for private small and medium industrial enterprise (SMIEs). Cumulative credit lines to DFIs by end-1991 totaled \$4 billion to finance nearly 18,500 enterprises, mostly in the private sector.

1992: *Private Sector Support Unit created.* PSO was integrated in the Bank's overall operational activities and the Private Sector Support Unit in the Private Sector Department was created. The Unit will: (a) advise on privatization, financing of projects through build-operate-transfer (BOT) or build-operate-own (BOO) schemes and capital markets; (b) assist operational departments in promoting and facilitating private sector alternatives and project formulation Bankwide; (c) undertake regional operations in capital market/financial sector development; (d) assume responsibilities for portfolio management. Additionally, staff of the Private Sector Department have been redeployed to Resident Offices in Bangladesh, India, Indonesia and Pakistan to help evaluate and process private sector projects. (Response from DMC countries been encouraging. Several have given general assurances with regard to the Bank's right to repatriate payments arising from these operations free of tax.)

Promoting macro-environment policy framework, BOT-BOO. The Bank's dialogue with DMCs has been focused on foreign investment policies and regulation (including level of foreign equity ownership, taxation, and repatriation of dividends and capital gains) and policy reforms and other measures to develop the securities markets. While creating a favorable economic and policy environment is the basic objective, the Bank's second objective is to accelerate private sector development through BOT/BOO projects in power, roads, and telecommunications sectors, and through the privatization of state-owned enterprises. The third objective is to provide direct assistance to financial and commercial enterprises having a developmental, demonstrative and catalytic impact, through loans without government guarantee and equity investments.

1993: *Integration of PSO into overall operational activities.* This marked the first year when the Bank's private sector activities were integrated into the mainstream of its sector operations. The integration, initiated in July, was designed to ensure that private sector activities benefited from the various projects departments close knowledge of the DMCs. Private sector proposals are now processed by the projects departments concerned. Private sector priorities now constitute a thematic priority in the Bank's strategic planning process. The needs and concerns of the private sector in DMCs are reflected in the Bank's country operational strategies and work plans.

Some Bank-funded private sector enterprises: (a) an oil terminal in Pakistan on a BOO basis as part of the government's privatization program; (b) two power plants in the Philippines being built on a BOT basis; (c) two agro-industrial ventures in Indonesia and Philippines; (d) credit lines to four private non-Bank financial institutions in India, the first such credit facility in the country, to augment their resource base for financing private enterprises.

1994: Asian Infrastructure Fund. After a decade of private sector activities, the Bank had approved equity investments and private sector loans totaling \$954.7 million in 104 operations. In 1994, equity investments were made in the Asian Infrastructure Fund (AIF), which has been set up at the Bank's initiative, among others.

At the Bank's Annual Meeting in Auckland in May 1994, a seminar on Law and Development was held to focus on legal issues relating to: (a) the corporatization and privatization of state enterprises in the Bank's DMCs; and (b) private sector infrastructure development through BOO and BOOT (build-own-operate-transfer) arrangements.

1995: Capital market development and infrastructure. Eight projects, totaling \$297 million (the second largest annual volume of private sector investments) reflected the Bank's strategy of maximizing its catalytic role in capital market development and the infrastructure sector. Several of the investments were the first of its kind and were almost exclusively developed by the Bank: (a) a regional company to finance infrastructure projects (AIF); (b) a sub-regional fund to promote economic development in the Greater Mekong area; (c) a regional bond insurance company.

Based upon projections, the Bank's total private sector investment approvals should mobilize additional funds totaling \$1,3367 million. This would indicate that for every US dollar invested by the Bank, an additional \$8 would be mobilized from the private sector.

Governance as 'sound development management'. In October 1995, the Board of Directors approved a policy on *Governance: Sound Development Management*, which highlighted the importance of legal frameworks for the private sector and 'for development more generally'. In 1995, the Bank approved, implemented or completed 45 law-related technical assistance and loan projects, including: (a) developing an institutional and regulatory framework for the leasing industry in Sri Lanka; (b) strengthening Tuvalu's foreign investment framework; (c) developing a legal framework and formulating legal training program to meet the needs of a market economy in Mongolia; (d) preparing national regulations for the public sector in Lao PDR; (e) TA for state enterprises insolvency reform in PRC.

Initial issues raised by NGOs

At the NGO campaign at the 1994 ADB Annual Meeting in Auckland, NGOs raised initial concerns on a seeming over-reliance on the private sector as the primary engine of development. Questions were asked regarding the criteria used in the selection of these projects. Moreover, NGOs are dubious about transparency, accountability and participatory processes in ADB-supported private sector projects. Can public citizens rely on the private sector to comply with social and environmental policies and guidelines of the ADB? Or, is the private sector exempt from these policies? A case is cited below to highlight these issues.

The Marcopper Fiasco

To the above set of concerns should be added further questions in the light of a very recent mining disaster of unprecedented proportions in Marinduque, a small island in the Philippines. Marinduque Copper Mining Corporation (Marcopper), a 40% Canadian owned (Placer Dome) multinational company operating in the island of Marinduque, has been granted two successive private sector loans, totaling \$40 million, in 1991 and 1992 by the ADB. In late March 1996, Marcopper mine tailings spilled over to the nearby Boac River, which immediately destroyed fish and marine resources. Environmental officials say Boac River is now dead, covered with foul-smelling mine tailings. Hundreds of families living near the river were rendered isolated. Futile attempts at blocking the tailings from flowing into farmland have been made. Reports from the Department of Science and Technology indicate that Marcopper's tailings containing poisonous substances. The government has banned Marcopper Mining Corporation, its Canadian partner and subsidiary firms from further mining activities. Marcopper officials are now facing criminal charges. In April 1996, ADB officials went

on a mission to the site; its unofficial findings parroted Marcopper' s line that the mine tailings is mostly mud and not toxic, and hence the death of marine life. Some quick questions:

1. What is the selection criteria for the ADB' s private sector lending- which private multinationals get to be favored by the ADB' s loans?
2. In the light of the Marinduque disaster, how will the Bank tighten environmental and social conditionalities on private sector projects?
3. What information disclosure policies guide private sector operations of the Bank?
4. How is the Bank, financed by public funds, accountable for Bank-funded private sector lending which result in public harm and disasters?
5. To save its skin, the Private Sector Group of the ADB would rather follow the line of the clearly erring private sector company, and run against the official reports and findings of the Government of the Philippines, one of its stockholders and co-owners. **Where, then, lies the loyalty and accountability of the ADB?**

Table 1. ADB's Role in Promotion of Private Sector Participation, as excerpted from Speeches of the ADB Board of Governors at the 28th Annual Meeting (3-5 May 1995, Auckland, New Zealand)

COUNTRY (voting %)	ON ROLE OF ADB/ PRIVATE SECTOR
Japan (21.753 %) Masayoshi Takemura (Gov)	Japan regards ADB as core of financial assistance in the Asia-Pacific region; Need for Bank to play leading role in promoting regional cooperation
United States (11.058 %) Jeffrey Shafer (Governor ad interim)	Private financing accounts for only ~7 % -- should increase; Caution against Bank's traditional approach to cofinancing that tends to promote status of some private creditors rather than getting good projects off the ground
People's Republic of China (4.779 %)/ Chen Yuan (Alternate Governor)	Objective of reform in China: to establish a socialist market economy
India (4.702 %) N.K. Singh (Governor ad interim)	ADB has to catalyse private investment by providing financial support from OCR and by "guarantee structure" which can act as a comfort to investors
Indonesia (4.096) Gov. Mar'ie Muhammad	ADB should determine how it can best complement the private sector, but risk must be properly allocated between the parties
Canada (3.948%)/ Nicole Senecal (Gov ad Interim)	Support for private sector development
Republic of Korea (3.816 %) Jae-Hyong Hong (Governor)	Bank should take a greater role in addressing infrastructure shortage in the region; ADB should play the role of catalyst in fostering regional cooperation in the context of environmental destruction transcending national borders
Pakistan (3.349 %)/ Aftab Ahmad Khan (Gov ad interim)	Private capital has overshadowed ODA but it is essential to recognize that it is not a substitute; Ensure that the Bank is operating well within its charter and comparative advantages
Germany (3.328 %)/Eberhard Kurth (Gov ad interim)	Clearer definition of Bank's potential in promoting private sector; Creating an enabling environment for private sector rather than engaging directly in large scale private sector operations
Malaysia (2.230 %) Clifford Herbert(Alt Governor)	Bank has to be more active in its attempt to promote and energize the private sector
Thailand (2.230 %)/ Chavarat Charnvirakul (Gov ad interim)	Fully supportive of regional cooperation to foster economic and social development in the DMCs; Private sector should finance commercially viable projects
Philippines (1.966 %) Roberto de Ocampo (Governor)	Bank should double its efforts in providing more technical assistance and support for infrastructure development including financing by the private sector
France (1.959 %) Daniel Maitre (Temp Alt Gov)	Large disparities in growth within the region calls for a close look at regional cooperation
Bangladesh (1.763 %) GovMohammad Saifur Rahman	Fundamental objective of all developmental activities must be poverty alleviation
Italy (1.602 %)/Roberto Mori (Temporary Alt Governor)	Bank can play a meaningful role to continue opening up markets not only to the region but to the rest of the world
Netherlands (1.067 %) Pieter Stek (Governor ad interim)	Bank now well on the way to changing from an institution predominantly engaged in traditional growth projects into an institution with a broad based policy agenda aimed at sustainable development; Important that the ADB define its role vis-a-vis other multisectoral institutions
Switzerland (0.764 %) GovNicolas Imboden	Bank should only be active in areas where private sector is not yet present

Viet Nam (0.598 %) Gov Cao Sy Kiem	One should not lose sight of physical infrastructure
Denmark (0.597 %) Ole Loensmann Poulsen (Governor)	ADB is a development Bank and not a commercial Bank; Private sector and free market are not magic words which solve all the problems; Commitments in Copenhagen (Social Summit) must be guiding principle for ADB as well
Sweden (0.597 %) Malin Karre (Alt Governor)	Bank can participate in sectors which attract private capital, cannot compete with private capital in size, but it can complement it
Spain (0.597%) Juan Calaf (Gov ad interim)	Hope private sector policy will provide necessary framework to encourage private initiative, but it is important to preserve national character
Nepal (0.464%) Bharat Mohan Adhikari (Gov)	Bank should initiate studies for inclusion of Nepal with other South Asian countries in growth triangles
Papua New Guinea (0.428%) Gerea Aopi (Alt Governor)	How far does private sector strategy sincerely address uniqueness of South Pacific economies?
Cambodia (0.398 %) Keat Chhon (Gov)	ADB has distinct developmental role due to: multilateral character, location in the region, comprehensive range of financing instruments