

Critique of the Asian Development Bank's Private Sector Development Strategy

November 17, 1999

This analysis, jointly prepared by a number of Washington DC-based non-governmental organizations (NGOs), outlines our initial thoughts on the emerging Asian Development Bank's (ADB's) *Private Sector Development Strategy* (see *ADB Private Sector Development Strategy*, September 1999). We welcome the ADB's willingness to engage NGOs in this matter and we look forward to continuing and broadening the consultative process on the relationship between the ADB and the private sector. It is our hope that the issues and recommendations raised below will be clearly reflected in the final version of *the Strategy* to be presented to the Board.

1. Strengthen the Linkage Between Private Sector Development and Poverty Alleviation.

1.1. Fostering "pro-poor growth" via the private sector requires promoting economic activity that directly responds to the needs of the most disadvantaged sectors of society. The ADB should further elaborate on how each component of its strategy will address the overall objective of sustainable poverty alleviation and prioritize those areas where the linkage between private sector development and poverty reduction is strongest. This, combined with a more rigorous means of assessing the environmental and social impact of private sector programs, will help the ADB avoid the dubious assumption that any kind of economic growth will by definition result in a significant reduction in poverty.

1.2. *The Strategy* already identifies a number of the areas where the linkage between economic growth and poverty reduction is well established:

- Investing in small and medium sized enterprises - especially those owned by women - and working to broaden access to small-scale but long-term financing should promote job creation and poverty reduction.
- Fostering economic growth spurred by domestic investors/companies tends to maximize the potential multiplier effect since profits are often reinvested locally rather than repatriated.
- Strengthening the capacity of both public and private institutions to integrate and monitor social and environmental priorities will help ensure sound corporate governance and, by extension, sustainable development.

1.3. These areas should be prioritized while other areas, such as developing physical infrastructure, should focus on ensuring that social and environmental concerns are clearly integrated. For instance, the *PSD Strategy* should expand on how it intends to guarantee that privately-provided infrastructure will reach marginalized communities. In too many cases we have seen examples where much-needed services for the poor are bypassed in favor of more commercially viable development projects. The benefits of private sector development are often offset by the parochial priorities of a competitive

market. For instance, the International Finance Corporation (IFC) recently surveyed companies operating in three Asian countries and asked them to identify governmental obstacles to doing business (see IFC Discussion Paper #33). Overly strict labor and environmental regulations were among the top "obstacles" named. The desire for a shorter project cycle, which can compromise adequate public consultation, was also expressed. The *PSD Strategy* should put greater emphasis on explicitly developing the core values of sustainable development and poverty alleviation throughout its private sector programs. This will help the ADB avoid compromising long-term social cohesion and wellbeing in the interest of facilitating short-term profit maximization.

1.4. One way of doing this is to expand and rigorously apply initiatives like the ADB's proposal to track impact via a development scorecard. This proposal, modeled after an evaluation mechanism used by the IFC, can be a valuable tool. We recommend that, in addition to the scorecard, the Bank should strongly consider "upstreaming" development objectives in the project cycle, so those development objectives are considered before financing. We have called this concept a "development-based investment screen," which can be used in conjunction with an ex ante scorecard. Furthermore, the *PSD Strategy* should commit the Bank to measure direct poverty alleviation impacts by using social and local development indicators, such as impact on women, reinvestment of profits in the local economy, impact on income distribution, etc.

1.5. Finally, with respect to Bank Processes and Procedures, the Bank should more clearly describe how the *Strategy* will be integrated into the Country Operational Strategy (COS) and the Country Assistance Plan. In particular, we are concerned that some developing member countries (DMCs) may eventually rely on the ADB staff or outside consultants to develop a private sector development strategy for the COS. The development goals of DMCs themselves need to be reflected and preserved in this push for private sector development.

2. More Fully Incorporate the Lessons Learned from the Asia Crisis and Relate International Processes to Domestic Poverty Alleviation.

2.1. We applaud the *PSD Strategy's* efforts in addressing the lessons learned from the Asian financial crisis and in assisting DMCs in creating the capacity to avert such a crisis from taking place. However, we question some of the assumptions relating to market liberalization and globalization (point 12 and Appendix 2) and we request that the *Strategy's* analysis of these processes be more explicitly linked to a poverty reduction framework.

2.2. A growing number of mainstream economists have concluded that the costs of capital market liberalization have outweighed the benefits. Moreover, there is overwhelming evidence that liberalized capital flows tend to be extremely volatile and have contributed to the spread of financial crises around the world. These crises have been most severe in countries with weak regulation and supervision in their domestic financial markets. In addition, it has been shown that liberalized financial markets constrain national policy makers, but the constraints vary in nature and severity

depending on the country and the time. While the *PSD Strategy* does tackle the governance agenda of such countries and pledges to integrate operations on a country-specific basis, it does not address the costs associated with the liberalization of markets. In addition, it does not propose an agenda that promotes stabilization mechanisms in the DMC' s economy. The *Strategy* should address the inherent information problems in liberalized international capital markets, and outline an approach that prevents short-term speculative flows from destabilizing domestic economies. For example, the *Strategy* could insert language on a variety of measures such as: capital controls, exchange controls, and transaction taxes (including a "Tobin tax" on foreign exchange transactions) - which can help discourage short-term speculative capital flows, restore greater national policy autonomy, and encourage more stable, long-term investment.

2.3. In addition to the significant emerging markets, there are billions of people in other Asian countries whose economies have rudimentary financial institutions. In the words of economists Charles Saludo and Musunuru Sam Rao, these economies are almost "completely by-passed by the developments in the global system." In most of these economies, more than 50% of production takes place in the informal sector. In these environments of daily subsistence, a fundamental challenge is how to ' create' and how to ' promote' the development of a formal and viable financial system that can be used as a potent vehicle for poverty eradication. What may be necessary is a package to help them ' build' viable financial systems. This process, and the way in which it will be grounded in a poverty reduction framework, could be more fully explained within the *PSD Strategy*.

2.4. Furthermore, we would like to better understand the linkages between the ADB' s private sector strategy and the ADB' s strategy on trade policy. Similar to financial liberalization, trade liberalization has not succeeded in generating sustainable development (see the *1999 UNCTAD Trade Development Report*). We believe that the *PSD Strategy* primarily addresses the financial sector and fails to fully analyze the role played by trade liberalization within the broader context of poverty alleviation.

3. Develop Private Sector Operations Policies that Reflect Environmental, Labor and Social Concerns and a Framework in Which to Enforce These Policies.

3.1. Beyond traditional extractive and infrastructure project lending (which we address in Section 4 of this report), the *PSD Strategy* includes three clear goals. They are as follows:

- to shift the role of government in the market from owner and producer to facilitator and regulator
- to promote private sector participation in physical and social infrastructure including basic services for the poor, and;
- to create an "enabling environment and incentives to make markets work better."

3.2. However, these basic objectives are not clearly linked to transparent policies that will promote environmental, social and labor goals and safeguard protections. For

instance, in the area of commercialization and privatization of state-owned enterprises, there is no policy on how the ADB will determine whether the proposed privatization is beneficial to the environment, to labor, and to key social issues. Advocates of privatization cite its numerous potential benefits, such as improved economic efficiency, better management and creation of government fiscal space. However, case studies now clearly indicate that if the appropriate policy reforms are not implemented prior to the privatization process there may be adverse effects. At best a country might not realize the full efficiency gains. At worst, the country may experience significant social economic consequences, such as increased poverty and unemployment, disproportionate impacts on women, and the collapse of social services and environmental protection. The ADB should design strategies and policies that will aid efforts to alleviate significant environmental, social or labor impacts if a privatization project with negative impacts does go forward. We would like to recommend that the ADB' s final strategy on privatization ensures that these concerns are sequenced so as to be fully and transparently addressed by the Bank prior to moving forward with a privatization project.

3.3. We strongly urge a specific reference to the problems of migrant workers within the *PSD Strategy*. While the document does make reference to the advantages of “increased trade and flow of labor” brought about by globalization, it does not address the particular vulnerabilities of the Asia-Pacific region’s migrant labor workforce. The vulnerability of this workforce was highlighted dramatically after the start of the Asian financial crisis. Human Rights Watch has noticed that more than seven million Asians work outside their own country, and that more than two million new migrants leave their home countries in Asia legally each year. As the Asian financial crisis began to take hold, some governments, most notably Malaysia, reacted by deporting migrant workers en masse. These workers were forced to return to countries whose economies had contracted, meaning there was little likelihood of finding work. In addition there were insufficient safety nets in place to assist their transition. Moreover, the migrant workers suffered the brunt of harassment and abuse, including physical violence, as they sometimes became the scapegoat for social and economic ills. Women have been particularly vulnerable. In the 1980’s it was estimated that the female migrant population has outnumbered the male migrant population. Although governments throughout the Asia-pacific region actively promote labor migration, few have policies designed to protect such workers in host countries or provide them with adequate safety nets. In addition to promoting labor mobility, ADB policies and programs must ensure that governments promote adequate safeguards for migrant workers.

3.4. In the area of effective financial intermediation, we have similar concerns for environmental, social and labor standards. Investment funds directed at sustainable development initiatives have the potential to catalyze the private sector. However, the social, environmental and labor impacts of the ADB’ s 29 investment funds are not analyzed in the *Strategy* and no attempt is explicitly made to learn from the past. Prior to going forward with a final strategy, we think a ‘*lessons learned*’ analysis should be prepared and released for public input. This will result in a more coherent and transparent way of attacking these issues before systematically going forward.

3.5. We support the ADB initiative for increased outreach to small-and medium-sized enterprises. We also believe that the ADB's private sector strategies on good corporate and public governance are directly related to effective implementation of this operational focus. A major obstacle preventing the inclusion of the private sector more effectively in poverty reduction strategies is a lack of open competition. Closed processes induce corruption. Corrupt practices can be particularly problematic in bidding systems that are not transparent. A corrupt, bribery-laden atmosphere does not allow small-and medium-sized businesses to compete viably. Such circumstances can also cause significant harm to the environment. For example, many renewable energy businesses are not yet at a growth level equal to the fossil fuel industry. Therefore, the exclusion of small-and medium-sized electricity producers and distributors can lead to a decrease in the use of clean renewable energy sources. There should be a clear and more direct *PSD Strategy* and policy that links concrete efforts towards building the capacity of SMEs to creating the correct environment to enable these businesses to compete on a level playing field.

3.6. An additional issue to raise in the *PSD Strategy* comes in the area of regional and subregional cooperation. There is an implicit assumption in the strategy that ADB regional corridors will result in long term beneficial development impacts consistent with the growth and poverty reduction mission. Thus, it is also implicitly assumed that the private sector is reducing poverty and creating sustainable development. However, on the contrary, some point to the potential long-term adverse social and environmental impacts of the Greater Mekong Subregion strategy. It is too early to generalize the success. The *PSD Strategy* needs to systematically assess the long-term cumulative and associated impacts on the environment, social concerns and labor standards. It is also necessary to have a policy that ensures that the private sector will create the intended sustainable impacts.

3.7. A final matter with respect to this area of the *PSD Strategy* deals with implementation. Assuming that the ADB intends to integrate these concerns into every aspect of private sector operations, it will need to target the following:

- **Staffing and Review:** The Bank's private sector unit must be qualified to handle these issues in a comprehensive and systematic manner. The *PSD Strategy* must include distinct provisions that will increase staffing, and require reviews to be carried out by qualified individuals with social, environmental and labor expertise. Such individuals should be in charge of making sure that the aforementioned concerns are integrated effectively into every ADB private sector initiative.
- **Transparency and Accountability:** It will not be acceptable to simply throw a blanket of claimed business confidentiality over all aspects of actual implementation of the *Strategy*. To receive support from those directly impacted and the international community at large, the ADB must develop transparent accountability mechanisms that allow effective public review on implementation of policy on a case by case basis. Furthermore, the operations must be subject to independent review after a designated period of implementation.

4. Further Develop Transparent and Accountable Private Sector Project Implementation Procedures.

4.1. While there may be benefits created from a public-private partnership, there is also a need to develop a system of clear guidelines and criteria to determine and define these partnerships. Analyzing the costs and benefits of these relationships is essential. We would like to propose that the guideline/criteria be made an ADB Operation Manual (OM). The ADB should also develop a negative screen for the private sector, meaning those private sector projects/investments that the ADB will not finance because they may have adverse impacts. Likewise, there should also be a positive screen outlining those projects that the ADB will readily finance because they further the goal of poverty reduction. In this way, the decision on what private sector projects the ADB should and should not finance are not left to the task team. In addition, this will ensure that the goal of involving the private sector in poverty reduction will be maintained (this issue was also touched upon in Paragraph 1.4. above).

4.2. With the increasing role of the private sector in areas that have traditionally been public, we find that the issue of transparency at the project level becomes a key area to address within the *PSD Strategy*. Any ADB-funded projects involving the private sector should fully adhere to the existing Policy on Confidentiality and Disclosure of Information. We would like to reiterate that private sector lending should require transparency from the earliest stages of project preparation to completion. In addition, the selection process for involving the private sector in a particular project should be transparent and it should be outlined in an Operation Manual (OM). We do not think that the ADB should use competition as an excuse for not ensuring adequate transparency in private sector involvement. This is particularly true because the private sector now has almost unlimited opportunities in the traditionally public areas, thus the private sector should adhere to the public's right to information and accountability in all areas. We support the statement in the *PSD Strategy* that transparency makes for good business. A full description of what this statement means in practice is necessary.

4.3. When a shift occurs from the public sector to the private sector's provision of goods and services, it is important that accountability to those people affected by these projects be maintained. In addition, in cases where the public sector was not entirely accountable, it will be imperative that the private sector strengthen and heighten its accountability. The crafters of the *PSD Strategy* do not yet address this issue but its inclusion is highly necessary. Furthermore, in the act of being accountable to the local project people, it is necessary that there is meaningful consultation and participation in the decision-making process. This requires compensatory mechanisms in cases where adverse environmental, social, and economic impacts are found, and the assurance that proper mitigating steps are adequately taken.

4.4. In the cases of privatization where a regulatory body will take over control of the sector from the government, it is necessary to develop a clear reference on the scope of authority and accountability of that regulatory body. This should be transparent with full

public consultation. This regulatory body should also have some measure of control over ensuring adequate public accountability and should be accountable themselves.

4.5. We understand that the ADB will apply all relevant public sector policies to those projects that involve the private sector. While we mention above that it is necessary to reconstruct the existing public sector policy to make it applicable to the private sector, we also feel that a mechanism to monitor the adherence of the private sector to those policies is needed. The existing monitoring mechanism – developed for ADB public sector investment – may not necessarily address the situations that occur in the private sector, such as differing levels of government involvement and authority in privatized sectors.

4.6. We support the inclusion of the three-year review. However, the draft of the *PSD Strategy* should outline the need for that review to be transparent. It should also stress the need for the involvement of a wide audience that is given the appropriate information and amount of time in order to conduct a productive evaluation. It must be understood that without a sufficient amount of time in the consultation process, NGOs will not be able to offer their comments on proposed policies.

5. Incorporate a Risk Assessment as well as Lessons from Past Evaluations.

5.1. The *Strategy* does not adequately develop a risk assessment in the areas of globalization and Private Sector Operations (PSO). The *PSD Strategy* outlines the positive aspects of globalization and PSO, but it fails to address the negative issues that may realistically occur. Such adverse effects include both the risks that face the private sector and other stakeholders, such as governments, and the risks that face the environmental and social arenas. Likewise, it was not apparent whether or not globalization would strengthen or weaken governance in both the private and the public sectors.

5.2. In addition to the need for adequate risk assessment, there is a need to incorporate the lessons learned from previous Operations Evaluation Department (OED) studies on the private sector into the *PSD Strategy*. It is necessary to address the issues that the OED studies have raised, and apply them to the *PSD Strategy*.

6. Make Specific Reference to Existing Global Standards.

6.1. Governments, NGOs, and even the private sector have long worked together to develop an international consensus on issues surrounding global international agreements. We note that in several places the *PSD Strategy* refers to the need to promote uniform environmental, labor, and social standards, but it does not reference the actual standards that are most universally accepted today. These agreements should be included in the language of the *PSD Strategy*, even if they are not discussed in depth. This is particularly important in the ADB' s efforts to expand public-private partnership as well as

regional and subregional cooperation. More importantly, how will the ADB harness the capacity of the private sector to address these global international agreements?

6.2. Global standards that we would particularly like to see referenced within the *Strategy* include:

- Environmental Standards such as: the Convention on Biological Diversity; the United Nations Framework Convention on Climate Change, and; the Convention on Access to Information, Public Participation in Decision-Making and Access to Justice in Environmental Matters (Aarhus Convention). The Asian Development Bank would be in a suitable position to work with civil society and the private sector to accelerate the business community' s acceptance of these standards and encourage innovative private sector solutions. Equally important, ADB' s interface with DMCs could be used to enhanced developing country involvement in the Climate Treaty through innovative environmental policies and alternative financing of projects that have clear development benefits while slowing the use of fossil fuels.
- Internationally accepted core labor standards as defined by the International Labor Organization, such as: the right to associate (ILO Convention No. 87); the right to organize and bargain collectively (ILO Convention No. 98); equal employment opportunity and non-discrimination (ILO Convention Nos. 100 and 111); prohibition of forced labor (ILO Convention Nos. 29 and 105), and; prohibition of child labor (ILO Convention No. 138).
- Social Standards that are not necessarily defined as core rights but that should be explicitly cited given the *PSD Strategy'* expressed concern for “social standards.” These include: adequate protections for migrant workers in the Asia-Pacific region (ILO Convention 143, Migrant Workers Convention; adequate protections for home-based workers (ILO Convention 143, Home Work Convention), and; adequate protection of indigenous people whose land may be affected by the operations of private corporations (ILO Convention 169, Indigenous and Tribal Peoples Convention).