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ADB's Private Sector Development Strategy: Private Sector as the Engine of Growth

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In March 2000, the Asian Development Bank (ADB) unveiled its new Private Sector Development Strategy (PSDS) aimed at strengthening the role of the private sector as the engine of growth in Asia. According to ADB, a robust private sector can play a key role in poverty reduction, the 'overarching goal' of the Bank. Growth, moreover, creates jobs that use the poor's main asset (i.e., labor) and increases the tax base that enables government to provide basic social services to the poor. The new strategy has been hailed as 'the instrument by which ADB will harness the private sector's contribution to its vision of an Asian and Pacific Region free of poverty.' This guidebook will present how ADB implements this new strategy, as well as some of the more fundamental concerns raised by local communities and citizens groups around the region about the potential and actual impacts of the new PSDS being implemented by ADB.

THRUSTS AND AREAS OF OPERATION

The new PSDS has three main thrusts, namely: (a) creating enabling conditions for business to flourish and an environment conducive to pro-poor growth; (b) generating business opportunities; and (c) catalyzing private investments. The areas of operation are four-fold -- Governance in the public and private sectors; Financial intermediation; Public-Private Partnerships; and Regional and subregional cooperation.

At the first Asia-Pacific Poverty Forum organized by ADB in February 2001, PSG head Christine Wallich described how the private sector can play a key role in reducing poverty through job generation and creation of so-called 'fiscal space' that 'relieves pressure on public budgets and allows governments to redirect resources to social spending.' Wallich also advised on the kind of 'public-private partnership' that is needed.

PUBLIC-PRIVATE PARTNERSHIP IN POVERTY REDUCTION

- Public-private partnerships should be formed through government design of concessions that call for bidders to provide services where it will not otherwise provide to the poor.
- Private utilities should be effectively regulated to make sure the poor get better access to services at lower prices.
- Responsible corporate citizenship must be encouraged.
- Privatization and divestiture should be linked to poverty reduction as, for instance, when state-owned assets are sold to investors and some of the proceeds could be shared with the poor.

ADB will be training staff members and exposing them to the opportunities of dealing with the private sector. Experienced private sector development specialists are already in place, and the core team will continue monitoring the implementation process. A private sector development network is also being created to prepare a database on activities, provide advice on opportunities and implement a 'private sector scorecard' while preparing projects.

THINK 'PSD' IN PUBLIC SECTOR OPERATIONS / THINK 'DEVELOPMENT IMPACT' IN PRIVATE SECTOR OPERATIONS

ADB uses a range of instruments -- such as policy dialogue and advice, program lending and technical assistance -- to help address problems that impede private sector growth in its DMCs (Developing Member Countries). Through its public sector operations, ADB will support DMC governments in creating enabling conditions for business. Through its private sector operations, on the other hand, the Bank will catalyze private investments that deliver

'developmental impacts' and/or 'demonstrational effects'. Hence, Bank staff should 'think PSD' in its public sector operations, and to 'think development impact' in its private sector operations.

In its public sector operations, ADB will help shift the government's role from 'owner-producer' to 'facilitator-regulator' of private sector activities, freeing public resources for use in basic education, health services, and social safety nets ('fiscal space'). ADB will ensure that its public sector investments do not 'crowd out' the private sector, and that it takes all possible opportunities to 'crowd in' private sector participation.

In its private sector projects, thinking 'development impact' means that due consideration should be given to creating employment opportunities, increasing income, improving access to public services and promoting effective competition and better corporate governance. ADB will continue to provide direct loans to private sector projects with focus on two sectors -- infrastructure and finance.

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This may be illustrated by the scorecard approach to gauging Bank-funded projects. A scorecard can 'score' all prospective public and private sector projects against a set of development

impacts and private sector development, respectively, desired in the DMCs. Below is a conceptual illustration of the 'scorecard' concept, using the Bank's public and private sector projects as examples.

Development Impact Scorecard (An Illustration)											
Country	Project	Development Impact Areas									
		Poverty Reduction through growth	Environment Protection	Subregional Cooperation	Infrastructure Improvement	Capital Market Development	Better Banking	More Competitive Sector	Opening to FDI	Good Governance	Forex Saving/Earning Initiative
BANGLADESH	Grameen Phone	✓	✓		✓			✓	✓	✓	
BANGLADESH	La Farge Surma Cement	✓	✓	✓	✓				✓	✓	✓
PEOPLE'S REPUBLIC OF CHINA	Everbright Bank	✓					✓	✓	✓	✓	
PHILIPPINES	Maynilad Water Services	✓	✓		✓				✓	✓	
THAILAND	Eastern Power	✓	✓		✓	✓		✓	✓	✓	

Scorecard for Private Sector Development Effects of Public Sector Projects (An Illustration)									
Country	Project	Private Sector Development Effects							
		Create enabling environment	Build regulatory capacity	Promote effective governance	Facilitate financing	Develop capital markets	Provide support infrastructure	Generate investment opportunities	
INDIA	Private Sector Infrastructure Facility			✓	✓	✓	✓		
INDONESIA	Financial Governance Reforms		✓	✓	✓				
PHILIPPINES	Power Sector Restructuring	✓	✓	✓			✓	✓	

(Source: PSDS Working Paper, September 1999)

A 'Conflict Office', similar to that of the World Bank Group -- will be created to prevent any 'significant reputation risk' that will jeopardize ADB's ability 'to provide impartial advice or make impartial investment decisions.' As this

PRIVATE SECTOR OPERATIONS

ADB had crafted a Private Sector Strategy in 1995 that reaffirmed the role of the private sector in promoting development. The Private Sector Group (PSG) was then created to focus on five key activities: (a) infrastructure investment; (b) capital markets; (c) privatization; (d) large, complex industrial deals; and (e) small projects, manufacturing and commercial deals through an ADB financial subsidiary -- the ill-fated Asian Finance and Investment Corporation Ltd. (AFIC). ADB made its first

has yet to be institutionalized, however, the primary responsibility will still remain with the project departments and senior management concerned.

equity investment in 1983, and provided its first loan without government guarantee in 1986.

Two months after the creation of the PSG to consolidate private sector operations (PSO), ADB approved a focused operational strategy for PSO which accorded high priority to two sectors -- infrastructure and finance. Accordingly, PSG has focused on the two sectors and on relatively large projects; it was considered that AFIC could lend to and

invest in other sectors and in small and medium companies and projects.

Under the new Private Sector Development Strategy, the PSG is responsible for all of ADB's unguaranteed, enterprise-level private sector operations that include:

- formulating and implementing Bank policies for direct assistance to the private sector;
- processing funding support for private entities;
- monitoring the portfolio and managing risk;
- providing advisory service to entrepreneurs and corporations wishing to undertake BOO/BOT-type investments;
- mobilizing funds for private sector activities, including syndicating loans for private sector operations, and
- designing investment funds for small and medium enterprises (SMEs), and infrastructure projects.

The PSG currently has a 'lean' staff of 23 out of a total of 800 Bank staff; infrastructure and finance remain the core areas of PSG activities. The PSG uses certain 'filters' in the selection of its private sector projects: (a) Project should fit with country strategy; (b) Project should fit sectoral strategy; (c) 'Governance' components are in place (e.g., environmental compliance, social assessments, political acceptance); and (d) Economics of the project. It should be strongly noted, however, that ADB's PSDS is a strategy for the entire Bank, and not only for the PSG.

ADB justifies its direct participation in private sector projects -- through private sector loans or direct equity investments -- by saying that this helps mitigate perceived sovereign risks and provides 'comfort and confidence' to investors, particularly by demonstrating the feasibility of pioneering transactions in client countries. Direct participation also provides the Bank with the opportunity to understand firsthand the impediments to private sector development, and 'increases ADB's credibility as a public policy adviser' that promotes creating an enabling environment for private investment.

This same rhetoric permeates the IFC's much earlier private sector policy. Both public and private sector clients might think twice of ADB as a 'credible policy adviser', however, were they disclosed more intimate information about one of the Bank's earliest forays into private sector operations -- AFIC. The Bank's AFIC misadventure resulted in a commercial fiasco with the onslaught of the Asian crisis and AFIC among the list of financial intermediaries near-collapse despite successive bail-out packages led by the ADB. The Bank's Board is currently deliberating on a 'final exit strategy' for AFIC.

AFIC was formed in 1989 with ADB as top shareholder along with other mostly Japanese banks. AFIC concentrates largely on mid-sized projects and transactions that the Bank would find too small, especially in sectors such as industry or manufacturing. Moreover, AFIC provides underwriting, syndication, and other merchant banking services which the Bank does not generally get involved, especially in the industrial and manufacturing sectors. AFIC was mentioned in the same breath as the IFC is to the World Bank in the 1995 PSD strategy. The new PSD strategy made no mention of AFIC.

Asked whether ADB would have a separate IFC-like entity within the ADB (the International Finance Corporation is the World Bank's private sector arm), Strategy and Policy Department (SPD) head Shoji Nishimoto replied that he doubted this very much, although he thought that a wholly subsidized organization similar to the IFC should still be considered an option for the Bank. Asked whether the Bank's PSD strategy would increase the 'risk factor' in ADB's lending, Nishimoto replied that as long as the exposure remained at a single digit percent of the lending portfolio, the risk would not be great; if this became more than 20% and performance poor, however, ADB's credit ratings might be affected.

The Bank's private sector operations accounted for roughly 3% of the Bank's total portfolio in 1999; of the total lending of \$5 billion, four loans (total \$146 million) without government guarantee went to the private sector; ADB also made one equity investment (\$7 million). ADB frequently boasts that although its participation in a project is usually small, it leverages larger funds from commercial sources and is seen as a source of 'comfort' by other lenders and investors. In 1999, for instance, some \$3 billion cofinancing was mobilized for 28 projects; this was equivalent to 61% of ADB's total lending in the same year. In 2000, ADB's participation in 11 PSO projects catalyzed a total of \$1.6 billion of investment commitments.

The Bank's PSG further claims that its involvement in private sector activities could exert influence on the design and implementation of a project to ensure environmental protection and good corporate governance. This is being done through covenants, or by dealing only with responsible parties or those with 'good corporate citizenship'.

ADB: POLICY ISSUES IN PRIVATIZATION

- Privatization is grounded on the changing role of governments in the economic development process.
- Privatization is vital for long-term development of the private sector, development of local capital markets and financing institutions, fostering an enabling environment that facilitates private initiatives and rewards risk-taking, improving fiscal balances, and may promote democratization through the devolution of power.
- The driving force for privatization and economic policy reforms must come from within developing countries.

- Privatization may result in increased efficiency gains due to less political interference in decision-making, among others.
- Three major pre-conditions are required -- irreversible political commitment; legal and regulatory reforms; structural reforms across all economic sectors.
- Privatization is a political process.
- Building capacity in government institutions is necessary.
- Menus of privatization programs are recommended according to objectives.
- An emerging 'core lesson' is privatization to a capable strategic investor.

PARTIAL RISK GUARANTEE (PRG)

The PRG scheme is one of ADB's instruments to promote financial flows to developing countries. It is aimed at providing loan default protection against political risks that may arise in connection with the project. In February 2001, the Bank revamped its political risk guarantee policy by making it more 'user-friendly and transparent'. The scope of coverage for lenders to private sector projects has also been expanded and made more explicit. Areas of political risk coverage now include expropriation, currency inconvertibility and/or nontransfer, political violence, and breach of contract.

This revamp provided a major shift in focus in the marketing of ADB's PRG instrument to attract commercial lenders, on top of direct loan assistance. This will enable ADB to focus on assessing and mitigating country and political risks, areas in which ADB has a comparative advantage, leaving commercial risks to private sector lenders. The enhanced policy also includes a new 'Coguarantee' program and a Collaboration program.

Under the 'Coguarantee' program, ADB will issue a contract of guarantee for the entire amount of coverage requested but will retain only a portion of exposure under the contract with the remainder being underwritten by private political risk insurers. The 'Collaboration' program will enable private and public political insurers to offer guarantee facilities jointly with ADB, under their respective names. The improved policy also offers a more market-oriented and transparent fee structure.

In recent months, ADB had used the PRG instrument for three projects -- including Dhaka's 450-mw power plant (a first for ADB approved in December 2000) and Colombo's 163-mw power situation. In the Dhaka (Bangladesh) power plant project, the PRG scheme aimed at providing loan default protection against political risks that may arise in connection with the project. Such risks included expropriation or nationalization of all or part of the borrower's assets, the imposition of foreign exchange restrictions, and failure by the Bangladeshi Government to honor its payment obligations. Any claims paid by the Bank in relation to the PRG will be reimbursable by the Bangladesh government and may be converted into public sector loans from ADB to Bangladesh. ADB's PRG risk

exposure will be offset by a counterindemnity offered by Bangladesh in favor of the Bank.

PRIVATIZATION OF STATE-OWNED ENTERPRISES (SOEs)

The Bank promotes privatization as a vehicle for improving efficiency and creating 'fiscal space'; privatization, however, is not seen by the Bank as a panacea, as 'a private monopoly can be worse than a public one.' The Bank also recognizes the many drawbacks experienced in privatization and private provision of services -- *'In some cases, public institutions that have been privatized have been put to some other use or have entered into monopolistic contracts for service delivery, increasing fees while allowing services to deteriorate.'*

At the 1999 ADB Annual Meeting, ISG head Wallich described how the role of governments had evolved to 'facilitate the process of production, rather than own the means of production.' Privatization -- when carried out where ownership was concentrated, or where there were dominant interests -- could have negative and unintended effects. According to Wallich, it was important to ensure that public interest was protected through an appropriate legal and regulatory structure and framework which addresses consumer concerns, establishes fair trade practices and the like, regulates monopolies and quasi-monopolies, deals with unlawful restraints and anti-competitive practices, and does away with barriers to entry and exit. The regulatory authority must be well equipped to enforce regulations. Equally important, added Wallich, labor concerns must be adequately addressed either through social safety nets or retraining and redeployment.

PSG head Wallich had also 'surprisingly' noted that the privatization approach taken in such countries as Bolivia and Poland has not picked up in Asia, 'perhaps in light of the magnitude of assets on hand after the financial crisis.' In Bolivia, government shared SOEs privatization revenues with the general population on the grounds that nationally-owned assets had been created with people's taxes; in Poland, 20% of shares in privatized enterprises were reserved for workers who lost their jobs. In November 1999, the Tokyo-based ADB Institute highlighted some policy issues at a capacity-building seminar it organized on privatization, with government policy-makers from around the region as main participants.

ADB has limited experience in privatization and public enterprise reform, but will 'encourage more privatization projects in future.' More recent Bank experience on privatization is in support of International Monetary Fund (IMF) economic stabilization program among crisis-

stricken countries in the region -- e.g., Thailand, Indonesia, Philippines -- particularly in the areas of 'reforming' SOEs to promote 'good financial governance'.

WHAT HAPPENS TO WOMEN IN A PRIVATIZATION REGIME?

The experience of women under various privatization regimes indicates the erosion of social, cultural and economic gains which women have painstakingly earned in the past through various struggles and negotiation processes. Where the public sector is an important employer of women, its restructuring under a privatization regime has disastrous consequences for women. As paid workers in the public workforce, women are at the forefront of the onslaught of privatization. Women dominate the public sector as lower-rung members in the rank-and-file (clerks/typists/secretaries); they perform most of the much-maligned bureaucratic red-tape which are traditionally low-skilled and low-paying. With privatization's aim to reduce 'inefficiencies' and other 'redundancies', women would be deemed less 'competitive' due to less educational skills or lack of training opportunities will more likely be affected than men. Women dominate the health and education public sector agencies because of their traditional role as caregivers and nurturers in the family; this notion extends to the larger society in terms of career choices that are made open to them. As paid workers in the productive sphere, women are vulnerable to the 'last in, first out' syndrome, in which women are likely to be the last one hired, but the first one fired.

Privatization places additional stresses on women's 'private' lives. Burdens once borne by the public and the larger society would now be borne by women privately, adding further stress to their reproductive work at home. Through privatization, public enterprises with combined social and income-generating functions will be transformed into purely profit-oriented enterprises. The losses would be in the social function, where support mechanisms and subsidies for the poorer sections of society lie. Privatization of an erstwhile public good like water which price is largely subsidized by the public, will now find its price in the 'market'; price consequences on the accessibility and quality of water would further challenge women with already over-stretched budgets to keep the household economy afloat. Rising tempers and stress-related domestic violence are not likely to be far behind.

PSD IN INFRASTRUCTURE

ADB will support the development of workable public-private partnerships to involve the private sector in areas such as energy, water, wastewater treatment transport, telecommunications, and where practicable, the social sectors. The Bank believes that the private sector alone cannot deliver efficient public services and that 'public-private partnerships' can balance development goals with commercial interests. The public and private sectors must work together to inject greater competition, increase efficiency, and avert market failures. ADB has actively financed pioneering BOT projects in the region and accompanying 'capacity-building' assistance.

Recently, the PSG worked overtime to process the approval of at least two 'model' PSD power projects. In December 2000, the Bank approved a financing package to construct a 163-megawatt power station in Colombo, Sri Lanka, making the power station ADB's first private power project and the largest such scheme in the country. In Bangladesh, a \$140 million loan was approved for the construction of a 450-mw power plant in southeast Dhaka. This is the first ever power project supported by the private sector in the country and the first to be competitively bid. In both cases, US-based AES Corporation, a leading independent power producer (IPP), is the 'strategic' private sector partner, leaving one askance about the degree of 'competition' existing amongst transnational power producers.

In January 2001, ADB approved its Water Policy in response to what the Bank perceives as a growing inefficiency in water allocation across the globe, particularly in major urban centers. With the new water policy, ADB will focus on

water sector reforms, integrated management of water resources and the improved delivery of water services. This new policy came about with the Bank's alarming forecast on the inability of existing water supply to meet the 'rapidly increasing demand for domestic and industrial water'.

ADB has several PSD initiatives in the Asia-Pacific region, following the IFC-assisted privatization of the Philippines' Metropolitan Waterworks and Sewerage Services (MWSS) in 1997. The World Bank's private sector arm -- International Finance Corporation (IFC) -- engineered this first large-scale privatization of a water utility in the region. After the privatization, ADB provided loans totaling over \$170 million in September 1999 to one of the two private concessionaires -- Maynilad Water Services, Inc -- making this the Bank's first assistance to a privatized water and sewerage utility. ADB assistance was part of a \$350 million debt package being raised by Maynilad to meet its financing needs up to 2002; this meant that at least half of the financing requirements needed by the private concessionaires was raised from public coffers (ADB's) in what may be a case of the private 'crowding out' public investments.

At the ADB Poverty Forum (February 2001), PSG head Christine Wallich cited the MWSS privatization as an example of a 'creative public-private partnership' and described how a concessionaire was chosen to 'provide public faucets in slum communities where the poor had previously brought trucked-in water at high prices.' According to Wallich, the government accepted lower concession revenues in return for providing drinking water to nearly 68,000 low-income families. Furthermore, the

project reduced illegal connections and water theft and thus helped to improve the general delivery of basic water services. Civil society groups, however, belie these claims, as no independent (or perhaps even official) monitoring had been made to ensure that these performance targets had actually been reached.

In Nepal, ADB approved the Melamchi Water Supply Project (\$120 million loan) in December 2000. This involves the construction of a 26-kilometer tunnel primarily to divert 170 million liters of water daily from the Melamchi River to Kathmandu, the country's capital. Aside from tapping new water sources, the project will privatize the management of the Kathmandu Valley water supply. Even in the early stages, the project has already earned resounding objections from Valley residents largely due to the lack of consultation as to how water can be provided for through other means, including harvesting of rainwater that will not tax consumers of what is primarily a free good. The project's intent to privatize the public water utility has no foreseen benefits to the poor who cannot pay the new water rates.

In Sri Lanka, ADB approved a \$19.7 million loan in 2000 to 'improve water resources management'; institutional reforms will include the creation of the National Water Resources Authority (NWRA) as the single government agency to manage and have stewardship over the country's water resources. The project will also construct the Kelani Conservation Barrage which will provide improved domestic water supplies to Greater Colombo. Peasants' and other people's movements in Sri Lanka have raised the fundamental issue of the privatization of water, a resource freely available in nature and a requisite to life itself. Under the guise of water resources management, a new government policy -- largely kept under folds and adopted in March 2000 -- vests all water rights in the state and now allows the government to sell its water. This is but part of a continuing trend promoted by the multilateral banks (e.g., ADB, WB) which, in 1996, supported legislation that would have the country's 1.8 million farming families pay for irrigation water. This was also in line with the move to wean farmers away from growing non-export food crops, the rationale being that as long as government continues to supply water freely to farmers, the latter will continue to cultivate what they wish. Hence, the proposal to charge user fees for water.

'Capable strategic investor'. Citing diverse regional experiences in 1999, IFC Lead Economist Frank Lysy concluded that an emerging 'core lesson' was privatization to a 'capable strategic investor' rather than to 'insiders'. This generally 'worked best' rather than 'dispersed ownership,' although it was important to 'ensure minority shareholder rights.' These lessons, according to Lysy, were largely influenced by instances of 'privatization disasters' in the former Soviet bloc-- e.g. the so-called loans-for-shares scheme in Russia that became 'hopelessly corrupt' and the 'controversial' voucher privatization in the Czech Republic.

At ADB, a core of 'capable strategic investors' is beginning to emerge, in much the same way that the same Japan or

US companies have managed to consistently land on Top 5 slots as Bank contractors, consultants or TA grantees. These are mostly large transnational corporations with headquarters based in the top donor countries (e.g., US). In the power sector, for instance, US-based AES Power Corporation seems to be a top favorite at the PSG; multiple loans and credit guarantees to two of its subsidiaries were provided by the Bank in December 1999 alone -- AES Meghnaghat Power Limited, Bangladesh (\$50 million), and AES Kelanitissa (Private) Limited, Sri Lanka (\$26 million). AES Kelanitissa is the first recipient of the Bank's Political Risk Guarantee; AES Meghnaghat Power has also benefited from ADB's Complementary Financing Scheme and Political Risk Guarantee .

In the water sector, French-based Lyonnaise des Eaux (Lde) is a consistent recipient of the Bank's private sector loans; Lde belongs to an elite cartel of water transnationals based largely in donor countries (e.g., England and France) which have acquired privatized water utilities in the Asia-Pacific region. Lde is the foreign partner of the Philippines' Maynilad Water Services which received the Bank's first private sector loan (\$170 million) to a privatized water utility in 1999; in 2000, ADB granted a \$35 million loan to another Lde subsidiary in Vietnam -- Lyonnaise Vietnam Water Company Limited. Aside from water and sanitation, Lde is also active in waste management, prisons, energy, health services and telecommunications.

FINANCIAL INTERMEDIATION

To ADB, well-functioning financial systems are important for private sector development, especially in the aftermath of the Asian crisis. Financial institutions need to be strengthened to develop the domestic capacity to finance private-sector led growth.

Financial sector reform. To provide support to the IMF package of reforms in countries hardest-hit by the financial crisis, ADB poured unusually large bail-out packages in support of reforms in the banking and finance sector -- \$1.2 billion to Thailand in August 1997, \$4 billion to Korea in December 1997 (the largest loan ever granted by the Bank), and \$1.5 billion to Indonesia in 1998. These policy-based loans typically include the restructuring of state-owned banks and improving the legal and regulatory environment 'to facilitate debt recovery.'

Capital market development. ADB will also look towards substantial domestic savings in Asia-Pacific countries by developing a financial sector that allows these savings to be channeled into productive long-term investment. Through direct funding investments with emphasis on 'good corporate governance', ADB will help establish role model banks, insurance companies, mutual funds, leasing firms and pension fund management companies. Thus, pension funds reform and housing project models will soon become staple fare in the Bank's policy-based lending operations.

In March 2001, for instance, the Bank identified a housing project model in Sri Lanka for capital market development in the region. ADB approved an equity investment of up to

\$360,000 in the proposed NDB Housing Bank, a new market-based financial institution in the country, to provide housing finance. The institution is an example of the types of projects supported by the Capital Markets team of PSG. NDB Housing Bank is the first private sector housing bank investment in Sri Lanka; it will focus on providing loans to medium and low income borrowers, initially in the Colombo region; over time, the bank is expected to diversify provide a wide range of loan products designed to meet the funding needs of low and medium income home owners.

Pension reform. In December 1998, former ADB Vice President Peter Sullivan cited the need to reform pension systems to avert a 'looming social security crisis and to develop financial markets.' VP Sullivan stressed that pensions offer a large pool of savings and provide an impetus to the development of debt and equity markets. He also pointed out that most Southeast Asian economies needed to design reforms of 'partially funded' systems; in the transition economies, there was a need to 'restructure and tighten the welfare systems by enhancing contributions while allowing for market forces to determine the use of resources.' In 1997, the Bank funded Kazakhstan's pension system reform with a \$100 million loan that will support the transition of the existing 'pay-as-you-go' pension system to a 'fully funded, defined contribution' pension system. In 1999, ADB co-organized a 'capacity-building' conference to explore appropriate strategies to reform pension systems in South Asia.

FINANCING SMEs AND MICRO-INDUSTRIES

According to PSG head Wallich, private sector financial institutions can assist in poverty reduction in more direct ways – by providing easy access to financing on reasonable terms to SMEs and tiny industries and even individual entrepreneurs. There is great interest in SME and microcredit financing, particularly in the aftermath of the Asian crisis, and given the need to provide assistance to sectors which employ the largest number of people -- and that is a very good thing. SMEs are the largest source of employment in Asia. Their access to finance could make a real difference for the betterment of many lives in the region.

Wallich further describes microcredit as being a 'quite recent phenomenon' and a major challenge being to make micro-credit 'bankable', i.e., commercially viable. The first initiatives were made in Bangladesh by the Grameen Bank; in Viet Nam, the Bank for the Poor and a large number of peoples' credit funds providing credit to small farmers exist. In the Philippines, NGOs play an active role; German-designed schemes have also been successfully coursed through local chamber of commerce. Another challenge – further in the future -- is getting these enterprises capital market access. For instance, explains Wallich, can a microcredit portfolio be securitized to reduce its dependence on donors?

'PUBLIC-PRIVATE' PARTNERSHIP IN THE SOCIAL SECTOR

In 1999, the Tokyo-based ADB Institute (ADBI) convened major policy makers in the region to a conference on *Dealing with Public-Private Partnerships in the Social Sector* to 'explore economic systems and the combination of roles and functions of the economic entities of markets, institutions and governments.' In education and health, the 'public sector needs to recognize the skills and capacities of the private sector, while the private sector needs to consider its social responsibilities beyond that of self-interest.'

In recent years, some 'consensus' had seemingly been reached on the financing and provision of social services. In health, for instance, the public sector is 'most naturally suited' to addressing issues involving communicable diseases, availability and quality of information about health and health care, creation of viable health insurance programs, safety nets for the poor, and equity in distribution of health resources. The private sector is believed to control costs and promote efficiency. In the education sector, the public sector is 'bound to provide primary education' as it impacts so deeply on all areas of the country's well-being; government should oversee private sector provision. Tertiary education is more suitable for private partnerships, either in financing and provision or both, as education becomes more specialized; the public sector must ensure that quality and equity are maintained. ADB recently assisted the creation of the first private university of Vietnam.

Earlier in 1995, former ADB President Mitsuo Sato set the tone for public-private partnerships in health when he cited the urgency to develop concerted policy reform to address problems of access, high costs and diminishing resources for health care in Asia; a key element in this strategy was the encouragement of greater private sector involvement in health care provision. Among the key issues on the agenda for debate were public expenditure on health; decentralization of the health care system; broadening health financing options to include user fees, community finance and social and private insurance; promoting private sector participation; and improving access to, and the efficiency, of health care services.

PRIVATIZATION IN THE AGRICULTURE/ NATURAL RESOURCES SECTOR

The increasing commercialization of agriculture will be intensified with ADB's PSD strategy in its public sector operations, particularly in the agriculture and natural resources sector. Some recent agriculture ADB loans with PSD components are:

- The ambitious Grains Sector Development Program in the Philippines (\$175 million, approved April 2000) which will overhaul the 'largely protected' grains sector and make it more 'market-based, productive and internationally competitive'; an accompanying TA will recommend strategies to privatize the National Food Authority.
- In November 2000, ADB approved a \$45 million loan to restructure already privatized farms in Kazakshtan. The Farm Restructuring Sector Development Program will promote the recovery and growth of the agriculture sector through 'efficient agricultural

taxation' and use of water fees, facilitation of local private initiatives and the formation of voluntary rural associations, efficient pricing of agricultural inputs and encouragement of private investments in agriculture.

- In November 2000, ADB approved a \$11 million loan to Nepal's Crop Diversification Project that will use private service providers, including NGOs, to assist groups of farmers -- especially women -- how best to grow and market cash crops.

Decreased subsidies, irrigation water fees, and other 'cost-recovery mechanisms' will again be imposed which further burdens poorer farmers. The privatization of common access resources -- such as the leasing of fishing lots in support of industrial development -- has resulted in increasing lack of access by poor fishers and their families of cheap sources of fish and protein needed as caloric requirements of poverty reduction. Moreover, opening the agriculture and natural resources sector to market-oriented approaches will disrupt the lives of indigenous men and women whose livelihoods depend on their natural environment and threaten their survival as a people.

SUBREGIONAL COOPERATION

ADB's mandate to promote regional cooperation was translated into policy in 1994. The Bank has since supported several subregional cooperation programs in Southeast Asia (e.g., Greater Mekong Subregion or GMS, East ASEAN Growth Area or BIMP-EAGA), Central Asia, and more recently, in South Asia. In these schemes, ADB plays a coordinating role cum 'honest broker' between governments and the private sector. ADB's support to subregional cooperation covers the whole range of activities from technical studies and workshops in support of 'cooperation dialogue', to physical investments in cross-border projects and, where appropriate, assistance for cross-border agreements like the 'landmark' Framework Agreement on Movement of Goods and People recently signed by Thailand, Lao PDR and Vietnam in the Greater Mekong Subregion scheme.

According to ADB, the basic rationale for economic cooperation is four-fold.' It supports the development process beyond national limits. It helps exploit 'complementarities' among groups of countries or areas to be able to generate a momentum of growth. It involves the joint development of collective goods such as transportation, telecommunications, and power facilities. It strengthens responses to common concerns involving the environment and human resource development. Moreover, subregional cooperation enhances the investment attractiveness of participating countries as a group, well beyond their individual abilities, i.e., the 'subregional whole can be greater than the sum of the individual parts.

Greater Mekong Subregion The GMS consists of the six countries of Thailand, Vietnam, Cambodia, Laos, Burma, and Yunnan province of People's Republic of China. Several TA grants from the ADB in 1991-1993 initiated the process of bringing together government officials from the

subregion to discuss greater economic cooperation and to facilitate trade and investments in the GMS. Some 100 priority projects have been identified -- several already funded by ADB -- in the key areas of energy, transport, trade and investment, telecommunications, human resources development, tourism and environment. ADB views the GMS as a Mekong-centered 'natural economic area' where a 'natural process' of integration in trade and investment develops as subsistence levels rise from an expected rapid economic growth. The ADB's experience in the GMS has considerably strengthened its theory-building on the concept and actual practice of subregional economic cooperation.

In a 1999 impact evaluation of the GMS program by ADB's Operations Evaluation Office, key lessons emerged. The evaluation cautioned against building unrealistic expectations and that the program should remain focused on achievable targets. Moreover, the review recognized the constraints of an 'ad hoc approach' and suggested the creation of appropriate institutional arrangements, with separately dedicated TA and loan resources and staff to pursue strategic planning and medium-term programming.

South Asia Subregional Economic Cooperation (SASEC)

To ADB, several factors signal the growing momentum for cooperation in South Asia --

- Chukha Hydel Project for power delivery from Bhutan to India;
- Signing of Mahakali Treaty between India and Nepal;
- Enhancement of transit facility from Nepal to Bangladesh through the eastern corridor in India;
- Signing of Ganga Water-Sharing Agreement between India and Bangladesh;
- Signing of India-Sri Lanka Free Trade Agreement;
- Activities initiated under the Bangladesh, India, Myanmar, Sri Lanka, Thailand Economic Cooperation initiative (BIMSTEC);
- Formation of the South Asia Growth Quadrangle (SAGQ).

ADB promotes South Asia as the region accounting for the 'single largest concentration of poor people in the world', or about 500 million out of a total 900 million persons living in poverty. Full-fledged subregional loan projects, however, have yet to be financed in South Asia. An initial subregional TA facilitated a power exchange agreement between India and Bangladesh in May 1997; another TA provided support to the first meeting of the Private Sector Forum promoted by the chambers of commerce from SAGQ countries (Bangladesh, Bhutan, India and Nepal) in November 2000.

The SAGQ was formally launched by the foreign ministers of 'member' countries in April 1997; Nepal became overall coordinator and the following key sectors identified -- environment, energy and power, trade and investment, transport and tourism. Consequently, SAGQ countries

requested ADB's assistance in identifying and preparing subregional projects.

The first Private Sector Forum on SASEC in Calcutta (India) brought together public and private sector representatives and was seen as a major step towards identifying an investment program to develop the SAGQ; the event was attended by a large ADB delegation. The Calcutta forum aimed to begin translating these broad concepts into specific, bankable, investment projects. ADB will urge SAGQ governments and private sector representatives to prepare a regional development masterplan to identify specific projects in different sectors, and prioritize them for financing.

Central Asian Regional Economic Cooperation (CAREC) In 1997, ADB initiated support to CAREC with a three-year TA plan prepared for 2000-2003. In March 1998, ADB crafted a private sector strategy for the newly-independent republics of Central Asia formed after the break-up of the former Soviet Union. The transition economies were then encouraged to design broad-based reforms that promote the development of a viable and healthy private sector, especially in those areas concerned with developing commercially viable firms and farms.

In October 2000, ADB approved a \$70 million loan to rehabilitate the road linking the Central Asian republics of Kazakhstan and Kyrgyz; the road forms part of the famous 'Silk Road' which links Europe and the People's Republic of China. This the first subregional cooperation project in Central Asia; twenty-five percent of the traffic is international, largely of agricultural and industrial goods. To encourage privatization as the countries move towards market-based economies, the project will also establish a pool of equipment which can be rented out to private contractors competing for road construction and maintenance work. Importantly, the project will also 'modernize' border control facilities and procedures.

Pacific Islands In March 2001, ADB approved its new Pacific strategy which focuses on the streamlining of Pacific countries' public sectors and boosting private sector investment. The new strategy responds to five key challenges in the Pacific Island nations:

- Vulnerability due to remote locations and a narrow resource base, and susceptibility to natural disasters and global markets;
- Political instability and poor governance;
- Limited skilled human resources;
- Socio-cultural factors that affect politics and productivity; and
- Inadequate physical, technological and financial sector infrastructure for sustainable growth.

ADB's Pacific strategy underscores the importance of regional cooperation to collectively reap the benefits of economies of scale. ADB is currently supporting regional cooperation in fisheries, air transport, financial sector restructuring (including addressing money laundering), public sector management and governance.

In the countries which are resource-rich but have poor growth and high population rates (Papua New Guinea, Solomon Islands and Vanuatu), the strategy will focus on governance, public sector reform and poverty reduction through social and infrastructure investments. In the more economically advanced countries with a higher skill base, moderate resource potential and relatively low poverty (Cook Islands, Federated States of Micronesia, Fiji Islands, Samoa and Tonga), the strategy will promote private sector growth through policy reform and physical and financial sector strengthening. In the island atolls of Kiribati, Marshall Islands, Nauru and Tuvalu which are severely disadvantaged by their smallness, isolation and weak resource base, the strategy is to establish and expand trust funds to support the sustainable financing of basic services.