

Address by Mr. Juan Miranda, Director General, Central and West Asia Department,  
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### **Unleashing the Potential of the Private Sector**

Honorable Prime Minister Shaukat Aziz, Adviser on Finance Dr. Salman Shah, Ministers, Members of Parliament, Development Partners, distinguished guests, ladies and gentlemen:

I am delighted to be here today. I want to thank the authorities for the invitation to this Forum, and for the warm reception given to all us. We look forward to our deliberations, and like others present here today, I wish for, and expect, a meaningful outcome.

I am a newcomer to the Forum but also to Pakistan. I assumed office of a new department covering this country and a few others around it only two weeks ago. This means I have much to learn. This in turn also means I will probably be asking lots of naive questions. But to compensate, I do promise I will do my best to listen and catch up. In the meantime, I implore you to be patient with me during the process, and to be half as nice to me as you have been to my predecessors.

Past themes covered under the Forum have been interesting, relevant and timely. The one chosen this time around, *Drivers of Economic Growth - Unleashing the Potential of the Private Sector* - fits those criteria. The private sector can help the development process. I believe it can be unleashed in most sectors of the economy, particularly in infrastructure, utilities and selected public services. It also fits well with the mandate of the development partners here today - be these private, official, bilateral or multilateral. The theme offers great and ample scope for debate.

Ladies and Gentlemen,

After suffering the biggest natural disaster in its history last October, an image of strength and resilience has emerged in the world when looking at Pakistan's relief and reconstruction efforts. We are truly impressed by the Government's leadership in this time of extreme adversity. A large-scale loss of life - anticipated in the winter - has been successfully averted. The resolve shown by the people in the earthquake-affected areas to cope and deal with hardship, to deal with a period of immense trial and tribulation is simply admirable. It is also good to see that the development community has done its part. In November 2005, it agreed to provide long-term assistance, this time for reconstruction and rehabilitation, at the successful Donor Conference organized in Islamabad. I would like to take this opportunity to reassure the authorities of ADB's continued commitment and support in this endeavor.

The earthquake showed Government at its best. But it also showed how civil society organizations and the private sector can work side by side with the Government at the central and local level - first on earthquake relief and then on reconstruction. The private sector includes big multinational companies, as well as large and small national businesses. Each of these reacted positively and quickly to the challenge. In many ways, but not surprisingly, the experience has shown the acceptable and the "other" face of the corporate world. The non profit oriented face.

Turning now away from the emergency, and into the drivers for economic growth, a question that is being posed here today is why and how should the private sector be encouraged or unleashed on the economy? The best standpoint from which to debate this issue is by focusing for a moment on the **need** versus the **capacity** to finance it.

This leads to other questions: what is this need, and in which sectors or services areas does it manifest itself most? Are these areas really important to growth and development? Where do they rank in relation to others, for instance macroeconomic stability, regulatory and legal frameworks, structural reform, etc? Also critical to ask is what is the government's capacity to finance the need on its own? And if it cannot

finance it all on its own, to who should the Government turn for help? And if the private sector is an option, what terms and conditions it is likely to require? Conversely, we should ask about what type of things should the public administration be asking for before and after it engages and partners the private sector.

I do not profess to know all the answers to these questions. But I do want to share with you some points that I anticipate will also come out of the individual work sessions and presentations scheduled for the next two days.

Let me try to go through some of these, although not necessarily in the order just given. I then want to focus on the role that institutions such as ADB can play in helping to entice, finance and keep the private sector engaged. At ADB, for instance, we have made some changes to our business model, almost all driven by the need to foster and support partnerships between the public and the private.

I will start with the need and the capacity to finance it.

Pakistan, just like any other emerging market economy, has huge and rapidly increasing investment needs, particularly in relation to the rehabilitation and expansion of basic infrastructure, key utilities and selected public services such as roads, ports, airports, railway systems, telecommunications, electricity, gas, water, wastewater and waste management. These are determinants and drivers for growth, employment, income and ultimately for poverty reduction. They impact on direct foreign investment, on productivity and on competitiveness. They also affect the livelihood and quality of life of all citizens. But these areas, individually and combined, require major outlays over the next few years - calling on huge amounts of capital and recurrent expenditures. In the region as a whole, the investment requirement in these areas runs into \$300 billion a year - an amount equivalent to around 10% to 11 % of GDP. In Pakistan the investment need is more or less in this order of magnitude.

But financing this level of investment is the real challenge, in Pakistan and elsewhere. The establishment and adherence to a balanced monetary and fiscal policy stance, which from experience we know is essential to ensure macroeconomic stability and predictability, makes it difficult, if not next to impossible, for the public sector be a sole financier of such endeavor. Doing so will mean printing money, and doing that will lead to inflation, forcing millions into poverty, not prosperity. Other monies must and need to be mobilized - including domestic savings and international funds. This scenario indicates why the private sector should be tapped and unleashed for the purposes of investing and managing productive activities but also development projects.

This scenario also suggests that such involvement should be in the form of "win win" partnerships. And a partnership between public and private sponsors almost always implies, and leads to, a partnership between public and private sector monies. Put in another way, the financing of public/private partnerships can, and should, combine government funds, including state-owned enterprise shareholder advances, commercial bank lending, capital market operations, private equity, and bilateral, official, export credit agency, and multilateral development bank assistance. I will come back later to this.

But unleashing the private sector into infrastructure, utilities and public services requires well-crafted policy frameworks. Partnerships need to be supported by set of minimum criteria. These are often intertwined and almost always interdependent. Striking the right balance is not easy. Doing so yields dividends. Not doing so yields risks and ultimately poor results and discontent. These frameworks include sound monetary and fiscal policies, structural reforms, governance, capacity, transparent and efficient procedures and systems for bidding and contracts, regulatory arrangements that provide confidence and predictability, and a strong financial system.

The first building block to allow the private sector to invest and manage projects is the one that creates the entry point or it in the first place. This effectively means structured and targeted public sector reform calling precisely for that. Such reform can

take place at the central and local government level. In other words, it starts with dedicated advisory mandates to place infrastructure, utilities and services with private operators.

This placement does not have to mean selling assets. The range of modalities that can be used to engage the private sector is diverse and broad. The so-called **private sector content** can range from a "little to a lot". It can go from management contracts to joint ventures, concessions, BOTs, partial sales and outright sales. But before any of these modalities can be applied, a key success factor is to have a properly organized, transparent and efficient process, backed by the framework of various policies on the legal, regulatory, financial, bidding, and other fronts. This means that the entry point in itself is never enough. Private sector interest, its investment plans, its continuity and ultimately its success, needs actions or clear-cut measures that feed stability and predictability. Risk cutting, risk sharing and risk mitigation are important to the private and the public investor alike.

Another factor behind the successful incorporation of the private sector in investment and management of development projects is political commitment. The political dividend to a public administration arising out of private public/partnerships is not always immediate or apparent. Service efficiency gains, greater physical coverage, improved quality and continuity are basic service targets. But these need investments and time to come to fruition. Tariff hikes are felt immediately by the end-user - quite often well before the services are improved. If we depart from a premise that shows that the economic cost of delivering services may well have been hidden for years or one where the ability of end-users to pay may be constrained, political commitment may require a **"transition strategy"**. This may involve viability gap financing assistance, output based contracts backed by financial support and protective measures for lower income end-users. It may also involve the alignment of investment programs to the end-user's ability to pay. Working on efficiency gains first before asking the private sector to embark on major investments, which by definition always requires the right fee

structure to ensure cost recovery and profit, is an alternative strategy. This approach can normally be handled through the contractual arrangements.

Political commitment is also related to the modality chosen. This too is an area that requires careful crafting. Ownership is often a "deal breaker" for the authorities. But this does not have to be a stumbling block. In fact, in the case of most utilities and public services, ownership has tended to remain with the public sector. The involvement of the private sector can include, as already suggested, management contracts with or without specific investment conditions, joint ventures, concessions and BOTs. Partial and outright sales often only take place in a few sectors. Telecommunications and electricity distribution are cases in point. But other services such as water, wastewater, waste management and electricity transmission, normally involve the other modalities. IPOs and private placements are also interesting options. These often take place in local or domestic capital markets.

Let me quickly turn to what multilateral banks like ADB can do to further this process. At the moment we support the private sector in a number of ways. Firstly, through our Private Sector Operations Department, which provides debt, equity and guarantees to private sector-led projects - projects with development impact, and that at the same time adhere to sound banking principles. Pakistan has traditionally been a major recipient of ADB assistance in this area. Our investment portfolio includes transactions in the financial sector, leasing, power and energy, cement, and fertilizer plants, among others.

Secondly, ADB works on the definition, introduction and finance of specific interventions conducive to private sector development. These include investments on reforms, governance, capacity, financial management and others - actions that contribute to a better and more predictable business environment. Our SME Sector Program falls into this category. This tackles key policy and institutional reforms to enhance the competitiveness of SMEs. These include a new SME sector strategic framework, backed by improved and simplified tax, labor, and industry legislation. We

are also assisting the Government in deepening reforms in the financial sector, promoting diversified and competitive capital markets, and extending the scope and outreach for microfinance. A key focus of our financial sector operations is to give private businesses access to long-term finance. The same SME sector program includes guarantee products for financial institutions to encourage them to undertake more SME financing. A small business fund for SMEs has been established. A similar fund for small entrepreneurs in the agribusiness sector is also being considered.

Similarly, we are working at the local government level, assisting with the introduction of specific measures to improve the efficiency and reach of selected public services, including the incorporation of the private sector in their investment and management. Our work on decentralization and on services associated with local government - provincial and municipal - is advanced and we like to think successful. Local government is where the action will be in future. Decentralization means devolving to the locality responsibility and accountability over basic public services. But this process has not always been accompanied by prorata financial transfers. If the local government is to maintain the quality and reach of these services - demanded by end-users - then this means larger investment needs. Here too there is scope for reforms and partnerships between the public and private.

ADS also finances "enabling infrastructure" or public goods and services required to improve business conditions, cut costs and increase efficiency and competitiveness. We are financing roads, power, energy and urban services on this basis. I submit that this is an area where the authorities and the development partners have to start thinking 'out of the box'. Structured finance and transactions with private sector content provide a unique opportunity for us to make a difference.

Under ADS's Innovation and Efficiency Initiative we have launched a number of financial instruments and modalities aimed in large part at servicing PPPs. The new instruments include

- . Multitranche financing facility - an instrument very much akin to a credit line, non contingent and flexible, that allows the client to finance operations "as you go". It has been already used in Pakistan in the case of a Highway Development Program. It is also being considered in the case of a renewable energy and can be used in all other sectors with a road map and investment program.
- . Subsovereign finance - we now have the possibility of financing state owned companies and municipal entities directly, obviously with central government clearance, under strict financial and reform conditions and without a sovereign guarantee.
- . Refinancing facility - a new instrument to support the restructuring of existing projects with the right fundamentals but with inappropriate financing plans
- . Local currency lending - through the issuance of bonds and swaps, we can now create local currency to finance projects on a sovereign and non sovereign basis. This is a huge potential area for us, and one that I consider essential to support PPPs. We intend to work closely in this area with the authorities in the short to medium term.

There will never be an avalanche of private investors into the infrastructure and utilities field in the short to medium term unless we create **special incentives and risk sharing and risk mitigation arrangements**. Besides the use of political risk and partial credit risk guarantees to support financiers -accompanying the private sector, and the definition and financing of reforms, ADB is also working on the establishment of a **special purpose vehicle or fund** and support policy program to foster PPPs. The approach taken by us and the authorities is to come up with "viability gap" financing schemes to support transition strategies in projects and with an instrument to kick start and/or co-finance operations involving the public and private sector - that is, by



providing seed capital and advisory services. We are optimistic that this program and special purpose vehicle will increase the level of PPP activity and deal flow. The special purpose vehicle will need to be backed with financial resources and expertise to undertake basic due diligence on the technical, commercial, financial, legal, regulatory, safeguards, social and other fields. It will also need work with the local banking community to encourage business proposals and co-financing. A policy framework will also be put in place to remove obstacles in target sectors.

Ladies and Gentlemen

Pakistan has successful examples of public-private partnerships in infrastructure. Our objective now is to increase their number by paving the way through second generation reforms and kick start financing. There is great scope to do more. There is great scope for the public and private to join together. But also for the development partners to do the same. I hope this Forum will help clarify further the "what" and the "how". I look forward to our deliberations and remaining engaged with the authorities and our partners in this process.

Actions of course speak louder than words. Our confidence in Pakistan and its people is fully reflected not only in our longstanding development partnership with the country but also in the fact that Pakistan was the largest beneficiary of ADS's assistance in 2005. As requested by the Government, ADB will endeavor to maintain a high assistance level over the years to come. We hope that this assistance will encourage the public and the private sector to invest in a prosperous and progressive Pakistan.

Thank you.