Promoting Financial Resource Mobilization for Infrastructure Development through Public-Private Partnerships

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The Asian Development Bank welcomes this opportunity to share some thoughts on mobilization of capital for infrastructure development, especially at a critical time like this when the Asian financial crisis is still upon us.

With Asia's population growing at a rate of 60 million per annum and expected to more than triple in a decade, demand for infrastructure is also set to increase. For the near term, the Asian crisis has produced excess capacity. But the long run tells a very different story. The share of infrastructure—now about 4 percent of GDP—is expected to rise to 7 percent early next century. In India, investment needs will likely rise from about $14 billion per annum now to about $42 billion per annum by 2005. In China, over the next ten years, infrastructure investment requirements will likely be approximately $280 billion for power, $350 billion for transport, and $100 billion for water supply. Mongolia will need approximately $100–150 million per annum over the next 10 years. Even assuming better demand management and operating efficiency, rapid urbanization and the rise of megacities will place considerable pressure on infrastructure across Asia. (Urbanization has risen from 22 percent to about 33 percent since the 1960s when the Bank was established.) There are already nine megacities (those with populations exceeding 10 million) in Asia, including Tianjin. So, the need to raise resources for infrastructure cannot be overemphasized.

Today, some 80 to 90 percent of infrastructure investments in developing countries come from public finances or are supported by governments. Such levels of public funding are clearly unsustainable, and the amounts involved are unlikely to be available.

PUBLIC–PRIVATE PARTNERSHIP

Clearly, provision of infrastructure is not a matter for the public sector alone, with its limited finances and entrepreneurial skills. Nor is it for the private sector alone, although there has sometimes been a perception that "the private sector can do it all." The reality is that the private sector has limited capacity to influence policy, establish laws, and regulate markets. In short, only through a combined effort—a public–private partnership—can the infrastructure challenge be met.

The Government and the Private Sector

First, a quick aside about the role of the government versus the role of the private sector. The private sector is good in taking on project risks, construction, technical, operating, and investment/commercial risks. Nonetheless, in many of the Bank's developing member countries, taking on these risks becomes problematic, given the weak institutional environment and capacity of governments to be credible in delivering "performance." At the same time, social concerns and the impact of projects on the environment and the poor, along with issues of resettlement and governance, have not always been fully appreciated by the private sector.

What contributions can governments make?

- First, would be to maintain macroeconomic stability and promote appropriate structural policies.
- Second, we would like to see governments create the necessary enabling environment for private-sector involvement, including the legal and regulatory frameworks, competitive mechanisms, model agreements, standard pricing formulations, and the setting of tariffs.
- I should also add that government regulation is probably necessary to promote access of the *poor* to infrastructure—through pricing—and design of projects and bidding documents. We now know that, for sustainability, for political acceptability, even understanding that "the poor matter" is key to the success of all investments.

But many risks still need to be addressed. These include:

- Transfer and convertibility risk.
- Legal risk, relating to the enforceability of contracts and inefficient courts in our client countries.
- For sustainability, for political acceptability, even understanding that "the poor matter" is key to all investors.
- Government performance risks, including those related to pricing and regulatory regime changes.
- *Force majeure* and fortuitous events.
- From the IPP experience, we have also learned about the special risks of foreign-currency borrowing to support local-currency revenue-generating projects.

These risks, among others, stand in the way of greater private involvement.

The Role of Multilateral Financing Institutions

What is the ADB doing? First, and perhaps most important, we are promoting good governance. This is essential in Asia, where we are facing a "governance crisis"—in the public and the private sectors. In the public sector, good governance means transparency, economy, and efficiency in public procurement, equitable taxation, public spending in the best interests of the whole population, accountability of public officials, and much more.

In the private sector, good governance means acting to maximize shareholder value through responsible management of the corporation, and sensitive to all its stakeholders in society. Institutional investors and multilateral development banks should factor in the quality of corporate governance in their decisions to do business with potential partners. As providers of substantial capital, institutional investors and other lenders can influence the quality of corporate governance. As a responsible institutional investor, we in ADB put great weight on this, as we make investments in all sectors.

Rating agencies should also throw the spotlight on the quality of governance as one of the factors in their overall evaluation of the integrity and soundness of banks and other corporate institutions. It is not adequate to evaluate only the quality of management. The quality of the board should also be critically evaluated.

ADB Financial Products and Modalities for Resource Mobilization

The Bank has at its disposal, various products that can assist directly and indirectly the mobilization of private capital. In our normal provision of loans and technical assistance for public-sector projects, where possible, we are looking at structuring these projects and their financing requirements such that private capital, ownership, and/or operation may be attracted at some point in the projects' development and/or operation. We can loan to and invest in projects sponsored and owned by the private sector. This enables the Bank to catalyze additional loans and investments from other private financiers for the project.

In addition, we can provide partial credit and partial risk guarantees to private financial institutions, in both local and foreign currency, as a part of a risk mitigation package. The partial risk guarantee covers political risks of concern to both lenders and investors. The Bank's Complementary Financing Scheme (CFS) is available for use in private sector projects to provide private financiers with country risk cover under the Bank's preferred creditor status. The recently approved Asian Currency Crisis Support Facility (ACCSF) can provide guarantees supporting financing to Asian crisis affected countries (currently within the countries making up the Northeast Asia Economic Forum, only the Republic of Korea is eligible for ACCSF assistance).

PROJECT STRUCTURE EXAMPLES

Let me now describe some examples, at the project level, of ADB's support. While some of these project structures are in the Bank's West region, they are applicable to projects in any of our developing member countries.

To bring local currency resources to infrastructure, the ADB established its first private-sector $300 million infrastructure facility, in India. This supported the issue of local currency debentures for infrastructure subprojects: the project is thus also helping to develop a market for long-term securities in local currency.

Another dimension of public–private partnership is one where the private sector was not yet ready to make an investment commitment, most likely because of concerns over government performance risk. The Bank is providing a loan to the National Highways Authority of India for $180 million for the Surat–Manor tollway project. The completed highway will be operated by the private sector through a toll concession–management contract. This offers both the public and the private sector a "step-wise" approach to involvement—a "getting to know you" period, so to speak, before committing significant resources.

More directly, the Bank financed the first build-operate-transfer (BOT) power project in the Philippines—the Hopewell Power (Philippines) Corporation—together with IFC, CDC, and a syndicate of international banks. The use of the Bank's Complementary Financing Scheme (CFS), to enhance the commercial credit, made this project-financing package possible.

In China, the Bank financed the first-ever BOT water supply project—a model project to encourage private sector participation in water, in Chengdu, the capital of Sichuan Province and the second largest city in southwest China. We helped draft the bidding documents, advised the government on offers, helped to create a regulatory framework, and also provided a direct loan of $26.5 million. In addition, to complete the financing for the winning bidders, we arranged cofinancing of $26.5 million from bilateral sources, and again under our CFS credit enhancement modality, cofinancing of up to $21.5 million from commercial lenders.

The tight loan syndication market brought about by the financial crisis made the Bank's catalytic role key to the success in closing the limited-recourse debt financing for the Meizhou Wan Power project, a 720-megawatt coal-fired generating plant to be built in the Fujian Province of the PRC. The project is one of the first wholly foreign-owned power projects in the PRC based on build-operate-transfer (BOT) principles. Insufficient power is regarded as a major constraint to economic growth in the area. The Bank's support for the $828.5 million project consists of a $50 million direct loan and equity investment, and a $150 million loan funded by international banks under the Complementary

Financing Scheme. The Meizhou Wan Power project has set a benchmark for project financing in the PRC on contractual and financing documentation.

In the Lao PDR, the ADB helped finance the first joint venture between the Lao government and a foreign utility-investor, the $270 million Theun-Hinboun hydropower project. Of special interest here is that the ADB financed the government's equity stake in the venture.

In Bangladesh, our focus and contribution to the public–private partnership has been on the regulatory and enabling environment. The Bank helped to unbundle the power sector by separating generation, transmission, and distribution and also helped create an enabling environment for the private sector, which made the Meghnaghat BOOT project possible.

More generally, through its program lending, the Bank also helps encourage policy reforms to help sector restructuring and market development. For example, the Bank has provided technical assistance and/or program loans for financial and capital market development in China, Mongolia, Indonesia, India, the Philippines, Bangladesh, Pakistan, and more recently Thailand (under its $300 million Financial Markets Reform Program Loan which was part of the $17.2 billion IMF-led assistance package).

Through its private-sector window, the Bank has also catalyzed investments into the region and has supported regional and domestic infrastructure funds, such as the $780 million Asian Infrastructure Fund. We have also helped set up the first bond insurance in Asia, the $150 million Asian Securitization and Infrastructure Assurance Ltd. The Bank has also made equity investments in three credit rating agencies, critical to building confidence in the region and among private sector enterprises.

CONCLUSIONS: LOOKING AHEAD

Looking ahead, the challenges remain formidable. Let me mention a few of them. First, of course is to continue policy reforms in the various infrastructure sectors that impede sector development. In this regard, as I alluded to earlier, one approach the Bank is taking is to formulate projects in such a way that may attract private capital, ownership, and/or operation. This can involve either the Bank operating through its private sector window as a "project developer" along with other sponsors and/or making the project a "pilot project" where factors that have impeded private capital from operating in the sector are removed as part of the project objectives. If successful, the project can then be used as a model for other projects in the sector. Second is to continue to develop long-term local-currency debt and equity markets to meet the long-term financing requirements of infrastructure projects. Here, the ADB is actively promoting several approaches:

- Establishing government securities markets to provide a real market benchmark rate and yield curve for issuers of securities. As is well know, most public bonds have been placed on a nonmarket basis with pension funds or domestic banks, and few "market" benchmarks exist.
- Developing secondary markets for securities to provide liquidity to issued securities.
- Promoting long-term institutional sources of funds, such as pension and provident funds, insurance companies, mutual funds, and venture capital, among others.
- Creating a network of intermediaries, investment banks, securities firms, etc., that will originate, package, and distribute securities in the market.

Another challenge is to bring this public/private sector partnership to the subnational level—to smaller infrastructure projects. Much of the infrastructure activities in the future will be in "secondary cities." For example, Chengdu will be the model for 19 other cities in China.

Let me conclude by saying that public-private sector partnerships will not materialize and be sustainable unless reforms in the infrastructure sectors are undertaken seriously. Good governance, transparency, pricing reforms, adherence to the rules—all this will be needed on the part of the public sector. ADB is committed to working with its client countries and the private sector to support creative public–private partnerships.