Chapter 3
Appraising Development Results

What’s in it for development? Assessing the Belgian Investment Company for Developing Countries’ (BIO) Development Outcomes
Jan Van de Poel, 11.11.11 – Coalition of Flemish North South Movement

Mass Transport and Development in the Philippines:
Privatizing the rail transit system
Arnold Padilla, IBON Foundation

Private Sector in Development:
Infrastructure challenges and opportunities for Africa
Fanwell Kenala Bokosi, PhD and Taurai Chiraerae,
African Forum and Network on Debt and Development

Does private sector focus on real development in Bangladesh?
Ahmed Swapan Mahmud and Farjana Akter, VOICE
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Introduction

In the light of declining aid budgets in Europe’s ‘Age of Austerity’, governments are looking for a cheap ‘win-win situation’ where reduced ODA is supposed to leverage significant amounts of additional private capital to be committed to developing countries. As a result, ODA flows to the private sector have been growing rapidly in recent years, albeit remaining a relatively small share of the total.

Different multilateral and bilateral development agencies are becoming the main interlocutors making public funds available for private investments in the developing countries. According to a recent Eurodad study these Development Finance Institutions (DFIs) increased their portfolios by 190% between 2006 and 2010. In that same period DFIs moved into new areas and sectors – such as infrastructure – where finance is no longer available from private credit markets. Belgium and Sweden are striking examples of increasing amounts of ODA being channeled to the private sector. Within Belgian ODA, private sector support quadrupled since 2006 (see Belgium Country Chapter in this report). Most of these resources were spent through the Belgian bilateral DFI, the Belgian Investment Company for Developing Countries (BIO).

This chapter assesses the effectiveness of BIO in the realization of its mission. According to the 2001 Act creating BIO it is to ‘invest in the development of companies in developing countries in the interest of economic and social progress [...] with the aim to achieve the Millennium Development Goals’. BIO’s ambitions, however, to enhance its ‘leverage capacity’ - the additional private capital that is attracted by matching public funds – seem to be at odds with stakeholder’s expectations in terms of sustainable development and poverty eradication. There is a trade-off between financial performance and development outcomes in BIO’s activities.

A new actor in Belgian development cooperation?

BIO was created in 2001 by the Belgian government to invest in growing companies in developing countries in order to promote the economic and social development of those countries. According to its law of establishment, BIO’s interventions should directly or indirectly lead to sustainable productive employment taking into account basic social rights as defined in the fundamental conventions of the ILO. The Belgian government intended to involve the Belgian business community in its initiative. Therefore the Belgian Corporation for International Investment, a semi-public provider of medium and long-term financing for Belgian business ventures overseas, was engaged to commit half of BIO’s registered capital.
Additional financing for BIO is provided by the Belgian state through ‘development certificates’, redeemed shares that do not influence BIO’s ownership structure. Since 2001 BIO has received more than €500 million additional resources, all designated as ODA. The spectacular growth of BIO (see Chart 1) has been largely motivated by the neutral impact of its activities on the government’s budget. Since BIO makes investments, which are projected to generate a certain return, they do not need to be booked as expenditures in the State’s budget. BIO, thus, allows the state to increase its ODA-budget without having an impact on the budget. This, however, implies BIO must generate sufficient returns on its investments (approximately 5% on average for its total portfolio).

BIO holds an ambiguous statute within Belgian development cooperation, outside the Belgian law on international cooperation, which determines the objectives for all actors in Belgian development cooperation. The state’s expectations for BIO, as its main shareholder, instead are defined in its Investment Charter, a seven-page document that includes BIO’s investment criteria, target sectors, geographical focus, code of conduct and principles of ethical and sustainable entrepreneurship, and exclusion criteria. The Charter also sets out a number of basic principles such as additionality and the catalytic role of the investments, local added value, good governance and transparency. Nevertheless, BIO’s ambiguous position within development cooperation allows for its

**Chart 1 Growth of BIO, 2001-2010**

investment policies to be insufficiently targeted towards development outcomes and inconsistent with the principles and objectives laid out in the law on international cooperation. Furthermore, BIO’s Investment Charter is currently not even inspired by a strategic and comprehensive vision on private sector development (PSD) of Belgian development cooperation.

**Who profits?**

In order to fulfill its development mandate, BIO should contribute to a thriving private sector in developing countries providing goods and services for local markets, which in turn unleashes the sector’s potential to create sustainable decent jobs and an increasing tax base for developing states. It should be doing so by directing its resources to companies that have most difficulties in accessing private capital markets. Moreover, those companies need to be active in regions and sectors that are delivering best outcomes for the poor. Under these conditions, we believe BIO assumes its additionality, catalytic role and local added value to the fullest.

Between 2006 and 2011 BIO mainly focused on lower middle income countries (32% of its total portfolio), while least developed and low income countries on average received 12% and 11% of BIO’s resources respectively. This bias towards middle income countries is amplified by BIO’s investments with a regional coverage, which accounts for nearly 45% of its total portfolio, and are mainly directed towards more developed, middle income countries. In some cases even upper middle income countries, where BIO has no mandate, are targeted. The financial sector is by far the most important benefiting sector making up 54% of the total portfolio between 2006 and 2011, seconded by financing of small and medium sized enterprises (SME) through intermediary funds (29%). Agri-business (5%), manufacturing (2%) and health and education (1%) have a minor share in BIO’s portfolio. Recently, infrastructure is becoming more important as target sector. In 2010, 21% of all invested resources went to infrastructure projects, contrasting to only 8% on average between 2006 and 2011.

**Targeting financial sector investments**

BIO’s focus on the financial sector is replicated at international level. Eurodad found that over 50% of public finance flowing from donors’ DFIs to the private sector went to the financial sector. Investments in the financial sector are usually targeted towards commercial banks, microfinance institutions and funds specializing in microfinance and specialized service deliverers such as leasing companies, factoring, etc. In a few cases BIO also participates in derivatives, such as currency swaps. In the financial sector, BIO’s portfolio between 2006 and 2011 breaks down as follows: commercial banks (37%), microfinance (36%) and non-banking financial institutions (27%).

BIO and other DFIs focus on financial sectors because they expect those institutions to scale up financing opportunities for local business life. These scaling up effects however are largely assumed, while hard data is lacking to check that assumption. From BIO’s reporting it is impossible to learn even which companies benefit from BIO’s investments in commercial banks and equity funds, not to mention their development outcomes. Moreover, an assessment of BIO’s activities in the microfinance sector revealed clear signs of crowding out effects. BIO and other DFIs are aiming for the ‘low hanging fruit’ in the market, thus pushing away conventional players. According to a study by rating agency MicroRate DFIs are mainly interested in spending public...
resources relatively quickly through easy, risk-free and profitable Micro Finance Institutions that are hard to discern from regular commercial banks. The former offer consumer credits, mortgage loans, remittance transfers, etc. In some countries, such as Nicaragua, Peru and Bosnia-Herzegovina, competition between private investors and DFIs led to overheated markets and debt crises pushed many small borrowers into poverty.

Reaching small companies?

Between 2006 and 2011 nearly 36% of BIO’s investments were channeled through specialized microfinance funds and private equity funds that serve as intermediaries between BIO and the final beneficiary company. BIO engaged with these intermediary funds because they reduce transaction costs and allow for direct engagement with small and medium sized enterprises. Although, working with intermediary funds creates opportunities for BIO, their day-to-day practices seem less tailored for maximum returns in terms of development outcomes. Financial intermediaries, such as private equity funds, are usually very opaque in their investment strategies. Similar to the financial sector, it is often impossible to determine the final beneficiaries of fund investments, let alone their development outcomes. Moreover, fund managers – private consultancy companies that receive a fee of approximately 2.5% for managing these funds – are in the driving seat controlling investment strategies. DFIs such as BIO are often not even in the back seat, because their share of such intermediary funds is too limited.

Leveraging additional private capital in intermediary funds creates certain expectations about returns on the part of private equity and venture capital investors. Usually they expect a return on invested capital of approximately 15 to 20%, bringing about a Matthew effect in the selection of projects and companies. Intermediary funds, in which BIO is participating, make investments in large, industrial corporations with proven profitability and growth and able to absorb €3 to €5 million investments in mining, leisure, chemical industry, etc.

In order to fulfill its objective of additionality, BIO should be investing in companies in developing countries that would otherwise not be able to access other private capital markets. Those companies are mostly small-scale local firms, strongly embedded in the socio-economic fabric of developing countries. Country ownership is one of the key principles of effective aid and is also applicable to investments in the private sector for development outcomes. Just because a project is situated in a developing country, it does not mean that it is owned or operated by companies rooted in the economic fabric of the target country for the investment. From the top ten direct investments made by BIO between 2006 and 2011, only 4 showed beneficial ownership in the targeted country. Companies that receive loans or equity investments are often subsidiaries of transnational corporations that are ‘special purpose vehicles’ specifically created to implement a particular project. These findings seem to undermine BIO’s claim for financial and development additionality in its investments. (See Table 1)

When making direct investments, BIO adheres to an internationally-agreed definition of SMEs as an enterprise with less than 250 employees, a maximum annual turnover of €40 million and maximum €27 million in assets. The ‘ideal business case’ for BIO is a profitable, export-oriented company that has been growing for at least five years and is looking for financing in Euros or US dollars. Moreover, the company should be able to absorb an amount between €1 million and €3 million.
Various studies demonstrate that mainly local microenterprises, with maximum ten employees and a maximum annual turnover of €2 million, have difficulties to get the necessary funding. According to a study by Root Capital, quoted by the FAO, the ‘missing middle’ in Africa and Latin America is largely crowded by companies active in agriculture in need of financial support between US$10,000 and US$1 million. Those SMEs in particular play a crucial role in economic development, because they often constitute the first step in the transition from an informal, ‘black’ economy to a formal, ‘white’ economy. Particularly in agriculture there is indeed a so-called ‘missing middle’ between family farming and large, industrial corporations. BIO and the other DFI’s avoid investing in that ‘missing middle’ because risks are considered too high and growth is relatively slow.

**Demonstrating development effects**

For all development actors demonstrating a causal link between their interventions and development outcomes can be very difficult. For DFI’s such as BIO this challenge is compounded. Development outcomes in fact do not constitute the main objective of the private entities with which BIO is partnering in its investment strategy. A recent report of International Finance Corporation (IFC, a similar DFI to BIO in the World Bank) by its Internal Evaluation Group demonstrates that the IFC’s investments lack a clear focus on poverty eradication. ‘Fewer than half of the projects reviewed included evidence of poverty and distributional aspects in project objectives, targeting of interventions, characteristics of intended beneficiaries, or tracking of impacts.’

To assess its development impacts, BIO uses the Corporate-Policy Project Rating (GPR) tool, which has been developed by DEG, the German DFI. The GPR-analysis is performed ex ante, prior to the investment’s approval, and maps the expected results in terms of development and the strategic role of BIO’s portfolio. The GPR tool uses sector specific ‘development impact criteria’ such as number of jobs, generated income, access to education, market expansion, environmental protection and gender effects. Based on the scores for development outcomes the project will be allocated to one of six groups, of which only projects in groups 5 and 6 will not be implemented.

Although development effects are taken into account for 60% of the GPR’s total score, the test is essentially hard to fail. The tool has several deficiencies: information is essentially delivered by the benefitting company, there is no triangulation by gathering information through independent sources, the analysis is only focused on potential positive development, there is no indicator for country ownership, no minimum standards or exclusion criteria are defined. The tool places too much emphasis on financial outputs and quantitative aspects to the

**Table 1** Final beneficiary of top 10 direct investments by BIO, 2006-2011

<table>
<thead>
<tr>
<th>PROJECT</th>
<th>COUNTRY OF OWNERSHIP</th>
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<tbody>
<tr>
<td>Sacombank</td>
<td>Vietnam</td>
</tr>
<tr>
<td>Jakarta Tank Terminal</td>
<td>The Netherlands &amp; Indonesia</td>
</tr>
<tr>
<td>Maple Ethanol</td>
<td>UK &amp; Peru</td>
</tr>
<tr>
<td>Amayo</td>
<td>Panama &amp; US</td>
</tr>
<tr>
<td>Polaris</td>
<td>US</td>
</tr>
<tr>
<td>Banco Financiera del Peru</td>
<td>Peru &amp; Ecuador</td>
</tr>
<tr>
<td>Hohhot Cokes</td>
<td>China</td>
</tr>
<tr>
<td>BOA Group</td>
<td>Luxemburg &amp; Mali</td>
</tr>
<tr>
<td>Banco Nacional de Bolivia</td>
<td>Bolivia</td>
</tr>
<tr>
<td>Bancenort</td>
<td>US &amp; Nicaragua</td>
</tr>
</tbody>
</table>

*Source: BIO Portfolio and project/company websites*
The detrimental impact of qualitative outcomes (‘incremental job creation’, quality of employment and transfer effects, impact on inequality, etc.). Moreover, such measuring tools ‘tend to begin once the key decisions on who, how and where investments will be made, are already determined’. In order to be aligned with development priorities of a given developing country and have a real impact on its development, project selection should be based on a clear assessment of different alternatives for investment linked to expected development outcomes of various alternatives. Furthermore, BIO needs to invest in effective environmental, social and governance assessment mechanisms that allow for development finance to be channeled towards the sectors and companies that have demonstrated the potential for impacts on development outcomes for people living in poverty.

**Conclusion**

BIO and other Development Finance Institutions offer opportunities for development since the private sector in developing countries can indeed be a motor for the creation of decent jobs, increasing revenue for governments from tax, providing local markets with necessary goods and services, etc. DFIs need to demonstrate the potential of their investment policies to address poverty eradication and inequality through sustainable private sector development targeted at poor and marginalized people. As the OECD-DAC is suggesting in its policy guidelines for PSD, ‘reducing poverty requires greater efforts to address the needs and maximize the contribution of the many informal enterprises, family run farms and self-employed men and women that conduct business in developing countries’. DFIs also need to devise strategies to aim at formalizing micro-enterprises in which poor and marginalized people tend to be active. However, in the case of BIO the evidence suggests that leveraging public resources to attract additional private capital clearly has meant a setback for development returns on their investments.

A new balance is required between financial and development objectives in which development returns are at the heart. Development returns means investing in locally embedded and owned company life, stimulating local entrepreneurship, creating additional, permanent and decent jobs, sustainably increasing tax incomes for local governments, providing knowhow and innovation to local businessmen, respecting the highest standards of environmental protection, transparency and accountability. Maximizing development returns for DFIs means engaging in innovative financial services and products that mitigate risk for local entrepreneurs in order to foster private enterprise adapted to and strengthening local markets and value chains. Through these approaches DFIs will fulfill their goal of additionality for development, which is a fundamental principle to justify spending public ODA resources in private sector development.
Endnotes


3 BMI-SBI is for 63% state-owned, 37% of ownership is in hands of private investors such as BNP Paribas Fortis (bank), ING (bank), Electrabel (energy production), etc. BMI-SBI’s main objective is to strengthen exports and foreign expansion of Belgian enterprises.

4 These calculations are based on BIO’s portfolio, compared with OECD-DAC list of ODA recipients, effective for reporting on 2009 and 2010 flows.


7 A sociological term describing a process whereby the rich get richer and the poor get poorer.


Mass Transport and Development in the Philippines: Privatizing the rail transit system

Overview

The privatization of Metro Manila’s rail transit system is one of the top priority projects for President Benigno Aquino’s Public-Private Partnership (PPP) program. To advance this, since 2010 the government has been proposing a controversial fare hike of as much as 100% when implemented. The fare hike, authorities said, will “send a clear signal to private sector investors that regulatory risks will be minimized in future PPP projects.” Government officials are aware that investors are closely monitoring the privatization of the Metro’s mass transit system as this could potentially affect the success or failure of PPPs, which is the Aquino government’s centerpiece economic program. Unfortunately, while government’s concern about the interests of the private investors is apparent, the same concern cannot be said about the interests of over a million daily train commuters who will soon be paying higher fares.

Introduction: system and passenger profiles

Metro Manila is served by two metropolitan rail systems: the Light Rail Transit system (LRT) and the Metro Rail Transit system (MRT). The LRT and MRT are operated by the Light Rail Transit Authority (LRTA), a government-owned and controlled agency under the authority of the Department of Transportation and Communication (DOTC). The LRTA was founded in July 1980 under Executive Order (EO) No. 603 as a “government corporation primarily responsible for the construction, operation, maintenance, and/or lease of LRT Systems” in the country.

The LRT and MRT system is composed of three operational lines: LRT-1 (Yellow Line), LRT-2 (Purple Line) and MRT (Blue Line). The three lines have a combined span of 48.4 kilometers, covering 44 stations, and serving over a million passengers on weekdays (see Table 1).

A survey on the ridership profile of the LRT/MRT passengers revealed that almost 90% are students, employed and unemployed workers. Among LRT/MRT respondents to the survey, the groups with income less than Php 10,000/month (US$242/month) comprise more than 60% of the total.5 Those groups with less than Php 8,000/month (US$193/month) income comprise more than 40% of the respondents (see Table 2).

Historical role of ODA and private investors in mass transit construction

The Manila Electric Company (MERALCO) operated an electric tram network since 1903, but it was damaged in World War II. Studies to rebuild a rail system in the capital were funded by the Japan International Cooperation Agency (JICA) and the World Bank. A study commissioned by the World Bank in 1976 suggesting a street-level light railway and this proposal became the basis...
of then President Ferdinand E. Marcos’s LRT project, with some revisions to the proposal. The then newly created Ministry of Transportation and Communications (MOTC) reviewed and revised the study’s recommendations and introduced an elevated version because of the many intersections, raising the cost from Php1.5 billion (US$35.4 million) to Php2 billion (US$47.3 million). The LRT project (LRT 1) took off with official development aid (ODA) from the Belgian government, which granted a Php300 million (US$71 million) “soft” and interest-free loan, with a repayment time of 30 years. An additional loan of Php700 million (US$16.5 million) was provided by a Belgian consortium of private companies that also supplied equipment and technical assistance. The project was expected to be self-sustaining through revenue alone within a period of 20 years. The entire system was expected to be out of debt by 1993. Against an expected gross revenue of Php365 million (US$8.63 million) for the first operating year, government losses were expected to reach Php216 million (US$5.1 million). The system was intended as a public utility rather than as a profit center.

LRT-2 was also built in 2000 through ODA loans amounting to about Php 31 billion (US$733 million) mainly from the Japan Bank for International Cooperation (JBIC). The Asia-Europe MRT Consortium participated in the construction of the structures and associated components, including trains and other equipment. The consortium was composed of British, Korean and Japanese companies under the leadership of Japanese-owned Marubeni Corporation.

### Table 1. Profile of the LRT and MRT system

<table>
<thead>
<tr>
<th>INDICATOR</th>
<th>LRT LINE 1 (YELLOW LINE)</th>
<th>LRT LINE 2 (MEGATREN/PURPLE LINE)</th>
<th>MRT (METROSTAR/BLUE LINE)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year commercial operation began</td>
<td>1984</td>
<td>2003</td>
<td>1999</td>
</tr>
<tr>
<td>Commercial length (km)</td>
<td>18.95</td>
<td>12.49</td>
<td>16.95</td>
</tr>
<tr>
<td>No. of stations (location)</td>
<td>22</td>
<td>11</td>
<td>13</td>
</tr>
<tr>
<td>No. of trains</td>
<td>40</td>
<td>18</td>
<td>20</td>
</tr>
<tr>
<td>Capacity per train</td>
<td>1,200</td>
<td>1,628</td>
<td>957</td>
</tr>
<tr>
<td>No. of passengers daily</td>
<td>431,879</td>
<td>175,501</td>
<td>487,000</td>
</tr>
</tbody>
</table>

Table 2 Occupation and income distribution of LRT/MRT passengers on weekdays

<table>
<thead>
<tr>
<th>BY OCCUPATION</th>
<th>SHARE (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Student</td>
<td>31.5</td>
</tr>
<tr>
<td>Employed</td>
<td>48.8</td>
</tr>
<tr>
<td>Unemployed</td>
<td>9.5</td>
</tr>
<tr>
<td>Businessman/Self-employed</td>
<td>5.1</td>
</tr>
<tr>
<td>Professionals/Executive</td>
<td>3.2</td>
</tr>
<tr>
<td>Others</td>
<td>2.1</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>BY INCOME (PHP/MONTH)</th>
<th>SHARE (%)</th>
</tr>
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<tbody>
<tr>
<td>None</td>
<td>15.3</td>
</tr>
<tr>
<td>&lt;8,000</td>
<td>28.5</td>
</tr>
<tr>
<td>8,000 – 10,000</td>
<td>24.3</td>
</tr>
<tr>
<td>10,000 – 15,000</td>
<td>18.8</td>
</tr>
<tr>
<td>15,000 – 20,000</td>
<td>7.8</td>
</tr>
<tr>
<td>20,000 – 30,000</td>
<td>3.9</td>
</tr>
<tr>
<td>&gt;30,000</td>
<td>1.4</td>
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In contrast to the LRT lines, the MRT was built through the Build-Operate-Transfer (BOT) scheme, under which the Department of Transport (DOTC) entered into a 25-year agreement with the Metro Rail Transit Corp. Ltd (Metro Rail) in August 1997. Metro Rail is a consortium led by Fil-Estate Management Inc. and Ayala Land Inc. Under the contract, Metro Rail is responsible for the construction and maintenance of the MRT, after which it will lease the system to the DOTC. The DOTC would then assume all administrative functions such as the regulation of fares and operations.

Total cost of the MRT project amounted to Php 28.6 billion (US$675.5 million) comprised of Php 8.1 billion (US$190 million) in equity from Metro Rail and total loans of Php 20.5 billion (US$485.5 million) from JBIC and other Japanese, European, Chinese, American and local banks. Under the BOT scheme, the DOTC would pay Metro Rail monthly fees for a certain number of years to reimburse any incurred costs. This includes equity rental payments (ERP) for the guaranteed annual 15% return on investment (ROI) for investors as well as reimbursement for maintenance expenses and loans assumed by Metro Rail to finance the project. To compensate for costs, the DOTC originally proposed a maximum Php 60 fare for a one-way single ticket journey for the MRT. This fare proposal was vehemently opposed by several groups as being too high, forcing the government to reduce the fares to Php 12 – 15. Thus the government claims that it pays a minimum of Php 7 billion (US$165 million) subsidy yearly for approximately 500,000 MRT commuters since it shoulders Php 40 of the Php 60 actual cost.

**Mass Transit privatization plans**

In March 2011, President Aquino’s government formally announced public projects open to investors as it inaugurated its public-private partnership (PPP) program, with infrastructure projects spearheading the endeavor. Operation and maintenance contracts for the LRT and MRT are among the top priority PPP projects to be offered to investors by the government (see Table 3).

An LRT/MRT Expansion Program will begin with the LRT-1 Operation and Maintenance (O&M) privatization. The project aims to contract LRT operation and maintenance to a private sector service provider during the interim period of 3-4 years. This is an interim project for 3 to 4 years, after which the LRT Extension Project contractor is expected to assume overall responsibility for the integrated LRT and MRT systems.

The integration and expansion of Metro Manila’s rail system was first pursued by President Joseph Estrada in 1998 and continued by President Gloria Macapagal-Arroyo in 2003 as part of the Strong Republic Transit System. Nonetheless, the PPP efforts of President Aquino are arguably more aggressive in attracting private investors for

<table>
<thead>
<tr>
<th>Table 3 PPP projects in LRT and MRT for 2012 rollout</th>
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</thead>
<tbody>
<tr>
<td><strong>PROJECT</strong></td>
</tr>
<tr>
<td>LRT Line 1 South Extension and Operation &amp; Maintenance</td>
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<tr>
<td>LRT Line 2 East Extension and Operation and Maintenance</td>
</tr>
<tr>
<td>Automatic Fare Collection System</td>
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<tr>
<td>Integrated Transport System (ITS) Project</td>
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<tr>
<td>Cebu Bus Rapid Transit Development Project</td>
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the country’s rail development projects. Efforts include “pertinent incentives” provided to attract the private sector in financing the construction, operation, and maintenance of infrastructure and development projects. One such incentive is the protection of PPP investors from “certain regulatory risk events such as court orders or decisions by regulatory agencies which prevent investors from adjusting tariffs to contractually agreed levels” (see Box: Legal framework). In other words, under this scheme, private investors are guaranteed profits, especially at times when the public resists and protests fare increases.

**Current LRT/MRT projects and key players**

Private companies continue to play a key role in the development and operation of the LRT and MRT. In fact, renewed privatization efforts of the government, through its PPP program, have encouraged private investors to completely take over the LRT and MRT.

The Metro Pacific Investments Corporation (MPIC) and Ayala groups have jointly submitted to the government an unsolicited proposal to rehabilitate and upgrade the MRT (Blue Line). The two companies, which formed an “exclusive” alliance in early 2011 to pursue LRT projects, submitted the new MRT proposal to the DOTC in August 2012. In its previous offer submitted in 2011, MPIC asked to be given rights to manage the train line until 2040, extending MRT’s current BOT contract by 15 more years (current contract ends by 2025). Under the new deal, MPIC and Ayala groups sought to create new cash flows by doubling the capacity of the Blue Line and doubling fares to Php30 (currently Php 15) for a one-way, end-to-end trip. If approved, the deal will give the conglomerates a greater edge in acquiring 10 potential railway projects in Metro Manila, and thus bring MPIC closer to its objective of full ownership of the MRT. At present, MPIC already owns 48% of the economic interest in MRT.

Among these 10 potential railway projects in Metro Manila, the newly created alliance between the MPIC and Ayala groups, along with SMC Infra Resources Inc, is among the top bidders for railway projects that would extend the LRT-1 to the southern province (LRT-1 Cavite Extension).

The LRT Line 1 Cavite Extension Project aims to connect Metro Manila to nearby province of Cavite with eight passenger stations. The project, implemented through PPP, has an estimated project cost of Php 61.53 billion (US$1.45 billion), with government and private sector to provide Php 30.594 billion (US$727 million) each. Public sector components will be financed through ODA from JICA and National Government Subsidy Appropriation.
Official bidding will not begin until January 2013, but already large private investors, both local and foreign, have expressed interest to bid. Aside from MPIC and Ayala groups, Japanese, South Korean and French transportation contractors, as well as local and foreign banks, have also indicated interest to undertake the projects.

Meanwhile, the LRT-1 North Extension Project started by former President Arroyo in early 2007, aiming to complete the LRT-1 – MRT loop by 2010, has been shelved indefinitely. The total project costs Php 9.63 billion (US$227.7 million). The main contractors would have included Filipino-owned companies, DM Consuji, Inc (DMCI) and First Balfour, Inc, for the construction phase, as well as various foreign companies for electro-mechanical works. The announcement to shelve was made by former DOTC secretary Manuel Roxas in July 2012, citing planning and technical issues. South Korea-based Hyundai Rotem, a member of the Hyundai Motor Group, had already expressed interest in bidding for the O&M contracts of the LRT-1 and MRT, with costs of about Php 14 billion (US$331 million).

**Privatization projected impact on commuters: Doubled fare hikes**

As an added boost to its PPP program, the government has been pushing for increased fares in the LRT and MRT. The DOTC’s proposed fare hike in 2010 was derailed by strong opposition from several groups. In September 2012, however, the government announced that the MRT/LRT fare hike will proceed in 2013. The announcement was made after Congress slashed rail subsidies to allocate more funds to the development of the Philippine countryside. However, this time, former DOTC secretary Roxas called it a “fairness issue” saying, “It will be unfair for the areas in the provinces if we continue to subsidize Metro Manila as we have done so for the past ten years.”

Under the proposed fare matrix, according to DOTC, commuters will only shoulder a maximum of 60% fare increase (see Table 4).

However, the above presentation is too simple and does not show the full and actual impact of the fare hike, which can only be appreciated on a per station basis using the new fare matrix approved by the LRTA. Based on this new fare matrix, a train ride (single journey ticket) from both LRT-1’s Baclaran station to Roosevelt and from Baclaran to Tayuman will double, from P20 to P30 and from P15 to P30, respectively. But a train ride from LRT-2’s Recto station to Santolan will be 67% more expensive (P15 to P25) while the fare from Recto to Anonas will jump by 79% (P14 to P25).

<table>
<thead>
<tr>
<th>LINE</th>
<th>AVERAGE TRIP LENGTH (KM)</th>
<th>CURRENT FARE (PHP)</th>
<th>PROPOSED FARE (PHP)*</th>
<th>INCREASE</th>
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<td></td>
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<td></td>
<td>PHP</td>
</tr>
<tr>
<td>LRT 1</td>
<td>8.00</td>
<td>14.20</td>
<td>19.00</td>
<td>4.8</td>
</tr>
<tr>
<td>LRT 2</td>
<td>8.08</td>
<td>13.51</td>
<td>19.08</td>
<td>5.57</td>
</tr>
<tr>
<td>MRT</td>
<td>8.61</td>
<td>12.30</td>
<td>19.61</td>
<td>7.31</td>
</tr>
</tbody>
</table>

*Based on the fare structure of P11 boarding charge + P1/km
Source: Department of Transportation and Communication, Newsbreak. (Landingin. 12 Jan 2011)
Onerous deals resulting to major debt burden

The LRTA/DOTC further justifies the fare increase by claiming that the full cost per fare for operating the LRT/MRT ranges from Php 35.77 to Php 60.75, which is way above current fares of Php 12.30 to Php 14.20. Based on this comparison, the LRTA/DOTC calculates government subsidies reached Php 13.85 billion (US$327 million) in 2010, and an approximate of Php 17 billion (US$402 million) in 2011.30

In reality, a huge portion of this operating amount (Php 35.77 to Php 60.75) actually comprises the debt service burden of the LRTA and DOTC for the light rail infrastructure, and not simply the shortfall in the costs of operating and maintaining the trains. In fact, according to a DOTC official, the rule of thumb for large infrastructure projects, such as the LRT and MRT, is that 85% of the cost is made up of servicing loan principal and interest payments. This means that debt servicing consists about Php 51.64 of the alleged Php 60.75 full cost. Conversely this also means that the actual cost to finance the O&M expenses per passenger falls to only Php 9.11.

In the case of the MRT, the original proponents were private local and Japanese corporations, which formed the Metro Rail consortium. Under a Build-Operate-Transfer (BOT) deal, the Metro Rail was allowed to build the MRT infrastructure.

Table 5 LRT 1 Old rates versus New rates (in Php)

<table>
<thead>
<tr>
<th>BACALLARAN STATION TO/FROM:</th>
<th>STORED VALUE</th>
<th>SINGLE-JOURNEY</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>OLD</td>
<td>NEW</td>
</tr>
<tr>
<td>EDSA</td>
<td>12</td>
<td>12</td>
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<tr>
<td>Libertad</td>
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</tr>
<tr>
<td>Gil Puyat</td>
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<td>13</td>
</tr>
<tr>
<td>Vito Cruz</td>
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</tr>
<tr>
<td>Quirino</td>
<td>13</td>
<td>15</td>
</tr>
<tr>
<td>Pedro Gil</td>
<td>13</td>
<td>16</td>
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<tr>
<td>UN Avenue</td>
<td>13</td>
<td>17</td>
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<tr>
<td>Central</td>
<td>13</td>
<td>18</td>
</tr>
<tr>
<td>Carriedo</td>
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<td>19</td>
</tr>
<tr>
<td>D. Jose</td>
<td>14</td>
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</tr>
<tr>
<td>Bambang</td>
<td>14</td>
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</tr>
<tr>
<td>Tayuman</td>
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</tr>
<tr>
<td>Blumentritt</td>
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</tr>
<tr>
<td>Abad Santos</td>
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<td>22</td>
</tr>
<tr>
<td>R. Papa</td>
<td>15</td>
<td>23</td>
</tr>
<tr>
<td>8th Ave</td>
<td>15</td>
<td>24</td>
</tr>
<tr>
<td>Monumento</td>
<td>15</td>
<td>25</td>
</tr>
<tr>
<td>Balintawak</td>
<td>19</td>
<td>27</td>
</tr>
<tr>
<td>Roosevelt</td>
<td>20</td>
<td>29</td>
</tr>
</tbody>
</table>

Source: Light Rail Transit Authority
and supply the needed equipment. It will then lease the MRT to the DOTC as operator while Metro Rail takes care of maintenance. As a lessee, the DOTC will pay equity rentals to Metro Rail for a guaranteed annual 15% return of investments of the investors (US$190 million) throughout the 25-year lifespan of the BOT deal (2000-2025). The DOTC will also reimburse Metro Rail for the maintenance expenses and provide payments for loans by Metro Rail to finance the project (US$485.5 million), which the government guaranteed. These onerous deals were the source of the financial bleeding of MRT.

For instance, in 2010, the DOTC spent Php 8.52 billion (US$201 million) for the MRT, of which Php 5.3 billion (US$125 million) went to the ERP; Php 1.18 billion (US$28 million) for maintenance costs; Php 1.16 billion (US$27 million) for guaranteed debt payments; and Php 880 million (US$21 million) for other expenses. But actual revenues in 2010 were only Php 1.92 billion (US$45 million). Thus, the DOTC is short of Php 6.6 billion (US$156 million), which the government finances through additional borrowings.

Nonetheless, these are not actual losses, from a business point of view, but relate to a public investment for a public good. The debt issue is paramount. These debts should, in principle, be serviced through taxes (and if they are onerous like in the case of the MRT, should be renegotiated), and not through higher user fees. Debt servicing through higher user fees will negate the social and economic gains that the LRT and MRT create.

The debt issue also disproves the claim that the fare increase is needed because the government is losing money. The government is losing money due to onerous contractual and debt obligations, not because commuters pay below the actual operating and maintenance costs of the rail systems. In fact, without the guaranteed profits and debt payments stipulated in the BOT deal, passenger fares alone could cover the full cost of operation and maintenance expenses.

**Conclusion:**

It is not unusual for state agencies managing public infrastructure like the LRTA to be “financially in the red” because their performance is measured not solely in narrow financial terms, but through the net social and economic benefits they bring. The new capability that results from public infrastructure such as improved mobility of the economy’s workforce, for instance, far outweighs what government deems as its “losses”.

Moreover, the LRTA-DOTC, in its study on the fare hike, recognizes the social and economic role of the LRT and MRT, even though they are not profitable, to wit: “Most urban railway systems in the world are not financially viable, but are implemented for their socio-economic benefits. Our Manila Light Rail Transit (LRT) systems promote the use of high-occupancy vehicles, thereby reducing traffic congestion on the corridors served, local air pollution and greenhouse gases emissions. Besides the substantial savings in travel time cost of LRT riders, the LRT systems reduce infrastructure investment in Metro Manila road expansion.”

The government also recognizes that the increased fares in the LRT and MRT will immediately impact low income and vulnerable groups that compose over 90% of the ridership profile of the light rail system. The issue can be more appreciated if one will scrutinize the socioeconomic profile of regular LRT and MRT commuters (see Table 2).

Unfortunately, these benefits and issues do not appear to have been factored in by the
government in determining its next steps concerning the privatization of the Metro’s light rail system. In fact, it would appear that the fare increase and the government’s offer to guarantee so-called “regulatory risks for major PPP projects” continue to be used to further attract private local and foreign investors alike. Indeed for private investors these guarantees are particularly attractive as they are allowed to maintain property rights and maintain profits while avoiding operational risks.

Finally, the government should not, in principle, transfer its role in national development and delivering social services to the mercy of big corporations and foreign interests whose prime motive is maximizing profit without regard to public expense or interest. In particular, PPP projects, characterized by the BOT scheme in the case of the rail system, should be abandoned as this creates a high risk environment that leads to the government – and ultimately, the people – absorbing incurred losses while private companies still retain the right to rewards.

Endnotes

1 See box on proposed fare hike matrix.


3 Ibid.


5 Mega Manila Public Transport Study, April 2007 https://www.box.com/shared/g6xpggal7m

6 Ibid.

7 Ibid.


9 Ibid.

10 Ibid.

11 The consortium consisted of Ateliers de Constructions Electriques de Charleroi, BN (ACEC), Constructions Ferroviaires et Metalliques (formerly Bruegoise et Nivelles), Tractionnel Engineering International (TEI), and Transurb Consult (TC).

12 Ibid.


14 Ibid.


21 Ibid.


23 Ibid.


26 Ibid.


28 Ibid.


31 Ibid.
Development funding from the private sector is becoming more significant in the form of investments, loans, and guarantees. The private sector received recognition in the Paris Declaration (2005), the Accra Agenda for Action (2008) and the Busan Partnership for Effective Development Cooperation (2011) as an active actor in the development discourse, as a source of financial flows, and as a benefactor from an enabling environment for investments at the country level. A number of private sector activities have been funded with aid resources over the years. Hitherto there has not been much documentation of the positive/negative development results of private sector activities funded with aid. This chapter takes a closer look at the development results generated by aid to infrastructure projects in Africa.

The conventional view has been that supporting infrastructure development projects accelerates growth and poverty reduction in low income countries and is needed to support pro-poor growth. Thus infrastructure, especially economic infrastructure underpins wealth creation, human development and poverty reduction. Infrastructure is required for the achievement of the Millennium Development Goals. Given that the private sector has a fundamental role in defining the directions of infrastructure development, it has been noted that having the “right” infrastructure enables the private sector to flourish.

Governments have long recognized the vital role that modern energy, telecommunications, transport and water services play in economic growth and poverty reduction. The African Development Bank notes that prices paid by African consumers for infrastructure services are exceptionally high by global standards. Tariffs charged in Africa for power, water, road freight, mobile telephone, or internet services are several times higher than those paid in other parts of the developing world. In line with these potential profits, the donor community is guaranteeing private companies to implement development projects in Africa as part of the Official Development assistance (ODA) programs. A significant number of countries now highlight private sector development as a key element of poverty reduction or national development strategies.

Whilst the decade from 1999 to 2009 has clearly demonstrated that private sector involvement in infrastructure projects is not a complete panacea to poverty reduction, it cannot be denied that the lack of an efficient infrastructure is part of the root causes of poverty in Africa. Lack of a vibrant transport network hurts intra-regional and international trade, thereby undermining economic growth. The Millennium Development Goals agreed by the world leaders in the UN Millennium Declaration also acknowledged the centrality of infrastructure to poverty reduction. For example, infrastructure projects in the transport sector (roads, bridges) for rural areas increase agricultural productivity by easing mobility challenges to and from the...
market. It also promotes access to education and health facilities for rural populations, as well as stimulating the development of private sector activities and providing employment.

Nevertheless, the demand for infrastructure oriented to the needs of the majority of Africa's population is not being met. On just about every measure of infrastructure coverage, African countries lag behind their peers in the developing world (Yepes, Pierce, and Foster 2008). It is estimated that around the world more than one billion people lack access to roads, 1.2 billion do not have safe drinking water, 2.3 billion have no reliable sources of energy, 2.4 billion lack sanitation facilities and 4 billion are without modern communication services. It is clear that Africa takes the largest share in these global statistics, given that countries on the continent have continued to lag behind in comparison to other developing countries. For example, according to the African Development Bank (2012), the proportion of the population who have access to water is 29% in Somalia, 45% in the Democratic Republic of Congo, 50% in Mauritania, 51% in Angola and Chad, while in Tanzania it's 53%. This low level of access to safe drinking water is attributed partly to lack of infrastructure.

The importance of infrastructure for growth, poverty alleviation and the Millennium Development Goals (MDGs) has been recognised at several other major platforms like the International Conference on Financing for Development (Monterrey, 2002) and World Summit on Sustainable Development (Johannesburg, 2002). Donors such as DfID have presented evidence that private sector investment is necessary for infrastructure development and poverty reduction and that private provision can improve the quality and efficiency of services (DfID, 2007).

The OECD notes that US$93 billion is needed annually for Africa’s infrastructure: two-thirds for investment in new physical infrastructure and a third for operations and maintenance of existing assets. ODA to Africa is directed mostly to the social sector (45%), followed by economic infrastructure (15%), and the remaining resources allocated to the production sectors, multi-sector programs, debt, humanitarian and other needs. Interesting to note is the increasing role played by infrastructure investors from emerging markets. A number of companies from India, Malaysia, and South Africa are active investors and operators in infrastructure projects all over Africa. The African continent lags behind the other regions for almost all measures of infrastructure (road density, telephone density, generation capacity or service coverage). The African Union and African Development believes that the need for infrastructure is a critical challenge for Africa in its bid to compete in global and regional trade markets that rely on just-in-time production and flexible, speedy and reliable delivery. From this African Union perspective, infrastructural projects are critical for poverty reduction and the development of the continent. It was for this reason that the African Union endorsed the Programme for Infrastructure Development in Africa (PIDA) to channel resources to deal with the deficit.

Different perspectives on approaches to reduce poverty and improve the impact of aid have sometimes led to different and unrelated motives and consequences in determining and completing projects. Large scale infrastructure projects especially in construction, such as highways and bridges, in some instances have also been chosen
for political millage rather than pro-poor poverty reduction purposes. In Zimbabwe projects such as the world-class swimming pool (Chitungwiza Aquatic Complex) have been built in a high-density area with no adequate schools. Projects may proceed without sufficient knowledge of maintenance costs. Zimbabwe has many examples of derelict, crumbling and abandoned infrastructure. Investments in roads and bridges rarely generate short-term revenue that can be used to pay the cost of the capital invested in building and maintaining them.

**Infrastructure opportunities for Africa**

Apex organisations like the African Union underscore the importance of development partners’ support for national and continental infrastructure initiatives. The New Partnership for Africa’s Development (NEPAD), as the flagship development programme of the African Union, identifies infrastructure as a key sector priority. Africa has prioritized increased investment both in maintenance and in new infrastructure, new regulatory frameworks, and the promotion of public-private partnerships depicting the centrality of private sector in poverty reduction.

While companies are investing, improving productivity, employing people, paying salaries, providing goods and services, generating profits and paying taxes, to be effective for development progress they must also consider corporate social responsibility, which should assume a poverty reduction dynamic. In this context, recognizing that Africa’s infrastructure projects remain central to its future, continued aid to that sector is essential, alongside effective taxation regimes that transfer financial resources from the private sector to the public sector. Private sector activities in this sector should have a long term focus on sustainability, and should continue to be strategically oriented to development goals, rather than being led by profit motivation alone.

A major problem that has plagued African industrialisation has been the focus on Africa’s natural resources by a number of donors funding the private sector, such as Chinese and Indian assistance and investment. For example, in Angola China has been swapping infrastructure projects on roads for oil and minerals. Since the mid-1990s, under the influence of the World Bank, China has been securing around 20% of all construction contracts in Africa. (Taylor, 2010) Chinese enterprises have built more than 6,000 kilometres of roads, 3,000 kilometres of railways, and 8 large and medium-sized power plants in Africa. (Wang, 2007). The two largest beneficiary sectors of Chinese infrastructure investment are power and transport. This assistance is often tied, with Beijing requiring that “70% of infrastructure construction and other contracts are awarded to ‘approved’, mostly state-owned, Chinese companies and the rest handed to local firms, many of which are also in joint ventures with Chinese groups. Many [of these] projects have been undertaken with imported Chinese labour.” (Reality of Aid Network, 2010) At the India Africa Forum Summit in May 2011, India’s PM, Manmohan Singh, announced a US$300 million contribution to the African Development Banks’ funding of the Ethiopia-Djibouti railway line, for which India has already provided significant investment. (Maasho, 2011) In addition, Indian firms are also heavily involved in Africa’s energy production.

**Angola and China Infrastructure synergies**

China and Angola have developed a unique model of cooperation. Angola receives loans from Chinese banks and in return contract Chinese
companies to construct new infrastructure, while also extending in return rights to extract natural resources.\textsuperscript{10} This has resulted in the reconstruction of the war torn sub-Saharan African country, with massive economic growth recorded due to the extraction of Angola’s mineral resource. The standard of living for the ordinary Angolan has thus started to improve. Benefits to poverty reduction are just but a mere spill-over effect and the real beneficiaries are the companies extracting the mineral resources. Angola is a particularly favorable market for Chinese companies in the construction industry since the country needs significant outside investment after years of war. In addition there is little competition in this sector in Angola and as a result Chinese firms have found profitable deals.\textsuperscript{11}

**The private sector as a recipient of aid**

Support for private sector initiatives have resulted in positive development outcomes for some sectors. A mega project funded by Emerging Africa Infrastructure Fund\textsuperscript{12} provided aid to the telecommunications sector by sponsoring a Seacom cabling project. It was the first undersea fibre optic cable project along the east coast of Africa and involves the construction of a 15,000 kilometers of cable directly connecting Mtunzini in South Africa to Mumbai India, via Marseille in France, Egypt, Mozambique, Madagascar, Kenya and Tanzania. This region was the only one in the world not served by such an infrastructure. The project was completed in November 2007. In Senegal, the introduction of the private sector in the provision of water in Dakar increased coverage of low-income households by 3.2% per year after receiving funding from the AFD, the French development agency. This privately managed utility did better at connecting the poor than the 8 publicly-managed utilities in Africa for which data was available (Clarke and Wallsten, 2002). A private sector firm, SNE, received funding to undertake this project, and was the operator in charge of drinking water systems, together with SONES, Senegal’s national water operator and ONAS, Senegal’s national sanitation authority.\textsuperscript{13}

The private sector has also played a positive role in the energy sector. Access to electricity can drastically improve the quality of life. The provision of energy, particularly renewable energy sources such as solar electrification and hydropower, can have many positive impacts on the poor communities. The majority of people in Africa live in rural areas where access to electricity is very limited and where access to the national power grid is too expensive. DfID has provided funds to firms working towards clean energy in Africa such as the Abellon clean energy project in Ghana. Many rural areas in Ghana do not have grid access and have generally poor energy coverage. To address these energy gaps, Abellon built the Bio Power Plant that aims to produce up to 50 MW power from biomass sources by 2015. They have also built the Solid Biofuel Manufacturing Plant in Central Ghana, and in other Biomass Rich Zones. It is estimated that the project will create employment opportunities for up to 25,000 Ghanaians over five years by 2015.\textsuperscript{14}

**Private sector as donors**

The private sector also plays an active role in the aid sector as a partner in global health. In 2008, the private sector and NGOs contributed a total of US$182 million, representing 6.6% of the monetary donations to the Global Fund. By the end of 2010, more than US$160 million had been raised for the Global Fund through this channel, through partnerships with companies such as Apple, Bugaboo, Converse, Starbucks, and Nike.
In 2010, the Global Fund launched its “Gift from Africa” campaign, which invites private sector leaders from the continent to invest in its fight against disease, achieving initial pledges of US$5 million.\(^1\)

However it has also been noted that the private sector has won tenders for projects funded with aid through corrupt means in some countries. In the Chad-Cameroon Petroleum Development and Pipeline project, financed also by the World Bank, regimes with poor human rights records and well-documented corruption were supported. There was failure to disclose the environmental and social impacts associated with this project, and a failure to properly consult with affected populations. Resettlement was undertaken without adequate compensation being provided to the affected population.

This chapter has only been able to point to a few of the negative impacts of aid-funded private sector activities. Private sector activities have a record of violation of environmental regulations ranging from contamination, pollution to deforestation. On the management side, the private sector (if firms) is accountable to the owners of the business, and not to the public. Hence there are fears of corruption in aid activities which might not be transparent and lack full accountability.

However, infrastructure remains core for the development of the African continent and as a popular Chinese maxim notes “development follows where there is a road”. Private sector involvement in development will thus remain a viable option to work towards poverty reduction and social service delivery. Delivering official development assistance through the private sector might increase the visibility and roles of the private sector as development actors. Notwithstanding the foregoing statistics, Africa’s infrastructure still carry a large deficit that needs an estimated US$20 billion in investment per year, and has an associated funding gap in the order of US$10 billion per year (Foster et al, 2009). It is apparent therefore that there is critical room for engaging the private sector in closing this gap in infrastructure development, which is a sector that can play both the funding and implementing roles towards strengthen Africa’s development potential.

Endnotes

Chapter 3 Appraising Development Results


12 Emerging Africa Infrastructure Fund was initiated by the Private Infrastructure Development Group (“PIDG”), whose founding members are the UK Government’s Department for International Development (“DFID”), the Netherlands Ministry of Foreign Affairs (“DGIS”), the Swiss State Secretariat for Economic Affairs (“SECO”) and the Swedish International Development Corporation Agency (“SIDA”). See http://www.emergingafricafund.com/about-us/fund-structure.aspx


14 http://www.businesscalltoaction.org/members/2010/12/abellon-cleanenergy/


Further reading:


Traditionally, Bangladesh’s economy is based on agriculture, although with the increasing influence of the free market economy, the service sector is rapidly expanding. More than half of Bangladeshi national production now comes from the service sector. In terms of market trends, Bangladesh has become an emerging market in South Asia. Ready-made garments and remittances have emerged as the prime contributors to economy. Bangladesh is now the third largest exporter of garments in the world, while total export earnings were US$23 billion in 2010-2011. It also provides employment opportunity to around 4.2 million Bangladeshis. Progress has also been made on poverty, with the poverty rate declining from 57% of the population in 1990 to 31.5% in 2010 (World Bank Bangladesh country overview 2010). The country is in a better position to achieve Millennium Development Goals by 2015.

Right after independence, Bangladesh undertook a major drive to nationalize about 92 percent of its total fixed assets that were abandoned by the Pakistani Entrepreneurs (Rahman 1994). Since then the Bangladesh economy was protected up to the end of the 1970s. However, during the early 1990s, the country sharply adopted financial sector reforms and was among the fastest to undergo structural reforms in the world. In the 1980s, a Structural Adjustment Programme was introduced, and in late 1990s, a Poverty Reduction Strategy Paper (PRSP) was introduced as a core part of the country’s development strategy. In fact, the national development plan was greatly influenced by the International Financial Institutions and the international donor agencies through the PRSP. The latter promoted high economic growth related development and privatization of public institutions. It is worth to mention that the close involvement of the private sector in Bangladesh’s development began through the implementation of the Structural Adjustment Programme and the Poverty Reduction Strategy Paper.

Like many other developing countries, Bangladesh now considers the private sector as the engine of economic growth and development as well as essential tool for poverty reduction. In general, the sector is also considered a powerful tool for job creation, which is essential for poverty reduction. As a result, the government of Bangladesh highly encourages private sector investment and development in its development plan and strategies. The country is on way to implement its Vision 2021 through investment-friendly economic policies and trade liberalization.

Bangladesh had much earlier created an enable environment for investment through the Foreign Private Investment (Promotion and Protection) Act in 1980, which ensures legal protection to foreign investment. In all recent documents setting out Bangladesh’s development strategy, the Poverty Reduction Strategy Paper (PRSP), Vision 2021 and the 6th Five Year Plan, the focus is on the involvement of the private sector and the non-government sector in economic
development. Some sectors have been developing over the past 30 years. The financial sector is the key driver for any economy. In 1982, the first private sector bank was established in Bangladesh. Currently, there are 43 private banks, while public sector banks are under attack for corruption and weak management. The telecommunication sector is almost fully privately owned. The state-owned telecommunication sector is small compared to private telecommunication companies. Bangladesh pharmaceutical companies have a global footprint in 70 countries including Singapore, Denmark, France, Fiji, among others. (Rahman, ASF, 2011)


Bangladesh is looking to achieve rapid inclusive growth, which would increase the GDP growth rate to 8% by 2013. To achieve this level of growth, the share of investment to GDP needs to increase significantly to between 35% and 40%, from its current level of 25%. The country has investment deficit, and to meet this gap Bangladesh has encouraged the participation of the private sector through public-private partnership in its development plan. There are 18 sectors selected as the priority area in the PPP position paper. Among them, exploration, production, transmission, and distribution of oil, gas, coal and other mineral resources, highways and expressways including mass-transit, bridges, tunnels, flyovers, water supply and distribution are critical areas for investment.

Donors also think that private sector investment is the only solution for poverty reduction through high economic growth. They are interested to provide support for PPPs. It is increasingly seen as an important modality of development cooperation by some development agencies. The Asian Development Bank (ADB) added direct Private Sector Operations (PSO) to provide direct assistance to private enterprises through equity investments and loans, without government guarantees. Development agencies believe that improvement of the institutional foundations of the market economy would be helpful in reducing poverty and inequality. In this regard, donors promote a regulated private sector in most of their sectoral development programs. For instance, they encourage the leasing of the government’s ‘express mail delivery service’, or corporate commercial banks owned by the state, and compel them to run on a solely profit motive, instead of the previous intention to provide services to the general masses in the country.

As a consequence, donors have increased their portfolio of private sector development projects. Nevertheless a study published by EURODAD (European Network on Debt and Development), ‘Public Private Partnerships: Fit for Development’, has observed that during the past twenty years, the annual volumes of PPPs have fluctuated considerably, making them an unpredictable source of development finance.

As part of these donor initiatives, a Local Consultative Group has been formed on Private Sector Development and Trade. The group provides a forum for information exchange, coordination and collaboration among donors and the Government of Bangladesh in the area of private sector development. In 2006, the government of Japan and Germany, on behalf of the Local Consultative Group, conducted a donor mapping, while the Bangladesh Enterprise Institute worked as the local partner. The main purpose of the mapping was to avoid duplication,
and promotes coordination and collaboration in private sector development. According to the mapping, the following graph demonstrates that DFID is the largest funder in this area of cooperation.

**Private Sector Development Donor Mapping**

In January 2012, DFID launched a new private sector development strategy. Mike Foster, Parliamentary under Secretary of State in the UK commented that “the 90 million people who face extreme poverty because of the global slowdown need the opportunities that business provides”. (Business Fights Poverty, 2009) This statement reflects DFID’s integration and focus on a core business philosophy in its strategies for poverty reduction and economic development in partner countries.

The World Bank is the key player in providing funding to the private sector in Bangladesh. In 2011, according to the World Bank’s portfolio, domestic credit, which refers to financial resources provided to the private sector, such as through loans, purchases of nonequity securities, and trade credits to the private sector in Bangladesh was 49.4%, while in 2002 it was 30.1 percent. (World Bank)

The Asian Development Bank (ADB) is another lead donor in Bangladesh. According to ADB’s ‘Country Operation Business Plan’ for Bangladesh, the ADB will step up private sector development and private sector operations during 2012–2014. ADB promotes ‘reforms’ of the water sector and introduced public-private partnership in that sector, with the result that the state gradually withdrew from the domain of the utility sector.

Most of the donors in Bangladesh are signatories to the Paris Declaration. In the context of aid effectiveness, therefore, it is necessary to look into whether private sector funding is following the Paris Principles to realize aid and development outcomes. The private sector prefers to invest in projects where they can maximize their profits. So on the whole, this sector is mainly concerned with financial benefits for its owners and shareholders, rather than economic outcomes for development.

While there is often a lack of coordination and cooperation, as well as political will, from government’s side, private sector projects seldom follow the development principles of the Paris Declaration and the Accra Action Agenda. Donor-funded projects are mainly implemented through a direct agreement between the donor and the private sector directly concerned. The national government has hardly any ownership over these projects and they often are not consistent with national development strategies.

Most PPP projects have been followed BOO (Build-Own-Operate) model of PPP, with the private sector managing the infrastructure on a build-own-operate basis. The government usually does not manage the infrastructure developed under this model. The model raises questions about country ownership and the share of benefits. Companies’ first priority is profit and a PPP has financial incentives. The Bangladesh government has policy guidelines for PPP, but there is no regulatory framework under the PPP will operate. Without any legal framework, the partnership may not be effective and accountable. In addition, financial risk could be disproportionately carried by the public sector. A strong regulatory framework is needed.
to ensure these investments comply with human rights, social and environmental standards as well as high standards of transparency and public consent, and pay their fair share of taxes. (Policy Strategy for PPP, 2010) However, the tax system of the country is regressive and bias in favour of the wealthy and the corporate sector. The government continues to enhance VAT tax, while there is hardly any concerted effort to increase income tax and reduce tax evasion by corporate houses. While inflation is increasing, there are no adequate policies to offset income erosion for the poor. (News today, 2011)

In spite of growing involvement and increasing growth of the private sector in development in Bangladesh, the gap between the rich and poor is widening and inequality is increasing. The reduction of both the depth and the severity of poverty is moving at a slower rate than in earlier decades, due to a rise in inequality. The rate of decrease in the percentage of poverty during 2005 to 2010 (5.6%) was lower than that of 2000 to 2005 (5.9%) at national level. In case of rural areas, the percentage of both the depth and severity of poverty has also reduced at a slower rate during the 2005-2010 period than that between 2000 and 2005. Affluent classes have been getting most of the benefits from the private sector growth. Although the poverty rate is declining, the poor are becoming poorer, with one-third of the population living under poverty line. Donors’ promotion of privatization has increased the price of basic services such as water, electricity, health, and education. Private sector engagement in development is seemingly not stimulating pro-poor growth.

No doubt all sectors have potential to contribute to development. If the government is financing private companies to work in important sectors for development, they need to maintain strict monitoring mechanisms in order to realize robust outcomes. But to realize a quick and fruitful outcome, a number of priorities should be under consideration. For example ‘poverty reduction’ is a long-term process and it success is related to a number of associated issues, for example, illiteracy, political turmoil, natural calamity, and the economic policy of the government. Government should concentrate on reducing the conditions that increase poverty and vulnerability in the society.

The private sector should not be given the leading role to manage projects on critical areas affecting ‘poverty alleviation’ or social development. Neither should it be endowed with the duty of building large infrastructure projects like seaports, airports or oil refineries, because the private sector in Bangladesh is presently not adequate for these major initiatives. The private sector should be financed for projects that require a modest level of investment and an equally modest level of service delivery.

Above all, private sector can only contribute in the real development in Bangladesh, if it maintains country ownership and bring effective development result for poor and vulnerable populations.
References


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