

Using Market Mechanisms to Expand Access to Basic Services in Asia Pacific: Public-Private Partnerships for Poverty Reduction

DRAFT FOR COMMENT ONLY

07 February 2005

Adrian Panggabean¹

¹ The author is an economist in the Regional and Sustainable Development Department of the Asian Development Bank. This paper, prepared with the assistance of Mr. Steve Tabor, is to be presented in a Joint Workshop on “Making Markets Work Better for the Poor”, sponsored by Asian Development Bank, Asian Development Bank Institute and Department for International Development, United Kingdom, in Manila, 15-16 February 2005. The views expressed in this paper are of the author and do not necessarily represent the views of the Asian Development Bank.

1. The context: poverty reduction and infrastructural needs

1. Despite significant progress, governments in Asia Pacific continue to face enormous poverty reduction challenges. Using the \$1 a day standard, as of 2000, the number of poor people in Asia was estimated at 720 million. This number makes Asia home to some 60% of the world's poor. The challenges look more daunting when we also consider the non-income dimension of poverty using Millennium Development Goals (MDGs) indicators. The numbers suggest that only some countries in Asia Pacific will meet all goals. Some countries may not meet any of the goals. The majority of countries in this region will fall in between, meeting some goals but not others. For example, Asia Pacific performance on health, such as child immunization and maternal mortality, suggests that this region is not on track to reduce child mortality sufficiently to meet MDGs targets. Governments in this region need to develop strategies to assist the poor, and to ensure that they are reached by essential infrastructure, however. Making progress in human development goals will require more and better efforts to expand access to infrastructures and improve the delivery of key services, such as basic health, education, water and sanitation to the poor.

2. There are evidence of the link between infrastructure and achievement of poverty reduction goals. Promoting growth is one channel through which infrastructure contributes to poverty reduction. The availability of reliable and affordable infrastructure also contributes directly to poverty reductions through the provision of or support in the delivery of key services. Achievements of MDGs (as non-income measures of poverty) relate to particular infrastructure services, such as those that aim to reduce the proportion of people without sustainable access to safe drinking water and basic sanitation, and to make housing and shelter more accessible. Other MDGs relate to human development that require services whose effective delivery depends greatly on supportive infrastructure: improved water and sanitation to prevent disease and free up women's time from daily chores; electricity to serve schools and health clinics; and roads to access them. The following studies should exemplify the point. A study on India by Datt and Ravallion (1998) of rural poverty rankings of Indian states found that states starting with better infrastructure and human resources saw significant higher long-term rates of poverty reduction. Jalan and Ravallion (2001) found that the prevalence of and duration of diarrhea in rural India among children under five were significantly lower on average for families with piped water than for those without it. A study on P. R. China by Fan, Zhang and Zhang (2002) documents the critical role of infrastructure development, particularly roads and telecommunications, in reducing rural poverty in China between 1978 and 1997.

3. To make infrastructure interventions effective in serving the poor, both the governments and businesses need to take into account cross-effects among goals in the MDGs. Health and nutritional status, for example, directly affect a child's probability of school enrollment. Access to safe water and sanitation is critical for child survival. In order to meet the goal of universal primary education, the government not only need to invest in schools, but also should provide better transportation network (to ensure access) as well as basic electricity to allow school children to read at home. The existence of such inter-linkages means that isolated infrastructure interventions may do little to achieve goals if bottlenecks remain in other sectors. Accordingly, national investment program must be built on multi-sectoral analysis and anchored in coherent country poverty assessments.

4. However, the cost to cater for the needs of Asia's poor is high, and resources are in scarce supply. In the one hand, investing in infrastructures to support economic growth and reduce poverty is costly. On the other hand, the public sector's ability to mobilize more revenue in taxes is everywhere constrained. One way of making limited resources stretch even farther is by exploring new and innovative ways of providing private businesses with incentives to reach the unserved poor. Narrowing gaps in access and quality will require sizeable increases in investment and in associated spending on operation and maintenance (O&M). While the enabling environment for private sector investment in the productive sectors has improved, much remains to be done to harness the potential of private sector investment for economic and social infrastructure. From public sector point of view, efforts must continue to improve the enabling environment for private investment.

5. But from private business point of view, is it financially feasible for them to cater for the needs of the poor? If so, how much demand for investment is there in Asia Pacific for them to help meet? To the first question, we should perhaps start to see the poor in a different way. It is often assumed that people with low incomes have little to spend and buy little beyond food and shelter. It is also a common assumption that infrastructure provision is not profitable for private sector to participate. But these assumptions are often seriously challenged, especially given the state of technology the world is in right now. Consider the following micro level examples. Many multinational corporations already successfully do business in developing countries by serving the large lower segments of markets. In many cities in Asia, urban slum dwellers without access to piped treated water often pay up to 10-20 times what the middle class pays for water. In Mumbai, India, as one research report pointed out, the cost of phone call per minute that slum dwellers in a part of Mumbai pays could be double than what a middle class community in the same city pays. Diarrhea medication in that part of the city was ten times higher, too. In many developing countries of Asia, effective interest rates of 100% or even 1000% per annum are not uncommon. In rural Bangladesh, villages have an income of less than \$1 a day, yet as the Grameen Phone experience shows, the aggregated buying power of a whole poor community can be commercially significant. All these examples suggest that the poor have purchasing power. These also show that costs to the poor can potentially be reduced if they could benefit from a certain scale of provision. And business can potentially gain from serving the poor, too.

6. Considering those examples, we could say that in cases where countries are lagging their national and international commitments, there may be a situation where opportunities to structure incentives for the private sector to contribute to delivering services were under-exploited. And if they get the incentive structure right, those countries can get themselves closer to their MDG commitments. In other words, poor performance in delivering MDGs can be interpreted as a series of potential private sector business opportunities waiting to be *made to happen*.

7. To the second question (ie, how much investment is needed?), at present there is a large gap between what is required, and what is available, in terms of economic and social infrastructure. Within countries, infrastructure coverage is typically much lower in rural Asia, where the majority of the poor population lives. And despite continued investment in the urban areas infrastructure coverage in urban Asia is under pressure from rapid rural-urban migration.

8. In the first half of the 1990s, investment requirements for infrastructure in Asia were forecast to be on a scale that far outstripped earlier projections and experience. Asia was rapidly urbanizing and industrializing, and several countries were experiencing double-digit rates of economic growth. In much of Asia, there was also the sense that socio-economic development was being hindered by bottlenecks in the provision and/or management of essential infrastructure and social services. Since government spending, international aid, and other official sources of financial support were unlikely to be sufficient to meet requirements, the infrastructure development focus turned to the private sector. In the early 1990s, ADB estimated infrastructure requirements to be on the order of \$1 trillion for the 1990s for East Asia alone. In comparison, they were estimated by World Bank to be on the order of \$1.5 trillion for the decade 1995-2004². The 1997/1998 financial crises had slowed demand for new infrastructure, but infrastructure gaps continues to constrain growth in many parts of the region.

9. Based on some assumptions and adjusted for slower (post 1997 crises) growth, it is estimated that developing countries on average would require some 3% of GDP for new capital investment in economic and social infrastructure. On top of that, developing countries will require between 5 - 5.5% of GDP for O&M purposes. Such figures translate to requirements for Asia Pacific of around \$250 billion a year. It is important to note that this figure is for the "hard" infrastructure such as telecommunications, power, roads, and water and sanitation. Investment in social infrastructure would be in addition to that.

10. Traditionally, the vast bulk of investment in infrastructure has been publicly funded. According to one estimate, some 70% of all infrastructure spending in developing countries worldwide during the 1990s was financed through the government's budget, or by public utilities own resources. The private sector contributed between 20-25%, while the remainder was financed through official sources of development assistance. If developing Asia is to attain economic and social infrastructure investment levels that are required, while maintaining prudent fiscal positions, then private participation will need to increase. Reform is thus unavoidable to facilitate private sector involvement in the provision of infrastructure.

2. Infrastructure financing: Private Public Partnerships (PPPs)

What is a PPP?

11. PPPs refer to changing roles of the Government and the private sector. In this paper, PPP is defined more specifically as a financing modality that involves the deployment of private sector capital to build socio-economic infrastructures to improve public services, or the management of public sector assets.

12. This definition allows us to differentiate between PPPs and privatization. A privatized business is one that was formerly owned by the public sector and is now owned by the private sector. A privatized business can operate in highly competitive

² ADB (2002), "Developing Best Practices for Promoting Private Sector Investment in Infrastructure", ADB / PIAF Conference on Infrastructure Development: Private Solutions for the Poor: The Asian Perspective, October 30, Manila.

markets or it may hold a monopoly position and so require an active regulation once it is transferred to the private sector. In either case, the public sector is disengaged from the business. In contrast, PPPs operate on the basis of a contract between a public sector client and a private sector contractor that “obliges” the private sector to deliver services; and the public sector to articulate its long-term service needs, to establish effective regulations, and to ensure that the private sector will not put its capital at risk in delivering these services.

13. Another difference between PPP and privatization is that the scope of PPP business (and hence its potential for profit) are constrained contractually, rather than by market forces alone. Normal private incentives still apply in the management of a PPP, such as the need to earn an adequate return on capital, but the business risk is, in effect, partly regulated by virtue of the constraints defined in the terms of the contract.

14. In addition, with a PPP, the public sector pays for services on behalf of the general public and retains ultimate responsibility for their delivery, whereas the private sector’s role is limited to that of providing an improved delivery mechanism. In the case of privatized utilities, ultimate responsibility for service delivery is transferred to the private sector.

15. Finally, the essential role of the public sector in PPPs is to define the scope of business, to specify priorities, set targets, and specify performance standards against which the management of the PPP is given incentives to deliver. The essential role of the private sector in all PPPs is to deliver the business objectives of the PPP by offering higher value-for-money to the public sector than could be achieved by public sector provision alone.

16. PPPs can be implemented using a number of different institutional arrangements. This could include: service contracts, management contracts, leasing, Build-Operate-Transfer (and its variations such as Build-Owned-Operate-Transfer), concessions, and private divestiture (either partial or complete divestiture). What PPP modality is most appropriate is a matter that is both country and sector specific, and it hinges on a range of economic, political, institutional and historical considerations.

17. PPPs can assist in the process of poverty reduction in many ways. By easing binding constraints to economic growth, PPPs can help to generate incomes, employment and government revenues that are used to finance higher levels of private and public consumption. PPP projects can also have a direct influence on the poor by:

- providing available and affordable access to good-quality, economic and social infrastructure services to poor people;
- providing employment and business opportunities to the poor;
- enabling poor people to have a better quality of life by increasing access to health care services, education, clean drinking water, information and markets;

Why do governments turn to PPPs?

18. Governments across Asia-Pacific are becoming increasingly interested in exploring PPPs for a variety of reasons. The first reason is that PPPs have been effective in helping government’s respond to rapid demand for public goods and

services. Demand for economic and social infrastructure is rising much faster than governments' ability to finance these investments through the budget. With population growing at 60 million a year, growing industrialization, rapid urbanization and the phenomenal emergence of Asia-Pacific megacities (17 of the world's 19 megacities are in Asia), are placing tremendous strains on the region's infrastructural services.

19. Second, PPPs can help governments do more with less. Since PPPs combine the deployment of private sector capital to improve public services or the management of public assets, PPPs spread the costs of procurement of assets over time and shift the burden of capital spending more to private firms, and less to the public-sectors balance sheets. These objectives may be achieved by basing the procurement on the public services required (ie, upon outputs) rather than on the underlying assets (or inputs). Where public sector capital budgets are highly constrained, PPPs can be an important means of mobilizing social overhead investment that Government wouldn't otherwise be able to afford.

20. Third, PPPs can contribute to enhanced efficiency in delivering services. Much of the improved value for money comes from the fact that when private sector capital is deployed and is at risk, the right commercial decisions are made about designing, operating, maintaining, staffing, costing and otherwise delivering investments and services in an efficient manner.

21. Finally, PPPs are often considered to be politically safer than privatization. PPPs structure a partnership between Government and the private sector that implicitly recognizes that the public sector is held to be politically responsible for ensure that infrastructure is available and social services are delivered. Moreover, and in a practical sense, PPPs represent a form of collaboration under contract by which public and private sectors, acting together, can achieve what each acting alone cannot.

22. It is well known that PPPs can be made to work for society at large, and there are ample experiences across Asia-Pacific to prove this point. But putting the PPP modality to work to serve the poor is a different matter. While delivering value-for-money remains important, more emphasis needs to be placed on ensuring that the poor do benefit from PPPs, and that strategy, policy and institutional arrangements are framed with the needs and interests of poor communities squarely in mind.

3. Making PPPs work for the poor

First, integrate PPPs into National Poverty Reduction Strategies, and this step includes...

23. Just as the nature of poverty is diverse, so too are its causes. The poor may not have acquired essential assets or capabilities because they live in a remote, conflict prone, or resource-poor areas, or because they are vulnerable on account of age, health, living environment, or occupation. They may be denied access to assets or services because they belong to an ethnic minority or a community considered socially inferior, or simply because they are female or disabled. At a broader level, poverty may stem from situations where gross inequality persists because of vested interests and entrenched power structures. The great diversity of poverty conditions and causes

implies that poverty-reduction interventions must be tailored to diverse circumstances, and therefore requires a country specific approach.

24. Many countries in the developing Asia have formulated and adopted National Poverty Reduction Strategies (NPRS) or have defined strategies for poverty reduction within the remit of National Development Plans. These strategies and plans are based on a sound, empirical assessment of the many dimensions and causes of poverty.

25. **... interpreting NPRS as a kind of “market research”...** If we think of PPPs as a vehicle for providing services to the “under-served” group of consumers, then understanding the many causes, manifestations and consequences of poverty can be interpreted as a form of “market research”. Identifying those consumers who aren’t adequately served, documenting their ability and willingness to pay for different services, and assessing the main constraints to reaching new customers is precisely the essence of market research. Such information helps Government formulate policy on the one hand, and private providers, to identify market-viable options for reaching the poor, on the other. It would be difficult to frame suitable pro-poor PPP strategies in the absence of such information. Take for example the case of poor communities living in remote, scattered villages, far from markets and major infrastructure. In these instances, public partnerships with community-based organizations may be the appropriate choice for delivering locally generated power, potable water and other essential services. By contrast, imagine a group of poor urban dwellers who suffer from poverty largely because of irregular employment. This group may be perfectly willing and able to afford to pay for power, clean drinking water and other utilities supplied by commercial providers, but only if bill collection systems are geared to serving customers with irregular incomes. In order to understand the needs of the poor as customers, it is important that poverty assessments respond to the following³:

- Who are the poor?
- Who do they currently obtain services?
- What can they afford?
- How are they organized?
- What do they want?

A variety of survey techniques can be used to “value” the willingness and ability of the poor to finance quasi-public goods. Such information is essential to frame relevant sector-specific strategies for linking private provision to the expressed-needs of the poor.⁴

26. **... and use NPRSs as “marketing” opportunities...** The discussions that take place around the formulation of a NPRS provide a good opportunity for reviewing the roles played by Government and the private sector in a given sector, and for recasting these roles to provide services more efficiently and effectively to the poor. Such discussions also provide a useful meeting grounds for multi-stakeholder discussion to build a consensus for pilot-testing innovative partnerships. It is therefore important to

³ Sophie Tremolet (2002), “Pro-Poor Regulation”, ADB/PIAF Conference on Infrastructure Development: Private Solutions for the Poor: The Asian Perspective, October 30, Manila.

⁴ Dale Whittington (2002), “The Challenge of Demand Assessment in Pro-Poor Infrastructure Projects”, ADB / PIAF Conference on Infrastructure Development: Private Solutions for the Poor: The Asian Perspective, October 30, Manila.

actively involve representatives of the private sector (i.e. business councils, associations) and non-governmental organizations in the discussion of poverty reduction strategies for which PPPs may be appropriate. Indeed, the greater the extent to which the private sector participates in defining common goals and objectives, and in finding solutions for delivering services to the poor, the more likely it is that they will share responsibility with government in meeting such commitments.

27. **In making strategic choices...** There are many possible strategic approaches for using PPPs to contribute to poverty reduction. Sometimes the best strategic approach addresses poverty indirectly, as in the case of export-oriented PPP ventures that generate revenues that Governments can then use to fund essential social programs (as exemplified by the Lao PDR experience, showcased in Box 1). In terms of PPPs that directly provide services, there are many options that can be pursued, ranging from widening access to investors, contracting-out services, introducing management contracting, concessions, BOT and BOOT investments, to divestiture of public assets. Choosing the PPP strategy that best suits the poverty reduction challenge requires an assessment of the likely costs and returns of different forms of PPP interventions, their institutional, technical and socio-political feasibility, and the transition costs from one set of public-private roles to another.

Box 1: Building a national revenue base to fund the social sectors: the Lao PDR Nam Theun Hydropower Project

In some cases, the most important impacts of a PPP on poverty reduction are indirect. The Lao PDR Nam Theun Hydropower Project provides a good illustration of the importance of indirect strategic linkages between a PPP and poverty reduction.

The Lao People's Democratic Republic (Lao PDR) has been exporting surplus power to Thailand since 1972, and power exports are a major source of foreign exchange and government revenue. Following a site investigation financed by the UNDP, a feasibility study for a hydropower project was prepared with a TA grant from the Norwegian Agency for International Cooperation in 1993. In February 1993, ADB was requested by Government to act as the lead coordinating agency for its negotiations with foreign investors, and to provide financial and legal advice. In June 1993, Government signed a MOU with two foreign investors, MDX Lao Public Company Limited (MDXL) and Nordic Hydropower AB to jointly develop the Project. A public-private partnership, the Theun-Hinboun Power Company (THPC) Limited, was incorporated, with Electricite du Laos (EdL) the state-owned power utility, contributing 60% of the share capital and two foreign investors (MDX Lao Public Company Ltd, and Nordic Hydropower AB), providing 20% each to plan, finance, construct, own and operate the project. In October 1994, a license agreement signed with Government allowed THPC to plan, finance, construct, own and operate the Project for 30 years from the start of commercial operation. In November 1994, ADB approved a loan of \$60 million from the Asian Development Fund to finance its contribution to THPC. The \$210 million project financed a transbasin hydropower scheme, which diverted the Nam Theun through an underground tunnel to generate 210 megawatts (MW) of power. An 86 kilometer transmission line was built up to the border at Thakkhek to export the major portion of the power output to Thailand. A power purchase agreement (PPA) with the Electricity Generating Authority of Thailand (EGAT) was signed in June 1996. This guaranteed an offtake of 95% of THPC's power generation, which was estimated to average 1,645 gigawatt-hours per annum.

The Nam Theun hydropower project is currently Lao PDR's largest foreign exchange earner. Thanks primarily to the boost in export earnings, Lao PDR's current account deficit was reduced from 16.5% in 1997 to 6.9% in 2001. Dividend payments to EDL and royalties paid to Government provided additional revenues in excess of \$25 million per annum that were used to augment spending on the social sectors. The total share of education, health and social welfare in the national development budget increased from 3% in 1994 to 21% in 2001.

Source: ADB OED, 2002. *Project Performance Audit Report on the Theun Hinboun Hydropower Project*, Manila

28. Ultimately, the poverty reduction strategies that involve PPPs approaches should define joint goals, clarify and advocate clear public-private partnership vision and generate confidence and trust in this approach to delivering services. Such strategies should explain the:

- rationale for modifying the role of the public and private sector (i.e. changing the terms of the partnership);
- role of the public-private partnership, as a poverty-reducing intervention;
- expected performance criteria, in terms of the expected gains that will be made by the poor, in terms of costs, access, or quality of services received; and
- ultimate impact of the PPP on the poor;

29. **...the role of context is critical in integrating PPP approaches...** Many PPPs are launched during episodes of fiscal stress or when the provision of public utilities has reached crisis levels. In response to a distress situation, Government's call for PPPs to quickly augment the supply of services that Government may be providing. Unless these fast-track PPPs are properly selected, structured and regulated, there is a risk that of privileged deals that ultimately lead to high costs and sub-standard services. Moreover, since each major PPP transaction tends to create precedents for the next, there is a risk that deals launched quickly at a time of distress may create bad-practice precedents that promulgate from one generation of PPPs to the next (see Box 2).

Box 2: Haste makes high cost: Power PPPs in the Philippines

In the wake of an energy crisis of late 1980s and early 1990s, the Philippines entered into nearly 40 agreements with private sector power providers. IPPs offered a quick solution by offer generating capacity needed for rapid growth. The costs, however, were high because new capacity was not consistent with a least-cost expansion path, and because the private sector required high rates of return.

Contracting arrangements for these IPPs were flawed in several respects. Competitive bidding was not used and instead, contracts were entered into on the basis of unsolicited fast-track bids of interested investors. Profit guarantees were built into the IPP agreements; cost controls were not adequately provided for; and most importantly, the use of take-or-pay (i.e. capacity charge plus energy charge) power purchasing agreements led to a situation in which costs remained high even when capacity utilization was low.

ADB provided support to the Hopewell Energy (Philippines) Corporation to build a peaking plant of three gas turbine generators with a combined capacity of 200MW on a 12 year Build-Operate-Transfer contract; to the Batangas Power Corporation in 1993 to construct a 123 MW Bunker C-fired diesel power plant. The Hopewell Energy Plant was subsequently taken over by Mirant Philippines, which turned over the first plant of 200MW to the National Power Corporation after 12 years of operation. This plant was then closed by NPC due to surplus generating capacity in Luzon. The second plant, located in Pagbilao, has been operating at half of its rated capacity. The Batangas plant, although profitable, has been operating a high cost due its dollar-denominated debt, and low rates of capacity utilization.

Source: ADB OED. 2004. Sector Assistance Program Evaluation of ADB's Assistance to the Philippines Power Sector (forthcoming).

30. **...and so is the role of a stable political support.** PPP policy frameworks must be embedded in a solid base of bipartisan political support, otherwise they will be vulnerable to changing political cycles. On-again, off-again support for PPP arrangements can be especially costly to the poor because of the time-required and high

start-up costs associated with establishing PPP services in remote and low-income communities. High political risk perceptions will also raise expected service costs to private providers, which will, in turn, make PPPs less affordable to the poor. Building a social consensus in favor of changing public-private roles often takes time, and may require trading off small benefits to many (i.e. consumers) against large costs incurred by a few (i.e. providers now subject to competition). This may require a phased approach to introducing changes in the roles of the public and private sector, especially when perceived adjustment costs are high. ADB support for the privatization of the state plantations in Sri Lanka (Box 3) is illustrative of the role that a phased approach to fostering PPPs was in building political support for changing public-private roles.

Box 3: A process approach to introducing PPPs: commercializing state plantations in Sri Lanka

A process of gradually building support or organized labor, and public confidence in private management of state plantations led to bipartisan political support for privatization in Sri Lanka. Securing such support, in a politically charged and polarized setting, was central to the change in the nature of public-private roles.

Plantation crops (tea, rubber and coconut) are a major source of export earnings in Sri Lanka. The plantation industry was nationalized during 1972-1975, and the management of nationalized estates placed in the hands of two state-owned corporations, the Sri Lanka State Plantation Corporation (SLSPC) and Janatha Estate Development Board (JEDB). Heavy taxation, political interference and weak financial discipline led to a sharp deterioration in the technical and financial performance of the SLSPC and JEDB, which led to heavy reliance on long-term loans from state banks to meet working capital requirements. By 1992, operating losses of the two plantation companies were approximately SLRs 1.5 billion per annum.

Privatization of SLSPC and JEDB was proposed by the MOF in the late 1980s, but was objected to by powerful trade unions and political party leaders. In 1990 and 1991, consultations were undertaken with representatives of the worker's trade unions, business associations and other stakeholders. This culminated in the development of a phased-strategy for privatization that secured bipartisan political support. In 1992, the first phase was implemented: Four hundred and sixty-five estates managed by SLSPC and JEDB were constituted into 23 regional plantation companies (RPCs), and management of these companies was assigned to private management companies on the basis of a five year, performance-linked, contract.

Private management was able to quickly secure efficiency gains, thanks largely to improved access to working capital for fertilizers and other essential inputs. Higher output and export earnings allowed the RPCs to boost wages. Once it became apparent that private management would not lead to sharp job losses, the trade unions cast their political support for private management. To mobilize capital, fourteen of the 23 RPCs were listed on the Colombo Stock Exchange, increasing market capitalization and also boosting support of the general public for private sector management. In 1994/1995, the Government undertook the next stage of divestiture by transferring 50-year lease holdings to the RPCs. Privatization was carried out by offering the management agents of the RPCs the option to purchase 51% of the shares of their respective companies at market prices.

Under private management from 1991 to 1998, average tea yields increased by 48 percent, tea production rose from 231 million kg in 1993 to 280 million kg in 1998, and labor productivity rose by 22%. Rubber and coconut production remained stable, despite a marked deterioration in international market conditions. Primarily as a result of the upturn in tea production and exports, the RPCs quickly returned to profitability, and began paying dividends to government.

Source: Asian Development Bank, OED. 2002. Program Performance Audit Report on the Second Sri Lanka Agriculture Program Loan. PPA, SRI: 24320, Manila.

Second, weave poverty considerations into the PPPs policy setting, and process requires...

31. ...getting the PPP “framework” right... An appropriate, predictable, and fair enabling environment for contracting the private sector to provide services hitherto in the public domain, and for private sector investment in general, should exist to minimize the likelihood or appearance of corruption. There are three distinct domains in which improvements in an enabling environment are generally required---these are in the legal system; the regulatory front; and in the political system. In the legal system, required changes may include measures relating to tendering and bidding for services, improvements in contract law, and in dispute resolution measures. Both changes in the legal framework, and in manner by which laws are enforced, may be required. In the regulatory front, there is a need for (i) clear regulatory frameworks; (ii) appropriate tariff regimes; (iii) appropriate and transparent subsidy mechanisms; (iv) open and transparent communication channels between public- and private-sector so they can define and regulate their relationships with each other and their roles in providing services; (v) a clear statement of the government’s role as a provider and regulator of public goods and services. On the political front, there is the need to build public acceptance that the private sector will be “partnered” with government to deliver public goods and services. To minimize risks of political interference, there is a need for highly specific contract terms to allow both parties to predict the profitability of venture and to facilitate informed investment decision-making. There is also a need for political will to strengthen public administration and regulatory bodies to reduce imbalances between the government’s limited means vis-à-vis capabilities as regulators. Unless suitable policy frameworks are in place, it is difficult to attract bona fide investors or to secure the financial support required to put pro-poor PPPs into operation (Box 4).

Box 4: Be mindful, not all pro-poor PPPs can get off the ground...

Having a sound PPP policy framework in place is necessary to attract qualified investors and to bring projects to fruition. Sometimes private-public partnerships, although desired, face severe regulatory hurdles. For example, the water supply in the city of Pekanbaru, is provided through a semi-autonomous water supply enterprise (PDAM). As in many parts of Indonesia, the PDAM has been unable to meet local water supply needs. In 2000, at the request of Government, ADB’s Private Sector Group began discussions with private parties who could potentially serve as concessionaires in the area. Despite protracted negotiations for over two years, a concession could not be finalized. Deficiencies in the policy environment, combined with a shift in decision-making from central government to regional authorities, who do not yet have the requisite skills to negotiate and structure concession arrangements, hampered the conclusion of a suitable concession agreement. To help address these problems, ADB has undertaken a technical assistance project to develop the regulatory environment for the water sector. Assistance for capacity building of regional authorities is also planned.

Source: Asian Development Bank (2002). Indonesia: Country Strategy and Program, Manila. p.29

32. Typically, PPP policy frameworks focus primarily on aspects related to the commercial practices of the proposed PPPs, such as the nature of services to be provided, qualifications of eligible providers, service performance specifications, tariff arrangements, dispute resolution procedures and the like. But getting the PPP framework right is only the *first* step to making PPPs work for the poor. Changes in the enabling framework do have distributional implications, and hence will impact on the

poor. The degree to which the private sector will have an incentive to serve the poor, especially when their ability to pay is constrained, must be addressed if PPPs are to be an effective instrument for poverty reduction. Experience to date suggests that it is difficult to ensure that PPPs will serve the poor because of certain features inherent to the ways in which PPPs are commonly undertaken:

- Service contracts: a combination of retention of ownership in the hands of government; transfer of design and construction risks to private sector; and short contract periods (e.g. between several months to a few years); provides limited incentive for whole-life-costing for the private sector, and causes the private sector to focus more on efficiency than reaching the poor;
- Management contracts: retention of ownership in the hands of government; transfer of operating risk to private sector (with a fee, profit sharing); limited (usually around 3-5 years) span of contract period; provide more incentives to improve services to existing customers rather than to reaching the poor;
- Build-Operate-Transfer (BOT): This has the potential of bypassing the poor *unless* the distribution system and/or network is upgraded and extended to unserved areas or areas populated by the poor. Private sector may design projects to be more cost-effective by bypassing poor customers and regions.
- Concessions. These have the potential to benefit the poor if certain conditions are met---i.e., universal service requirements, consumers orientation, effective monitoring. But experience suggests that in many countries such conditions are *not commonly met*, hence the poor don't necessarily benefit.
- Divestiture: the poor *may or may not* benefit -- *depending* on the license conditions and the design of regulation (e.g, specification on universal coverage target, differentiation of services to meet the needs of the poor, affordability of tariff).

33. ... and precise understanding about the “universal service objectives”... Framing PPP policy objectives in a way that explicitly recognizes the importance of reaching the poor is essential if these are to be structured and motivated to play a positive developmental role. The most common way of doing this is to define universal service access as one of the major performance goals for any given PPP (Box 5). Absent the specification of universal service requirements, there is the risk that the poor may be excluded from privately-provided services, especially if the revenue yield is higher for serving the wealthy and middle class consumers. There are a variety of ways in which universal service objectives can be met. In the case of the Manila municipal water concession, the Maynilad Water Services company was provided the right to collect revenues for 25 years in the western zone of the city with an obligation to provide service to an increasing proportion of residents, with targets set for access every five years, and an end-of-contract target of 98.4% connected by the end of the 25 year concession⁵.

⁵ Sophie Tremolet (2002), “Pro-Poor Regulation”, ADB / PIAF Conference on Infrastructure Development: Private Solutions for the Poor: The Asian Perspective, October 30, Manila.

Box 5: Bringing water to all consumers in Chengdu, P. R. China.

The Chengdu Water Supply project involved the construction of a treatment plant and the establishment of a 27 kilometer transmission line to provide the population of Chengdu, an industrial city in southwest China, with an additional supply of 400,00 cubic meters of treated water daily. Prior to this, urban water supply projects were funded by central or municipal governments, on a grant basis. Insufficient government funding meant that water shortages occurred, particularly in rapidly growing metropolitan areas. As the first BOT water supply project in PRC, the Chengdu Project demonstrated that this approach can be successfully implemented at the municipal level, and externally financed without government guarantee. ADB's private sector operations extended a direct loan of \$26.5 million for the project, and through ADB's complementary financing scheme, ADB made possible commercial debt funding of \$21.5 million.

34. **...competitive service delivery...** The poor will generally be better served if providers compete for their business. In fact, the rationale for introducing PPPs is often to expand the range of service providers beyond traditional public sector monopolies and to inject a measure of dynamism and consumer-responsiveness to hitherto sheltered sectors. This can be accomplished by liberalizing the market, avoiding exclusivity, unbundling services and coordinating interconnection. For low-income consumers, competitive provision of infrastructure may imply a need to license small-scale operators who are not able to provide services at a lower cost than "network" connections. However, small-scale operators are often more flexible in reaching remote communities; may be able to provide a "basic needs" level of service at an affordable cost; and may be able to introduce innovative tariff and payment systems (such as pre-paid cards) that match the ability of low-income households to pay with tariff obligations.⁶ There are numerous examples of PPPs, most notably in the telecommunications sector, in which creating competition in service delivery has lowered costs, improved access, and greatly improved the reliability of services offered to the poor (see Box 6). PPPs policy should encourage, to the greatest extent possible, measures that create competitive delivery of services to the poor. Conversely, PPP policy should avoid replacing monopoly public providers with private monopolies.

35. **... as well as careful design of tariff policy.** The poor can, and often do, pay for utilities and social services, but in practice, their ability to pay is highly constrained⁷. An affordable pro-poor tariff structure often implies a subsidy and means of targeting benefits to the poor. Unless this is calculated and targeted properly, such subsidies can drain the budget and dilute the pursuit of value-for-money. Blanket subsidies for utilities tend to disproportionately benefit the middle- and upper-income households due to their higher level of consumption⁸. Lifeline tariffs, or subsidies for the first so many consumption units, are typically built-in to PPPs projects to protect the consumption of the poor. But even this may have adverse effects on the viability of the PPPs if it

⁶ N. Taylor (2002), "Role and Design of Free Entry Policies: Expanding Service Options for Low-Income Households", ADB / PIAF Conference on Infrastructure Development: Private Solutions for the Poor: The Asian Perspective, October 30, Manila.

⁷ Almud Weitz and Richard Francys (2002), "Beyond Boundaries: Urban Services for the Poor", ADB / PIAF Conference on Infrastructure Development: Private Solutions for the Poor: The Asian Perspective, October 30, Manila.

⁸ Ian Alexander (2002), "Paying the price: the True Cost of Public Provision of Services", World Bank paper presented at ADB/PIAF Conference on Infrastructure Development: Private Solutions for the Poor: The Asian Perspective, October 30, Manila.

excessively boosts management costs due to low levels of consumption by a large number of low-income consumers.

Box 6: Injecting competition into the Bangladesh Telecoms market: the Grameen Phone

In March 1997, a cell phone company, Grameen Phone, was licensed Government. The company was launched by the Grameen Bank with the financial and technical support of a consortium of local and foreign companies. The aim of Grameen Phone was to bring connectivity to rural Bangladesh. Prior to this time, the public telecommunications monopoly, which operated 95% of all phones, had provided few connections in rural areas, where most of the poor in Bangladesh reside. In 1993, there were only 2 phones per 1000 inhabitants, and many of these were analog and functioned sporadically.

From 1997 to 2002, the subscriber base of Grameen Phone grew at a rapid pace, reaching 730,000 subscribers at the end of 2002. By that year, Grameen Phone captured more than 70% of the mobile phone market in Bangladesh and provided services to 44 districts in all six divisional headquarters of the country.

During its inaugural year, Grameen Phone launched the innovative Village Phone Program. Under this program, a Grameen Bank borrower (i.e. a phone operator) is provided lease financing of about \$350 to buy a phone. The phone operator allows villagers to use the phone according to prescribed rates for outgoing and incoming calls. Experience to date suggests that the phones earn about \$2 per day, allowing the phone operator to recover their investment in a period of approximately 6 months. Besides being a profitable investment for rural borrowers, this program creates access to telephones for all in the villages in which it has been introduced.

Research shows that village phones have had large, positive social and economic impacts on the poor. Introduction of modern technology has improved the social and economic standing of the village phone lady, and has expanded her knowledge of modern business practices. Phone users benefit from better access to market information; are able to maintain regular contact with relatives working in cities or abroad; are used by patients to obtain health information and arrange medical appointments; and provide timely access to information in emergency situations. A call that would replace a single trip from the rural areas to the urban centers can be as much as 2%-10% of the annual income of the poor, savings that few other innovations could match.

Source: A.M. Yahya (2002), "GrameenPhone's (GP) Experience in Delivering Services (Village Phones) to the Poor", ADB Conference on Infrastructure Development-Private Solutions and the Poor, Manila.

36. The way in which subsidies for PPPs services are delivered matters a great deal to the poverty impact of any given PPP operation. Practically all utilities in Asia-Pacific practice some form of cross-subsidy, often with substantial impacts on public finance and the soundness of the banking system. Experience to date suggests that general subsidies---i.e., across the board under-pricing of PPP services---primarily benefits the non-poor since they have a higher consumption of the goods and services that PPPs deliver. There are a variety of ways of targeting subsidies to the poor so that they can afford services provided by PPPs. This includes delivering subsidies directly to the poor, through cash assistance or coupons to augment their purchasing power for public utilities or social services. Tariff arrangements for PPPs often include implicit subsidies aimed at reaching the poor. Common approaches include lifeline tariffs to make low (or minimum) levels of utility consumption affordable, differential tariff arrangements for consumers in poor compared to wealthier regions, and lower charges for categories of enterprises or activities (i.e. farms, irrigation systems and small businesses) that tend to employ proportionately higher levels of poor persons. Ideally, such subsidies should be made explicit in the financing arrangement of a PPP, and public support provided to

directly meet these costs. In practice, and reflecting the weak tax bases of many developing Asia-Pacific states, it is customary for PPPs to redistribute revenues from non-poor to poor consumers through cross-subsidies. It is important to remember that structuring PPPs to deliver services as efficiently as possible can keep costs low for all consumers, including the poor (see Box 7).

Box 7: Keeping tariffs affordable: The Meghnaghat power project of Bangladesh

This was the first power generation project to be financed by the private sector in Bangladesh. It has a 450MW capacity and supplies power to agriculture and industry in the northern bank of the Meghna River. The project was assisted by ADB through technical assistance to prepare a master plan; for a feasibility study; engineering design; site selection; and the solicitation of bids and structuring of the IPP agreement.

This is the first build-own-operate power generator in Bangladesh and has *the lowest power tariff* in the world. ADB was able to catalyze commercial funding through the use, for the first time, of a political risk guarantee. ADB also provided a loan to the project of \$50 million, and a second loan, under the complementary financing scheme, of an additional \$50 million.

37. No subsidy arrangement is perfect. Some benefits will ultimately leak to non-poor households, and no arrangement can meet the needs of all categories of poor consumers. Ultimately, the formulation of a subsidy policy has to take into consideration the efficacy of various targeting approaches, the affordability of different schemes, and the incentives that such subsidies create for service providers and consumers. Moreover, it is often the limits posed by administrative cost and capacity that limit the choice of subsidy approach.

Third, pro-poor regulatory design and enforcement should be in place to help make PPPs work for the poor...

38. **Pro-poor regulation** is necessary to sustain mutual interests and benefits from PPPs projects. By virtue of market structure or contract terms, PPP providers tend to have a dominant position in the delivery of utilities or other public services. Regulation is required to protect the general public, and especially poor customers, against the risk that this dominant position will be abused. Such regulation generally covers tariffs, quality standards including an allowance for quality-deviation to improve access for the poor, and the types of goods and services that will be provided (see Box 8). This also requires the establishment of an effective institutional mechanism for regulating PPPs, with well-defined powers and responsibilities, adequate skills and resources for regulation, and appropriate legal backing for enforcement. Regulation should also cover the assessment of subsidies provided---either directly or through transfers---to ensure access by the poor. In some cases, the subsidy policy and regulations agreed at the start of the PPP become inappropriate shortly after the project is implemented. In other cases, experience shows that subsidies were either inefficient or inequitable in the way they were designed to reach the poor. Another common problem is that the tariff structure is not reviewed frequently enough. Once it becomes obsolete, the tariffs provide neither sufficient financial incentives to operators not suitable protection to the poor. This points to the need for timely and effective regulatory review and revision of the tariff structure, the manner in which subsidies to the poor are delivered, service

quality and the adequacy of incentives to deliver services while ensuring value-for-money in service delivery.

39. The effectiveness of PPPs hinges on the presence of adequate legal framework and regulatory structures to translate policies into practice. In much of developing Asia, performance in this area has lagged expectations. The basic regulatory objectives of autonomy, accountability, transparency and predictability have been difficult to achieve in the agencies that regulate PPPs in Asia. Many countries have been slow to establish and staff independent regulatory agencies with an adequate funding base. As a result, tariff regulation practices tend to be under-developed, although this is a crucial variable for determining who gets served by a PPP.

40. **Effective regulation** of PPPs also plays an important role in deterring anti-competitive behavior. Many of the developing Asian nations lack laws or agencies geared to combat anti-competitive practices. In addition, a lack of well-established legal and regulatory procedures for contract law means that enforcement of contracts and resolution of disputes are not well established. Weak regulatory capacity has, in turn, created opportunities for political interference in the awarding of PPP contracts in several countries.

Box 8: Establishing a pro-poor PPP regulatory framework: urban water supply in the Katmandu Valley

The population of the Katmandu Valley of Nepal suffers from a chronic shortage of clean drinking water. The Melamchi Water Supply Project (MWSP) is a \$464 million dollar project, co-financed by ADB and six bilateral financiers, which will divert water from the snow-fed Melamchi River in the Snidupalchowk district to the Katmandu valley. In its first phase, to be operational in 2009, the project will divert 170 million liters of water per day through a 26 kilometer long tunnel to the Katmandu Valley.

To ensure that the improved water supply and sanitation system is viable and meets the needs of the poor, the Government has agreed on several basic principles, including cost-recovery primarily from consumers, demand management by proper pricing, increasing access to clean drinking water and affordability for the urban poor, and improved procedures for paying water bills. Tariffs have been set in a way that ensures that the poor will be able to meet their clean water requirements. For an average urban household in Katmandu who would use an estimated 18,000 liters per month, the monthly water tariff is estimated at NRs 540 (\$8). Poor families who use less water than the average will pay significantly less.

ADB has approved two loans under the Katmandu Valley Water Services Sector Development Program to support a series of institutional reforms that are being made to ensure that the public-private partnership delivers value for money. A National Water Supply Regulatory Board is being established to carry out regulatory functions to protect consumer interests. The Nepal Water Supply Corporation and a newly established Water Authority will be the owner of the new assets, and will be responsible for developing policies and oversight for water supply and wastewater services in the Kathmandu Valley. A licensing system for groundwater will be established in the Kathmandu Valley, and alternative private-public partnership arrangements for reaching currently unserved areas will be made. A suitable qualified private operator (Management Contractor) will be recruited through international tender to manage the operations of the water utility for a period of up to six years. This marks the first time that a performance contract arrangements with a private utility contractor has been financed under an ADB public sector loan. Under the performance contract, the management contractor will receive a fixed fee plus performance based payments based on achievement of targets set for a number of performance indicators. The management contractor will not have responsibility for making investments or setting tariffs, but will manage the collection of tariffs and will have specific responsibilities for improving services to poor consumers, both those already connected to the water supply system and those yet to be connected.

Source: ADB. 2004 Katmandu Valley Water Services Sector Development Program. Manila.

41. **PPPs governance.** In any “partnership” between the public and private sectors, there is always the potential for misuse of authority, corruption and nepotism. Establishing a policy framework that embodies good PPP governance helps to establish safeguards against such practices. This includes measures aimed at combating corruption; fostering selection of qualified service providers through a transparent and competitive bidding and selection process; professionally sound accounting, auditing and reporting requirements; independent monitoring and evaluation; and establishment of fair procedures for registering and resolving disputes. Good governance policy principles are especially important for making PPPs pro-poor because: (i) the higher the hidden costs of a PPP venture, the less likely it is that its services will be affordable or accessible to the poor; (ii) the poor are least able to protect themselves from abuses committed by a mal-governed PPP; and (iii) public perceptions of mal-governance can undermine public support for PPPs as a whole, which threaten the existence and sustainability of any given arrangement, and of all other such innovative ways of public-private collaboration.

Fourth, the financing structure of PPPs (often overlooked) should be taken care of carefully. Asymmetrical allocation of financing risks can weigh on the poor...

42. The way in which PPPs are financed, and the manner in which risks are allocated between Government and private participants, has an important bearing on the degree to which such initiatives will benefit the poor. If a PPP is adequately capitalized, competitively financed, and has made adequate provisions to manage political, market, financial, institutional and external risks, then it is likely to provide services at a competitive price to all consumers, including the poor. If, on the other hand, such ventures are under-capitalized, financed at a high cost, or ill-prepared to manage likely risks, then the costs are liable to be excessive, and the long-run viability of the endeavor may be in doubt.

43. **Balancing the financing obligation between involved parties.** Government's role in financing PPPs can range from full financial support for all activities (i.e., in cases of contracting out provision of subsidized services to the poor) to providing no financing support at all for ventures that are expected to be commercially viable. Where domestic financial markets are shallow, and international sources of term finance unavailable or insufficient to support private investment, the public sector plays an important role in securing and channeling term-finance, and in helping to attract suitable international investors, for large-scale PPPs. International financial institutions, including the multilateral development banks, have therefore an important role to play in securing and structuring the financial support to create viable PPPs.

44. **Proper allocation of financial risks of PPP.** Risk allocation is one the most difficult institutional areas of PPPs, and is key to making these work for the poor. Risk influences the overall cost of project through the premiums for services demanded by contractors, and will ultimately affect the degree to which value-for-money is delivered. The objective is to achieve a cost-effective risk transfer, and *not simply risk allocation for its own sake*. This implies that risk should be transferred to the party best able to manage it in the most cost-effective manner. If too much of the service delivery risk is to be borne by the private sector, this can result in service charges that are set too high for

poor communities, or cases in which new capital investment in wealthier (i.e., low risk) areas is accorded preference over under-served poorer areas. A special risk-management problem is created by the lack of clear land tenure or residency permits for many low-income communities, particularly in slums or peri-urban areas. Clear provisions must be made to define the legal risks and responsibilities for providing services to those who reside in areas whose settlement rights are unclear, otherwise these poor areas are bound to be bypassed.

45. The way in which a PPP's financial risks are anticipated, structured and managed also has a major influence on the costs and viability of the services that it provides. Unless major risks are anticipated, and suitable arrangements made for their management at the time project financing is secured and approved, the sustainability of a PPP can be placed into jeopardy. The degree to which the PPP is exposed to, and manages interest-rate risk, foreign exchange exposure, political risk, labor-risk, and market risk exert a major influence on the costs and returns of the services it delivers. The public sector has a legitimate interest in ensuring that costs are sufficiently contained and risks well-managed to ensure that the services provided are not prohibitively expensive, on the one hand, or commercially unviable, on the other. While responsibility for the commercial viability of the PPP should be assigned to the private provider, responsibility for other forms of risk (i.e. political, exchange rate, natural disaster etc.) should be born by the party best able to manage such risks (see Box 9).

Box 9: Carefully structuring project risk: Power in Bangladesh

In 2001, ADB approved a US\$50 million loan for Bangladesh's first private sector power project. ADB helped generate a further US\$90 million for the project from commercial banks. A government-owned financial institution put up another US\$80 million and the US independent power producer AES made an equity investment of another US\$80 million. ADB helped the Government of Bangladesh design the project specifically to increase private sector participation in the power sector. This was also the first project in which ADB used its political risk guarantee (PRG) scheme to leverage funds, raising US\$70 million in this way for the US\$300 million project. The PRG offers protection against political risks that may arise in connection with a project, such as nationalization, foreign exchange moratoria, and the government's failure to honor its payment obligations.

Source: ADB OED (2003), Sector Assistance Program Evaluation of ADB Assistance to Bangladesh Power Sector, Report BAN 2003-30. Manila.

46. **Is there any room for grants component in PPP?** Arguably, at least from theoretical standpoint, there are cases in which it may be in the public's interest to subsidize the capital investment of commercially viable PPP operations⁹. For example, capital subsidies may be warranted if this would enable the PPP to extend the reach of its services to poor regions or poor groups of consumers who would otherwise be excluded. Another example are cases in which public subsidies would enable the PPPs to reap positive economies of scale, scope or network economies that would allow it to lower its costs of delivering services to the poor. The key test of whether or not capital

⁹ This occurs in cases in which the optimal ratio of social returns to benefits can be obtained at a level of service provision greater than that generated by private comparisons of financial costs and returns.

subsidies for a PPP is warranted is if this is the most cost-effective way of ensuring that the poor have access to an essential service at an affordable price¹⁰.

47. **Risks** to investors are increased in the absence of well-developed legal and regulatory frameworks. Higher risks are reflected in higher project costs, which are then passed on, directly or indirectly, to the poor. The absence of well defined legal frameworks and regulatory institutions encourage investors, many of whom may not be qualified, to rely on special favors and political relationships rather than their technical merits to secure and structure contracts. In such settings, the profitability of an investment has little to do with the degree to which the poor are well served, and a great deal to do with the special regulatory treatment or forbearance from the authorities that can be obtained.

48. As a general principle, the transfer of infrastructure or social services to the private sector should not lead to privileged deals or to profits secured by government guarantees. Building a strong legal framework and regulatory enforcement capacity for PPPs is important to guarantee that this will not be the case.

Finally, building pro-poor practices into PPP project design can be strengthened through...

49. **Participation...** is key to fostering PPP project designs that are responsive to the needs and desires of the poor. Such participation can take many forms. Public consultation, hearings and stakeholder meetings can be used to ensure that the voices of those who will be directly affected, and those that are expected to benefit from the PPP, will be heard. Strategic alliances can be struck between commercial service providers and community-based or non-governmental agencies to boost the representation of the poor in project design. In ADB supported PPPs, it is common that NGOs and CBOs are encouraged to participate in identifying options for extending and improving services to poor communities. And in some, involvement of NGOs is central to the public-private partnership (see Box 10). Involving NGOs and CBOs can also assist in developing and delivering public awareness campaigns targeted to low income households. Such measures can help to help foster a sense of community ownership, awareness and shared responsibility for the success of the PPP.

50. Participation also has a commercial dimension. Estimates can be made of the ability and willingness of the poor to pay for PPP services to establish appropriate tariff policies. Special problems that would hinder participation of the poor in PPPs on a purely commercial basis, such as a lack of clear titles to urban dwellings or inadequate ancillary services, could be locally addressed.

¹⁰ ADB (2002), "Subsidy Design in the Power Sector", ADB / PIAF Conference on Infrastructure Development: Private Solutions for the Poor: The Asian Perspective, October 30, Manila.

Box 10: Building a Government-NGO partnership to reach the urban ultra-poor: healthcare in Bangladesh

The Bangladesh Urban Primary Health Care Project has contracted-out the delivery of primary health services to non-governmental organizations (NGOs). The pilot project has targeted the urban poor in the major cities of Dhaka, Chittagong, Khulna and Rajshahi, which have most of the country's slums. The project provided services such as immunization, micronutrient support, family planning, prenatal care and assistance to victims of domestic violence. Approximately one quarter of deaths among women aged 15 to 44 are maternity-related, with violence accounting for a large proportion of the remainder. Competitive tendering for the provision of primary health care services has been used to decrease prices, enhance access and improve quality of health services. Some 16 partnership agreements with contractors in the four cities were entered into, of which 15 were with NGOs and one with the Chittagong City Corporation Health Department. Each performance contract involves a clearly defined catchment area of generally 4-5 wards, with an average population of 300,000. To decentralize and expand access of the poor to primary health care services, the project will construct 143 new and fully-equipped health centers, to be located near slums and used by the NGO and private sector health contractors. The primary health care centers provide affordable quality treatment to improve the health of women and children in the urban slums. In addition to safe deliveries, ante-natal and post-natal care, the centers provide comprehensive reproductive health care and advice on hygiene, nutrition, and maternal and child health. More than 1 million client visits were made to the centers in 2002, and the numbers have been steadily rising each year. The project has also helped local governments strengthen their ability to manage, finance and plan health services. The project will address infectious diseases such as polio, measles, tuberculosis, and sexually-transmitted diseases. Successful bidders for the partnership agreements are required to offer a plan that deals with domestic violence, including proper referral to legal, counseling and crisis management services. As health workers are often the first point of contact for victims, they are trained to provide immediate psychological support, detect cases of assault, and increase community awareness of the issue. The Local Government Division, Ministry of Local Government, Rural Development and Cooperatives, is the executing agency for the project, has been operating this PPP since 1997. A second phase of project support is due to start in 2005.

51. **...community involvement...** Another way to foster pro-poor PPPs is to encourage community ownership and participation in projects. Community-based initiatives may be valuable and viable in their own right, particularly as small-scale ventures that are linked to local demand in under-served regions. In addition, community-based initiatives can also play an important role as a bridge between large-scale commercial PPPs and services suitable for poor groups (Box 11). Support for community-based PPP initiatives can also have a long-term benefit, in terms of building the capacity of alternative service providers for the poor.

Box 11: Using a Public-NGO partnership to link the poor to a PPP: the Low Income Consumer Support Unit (LICSU) of the Katmandu Urban Water Supply Project

The establishment of a Low-Income Consumer Support Unit (LICSU) that will facilitate service delivery for the poor will be one of the new management contractor's contractual obligations in the Katmandu Valley Water Services Sector Development Program. The LICSU will help nurture pro-poor corporate culture and commitment to serving the poor. In parallel, tariff reforms will be implemented to increase overall tariff revenues by 15%, and modify the tariff structure so as to minimize potential abuse, especially by unmetered customers. Finally, performance indicators will be introduced to give incentives for the management contractor to undertake a more equitable distribution of water with more hours on a regular schedule during the daytime rather than haphazardly at night, and improve the operational efficiency.

Consumer surveys in Kathmandu Valley indicate that an estimated 29% of households are not connected to the piped water supply network, and of these, 60% are poor (measured as earning less than the official poverty line of Rs 6,100 [US\$84] per person per year). According to the census, there were about 218,000 households in the five municipalities of the Valley in 2001, which means that about 63,000 households were unconnected, of which about 38,000 were poor. The unconnected poor have to rely on traditional stone-spouts, tapstands, shallow wells, or informal connections. Such alternative supplies are usually grossly inadequate even for basic hygienic needs, unreliable, in poor quality, and/or expensive. A considerable amount of time is spent, especially by women and children, for queuing at water sources and carrying it home. It is estimated that there are at least 1,500 existing tapstands in the Valley, although there is no precise record of the number or evaluation of the levels of service they currently provide. Many of the existing tapstands are in areas where they are little used, while there is a great need for new tapstands in other areas, particularly near squatter areas. An ADB grant will help to finance the first three years of LICSU activities by financing interim services for the poor in order to relieve the immediate water stress in neighborhoods identified as high priority, using rehabilitated or new community tapstands served by the piped water supply network or tankers; carrying out a network densification and adding new connections in priority neighborhoods where many poor people live; and in the long term, extending and rehabilitating the piped water supply network to allow regular connection with full services for all residents of the Valley.

52. ... and, **environment and social safeguards**. PPPs, and particularly those that involve large infrastructure investments, may have adverse environmental and social impacts. Unless good environmental and social practices are observed, it is possible that the poor residing in the immediate vicinity of the PPP project could be adversely affected. Good standards of environmental and social practice will allow a PPP to anticipate and minimize adverse environmental and social impacts at the start, and to take proper action to mitigate adverse impacts. Projects tend to proceed faster, with less delays and disruptions, when social and environmental risks are adequately assessed, mitigation measures devised, and the support of affected communities secured at the start of a PPP project. In Asia-Pacific, the record of many PPPs in observing sound environmental and social safeguards is mixed. This is one reason why ADB, together with other multilateral financiers, has attempted to devise good practices for others to emulate (Box 12).

Box 12: Catching up to good environmental and social practice: the Lao PDR Nam Theun Hydropower Project.

The Lao PDR Nam Theun Hydropower Project was designed and constructed before ADB had adopted its thorough environmental and social impact assessment policies. Although an environment and social assessment was conducted, this did not include adequate baseline information. During project implementation, it became apparent that the environmental and social impacts were more extensive than anticipated. Some 57 villages were affected by loss of river gardens, erosion, and impacts on fisheries. A more detailed agreement on mitigation measures was signed by Government and THPC and more funds were allocated for this purpose. In June 2000, a ten year mitigation and compensation program was agreed on, and a new Environmental Management Division was formed within THPC in 2001 to implement it. This embodies best international practice in terms of participation, gender development, and promotion of integrated health, social development and sustainable livelihood initiatives.

4. Summary of lessons and conclusions

53. **PPPs can and do help to reduce poverty...** To make PPP's pro-poor, the primary challenge is to maximize the potential of this family of institutional arrangements to create value-for-money in providing services to the poor. For this, Governments needs to get the PPP framework right, so that it is possible to involve the private sector in delivering what were hitherto considered public services in a way that is efficient, effective and sustainable. Above and beyond this is the imperative of ensuring that PPPs are designed and deployed as a poverty reduction intervention, rather than simply for delivering services or easing the government's budgetary burden. This second layer of challenges adds new and important dimension to the way in which private and public sector roles and responsibilities are organized and put into practice.

54. **... and the necessary first step is to make the PPPs work.** PPPs can only serve the poor if they deliver *value-for-money* in the services they provide. Changing the balance of public and private roles and responsibilities is warranted if there is a sustained improvement in access, quality, and cost of services provided. The key challenge in fostering pro-poor PPPs is to create a process and an environment by which quality results can be guaranteed and regularly monitored and assessed. For that purposes, rules and regulations that work well for both partners need to be created. This involves:

1. A move from input-based to output-based contracting, to instill a more sophisticated and cost effective approach to the management of risk by the public sector than is generally achieved by traditional, input based procurement.
2. Relevant procurement processes, procedures and instruments
3. Clear legal structure and legal due diligence to cater to contractual issues, define constraints to PPP implementation as well as project scope, and to enable long-term financing
4. Creating effective regulatory institutions. This involves well-crafted checks-and-balances to create co-dependency, transparency, fairness and proportionality in project risk; effective user charges to safeguard consumer interests, and appropriate over-sight.
5. Macro-economic stability. A stable macro-setting is required to facilitate planning and forecasting of project costs and returns, and for adequate regulatory oversight.

55. **Then, to make PPPs work for the poor.** Can PPPs be made to work for the poor? The answer to this question is yes, and not only because theory would suggest that it is possible. There is ample evidence in a number of Asia-Pacific countries that PPPs can be a powerful, market-friendly instrument for poverty reduction, especially if policy frameworks focus on widening service access and encouraging competitive service delivery; if subsidies are well designed; if risks are properly allocated; if tariff affordability considerations are carefully assessed; and if pro-poor regulations and effective regulators are in place. Added to this is the need for Governments to recognize that they may also have a true "equity" stake in PPPs --a case can be made for inserting a public grant in a PPP if this will substantially extend its social benefits.

56. The examples from ADB-assisted PPPs demonstrate that there are many different ways in which PPPs do convey benefits to the poor. In terms of impact, some of the ways in which PPPs can reach the poor include:

- Generation of **fiscal savings** that Governments can use to finance needed social programs;
- **Reduction in the cost of service delivery** through careful contracting and **proper risk allocation** so that the poor can afford to pay for services;
- **Connecting the hard-to-reach poor to essential utilities** and social services by integrating companies with NGOs;
- **Meeting the locally-identified service requirements** by providing sufficient financial incentives for local government to attract private businesses;
- Putting in place a pro-poor regulatory regime to provide companies with a positive incentive **to progressively widen coverage**;
- **Involving the poor directly in delivering services** which had previously been a monopoly of the Government;
- **Lower costs** of service provision **by injecting competition** into the market;
- Innovating and creating new **services tailored to the special needs of poor consumers**.

57. Experience suggests that **complex web of incentives and institutions underpin a successful PPP operation**. Structuring incentives so that the corporate sector, NGOs and CBOs would be willing to provide services effectively and efficiently to poor customers is at the heart of this institutional equation. Good practices drawn from experience in Asia-Pacific suggest a number of lessons. **First**, we need to begin by looking at the MDGs indicators not as problems but as business opportunities. **Second**, we need to locate PPP strategies and business plans within the context of national poverty reduction strategies. **Third**, the policy setting for PPPs should be structured in a way to ensure that issues of relevance to the needs of the poor, such as affordability and universal coverage, are adequately addressed. **Fourth**, pro-poor regulations and effective regulatory bodies ought to be put in place to safeguard the interests of the poor from PPP-abuse. **Fifth**, PPP contracting processes accord emphasis to competitive service delivery, and the structuring of risks and tariffs should ensure that the poor will be provided affordable services. And **sixth**, that project development processes are participatory, innovative, and safeguard effects of those residing in the project sites. As long as such measures are made consistent with good commercial practice, than there will clearly be opportunities for businesses to profit, in partnership with Government, from serving the poor.