Private sector crucial in poverty fight

Its contribution to development is viewed as more effective than direct aid and having greater impact

ZHANG CHENGLIANG / CHINA DAILY

Worldwide, the private sector is considered to be a central engine of economic growth, a driver of innovation and a source of tax revenue for public expenditure. There is growing recognition that the potential contribution of the private sector to development far outstrips the potential impact of aid.

In recent years, direct aid from developed countries to help alleviate poverty has lacked transparency and efficiency and has failed to demonstrate remarkable development impact. Instead, governments these days are inclined to rely on the private sector in their efforts to enhance people's lives and help them escape poverty. The increasingly popular trend is to channel aid funds to address market failures and invest in private sector companies and funds in developing countries.

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Statistics from the Overseas Development Institute, the UK's leading independent think tank on international development, suggest that in 1990, there were hardly any investments of this kind, but by 2015 they had grown to $65 billion, equivalent to roughly half of the aggregate global aid of $132 billion.

There are still enormous development challenges in increasing inclusive growth, reducing poverty and improving people's lives. The private sector has a key part to play in addressing these challenges by supporting economic growth, poverty reduction and job creation. In addition to its direct contribution to economic growth, the private sector also plays an important role in providing essential services such as infrastructure, health, education and finance that are crucial to poverty reduction and achieving sustainable development goals. The private sector's participation in infrastructure and other services has become more outstanding over the past decade, as governments have sought alternatives to public funding and looked for more efficient ways to deliver services.

However, the private sector alone is prone to various setbacks in emerging markets. The top obstacles for private corporations in developing countries include problems with access to finance, investment climate and worker skills. Based on a research paper by the Center for Global Development in 2010, the lack of financing has frequently been identified as a major constraint to business activity in developing countries and a brake on company growth prospects. This bottleneck tends to be worse in poorer countries and for smaller companies. This is where the public sector, governments and international financial institutions alike can kick in, offer financial assistance, mitigate risks for private investment and help their growth in emerging markets.

Yet the private sector still enjoys unparalleled intrinsic advantages. Complementing the role of the government, market-based solutions can expand the provision of these essential services at affordable rates, improving the quality of life in local communities in measurable ways — often through public-private partnerships. There are abundant successful case studies on how the private sector helps poverty reduction and improves people's well-being, with necessary guidance and help from the public sector. The private sector brings an entrepreneurial, results-driven approach to the industry and proves to make a huge difference.

A case in point is a wind-power public-private partnership project in Pakistan jointly established by International Finance Corp (IFC), the private-sector arm of the World Bank Group, and Zorlu Energy Group, a Turkish power company. The Turkish industry champion has an integrated business that covers project development, engineering and construction. The group has capabilities to build and operate wind power plants but generally lacks sufficient funding to expand its business. However, Pakistan, with its rich wind resources and geographical adjacency, captured Zorlu's attention. Zorlu began tapping Pakistan's wind potential and self-financed an initial 6-megawatt project for a local utility near the capital city of Karachi. Later, Zorlu negotiated a 20-year contract with the national grid for a new 50 MW plant at the same site.

Plagued by chronic power shortages, Pakistan is in desperate need of developing renewable energy facilities to replace costly foreign oil and cut back on the resulting greenhouse gas emissions. Despite the fact that Zorlu's project design was sound, financing the project was challenging. Then IFC provided a $38.1 million, 12-year loan that lifted the project out of its predicament and eventually helped close it financially in October 2011. Later, more financial institutions such as the Asian Development Bank (ADB) and Pakistan's Habib Bank also joined.

Thus financially more equipped, the project was able to use world-class wind turbines from the industry leader, Vestas of Denmark. The project was a great success. According to IFC, more than 10 other private sponsors are now developing their own 50 MW wind farms in Pakistan, based on the same model, creating business opportunities while addressing the local electricity shortage problem.

The successful wind power project in Pakistan reinforces the importance of the private sector's involvement in tackling development issues, especially on the infrastructure front. However, the private sector is not only valuable in terms of its expertise and efficiency, but also its large pool of funding that could be mobilized and make up for the government's limited financing capabilities. Hence, China's master plan in boosting infrastructure development and regional integration, the Belt and Road Initiative, also calls for active participation of the private sector.

The ADB estimated in early 2017 that Asia must invest more than $1.7 trillion annually in infrastructure until 2030 to maintain its growth momentum. According to the ADB's calculations, the region currently invests only half of that amount each year. The Chinese government, under the Belt and Road framework, has pledged to invest $900 billion in infrastructure in the following years. China already contributed a great share to Asia's infrastructure funding in 2016, with Chinese banks accounting for more than 60 percent of the total infrastructure funding, reaching $38.4 billion. Nevertheless, it is still inadequate to meet Asia's growing needs for infrastructure financing.

The ADB suggests that government reforms such as streamlining administrative bodies and improving transparency in public expenditure can only bridge up to 40 percent of the financing gap, in the best scenario; the rest still needs to be filled by the private sector. Zhou Xiaochuan, the governor of the People's Bank of China and a well-respected economist in China, has also advocated for a market-oriented and sustainable financing system, encouraging greater cooperation between government and private capital. From this perspective, there is wide consensus to bring in private sector funding to support local infrastructure development.

Against this backdrop, the two newly established multinational development banks that devote to infrastructure investment in emerging markets — the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB) — both explicitly state that they will engage the private sector to achieve a win-win partnership.

In June 2017, the AIIB announced its first group of approved projects, including two loans and one equity investment totaling $324 million to support infrastructure projects in India, Georgia and Tajikistan. The bank's first equity investment of $150 million is a milestone, since it marks the bank's efforts in attracting private capital investment to much-needed infrastructure projects in India.

Similarly, the NDB has been making steady progress in advancing cooperation with the private sector. Its president, KV Kamath, said at the second NDB-BRICS Business Council Dialogue in Shanghai, shortly after the 9th BRICS Summit in Xiamen in September, that the bank plans to channel 30 percent of its loans to the private sector to facilitate infrastructure development.

The private sector is a critical component in addressing development challenges through its contributions to such things as economic growth, job creation, poverty reduction, service delivery and tax revenue. There is no known, effective substitute for relying on markets to allocate resources efficiently. Private corporations and entrepreneurs invest in new ideas and production facilities, and this is associated with vibrant economies and improvement of people's well-being. However, it is also worth noting that the private sector faces many challenges in developing countries.

The public sector could think about the intelligent and carefully prioritized use of policies or helping with finance to encourage and facilitate the private sector's development, in a market-friendly way. The close partnership between the two sectors will unleash emerging markets' potential and achieve better development results.

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