LSE European Institute "Perspectives on Europe" public lecture

Delivering the Sustainable Development Goals: A New Partnership Between State and Private Sector

Lecture delivered by Sir Suma Chakrabarti, EBRD President, to the London School of Economics

Tuesday 27 October 2015

Introduction

Good evening. It's a great honour to be invited here to deliver this lecture tonight.

I am delighted to be speaking at the London School of Economics. An institution of which I have fond memories. Not because I ever studied here. I didn't. But for some other vica rious reasons.

First, because my wife, who did study here – was also a member of the LSE faculty in the late 1980s and first half of the 1990s. Because of her association I seemed to spend a lot of time in the Beavers' Retreat bar. Solving all the problems of humanity no doubt.

Second, because of friends who studied here, I played football for the LSE veterans team, "the Economicals", for some time. At least before injuries and my basic lack of skills ended that career.

Third, because – somewhat unwittingly – my wife and I became a marketing tool for LSE. If you were able to dig out a copy of an LSE prospectus from the 1980s – 1984 or 1985, I believe – you would find the younger versions of the two of us on the front cover, sauntering down Houghton Street. Probably arguing over one of humanity's problems after a session in the Beavers' Retreat! I am still trying to work out whether the LSE owes me a fee for using my image without permission!

I hope tonight that, together with you, I can make a more useful contribution here at the LSE.

Still focussed on the challenges facing humanity – how to deliver the Sustainable Development Goals. And still focused on a question much debated in past decades – the relative roles of the private sector and the state in the financing and delivery of such goals.

But with a different answer to that which would have been given in the 1980s and early 1990s, during the period of my past association with this institution.

Synopsis

I will start by explaining why I believe the new Sustainable Development Goals are an important staging post in the thinking about the characteristics of economic development.

On their own, the Sustainable Development Goals have nothing to say about means – in particular, the balance between the private sector and state in their financing and delivery.

So I also want to describe how we got to where we are in the debate on means, to the very point about the need for a new partnership between the state and private sector.

I will then go on to give a couple of concrete and very detailed examples of what that partnership means in practice, using EBRD examples to illustrate my points.

And then I will finish by describing how that new partnership needs a visible, rather than invisible, hand to be built.

The Goals: From MDGs to SDGs

Let me start by charting the sort of journey that international development folk like me have travelled as a way of explaining how we got to the SDGs and the need for a new partnership between state and private sector.

Let me begin with the goals themselves, and then come back to the means.

The Sustainable Development Goals - the SDGs for short – were adopted by the United Nations only last month.

These SDGs set the global development agenda for the next 15 years. And, by year end, world leaders will, I hope, supplement the SDGs with a legally binding and universal agreement on climate change.

The SDGs are, in my view, a far better - certainly far fuller - description of the full complexity of today's thinking on development than their predecessors, the Millennium Development Goals.

I should say that I remain immensely proud of the old Millennium Development Goals. And not just because I was there at their creation 15 years ago!

The eight MDGs introduced real coherence and proper, measurable targets to a development agenda that had previously been short on both.

They focussed attention on crucial development challenges, such as eradicating poverty, access to education and basic services, and reducing child mortality. And they galvanised action and secured impressive results in these and other areas.

For example, millions of people have now been lifted out of extreme poverty, largely thanks to rapid economic growth in China and India but also because of similar trends in sub-Saharan Africa.

So we should all applaud the – at least partially - successful delivery of the MDGs.

But we should recognise that they represented only a sub-set of the challenges we currently face. Indeed, the MDGs concentrated largely, though not exclusively, on social outcomes. Some key development priorities, such as infrastructure and energy, were absent from the list.

And, yes, they cast the state as the main actor in development with, perhaps, a supporting role assigned to civil society.

'Bringing Beveridge to Africa,' as we joked at the time, in homage to William Beveridge's contribution to the creation of the welfare state in Britain.

Of course, this is another LSE reference as Beveridge was Director of this institution between 1919 and 1937.

The "welfarism" implicit in the MDGs was not because, back in 2000, we did not know of the importance of the hard economic sectors in development.

Or that we did not know about the importance of the private sector or of an effective state.

No, it was – in retrospect – much easier to rally public and civil society support in aid-giving countries for these social outcomes. And easier to get developing country governments' agreement if no-one raised the role of the private sector or the need for better governance.

The MDGs were good. But they were essentially a product of the bargain that could be struck between the various constituencies at that time.

Well, the last 15 years have led to a more honest discourse. Developing countries want the hard economic sectors on the list of development goals. And they are now willing to recognise explicitly the importance of inclusive and accountable institutions.

At the same time, in the so-called "North", it has become obvious that many government aid budgets are not expanding and the private sector will have to take more of the financing and delivery strain of meeting these goals.

Buy-in to the SDGs is also based on far more consultation with countries themselves and brought new bodies into the mix, including us at the EBRD.

That more honest discourse and that wider buy-in are enshrined in the new, expanded list of SDGs which will guide our efforts for the next 15 years.

Critics have been quick to point to what they call a lack of discipline and focus in these new SDGs. The critics say they are 'fuzzy,' 'higgledy-piggledy' even.

And, yes, a cursory look might suggest that the SDGs have indeed suffered a touch of middle-age spread.

There are 17 SDGs with 169 associated targets. That's a sizeable increase on the MDGs' 8 goals and 21 targets.

But, by themselves, those numbers do not tell the whole story.

As I have said, I would argue that the new SDGs do a significantly better job than the old MDGs of reflecting the challenges we face in development – in all their complexity.

Unlike the MDGs, the SDGs emphasise the underlying drivers of sustainable development, not just measurable outcomes. Hence the increased number and range of the new SDGs.

They focus on issues as significant as inclusive growth, addressing inequality, building strong institutions, sustainable infrastructure and addressing climate change.

And they also involve middle income countries in the development agenda in a way that was simply not the case before with the MDGs. Another reason for a more comprehensive list of goals.

But that does not mean each and every SDG should be an equal priority for each and every country. That way madness lies.

No, each country should determine for itself its list of priority SDGs and focus on delivering those.

So, provided we interpret the list of SDGs intelligently at global, national and institutional levels, then I would not be concerned about ‘mission creep’ or ‘fuzzy vision’. Quite the contrary.

Indeed, I believe the SDGs represent the best possible statement of all the complexities of economic development that we face today.

The Means: From Statism to Neo-Liberalism

Crucially, in the discussions on financing and delivery of the SDGs, the vital role of the private sector and well-functioning markets was acknowledged without great debate. It was not always this way.

When I left university in 1981 to work as an economist in the Botswana Government, there had already been several major phases of development theory and practice.

From the 1940s to the 1960s, the state played a very large role in promoting economic development – particularly through investment in heavy industry. Import substitution at a time of foreign exchange shortages was stressed.

The 1970s can best be characterised as a period focussed on “basic needs” – human capital development and redistributive policies, with the state still the main actor.

By the 1980s, a sense of gloom had descended as many development economists recognised that the state-directed, state-financed, state-delivered model had shown modest results.

And, just as in some developed economies, notably in the US and UK, the neo-liberal approach to development became the response.

All the talk in the 1980s was of getting the prices right. And getting the state out of the road.

I remember the neo-liberal evangelists going so far as to say market failure was preferable to state failure.

So, at the time of the fall of the Berlin Wall in 1989 and the creation of the European Bank of Reconstruction and Development – "EBRD" for short – in 1991, the market-based model of development held sway. There was a strong belief that the private sector could do it all.

The most extreme version of this approach would have the state doing little more than performing "night watchman" duties, its public service provision being limited to defence of the country.

Remember, this was at the tail end of the Reagan and Thatcher eras.

But, quite quickly in the 1990s, a new set of issues emerged that gave better colour to or even challenged this neo-liberal consensus. Many of these issues were advanced by a burgeoning civil society movement. Let me give you four examples to show what I mean.

First, neglected social costs from development could be neglected no longer. For example, build a dam and one should take much more seriously the interests of communities directly affected.

Second, the gender dimensions of development began to be raised. What use was development that neglected the needs, views and opportunities of half a society?

Third, the environmental dimensions of the development process came to the fore. Rightly, we practitioners were asked what steps could be taken to make development environmentally sustainable.

And fourth, it became patently obvious that a "do nothing" or "do very little" state was often a stumbling block to development.

States that avoided environmental regulation or did little to promote the education of girls or were governed in the interests of a personality or a party rather than a nation were rightly recognised as "anti-developmental".

Without an effective state to protect property and contract rights, promote competition and uphold the rule of law, in short to support markets and ensure social cohesion, making progress on what really mattered in development was going to be well nigh impossible.

Hence the search, not for a return to the statism of the 1950s to 1970s, but at least to an effective state, alongside the emphasis on the private sector as the twin instruments for driving economic development.

The Means: The EBRD Story

The EBRD's own story illustrates the journey on means over the last twenty-five years. Our purpose and modus operandi tell you something about the shifts in thinking.

We are a multilateral development bank. Like the World Bank and regional development banks for Africa, Asia, and Latin America.

We are owned by governments, 64 of them, plus the European Union and European Investment Bank.

But we are very different from other multilateral development banks in three respects that reflect the time in history when the EBRD was created.

First, we strive to work only in countries committed to multi-party democracy, political pluralism, and market economies. No other multilateral development bank has such as explicit political and economic mandate.

By the way, the key is the direction of travel. A country has to be on the journey towards markets, democracy and pluralism. It does not necessarily have to be at the final destination – if there is such a thing with democracy and markets – to receive our support.

Second, our constitution lays down that 60% of our lending must be to the private sector. It currently stands at 80%.

No other multilateral bank, with the exception of International Finance Corporation, an arm of the World Bank Group, has such a deep knowledge of working in the private sector for development purposes.

And third, we are project based, providing loans and equity to corporates.

We do not, unlike the other multilateral development banks, fill budget or current account deficits. Because of our projects, we know a lot about sectors and companies.

That holy trinity – the focus on helping countries transition to open market economies, the focus on the private sector as the motor of development, and the focus on companies rather than government agencies – marks out the EBRD as an institution that reflected key characteristics of the development consensus of that time.

All the more so as we started in the command economies of eastern Europe and the former Soviet Union. Note though that, since then, Mongolia, Turkey, Morocco, Tunisia, Egypt, Jordan as well as – temporarily – Cyprus and Greece have been added to our countries of operation.

Our geography now stretches from Casablanca to Vladivostok! And it now includes countries that were never command economies but where our shareholders believe we can have impact.

Next year, EBRD will be celebrating its 25th birthday. That trinity of characteristics is still there and embedded in our business model. I believe that trinity of characteristics remains valid. It gives EBRD its distinctiveness and allows us to complement the work of other multilateral development banks.

But we in the EBRD have not stood still. We have learned a lot about the role of the private sector in the development process, in the transition to market economies, over that period. And we have evolved to reflect the fact that the consensus on what constitutes good development practice is different today than in 1991. EBRD today is experienced in a number of areas that are now part of the mainstream in global development thinking. That includes:

- leveraging the private sector to achieve development outcomes;
- years of experience of devising financial instruments to build sustainable infrastructure;
- long running programmes to help small and medium-sized businesses, thus creating new jobs, enhancing skills and driving growth;
- sustainable energy, reducing waste and lowering carbon emissions; and
- promoting energy security based on the private sector and the blending of grants and loans.

We are a powerful catalyst for foreign direct investment and the channelling of equity and private financial flows into emerging market countries.

And, yes, we are focussing on inclusion and bringing more women and other excluded groups into the workforce.

That puts the sort of expertise we have gained over the years right at the heart of the new, expanded development goals for our planet.

Indeed, the way we measure the transition to a market economy – the Godfather of which is Nick Stern himself – now takes in all of the shifts in development thinking of the last twenty-five years.

Our methodology for project assessments now takes account of social, environmental and gender issues.

And we have learned a lot about the role of an effective state in that process too from our unique vantage point. That too is now part of our toolkit.

So, the EBRD now marries a private sector focus on financing and delivery of development goals to working with our countries of operation to building effective state responses: the new partnership between the state and the private sector.

And we want to put all that learning, that expertise, that approach to work in the financing and delivery of the new Sustainable Development Goals.

Two Case Studies – Infrastructure and Energy Efficiency: the Relative Roles of the Private Sector and the State

Let me illustrate what I mean in terms of the new partnership in very concrete terms for two of the SDGs – infrastructure and energy efficiency. I am now going to move from the macro to the micro. I am going to get detailed to make the point about the inter-relationships between state and the private sector crystal clear.

a. **Infrastructure**

Infrastructure, a development goal conspicuous by its absence in the MDGs, is something that the EBRD knows a lot about.

Annual global infrastructure needs are estimated to be somewhere in the order of €3.3 trillion. Only €2.4 trillion is currently being met.

That shortfall of just under €1 trillion will have to come from somewhere. The public sector, on its own, cannot raise those sorts of funds.

Only one tenth of the shortfall can be covered directly by international financial institutions. The private sector can help to fill this 'infrastructure gap'.

Whether it is in small-scale municipal infrastructure projects designed to improve service delivery and quality in urban transport, water, waste-water or solid waste or in larger transport and power sector projects, the EBRD works to bring about the kinds of key reforms that make effective partnerships with the private sector possible.

This means mobilising private sector capital and know-how to raise standards and deliver value-for-money. It means working with private operators to improve business conduct and commercial practices.

It means reforming tariffs to move towards cost recovery while protecting the poorest. And it means establishing a sound legal framework for Public-Private Partnerships and concessions.

A good example of this approach is Romania's water sector. When the EBRD first began working in the sector in the mid-1990s, typically a municipality water system operated with a chronic funding gap.

Operations and maintenance were costing more than the annually negotiated subsidies granted through the national and city budgets. Over time, water system assets - pipe networks, pumps - were neglected by deferring maintenance, leading to ever lower service quality.

This in turn reduced users' willingness to pay for the water services, thus leading to even lower revenues. This downward spiral was self-perpetuating and damaging.

To reverse this, EBRD introduced Public Service Contracts. This approach is now used in over 200 municipal-level projects, across not only water and wastewater operations, but also urban transport and district heating utility companies throughout Eastern Europe.

It has established the Public Service Contract as the linchpin agreement between a municipality as 'Owner' and the public utility company as 'Service Provider'.

The contract defines the quantity, quality and service standards using a pre-defined regime of performance indicators that must be met for the municipal utility company to 'earn' the full support payments from the municipality.

Proper regulatory oversight of such contracts must also happen to keep all sides honest.

This structure locks in a virtuous cycle that underpins lasting funding sustainability. It also creates the essential creditworthiness of the utility company, allowing the EBRD to make a non-recourse loan to that same utility.

The EBRD began to invest in the Romanian water sector in 1994, beginning with the cities of Brasov, Iasi and Timisoara, three secondary cities of about 300,000 people.

Since then the Bank has made some 20 successive loans to Romanian water utilities, often together with commercial lenders, to achieve deep systemic impact across the sector.

The improvement to water quality and reliability in Romania has been significant. EU water standards have been attained, as has 24/7 reliability. The increase in revenues over the last 20 years has also been important: the revenue following investments in modernised water systems coupled with the PSC approach and the introduction of cost-reflective tariffs.

Water tariff rates have continued to grow, yet remain within affordability constraints.

Today's average tariff of nearly €1.40 per cubic metre represents less than 5% of average disposable household income. Many municipal companies are now running healthy cash surpluses.

In our view, this level of self-financing capability of the local entity is the ultimate test for any multilateral bank with a true development aim.

The litmus test is whether, following a series of projects in the sector, the country's own operators can create sufficient internal funding capacity to complete the modernisation of the sector.

And where have we got to in meeting that objective? Well, Romania's water utilities are now looking at partnering with private sector operators.

Doing that will help them to achieve deeper efficiency gains through deployment of advanced metering and leak detection technologies, using multi-year management contracts with specialised private companies.

b. **Energy Efficiency**

Let me turn now to the second case study – energy efficiency.

We recognise that we can only deliver the SDGs in the field of energy by being much more ambitious about our own goals. And to do that we need to mobilise the private sector.

We've scaled up our contribution to the global fight against climate change by sharply increasing our own level of green financing for the next five years.

So we're aiming to invest €18 billion in the field over that period. That's as much as we've invested in it in the last 10 years.

Based on the historical leverage of EBRD climate finance, this would mobilise another €60 billion for a total project value of up to €78 billion.

And, looking at our overall business model, we would expect between half and two-thirds of that financing to be in the private sector.

In the energy efficiency field, the EBRD works with a broad range of private sector clients.

These include large local industries, large industries with foreign strategic sponsors, SMEs, commercial banks, equity funds, project developers, utilities and individual homeowners (through residential energy efficiency lines).

The EBRD has developed a broad range of climate finance products to address energy efficiency and renewable energy opportunities across sectors and countries with specific characteristics. Among them are:

- direct industrial energy efficiency projects with medium-sized and large enterprises building on effective combination of energy audit and financing capacity;

- indirect energy efficiency and small scale renewables financing intermediated through local banks with Sustainable Energy Financing Facilities;

- municipal infrastructure energy efficiency and renewables projects involving a combination of energy audit approach with non-sovereign financing capacity;

- supply side energy efficiency project financing including power generation rehabilitation, transmission and distribution efficiency, and metering smart grids projects;
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- renewable energy project financing; and

- adaptation financing.

A good example of how we work to promote public-private solutions in climate finance is a recent transaction in energy-rich Kazakhstan.

The renewables potential in Kazakhstan was identified over a decade ago. But the necessary legal framework to attract foreign investment in the sector was not in place.

The EBRD worked with the Kazakh authorities for several years to improve the renewable energy law, including the development of appropriate feed-in tariffs for a range of technologies (wind, solar, biomass, hydro), and an analysis of the social impact of spending on renewable energy.

A new law was adopted in 2013, which allowed us to start building a private sector pipeline.

The involvement of the state was necessary to give confidence on the framework to private investors. And to kick-start the development of the necessary support infrastructure, such as the equipment suppliers and wind tower maintenance companies, which the renewables industry needs to develop.

With this in place, the Bank signed in June 2015 Kazakhstan's first large-scale solar plant 'Burnoye Solar', which is jointly owned by Samruk Kazyna Invest and United Green, a UK developer.

The New Partnership Between State and Private Sector

These two detailed case studies – for infrastructure and energy efficiency – hopefully give a sense of the new and complex partnership between state and private sector that I believe will be required to deliver the SDGs.

I could have gone through many more of the SDGs and come up with similar points about the partnership.

But how to build that partnership? In many countries there is no dialogue between the state and private sector.

At the extremes, we've seen cases where the state captures the private sector and cases where the private sector captures the state. These are not stable equilibria.

For markets to function well, crucial to the delivery of the SDGs, we believe there need to be clear rules of the game for how the state interacts with the private sector.

There needs to be a level playing field and platforms for constructive dialogue between state agents and private business.

The EBRD is an institution owned by governments, with a public policy mandate to foster transition. And we are a major investor with a private sector-focused business model.

So I believe the EBRD is uniquely place to help forge the kind of partnership between the state and the private sector that can lead to sustainable development and growth.

We do this in a number of countries through the establishment of independent Investment Councils.

These councils provide a platform for public-private dialogue that brings government policymakers and business representatives together to consider obstacles in the business environment.

To share ideas on how to remove or lower those obstacles and build mutual confidence and trust.

The EBRD currently sponsors Investment Councils in six countries, supporting the establishment of independent professional secretariats that identify constraints and help to broker solutions.

That is at the national level. We also work to put similar platforms in place to tackle sector specific issues such as SME development, attracting foreign investment, and addressing problems of food security and the development of the agribusiness value chain.

Platforms are helpful, but they are not a cure-all. For them to work, and for real partnership to be formed, governments have to be ready to listen, to make good policy choices and to think long term.

Private sector businesses have to be ready to think beyond their own narrow interests and be part of a discussion on how to foster competition and a level playing field for everyone.

The EBRD cannot force them to do that.

But we can use our leverage as a major financial investor and our expertise in creating a sustainable framework for markets to nudge state and private sector clients towards reform and better governance.

Two years ago, after reading our landmark *Transition Report* that described in detail how countries where the EBRD invests had gotten 'stuck in transition', we launched the Investment Climate and Governance Initiative.

We saw that a main stumbling block to transition was poor governance, at the state level and at the corporate level.

Businesses do not get started, thrive and expand where the state does not provide certain essential 'public goods' – such as sound regulation, market-supporting laws that are implemented fairly by honest and well-trained judges and a transparent procurement system.

Trust cannot be established without the means to address abuses by public officials for private gain – in other words, corruption.

The Investment Climate and Governance Initiative aims to support reform-minded governments and the Bank's corporate clients to increase transparency, good governance and healthy competition.

We do this in many ways. We provide advice on legal reforms, train judges and set up alternative dispute resolution mechanisms. We reform the public procurement system (which is where a lot of corruption originates).

And we put in place corporate governance action plans at both state and privately owned companies that want to optimise performance and attract commercial finance.

Corruption and misgovernance are huge problems that the EBRD does not have the means to tackle alone. But we can be part of the solution.

In countries like Ukraine, together with partners in the public and private sector, we have put in place an independent Business Ombudsperson that establishes a recourse mechanism for businesses with legitimate claims against state or sub-state entities that infringe on their rights.

This is one key ingredient for fighting corruption and the epidemic of corporate raiding that impedes private sector businesses and the economy as a whole,

And in Ukraine it is working. Other countries are noticing and asking for our help in setting up such institutions.

So, as you can see, a better investment climate, better governance, the fight against corruption, and tackling the nitty gritty of the obstacles that impede private investment – these are all part of the new partnership between state and private sector.

Conclusion

To conclude, let me return to this lecture’s title and the original purpose of this talk: developing *a partnership* between the state and private sector.

Both are important. Neither can succeed in isolation from the other.

It is no secret that in many countries around the world we are witnessing a backlash against the private sector and markets as a whole and banks in particular.

This is understandable. There were excesses aplenty in the years running up to the financial crisis. Yes, the fruits of growth should have been shared far more equitably.

But the backlash can go too far.

The answer to too much financial deregulation and inequality is, in our view, not more state. Not less market.

It is more effective state institutions - and better functioning and well-regulated markets.

Key is the balance between state regulation and the invisible hand.

States need a dynamic and productive private sector to generate jobs and growth. The private sector needs an effective, enabling state.

The lesson I learn from the shifts in development thought and practice over the years, and the tacking from one end of the spectrum to the other, is that we can’t know all the answers at any one time.

Sometimes I’m not sure we are even asking the right questions!

So we look to you, students, academics, or just the concerned general public, to help us.

Some of you in the audience tonight will be from countries where the EBRD invests.

Many will be citizens of our 64 shareholder nations.

You too can make a contribution to the development agenda.

It might be in the form of research that throws new light on the problems we come up against on the ground.

But I wouldn't be at all surprised if a few of you here now go on to work for the EBRD - or other multilateral development banks – later in your careers.

And I trust I have made clear that there are many other routes into the sustainable development project.

There is, of course, the way in via civil society, a very important partner of ours.

And you could go back to your home country and work within government there. If you do, don't forget the state's vital role in providing the right conditions for private businesses to thrive.

I do hope that some of you will give some thought to another pathway, that of the private sector. At its best, generating wealth, creating new opportunities for men and women and fostering sustainable and resilient economic growth.

There has never been a better time to get involved. There has never been a better time to help forge the new partnership.

The new SDGs set out an ambitious but credible programme of change. It's now up to us all to deliver it.

Thank you very much.

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