

The Road Less Travelled

by

Robert Bestani

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FOREWORD



THE ROAD LESS TRAVELLED

By Robert Bestani, Director General — Private Sector Operations,
Asian Development Bank

Most people give very little thought to the road they travel on until they find it either does not go where they want, or that its condition hinders their progress. However, for the governments of the world, it is a major and universal issue. Indeed, it is a universal test of government effectiveness as it is very difficult for any government to point the finger of blame elsewhere when a road network is not in place.

Yet, this is an era of very limited government spending. Governments in Asia and around the world are strapped for funds, but the requirement for a proper and effective road network cannot be ignored. As such, the key issue in road construction has dramatically shifted in the last few years to the subject of finance. Where are the tens of billions of dollars in needed funds to come from?

To meet this urgent need for funding, governments have used a variety of new tools. In China's case they have turned to private sector securitization to secure financing. On the whole this has worked quite well, though the Chinese model has its drawbacks – namely that China has the cash reserves to cover the upfront expenditure needs of this type of funding. So what do those countries without US\$400bn in idle cash do?

This has been the fundamental problem for most countries. India, with typical ingenuity and help from the ADB, is trying a new model that is being closely watched by the rest of the world. Faced with the need for at least US\$25bn in short term monies to build a high density toll network, India is currently experimenting with a model that is familiar to most other infrastructure sectors – the 'Build-Operate-Transfer' formula, otherwise known as 'BOT'.

In a very real sense this is a radical departure with a great deal of promise. After an appropriate bidding phase the private sector will be commissioned to undertake and finance the

construction and operation of three new roads on key high congestion corridors. The private sector company will thus manage the project for 10 or 15 years, get the required payback and then hand over formal ownership to the host country.

For its part, the host country can throw in the 'gap financing' needed to help meet the financial needs of the project during the initial life of the road. A new road usually takes time to build up traffic levels to their full potential, as people gradually get used to using it and as the community builds up around it. During this phase, the cash flow levels require time to build up to a point of self sufficiency. Other grants are to be provided to keep tolls affordable to all segments of the community.

The BOT model represents a paradigm shift in road financing. Obviously, such financings and construction will require very close cooperation between the host government and the private sector company, just as they do where BOT financing is more commonly used, i.e. in the power sector. In the traditional phrase, it requires a good deal of 'public-private-partnership'.

All too often, however, public-private-partnerships can get very one sided as governments and priorities change, and new ministers come and go. Often the problem with the BOT model is that the government 'partner' is the dominant one and the 'junior partner' can very quickly find that they have no cards left to play. It is for this reason that the structure needs to find a way of leveling the playing field in order to build confidence in its security. We at the Asian Development Bank's Private Sector arm, have long regarded this as our 'long suit', acting as a bridge from the public sector to the private sector and back. As the 'honest broker' in the game we can help ensure that both parties keep to their end of the deal and that agreements stay

'on the road'. (See: <http://adb.org/PrivateSector/Finance/New-Key-Asian-Finance.pdf>)

Beyond this, we have now also brought a much needed financing tool to many of the emerging countries we work in. For the first time, we are in a position to provide long term, fixed rate, local currency loans. The importance of such financing can not be overstated. One of the principal reasons why projects have failed in the past is because of the currency risk of devaluation that is always associated with cross border investments. With this risk eliminated the risk premium associated with covering this aspect of any project is eliminated. With that charge gone, the price to the end user can be materially reduced, giving the project a much greater chance at success.

It will be very interesting to watch this agreement unfold in India. If it works, as all the parties expect, it could open up a major new lane of financing for this most critical infrastructure segment.

By Robert Bestani

Director General - Private Sector Finance Department

Asian Development Bank

6 ADB Avenue, Manila, Philippines.

Tel: +632 632 6315

Fax: +632 632 5502

Email: rbestani@adb.org

<http://adb.org/PrivateSector/Finance/default.asp>