

**WORLD BANK GROUP
PRIVATE SECTOR DEVELOPMENT STRATEGY
IMPLEMENTATION PROGRESS REPORT**

June 20, 2003

TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
I. INTRODUCTION	1
II. POLICY ENVIRONMENT	2
A. Investment Climate.....	2
1. Systematic approach to diagnostics and results measurement.....	2
2. The complementary mix of survey tools.....	3
3. Investment climate assessments.....	5
4. From diagnosis to reforms.....	7
B. Private Participation in Infrastructure.....	14
1. Emerging issues in private participation in infrastructure.....	14
2. Voluntary principles for regulatory systems in infrastructure.....	15
3. Transparency in contractual arrangements.....	16
4. Output-based aid schemes.....	17
5. Support for sub-sovereign entities and local currency financing.....	17
C. Private Provision of Social Services.....	19
III. SUPPORT TO PRIVATE FIRMS	22
A. Financial Support	22
1. Revision of OP/BP 8.30	22
2. Unbundling IFC's commercial and non-commercial activities	23
B. Capacity Building of SMEs.....	24
1. Provision of business development/advisory services: the move towards a wholesale approach	25
2. Access to capital.....	26
3. Linkage to investment climate work and inputs to CASs and Bank projects	26
4. Evaluation and impact analysis methodologies	27
IV. WORLD BANK GROUP ORGANIZATION AND PROCESSES	27
A. Alignment of the WBG's PSD Approach and Work Program with Country Needs and Priorities	28
1. Implementing the PSD strategy in the regions.....	28
2. PSD in PRSPs and other client strategies.....	28
3. PSD in the WBG's country assistance strategies.....	29
B. Collaboration and Coordination within the WBG.....	29
C. Partnerships	32
D. Knowledge Dissemination	33
E. Results Measurement.....	34

BOXES

Box 1: The Doing Business Indicators.....	5
Box 2: Private sector involvement in investment climate surveys and assessments	7
Box 3: Investor Advisory Councils.....	8
Box 4: Catalyzing private sector participation in PRSPs.....	9
Box 5: MIGA-Swiss Partnership for Africa.....	10

Box 6: FIAS diagnostics lead to investment climate reform efforts in Turkey	11
Box 7: Corporate Social Responsibility (CSR).....	12
Box 8: WBG work on corporate governance.....	13
Box 9: Examples of output-based aid projects.....	18
Box 10: Output-based contracting initiatives in the social sectors	21
Box 11: SME Capacity Building Facility	25
Box 12: Pamir Private Power Project.....	31
Box 13: PPIAF's support to capacity building	33

FIGURES

Figure 1: Building blocks of an investment climate assessment.....	6
Figure 2: Cost and time involved in registering a new business in Karachi, Pakistan (January 2002).....	34
Figure 3: Cost and time involved in registering a new business in Karachi, Pakistan (January 2003).....	35

ANNEXES

Annex 1: Progress in Implementing Specific Actions Committed in the PSD Strategy .	36
Annex 2: Investment Climate Surveys and Assessments.....	38
Annex 3: Pilot projects with output-based aid components	39
Annex 4: List of IFC's Project Development Facilities	42

ACRONYMS

AAA	Analytical and Advisory Activities
ADB	Asian Development Bank
AFUR	African Forum for Utility Regulation
AKFED	Aga Khan Fund for Economic Development
APDF	Africa Project Development Facility
APL	Adaptable Program Loan
ARD	Agriculture and Rural Development
BEEPS	Business Environment and Enterprise Performance Survey
BOAD	Banque Ouest Africaine de Developpement
BP	Bank Procedure
CAO	Compliance Advisor/Ombudsman
CAS	Country Assistance Strategy
CGAP	Consultative Group to Assist the Poorest
CII	Confederation of Indian Industries
CSR	Corporate Social Responsibility
DECRG	Development Economics Research Group
DFID	Department for International Development
DGF	Development Grant Facility
EBRD	European Bank for Reconstruction and Development
ECA	Europe and Central Asia
EIU	Economist Intelligence Unit
ESMAP	Energy Sector Management Assistance Program
ESW	Economic and Sector Work
FAO	Food and Agriculture Organization
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Services
GCGF	Global Corporate Governance Forum
GPOBA	Global Partnership on Output-Based Aid
ICA	Investment Climate Assessment
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
IFI	International Financial Institution
IFUR	International Forum for Utility Regulation
IMS	Investment Marketing Services
InfoDev	Information for Development Program
IPO	Initial Public Offering
MDG	Millennium Development Goal
MENA	Middle East & North Africa
MIGA	Multilateral Investment Guarantee Agency
MSME	Micro, Small, and Medium-Sized Enterprise
NGO	Non-Governmental Organization
OBA	Output-Based Aid
OED	Operations Evaluation Department
OEG	Operations Evaluation Group
OEU	Operations Evaluation Unit
OP	Operational Policy
PDF	Project Development Facility

PIDG	Public-Private Infrastructure Development Group
PPI	Private Participation in Infrastructure
PPIAF	Public-Private Infrastructure Advisory Facility
PREM	Poverty Reduction & Economic Management
PRSP	Poverty Reduction Strategy Paper
PSAIC	Private Sector Advisory Investment Climate
PSAS	Private Sector Advisory Services
PSD	Private Sector Development
PSI	Private Sector and Infrastructure
PURC	Public Utility Research Center
ROSC	Report on the Observance of Standards and Codes
RPED	Regional Program on Enterprise Development
SAFIR	South Asia Forum for Infrastructure Regulation
SEED	Southeast Europe Enterprise Development
SIDA	Swedish International Development Cooperation Agency
SME	Small and Medium Enterprise
UEMOA	Union Economique et Monetaire Ouest Africaine
WBG	World Bank Group
WBI	World Bank Institute
WSP	Water and Sanitation Program

World Bank Group Private Sector Development Strategy: Implementation Progress Report

Executive Summary

- i. The current World Bank Group Private Sector Development (PSD) strategy was released on April 16, 2002. This report covers progress with implementation one year later. No specific action is required. Executive Directors may wish to comment on the pattern and pace of progress made so far and discuss in particular:
- challenges of prioritizing and sequencing reform proposals, for privatization and investment climate reform;
 - the approach to results measurement in the area of investment climate reform and private infrastructure projects; and
 - challenges in co-ordinating approaches to PSD across the World Bank Group.
- ii. **Investment climate.** During discussions of the PSD strategy, Executive Directors had given clear emphasis to creating a sound investment climate for private businesses, not the least for small and medium enterprises/farms in urban and rural areas. The main implementation efforts have consequently been concentrated on investment climate reforms – so far with activity levels and results exceeding initial expectations. An integrated program of diagnosis, dialogue with in-country stakeholders and financial or advisory support for reform is taking shape, complemented by capacity building efforts.
- iii. More rigorous and standardized measurement is now underpinning diagnostics, both of the constraints facing firms as well as the ensuing firm-level performance which leads to the creation of more productive jobs and hence poverty reduction. A common set of survey instruments has been agreed Bank-wide. In-depth firm-level surveys have been launched in over 30 countries. Complementary standard indicators of the regulatory environment for firms are now annually or bi-annually assembled for 110 countries (to be expanded to 130 to cover more IDA countries). Two of the indicators are currently being used as part of the IDA13 results management system.
- iv. Based on these survey and measurement tools as well as other relevant internal or external information, 13 investment climate assessments are expected to be completed by end of FY03. Another 15-20 are planned for FY04. Surveys and assessments are not part of mandatory due diligence products. Yet, demand exceeds delivery capacity at this time. The PSD family has started coordinating with related survey and assessment efforts of other parts of the Bank to tackle “survey fatigue” and “assessment mania”.
- v. Both surveys and assessments are being integrated in programs of dialogue with stakeholders and client governments, not least to strengthen the voice of private firms in the PRSP processes. Capacity building accompanies these efforts. For example, surveys are typically carried out in concert with institutions in client countries.
- vi. All these efforts are starting to feed into reform programs in countries across regions, for example, Algeria, Russia, Bolivia, Senegal, and India. Moreover, specific programs of

reform are being pursued in about a dozen countries worldwide in line with IDA results targets, which so far appear to be on track.

vii. **Private participation in infrastructure and in social services.** Substantial work on the lessons of private infrastructure during the 1990s has been completed. Efforts are being made to support infrastructure investments by flexibly using private-public partnerships, by innovating with local currency financing instruments and with lending to sub-sovereign entities. New forms of synergy between IDA and IFC are being tried, for example, in the Pamir Private Power project in Tajikistan. At the same time further emphasis is placed on creating sound regulatory regimes for infrastructure. Innovative project designs are being pursued to target subsidies to poor people, while maintaining effective forms of private provision. Currently over 20 output-based aid projects are under preparation, mostly small scale infrastructure projects. One is under implementation (Paraguay water). In Africa and South Asia, various performance based schemes to provide basic health services by the private sector are being developed.

viii. As set out in the strategy, consultations with regulatory agencies and other stakeholders have progressed and confirmed interest in developing certification schemes for individual regulators as well as basic principles for the design of regulatory regimes. An initiative to improve transparency of contractual arrangements is under preparation for concession-type arrangements that affect end-users of services such as water and electricity.

ix. **Support by the World Bank Group to firms.** The unbundling of IFC's operations into "commercial" and "non-commercial" areas has been initiated. Results were presented to the Executive Directors in January 2003. This approach has focused strategic attention on the growing technical assistance and advisory activities of IFC, which (including trust funded programs) are now almost as important as its traditional operations. A key challenge is to evaluate results better for such activities where market feedback is limited. On the World Bank side efforts continue to better review credit line operations under OP 8.30, for example for rural credit and social funds. Led by the Financial Sector Board, dialogue is proceeding among the relevant parties.

x. Major efforts are being made across the Bank Group and in particular by the IFC to enhance support to SMEs and to direct it away from firm-level financial assistance to support for intermediaries, and from firm-level advice to creation of a market for business development services for SMEs. Moreover, the almost 700 staff, mostly in the various in-country IFC project development facilities are also directing some attention to matters of the investment climate and policy reform.

xi. **World Bank Group organization and processes.** Work on PSD strategy implementation plans for all Bank regions is progressing as planned for completion in FY04. IFC and MIGA have prepared their regular operational strategies. A new joint Bank-IFC PSD vice-presidency is to help integrate better various PSD related initiatives across the World Bank Group, including inputs to PRSP and CAS processes reflecting Bank and IFC perspectives.

World Bank Group Private Sector Development Strategy: Implementation Progress Report

I. INTRODUCTION

1. This is an update on the implementation of the World Bank Group's Private Sector Development (PSD) strategy which was discussed by the Board on February 26, 2002.¹ It reports progress in implementing the key actions committed in the strategy as well as in fulfilling the overall mandates of the strategy.

2. The PSD strategy places particular emphasis on improving the investment climate and enhancing the delivery of basic services, especially to poor people. To this end, it argues for policy reforms and commercial disciplines on World Bank Group (WBG) support to the private sector. It identifies results measurement as critical to achieving results on the ground. It also stresses the need to systematically engage stakeholders, in particular the private sector, in the diagnosis of development issues, the identification of reform priorities and the implementation of programs and projects.

3. The WBG's work on implementing the PSD strategy during the past year has largely focused on achieving the above agenda in the area of investment climate. In addition, there has been considerable progress in policy work related to the delivery of basic services and in enhancing commercial disciplines on WBG support to the private sector. Progress in achieving the specific actions committed in the PSD strategy is summarized in a matrix in Annex 1 and discussed below in the relevant sections. Each region in the World Bank is preparing regional PSD strategy implementation plans. These plans will discuss the implementation challenges relevant for the regions, including issues of staffing and budgetary resources, and will outline medium-term action plans to meet the challenges. The WBG's PSD strategy is complemented by other operational strategies, notably those related to the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), small and medium enterprises (SMEs), and the various sectoral strategies of the World Bank.²

¹ The final version of the strategy was released on April 16, 2002. The strategy document, "Private Sector Development Strategy- Directions for the World Bank Group", is available at <http://rru.worldbank.org/documents/PSDStrategy-April%2009.pdf>.

² The relevant strategies for IFC, MIGA and the WBG's SME work are articulated in "IFC Strategic Directions." *Report IFC/R2001-0035*, March 16, 2001, updated in "IFC Strategic Directions", February 24, 2003; "MIGA Review 2000", *Report MIGA/R2000-30*, June 30, 2000; and World Bank, "Small and Medium Enterprises (SMEs): Sub-sector Strategy", *Report R2000-67*, May 4, 2000.

II. POLICY ENVIRONMENT

A. Investment Climate

4. The PSD strategy places particular emphasis on improving the investment climate in support of poverty reduction. A sound investment climate unleashes the entrepreneurial talents of people, including poor people, leading to productivity improvements, diffusion of best practices and creation of productive jobs. The WBG's work in helping client countries improve their investment climate covers many areas. The core areas of investment climate work include regulation and competition policy, legal institutions for a market economy, property rights, corporate governance and dispute resolution mechanisms. In addition, the World Bank's work on infrastructure, promotion of macro-economic stability, access to international markets, financial sector development and public sector governance also play a significant role in helping clients build a sound investment climate. IFC's efforts to improve the investment climate include extensive direct investments in areas such as infrastructure and financial markets. These are core areas for IFC and constitute well over half of IFC's investments each year. Similarly, MIGA is heavily concentrated in these areas, with over 70 % of its guarantees (by amount) focused in these sectors.

5. The WBG PSD strategy proposed a renewed emphasis on investment climate work, including a systematic approach to analyzing investment climate issues. The strategy argues that improvements in the investment climate require systematic result-oriented work, a first step in which is measurement. Good measurement of investment climate conditions is critical for sound analysis which, in turn, is a pre-requisite for better policy design and results monitoring.

1. Systematic approach to diagnostics and results measurement

6. Significant progress has been achieved in meeting this challenge. Over the past year, the WBG has developed methodologies for systematic surveys that gather information about investment climate conditions by interviewing firms or experts. These surveys generate information that is comparable over time and across countries and feed into indicators and assessments of investment climate conditions.

7. The surveys, indicators and assessments are components of a process that helps clients understand investment climate conditions in their country in comparative light and induces action to build a sound policy and institutional environment for investment. Assessments of investment climate or overall private sector conditions are not new analytics. What is new from the PSD strategy is the emphasis on standardized approaches to assessments and systematic measurement of results, and the view that active participation of stakeholders in the assessment process is key to achieving results on the ground. Diagnostic products become powerful tools for building ownership for reforms when they are developed and applied in close consultation with the clients, in particular the government and the private sector. These diagnostic products have started to inform the WBG's Country Assistance Strategies (CASs) and lead to WBG lending operations.

Moreover, they are valuable as stand-alone advisory products that may catalyze, and inform, reform actions by clients and feed into the country's own Poverty Reduction Strategy Paper (PRSP). Examples of how investment climate related diagnostic work has fed into strategies and projects are provided below (paragraph 25).

2. The complementary mix of survey tools

8. No single tool is adequate to capture all important dimensions of the investment climate. At the same time, multiple overlapping methodologies contribute to survey fatigue and disjointed pictures of the investment climate. A critical challenge is thus to develop a complementary set of diagnostic tools while avoiding duplication. To meet this challenge, the WBG has developed, over the past year a standard core questionnaire for firm surveys, a survey instrument to capture rural investment conditions and a set of indicators based on expert surveys (The Doing Business Indicators).

9. *Firm surveys.* The core questionnaire for firm surveys was developed through a collaborative effort led by the Development Research Group of the World Bank (DECRG) and the Investment Climate Unit in the Private Sector Advisory Services Department (PSAIC) and involving several units in the WBG.³ It helps identify existing investment climate conditions, benchmark these in order to monitor changes over time, and analyze their impact on firm-level performance. The core questionnaire is supplemented by seven specialized survey modules, which may be used where country conditions warrant more in-depth examination of any of these topics.⁴ The key here is standardization; the core questionnaire replaces many of the multiple survey and assessment tools previously used in the WBG while incorporating relevant elements from these.⁵

10. Firm surveys have been launched in over 30 countries so far and another 15-20 are expected to be launched by end of FY04 (Annex 2). In Europe and Central Asia (ECA), the WBG is collaborating with the European Bank for Reconstruction and Development (EBRD) in carrying out firm surveys using an agreed questionnaire. A similar collaboration, based on an agreed tool, is underway with the Asian Development Bank (ADB) in Indonesia, the Philippines and Sri Lanka.

³ For example, the Gender family contributed to the development of the core instrument so that it covered some gender dimensions of the investment climate. PSAIC is now collaborating with the WDR 2004 team to develop survey instruments that will capture conditions in the informal sectors.

⁴ The specialized modules cover the following areas: finance, training, SMEs, transport and logistics, administrative and regulatory costs, labor and human resources, and relations with suppliers and customers. Examples of ICA-surveys where specialized modules have been used include the Philippines (logistics module), Zambia (administrative and regulatory costs module) and Kenya (labor and human resources module). The approach followed in the ICA-surveys helps retain cross-country comparability while accommodating country specificities.

⁵ For example, several questions from the SME country mapping instrument have been incorporated in either the core questionnaire or the specialized SME module.

11. *Rural investment climate surveys.* The WBG's PSD as well as Rural Development Strategies stress the importance of a thriving private sector in rural areas for achieving growth, employment creation and poverty reduction. Following upon this, the Agriculture and Rural Development (ARD) family, in collaboration with PSAIC and DECRG (rural group), has developed a core survey tool for assessing the rural investment climate. The survey is intended for non-farm enterprises with more than one employee. The sampling will be constructed either from household surveys or community interviews that identify the businesses in rural towns and villages. This tool will be tested in up to seven pilot countries beginning in the last quarter of FY03.

12. *The Doing Business project.* The Doing Business project involves the development of quantitative indicators on several dimensions of the investment climate, which can be compared across 130 countries and over time (Box 1). These are based on expert surveys and allow for a cost-effective way to assess certain dimensions of the investment climate. Some constraints faced by businesses (such as basic incorporation procedures) can be captured effectively and inexpensively by interviewing relevant experts (e.g. incorporation lawyers) without having to conduct relatively more expensive and time-consuming firm surveys that are necessary to understand other dimensions of the investment climate.

13. *Improving the mix of diagnostic tools.* The Doing Business indicators and the firm surveys are complementary tools for understanding the investment climate. The firm surveys identify the relative severity of investment climate constraints, such as the degree to which firms are harassed by bureaucrats or whether firms consider labor regulations to be a serious constraint. The Doing Business indicators complement these findings by bringing out institutional details underpinning these constraints. For example, these indicators can help identify the labor regulations that create the most problems for firms in a country and also benchmark these against regulations in other countries. Such information helps identify reform areas with the highest potential pay-off.

14. The Doing Business indicators also complement the firm surveys by addressing issues that the surveys are not well-equipped to cover. Firm surveys collect information from existing enterprises, typically those in the formal sector. Hence, they are not designed to solicit responses that could be provided by firms that have exited, such as on bankruptcy procedures, or by firms unable to enter the formal sector because of entry barriers. The Doing Business indicators help fill this gap by collecting in-depth information on such topics as business registration procedures and bankruptcy processes that help identify the bottlenecks in these areas.

15. The issue overall is how best to generate useful systematic information in a cost effective manner. For example, where good industrial survey and census data are available, these could provide information on firm-performance, obviating the need for separate firm survey data on performance. The best mix of diagnostic tools would be a function of analytic usefulness, coverage, cost and usability for results measurement. There will be a need to assess, for all approaches, which questions and instruments are most useful for policy analysis. This would happen through analytic work on the basis of

the various indicators/survey results. The WBG, along with its partners and clients, will periodically evaluate the experience with the current methodologies and make necessary refinements.

16. Partnerships with donors have played a critical role in scaling up the diagnostic work and will remain important as the WBG turns to capacity building efforts. The United Kingdom's Department for International Development (DFID) has funded several of the firm surveys and the Norwegian government is providing substantial support to the ICAs, including rural investment climate work, and their follow-up. Finland and Canada are also supporting work related to investment climate assessments.

Box 1: The Doing Business Indicators

By 2005, 12 core sets of indicators are expected to be developed and their relationship with private sector development outcomes analyzed. Each set of Doing Business indicators is developed in conjunction with leading academics and private sector agents, and is backed up with rigorous analysis that demonstrates how these indicators matter for private sector development.

The indicators cover the following areas: Regulation of business entry (time, steps and cost to register a new business); Efficiency of dispute resolution (time, steps and cost); Regulation of labor (index of restrictiveness of labor regulations); Access to credit (extent of credit information sharing and creditor rights); Bankruptcy (steps, time and cost in bankruptcy process); Bureaucratic hassle (business inspections and licensing); Property (land rights; movable property and collateral law); Taxes (statutory rates, collection mechanisms); Infrastructure for business (water, electricity, telecoms); Infrastructure for trade (transport, customs, quality standards); Corporate governance (securities laws, expropriation, takeovers/competition); and Protection of property rights (enforcement systems for rule of law).

Findings will be published through the annual Doing Business report, with the first edition distributed by mid-2003 and focusing on regulations; a currently active online database of indicators (rru.worldbank.org/doingbusiness) featuring indicators already available; and papers with leading academics. The indicators are amenable to independent verification. The main indicators will be updated annually, and each year a new special focus will be featured over a three year cycle.

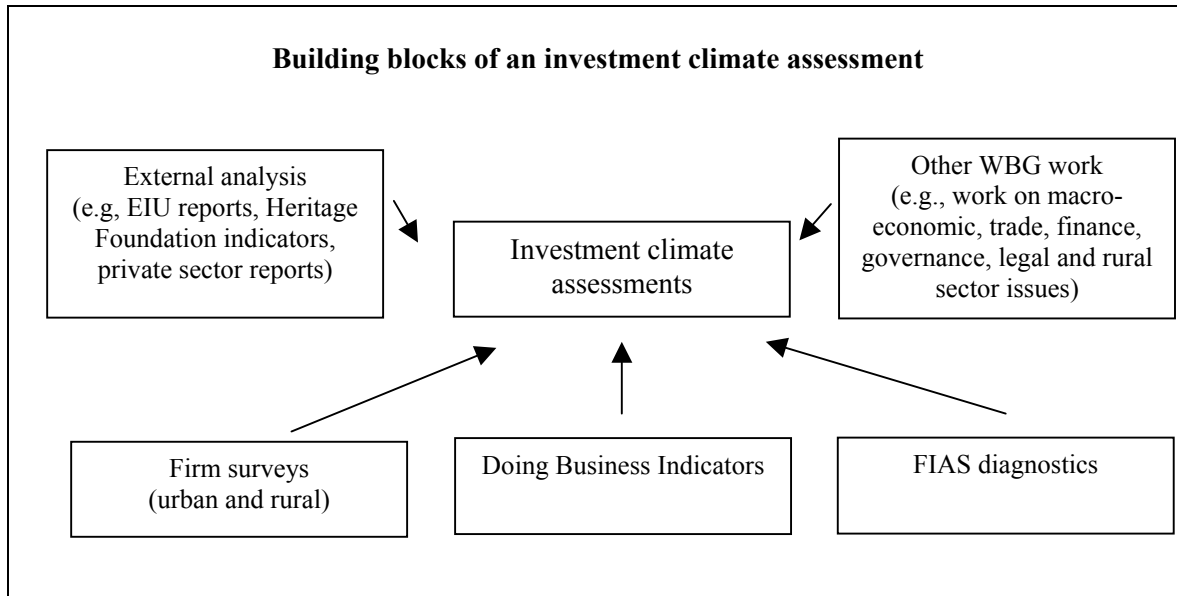
3. Investment climate assessments

17. The firm surveys (urban and rural) and the Doing Business indicators are building blocks for assessments of the investment climate in a country. The Investment Climate Assessments (ICAs), which also draw upon information from other relevant internal and external sources, interpret the overall picture and derive policy recommendations (Figure 1).⁶ They cover a core set of topics, such as an overview of the political and economic

⁶ For example, additional analytical work beyond the survey could be drawn upon to bring in a macroeconomic perspective (e.g., with respect to interest rate or exchange rate changes) or to balance the costs and benefits of regulations (e.g., for environmental or labor regulation).

context of the country, factor and product markets, and within-country differences in the investment climate.⁷ However, the overall framework is flexible. ICAs can be either stand-alone documents or part of other pieces of ESW, such as Development Policy Reviews.

Figure 1



18. The evolving work on the investment climate is an example of the way in which WBG resources are being aligned with country needs through a process intermediated by the regions. The ICA work program in a region is typically produced through an iterative process involving the Regions and the anchor units, PSAIC and DECRG. The Regions propose a three-year rolling work program for ICAs, based on country needs and expected synergies with WBG operations, and then consult the anchors and decide on the exact timing of each survey and assessment. Current trends indicate strong demand for such assessments from clients and country teams within the WBG. 13 ICAs are expected to be completed by end-FY03 and 15-20 are planned for FY04.

19. *Quality assurance of investment climate assessments.* The PSD Sector Board governs the processes and progress of the ICA initiative. It approves the detailed work program, reviews implementation progress and certifies the quality of completed ICAs. In September 2002, it approved formal guidelines for preparation of the ICAs. In February 2003, it instituted a process for certification of the quality of the ICAs and revised the guidelines to incorporate this process. The PSD Sector Board review will focus on cross-country comparability in coverage and approach, and on consistency of analysis and policy recommendations.

⁷ The PSD sector board has issued formal guidelines for preparing ICAs that describe the core contents of an ICA.

4. From diagnosis to reforms

20. *Private sector consultations.* To be useful, surveys and assessments should be planned as part of an overall process that includes extensive dialogue on the assessment findings, and provision of advisory services and other support to help identify and implement reform actions. Involvement of public and private sector clients in the design and implementation of the surveys and assessments has thus been a critical element of the WBG's evolving work on investment climate.

21. The surveys, which typically cover 400 to 1000 firms, are a representative form of consulting the private sector and provide a more comprehensive feedback than usually available from conventional consultation processes. Moreover, in many countries, the private sector and policy makers have: a) helped with survey design and implementation; b) provided feedback on survey and assessment results, including help with identifying policy implications and c) arranged consultations on the assessment findings (Box 2). Feedback on survey results have been particularly helpful in developing policy recommendations included in the assessment reports. In many countries, assessment findings have been used to advocate policy reforms.

Box 2: Private sector involvement in investment climate surveys and assessments

Assistance with survey design and implementation

In India, members of the Confederation of Indian Industries (CII), a private sector collective body, provided feedback to help design the questionnaire. In Pakistan, the World Bank consulted with heads of several chambers of commerce and had focus group meetings with private sector firms on the survey questionnaire. In the Philippines also, the private sector provided feedback on the survey questionnaire.

Feedback on survey and assessment results

In Nigeria, the results from the 2001 Regional Program on Enterprise Development (RPED) survey were informally discussed with the private sector before the report was written. This helped the private sector put forward concrete policy recommendations backed by solid evidence. In Eritrea, results from a similar survey carried out in 2002 were discussed with the private sector and other stake-holders before the report was written. The Uganda Manufacturers Association held a major workshop in Kampala for owners of private enterprises in a variety of sectors (manufacturing, tourism, commercial agriculture) to promote the results of the Investment Climate Assessment.

Dissemination of assessment findings and advocacy of policy reforms

The India ICA, completed in early 2002, was widely disseminated in the country. The CII, which was the Bank's partner in all stages of preparation of the assessment, organized workshops and seminars in several Indian cities. These events led to follow-up actions. For example, in Chennai, the business community used the assessment results to raise specific reform issues with the state government. The results of the Eritrea Investment Climate Assessment were disseminated to private sector representatives at a meeting in Asmara in October, 2002. The private sector strongly endorsed the ICA and argued that its main result--the impact of lack of demobilization on the private sector--was very timely in terms of enabling a better dialogue with the government on this very difficult subject.

22. The consultations around investment climate assessments are part of a broader WBG effort to support the development of government-private sector consultative forums. Such mechanisms help enhance understanding between governments and the private sector and spur measures to improve the investment climate. Recent examples include Investor Advisory Councils in Africa (Box 3), and private sector forums in Cambodia, Indonesia and Vietnam. The WBG is also making particular efforts to make the consultative processes more representative.⁸ While the firm surveys themselves are representative polls of business views, the WBG is also working in other ways to enhance the voice of the small players in the private sector. In Nigeria, for example, the WBG's SME department, in collaboration with the Regional Program on Enterprise Development (RPED), is helping to build capacity in the SME community so that it has a greater voice in policy-making. In Indonesia, where increased decentralization has enhanced the importance of the local level investment climate, the WBG, responding to the Government's request, has initiated a program to extend the dialogue process to the local level through regional private sector forums.

Box 3: Investor Advisory Councils

Investor Advisory Councils are small, high-level, private sector-driven advisory groups, typically comprising of 15-20 business leaders drawn from the domestic private sector and foreign investors, both actual and potential. The Councils usually meet twice a year, chaired by the President or Prime Minister of the country, with selected Ministers also in attendance. Issues identified in the meetings are followed up by working groups comprised of companies, local business associations, and policymakers. The WBG, led by the regions in collaboration with IFC and MIGA, has been exploring and/or supporting the development of these Councils in the Africa, ECA and MENA regions. The IMF has also been involved in the establishment of the Councils in Africa. The WBG has provided technical assistance to the countries, including facilitating the participation of corporate members, and has provided some lending to support the functioning of dedicated secretariats. Investor Advisory Councils have been launched in Ghana (in May 2002), Senegal (in November 2002) and Tanzania (in July 2002) on a pilot basis, and are being explored in Turkey and Algeria. Additional Councils are being considered in the Africa region, pending the assessment of the pilots there.

23. An important dimension of the consultative process is the involvement of the private sector in the PRSP processes. PRSPs are the key vehicles by which PSD issues are to be addressed in country development strategies in low-income countries. Most PRSPs identify growth as critical to poverty reduction and emphasize the role of the private sector in generating growth. However, reviews of PRSPs indicate that there has been a wide variation in the treatment of PSD issues in these documents and that, overall, the

⁸ This allows for the expression of a more diverse set of private sector views. This helps identify more nuanced reform actions and also prevents the deliberations from being distorted by the parochial concerns of particular elite, often rent-seeking, groups within the private sector.

treatment has been inadequate.⁹ One reason for this is inadequate participation of the private sector in the PRSP process, especially compared to the participation of other civil society groups. The WBG has thus been making efforts to facilitate better participation of the private sector in the PRSP processes (Box 4).

Box 4: Catalyzing private sector participation in PRSPs

In Ethiopia, systematic consultation with the private sector has had a substantial impact on the PRSP process. Here, the WBG catalyzed consultations between government and the private sector in the context of the 2003-2005 PRSP. In the first half of 2002, it helped organize consultations with the private sector in several Ethiopian cities and a study tour by government officials and business leaders to Vietnam and Malaysia. This was followed by a tripartite workshop on PSD in Addis Ababa in July 2002, which was attended by more than 150 participants from government, the donor community and the private sector. This workshop was pivotal in changing the Government's approach to its finance, private sector and infrastructure programs and led to substantial revisions to the Government's PRSP to include a comprehensive section on these issues under the cross-cutting theme of PSD. This integrative view was a substantial change from previous drafts of the PRSP and I-PRSP.

In Mali, in order to support implementation of the government's new PRSP, the SME Department is helping a nationwide private sector umbrella group, APEP, build an independent body to promote private sector initiatives, strengthen business associations, and craft new proposals for economic reform. The West African Enterprise Network, a respected grouping of successful business leaders, is an important voice in these efforts.

24. *Advisory services.* The WBG provides a range of advisory services to its clients that help build upon the diagnostic work and government-private sector consultations. FIAS, for example, often follows up its diagnostic work with advisory services to help clients implement the recommendations that come out of the diagnosis. IFC, in addition to its direct investments that help improve the investment climate, provides a wide range of investment climate advisory assignments, including advice on privatization, structuring financial markets, developing business forums and associations, regulatory development in infrastructure and corporate governance, and training programs and institution building. As FDI flows have ebbed in recent years, the demand for MIGA's technical assistance has surged. Most of the technical assistance that MIGA provides is country- and client-specific, tailored to meet individual demands and capabilities, and the scope of services currently offered is extensive. Assistance includes assessment of client agencies; advice on institutional strengthening; development of FDI promotion strategies, both

⁹ The joint World Bank-IMF review of experience with PRSPs, "Review of the Poverty Reduction Strategy Paper (PRSP) Approach: Main Findings" March 15, 2002, says "Various concerns have been expressed about the lack of involvement of specific groups in the participatory process. While the patterns differ across countries, CSOs that were out of favor with the government; local government officials; private sector representatives; trade unions; women's groups; and direct representatives of the poor are among the groups that have not always been fully involved in the PRSP process."

general and sector-specific; market intelligence; investor targeting; image building; capacity building for investment promotion intermediaries and development of new tools to support investment promotion efforts (see Box 5 for a specific example of MIGA efforts in Africa).

Box 5: MIGA-Swiss Partnership for Africa

In collaboration with the Swiss Government, MIGA has developed a multi-year initiative to encourage investors to take advantage of increased African trade access to the United States and the European Union. The Swiss Government is providing funding to complement MIGA's advisory and capacity building services in four pilot countries: Senegal, Ghana, Tanzania, and Mozambique. Apparel and tourism, for example, have been identified as key sectors for some of the countries. In Tanzania, MIGA arranged a tourism investment forum in Arusha in October 2002 that attracted about 180 delegates, including 30 foreign companies. Investor interest is now high for a number of large investments in this sector.

25. *Catalyzing operations, results monitoring and further analysis.* Systematic diagnosis, effective consultations and advisory services create a momentum for reforms and a focus on results. The recent experience in Ethiopia with private consultations and its impact on the design of the World Bank's Poverty Reduction Support Credit (Box 4) is an example. Other examples of how diagnostic work is feeding into strategies, World Bank lending projects, other analytic work and the clients' own efforts to carry out future diagnostics and implement reforms, include the following:

- *Algeria:* The new CAS draws heavily upon the recent investment climate assessment and puts PSD issues at center-stage; the CAS is intended to help Algeria move away from excessive dependence on the state-owned hydro-carbon industry to a more diversified, private enterprise sector.
- *Bulgaria:* The Doing Business indicators have been used to help design some of the investment climate related components of the recently approved Programmatic Adjustment Loan.
- *Bolivia:* Following the completion and dissemination of the Bolivian investment climate assessment, the Government decided to set up the Productivity and Competitiveness Unit to continue with detailed analysis, policy recommendations and program implementation. The unit is now actively working on such programs as Bureaucratic Simplification and improvements in Business Development Services Programs.
- *Russia:* FIAS's oblast-level administrative barriers studies have led to implementation action plans and a demand for cost-effective repeat surveys and results monitoring that could be carried out by the clients themselves.

- *Turkey*: A series of FIAS diagnostic work has led to a concerted effort by the Government to carry out reforms to improve the investment climate (Box 6).
- *Latin America region*: Several projects that address competitiveness issues have benefited from FIAS diagnostic work.
- *Senegal*: Two projects under-preparation (the Private Sector Adjustment Credit and the Private Investment Promotion Project) draw upon FIAS diagnostics.
- *India and Bangladesh*: Up-coming Development Policy Reviews for India and Bangladesh are expected to place considerable emphasis on investment climate issues, drawing upon the investment climate assessments for these countries.

Box 6: FIAS diagnostics lead to investment climate reform efforts in Turkey

FIAS conducted a diagnostic review of the FDI environment in Turkey in late 2000. This was followed by a number of studies: Administrative Barriers to Investment (September 2001), Legal Framework for FDI (early 2002), and Institutional Strategy for FDI Promotion (early 2002). Following this, the Government of Turkey adopted a government decree setting up a program and institutional structure for implementing the FIAS recommendations. A formal mechanism for public-private sector dialogue has been set up comprising of nine technical committees that focus on specific subjects and report to a coordination committee which, in turn, reports to the cabinet. Work is proceeding on implementing action plans for each focus area. An example is the work on the company registration process. The relevant technical committee is planning to reduce the number of steps required to register a company from nineteen to seven and the number of forms from 68 to a single unified form. A new FDI Law has been drafted with FIAS guidance and is currently under parliamentary review.¹⁰

26. In addition to the work on investment climate overall, the WBG's activities in certain specific areas, such as corporate governance and corporate social responsibility (CSR), also exemplify the manner in which good diagnostic work and consultations lead to results on the ground (see Boxes 7 and 8).

27. *The sequencing of diagnosis, reforms and projects.* Diagnosis, policy and institutional reforms, and investment projects do not need to occur in a tight sequence. Sometimes, the need for certain reforms are clear even without a rigorous diagnosis of the investment climate. The design and implementation of such reforms may thus precede or happen in parallel with investment climate assessments, which help identify other areas of reform. Sometimes, investment climate assessments may identify the need for more in-depth diagnosis of some issues while identifying reform priorities for other areas.

¹⁰ FIAS now systematically tracks the implementation of its recommendations allowing improved impact evaluations.

Here, also, additional diagnostics can be done in parallel with reforms. Finally, investment projects, especially that of a demonstration nature, need not wait till a comprehensive set of reforms have taken place. Successful projects can be carried out even in an environment of partial reforms and may indeed provide insights for additional reforms.

28. *Capacity building and knowledge sharing for policy reforms.* The PSD strategy considers capacity building and knowledge sharing as critical to the success of efforts to improve the investment climate. WBI and the Private Sector networks are jointly developing a capacity building program in investment climate. In addition, investment climate will be a major area of emphasis in one of the seven WBG-wide country pilot projects on capacity enhancement, i.e., that for Kenya. The WBI is also involved, along with other WBG units and the Global Corporate Governance Forum (GCGF), in a significant amount of corporate governance related work (Box 8). WBI has been using the CSR framework to address government, private sector and civil society consultation in a number of programs aimed at ensuring that the private sector has a strong voice in the development of a country's own development strategy. Recent examples include the Philippines, Russia, and Romania.

29. A WBG-wide thematic group on investment climate has been revitalized. It has over 250 members, drawn from several World Bank networks, IFC and MIGA, and including a sizeable number of field office staff. The group has started a seminar program and is developing a range of knowledge documentation and dissemination initiatives. This would include the identification of best practices, and development of toolkits to provide guidance to policy makers and the aid community in supporting investment climate related reforms.

Box 7: Corporate Social Responsibility (CSR)

The WBG's PSD strategy noted that the Bank Group is involved in a number of partnerships with the private sector, as well as other entities, whose aim is to promote environmental and social sustainability. The drivers of CSR are the mix of incentives and risks directed at companies to improve standards. When successfully implemented, CSR code compliance schemes act as an effective market-based complement to public sector inspection processes with their associated regulatory sanctions. Within the implementation of the PSD strategy, the WBG has looked more systematically at public sector roles and policy instruments to encourage these forms of corporate social responsibility (CSR). Experience from a number of countries suggests that governments can choose from a range of public sector roles to encourage the business drivers that underpin CSR, as a component of its broader investment climate. Over the last 12 months, PSAS has piloted the provision of technical assistance to client countries on public sector roles to encourage CSR, has developed a set of diagnostic tools, and has commissioned a series of studies on CSR codes of conduct and the challenges facing suppliers in our client countries. The combination of these studies and technical assistance have started to inform related Bank lending operations, and a growth of this activity is expected in coming years.

[There has been significant advance in IFC's work in sustainability, described in IFC's 2002 Annual Report]

30. Individual units in the WBG have their own knowledge sharing programs. An example is MIGA's Investment Promotion Toolkit, published in 2001, which has been distributed to hundreds of developing country clients both public and private, as a comprehensive introduction to good practices worldwide. MIGA also provides a number of online investment information services, i.e., IPAnet, PrivatizationLink and FDI Xchange.¹¹

Box 8: WBG work on corporate governance

Corporate governance assessments have been completed for 25 countries so far as part of the Report on the Observance of Standards and Codes (ROSC) initiative. The assessments follow a standard template which has been updated recently in the light of experience with conducting the assessments. One of the most important lessons learned from the preparation of corporate governance country assessments is that laws, rules and regulations in developing countries and transition economies are seldom enforced effectively. Understanding and improving enforcement mechanisms will be one of the objectives of the WBG's work on corporate governance going forward.

The WBG is actively participating in the revision of the OECD Principles of Corporate Governance. IFC's Global Financial Markets team has made some major progress in developing its methodology for corporate governance improvements at the company level - this is being rolled out through training for investment officers. WBI is developing a web based corporate governance training program, with the ECA region piloting a series on risk management. The Global Corporate Governance Forum (GCGF) has established a global version of an investor council, through its Private Sector Advisory Group, which has engaged in practical dialogue with governments and the private sector in Brazil, Russia, South Africa and most recently China. Brazil exemplifies the impact such dialogue can have on reforms—here two recent IPOs in infrastructure (in water and toll roads) have raised over \$300 million following corporate governance reforms induced by the dialogues. GCGF also helps run the World Bank-OECD Roundtables to promote developing country dialogue on the international standards and codes in the field. The Forum's capacity building work is well underway with regional networks being established to promote director training in East Asia, Latin America, and ECA.

31. FIAS has started a pilot initiative to help build capacity in client countries to carry out self-assessments of investment climate conditions. Latvia is the first pilot country; here FIAS is helping to build in-country capacity to carry out administrative barriers studies. The investment climate surveys and assessments are being carried out in collaboration with local institutions, such as government agencies, private sector collective bodies, think tanks, consulting firms and universities. Examples include the Confederation of Indian Industries (CII), the Bangladesh Enterprise Institute (BEI- a private sector think

¹¹ IPAnet (www.ipanet.net) provides FDI information on the Web; Privatizationlink (www.privatizationlink.org) provides support for practitioners structuring transactions, and the opportunity to post privatization opportunities; and the latest service; FDI Xchange uses customized e-mails to update clients and share information about investment opportunities worldwide (www.fdxchange.com).

tank cum advocacy body), the Small and Medium Enterprise Development Authority of the Government of Pakistan, the Nigerian Manufacturers Association and the Kenya Institute of Public Policy Research and Analysis (KIPPRA). This collaborative work has build capacity in these institutions to carry out such assessments. In India, CII is now playing the lead role in conducting investment climate surveys in a number of states. There has also been knowledge diffusion across countries--CII helped trained BEI staff in conducting the survey in Bangladesh. The WBG will continue to work with local institutions in carrying out the surveys and assessments and help build in-country capacity for carrying out similar surveys in the future. Similar capacity building work is envisaged with regard to the Doing Business indicators.

B. Private Participation in Infrastructure

32. The PSD strategy stresses the critical need to provide better and broader access to basic services. To this end, it proposes continued support for private participation in infrastructure (PPI) focusing on establishing the policy framework under which private provision is likely to make a positive contribution, and on developing regulatory regimes, institutions and capacity to effectively supervise the private sector. The strategy recognizes the critical on-going role of government programs, which PPI will supplement. The approach to PPI, as articulated in the PSD strategy, is built upon the lessons of recent experience and addresses emerging issues in this area. A comprehensive analysis of the emerging issues in private provision of infrastructure carried out by PSAS during the past year updates this assessment.¹²

1. Emerging issues in private participation in infrastructure

33. The 1990s saw a rapid and widespread move by governments round the world to involve the private sector in the provision and financing of infrastructure. Developing countries saw investment of nearly \$755 billion in nearly 2,500 private infrastructure projects over the period 1990 to 2001. However, annual investment flows peaked in 1997, and have since dropped by more than half. There have been high profile renegotiations of projects in many developing countries and several projects have been cancelled or re-nationalized. Many traditional investors and operators are shying away from infrastructure projects in developing countries. There are signs of public discontent towards the private provision of infrastructure services, particularly electricity and water.

34. These problems do not undermine the basic rationale of private participation. The weight of evidence shows that well-designed private participation schemes, particularly those where commercial risks are effectively shifted to the private sector, can lead to more efficient provision and significantly better quality and quantity of infrastructure

¹² Clive Harris, "Private Participation In Infrastructure in Developing Countries: Trends, Impacts and Policy Lessons", World Bank Working Paper No. 5, March 2003; [http://rru.worldbank.org/Documents/PPI_Review_PRWP\[1\].pdf](http://rru.worldbank.org/Documents/PPI_Review_PRWP[1].pdf).

services. Rather, these problems confirm the fundamentals of efficient private provision while also suggesting the need for some innovative approaches based on these fundamentals in order to address client needs and concerns.

35. Many of the problems originate in the failure to carry out fundamental policy and institutional reforms, in particular pricing reforms including effective means for subsidizing poor consumers, and setting up credible regulatory frameworks and contracting arrangements. In some cases governments may have understood that price increases and subsidies were required but over-estimated the ability to manage the politics of reform and under-emphasized the need to make provisions for poor people. In many cases, private investors had unduly optimistic expectations about the ability of governments to carry out the reforms as well as the level of effective demand for services. In some cases, the limited development of domestic financial markets has led to substantial currency mismatch in the financing of private infrastructure projects making them vulnerable to currency devaluation. In some regions, especially in Africa, the small size of individual country markets may be a disincentive to investors. This suggests the need to also think at the sub-regional level when devising strategies for attracting investment into infrastructure.

36. Going forward, the challenges are to maintain focus on the policy and regulatory framework, both their legitimacy to the public and credibility with investors, build capacity, make judicious use of public-private partnerships and focus on improving access of poor people to basic services. To this end, the WBG is now working on a number of fronts:

- continued support to strengthening regulatory frameworks through support to regional regulatory fora, the development of principles for regulatory frameworks and certification programs for regulatory practitioners, and post-privatization regulation.
- improving the efficiency and accountability of service provision through sound contract design (covering the range of public-private partnerships) and targeting of subsidies, including output-based aid schemes that combine public funding with private provision.
- developing tools that facilitate lending to sub-sovereign entities combining adequate performance incentives and management structures with sound credit judgment.
- developing local financial markets.
- ensuring the transparency of privatization or award processes.

2. Voluntary principles for regulatory systems in infrastructure

37. Regulatory agencies have come to play a crucial role in developing countries in determining the terms under which private investment is attracted as well as the sustainability of reforms. This is a particular challenge for new regulatory agencies in developing countries, which often have to pioneer a new role and make complex decisions in the face of questions over their competence and legitimacy. It is thus critical

for them to quickly establish their professional competence and credibility with stakeholders.

38. This requires strengthening regulatory capacity. Existing initiatives such as capacity building, training and related initiatives (such as regional forums) play an important role in building this capacity. A complementary task is the development of principles for assessing the extent to which capacity has been built. Currently, there are no global principles for assessing regulatory systems or for measuring the knowledge of individuals working in agencies belonging to these systems. The Bank has, therefore, begun to explore the feasibility and desirability of establishing (i) global principles for the design of regulatory regimes; and (ii) a certification program for regulatory practitioners which would provide a measure of whether individuals have achieved a globally recognized standard of knowledge.¹³ These principles would constitute an attempt to introduce technical rigor into politically charged processes and debates so that there is better balance between autonomy and accountability of regulatory agencies.¹⁴

39. Consultations have led to recommendations that efforts be focused at developing the body of relevant knowledge. This will be undertaken in partnership with a group of leading experts in the area, including the Public Utility Research Center (PURC) at the University of Florida. The World Bank has also begun to explore principles for regulatory agencies and regulatory regimes against which agency performance could be measured. Consultations with regulatory experts indicate sufficient interest in this and highlight the need for further analysis of the implementation challenges involved.

3. Transparency in contractual arrangements

40. The World Bank is preparing an initiative that will enhance the transparency of the principal regulatory instruments---contracts and licenses---governing the delivery of basic infrastructure services to final users in developing countries. The proposed initiative will consist of two main mechanisms: (i) encouraging disclosure through ongoing policy dialogue with governments, including in the context of advising on the design and execution of relevant infrastructure schemes and regulatory frameworks; and (ii) facilitating disclosure---and the benchmarking of approaches between jurisdictions and the dissemination of emerging practices---through the establishment of a dedicated web-site (currently under construction) providing links to publicly accessible web-sites of governments and regulatory agencies that publish private infrastructure contracts and licenses.

¹³ A number of initiatives were taken in 2001-2002, aimed at exploring the feasibility and desirability of developing an individual certification program. These include: a) a needs-assessment covering regulatory agencies in Latin America, Africa, Europe, and Asia; b) a report on the governance and administration structures of various certification programs; and c) a convention of regulatory experts (in May 2002), to discuss the possibility of developing a certification program for regulatory professionals.

¹⁴ There is no suggestion that the World Bank Group would be an agency enforcing such principles.

4. Output-based aid schemes

41. Output-Based Aid (OBA) has been proposed in the PSD strategy as a tool, among others, for supporting the delivery of basic services - infrastructure, health and education. OBA schemes help introduce the commercial discipline and efficiency of private providers in the provision of basic services while also addressing affordability concerns. Under such an approach, disbursement of the public funding (including the proceeds of World Bank loans or grants) would essentially be tied to the delivery of specified outputs or services by the providers. The providers would bear significant performance risks related to the delivery of such services. This contrasts with the traditional approach of directing public funding to the financing of assets where tax payers pay even if there is non-performance. OBA schemes thus provide strong incentives to achieve results on the ground.

42. The OBA portfolio currently comprises of 22 pilot operations (See Annex 3 for a list of operations). One of the pilots, the Paraguay Rural Water and Sanitation Project, is under implementation; the others are in various stages of preparation. All of them involve credible commitments both by client government and by the World Bank to pursue operations that incorporate OBA features. OBA projects span several sectors and countries (Box 9). In addition, the joint IDA-IFC Pamir Private Power project (see Section IV), and the Aguas do Amazonas project in Brazil (private water concession) are examples of IFC projects with output-based aid components.

43. A number of activities have been launched to strengthen and enhance output-based features in WBG operations. The Global Partnership on Output-Based Aid (GPOBA) was established in early 2003 to assist in the development of pilot demonstration projects and in documenting output-based aid methods. The GPOBA was initiated with support from the World Bank and DFID with subsequent expressions of interest by other donors to join the facility. A series of internal clinics and workshops for WBG staff was launched in 2002 to share the emerging lessons of experience and broaden interest in the approach. In addition, an internal website and online discussions on the Rapid Response website, as well as publications illustrating case studies, have facilitated information exchange on practical “nuts and bolts” questions.

5. Support for sub-sovereign entities and local currency financing

44. The mismatch between foreign exchange financing and domestic currency revenue has emerged as a major constraint to PPI in many countries. In addition, decentralization and increasing urbanization have placed the onus for providing basic infrastructure services on local governments, which often lack the experience and track record that would enable them to access local capital. At present, IBRD can only lend at the sub-sovereign level with sovereign guarantees and the private sector is reluctant to assume the risk of investment in long term infrastructure projects at the sub-sovereign level. The WBG is responding by developing innovative solutions in both areas, i.e., development of local currency loan products and facilitating lending to sub-sovereign borrowers. One

of the working groups established after the World Bank's January 2003 Implementation Forum is focusing on these issues.

Box 9: Examples of output-based aid projects

Paraguay (Fourth Rural Water & Sanitation Project)

The project component provides connection subsidies through a negative concessions approach in 4 selected towns.¹ Responsive bids for pilot towns were received in 2002 and projects are under implementation. A second batch of target communities is under preparation.

Cambodia (Provincial and Peri-Urban Water and Sanitation Project)

The project provides payments to small scale providers on an output basis to establish and operate small networks in 4 selected towns, subsidies being provided for about 40% of envisaged connections targeting low income households. The project included training to potential bidders on the contracting approach and bids are expected in June '03.

Mozambique (Energy Reform and Access Project)

The project will provide connection subsidies to small scale providers in a concession framework. The first phase of this APL includes about five rural concessions, the first of which, in Northern Inhambane, is currently being prepared and aims to provide connections to 5000 households within five years. Up to 15,000 additional connections are to be financed under the subsequent concessions.

Uganda (Energy for Rural Transformation APL)

The project includes the award of negative concessions for rural services, including public telephone services, public internet access facilities and telecenters in each of 154 rural sub counties in the context of broader sector reform. Subsidy requirements are estimated to be US\$ 6 million, of which the World Bank would provide about US\$ 5 million. Tender documents are currently being drafted.

¹ Negative concessions refer to least-subsidy biddings, i.e., contracts where service providers bid on the basis of subsidies they require, rather than fees they would pay, to obtain the concession.

45. The ability to fund projects in domestic currency will facilitate the financing of projects which are impossible or inappropriate for financing in foreign exchange. It may help reduce default risk through a better matching of a project's debt service with its revenue flows.

46. IFC's equity investments and some quasi-equity investments are denominated in local currencies but senior loans have traditionally been made in major OECD country currencies. Responding to increasing client-interest in local currency borrowing, IFC has developed a number of local currency financing products. These include: a) loans denominated in a local currency in which a long-term swap market exists between dollars and the local currency; a recent example being A loans in Indian Rupees; b) risk management products, such as forwards and swaps, linked to local currencies; c) local currency guarantees, and d) local currency denominated credit lines.

47. In addition, World Bank guarantees can now cover local currency financing. World Bank support to intermediaries, discussed below, can also have an important role in

catalyzing local currency resources to infrastructure. The World Bank is also studying the feasibility of liquidity backstopping facilities to smooth the impact of devaluations on increases in consumer tariffs while maintaining viability of the concessions.

48. IFC's Tlalnepantla Municipal Water Conservation project in Mexico is an example of a local currency guarantee which is intended to facilitate sub-sovereign financing. Under this project, approved in February 2003, IFC is issuing a partial guarantee (of up to \$3 million) to a private Trust to help it raise funds from the local capital market. The Trust will finance water conservation projects carried out by a local water utility that is owned and operated by the municipality of Tlalnepantla. The venture will help create a financial instrument that would provide creditworthy municipalities with access to long term capital for essential infrastructure investments while also supporting private participation in municipal capital markets. MIGA has also been increasingly active in local water projects. For example, for a water and sanitation project in Guayaquil, Ecuador, MIGA recently provided an \$18 million guarantee to a foreign investor against the risks of expropriation and war and civil disturbance, including the wrongful calling of a performance bond.

49. In order to scale up such initiatives, the WBG, in collaboration with other donors, is developing products that will help sub-sovereign borrowers obtain financing without needing sovereign guarantees. An example is GuarantCo, a soon-to-be operational facility, which will offer partial guarantees on issues of paper by private sector infrastructure service providers and possibly municipalities and/or public sector authorities in lower income developing countries. It will tap institutional funds within these markets, help develop local government capacity to evaluate risk and manage investments, and help deepen local and regional financial institutions and capital markets. GuarantCo was initially conceived by the Swedish International Development Cooperation Agency (SIDA), but is now being developed under the auspices of the Public-Private Infrastructure Development Group (PIDG), of which the WBG is a member.

50. While these products are rolled out, there will be a continued need for some form of government support, including in the form of guarantees or counter-guarantees. The World Bank will have a key role in this respect through lending or guarantee support to intermediaries, support to other forms of pooling arrangements and partial risk guarantee facilities, with appropriate fiscal intercepts to encourage financial discipline.

C. Private Provision of Social Services

51. The PSD strategy states that the key challenge in the social sectors is to build nation-wide systems that provide affordable quality access, in particular, free access to basic health and primary education. In this context, it emphasizes the fundamental responsibility of governments to ensure affordable and universal access to basic social services through policy and regulatory development, public provision of basic services and funding of programs that have positive externalities or address affordability concerns.

The PSD strategy also takes into account the fact that, alongside the public sector, the private sector has played an important role in providing health and education services in a number of developing countries for many years. For example, more than half of all basic health services are provided by private parties in low-income countries. In Sub-Saharan Africa, about a third of primary education is provided privately, much of it by not-for-profit organizations, including religious charities. This reflects lack of access to publicly provided services. Recognizing the potential role of the private sector in supplementing public sector efforts to provide universal access, several governments have shown interest in exploring options to tap private initiative for social service provision.

52. Responding to this, the PSD strategy proposes that the WBG should help clients assess and, where desirable, implement options for private provision of social services. The strategy points out that public policy and funding functions are separable from service provision and governments have the option to tap private initiative, while providing funding to deal with affordability concerns. It thus proposes that WBG's incipient work on private participation in the social sectors continue, including more assessment of options for private provision.

53. In line with this, there has been some experimentation during the past year with private provision in health and education. Within the Bank, the Private Sector Advisory Services (PSAS) Department has conducted various research, training and operational activities in collaboration with the health anchor, various thematic groups and regional PSD and health sector counterparts. Feedback from World Bank staff indicate a clear need for technical support in developing operations that increase access and improve the quality of health and education services for the poor. Key and recurrent issues include: (i) market structure issues, i.e., how to promote competition among and between private and public providers of health care services, (ii) development of regulatory and accreditation frameworks, (iii) the design of incentive and subsidy schemes, and (iv) the design and award of contracts. The design of output-based aid contracting schemes is also an important component of the technical advice. In all these areas the lessons learned from infrastructure provided valuable insights into how such issues could be addressed in health and education related operations.

54. *World Bank's operational work.* Examples of recent operational work in this area include several with an output-based aid approach (Box 10). Examples of other activities include support to a private insurance scheme to assist poor communities access a broad package of health services (Bangladesh), assisting government with the design of a regulatory framework to oversee private providers of health care services (Rajasthan, India), and technical assistance to a pilot project in technical and vocational training, including exploring with the government different options for private sector participation (Egypt).

55. *IFC investments and advisory services.* IFC has built up considerable expertise in the financing of private health and education. Its Global Practice Group for Social Sectors graduated to become an independent department in FY02. IFC provides project financing through a variety of financial instruments including loans and direct equity investments.

This financing is normally in hard currencies but, where conditions are suitable, IFC also considers local currency financing. To date, the majority of IFC healthcare investments have been made in individual hospitals or hospital groups, and mostly in the form of debt financing. IFC has also financed a number of pharmaceutical production and distribution projects. A typical IFC-supported project in health and education costs more than \$5 million; however, IFC is currently considering other instruments better suited to respond to the needs of smaller projects, such as stand-alone outpatient clinics or networks of clinics. In the area of education, IFC has been largely involved in tertiary education and training and has supported the development of private universities in developing economies.

Box 10: Output-based contracting initiatives in the social sectors

Uganda: Technical advice to the Ugandan government in transitioning from an input-based partnership arrangement with NGOs to a contracting scheme that will link government payments to the delivery of outputs and outcomes.

Kenya: Advising the government on how to develop a performance-based contracting approach with general practitioners in delivering both primary and secondary care services. Part of this strategy also involves assisting the government in utilizing various incentives to promote public-private referrals systems for such conditions as HIV-AIDs and Tuberculosis.

India: Assistance to government with the development of output-based contracting regimes for maternal and child health services and certain diagnostic services.

Bangladesh: Help in designing the subsidy, contract, operating manual and institutional framework to support an OBA scheme in two of the poorest districts in Bangladesh.

56. The IFC arm of PSAS assists governments in structuring and implementing public-private partnership transactions to improve public services and maximize public benefits. In the health sector, IFC's advisory focus is on working with governments and national health insurers in contracting with the private sector (for-profit and not-for-profit) to expand and improve health care services for publicly-funded patients. An example is IFC's advisory assignment in FY03 with Romania's Ministry of Health and Family. Several other countries have also expressed interest in IFC advisory assistance in contracting for health services.

57. *Training, research and knowledge dissemination.* Given the pioneering nature of the work in this area, there has been an emphasis on training, research and knowledge dissemination. A variety of training seminars and clinics were organized in the past year. These courses were co-sponsored by the PSD anchor and related thematic groups with contributions from research institutions or practitioners, such as the U.S. Joint Commission on Accreditation, the London School of Hygiene and Tropical Medicine and the Johns Hopkins School. Examples of work in the area of research include joint-research with the Rockefeller Foundation on ways to promote social franchising in the areas of communicable disease control and joint research between the PSD and health

anchors on different incentive schemes in working with individual and small-scale practitioners.

III. SUPPORT TO PRIVATE FIRMS

A. Financial Support

58. The PSD strategy proposes increased commercial disciplines on the WBG to help improve the performance of public financial and advisory support for private entrepreneurs, including firms of all sizes. This will require that financial credit terms are not subsidized and that credit is preferably provided via the IFC, so as to limit the exposure of domestic taxpayers in poor countries to credit risk. Subsidies to stimulate supply response by private firms should be targeted transparently in ways that are performance-based, and to purposes that truly justify a subsidy, such as some types of institution- or capacity-building activities or other activities with identifiable externalities.

59. To this effect, the strategy proposes that the operational policy that governs financial intermediary operations of IBRD and IDA (OP 8.30) be redrafted and administered so as to cover intermediary operations for rural credit and social development/social funds, which previously escaped such discipline. For IFC it proposes that a minimum target rate of return be required on its lending and investment business that reflects its full risk-adjusted weighted average cost of capital. Subsidized operations, as is already the case for capacity-building for small and medium enterprises (discussed in section IIIB), are to be funded transparently out of net income. A prerequisite for this is the unbundling of IFC's commercial and non-commercial activities. Finally, the PSD strategy calls for improved methodologies for evaluating impact of direct support programs.

1. Revision of OP/BP 8.30

60. The Europe and Central Asia (ECA) Region is the pilot in developing the revisions to, and proposed implementation process, of OP/BP 8.30, as recommended in the PSD Strategy. The ECA region has developed proposed revisions to OP/BP8.30, which will be the basis for consultations across regions. The consultations will take two tracks: the first is the consultation across regions, through representatives appointed by the Financial Sector Board regional managers/directors, with the understanding that each representative will conduct consultations with the relevant sector units in each region. The second track is consultations with the various concerned sector boards (such as Rural Development, Urban Development and Private Sector Development) and Operations Policy and Country Services. The consultations are expected to take place in May/June 2003. The amendments will bring all lending operations involving credit lines and other forms of financial intermediation (e.g., rural credit cooperative programs, social funds and microcredit operations) under the purview of OP/BP 8.30, with the exception of emergency recovery operations and other types of operations which the Financial Sector Board determines, either generically or on a case-by-case basis, do not present the

systemic issues sought to be regulated by OP/BP 8.30. It is anticipated that any such exceptions would occur rarely and only in extraordinary circumstances. Prior to making any such exception, the Financial Sector Board would consult with, and take into account the views, of any other Network affected. The proposed new OP/BP will also be considered in the light of the investment lending modernization and simplification process, launched after the drafting of the PSD Strategy. The Financial Sector Board, in consultation with relevant sector boards, will also propose quality assurance processes for financial intermediation operations, as well as financial intermediation components of other investment operations.

61. As part of the pilot, the ECA Region has also undertaken to prepare guidelines and a "toolkit" of procedures and documentation necessary to implement and supervise financial intermediation operations and components, whether undertaken through the banking system or through other forms of financial intermediaries. These procedures, guidelines and documentation have been prepared for "traditional" credit lines. These proposed guidelines will be the basis for the consultations to be held within regions and across relevant sector boards, as described above. Once these core procedures, guidelines and documents have been agreed, the Financial Sector Board, will discuss their implementation with IFC, the Consultative Group to Assist the Poorest (CGAP), and Bank networks whose operations typically include financial intermediation components (e.g., Rural Development and Human Development) with a view to adapting the core approach to the specific conditions and needs of these sectors.

62. It is anticipated that work on OP/BP 8.30, as well as the core principles, guidelines and documentation, will be completed during FY03 and work on the application of these procedures, guidelines and documentation to other sectors will be completed in the first half of FY04. As noted above, the OP/BP work will be considered in the light of the ongoing investment lending modernization and simplification process.

2. Unbundling IFC's commercial and non-commercial activities

63. On January 15, 2003, IFC presented a technical briefing to the Board on unbundling commercial and non-commercial activities. Major types of non-commercial activities analyzed included support for SME development, work on environmental sustainability and coordination, Trust-Fund related activities, small offices in frontier countries with limited IFC investment, and certain operations related to IFC governance (Board, OEG, CAO). There are also synergies between the commercial activities of the IFC and its technical assistance. Technical assistance work may help improve returns to IFC investments and can also lead to new business opportunities for the Corporation. However, while these activities have incremental development impact and are important to building the private sector in developing countries, they also increase IFC's costs and lower its reported profitability.

64. Overall, it was estimated that in fiscal 2002 the non-commercial costs amounted to about \$100 million, while costs of commercial activities were about \$260 million. In addition, approximately another \$100 million per year of donor funds are administered by

IFC. In other words, the IFC non-commercial operations expenditures and the funding provided to IFC-managed operations from donors are almost equal to IFC expenditures on commercial operations.

65. In a limited number of investments, IFC caps interest rates it charges below prevailing market rates in environments with very high risk premia. It was estimated that together the costs of non-commercial activities and revenue loss due to interest rate caps represent approximately a two percent reduction in IFC's return on equity. Although there are many complexities in the development of a benchmark commercial return for IFC, comparisons were made of IFC commercial returns with commercial banks in the U.S. and Europe and also with other private sector-oriented international financial institutions (IFIs). It was found that in general IFC's returns are somewhat below those of commercial institutions, but somewhat above most other IFIs.

66. Looking forward, IFC will be considering the implications of these findings further in upcoming documents, such as the Budget Paper, as well as in upcoming CASs and regional strategies. Issues to be covered include the appropriate allocation of resources among the various types of IFC activities, the split of IFC investment and non-investment activities in frontier countries and middle income countries, measuring performance and impact of non-commercial activities, identifying financial resources to support non-commercial activities, and on-going benchmarking of returns for IFC's commercial operations.

B. Capacity Building of SMEs

67. Support to capacity building of enterprises, especially SMEs, and institutions serving such enterprises, is an increasingly important component of WBG activities. The WBG's SME and PSD strategies have highlighted the evolving nature of such support, in response to the lessons donors have learned from many years of SME support programs.¹⁵ The new approach emphasizes the enabling environment and market development interventions that support the demand and supply side of SME support services. This is reflected in WBG's work in: a) the growing importance of non-financial support; b) the shift away from direct support to enterprises to working with intermediaries, and c) some degree of focus on the enabling environment. Increased efforts are being made to exploit the synergies between direct support activities and the work on the overall business environment. Efforts are also being made to: a) improve the impact assessment of SME programs; b) expand work on linkage programs, focusing on the relationship between large international companies and small local businesses to

¹⁵ One of the first articulations of the new approach is in International Labor Organization (ILO), 2001. "Business Development Services for Small Enterprises: Guiding Principles for Donor Intervention." Prepared by the Committee of Donor Agencies for Small Enterprise Development at the World Bank, Washington D.C.; Geneva: International Labor Organization.

strengthen their supply capacity, and c) increase collaboration among the various actors involved, including different units of the WBG, the donors and practitioners in exchanging lessons and transfer of best practices.

68. IFC's SME facilities, also known as Project Development Facilities (PDFs), are the key vehicles for the WBG's non-financial work on SME support. There are currently eight such facilities active with 31 offices around the world (see Annex 4) and two new facilities are under preparation (for Indonesia and Latin America). There is a similar initiative for the former Soviet Union, i.e., the Private Enterprise Partnership. PDFs also work with financial intermediaries. About 700 IFC staff work primarily on SME issues, most of them in these facilities and largely based in the field. The shifting approach to SME support described above necessitates significant changes in the manner in which PDFs operate. Some of these changes are already evident and more is on the agenda.

1. Provision of business development/advisory services: the move towards a wholesale approach

69. The PDFs are shifting from direct retail service provision to a greater role in facilitating the creation of high-quality local markets for SME business development services. They are focusing on building the capacity of local advisory, technical and financial service providers, such as consultancy companies, training institutions, NGOs and banks. A major tool for this is the SME Capacity Building Facility (Box 11). Increased attention is also being given to working with large companies to build their capacity to develop stronger local supply chains for production and distribution of products. In future, a lot of the capacity-building work will be undertaken by supporting best practice intermediaries who will impart their skills, good practice and experience to local organizations. PDF's will continue to provide some direct support to firms but this will be restricted to initiatives with a potentially high demonstration impact.

Box 11: SME Capacity Building Facility

This is a grant window for pilots and partnerships funded annually with \$7.1 million of IFC's own funds that typically attract additional donor funds on a roughly 4:1 basis. Since its launch in 2000 it has built a portfolio of more than 70 active projects that are generating new learning that can be reapplied and scaled up for broader application in IFC. Examples include a partnership with the world's largest microfinance network, US-based ACCION International, that has helped facilitate the organization's expansion into Africa and led to the IFC-supported \$18 million ACCION investments in a microfinance holding company; close involvement with best practice organizations from Denmark, Canada, and the US that help build capacity in African and Asian business associations to effectively engage in policy debates in their countries; and a deepened relationship with FUNDES, a Costa Rican-based SME support organization with 10 country affiliates across Latin America.

2. Access to capital

70. PDF's have traditionally worked with SMEs to make them bankable and develop financing plans to present to local and international funding sources. More recently, PDF's have become heavily involved on the supply side of SME financing by working with local financial intermediaries to improve their SME finance strategies and improve policies, procedures and products for SMEs. This will become an important area of expertise going forward with many of the PDF's. While direct financing to SMEs is important, the PDF's are emphasizing making small business financing a profitable commercial endeavor for financial institutions.

3. Linkage to investment climate work and inputs to CASs and Bank projects

71. In the past, PDF's did not focus on catalyzing change in the business climate. However, their hands-on experience with SMEs provides them with valuable insights about the business environment in which SMEs operate. PDFs are now making increased efforts to incorporate the lessons they learn into the World Bank's policy reform dialogue with governments as well as to develop concrete, direct initiatives, such as one-stop shops for regulations or improved advocacy on behalf of SMEs. Greater effort is also being made to support the Bank's investment climate assessments in countries that the PDFs cover and identifying areas where PDFs can help identify and implement the Bank's enabling environment recommendations.

72. The above work is complementary to the PDFs' work on strengthening public-private consultative mechanisms and advocacy activities in business associations (see examples in Section II). The SME department is collaborating with practitioners experienced in public-private dialogues to develop and apply best practice approaches in this area.

73. Originally, the objectives of PDFs were closely tied to IFC regional strategy. Now, increasingly their goals and activities are being incorporated into the joint IFC/World Bank CASs. For example, the establishment of the Indonesia Enterprise Development Fund is an important component of the Indonesia Country Assistance Strategy and Private Sector Strategy. As part of its World Bank mainstreaming activities, the SME Department is providing inputs to CASs and PRSPs in selected countries where SME development has been seen to be a priority activity and not addressed by other partners. Examples include Mali and Nigeria. The objective is to raise awareness of critical SME issues at the outset so they can be well incorporated into future program design.

74. In the past, technical assistance provided by PDFs, such as the Africa Development Project Facility (APDF), was mostly linked to IFC investments by helping to catalyze deals. Going forward, the PDFs are integrating more of their activities to the Bank lending and policy advisory programs. An ongoing example of this is the active participation of the Balkans PDF (SEED) in the preparation and implementation of the Bank's Bosnia Business Environment Adjustment Credit Project.

4. Evaluation and impact analysis methodologies

75. WBG work on SME support, in particular the work of the PDFs, are now regularly monitored and are subject to a variety of independent evaluations.¹⁶ However, there remains scope to improve the evaluation/impact methodologies. Evaluations of SME programs have traditionally been limited to measurement of program inputs and outputs. The approach needs to be broadened to include assessment of impact, e.g., firm-productivity, institutional performance and market development. Issues that need to be addressed in developing an appropriate evaluation methodology include attribution of results to program interventions (this would require use of control groups), additionality and selection bias.¹⁷ With DGF support, the SME Department, in collaboration with the Operations Evaluation Group (OEG) of IFC and the Operations Evaluation Department (OED) of the World Bank, will be working with external partners to develop and trial new methodologies for evaluating the efficiency and impact of SME programs.

IV. WORLD BANK GROUP ORGANIZATION AND PROCESSES

76. The effective implementation of the PSD agenda depends critically on the working of the WBG's internal organization and processes. This includes: a) the processes by which the strategies and work programs of the WBG are aligned with country needs and priorities, b) the manner in which different parts of the WBG collaborate and coordinate, both at the global and country levels, c) the nature and extent of partnerships with other actors, notably other donors and the private sector, and d) the processes by which the outcome of WBG activities are assessed by clients, other stake-holders and WBG management. Internal coordination, external partnerships and results measurement are thus heavily emphasized in the PSD strategy. Much of the previous on-going work in these areas continued during the past year; in addition, a number of new initiatives were taken, some already mentioned in earlier sections.

¹⁶ In 2002, IFC's Operations Evaluation Group commissioned a rigorous independent look at one of the SME facilities, i.e., the Mekong Project Development Facility (MPDF). Based on 170 completed client surveys and 60 in-depth interviews as well as an extensive review of MPDF financial and operating data, the report found that the Facility had been successful at achieving most of its intended outcomes. The report also indicated several ways to refine MPDF's business model that are currently being adopted as part of the facility's new five-year funding cycle.

¹⁷ Kris Hallberg, "A Market-Oriented Strategy for Small and Medium-Scale Enterprises", IFC Discussion Paper No. 40, April 2000. Additionality refers to the question of whether the observed changes would have occurred anyhow in the absence of the program. Selection bias refers to the possibility that firms which obtained support from the programs were, on average, better to start with.

A. Alignment of the WBG's PSD Approach and Work Program with Country Needs and Priorities

1. Implementing the PSD strategy in the regions

77. The WBG's PSD strategy was written for the Group as a whole and provides an overarching framework for the individual strategies of the constituent institutions, such as the IFC and MIGA, and units such as the SME Department.¹⁸ For the World Bank, the PSD strategy has called for the preparation of follow-up regional PSD strategy implementation plans for all regions. These are intended to be the bridge between the WBG's overall PSD strategy and the country-specific needs and priorities. According to the PSD strategy, three regions were to prepare regional PSD strategy implementation plans by end-FY03 with another three completing the exercise by end-FY04. The PSD sector board has developed a template to guide the preparation of the implementation plans. Work has begun in all regions; the plans are expected to be delivered on schedule.

78. The regional strategy implementation plans will describe the PSD landscape and key challenges in each region, taking into account sub-regional differences, if any. They will discuss the recent work of the WBG and other actors in promoting PSD in the region and lay out the future directions of the WBG's PSD support to the countries in the region. This will include a discussion of the demand for PSD work as emanating from the clients and country directors, and the range of lending and Analytic and Advisory (AAA) work that will be deployed to meet these demands. The plans will spell out the organizational and staffing implications of implementing the work program and help identify the areas in the region's PSD work that require effective coordination between different parts of the WBG. The plans will also identify areas where substantial scope exists for partnering with other development agencies and the private sector.

2. PSD in PRSPs and other client strategies

79. The treatment of PSD issues in the CASs will be shaped by the countries' own priorities as articulated in PRSPs or other development strategy documents. Developing effective processes for engagement with the private sector in client countries is a key step towards ensuring that PSD issues are adequately addressed in the client's own development strategies. As is evident from the discussion in Section II, the efforts of the PSD family are now geared towards:

¹⁸ The relevant strategies are articulated in "IFC Strategic Directions." *Report IFC/R2001-0035*, March 16, 2001, updated in "IFC Strategic Directions", February 24, 2003; "MIGA Review 2000", *Report MIGA/R2000-30*, June 30, 2000; and World Bank, "Small and Medium Enterprises (SMEs): Sub-sector Strategy", *Report R2000-67*, May 4, 2000.

- working with client countries to help them ensure that the private sector has a strong voice in the development of the country's own development strategies, policies and programs, especially PRSPs,
- ensuring that the views expressed in the consultations are incorporated into WBG strategies (such as CASs) and operations.

80. Enhancing private sector participation in PRSPs will be a priority item in the WBG's PSD agenda. This will build upon the good practice cases described in Section II and the overall experience with private sector consultations. The specific initiatives would be guided by the following objectives: a) help build capacity in the developing country private sector to analyze and understand investment climate issues, especially those dimensions most relevant for poor people, and develop appropriate interventions in the area, b) develop an analytic framework and knowledge base on the links between investment climate and poverty reduction, and c) facilitate sharing of knowledge, expertise and experience among private sector representatives (and other stake-holders) working on PSD issues in PRSPs. The joint WBI-Private Sector network learning program on investment climate, mentioned in Section II, will be an important vehicle for implementing this agenda.

3. PSD in the WBG's country assistance strategies

81. The PSD Sector Board is currently developing a program to better mainstream the treatment of investment climate issues in CASs and the Bank's operations. The program will focus on a select number of countries that have ongoing/planned ICAs and upcoming CASs. The PSD Sector Board will identify the focus countries in consultations with the Regions, taking into account both the extent and significance of investment climate problems, and the countries' commitment and readiness to address them. To support this task, PSAS, in collaboration with other parts of the WBG, will maintain a database with country-specific information on the state of the investment climate in the country, on-going programs of the WBG and other partners to help improve the investment climate, progress in implementing the programs and impact on the ground.

B. Collaboration and Coordination within the WBG

82. Many entities within the WBG are involved in the implementation of the PSD agenda. In addition to the IFC, MIGA and the Bank regional vice-presidencies, several specialized groups have major roles. These include FIAS, the SME department, and the Investment Marketing Services (IMS) Department of MIGA. Several sectors/networks in the World Bank work on PSD issues. These include, in addition to the core PSD family, the rural development, finance, legal, PREM and infrastructure sectors/networks. Some work on PSD-related issues, i.e., private provision of social services, is also being done in the human development network. Effective collaboration and coordination among the various parts of the WBG are needed if duplication and conflicting agendas are to be avoided and synergies are to be maximized. These challenges are being addressed

through better alignment processes, notably through improved analytics, as exemplified by the work on investment climate assessments.

83. The work on investment climate assessments is an attempt to deal with the problem of multiple diagnostics and scattered knowledge. Several units in the WBG have in the past developed diagnostic tools, informed by their own perspectives and priorities. These have traditionally been applied in an uncoordinated fashion, leading often to a survey fatigue without creating a good, comprehensive picture of the PSD conditions in individual countries. As described earlier, broad consensus has now been forged on a core survey instrument and the specialized modules accompanying it. Expertise and resources from the regions, the center, WBI, IFC and multiple networks/departments (including PSD, Infrastructure, PREM, Rural, SME and Trade) are being brought together for the assessments. The overall efforts to mainstream investment climate issues, and PSD issues in general, in CASs and World Bank operations will lead to greater collaboration between the PSD family and other networks in the World Bank, in particular PREM.

84. Efforts are also being made to enhance IFC contributions to the World Bank's country strategy and lending work. IFC has been involved in several joint-CASs, the majority of which are in middle-income countries.¹⁹ IFC staff also provide inputs to other CASs, participate in Bank-government dialogue outside the CAS process, provide information on business impediments related to IFC projects in sectors where the Bank is working with the government, and provide information to the Bank to help with a particular Bank project or ESW work. Approximately 40 percent of joint CASs have been in IDA countries. Mechanisms are now being explored to increase IFC involvement in the CAS processes for low-income countries, as well as to enhance the sharing of IFC knowledge of country conditions with the Bank. IFC's increasing focus on technical assistance work in frontier countries is likely to broaden the number of countries where IFC can provide valuable input regarding the private sector business environment, and the Corporation will seek to leverage this knowledge to enhance the investment climate analysis in CASs.

85. An example of this, mentioned in Section IIIB, is the increased effort to engage the SME PDFs in investment climate work. The roughly 700, mostly field-based, staff working in these facilities acquire considerable knowledge about the investment climate conditions in their countries through their day to day work with private enterprises. In the past, such knowledge had remained largely untapped and the PDFs had focused almost entirely on specific transactions. Now, increasingly, the PDFs are paying attention to broader issues through their own analysis of the business environment, providing inputs to the World Bank's work on the investment climate and through catalyzing private sector engagement, including in the PRSP processes (see Box 4). In the same vein, MIGA is defining a new approach to its involvement in CASs that would allow it to both add to, and receive greater value from, the CAS process. The new approach, to be piloted over the next year in three priority countries, is expected to better serve host countries' development strategies, while at the same time allowing MIGA to position its technical

¹⁹ Reviews of CASs have shown that joint IFC-Bank CASs are, overall, of better quality than other CASs. See World Bank, "Country Assistance Strategies: Retrospective and Implications", May 22, 2000.

assistance and marketing of guarantees more effectively. The approach should also allow MIGA to better contribute to the diagnostic investment climate work being undertaken by the World Bank and IFC.

86. Within the World Bank, the PSD family has enhanced collaboration with several other networks, especially in the context of investment climate work. This includes partnerships with the rural development family on rural investment climate surveys, the trade and transport networks on trade facilitation issues, and the urban development department on city-level investment climate issues. As mentioned in Section IIC, some joint work is being done with the human development network on private provision of social services while there is a continuing collaboration with the various infrastructure sectors on PPI issues.

87. Considerable scope exists in exploiting synergies between the financing instruments of the World Bank, IFC and MIGA. An important challenge for the WBG is to exploit the synergy between the commercial discipline and private sector orientation of IFC financing and the potential of IDA funds to address affordability concerns by subsidizing poor consumers. A recent example of how this challenge is being met is the Pamir Private Power Project in Tajikistan, approved in June 2002 (Box 12).

88. An example of IDA and MIGA cooperation is a guarantee facility being jointly prepared by them to catalyze private investments in small and medium-sized infrastructure and privatization projects in eligible Union Economique et Monetaire Ouest Africaine (UEMOA) member countries. This facility will help mitigate certain government performance risks which currently constrain investor interest. IDA and MIGA will each provide US\$70 million of support for the Facility of the total Facility amount of US\$140 million. IDA guarantees will cover private financing against sovereign default on specific covered obligations to a project. MIGA will provide investment guarantees against certain non-commercial risks to eligible investors for qualified investments in developing member countries. The facility will be administered by Banque Ouest Africaine de Developpement (BOAD).

Box 12: Pamir Private Power Project

The Pamir Private Power Project in Tajikistan, approved in June 2002, involves joint IDA-IFC financing with equity participation by a private sponsor and grants from the Swiss government. It has an output-based aid component whereby funds from the Swiss grant and additional funds generated through the spread between the IDA loan rate and the on-lending rate (i.e., the rate at which the government will on-lend to the project) will be provided to the private service provider upon delivery of electricity services to targeted beneficiaries. IDA's concessional lending will also help keep the overall price of electricity low and help reconcile the commercial objectives of the private sector and the social objectives of keeping the electricity tariffs as low as possible. The private sponsor, the Aga Khan Fund for Economic Development (AKFED) will provide 70% of the equity (\$8.2 million) with the remaining 30% (\$3.5 million) coming from IFC. In addition, there is a \$4.5 million loan from IFC and a \$10 million loan from IDA besides the Swiss grant.

89. In the SME area, the Africa Region of the World Bank, the SME Department and IFC are preparing a joint initiative to support the development of micro, small, and medium-sized enterprises (MSMEs) in Africa through integrated country-level strategies in three key areas: (i) investment climate and enabling environment for MSMEs; (ii) access to finance; and (iii) business development services to build capacity in MSMEs. This will be piloted over the next three years in eight countries by bringing both existing and additional resources (IDA, IFC and other IFIs, SME Capacity-Building Fund, other donors) to bear in a coordinated way, together with governments and other stakeholders. It is expected that the framework and an initial group of three pilot countries would be presented to the Board within the next few months, with subsequent countries presented as comprehensive programs are prepared and adequately resourced.

90. To facilitate better alignment among PSD policies and activities across the World Bank Group, a new joint Bank-IFC PSD vice-presidency has been established as of May 1, 2003. In particular, it will help co-ordinate investment climate related activities across the Bank, IFC and MIGA, and improve policy dialogue by bringing WBG perspectives together. It will also help feed WBG input on private sector issues into PRSP and CAS processes. The vice-president will chair the PSD sector board and be part of IFC's senior management group. The vice-presidency will provide a central point of contact with the private sector and represent the Bank and IFC on matters of private sector development externally.

C. Partnerships

91. Effective implementation of the PSD strategy requires the use of partnership approaches. The previous sections have provided several examples of partnerships that encompass areas such as service delivery, diagnostic work, policy development, capacity building and corporate responsibility. The WBG's partnerships can be divided into three categories: a) partnerships with other donors (e.g., financing of investment climate surveys, PPIAF—see Box 13, FIAS and IFC's project development facilities); b) other international institutions (e.g., collaboration with the EBRD and the ADB on investment climate surveys and work with IFAD and FAO on rural development); and c) private sector (e.g., Investor Councils and work on corporate social responsibility). Several partnerships managed outside the PSD family touch upon PSD issues. These include the Water and Sanitation Program (WSP), the Energy Sector Management Assistance Program (ESMAP), the Consultative Group to Assist the Poorest (CGAP), the Information for Development Program (InfoDev), and the Cities Alliance.

92. Efforts are being made to align partnership efforts more closely with the WBG's strategic priorities in the PSD area. A recent example is the establishment of a consolidated Norwegian Trust Fund window for activities related to private sector and infrastructure. A centralized WBG committee, with inputs from relevant sector boards and the IFC committees, now prioritizes funding requests based on a consideration of the WBG's strategic imperatives, replacing the previous decentralized system.

Box 13: PPIAF's support to capacity building*Strengthening of project development and regulatory institutions*

PPIAF has funded the creation or strengthening of 18 institutions dedicated to the sustainable growth of private participation in infrastructure. Located throughout the developing world, 6 of these institutions are regulatory associations or project development organizations established at the regional level. The remaining 12 institutions are predominantly national-level, single sector and multi-sector regulatory bodies.

Training and workshops

PPIAF has also funded 22 training courses, primarily in the field of regulation, that have benefited over 1,200 attendees. On topics of sectoral reform and private sector participation, PPIAF has conducted over 30 international workshops and 150 national-level workshops that have been attended by nearly 7000 stakeholders in PPI, including government officials, donor advisors, journalists, regulators, consumer representatives, labor representatives, non-governmental organizations, investors, operators and financiers.

D. Knowledge Dissemination

93. The PSD family has done some innovative work in the area of knowledge services in the WBG. Two examples are worth highlighting: (i) the Rapid Response Unit, which takes a different approach to advisory services than most other Networks (see at rru.worldbank.org), and (ii) the work of the Infrastructure Regulators' Support Project Team, which was one of three recipients of the President's Award for Excellence in 2002. The first generation of these initiatives included the establishment of the International Forum for Utility Regulation (IFUR). Building upon the work of the IFUR, the World Bank has catalyzed the establishment of two regional forums with complementary objectives, the African Forum for Utility Regulation (AFUR) and the South Asia Forum for Infrastructure Regulation (SAFIR). Among other things, AFUR and SAFIR are offering courses on infrastructure regulation, building upon the World Bank-University of Florida course on infrastructure regulation and using local experts as trainers. In addition to its work on investment climate described earlier, the WBI has learning programs in the area of regulation and financing of infrastructure. The infrastructure regulation program, which is part of the above-mentioned Infrastructure Regulators' Support Project, provides technical training to regulators and promotes local research on infrastructure issues. The training is provided in partnership with local institutions and has modules specifically designed to answer the needs of the poor. WBI's infrastructure finance training program consists of a multi-disciplinary core course and nationally-tailored training activities, covering both new private infrastructure projects and the privatization of existing utilities. The program has established a strong network of regional partners including banks, industry groups and academic institutions.

E. Results Measurement

94. The PSD strategy emphasizes results measurement. This is in line with the increased results orientation of the WBG and global monitoring of the progress in achieving the Millennium Development Goals (MDGs). PSD-related dimensions figured prominently in the IDA13 replenishment discussions, and progress against PSD input and output indicators is being measured over the IDA13 period. Completion of investment climate assessments in a specified number of IDA countries is one of the IDA13 input indicators while a reduction in the average time and cost involved in starting new businesses constitute output indicators.

95. The WBG's work over the past year in developing the tools for systematic assessment and results monitoring in the area of investment climate constitute an integral part of the WBG's evolving results measurement agenda. For example, the Doing Business indicators are being used to monitor progress in meeting the IDA13 output indicators. Since these indicators go beyond aggregate numbers and identify the various components of policy and institutional processes (such as listing each major step in registering a new company with data on the time required to complete each step), they are useful for identifying where the main bottlenecks are and, hence, where reform actions may focus. This is illustrated in Figures 2-3, which show the changes over time in the area of business registration in Pakistan.

Figure 2

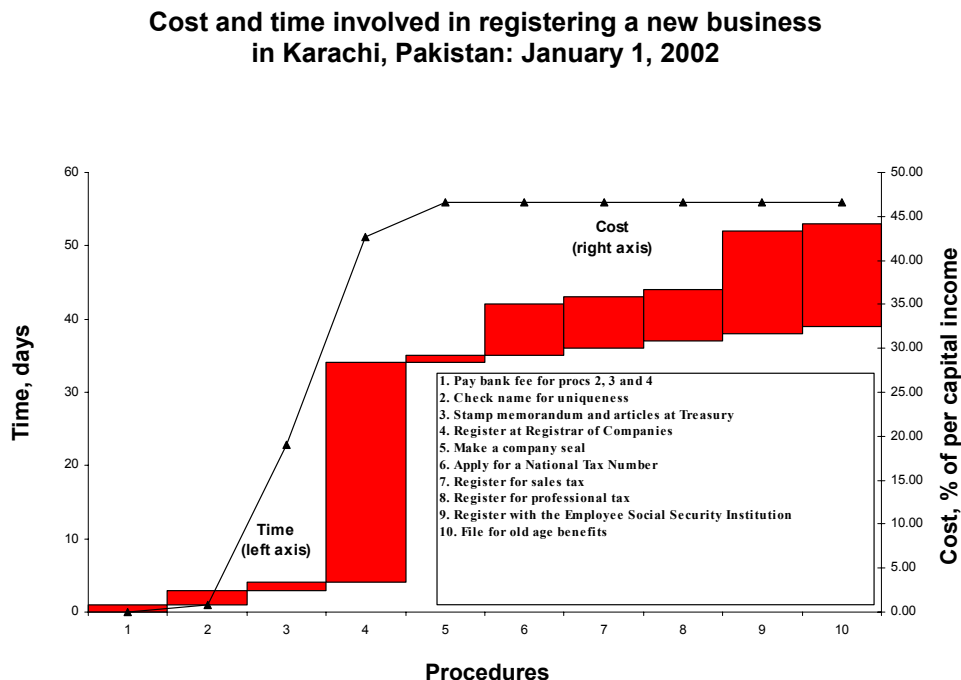
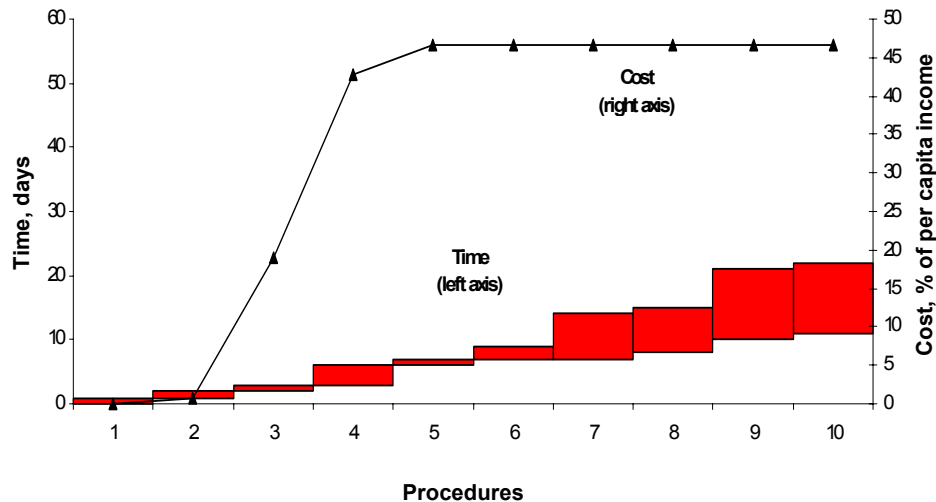


Figure 3

Cost and time involved in registering a new business
in Karachi, Pakistan: January 1, 2003



96. The periodic updating of the Doing Business indicators will provide a measure of the changes in these conditions over time. The degree of specificity of the indicators aligns well with the nature of Bank-supported PSD interventions and makes them useful instruments for assessing results. Future Bank projects with PSD components are expected to use these indicators to assess the results of the PSD-interventions supported by the projects.

97. OED has initiated an evaluation of the WBG's work on the investment climate. The study will be delivered in FY04. Two other PSD-related studies have been completed or are nearing completion, one on extractive industries and one on private sector development in the electricity sector. All three studies are being done collaboratively by the evaluation departments of the WBG, i.e., OED, OEG, and OEU. An OED study of the Bank's activities in transition economies, also for delivery in FY04, will have a substantial PSD content.

98. While the work on refining the investment climate indicators will continue, attention will also be focused in the coming year on developing scorecards for PSD projects. These scorecards are intended to capture the economic, financial, social and environmental impact of the projects. In addition, a program of cost-benefit analyses for PSD interventions is to be developed between the PSD Sector Board and DEC/OED.

Annex 1

Progress in Implementing Specific Actions Committed in the PSD Strategy

Subject Area	Action	Proposed timeline in PSD strategy	Implementation progress
Investment climate surveys	<p>Note on minimum standard methodology</p> <p>Workshop with interested development institutions to discuss common operational and funding approach</p> <p>Incorporation of survey results in CAS and core due diligence products</p>	<p>Completed prior to adoption of PSD strategy.</p> <p>Fall 2002.</p> <p>From FY03.</p>	<p>Completed prior to adoption of PSD strategy.</p> <p>Workshop not held, but collaboration on firm surveys underway with EBRD and ADB.</p> <p>A number of recent CASs are incorporating survey results; example Algeria and Mozambique CASs.</p>
IDA/IBRD on-lending operations	<p>WBG management to revise OP 8.30 so as to cover all on-lending operations including rural and social sector operations.</p> <p>Paper on proposed approach.</p>	<p>Summer 2002.</p> <p>Summer 2002.</p>	<p>Revisions to OP8.30 drafted and currently being reviewed by the Financial Sector Board.</p> <p>The paper is not being produced. Instead work is proceeding on two areas which were identified as top priority during the preliminary work for the paper. These are: a) processes for certifying regulators, and b) enhancing transparency on concession agreements. .</p>
Principles for regulatory systems in infrastructure	<p>Paper on proposed approach.</p>	<p>Summer 2002.</p>	<p>22 pilot projects with OBA components are currently being implemented or under preparation.</p>
Output-based aid	<p>Pilot projects for output-based aid focused on basic public services in a variety of sector and regions.</p>	<p>Under way.</p> <p>Evaluation of design and early implementation experience with first cohort of pilot projects by FY05.</p> <p>End 2002.</p>	<p>IFC has started the process of reviewing options for unbundling of subsidies. A</p>
Commercial disciplines for IFC	<p>Review, as part of IFC Strategic Directions paper, options for unbundling</p>		

Subject Area	Action	Proposed timeline in PSD strategy	Implementation progress
	<p>of subsidies, including:</p> <ul style="list-style-type: none"> • accounting separation between commercial and subsidized operations of IFC; • a specific target return for IFC commercial operations; • a decision-making mechanism to justify and allocate subsidies, and • a timetable to phase in the new disciplines <p>Continued dialogue with IFIs on consensus terms (disclosure rules, safeguard policies, rate of return policy)</p>	Ongoing.	<p>paper has been prepared and served as the basis for a Technical Briefing done for the Board in January 2003. IFC will be considering the implications of the findings of this review further in upcoming documents such as the Budget Paper.</p>
Regional PSD strategy implementation programs	Elaboration of regional programs to implement PSD strategy.	To be completed for all regions by end FY04, with three regions starting preparation in FY02 (Africa, East Asia and the Pacific, and South Asia).	All six regions currently preparing the regional plans using a template developed by the PSD sector board. .
Monitoring PSD dimensions of Bank	Review by PSD Sector Board of scorecards for projects with significant PSD components	Annual Review.	Under preparation.
Progress report on implementation of PSD strategy	Development of program of cost benefit analysis for PSD interventions A progress report on the actions set out in the PSD strategy will be provided to Executive Directors periodically.	Summer 2002. First one in March 2003.	Delivered to Board in May 2003.

Annex 2

Investment Climate Surveys and Assessments

Table 1: Investment Climate Surveys by Launch Fiscal Year

FY01-02	FY03	FY04
Algeria	Brazil	Bolivia
Bangladesh	Cambodia	Burkina Faso
Bhutan	Ecuador	Cameroon
Bolivia	Honduras	Dominican Republic
China	Kenya	India
Eritrea	Malaysia	Indonesia
Ethiopia	Moldova	Iran
India	Nicaragua	Kyrgyz Republic
Morocco	Philippines	Mali
Mozambique	Poland	Mongolia
Nepal	Serbia & Montenegro	Pacific Islands
Nigeria	Sri Lanka	Senegal
Pakistan	Syria	South Africa
Peru	Tanzania	Tajikistan
	Thailand	Uruguay
	Uganda	Vietnam
	Uzbekistan	Yemen
	Zambia	

Countries in bold indicate where surveys have been launched.

Table 2: Investment Climate Assessments by Completion Fiscal Year

FY01	FY02	FY03
Nepal	Bhutan	Algeria
	Bolivia	Bangladesh
	India	China
	Morocco	Eritrea
	Nigeria	Ethiopia
		Mozambique
		Pakistan
		Peru

Annex 3

Pilot projects with output-based aid components (status as of February 14, 2003)

Country	Sector	Scheme description
A. Projects including WBG participation in the financing of subsidies		
A-1. Projects under implementation (i.e. contracts awarded)		
PARAGUAY	Water	Pilot provides connection subsidies through a negative concessions approach in 4 selected towns, a second batch of target communities is under preparation. ²⁰
A-2. Firm pilot projects - under preparation (i.e. drafting of bidding documents well underway and launch of tender imminent within 3-6 months; sources of subsidy identified and assured, Board approval or equivalent)		
CAMBODIA	Water	Connection subsidies to small scale providers under least subsidy concessions to establish small networks in 4-5 selected communities, subsidies being provided for about 40% of envisaged connections.
PHILIPPINES	Water	OBA subsidies are provided as part of a concession for La Union Province, with the aim of providing new connections to about 40,000 households, out of which subsidies would be provided for connections to targeted households (~20% of total new connections).
NEPAL	Telecom	Negative concession for rural service; license to provide telecommunications services in a defined rural area which includes 534 rural towns; the operator will have to connect at least 2 pay-phone lines in each town and will have to operate them for at least 10 years.

²⁰ Negative concessions refer to least-subsidy biddings, i.e., contracts where service providers bid on the basis of subsidies they require, rather than fees they would pay, to obtain the concession.

Country	Sector	Scheme description
A-3. Possible pilot projects - under discussion (OBA concept approved by government; preparation of bidding documentation imminent or underway; possible sources of funding identified; draft PCD or equivalent)		
MOZAMBIQUE	Electricity	Connection subsidies for small scale providers; the first phase of this APL, includes about five rural concessions, the first of which, in Northern Inhambane, is currently being prepared and aims to provide connections to 5000 households within five years; up to 15,000 additional connections are to be financed under the other concessions.
PHILIPPINES	Electricity	Rural electrification; OBA subsidies will be used to partially fund 9000 connections in two isolated concessions as well as for loss reduction and service expansion in five rural coops.
DOMINICAN REP.	Water	This pilot envisages connection subsidies to extend existing sewerage system within the context of an integrated concession for water and sewerage services.
MADAGASCAR	Electricity	OBA rural connection scheme, with a focus on small scale isolated networks; detail targets are being developed as part of the project preparation.
MALI	Electricity	OBA rural connection scheme; small scale isolated networks, solar home systems (SHS) schemes and expansion of existing rural concessions envisaged; development will include the design of a bidding systems including incumbent concessionaires.
BANGLADESH	Water, social services	Social investment fund; OBA components are envisaged for small scale water supply and social services; subprojects would be identified by social fund management in line with the fund manual.
BURKINA FASO	Electricity	OBA rural connection scheme; pilot includes development of grid connected and off grid rural concessions, specific targeting under development.
SENEGAL	Electricity	OBA rural connection scheme, possibly under a minimum subsidy concession approach for up to 18 concession areas. Additionally, potential for OBA approaches for a renewed SENELEC concession being explored.
NICARAGUA	Electricity	OBA solar home system connection scheme, and mini-hydro based isolated systems for about 18,000 new connections.
BOLIVIA	Electricity	OBA solar home system connection scheme, specific connection targets being developed; focus provinces yet to be identified.
MALAWI	Electricity	Rural electricity access subsidies with focus on grid connections envisaged as part of a broader sector reform which is currently under discussion, possibly transition subsidies to ESKOM.
ECUADOR	Telecom	Provision of access to telecenter services under negative concessions in rural areas; project envisages provision of

Country	Sector	Scheme description
		166 telecenters (incl. Payphones, computer access, and learning facilities), to be managed under a 10-year concession agreement.
MOZAMBIQUE	Telecom	Negative concessions for rural areas; OBA component under discussion (incl. WB funding) for provision of rural telecom services under select pilot projects.
NIGERIA	Telecom	Negative concessions for rural areas have been agreed by government as part of a rural telecommunication access strategy; consulting assignment for the design of pilot projects will commence in 03/03; WB funding (up to USD 4 million) is provided for pilot projects.
UGANDA	Telecom	Negative concessions for rural areas, including public telephone services, public Internet access facilities and telecenters in each of 154 rural sub counties; estimated subsidy requirement USD 6 million, WB funding estimated of USD 5 million.
B. Projects including WBG participation through technical assistance or advisory mandates		
B-1. Projects under implementation		
DOMINICAN REP.	Telecom	Negative concession for rural service; first contract includes installation and operation of 500 payphones in 13 provinces; The concessionaire, CODETAL (the incumbent operator) was selected through competitive bidding, including a subsidy of USD 3.4 million; a second contract for the remaining 17 provinces is envisaged.
B-2. Possible pilot projects - under discussion		
MAURITIUS	Water	OBA subsidies for sanitation possible feature of a integrated water/wastewater concession.
SRI LANKA	Water	Pilot envisages two PSP contracts with OBA features to encourage rapid system roll out to targeted beneficiaries within the constraints of a national tariff that would initially not cover full costs.

List of IFC's Project Development Facilities

Project Development Facilities	Start-up of operations	Regions/countries covered	Headquarters	Total Donor Commitments for current five-year cycle (US\$ mil.)
Africa Project Development Facility (APDF)	1986	Sub-Saharan Africa	Johannesburg	26.0
South Pacific Project Facility (SPPF)	1990	South Pacific Islands	Sydney, Australia	7.1
Mekong Project Development Facility (MPDF)	1997	Vietnam, Cambodia and Laos PDR	Hanoi, Vietnam	24.6
Southeast Europe Enterprise Development (SEED)	2000	Bosnia and Herzegovina, Albania, Macedonia, Yugoslavia, Kosovo	Sarajevo, Bosnia	25.4
China Project Development Facility (CPDF)	2001	Sichuan Province	Chengdu, Sichuan Province, China	12.8
South Asia Enterprise Development Facility (SEDF)	2002	Bangladesh, Nepal, Bhutan, and NE India,	Dhaka, Bangladesh	11.9
North African Enterprise Development (NAED)	Late 2002	Morocco, Egypt, Algeria	Cairo	8.3
African Management Services Company (AMSCO)	1989	Sub-Saharan Africa	Johannesburg	16