Improving Investment Climates
An Evaluation of World Bank Group Assistance
WORKING FOR A WORLD FREE OF POVERTY

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Improving Investment Climates
An Evaluation of World Bank Group Assistance
# Contents

<table>
<thead>
<tr>
<th>Page</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>xi</td>
<td>Acknowledgments</td>
</tr>
<tr>
<td>xiii</td>
<td>Foreword</td>
</tr>
<tr>
<td>xv</td>
<td>Avant-propos</td>
</tr>
<tr>
<td>xvii</td>
<td>Prefacio</td>
</tr>
<tr>
<td>xix</td>
<td>Executive Summary</td>
</tr>
<tr>
<td>xxiii</td>
<td>Résumé analytique</td>
</tr>
<tr>
<td>xxvii</td>
<td>Resumen</td>
</tr>
<tr>
<td>xxxi</td>
<td>Acronyms and Abbreviations</td>
</tr>
</tbody>
</table>

## PART I OVERVIEW

### 3 Introduction

3 Evaluation Scope and Design

4 The Investment Climate, Investment, and Growth

### 7 World Bank Group Strategy, Activities, and Outcomes

7 The Investment Climate in the World Bank Group

9 World Bank

13 International Finance Corporation

16 Multilateral Investment Guarantee Agency

18 From Strategy to Outcomes: Illustrations from Country Case Studies

### 19 Coordination in the World Bank Group

19 Advice on Policies and Institutions

20 Assistance to Investment Promotion Intermediaries

20 Integrating Microeconomic and Macroeconomic Agendas

### 23 Recommendations

Annexes

25 I.A: World Bank Group Investment Climate Activities in Peru, Mozambique, and Romania
<table>
<thead>
<tr>
<th>Page</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>29</td>
<td>I.B: Management Response</td>
</tr>
<tr>
<td>33</td>
<td>I.B.1: Recommendations for the World Bank Group (from the Joint Overview Report)</td>
</tr>
<tr>
<td>37</td>
<td>I.B.2: Recommendations for the World Bank (from the IEG Evaluation)</td>
</tr>
<tr>
<td>45</td>
<td>I.B.3: Recommendations for the International Finance Corporation (from the IEG-IFC Evaluation)</td>
</tr>
<tr>
<td>49</td>
<td>I.B.4: Recommendations for the Multilateral Investment Guarantee Agency (from the IEG-MIGA Evaluation)</td>
</tr>
<tr>
<td>53</td>
<td>I.C: Chairman’s Summary, Committee on Development Effectiveness (CODE)</td>
</tr>
<tr>
<td>57</td>
<td>Endnotes for Part I</td>
</tr>
</tbody>
</table>

**PART II WORLD BANK EXPERIENCE**

<table>
<thead>
<tr>
<th>Page</th>
<th>Section</th>
</tr>
</thead>
<tbody>
<tr>
<td>61</td>
<td>5 Summary</td>
</tr>
<tr>
<td></td>
<td>61 Trends in the Investment Climate</td>
</tr>
<tr>
<td></td>
<td>61 The Bank’s Strategic Focus</td>
</tr>
<tr>
<td></td>
<td>62 Nonlending Services</td>
</tr>
<tr>
<td></td>
<td>62 Lending Operations</td>
</tr>
<tr>
<td></td>
<td>63 Organizational Issues</td>
</tr>
<tr>
<td></td>
<td>63 Recommendations</td>
</tr>
<tr>
<td>65</td>
<td>6 Introduction</td>
</tr>
<tr>
<td></td>
<td>65 Evaluation Scope and Design</td>
</tr>
<tr>
<td></td>
<td>66 A Review of Global Trends in the Investment Climate</td>
</tr>
<tr>
<td></td>
<td>69 The Big Picture: Determinants of Investment and Growth</td>
</tr>
<tr>
<td></td>
<td>71 The Determinants of Investment Behavior: Microempirical Evidence</td>
</tr>
<tr>
<td></td>
<td>71 Conclusions</td>
</tr>
<tr>
<td>73</td>
<td>7 The Bank’s Strategic Focus</td>
</tr>
<tr>
<td></td>
<td>73 From First-Generation to Second-Generation Reforms</td>
</tr>
<tr>
<td></td>
<td>74 The Investment Climate Takes Center Stage</td>
</tr>
<tr>
<td></td>
<td>74 IC Strategies at the Country Level</td>
</tr>
<tr>
<td></td>
<td>78 Translating the Strategy into Operations</td>
</tr>
<tr>
<td></td>
<td>79 Conclusions</td>
</tr>
<tr>
<td>81</td>
<td>8 Nonlending Services</td>
</tr>
<tr>
<td></td>
<td>81 Economic and Sector Work</td>
</tr>
<tr>
<td></td>
<td>82 Survey-Based Diagnostics</td>
</tr>
<tr>
<td></td>
<td>87 Conclusions</td>
</tr>
<tr>
<td>89</td>
<td>9 The IC Loan Portfolio</td>
</tr>
<tr>
<td></td>
<td>89 Definition</td>
</tr>
<tr>
<td></td>
<td>89 Composition</td>
</tr>
<tr>
<td></td>
<td>90 Performance</td>
</tr>
<tr>
<td></td>
<td>97 Conclusions</td>
</tr>
<tr>
<td>99</td>
<td>10 Implementation and Outcomes at the Country Level</td>
</tr>
<tr>
<td></td>
<td>99 Typology of Countries</td>
</tr>
<tr>
<td></td>
<td>101 Lessons Learned</td>
</tr>
<tr>
<td></td>
<td>107 Conclusions</td>
</tr>
<tr>
<td>109</td>
<td>11 Organizational Issues</td>
</tr>
</tbody>
</table>
111 12 Recommendations

Annexes
113 II.A: Evaluation Methodology
121 II.B: IC Theme Definitions
125 II.C: The Investment Climate in Sector Strategy Papers
127 II.D: Findings from IEG-World Bank Country Assistance Evaluations
139 II.E: Country Case Study Summaries

PART III IFC EXPERIENCE
155 13 Summary
156 Definitions
158 Recommendations
161 14 Introduction and Context: Why Is the Investment Climate Important to IFC?
161 Objectives
161 What Is the Investment Climate, and How Is It Operationalized in IFC?
163 Good and Improving Investment Climates Boost IFC’s Investment Project Outcomes
168 Do IFC’s Investment and Non-Investment Activities Improve Investment Climates? A Conceptual Model

171 15 IFC’s Investment Operations Show Wide Impacts on Investment Climate
171 Methodology and Limitations
172 How IFC’s Investment Operations Address Investment Climates
176 High-Impact Strategic Sector Investments Have the Strongest Direct Impacts on Investment Climate
178 Projects with Demonstration Effects Have Indirect Impacts

185 16 IFC’s Non-Investment Operations Have a Direct Impact on Investment Climates
185 Methodology and Limitations
186 Improving the Investment Climate Receives Increased Emphasis, but Not as a Strategic Priority
209 Issues Related to Planning and Coordinating IC TAAS
211 Overlap between FIAS and MIGA
212 Managing Conflict-of-Interest Concerns in IC TAAS

215 17 Summary and Recommendations
215 Summary
217 Recommendations

Annexes
221 III.A: Heritage Foundation/Wall Street Journal Index of Economic Freedom and Comparison with Selected Indices
225 III.B: Expanded Project Supervision Reports: Performance Ratings for Development Outcome and Investment Outcome
227 III.C: PSD Indicators and Rating Benchmarks
229 III.D: Non-Investment Evaluation Rating Template (for IC TAAS Operations)
231 III.E: Rating Benchmark for Non-Investment Operations
233 III.F: IC TAAS Descriptive Overview
243 III.G: FIAS’s Project Impact Monitoring System and Major Findings
247 III.H: Overview of the Results-Based Management Framework
249 III.I: Overlap between FIAS and MIGA
251 III.J: Managing Conflict-of-Interest Concerns

PART IV MIGA EXPERIENCE

257 18 Introduction
257 Background
258 Objectives and Evaluation Questions
258 Components of the Evaluation

261 19 MIGA’s IC Activities
261 In Which Types of Investment Climate Was MIGA Active?
262 Review of MIGA Guarantee Activities

267 20 An Evaluation of MIGA’s TA Activities
267 Overview of MIGA’s TA Activities
269 Relevance of MIGA’s TA Activities
273 Effectiveness of MIGA’s TA Activities
279 Resources for MIGA’s TA Activities
282 MIGA’s Role within the WBG and Collaboration with Other Agencies
285 Monitoring and Evaluation of MIGA’s TA Activities

287 21 Findings and Recommendations
287 Mandate
287 Strategy
288 Effectiveness
288 Resources and Efficiency
289 Operational Issues
289 Monitoring

Annexes
291 IVA: Methodology for Case Studies
293 IVB: Excerpt from MIGA’s Convention
295 IVC: Portfolio of MIGA’s TA Activities
297 IVD: El Salvador Case Study
299 IVE: Romania Case Study

309 Endnotes for Parts II–IV

319 Bibliography

Boxes
70 6.1 Institutions and Organizations
72 6.2 Diverse Factors Influence Foreign Investment Decisions Because Firms Are Diverse
78 7.1 The Increasing Focus on the Investment Climate in CASs: Evidence from Country Case Studies
83 8.1 Relevance of the Bank’s Analytical Work: Evidence from Country Case Studies
85 8.2 Investment Climate Surveys and Assessments
86 8.3 The Doing Business Project
87 8.4 The Costs and Benefits of Reforming Labor Legislation in India
103 10.1 Romania: Secured Transactions Reform
162 14.1 IFC’s 2004 Strategic Directions Address IC to Achieve Strategic Priorities
164 14.2 Recent IEG-IFC Analysis Shows That IC Is Important to IFC Outcomes
167 14.3 Importance of the Quality of the Investment Climate for IFC Client Investors
178 15.1 Strategic Sector Investments Have Yielded Significantly Better Outcomes
188 16.1 New PSD Vice Presidency Oversees Implementation of PSD Strategy and Coordinates IC Work Across the WBG
194 16.2 IFC IC TAAS at a Glance
195 16.3 Overview of IC TAAS Evaluation Ratings Criteria
200 16.4 Overview of FIAS Advisory Services
200 16.5 Strengths and Weaknesses of FIAS Assistance
203 16.6 Strategies to Boost Prospects of Achieving Better Results in TA Activities
206 16.7 Working Together: Donor Coordination Efforts to Streamline Business Registration in Bosnia
206 16.8 PEP’s Approach to Improving Investment Climate
268 20.1 Early Phase of MIGA TA Activities, 1988–97
268 20.2 MIGIM Mission Statement
271 20.3 Effectiveness of Promotion Agencies at Attracting FDI
284 20.4 MIGA and FIAS: How Does Cooperation Work on the Ground?

Figures
8 2.1 WBG Investment Climate Activities
9 2.2 Annual Volume of WBG IC Activity
11 2.3 The IC Share of World Bank Lending
14 2.4 IFC IC–Related Technical Assistance and Advisory Services
67 6.1 IC Indicators in Developing and Transition Economies
67 6.2 CPIA by Region, 1999 and 2003
68 6.3 CPIA Components, 1999 and 2003
91 9.1 Number of IC and Non-IC Projects, Fiscal 1993–2003
92 9.3 IC Lending as a Share of the Bank’s Portfolio, Fiscal 1993–2003
93 9.4 Core IC Themes in the IC Portfolio
94 9.5 Non-Core Themes in the IC Portfolio
94 9.6 Share of Core IC Projects by Region
95 9.7 Share of Core IC Projects by Income Group
165 14.1 Projects Done in Good IC Countries Have Significantly Better Outcomes
166 14.2 Better Investment Outcomes When Certain IC Factors Are Favorable
168 14.3 Logic Model for IFC’s IC Activities
169 14.4 Investment Operations Dominate IFC IC Activities in Terms of US Dollars
172 15.1 Increasing IFC’s Investment Approvals in High-Impact Strategic Sectors
173 15.2 Distribution of IFC’s US$ Investment Commitments: Strategic Sectors vs. Other Sectors (%)
173 15.3 Distribution of IFC’s US$ Investment Commitments: Strategic Sectors vs. Other Sectors (US$)
174 15.4 IFC’s Investment Approvals in Poor IC Countries Have Grown
174 15.5 Distribution of IFC’s Investment Commitments: Good vs. Poor Investment Climate Unrated Countries (%)
175 15.6 Distribution of IFC’s Investment Commitments: Good vs. Poor Investment Climate Unrated Countries (US$)
175 15.7 IFC Approvals Concentration in High-Risk Countries Has Declined Less than FDI and GDP Concentrations
176 15.8 IFC Approvals Are Significantly More Concentrated in High-Risk Countries than FDI and GDP Are, and the Gap Has Widened
177 15.9 The Inadequacies of Finance and Infrastructure Are Severe for Many Developing Countries
177 15.10 In Many Countries Firms Rate Skill Shortages as Major or Severe Constraints
180 15.11 Demonstration Effects Are the Most Common Indirect Impacts on Investment Climate
183 15.12 Projects with Positive PSD Impacts Have More Influence on Investment Climate When Country Conditions Are Difficult
191 16.1 The Number of IC Operations Is Increasing within Total Non-Investment Operations
191 16.2 FIAS Projects Represent the Bulk of IC TAAS Operations by Number
192 16.3 Volume Varied over Time with PEP’s Large Project Size Dominating
192 16.4 Excluding PEP Volume Shows Upward Trend
196 16.5 Survey Responses Show Satisfactory or Better Overall Quality of Assistance, but Outcomes and Impacts Received Lower Ratings or Were Not Rated
197 16.6 Responses from Government Officials Resemble Responses from Others, but with More Optimistic Views of Results on the Ground
197 16.7 Ratings at the Project Level Indicate High Work Quality on All Counts
201 16.8 How Did FIAS Perform?
216 17.1 Range of Impacts on the Investment Climate of IFC’s Investment Operations
258 18.1 Logic Model for Assessing the Effectiveness of MIGA’s TA
263 19.2 MIGA Guarantees Issued Increasingly in Countries with Low Investment Climates
264 19.3 Sectoral Distribution of MIGA Guarantee Portfolio (gross), June 2004
264 19.4 Regional Distribution of MIGA Guarantee Portfolio (net), June 2004
265 19.5 Concentration of MIGA Guarantees in Top 10 Developing Countries in Attracting FDI
Acknowledgments

This report benefited immensely from the insights of an external advisory panel consisting of Beatriz Boza, Roger Leeds, John McMillan, and Herbert Oberhansli. The panel provided useful comments on the draft reports and met in Washington, D.C., to discuss their views with Independent Evaluation Group (IEG) staff and management. The authors also are grateful to the staff members from the Bank, International Finance Corporation (IFC), and Multilateral Investment Guarantee Agency (MIGA) who shared their experience in discussion groups in headquarters.

The IEG-World Bank part of this report was written by Kristin Hallberg and Ramachandra Jammi, with assistance from Danuta Danilova. Valuable input was received from international investors who participated in discussion groups in Washington, Tokyo, Brussels, and London. Helpful guidance was provided by the internal peer reviewers for the report, Harry Broadman and John Nellis. Background papers were prepared by Tyler Biggs (literature review and Mozambique case study), Eric Oldsman (India case study), Paul Holden (Romania and Peru case studies), Ashok Khanna (Indonesia case study), Benjamin Rowland (international investor discussion groups), and Ramachandra Jammi (staff discussion groups). William Hurlbut provided editorial assistance, and Helen Phillip provided administrative assistance.

The IEG-IFC part of this report was written by Kelly Andrews Johnson and Rafael Dominguez. The report benefited from the valuable support and insight of Pelin Aldatmaz (Operations Analyst), Saliha Amroune (Program Assistant), Nicholas Burke and Denis T. Carpio (Peer Reviewers), Yvette Jarencio (Program Assistant), Nisachol Mekharat (Operations Analyst), Linda Morra-Imas (Head of Special Studies), Mariusz Sumlinski (Evaluation Officer), Vicky Viray-Mendoza (Operations Analyst), and Anna Zabelina (Peer Reviewer).

The IEG-MIGA part of the report was written by Stephan Wegner, Photis Bourloyannis-Tsangaridis and Timothy Neville contributed to the analysis, and Alima Ngoutano-Njoya and Esther Peckham formatted the report. Background papers were prepared by Eric Oldsman (Methodological Note and El Salvador case study), Kishore Rao, and Sheri Pitigala (Stocktaking of MIGA Technical Assistance and Romanian case study).
<table>
<thead>
<tr>
<th>Position</th>
<th>Name</th>
</tr>
</thead>
<tbody>
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</tr>
</tbody>
</table>
Foreword

The Investment Climate Study is a joint evaluation of the Independent Evaluation Group (IEG), covering the activities of the International Bank for Reconstruction and Development/International Development Association (IBRD/IDA), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA). The purpose of the evaluation is to assess the effectiveness of the World Bank Group (WBG) in helping its member countries improve their investment climates within the context of the WBG’s overall mission of poverty reduction and sustainable development. The findings and recommendations provide guidance for the WBG’s future strategy and activities in this area. The evaluation was conducted in parallel with preparation of World Development Report 2005: A Better Investment Climate for Everyone (World Bank 2005).

The methodology for this evaluation is outlined in the Approach Paper (IEG 2002). The evaluation spans the past 10 years and covers IBRD/IDA lending and nonlending services designed to improve the investment climate; IFC investment operations and investment climate–related technical assistance and advisory services; and MIGA guarantees and technical assistance (fiscal 1998–2003). The findings are based on a literature review, portfolio reviews, field missions to evaluate selected projects and prepare country case studies, and surveys of foreign investors, other stakeholders, and WBG staff. The overview (Chapters 1–4) highlights the main conclusions and recommendations of the joint evaluation, drawing on the separate accompanying reports of IEG-World Bank, IEG-IFC, and IEG-MIGA.

Special thanks are due to the members of the external advisory panel for the Investment Climate Study, who provided unique perspectives and advice:

- Roger Leeds, professor at the School of Advanced International Studies of the Johns Hopkins University and director of the school’s Center for International Business and Public Policy
- Beatriz Boza, former head of the regulatory body for competition policy in Peru (INDECOPI), as well as its investment promotion agency (PromPeru), and founding director of Ciudadanos al Dia, a nonprofit organization that promotes transparency and good governance
- Herbert Oberhansli, chief economist and head of economic and international relations, Nestle Corporation
- John McMillan, professor of economics at the
Stanford University Graduate School of Business, senior fellow at the Stanford University Graduate School of Business, and senior fellow at the Stanford Institute of Policy Research.
Avant-propos

L’étude du climat de l’investissement est une évaluation conjointe du Groupe indépendant d’évaluation (IEG), qui couvre les activités de la Banque internationale pour la reconstruction et le développement/la Association internationale de développement (BIRD/IDA), de la Société financière internationale (SFI) et de l’Agence multilatérale de garantie des investissements (MIGA).1


La méthodologie de la présente évaluation est décrite dans le document de synthèse sectorielle (IEG 2002). L’évaluation s’étend sur les dix dernières années, et couvre les activités de prêt et les services hors prêt de la BIRD/IDA visant à améliorer le climat de l’investissement ; les opérations d’investissement de la SFI ainsi que son assistance technique et ses services-conseils ; les garanties de la MIGA et son assistance technique (exercice 1998–2003). Les constatations s’appuient sur une analyse de publications, l’examen de portefeuilles, des missions sur le terrain pour évaluer certains projets et préparer les monographies nationales, et des enquêtes auprès des investisseurs étrangers, des autres parties prenantes et des services du Groupe de la Banque. La présente vue d’ensemble met en exergue les principales conclusions et recommandations de l’évaluation conjointe, en s’inspirant des rapports distincts y afférents et tels qu’élaborés par l’IEG de la Banque mondiale, l’IEG de la SFI et l’IEG de la MIGA. Nous tenons tout particulièrement à exprimer notre gratitude aux membres ci-après du groupe consultatif externe pour l’étude du climat de l’investissement, qui nous ont fourni des perspectives et des conseils de qualité exceptionnelle :

- Roger Leeds, professeur à la School of Advanced International Studies de l’Université Johns Hopkins et directeur du Center for International Business and Public Policy de cet établissement
• Beatriz Boza, ancienne responsable de l’organisme de réglementation de la politique de la concurrence au Pérou (INDECOPI), ainsi que de l’agence de promotion de l’investissement du même organisme (PromPeru), et directrice fondatrice de Ciudadanos al Dia, organisation à but non lucratif qui œuvre dans la promotion de la transparence et de la bonne gouvernance.

• Herbert Oberhansli, économiste en chef et responsable des relations économiques internationales de la société Nestlé.

• John McMillan, professeur d’économie à la Graduate School of Business de l’Université Stanford, et attaché supérieur de recherche au Stanford Institute of Policy Research.
El Estudio sobre el clima para la inversión es una evaluación conjunta realizada por el Grupo de Evaluación Independiente (GEI) que abarca las actividades del Banco Internacional de Reconstrucción y Fomento/la Asociación Internacional de Fomento (BIRF/AIF), la Corporación Financiera Internacional (CFI) y el Organismo Multilateral de Garantía de Inversiones (OMGI).

El objetivo de la evaluación es determinar la eficacia del Grupo del Banco Mundial en la tarea de ayudar a los países miembros a mejorar el clima para la inversión, en el contexto de la misión general del Grupo que consiste en la reducción de la pobreza y el desarrollo sostenible. Sus conclusiones y recomendaciones sirven de orientación para las actividades y estrategias futuras del Grupo del Banco Mundial en esta esfera. La evaluación se llevó a cabo en forma paralela con la preparación del Informe sobre el desarrollo mundial 2005: Un mejor clima para la inversión en beneficio de todos (Banco Mundial 2005).

La metodología empleada en esta evaluación se describe en la Síntesis sectorial (GEI 2002). El período estudiado comprende los últimos 10 años y abarca los siguientes aspectos: los servicios de financiamiento y de otro tipo prestados por el BIRF/AIF con el fin de mejorar el clima para la inversión; las operaciones de inversión de la CFI y la asistencia técnica y los servicios de consultoría brindados por la Corporación al mismo fin, y las garantías y asistencia técnica ofrecidas por el OMGI (entre los ejercicios de 1998 y 2003). Las conclusiones se basan en la revisión de las obras disponibles, exámenes de la cartera; misiones sobre el terreno de evaluación ex post de proyectos seleccionados, y de preparación de estudios de casos de países, y encuestas de inversionistas extranjeros, otras partes interesadas y personal del Grupo del Banco Mundial. En la presente reseña se destacan las principales conclusiones y recomendaciones de la evaluación conjunta, basadas en los informes adjuntos realizados por separado por los GEI del Banco Mundial, la CFI y el OMGI.

Expresamos nuestro especial agradecimiento a los miembros del grupo de asesores externos para el estudio sobre el clima para la inversión, que aportaron perspectivas únicas y valiosos consejos:

- Roger Leeds, profesor de la School of Advanced International Studies, y director de su Center for International Business and Public Policy, de la Universidad Johns Hopkins
- Beatriz Boza, ex presidenta del Directorio del Instituto Nacional de Defensa de la Competencia
tencia y de la Protección de la Propiedad Intelectual del Perú (INDECOPI); ex presidenta del Directorio de la Comisión de Promoción del Perú (PromPerú), y directora fundadora de Ciudadanos al Día, una organización sin fines de lucro que fomenta la transparencia y el buen gobierno,

- Herbert Oberhansli, economista principal y director de relaciones económicas e internacionales de Nestlé Corporation
Executive Summary

The quality of a country’s investment climate (IC) is determined by the risks and transaction costs of investing in and operating a business. These costs, in turn, are determined by the legal and regulatory framework, barriers to entry and exit, and conditions in markets for labor, finance, information, infrastructure services, and other productive inputs. The World Bank Group (WBG) supports improvements in investment climates by working with both the public and private sectors.

Through its lending and nonlending services, the Bank (IBRD/IDA) supports the broad policy environment (macroeconomic stability and openness) as well as microeconomic policies and institutions. The International Finance Corporation (IFC) influences the investment climate through its technical assistance and advisory services (TAAS) to both the public and private sectors and through its investment operations—directly, by increasing the quantity and quality of infrastructure and financial and social sector services, and indirectly, through the demonstration effects of investment projects in all sectors. The Multilateral Investment Guarantee Agency (MIGA) influences the investment climate through political risk guarantees, technical assistance to investment promotion intermediaries for capacity building, information dissemination tools, and mediation services.

The objective of improving investment climates in client countries has recently moved to center stage in the WBG’s approach to sustainable growth and poverty reduction. Yet improving the environment for private sector–led growth has always been a big part of what the WBG does. A large proportion of the Bank’s lending program is directed toward microeconomic policy and institutional reforms to promote the development of efficient markets. IFC’s founding Articles of Agreement state that in carrying out its purpose of encouraging the growth of productive private enterprise, the IFC is to help create conditions conducive to the flow of private capital into productive investments. And MIGA was created with the objective of facilitating foreign direct investment flows to developing countries.

Many of the WBG’s member countries are moving beyond first-generation reforms (achieving macroeconomic stability and trade integration) to second-generation reforms (improvements in the administrative, legal, and regulatory functions of the State). These second-generation reforms correspond to the
public sector’s role in establishing an investment climate conducive to private sector activity. Cross-country indicators of broad policy and institutional performance show that, although broad indicators of the policy and institutional environment have improved in recent years for most developing and transition economies, second-generation (or institutional) reforms still lag behind macroeconomic reforms. This suggests that these areas are now the appropriate focus of WBG assistance.

The joint IEG-World Bank, IEG-IFC, IEG-MIGA evaluation finds four main challenges for the WBG as the organization attempts to achieve better outcomes of its investment climate activities.

Focus on Reforms at the Institutional Level More than at the Policy Level
Institutions—the “rules of the game”—are key to the quality of the investment climate. Yet more is known—and more has been accomplished to date—in macroeconomic, financial sector, and trade reform than in institutional areas. The institutional agenda is on the frontier of the WBG’s knowledge of the development process. While the basic principles of good institutions are well recognized (such as market access and competition, protection of property rights, and contract enforcement), the institutional arrangements for carrying out reform seem to be country specific to some degree.

In other words, appropriate institutional designs are not completely exportable from one country to another. Moreover, unorthodox arrangements sometimes work. Strategies for improving the investment climate have suffered from a lack of knowledge about what kinds of institutional arrangements will work in different environments and about the dynamic process of change that is needed. To date, the WBG’s research and economic and sector work have provided insufficient guidance to client governments and WBG staff.

Customize Interventions to Country Needs
The quality of the investment climate varies significantly across countries (and even within countries), regions, and industries. This diversity results from varying macroeconomic circumstances, the progress made in earlier reform efforts, and the diversity among the firms themselves. Thus there is no single set of priorities within the broad set of characteristics that determine the investment climate—the priority issues are country specific.

When establishing strategies for improving the investment climate, the WBG needs to understand country-specific constraints and opportunities as well as country-specific institutional designs. It is critical for the WBG to build this understanding using local knowledge and expertise.

Political Economy and the Sequencing of Reforms
The feasibility of reform depends on the political economy of the reform process, and the sustainability of reform hinges on broad stakeholder support. The WBG needs to assess the capacity and incentives facing public sector organizations to implement reforms and be aware of the likely winners and losers and the political strength of key groups.

Organizational Challenges within the WBG
The broad nature of the investment climate as a topic and the need to work with both the public and private sectors creates internal organizational challenges for the WBG. Better use of the comparative advantages of the Bank, IFC, and MIGA would help the WBG deliver on its investment climate agenda more effectively. Corporate strategies need to be consistent with each other, and strategies and practice should be harmonized.

At the country level, IC strategies need to be integrated across the WBG, as well as across sector units within the Bank. In the IFC, the rapidly expanding TAAS activity needs to be provided on a strategic rather than an ad hoc basis. Similarly, MIGA’s delivery of technical assistance needs to follow a clear and coherent strategy for client selection to ensure high effectiveness and development impact. And all three parts of the organization need to do a better job of monitoring
the impact of their activities on measurable improvements in the investment climate.

To increase the effectiveness of WBG assistance to improve investment climates, the evaluation concludes with the following recommendations:

• The WBG should clarify the roles of the Bank, IFC, and MIGA in IC activities, bringing corporate strategy and practice into alignment. At the country level, coordination and consistency across the WBG on IC diagnosis, priorities, results focus, strategy, and assistance need to be improved.

• The Bank should do a better job of setting priorities and packaging IC reforms in lending operations and pay more attention to institutions and the political economy of reform.

• IFC should raise the profile of IC work and develop operating guidelines for technical assistance and advisory work related to the investment climate.

• MIGA should improve the focus and effectiveness of technical assistance by implementing a clear strategy for selecting clients, exercising greater selectivity, and aligning its work program more closely with WBG priorities and lending.

La Banque (BIRD/IDA) appuie l’environnement des politiques publiques au sens large (stabilité macroéconomique et ouverture) ainsi que les politiques et les institutions microéconomiques, par le biais de ses activités de prêt et de ses services hors prêt. La SFI influe sur le climat de l’investissement au moyen de l’assistance technique et des services-conseils qu’elle fournit aux secteurs public et privé, et grâce à ses opérations d’investissement — de façon directe, en accroissant le volume et la qualité des services financiers, sociaux et d’infrastructure, et de manière indirecte par les effets de démonstration des projets d’investissement dans tous les secteurs. La MIGA influe sur le climat de l’investissement en offrant des garanties contre le risque politique, de l’assistance technique aux intermédiaires qui assurent la promotion de l’investissement — afin de renforcer leurs capacités — des outils de diffusion de l’information, et des services de médiation.

L’objectif d’amélioration du climat de l’investissement dans les pays clients s’est récemment imposé comme le centre de l’attention de l’approche de la croissance durable et de la réduction de la pauvreté du Groupe de la Banque. Pourtant, l’amélioration de l’environnement en vue d’une croissance impulsée par le secteur privé a toujours fait partie des activités du Groupe de la Banque. Une grande partie des prêts accordés par la Banque est orientée vers les réformes institutionnelles et de la politique microéconomique, afin de promouvoir le développement de marchés efficaces. Les articles de convention portant création de la SFI stipulent que dans la poursuite de son objectif d’encourager la croissance d’une entreprise privée productive, la SFI doit aider à créer des conditions propices à la circulation des capitaux privés vers les investissements productifs. Par ailleurs, la MIGA a été créée dans le but de faciliter l’acheminement des investissements étrangers directs vers les pays en développement.
Nombre de pays membres du Groupe de la Banque passent de la première génération des réformes (assurer la stabilité macroéconomique et l’intégration commerciale) à la deuxième génération des réformes (améliorer les fonctions administratives, juridiques et réglementaires de l’État). Ces réformes de la deuxième génération sont cohérentes avec le rôle du secteur public qui consiste à établir un climat d’investissement propice aux activités du secteur privé. Les indicateurs de performance globale de divers pays en matière de politiques publiques et au niveau institutionnel montrent que même si les indicateurs généraux de l’environnement institutionnel et des politiques se sont améliorés au cours des dernières années dans la plupart des économies en développement et en transition, les réformes de seconde génération (ou institutionnelles) n’en continuent pas moins d’accuser du retard par rapport aux réformes macroéconomiques. Cette situation donne à penser que l’aide du Groupe de la Banque doit désormais cibler ces secteurs.

Il ressort de l’évaluation réalisée conjointement par l’IEG de la Banque mondiale, l’IEG de la SFI et l’IEG de la MIGA qu’il existe quatre principaux défis à relever par le Groupe de la Banque dans le cadre de ses efforts visant à obtenir de meilleurs résultats dans ses activités relatives au climat de l’investissement.

S’attacher davantage à réaliser des réformes au niveau des institutions qu’à celui des politiques

Les institutions — les « règles du jeu » — sont d’une importance capitale pour assurer la qualité du climat de l’investissement. Pourtant, par rapport aux secteurs institutionnels, on en sait plus — et à ce jour on a fait davantage — en ce qui concerne la réforme du secteur macroéconomique, financier et commercial. Le programme d’action institutionnel se trouve aux confins des connaissances du Groupe de la Banque sur le processus de développement. Si les principes fondamentaux des bonnes institutions (tels que l’accès au marché et la concurrence, la protection des droits de propriété et l’exécution des contrats) sont bien connus, les modalités institutionnelles de la mise en œuvre de la réforme semblent, dans une certaine mesure, être propres à chaque pays.

Autrement dit, les conceptions institutionnelles appropriées ne sont pas complètement transférables d’un pays à l’autre. Qui plus est, les modalités non conventionnelles sont parfois efficaces. Les stratégies d’amélioration du climat de l’investissement ont pâti du manque de connaissance sur les types de modalités institutionnelles qui seront efficaces dans différents environnements, et au sujet du processus dynamique de changement qui est nécessaire. À ce jour, la recherche et les travaux économiques et sectoriels du Groupe de la Banque n’ont pas suffisamment éclairé les gouvernements clients et les services du Groupe de la Banque.

Adapter les interventions aux besoins du pays

La qualité du climat de l’investissement varie considérablement d’un pays (et même au sein du même pays), d’une région et d’une industrie à l’autre. Cette diversité est attribuable aux conditions macroéconomiques qui sont variées, aux progrès accomplis dans le cadre des efforts antérieurs de réforme, et au caractère diversifié des entreprises elles-mêmes. Il s’ensuit que dans l’ensemble global des caractéristiques, aucun sous-ensemble unique de priorités ne détermine le climat de l’investissement — chaque pays a ses propres problèmes prioritaires.

Lors de la formulation des stratégies d’amélioration du climat de l’investissement, le Groupe de la Banque doit comprendre les contraintes, les opportunités et les structures institutionnelles propres à chaque pays. Il est crucial que le Groupe de la Banque exploite les connaissances et les compétences locales pour acquérir une telle compréhension.

Économie politique et jalonnement des réformes

La faisabilité de la réforme est fonction de l’économie politique et du processus de réforme, et la durabilité de la réforme est liée à un large appui de la part des parties prenantes. Il convient que le Groupe de la Banque évalue la capacité des organisations publiques de mettre en œuvre les réformes ainsi que les mesures prises pour
les y encourager, et qu’il soit conscient des ga-
gnants et des perdants ainsi que de la force po-
litique des principaux groupes.

Problèmes organisationnels au sein du Groupe de la Banque

Le Groupe de la Banque est confronté à des problèmes organisationnels liés au fait que le cli-
mat de l’investissement est un sujet large, et à
la nécessité de travailler avec les secteurs public
et privé. Une meilleure utilisation des avantages
comparatifs de la Banque, de la SFI et de la MIGA
aiderait le Groupe de la Banque à mettre plus ef-
ficacement en œuvre son programme d’action
sur le climat de l’investissement. Les stratégies
de l’institution doivent être cohérentes les unes
avec les autres, et il convient d’harmoniser les
stratégies et les pratiques.

Au niveau de chaque pays, les stratégies rela-
tives au climat de l’investissement doivent être in-
tégrées à l’échelle du Groupe de la Banque et de
toutes les unités sectorielles au sein de la Banque.
À la SFI, les activités d’assistance technique et de
services-conseils, qui sont en expansion rapide,
doivent être entreprises sur une base stratégique
et non en fonction des circonstances. De même,
dans la fourniture de son assistance technique, la
MIGA doit suivre une stratégie claire et cohé-
rente de sélection des clients, en vue d’une grande
efficacité et d’un impact sensible sur le dévelop-
peinent. En outre, la Banque, la SFI et la MIGA
doivent toutes les trois mieux suivre l’impact de
leurs activités sur des améliorations mesurables
du climat de l’investissement.

L’évaluation s’achève sur les recommandations
ci-après, formulées en vue de rendre plus efficace
l’aide du Groupe de la Banque en faveur de l’amé-
lioration du climat de l’investissement :

• Le Groupe de la Banque doit préciser les rôles
de la Banque, de la SFI et de la MIGA dans les
activités relatives au climat de l’investisse-
ment, en alignant la stratégie de l’institution
sur ses pratiques. Au niveau des pays, il est né-
cessaire d’améliorer la coordination et la co-
hérence à l’échelle du Groupe de la Banque
dans le domaine du diagnostic du climat de
l’investissement, des priorités, du ciblage des
résultats, de la stratégie et des besoins en
matière d’aide.

• La Banque doit améliorer l’établissement des
priorités et la mise au point des réformes du
climat de l’investissement dans ses opéra-
tions de prêt, et accorder plus d’attention
aux institutions et à l’économie politique de
la réforme.

• La SFI doit mieux faire connaître les travaux
portant sur le climat de l’investissement, et éla-
bror des directives opérationnelles sur l’as-
sistance technique et les activités de conseil
ayant trait au climat de l’investissement.

• La MIGA doit améliorer l’approche et l’effi-
cacité de l’assistance technique, en mettant en
œuvre une stratégie claire de sélection des
clients, en étant plus sélective et en alignant
son programme de travail plus étroitement sur
les priorités et les prêts du Groupe de la
Banque.
La calidad del clima para la inversión imperante en un país está determinada por los riesgos y costos de transacción que conlleva operar en una industria e invertir en ella. Dichos costos, a su vez, están dados por el marco jurídico y normativo, los obstáculos a la entrada y salida del mercado y las condiciones reinantes en éste en materia de trabajo, finanzas, información, servicios de infraestructura y otros insumos productivos. El Grupo del Banco Mundial respalda la mejora del clima para la inversión en colaboración con los sectores público y privado.

El Banco (BIRF/AIF), a través de sus servicios de financiamiento y de otro tipo, apoya tanto el marco general de políticas (apertura y estabilidad macroeconómicas) como las instituciones y políticas microeconómicas. La CFI influye en el clima para la inversión a través de la asistencia técnica y los servicios de asesoramiento que brinda a los sectores público y privado, y mediante sus operaciones de inversión, ya sea en forma directa, al mejorar la calidad y aumentar la cantidad de la infraestructura y los servicios de los sectores social y financiero, como en forma indirecta, a través de los efectos de demostración de los proyectos de inversión en todos los sectores. El OMGI influye en el clima para la inversión mediante el otorgamiento de garantías contra riesgos políticos, asistencia técnica para el fortalecimiento de la capacidad de los intermediarios dedicados a la promoción de inversiones, herramientas de divulgación de información y servicios de mediación.

En los últimos tiempos, el objetivo de mejorar el clima para la inversión en los países clientes se ha convertido en una prioridad dentro del enfoque del Grupo del Banco Mundial sobre el crecimiento sostenible y la reducción de la pobreza. No obstante, el Grupo del Banco siempre ha dedicado gran parte de su labor a la mejora de las condiciones para el crecimiento impulsado por el sector privado. Una elevada proporción del programa de financiamiento del Banco se destina a las reformas institucionales y de política microeconómica con el fin de fomentar el desarrollo de mercados eficientes. El Convenio Constitutivo de la CFI determina que, en cumplimiento de su objetivo de alentar el crecimiento de la empresa privada productiva, la CFI debe ayudar a crear las condiciones que propicien el flujo de capital privado hacia inversiones productivas. Y el OMGI se creó con el objetivo de facilitar los flujos de inversión extranjera directa hacia los países en desarrollo.
Muchos de los países miembros del Grupo del Banco Mundial están superando la etapa de las reformas de primera generación (logro de la estabilidad macroeconómica e integración comercial) y se encaminan hacia las de segunda generación (mejora de las funciones administrativa, jurídica y reguladora del Estado). Estas reformas de segunda generación se refieren al papel del sector público en la creación de un clima para la inversión que fomente la actividad del sector privado. Los indicadores multinacionales de desempeño general de las políticas e instituciones revelan que, si bien los indicadores generales del entorno institucional y de políticas han mejorado en los últimos años en el caso de la mayoría de las economías en transición y en desarrollo, las reformas de segunda generación (o institucionales) aún van a la zaga de las macroeconómicas. Esto indica que, en este momento, la asistencia del Grupo del Banco Mundial debería centrarse en estas áreas.

En la evaluación conjunta llevada a cabo por los GEI del Banco Mundial, la CFI y el OMGI se identificaron cuatro desafíos principales que encara el Grupo del Banco Mundial en sus esfuerzos por lograr mejores resultados en las actividades relacionadas con el clima para la inversión.

Meta primordial: las reformas institucionales más que las reformas de políticas

Las instituciones (las “reglas del juego”) son cruciales para la calidad del clima para la inversión. No obstante, se sabe más sobre la reforma macroeconómica, del comercio y del sector financiero (y hasta ahora se han alcanzado más logros en esas esferas) que acerca del área institucional. El programa de reformas institucionales se encuentra en el límite del conocimiento del Grupo del Banco Mundial sobre el proceso de desarrollo. Si bien se reconocen claramente los principios básicos de toda buena institución (como el acceso al mercado y la competencia, protección de los derechos de propiedad y cumplimiento de contratos), los mecanismos institucionales necesarios para llevar a cabo la reforma parecen ser en cierta medida específicos de cada país.

En otras palabras, no se puede aplicar en un país la misma estructura institucional adecuada para otro país. Asimismo, a veces resultan eficaces los mecanismos poco ortodoxos. Las estrategias para mejorar el clima para la inversión se han caracterizado por la falta de conocimiento acerca de qué tipos de organización institucional darán buenos resultados en diferentes entornos y acerca del proceso dinámico de cambio que hace falta. Hasta ahora, las investigaciones y los estudios económicos y sectoriales del Grupo del Banco Mundial no han brindado orientación suficiente a su personal ni a los gobiernos clientes.

Adaptación de las medidas a las necesidades de cada país

La calidad del clima para la inversión varía considerablemente de un país a otro (e incluso dentro de cada país) y de una región o industria a otra. Esta diferencia se debe a las distintas circunstancias macroeconómicas, a los avances logrados gracias a programas anteriores de reforma y a la disparidad entre las empresas. Por consiguiente, no hay un conjunto único de prioridades dentro del grupo más amplio de características que determinan el clima para la inversión; las prioridades son específicas de cada país.

A la hora de elaborar estrategias de mejora del clima para la inversión, el Grupo del Banco Mundial debe entender las limitaciones y oportunidades propias de cada país, así como sus estructuras institucionales específicas. Es crucial que el Grupo del Banco Mundial amplíe su comprensión del tema valiéndose de los conocimientos y pericia locales.

Economía política y la secuencia de las reformas

La viabilidad de la reforma depende de la economía política del proceso que entraña, y su sostenibilidad estriba en el logro de un amplio apoyo de las partes interesadas. El Grupo del Banco Mundial debe evaluar la capacidad y los incentivos con que cuentan las organizaciones del sector público para llevar a cabo las reformas. Debe asimismo saber quiénes probablemente habrán de ganar o perder con el proceso y conocer la fuerza política de los grupos clave.
Desafíos para la estructura orgánica interna del Grupo del Banco Mundial

La amplitud del tema del clima para la inversión y la necesidad de trabajar tanto con el sector público como con el privado genera desafíos para la estructura orgánica interna del Grupo del Banco Mundial. Un mejor aprovechamiento de las ventajas comparativas del Banco, la CFI y el OMGI le ayudarían a obtener mejores resultados en su programa de mejora del clima para la inversión. Las estrategias del Grupo del Banco Mundial deben ser coherentes entre sí, y se deben armonizar con la práctica.

Por otro lado, las estrategias relativas al clima para la inversión a nivel de los países deben integrarse a nivel de todo el Grupo del Banco Mundial, así como a nivel de todas las unidades sectoriales dentro del Banco. En la CFI, las actividades relacionadas con asistencia técnica y los servicios de asesoramiento, en rápida expansión, deben brindarse en función de una estrategia y no en forma ad hoc. Análogamente, la asistencia técnica prestada por el OMGI debe seguir una estrategia clara y coherente para la selección de clientes, a fin de asegurar un nivel alto de eficacia e impacto en términos de desarrollo. Y las tres instituciones que integran la organización deben realizar un mejor seguimiento del impacto de sus actividades sobre mejoras medibles en el clima para la inversión.

La evaluación concluye con varias recomendaciones destinadas a aumentar la eficacia de la asistencia que brinda el Grupo del Banco Mundial para mejorar el clima para la inversión. Dichas recomendaciones son las siguientes:

- El Grupo del Banco Mundial debería aclarar la función del Banco, la CFI y el OMGI en las actividades relativas al clima para la inversión, y lograr la armonización de la estrategia del Grupo con la práctica. A nivel de los países, es preciso aumentar la coordinación y la coherencia en todo el Grupo del Banco Mundial en lo que respecta al diagnóstico del clima para la inversión, las prioridades, el enfoque en los resultados, la estrategia y la asistencia prestada a tal fin.
- El Banco debería fijar mejor las prioridades e incorporar las reformas relativas al clima para la inversión en sus operaciones de financiamiento. Asimismo, debería prestar más atención a las instituciones y a la economía política de las reformas.
- La CFI debería conceder mayor relevancia a la labor relativa al clima para la inversión y debería elaborar directrices operacionales para la asistencia técnica y el asesoramiento relacionados con esta esfera.
- El OMGI debería mejorar el enfoque y la eficacia de la asistencia técnica mediante la aplicación de una estrategia clara de selección de clientes, una mayor selectividad y una mayor armonización de su programa de trabajo con las prioridades y el financiamiento del Grupo del Banco Mundial.
### ACRONYMS AND ABBREVIATIONS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>AAA</td>
<td>Analytical and advisory activities</td>
</tr>
<tr>
<td>ADR</td>
<td>Alternative dispute/disorder resolution</td>
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<td>ADRE</td>
<td>Annual Review of Development Effectiveness</td>
</tr>
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<td>ARIS</td>
<td>Romanian Agency for Foreign Investment</td>
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<td>AsDB</td>
<td>Asian Development Bank</td>
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<tr>
<td>BEE</td>
<td>Business-enabling environment</td>
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<td>BiH</td>
<td>Bosnia and Herzegovina</td>
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<td>CAE</td>
<td>Country Assistance Evaluation</td>
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<td>CAS</td>
<td>Country Assistance Strategy</td>
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<td>CIC</td>
<td>Investment Climate Department</td>
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<tr>
<td>CODE</td>
<td>Committee on Development Effectiveness</td>
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<tr>
<td>COI</td>
<td>Conflict of interest</td>
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<tr>
<td>CPIA</td>
<td>Country Policy and Institutional Assessment</td>
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<tr>
<td>DO</td>
<td>Development outcome</td>
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<tr>
<td>EBRD</td>
<td>European Bank for Reconstruction and Development</td>
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<td>EFW</td>
<td>Economic Freedom of the World</td>
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<td>ESW</td>
<td>Economic and sector work</td>
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<td>EU</td>
<td>European Union</td>
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<tr>
<td>FDI</td>
<td>Foreign direct investment</td>
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<td>FIAS</td>
<td>Foreign Investment Advisory Service</td>
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<tr>
<td>FRR</td>
<td>Financial rate of return</td>
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<td>FSAC</td>
<td>Financial sector adjustment credit</td>
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<tr>
<td>GDP</td>
<td>Gross domestic product</td>
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<tr>
<td>HFO/WSJ</td>
<td>Heritage Foundation/Wall Street Journal</td>
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<tr>
<td>IBLF</td>
<td>International Business Leaders’ Forum</td>
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<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development (World Bank)</td>
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<tr>
<td>IC</td>
<td>Investment climate</td>
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<tr>
<td>ICA</td>
<td>Investment Climate Assessment</td>
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<tr>
<td>ICR</td>
<td>Implementation Completion Report</td>
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<td>ICRG</td>
<td>International Country Risk Guide</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>IEG</td>
<td>Independent Evaluation Group</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>IICCR</td>
<td>Institutional Investor Country Credit Risk Rating</td>
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<td>IO</td>
<td>Investment outcome</td>
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<td>IPA</td>
<td>Investment Promotion Agency</td>
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<td>IPI</td>
<td>Investment Promotion Intermediary</td>
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<td>IPP</td>
<td>Independent power producer</td>
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<tr>
<td>M&amp;E</td>
<td>Monitoring and evaluation</td>
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<td>MFI</td>
<td>Multilateral financial institutions</td>
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<tr>
<td>Acronym</td>
<td>Full Form</td>
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<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
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<td>MIGIM</td>
<td>MIGA's Investment Marketing Services Department</td>
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<td>NATO</td>
<td>North American Treaty Organization</td>
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<td>OECD</td>
<td>Organisation for Economic Co-operation and Development</td>
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<tr>
<td>OPCS</td>
<td>Operations Policy and Country Services (World Bank)</td>
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<tr>
<td>PAS</td>
<td>Policy and advisory services</td>
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<td>PDF</td>
<td>Project Development Facility</td>
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<td>PDS</td>
<td>Project data sheet</td>
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<td>PEP</td>
<td>Private Enterprise Partnership</td>
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<tr>
<td>PIBL</td>
<td>Private Sector Institution Building Loan</td>
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<tr>
<td>PIM</td>
<td>Project impact monitoring</td>
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<td>PREM</td>
<td>Poverty Reduction and Economic Management (World Bank Network)</td>
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<tr>
<td>PSA</td>
<td>Private Sector Assessment</td>
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<td>PSAL</td>
<td>Private Sector Adjustment Loan</td>
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<td>PSAS</td>
<td>Private sector advisory services</td>
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<td>PSD</td>
<td>Private sector development</td>
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<td>PSRP</td>
<td>Poverty Reduction Strategy Paper</td>
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<td>RBM</td>
<td>Results-based management</td>
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<td>RDA</td>
<td>Romanian Development Agency</td>
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<td>RPED</td>
<td>Regional Program for Enterprise Development</td>
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<td>SEED</td>
<td>Southeast Europe Enterprise Development</td>
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<td>SME</td>
<td>Small and medium-size enterprise</td>
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<td>SOE</td>
<td>State-owned enterprise</td>
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<td>TA</td>
<td>Technical assistance</td>
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<td>TAAS</td>
<td>Technical assistance and advisory services</td>
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<td>TATF</td>
<td>Technical Assistance Trust Funds</td>
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<td>UNDP</td>
<td>United Nations Development Programme</td>
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<td>UNICE</td>
<td>Union of Industrial and Employers’ Confederations</td>
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<td>USCIB</td>
<td>U.S. Council for International Business</td>
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<td>VBF</td>
<td>Vietnam Business Forum</td>
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<td>WBES</td>
<td>World Business Environment Study</td>
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<td>WBG</td>
<td>World Bank Group</td>
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<td>XPSR</td>
<td>Expanded Project Supervision Report</td>
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OED has changed its official name to Independent Evaluation Group (IEG)-World Bank. The new designation “IEG” has been inserted in all of IEG’s publications, review forms, databases, and Web sites.
Part I

Overview
Introduction

A country’s investment climate (IC) is its environment for private sector activity. The risks and transaction costs of investing in and operating a business determine the quality of the investment climate. These costs, in turn, are determined by the legal and regulatory framework; barriers to entry and exit; and conditions in markets for labor, finance, information, infrastructure services, and other productive inputs.

Governments influence the quality of their country’s investment climate through policies, institutions, and their relationships with the private sector. The impact of better investment climates on private sector activity—and thus on economic growth and employment—links the quality of the investment climate to poverty reduction.

The Investment Climate Study is a joint evaluation by the Independent Evaluation Group (IEG, covering the activities of the International Bank for Reconstruction and Development [IBRD]/International Development Association [IDA], the International Finance Corporation [IFC], and the Multilateral Investment Guarantee Agency [MIGA]). This overview summarizes their combined findings and recommendations.

Evaluation Scope and Design

The evaluation spans the 10-year period of fiscal 1993 through 2002–3 and covers IBRD/IDA lending and nonlending services designed to improve the investment climate, IFC investment operations and IC-related technical assistance and advisory services (TAAS), and MIGA guarantees and technical assistance (fiscal 1998–2003). The evaluation addresses the following questions:

- **Strategic approach.** What was the World Bank Group’s (WBG’s) strategic approach to improving investment climates? How has this strategy been implemented?
- **Relevance of WBG assistance.** Has the WBG emphasized the right things in its IC work? How did the WBG’s approach to the investment climate compare with current thinking on the determinants of investment and growth and with the obstacles to investment as perceived by private investors?
- **Effectiveness of WBG assistance.** What have been the outcomes of WBG IC activities? Has the WBG been effective in motivating governments to undertake IC reforms beyond what they would have done in the absence of...
intervention? What has been the impact of WBG interventions on the quality of investment climates in client countries and on their investment and growth?

- **Sustainability.** What is required for IC improvements to be sustained?
- **Organizational issues.** Does the WBG’s organizational structure support good IC work?

### The Investment Climate, Investment, and Growth

The investment climates of developing and transition economies have improved modestly in recent years. The greatest improvements were in transition economies (which started from a low base), including those that aspired to accession to the European Union. Ratings of the quality of policies and institutions are higher for macroeconomic conditions (macroeconomic management, financial stability, and revenue stability) than for many institutional areas (property rights, public administration, transparency, and rules-based governance), suggesting that these latter areas deserve attention.

IEG’s 2003 Annual Review of Development Effectiveness (IEG-World Bank 2004) shows that policies and institutions matter a great deal in bringing about improved social indicators and the growth of per capita income. In turn, empirical research shows that growth is the key driver for poverty reduction, suggesting that policies and institutions that promote broadly based growth are central to the pro-poor growth agenda (see, for example, Kraay 2004). The literature review conducted for this study delves deeper into the relative importance of policies and institutions. Recent studies have found that institutions generally prevail over geography and policies in explaining cross-country differences in income. Macroeconomic and structural reforms are necessary conditions for growth, but modern institutions are necessary to sustain it.

Certain “good practice” principles—such as transparency, accountability, competition, rule of law, and protection of property rights—apply to all institutional arrangements. The institutional arrangements needed to implement these principles, however, are somewhat country specific. An institutional arrangement that is successful in one country does not necessarily transfer well to another without modification, and unorthodox arrangements sometimes work.

In addition, different aspects of the investment climate matter for different firms, because firms are diverse. Interviews with international investors conducted for this evaluation confirmed that IC conditions in host countries matter, but there are firm-specific global strategic factors that influence investment decisions, such as the size of the domestic market, low labor costs, and the actions of competing firms. Enterprise surveys show that firms that are private, newer, and smaller; that are not recipients of foreign direct investment (FDI); and that cater to the domestic market report more acute business constraints than do firms that are older and larger, that export, that have FDI, or that are State owned.

The importance of the investment climate for enterprise performance is also evident in IFC investment operations. Based on the measure of investment climate it used regularly, IFC achieved higher development and investment success rates when the investment climate improved from being high risk to being middle risk between project approval and evaluation. When the investment climate deteriorated, success rates dropped below average.

IFC also achieved better investment outcomes in countries with good investment climates at the time of either approval or evaluation; that is, both IC quality and its direction of change are associated with IFC investment outcomes, suggesting a robust, positive relationship between the investment climate and investment success. Moreover, certain aspects of the investment climate were highly correlated with investment success: trade openness, a dynamic banking and finance sector, effective government regulation, and the absence of black markets. These results are consistent with other recent IEG-IFC evaluations.

IEG-IFC interviews with IFC clients in five case study countries indicated that their invest-
ment decisions responded to opportunities such as access to domestic and foreign markets, strategic location, and favorably priced inputs such as raw materials and labor. On the negative side, many respondents expressed frustration with the host country’s regulatory framework, bureaucratic processes, weak institutions, inefficient judicial system, and underdeveloped financial markets. Although IFC clients appreciated investment incentives, they did not think that those incentives influenced their decisions to invest.
The Investment Climate in the World Bank Group

Under different names, the investment climate was a part of Bank private sector development (PSD) strategies throughout the 1990s. Recently, however, the subject has risen to become one of the two pillars of the WBG’s corporate strategy for reducing poverty and occupies center stage in the 2002 WBG Private Sector Development Strategy.

The increased prominence of the investment climate at the corporate level is mirrored in the shift in Country Assistance Strategies (CASs) in the past decade from first-generation macro-level reforms (macroeconomic stability and trade liberalization) to second-generation microlevel reforms (including improvements in the administrative, legal, and regulatory functions of the State). This “macro first, micro second” sequencing was not so much a planned strategy as it was the result of the disappointing supply response to first-generation reforms. The Bank has become increasingly aware of the importance of institutional reform to sustained growth. This shift in focus was appropriate and well supported by the literature.

Although CASs in all Regions show a trend toward second-generation reforms, the relative emphasis given to different institutional themes varies by Region. In East Asia, for example, following the economic crisis of the late 1990s, CASs give priority to corporate restructuring, corporate governance, and financial sector issues. In Latin America and the Caribbean, CASs emphasize regulatory and judicial reform and enterprise competitiveness far more than in other Regions. In Europe and Central Asia, property rights, judicial reform, bankruptcy law, and access to finance are top priorities. The differences across Regions reflect the diversity of constraints that firms face, varying progress in broader policy areas (privatization and financial sector reform) and dissimilar macroeconomic contexts.

The importance the IFC gives to improving investment climates has grown in the past decade—particularly from 2000 to 2004—in parallel with its frontier strategy and focus on high-impact strategic sectors. Its 2004 internal strategic directions document points out that, although IFC has been focusing on frontier countries and markets:

It is becoming increasingly clear that to meet the challenges in these markets, IFC
will have to . . . scale up its provision of technical assistance and advisory services and . . . take a more proactive approach to project development. IFC’s technical assistance and advisory services will continue to focus on both governments and private industry to improve the framework for investment and increase the capacity of businesses (mostly small- and medium-scale enterprises) to thrive and grow.

At the country level, an increasing number of joint CASs contain combined Bank and IFC strategies to improve the investment climate (the Annex illustrates joint Bank/IFC CASs with three examples: Mozambique, Peru, and Romania).

The Bank, IFC, and MIGA bring to bear a variety of instruments that influence the investment climate through policies, institutions (understood to mean the “rules of the game,” including the legal and regulatory framework), organizations, and the private firms themselves (figure 2.1). Through its lending and nonlending services, the Bank addresses the broad policy environment (macroeconomic stability and openness), as well as microeconomic policies and institutions. IFC influences the investment climate through its TAAS to both the public and private sectors and through its investment operations directly, by increasing the quantity and quality of infrastructure, financial, and social sector services; indirectly, through the demonstration effects of investment projects in all sectors. MIGA influences investment climate through political risk guarantees, technical assistance for capacity building of investment promotion intermediaries, online information dissemination tools, and legal and mediation services.

Figure 2.2 gives an idea of the Bank, IFC, and MIGA shares of WBG IC activities. The Bank’s lending for IC objectives, broadly defined, accounted for an average of 68 percent of WBG IC activities for fiscal 1998–2002;5 IFC invest-

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**Figure 2.1: WBG Investment Climate Activities**

**IBRD/IDA**
- Lending and AAA for policy reform (macro, trade)
- Lending for institutional reform (legal and regulatory framework, corporate governance, financial sector development, and so on)
- ESW on IC topics, survey-based diagnostics

**IFC**
- Investment financing for demonstration effects (mainly)
- TA to public sector on legal and regulatory issues, capacity building
- TA to private sector for capacity building

**MIGA**
- Guarantee operations and information dissemination tools
- TA to investment-promotion agencies for capacity building

*Note: AAA = analytical and advisory activities; TA = technical assistance; ESW = economic and sector work.*
ments (in all sectors) accounted for another 23 percent and MIGA guarantees for 9 percent. A small share—an estimated $186 million yearly, or 1 percent of the total—was devoted to all types of technical assistance, advisory services, and economic and sector work (ESW) of the three organizations. A breakdown of this combined technical assistance again shows the Bank accounting for the largest share (88 percent), followed by the IFC (9 percent) and MIGA (3 percent). The sections below describe these activities in more detail and evaluate their effectiveness in improving investment climates.

**World Bank**

**Nonlending services**

Analysis of IC topics is frequently part of both economic and sector reports. During fiscal 1993–2003, more than 300 reports were directed toward one or more core IC themes. The Bank also has developed diagnostic tools to assess the quality of a country’s investment climate and the constraints facing private enterprises. In addition to these formal vehicles of nonlending assistance, the Bank also provides advice informally to governments and the private sector through discussions, sharing of information, and in-country seminars.

The Bank’s economic and sector work has helped motivate IC reform in many countries. Nevertheless, more work needs to be done in some areas to provide guidance to clients as well as to Bank staff in designing reforms. Knowledge about good practices in institutional design or the dynamic process of changing institutions is insufficient. It would be useful to have a typology of country situations and institutional designs that would provide guidance on (a) which types of arrangements work where—in other words, an understanding of what types of institutional arrangements can be “exported” from one country to another, (b) how the change process happens, and (c) how the change process can be supported and sustained. The Bank’s economic and sector work and research have not yet provided enough of this knowledge.

Diagnostic work on the investment climate has evolved toward greater use of enterprise surveys to provide information on the constraints to PSD as perceived by firms. The
most recent versions of standardized diagnostic tools—the IC assessment and the survey instrument on which it is based, the IC survey—do a good job of benchmarking indicators of the quality of a country's investment climate in a way that allows cross-country comparisons as well as the monitoring of changes in individual countries over time. Some clients, however, have complained that these assessments duplicate earlier work and that the surveys are similar to existing surveys conducted by governments, think tanks, and other donors. This duplication is perhaps an inevitable consequence of the Bank's objective of using IC surveys to build a global IC database, but the Bank may need to clarify that objective to clients to manage expectations.

Other problems with IC diagnostics carried out during the review period have been (a) lack of prioritization of problems and their proposed solutions and (b) excessive focus on the manufacturing sector, urban areas, and formal sector firms as opposed to rural areas and the informal sector. The most recent IC assessments have begun to address these problems. Although enterprise surveys provide valuable information on the perspectives of the private sector, the views of business on public policies should balance other economic and social perspectives when formulating policy recommendations.

The PSD Vice Presidency's Doing Business Project has, more recently, begun gathering data on the costs of doing business in a large number of countries (145 according to Doing Business 2005). Surveys of experts, rather than firms, gather information; most indicators are structured around a hypothetical firm to allow comparisons across countries. The Doing Business Project has received high marks from external audiences as well as WBG staff for providing, for the first time, objective indicators of the costs of regulation and administrative procedures. At the same time, it is important to recognize some of the limitations of the methodology. Because countries differ in optimal firm size and structure, estimating the time required to set up a "straw firm" provides comparability but may provide an incomplete picture for countries with heavier reliance on the informal sector.

**Lending operations**

The Bank's IC lending operations were identified for this evaluation using a set of "core" and "non-core" IC themes to describe the objectives of each project. According to these definitions, a large share of the Bank's lending relates to IC reform. Projects that have core or non-core IC themes as primary or secondary objectives of the project (labeled "All-IC" in figure 2.3) accounted for 45 percent of all Bank projects and 52 percent of project value during fiscal 1993–2003. Core IC projects (those with one or more of the five core IC themes as a primary objective of the project) accounted for 14 percent of all Bank projects. Many projects, however, have both IC and non-IC objectives; IC components are often only a part of larger projects (for example, regulatory reforms in macroeconomic adjustment loans). This means that the size of IC lending is smaller than overall project volumes suggest.

Figure 2.3 underscores that IC lending has always been a large part of what the Bank does. At the same time, the WBG’s increased strategic focus on the investment climate, contained in corporate and sector strategies as well as in CASs, has not been accompanied by an increase in the share of lending devoted to this objective. Although both core investment climate and all IC lending have varied (notably during the East Asian crisis of 1997–98), neither share of lending that supports IC objectives shows an observable trend in the past 10 years. Nor has the composition of IC lending shown much change. Of the five core IC themes, regulation and competition policy has been—and remains—by far the dominant theme. Other areas—judicial reform, property rights, and corporate governance—received less emphasis, both in the early and later years of the fiscal 1993–2003 period. Across non-core IC themes, infrastructure for PSD and other financial and PSD accounted for two-thirds of the projects in fiscal 1993–2003. The importance of the latter theme declined in the period, and infrastructure for PSD is now the dominant theme in non-core IC lending.
The performance of IC projects and IC project components was mixed during fiscal 1993–2003. Completed core IC projects performed better than the Bank average: Outcome ratings for 81 percent of core IC projects were moderately satisfactory or better, compared with 77 percent for all Bank projects. Outcomes were worse in low-income countries than in middle-income countries (79 percent moderately satisfactory or better in low-income countries, compared with 83 percent in middle-income countries). Outcomes of IC operations are positively correlated with indicators of macroeconomic and financial sector performance, although no evidence indicates causality from operations to economic performance.

IEG-World Bank outcome ratings are assigned to the project as a whole, so the outcomes of individual project components may differ from the overall rating. A more detailed analysis of a sample of projects showed that, when the outcomes of IC components differed from overall project outcomes (found in 20 percent of the sample analyzed), the IC components usually performed worse. A number of factors contributed to disappointing outcomes: an apparent lack of attention and supervision when IC objectives were a minor part of a larger project, lack of government ownership and commitment, complex or overly ambitious project design, lack of overall institutional capacity, and political or social factors that had been underestimated at project appraisal.

Outcome ratings for core IC projects improved slightly during the decade: 81 percent of core IC projects were moderately satisfactory or better during fiscal 1994–98, a number that rose to 82 percent during fiscal 1999–2003. The performance of the overall Bank portfolio, however, improved significantly in the same period, from 78 percent in fiscal 1994–98 to 83 percent in fiscal 1999–2003.
Thus, the performance of IC lending has deteriorated relative to the average for Bank lending. An analysis of IEG-World Bank’s Implementation Completion Report reviews suggests that more recent IC projects were more heavily focused on long-term institutional reforms that were more vulnerable to the political economy of reform, implementation and enforcement shortcomings, and gaps in the capacity of public sector agencies. A greater share of the earlier projects involved reforms for which good practice was better understood (for example, privatization transactions and financial sector reforms).

The country case studies prepared by IEG-World Bank provide lessons on what worked and what did not, the factors that led to success and failure, and lessons that can be generalized to the Bank’s IC activities.10

- **Often, crisis or opportunity has politically enabled IC reform.** Urgency frequently motivated decisions by policy makers to take the measures necessary to improve the investment climate: on the negative side, by crisis (macroeconomic, financial, political, and so on) or on the positive side, by opportunity (the prospect of joining regional agreements, taking advantage of new technologies, and so on). The Bank has been successful in supporting reforms in both these situations.

- **Loan conditionality was sometimes helped by strengthening the hand of reformers.** No country’s government is monolithic. At any time, individuals within the government—top political leaders, senior government bureaucrats, party officials, and various formal and informal advisors—will support certain reforms, and others will oppose them. The Bank’s loan conditionality has played an important role in the political economy of reform in several case study countries by strengthening the position of reform-minded policy makers and other stakeholders against those opposed to reform.

- **Local champions often initiated reforms, but broad support was necessary to sustain them.** It was important to have the backing of key politicians to spur reform. However, although much attention was paid to the role of senior political leaders, other stakeholders—professional civil servants, business groups, and the public—were critical to sustaining reforms.

- **The implementation of reforms would get bogged down at lower levels of bureaucracy if incentives were not changed.** Professional civil servants have been essential to the success of reform efforts. The responsibility for the implementation of regulatory and administrative reforms often ran across a large number of government agencies and departments. Senior civil servants needed to understand, support, and assume ownership of reforms.

- **Modest, piecemeal efforts have been less successful than a comprehensive set of reforms.** Reform programs that were meaningful, coordinated, and sustained were more likely to be successful. Evidence from the country case studies shows that, in some countries, the reforms undertaken were not sufficient to reduce administrative and regulatory constraints to investment. The Bank’s support was too modest, too piecemeal, and too inconsistent to get the job done.

From different angles, the components of IEG-World Bank’s evaluation come to the same conclusion: Institutions are key to the quality of the investment climate, and supporting institutional reform is a critical challenge for the Bank. The literature review provides evidence that cross-country differences in the quality of institutions explain a large share of the differences in growth and may even prevail over other growth determinants. The case studies confirm this view by providing examples of countries where the Bank paid insufficient attention to institutional weaknesses, and as a result had little impact on the investment climate. In addition, slower-than-average improvement in the IC loan portfolio resulted from the increased concentration of IC projects on complex, politically sensitive institutional reforms that take time to achieve results.

At the same time, institutional reform is on the frontier of the Bank’s knowledge of the develop-
ment process. Although the basic principles of good investment climates are well recognized (for example, market access and competition, protection of property rights, and contract enforcement), the institutional arrangements for carrying out these principles seem to be country specific to some degree. Strategies for improving the investment climate in individual countries have suffered from a lack of knowledge about what types of institutional arrangements will succeed in different environments and the necessary dynamic process of change.

International Finance Corporation

Investment operations

Although all successful investment projects may have positive impacts on the investment climate, IFC investments in strategic sectors (infrastructure, financial, and social sectors) contribute to improving investment climates by directly addressing some of the major factors conducive to promoting private investments. Several studies, business surveys, and literature reviews show that the quality and quantity of infrastructure services are important determinants of investment decisions and operating success. IFC’s strategic sector projects deliver services that private participants alone are unable to provide. In addition, IFC’s investments in all sectors can have an indirect effect on the investment climate through demonstration effects, transfer of technology and expertise, improvements in management skills and company governance, and linkages with the domestic economy.

IFC approved $36.2 billion in investments during fiscal 1993–2003. Half of the volume ($18.6 billion) was in IFC’s high-impact “strategic” sectors: infrastructure (utilities, transport, and information), financial markets, and the social sectors. As IFC has pursued its frontier strategy, the volume of investments in countries with poor investment climates has risen. In fiscal 1993, 52 percent of investment approvals (by volume) were in poor IC countries; by fiscal 2003, this share had risen to 57 percent.

To evaluate the impact of investment operations on the investment climate, IEG-IFC used the PSD impact rating, one of four indicators included in the Expanded Project Supervision Report framework, in determining an investment project’s development outcome. For projects approved during 1993–97, 73 percent had satisfactory or better PSD impact ratings.

The PSD impact indicator has several potential components for any given project. The “demonstration effect” is often high for projects that serve as role models or lead to related investments. Pioneering or “first of its kind” projects have, by definition, strong demonstration effects. Another important component is “business linkages”—for example, project-related upstream or downstream supply chain linkages that help create or support a network of business infrastructure. The PSD impact rating also includes skills and knowledge transfer and provision of infrastructure services and direct impacts on the enabling environment such as changes in the legal and regulatory regime.

Noninvestment operations

IFC’s IC-related TAAS focused on identifying and removing specific constraints to investment (usually by sector) and other bottlenecks (institutional, administrative, and so on) that impede investment. The main clients for IC TAAS were governments; some activities were directed at private sector clients—for example, to build their capacity to engage in policy dialogue with the government.

IFC conducted 655 IC TAAS operations for a total cost of $167 million during fiscal 1993–2002 (38 percent of all IFC TAAS activities in volume). The Private Enterprise Partnership, IFC’s donor-supported technical assistance program in the former Soviet Union, accounted for about half of IC TAAS in volume. The amount of IC TAAS grew significantly in volume, number of projects, and diversity of instruments and activities in the past decade. Excluding this partnership, increased IFC investment department activity—financed mainly by the Technical Assistance Trust Fund and by growth in Foreign Investment Advisory Service (FIAS) activity—has dominated the
growth of IC TAAS since 1996 (figure 2.4). Since fiscal 2000, modest increases were attributable to the joint Bank/IFC Small- and Medium-Scale Enterprise Department and to IFC Project Development Facility activities.

Most of the growth in IFC’s IC TAAS was for advice on specific sector legislation and capacity building. More recent IC TAAS projects have incorporated capacity-building components, either as part of a policy advisory project or alone (for example, through the Small- and Medium-Scale Enterprise Department’s policy advocacy and corporate governance assistance). Recent growth in general IC advice has been brought about by an increase in FIAS administrative barriers studies as well as small- and medium-scale enterprise mapping exercises. Consistent with IFC’s frontier strategy, most of IFC’s IC TAAS operations were in countries with poor investment climates.

In general, IEG-IFC finds that IC TAAS work has not been strategically planned, and the work done by investment departments has often been driven by their desire to make sector-specific IC improvements to develop a pipeline of projects they can potentially finance. TAAS has grown in response to specific needs and opportunities but, unlike investment operations, has not fallen under corporate-level priority setting, performance measurement, or related incentives. In transition and frontier countries with small private sectors and limited prospects for IFC-financed projects, IFC tended to provide more IC TAAS to create opportunities for private participation in general, with less emphasis on paving the way for specific future IFC projects.

Noninvestment departments (the joint Bank/IFC FIAS, Private Sector Advisory Services, Project Development Facilities [PDFs], and Small- and Medium-Scale Enterprise Department) have developed projects and programs that are relatively independent from one another, from the IFC’s investment departments, and from the Bank’s country departments. Country-level program managers rarely have accountability for planning, prioritizing, coordinating, and overseeing implementation.

**Figure 2.4: IFC IC–Related Technical Assistance and Advisory Services (US$ millions)**

- **IC TAAS by volume, excluding PEP**
- **US$ millions**
- **Years: 1993 to 2002**

Note: TATF = Technical Assistance Trust Fund; SME = small- and medium-scale enterprise; PSAS = private sector advisory services; PEP = Private Enterprise Partnership.
of IFC’s IC work during the review period. Project-level monitoring and evaluation of IC TAAS operations is relatively recent or being introduced; similarly, it has not been well coordinated at the corporate level across TAAS providers.

It is difficult to attribute follow-up investments to IC TAAS, in part because little monitoring has taken place on which to base evaluation. More generally, establishing causality links from the quality of TAAS delivery to outcomes in terms of implementation of recommendations to impacts on the ground is problematic without good monitoring data. Changes in policies, laws, and practices—or their failure to materialize—often result from numerous actions or from the inaction of various stakeholders and other internal and external forces.

IEG-IFC evaluated IFC’s noninvestment IC TAAS activities through field visits to five countries. The evaluation covered the (a) quality of the TAAS (“input”), (b) implementation of recommendations (“outcome”), and (c) changes on the ground associated with implementation of recommendations (“impact”). Interviews were conducted with interviewed and/or surveyed people familiar with specific assignments, such as clients, task managers, investment officers, partners, consultants, business associations, and other donors.

Nearly all interviewees expressed full satisfaction with the overall quality of execution: 76 percent of responses rated the quality of IFC investment climate TAAS as satisfactory, and 16 percent rated it as excellent. They viewed the speed and timeliness of IFC’s assistance as more in line with commercial standards, compared with other donor-providers. Although IEG-IFC found only minimal execution quality issues in the small sample, it observed that in many instances the investment officer or task manager was the only representative of the IFC responsible for finalizing consultants’ inputs and presenting the report under the IFC logo. Without any well-structured quality-control mechanism in place, IFC runs a reputational risk that the advice might be inappropriate or of low quality.

Ratings for the implementation of recommendations (outcomes) and the final impacts of assistance were lower than for the quality of assistance. Forty-six percent of respondents indicated that IFC’s advice was largely implemented, 29 percent said it was implemented in part, and 19 percent indicated almost no implementation of the major recommendations. Barriers to implementation included poor dissemination, weak institutional capacity of government counterparts, opposition from influential interest groups, and political infighting. Implementation was more likely when the TAAS was teamed with follow-up programs—including lending conditionality by the Bank or other donors—supported by private sector associations, public-private working groups, and/or an influential local champion.

The most important themes that emerged from discussions with stakeholders on projects evaluated by IEG-IFC include the following:

- Strong client commitment to reform and a political “champion” with staying power were necessary for inducing change.
- Major stakeholders (across the public sector, private sector, and donor community) should be involved early. Proactive outreach and engagement of stakeholders throughout execution (for example, dissemination in the local language, participatory workshops, and so on) and shared commitment to an action plan were critical to moving the reform process forward sustainably.
- Implementation was enhanced through follow-up projects and capacity-building components. A strong local presence and/or network were necessary to keep issues alive and the reform process moving forward. Partnerships with donors and other stakeholders, based on a shared vision of desired outcomes and impacts, were very important for leveraging reform efforts.

Similar conclusions emerged from the 1998 IEG-IFC evaluation of FIAS and an analysis of data from FIAS’s Project Implementation Monitoring System. Implementation rates were lower for technical assistance that was broad in scope,
compared with more narrowly defined or sector-specific advice. Project follow-up was also important and identified as one of FIAS’s weakest characteristics, although recent client surveys have shown improvement. The Private Enterprise Partnership model incorporates many elements of good practice, including substantial program follow-up, local stakeholder involvement, and capacity-building components. The IFC-managed PDFs have undertaken only limited IC TAAS. Preliminary evaluative assessments of the facilities were not able to conclude how effective these activities were or whether their benefits justified their costs.

In the past year, IFC management has begun to implement two important initiatives to (a) develop a more strategic approach to developing and delivering technical assistance and (b) within a results-based management framework, set up a monitoring and evaluation system for IFC’s rapidly growing TAAS business line. Senior management has endorsed these initiatives and implementation was expected to take place in fiscal 2005.

**Multilateral Investment Guarantee Agency**

MIGA’s mandate is to facilitate FDI flows to developing countries through guarantee and technical assistance activities but does not explicitly encompass IC issues.

**Political risk guarantees**

MIGA offers insurance against certain political risks that are a subset of IC issues. Although its guarantees do not directly address IC issues (because MIGA does not normally work with governments in its guarantee operations), MIGA projects can affect the investment climate through demonstration effects and linkages to the local economy.

MIGA has made some progress toward meeting the objectives of its most recent strategy (IEG-MIGA 2000), focusing its guarantees on IDA-eligible countries (particularly in Africa), complex infrastructure projects, South-South investments, and small- and medium-scale enterprises. Between fiscal 1990 and fiscal 2004, MIGA supported more than 400 projects in 85 countries for a total exposure of $12.8 billion. These projects were associated with investment flows of $51 billion. In the past few years, MIGA has become increasingly active in countries with poor investment climates.

**Technical assistance**

MIGA offers capacity building to investment promotion intermediaries (IPIs). Working with government agencies, MIGA assists IPI strategy development (such as needs assessments, strategic plans, and marketing plans) and provides promotion support tools (investor information systems, information technology system tools, contact relationship management, and promotional materials) and staff training.

MIGA’s strategy for selecting technical assistance clients and focusing its activities has frequently changed. In 2002 MIGA identified several criteria for prioritizing technical assistance among countries and organizations, including countries with (a) low income; (b) a reasonably attractive investment environment; (c) strong government commitment to the goal of attracting FDI, demonstrated by providing adequate funding; and (d) ability to absorb support. Based on these criteria, MIGA developed a tiered assistance approach with a different menu of services targeted to each country category, but it was never formally adopted as the basis for client selection. In 2003 MIGA introduced additional criteria relating to investor interest to provide an active market for MIGA guarantees and complementarity with WBG strategies for PSD. Despite these stated priorities, MIGA has never limited itself to working within the framework of the tiered approach. Client selection has been demand driven for diagnostic needs assessments. In-depth technical assistance activities were driven by the results of needs assessments and availability of external funds.

During fiscal 1998–2003, MIGA provided technical assistance interventions to 63 countries. Of these countries, 41 received one or two technical assistance interventions.
(mostly needs assessments) and 22 received more in-depth technical assistance. The average IC levels for countries receiving in-depth technical assistance were similar to those of recipients of MIGA guarantees; the average IC levels for countries receiving diagnostic technical assistance was worse than for guarantee recipients.

In 2002 and 2003, after identifying new selectivity criteria, MIGA was active in 41 countries. Of the 41 with any MIGA technical assistance activity, 36 had reasonably attractive investment environments and 26 were low income (of which 21 also had reasonable investment environments). In 2002–3 MIGA delivered in-depth technical assistance activities to 19 of the 41 countries, and of these, 16 met both the low-income and reasonable IC-level criteria. MIGA's more recent in-depth technical assistance activities are, therefore, meeting these two major criteria well.

MIGA has used its own budget to fund diagnostic work and has mainly used donor trust funds to finance in-depth technical assistance work. Virtually all of MIGA's technical assistance trust fund and grant resources (which account for 40 percent of MIGA's total technical assistance resources) were tied to providing technical assistance in specific countries. Although external funding has enabled MIGA to provide in-depth and sustained assistance to a number of countries requiring its assistance, the lack of untied funding sources has limited MIGA's ability to maximize its development impact.

**Impacts**

Findings from a small sample of evaluated MIGA guarantee projects showed mixed results regarding their impacts on PSD (which includes demonstration effects). In some cases, MIGA clearly played a positive role in supporting early investments in a sector or country, and some of its projects have had follow-on investments and thus a positive demonstration effect. A majority of evaluated projects had low PSD impacts because of low financial returns due to economic or sector crises or regulatory problems. In addition, MIGA projects are mostly small, compared with their host economies, and therefore have limited PSD impacts.

MIGA's technical assistance activities were found to be effective in strengthening IPIs and improving their effectiveness. Surveys of MIGA clients have demonstrated a generally high degree of satisfaction with the quality of MIGA's technical assistance—above that of other technical assistance providers. MIGA technical assistance, however, does not normally address the legal and regulatory framework in host countries, which is under the purview of the World Bank and, to some extent, FIAS.

Empirical research is limited on the link between investment promotion and actual investment flows. Although a recent FIAS study concluded that a positive relationship exists between promotion activities and FDI flows, it is difficult to measure the ultimate impact of MIGA technical assistance activities on the investment climate and actual FDI flows. Findings from two case studies conducted by IEG-MIGA suggest that MIGA's technical assistance has had a positive impact on the quality of services of the IPIs. Although MIGA's recommendations to IPIs were mostly relevant, the degree of implementation varied. In the two cases, the impact of IPIs on actual FDI flows has thus far been limited. Most investors surveyed by IEG-MIGA for the two case studies stated that they would have invested in the country regardless of the IPI. They also stated that IPIs have contributed to a reduction in transaction costs (for example, cost of information and time) and improved the likelihood of their investment's success.

Evidence from the two case studies suggests that MIGA's technical assistance has been more effective when MIGA was engaged with committed governments and where a stable organizational framework for the investment promotion function existed within the government. Examples are IPIs with direct support from and reporting to the president or prime minister, for which increases in FDI flows were a government priority and funding for the IPI was adequate.
From Strategy to Outcomes: Illustrations from Country Case Studies

The Annex shows how WBG strategies and activities translated into outcomes in three countries that were the subject of case studies by both IEG-World Bank and IEG-IFC: Peru, Mozambique, and Romania. The findings include the following:

**Peru**
In the early 1990s, IC reforms in Peru supported by significant Bank involvement led to an increase in private investment. After 1997, however, the increasing unpredictability of the judiciary as well as tax instability dampened private investment. Overall, the long time needed to accomplish institutional change and political issues hindered progress in institutional development. IFC’s TAAS on the regulatory framework for mutual funds helped this industry grow significantly; however, recommendations on mortgage finance were largely not implemented.

**Mozambique**
WBG strategy increasingly focused on institutional issues, including administrative and regulatory reforms, simplification of licensing procedures and labor regulations, and revisions to the commercial code. Enterprise surveys were prepared under the Regional Program for Enterprise Development. Support for IC reforms came through a series of Economic Recovery Credits as well as financial sector and enterprise development projects. IFC supported the establishment of a foreign bank and investment banking affiliate and provided TAAS on financial sector issues and corporate governance. Despite progress in improving some aspects of the investment climate, the investment response has been less robust than expected. Investment has increased, but this was mainly due to several foreign “mega” projects (including an IFC investment in the MOZAL aluminum smelter). Institutional weaknesses and inadequate infrastructure continue to impede private sector activity.

**Romania**
Prospects for Romania’s accession into the European Union motivated the government’s push for improvements in the investment climate. A FIAS administrative barriers study initiated WBG support, which led to an action plan to improve the business environment. The Bank supported policy and institutional reforms through two sets of adjustment and technical assistance loans; IFC did so through TAAS related to housing, capital markets, mortgage finance, and private participation in health care. The investment climate has improved, but policy uncertainty and lack of transparency continue to concern investors.
Coordination in the World Bank Group

The 2002 PSD Strategy defines the broad division of labor among the World Bank, the IFC, and MIGA in implementing the IC agenda:

IBRD/IDA focus on investment climate and related institution building, improvements of governance, legal and regulatory systems, financial sector policies, and public financing. IFC pursues demonstration projects that promote the credibility of government policies, provides additional financial services in local markets, and provides political risk protection to cofinanciers. Its strategy is to deploy its instruments such that they support relevant institution building particularly in the financial sector and for small and medium enterprises. MIGA provides focused political risk guarantees, institution-building, and investment promotion assistance (World Bank 2003).

In practice, the division of labor on IC work among the Bank, IFC, and MIGA is less clear cut. Both the Bank and IFC provide policy advice to governments, and both FIAS and MIGA assist investment promotion intermediaries.

Advice on Policies and Institutions
There is a lack of consistency between the 2002 PSD Strategy and IFC’s own strategic documents regarding the division of labor between the Bank and IFC on providing policy advice to governments. IFC’s original Articles of Agreement state that one of its purposes is to “seek to stimulate and to help create conditions conducive to the flow of private capital . . . into productive investments.” IFC first proposed “strengthening its investment and advisory work in support of IC improvements in member countries” in 2001 and again in 2002–4. According to an IFC 2001 strategy, IFC is to promote and support technical assistance and advisory activities to improve the investment climate, including appropriate institutional and policy reforms.

IEG-World Bank and IEG-IFC investigated two issues related to the division of labor between the Bank and IFC on policy advice: (a) the degree of coordination between the Bank and IFC and possible duplication of effort and (b) concerns about conflicts of interest associated with WBG policy advice related to potential IFC investments.

Coordination between the Bank and IFC has been uneven. Although current practice is to prepare joint Bank/IFC CASs, discussions with staff indicate a perception within IFC that its participation has little impact on the Bank’s
lending and nonlending services. An exception is FIAS analytical work, which has often been taken up in Bank lending operations. At the project level, cooperation between the Bank and IFC often depends on personal relations as well as attention given by Bank and IFC management to encouraging collaboration in country teams. Regarding duplication of effort, client and staff feedback suggests that duplication of effort is not a real problem, because so much needs to be done on so many IC topics. Moreover, the Bank tends to focus on broader, economywide and sectorwide policy advice (for example, regulation or competition policy), whereas the IFC focuses more on industry-specific advice (such as advising on corporate bond markets), much of which is directed to the financial sector.

Since 2002 the joint Bank-IFC PSD Vice Presidency has attempted to enhance coordination and realize synergies across the WBG. Examples include organization of 12 WBG-wide country IC review meetings and development of a WBG-wide training program on IC reform. MIGA now participates in the PSD Sector Board, and both PSD and FIAS are members of MIGA’s Benchmarking Steering Committee. The vice president responsible for PSD in the Bank is also the chief economist of IFC. As noted earlier, this report does not evaluate these recent activities.

Although no specific examples or allegations of conflict of interest were identified in the field, there is concern that IFC’s dual role as an advisor to governments on legal and regulatory matters and as a direct (prospective and existing portfolio) investor could result in potential or perceived conflicts of interest that require careful management. Most of the TAAS reviewed for this evaluation appear not to involve conflicts of interest. Current conflict-of-interest rules require that a team that is separate and independent from any IFC investment team for a potential project undertake the advisory work and that disclosure of the potential conflict of interest and proposed mitigation measures be disclosed to the government client. Although the current conflict-of-interest guidelines and procedures offer a well-defined framework for dealing with potential conflicts of interest, it is difficult to determine the degree to which IC TAAS conducted by departments outside of those routinely screened (Global Product Groups and Private Sector Advisory Services) have actually followed conflict-of-interest rules.

**Assistance to Investment Promotion Intermediaries**

Both MIGA and FIAS provide technical assistance to promote FDI. FIAS’s mandate is to provide technical assistance to improve the overall investment climate and assistance in developing the legal and institutional framework for the establishment of Investment Promotion Intermediaries (IPIs). MIGA generally works with established IPIs on their organizational development and investment promotion efforts. Some overlap in this division of labor exists, due to the similarity of MIGA and FIAS objectives. The extent of overlapping activities—in terms of the number of projects and of project costs—is not significant and has been declining; however, the similarity of the two mandates is likely to create confusion among WBG clients about who is providing which services.

MIGA and FIAS have attempted to establish their respective functional roles and responsibilities in providing technical assistance to support investment promotion and have agreed to “hand off” clients to one another. Because of efforts to improve coordination between FIAS and MIGA, nearly half the FIAS projects in overlapping areas involve joint missions with MIGA staff and/or some form of MIGA involvement. Although IEG-IFC and IEG-MIGA found no major conflicts in the countries they studied, codification of coordination and cooperation between FIAS and MIGA, including protocols for the hand-off of clients, should occur.12

**Integrating Microeconomic and Macroeconomic Agendas**

Responsibility for the Bank’s IC operations is spread across the institution. The sector units for Finance and Private Sector Development, Poverty Reduction and Economic Management...
(PREM), and Infrastructure primarily manage IC lending operations in the Regions. The wide-ranging “ownership” of the Bank’s IC portfolio is apparent in the assignment of projects to individual networks and sector boards. In fact, more IC projects are assigned to non-PSD networks than to PSD. During fiscal 1999–2003, the Bank assigned 31 percent of the core IC portfolio to the PREM Network, 23 percent to the Infrastructure Sector Unit, and 19 percent to the Financial Sector Network, compared with only 17 percent to the PSD Network.

At the country level, coordination across the WBG on IC issues has been weak, both between the Bank and IFC and across sector units within the Bank. Competition between PSD and PREM units for the IC agenda has become pervasive and led in some cases to a lack of coordination and information sharing. The broad nature of the IC topic and the need to balance private sector interests with broader economic and social goals requires the Bank to have an organizational structure that facilitates integration across sectors and collaboration among staff. The burden of integrating different sector perspectives and setting priorities now lies with the country departments, but some country departments have been more actively involved in managing this integration than others.
Recommendations

The World Bank Group: Clarify the roles of the Bank, the IFC, and MIGA on IC activities, bringing consistency to corporate strategy and practice. Improve coordination and consistency across the WBG on IC diagnosis, priorities, results focus, strategy, and assistance at the country level.

a. Define the respective roles of the Bank and IFC in providing advice on policy and institutional reform, according to the comparative advantages of each institution on specific IC issues.

b. Formulate a joint Bank, IFC, and MIGA results-based IC strategy for each client country that is reflected in the Country Assistance Strategy and that uses the resources of each more effectively, and track the results.

c. Codify the respective roles of FIAS and MIGA and hand over protocols to ensure consistent application and smooth transfer of clients from one to another. In view of the partial overlap between services offered by FIAS and MIGA, Management should monitor coordination improvements closely to ensure they continue on track.

The World Bank: Do a better job of setting priorities and packaging IC reforms in lending operations, paying more attention to institutions and the political economy of reform.

a. Do more analytical work on institutional arrangements and the political economy of reform, involving local organizations in this work (IEG-World Bank part recommendation 1a).

b. Be less timid in dealing with vested interests and in building a balanced constituency for reform. Make better use of the Bank’s convening power to bring the government together with other stakeholders. Be more proactive in disseminating information and pushing for transparency (IEG-World Bank part recommendations 1b, c, and d).

c. Make better use of survey-based diagnostics, focusing them on specific country needs. Use surveys only as an input for making policy recommendations to balance business perspectives with broader economic and social concerns (IEG-World Bank part recommendations 2a, b, and c).

d. Consider packaging a critical mass of microeconomic reforms into IC adjustment loans, rather than piggybacking small IC components onto macroeconomic adjustment operations (IEG-World Bank part recommendations 3a, b, and c).
**IFC:** Raise the profile of IFC IC work and develop operating guidelines for technical assistance and advisory work related to the investment climate.

a. For its technical assistance and advisory services (TAAS) work, make investment climate a central theme and strategic priority. The regional investment departments should define the IC agenda and product mix relevant to each country’s IC needs. Each country technical assistance program should have a strategic plan and clear accountability for technical assistance coordination, execution, monitoring, and evaluation (*IEG-IFC part recommendation 1*).

b. As part of the corporate-wide initiative to develop operating guidelines and procedures for TAAS operations, management should (a) develop a quality control mechanism for advisory work provided to government clients; (b) incorporate good practice measures into TAAS operations within a results-based management planning, monitoring, and evaluation system; and (c) implement IFC-wide training in conflict-of-interest policies to ensure that current procedures are known and followed (*IEG-IFC part recommendation 3*).

c. Develop a mechanism to (a) track and follow up on IC issues to support IFC’s portfolio and potential client companies, (b) update IFC’s IC work program, and (c) inform relevant WBG staff charged with improving investment climates and setting CAS priorities (*IEG-IFC part recommendation 4*).

**MIGA:** Improve the focus and effectiveness of technical assistance.

a. Implement a clear strategy for client selection that ensures MIGA’s effectiveness and development impact, and exercise greater selectivity to improve the effectiveness of resource use and impact. Focus on areas in which MIGA has a comparative advantage and can provide additionality and complementarity to the WBG, other donors, or the private sector. Continue to complement its own resources with external funding, and align MIGA’s work program closer with World Bank/IDA priorities and lending to support capacity building (*IEG-MIGA part recommendation 1*).

b. Improve MIGA’s cost-measurement tools and tracking systems to be able to assess its cost efficiency and aid decision making in the future. Implement a monitoring system to track progress and impact of interventions. Facilitate research on impact of investment promotion on investment flows (*IEG-MIGA part recommendations 2, 3, and 5*).

c. Formalize MIGA’s relationship with client countries through formal contracts that clearly state the objectives, scope of work, costs, and indicators of success and include arrangements for sharing costs (*IEG-MIGA part recommendation 4*).
### ANNEX I.A: WORLD BANK GROUP INVESTMENT CLIMATE ACTIVITIES IN PERU, MOZAMBIQUE, AND ROMANIA

#### Annex I.A: World Bank Group Investment Climate Activities in Peru, Mozambique, and Romania

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Actions</th>
<th>Outcomes</th>
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<tr>
<td><strong>PERU</strong></td>
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<tr>
<td><strong>World Bank</strong></td>
<td>• Use a selective approach to PSD issues, considering the roles of partner institutions (CAS 1994).</td>
<td>• The reforms of the early 1990s, with significant Bank involvement, improved investment climate and private investment.</td>
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<td>• Pay greater attention to PSD as source of future growth, but not yet as an area of primary concentration; improve property rights through land titling and registration; strengthen regulatory environment; continue privatization and decentralization; and build capacity at the municipal level (CAS 1997).</td>
<td>• These were followed by increasing unpredictability of judiciary and tax instability and of the political situation in general, which dampened private investment after 1997.</td>
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<td></td>
<td>• Generate employment and increase competitiveness by addressing barriers to private sector growth and increasing exports, and increase focus on governance and institutions, property rights, and judicial reform (CAS 2002).</td>
<td>• Bank’s involvement in institutional development efforts overall were relatively less successful, due to the long gestation needed and political issues.</td>
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<td><strong>IFC</strong></td>
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<td></td>
<td>• Reduce poverty through private sector–led growth (CAS 1994).</td>
<td>• Four of five investment operations had high development outcome ratings and resulted in high PSD impact.</td>
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<td></td>
<td>• Strengthen role for PSD, especially financial sector development (CAS 1997).</td>
<td>• Implementation of IFC’s technical assistance recommendations helped mutual funds grow from $100–200 million to $1.6 billion with 62,000 individual investors.</td>
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<td></td>
<td>• Develop financial infrastructure, private participation in infrastructure, and post-privatization programs (CAS 2001).</td>
<td>• Recommendations on mortgage finance were largely not implemented, due in part to a change in government. IFC invested in a commercial bank to provide housing credit and support development of the primary market.</td>
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<td></td>
<td>• Reactivate private sector growth; enhance competitiveness; foster financial sector development; and support reform program (CAS 2002).</td>
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**World Bank**

- Private sector assessment (1994)
- Economic and sector work on secured transactions (1997)
- Judicial Reform Project (1997)
- Financial Sector Adjustment Loan (1999)
- Urban Property Rights Project (1998)

**IFC/World Bank**

- Study on private participation in infrastructure
- FIAS report on promoting foreign investment

**IFC**

- Thirty-nine investments in infrastructure (water, telecom, and power), mining, agribusiness, financial sector, and social sector (private university)
- Technical assistance for financial market reforms, including the regulatory framework for the mutual funds industry, and development of the primary and secondary mortgage market.

(Continued on the following page.)
## Annex I.A: World Bank Group Investment Climate Activities in Peru, Mozambique, and Romania (continued)

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<th>Strategy</th>
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<tr>
<td><strong>MOZAMBIQUE</strong></td>
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| **World Bank** | • Develop comprehensive strategy for rehabilitation and reform of the postwar economy. Create a more favorable investment climate was identified as a priority area (CAS 1991).  
• Accelerate privatization, and create a microeconomic environment for growth and diversification of private sector activity. Improve the business environment by removing bureaucratic red tape and restrictions embodied in the regulatory system, institutional development (CAS 1995).  
• Intensify efforts to improve the investment climate through continued macroeconomic reform, added efforts to enhance the microeconomic business environment, private sector capacity-building programs, and infrastructure development in high-potential sectors (CAS 1997). | |
| **World Bank** | • RPED manufacturing survey (1997)  
• Investment Climate Assessments (1997 and 2002)  
• Sponsorship of private sector conferences  
• Economic Recovery Credits (1992, 1994, and 1997)  
• Financial Sector Capacity Building Project (1994)  
• Economic Management Reform Credit (1998)  
• Enterprise Development Project (2000) | |
| **World Bank/IFC** | • FIAS administrative barriers to investment studies (1996 and 2001) | |
| **IFC** | • Continue to help reduce the impediments to PSD.  
• Provide financial and advisory services for financial development.  
• Promote innovation, competitiveness, and employment.  
• Intensify efforts for legal and regulatory reform including revision of the commercial code (CAS 1995, 1997, and 2000). | |
| **World Bank** | • Significant progress was achieved in financial sector reform and privatization, but the reforms of the early 1990s failed to pay enough attention to weak corporate governance and technical capability in State-owned banks and enterprises (IEG Country Assistance Review 1998).  
• The government’s preoccupation with the peace process and elections, as well as differences in perceptions between government and the Bank regarding implementation capacity and effect of reform retarded many areas of policy reform.  
• Investment and growth have increased, but primarily due to foreign “mega” investments; labor-intensive growth has not yet materialized. | |
| **World Bank/IFC** | • Interministerial working group was set up to reduce red tape. Many of the FIAS recommendations are under implementation. | |
| **IFC** | • Of four investment operations evaluated, three had low development outcome, but high PSD impact and one had low development outcome and low PSD impact.  
• In the banking sector, service levels and competition were improved.  
• MOZAL created local supply linkages.  
• In the insurance sector, nearly all technical assistance recommendations were incorporated into the law passed in September 2003.  
• Petromac privatization is still under way. | |
### Annex I.A: World Bank Group Investment Climate Activities in Peru, Mozambique, and Romania (continued)

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<th>Strategy</th>
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<td><strong>MOZAMBIQUE (cont.)</strong></td>
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<td><strong>MIGA</strong></td>
<td>• Support projects with high development impact and investment intermediaries charged with attracting FDI.</td>
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<td>• Continue support of Investment Promotion Center (CPI) and World Bank-funded technical program.</td>
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<td><strong>ROMANIA</strong></td>
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<tr>
<td><strong>World Bank</strong></td>
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<td></td>
<td>• Improve business environment by lowering barriers to entry for firms and joint ventures (CAS 1995).</td>
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<tr>
<td></td>
<td>• Promote PSD through macroeconomic stabilization, privatization, price liberalization, and restoration of financial discipline. Establish a well-functioning legal code and rationalize bureaucratic involvement in business. Establish a sound and competitive financial sector through bank competition and regulation. Improve infrastructure to reduce the unreliability and high cost of infrastructure services (CAS 1997).</td>
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<td></td>
<td>• Strengthen institutions for a market economy (CAS 2001).</td>
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<td><strong>IFC</strong></td>
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<td></td>
<td>• Strengthen business environment by lowering barriers to entry for firms and joint ventures and developing an adequate incentive framework for PSD (CAS 1997, 2001).</td>
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<td></td>
<td>• Increase private sector role in agriculture, energy, transport, water supply, local government, and telecommunications (CAS 1997).</td>
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<tr>
<td><strong>MIGA</strong></td>
<td>• MIGA issued 25 guarantees for 10 projects, for a total exposure of US$411 million (gross) during fiscal 1998–2004, especially in agribusiness, infrastructure, and oil and gas.</td>
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<td>• Pilot country for the MIGA-Swiss Partnership: long-term, multicomponent technical assistance program initiated in fiscal 2002, providing advice to CPI to advance free zone work program</td>
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<tr>
<td><strong>World Bank</strong></td>
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<tr>
<td></td>
<td>• Legal Framework for PSD (2002)</td>
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<td>• Financial Markets, Credit Constraints, and Investment in Romania (1999)</td>
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<td>• Financial and Enterprise Sector Adjustment Loan (1996)</td>
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<td>• General Cadastre and Land Registration Project (1997)</td>
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<td>• Private Sector Adjustment Loans I and II (1999 and 2001)</td>
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<td>• Public Institution Building Loans I and II (1999 and 2001)</td>
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<td>• Rural Finance Loan (2001)</td>
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<td><strong>World Bank/IFC</strong></td>
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<tr>
<td></td>
<td>• FIAS helped draft an investment promotion law, conducted an administrative barriers study (1999), and proposed an investment incentives policy.</td>
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<td><strong>IFC</strong></td>
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<tr>
<td></td>
<td>• Investment operations in telecom, financial sector, manufacturing, agribusiness, and small- and medium-scale enterprises</td>
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<td></td>
<td>• Technical assistance for housing regulations, capital market legislation, mortgage finance, private participation in health care, and the national pension system</td>
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**Outcomes**

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<th>Strategy</th>
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<tr>
<td><strong>MIGA</strong></td>
<td>• Outcomes of individual MIGA guarantees and technical assistance have not been evaluated; however, MIGA appears to have offered relevant products in its support for a post-conflict IDA country, making Mozambique MIGA’s fourth largest host country (in terms of outstanding guarantee exposure).</td>
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<tr>
<td><strong>World Bank</strong></td>
<td>• Projects had significant impact on the investment climate; however, political frictions and reduced transparency still impede increasing investments for the following reasons: (a) the legal system remains complicated with weak institutional capacity, (b) frequent changes in legislation create uncertainty for business, and (c) the legal status of fixed property is still unsatisfactory, especially in rural areas.</td>
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<td>• Customs reform has facilitated trade.</td>
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<td>• Secured transactions reform has led to increased access to finance.</td>
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<tr>
<td><strong>World Bank/IFC</strong></td>
<td>• FIAS’s administrative barriers study led to an action plan. Fiscal reform is under way, new tax code implementation is expected by 2004, land registration has improved, and lead time for business permits is lower.</td>
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<tr>
<td><strong>IFC</strong></td>
<td>• Of six investment projects evaluated, three had high development outcomes and four had high PSD impact.</td>
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(Continued on the following page.)
Annex I.A: World Bank Group Investment Climate Activities in Peru, Mozambique, and Romania (continued)

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<tr>
<th>Strategy</th>
<th>Actions</th>
<th>Outcomes</th>
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| **ROMANIA (cont.)** | • Strengthen financial and capital markets and privatize State-owned banks (CAS 2001). | • Joint study with European Bank for Reconstruction and Development and other international financial institutions to identify investment impediments
• Advised on privatization of Bucharest Water Supply, the State Ownership Fund (ball bearings), and tractor manufacturer (Tractorul) | • The health care sector was opened to private sector participation, and efficiency gains were achieved.
• Following privatization of Bucharest Water Supply, access and service were improved and new investments in the sector followed.
• Implementation of pension reform recommendations was limited, and private participation remains low. |
| **MIGA** | • Support government’s efforts to attract FDI by offering technical assistance for development of investment promotion capabilities (CAS 2001). | • Limited technical assistance for investment promotion capacity building, focusing on diagnostics.
• Guaranteed projects overwhelmingly in the financial sector (and in services) | • MIGA technical assistance had some positive outcomes in enhancing capabilities of the investment promotion intermediary to some degree, but the IPI lacks credibility, links with other government entities, and has a weak governance structure. |
| **MIGA** | • Issue guarantees in banking (notably for small- and medium-scale enterprises and rural finance) and infrastructure; support privatization program (CAS 2001). | |
This note sets out the joint management response of IDA/IBRD, IFC, and MIGA to the four-volume evaluation of WBG fiscal 1993–2002 activities in support of improving investment climates that was conducted by the respective independent evaluation units. Management welcomes the analysis, which comes at an opportune time and helps shape a joint Bank Group approach to dealing with investment climate issues. While components of investment climate activities of IDA/IBRD and IFC have previously been evaluated separately, this is the first comprehensive evaluation of the WBG on this topic. This is also the first IEG evaluation of MIGA’s investment climate activities. The joint reporting is helpful in bringing together the wide range of IDA/IBRD, IFC, and MIGA activities, illustrating the benefits of a Group-wide approach and the potential for enhancing synergies across and in the institutions.

Management agrees with the framing of the key challenges and notes that it has benefited from discussions with the evaluation units on the draft reports. Annexes I.B.1–I.B.4 contain the response matrices, which provide detailed responses to each recommendation of the evaluation reports, including the overview report for the WBG as a whole. Of particular note is the marked progress that has been made in meeting these challenges since the evaluation period ended in fiscal 2002. This progress on the investment climate agenda is acknowledged in the overwhelmingly positive reception of two recent WBG flagship publications: World Development Report 2005: A Better Investment Climate for Everyone and Doing Business 2005: Removing Obstacles to Growth, as well as to the report of the UN Commission on the Private Sector and Development, Unleashing Entrepreneurship: Making Business Work for the Poor, to which the Bank Group contributed.

The evaluation reports and our recent strides in meeting challenges identified in the reports provide a valuable reference and benchmark for ourselves as well as for the broader investment climate community of clients and donors. Moving forward, the main challenge for the WBG and its partners is to use this momentum to build constituencies for change on this broad but central agenda in client countries.

**Joint Findings**

The joint evaluation found that investment climates in developing and transition countries have been modestly improving. Many countries are moving beyond first-generation reforms (including macrostability and in some cases privatizations and trade reforms) to second-generation reforms focusing on institutional “rules of the game” for establishing an investment climate conducive to private sector activity. Given this overall context, the reports lay out specific areas of attention and perspectives on key issues for the WBG as a whole and for each institution with regard to assistance for the improving investment climate.

The evaluation reports indicate that, on balance, WBG IC activities are on track and have reasonably good results, noting that:

- Improving investment climate has always been a large part of WBG interventions and is increasingly moving to the center stage in the WBG approach to sustainable growth and poverty reduction.
IMPROVING INVESTMENT CLIMATES: AN EVALUATION OF WORLD BANK GROUP ASSISTANCE

• WBG IC assistance is moving toward second-generation reforms, in line with shifts in the IC reform agendas of its member countries.
• WBG non-investment activities through the Bank’s economic and sector work and IFC’s TAAS activities have contributed to improving investment climates; MIGA’s TA activities were found to be effective in strengthening IPIs and in improving their effectiveness.
• The Bank’s IC lending activities and IFC’s investment climate-enhancing operations (for example, investments in support of infrastructure and financial markets) have yielded outcomes above the average of those of all the operations of the respective institutions.

In the context of the WBG PSD strategy, Management takes from the joint evaluation four main challenges present over the evaluation period, fiscal 1993–2002:

• Undertake a fundamental approach to IC improvements that focuses on institution-building customized to country conditions and that recognizes political opportunities and constraints.
• In working with clients, support mechanisms, such as stakeholder consultation processes, that enable country specifics to drive strategy.
• Clarify the division of labor and enhance collaboration within the WBG that leverages organizational comparative advantages and that takes into consideration potential conflicts of interest between IFC and the World Bank.
• Enhance donor coordination.

Management also agrees with the evaluation’s emphasis on the importance of results measurement and monitoring of IC assistance activities.

Management Comments

Fundamental Approach to IC Improvements
Management agrees that the key to improvement in the IC work of the Group is progress in dealing with institution-building customized to country conditions and duly cognizant of political opportunities and constraints. Bank Group initiatives are under way to make progress on the diagnostic front, on solution design, and on implementation.

Diagnostic Work
The Bank is providing strong global leadership in the area of diagnostics and results measurement for key features of IC institutions. As the evaluation points out, the key challenge is to interpret the data sensibly, taking into account their limitations and adapting them to country-specific features. Based on the diagnostic work, the Bank Group has clearly made major progress in disseminating analyses and in setting the agenda for reform—not least through the Doing Business reports and the WDR 2005, but also country by country (where, for example, the Investment Climate Assessments (ICAs) have been part of high-profile outreach activities).

Notwithstanding the achievements and expanded efforts in the area of diagnostics and measurement, Management is pushing further within the framework of the PSD strategy to help develop policy-relevant measures for IC issues, with identification of good practice, studies of the political economy of reform processes, and support for results-based management of reform processes under way.

Solution Design
When it comes to solution design, more remains to be done, as noted in the evaluation. The Bank Group training program that is currently being designed is underpinned by an effort systematically to provide guidance on solution design for some 25 subtopics of the IC agenda that cover a wide array of issues, including:

• Governance topics (for instance, legal and institutional foundations for reforms, stakeholder management, and change management in implementing institutions)
• Factor markets topics (for instance, secured lending, labor regulations, education and vocational training, property rights, land policies)
• Judiciary systems (including contract enforcement and arbitration)
• Tax policies and administration
• Product market issues (for instance, competition, investment promotion agencies, inspections and project service regulations, corporate social responsibility).

Solution design materials cover technical as well as political economy aspects of reform. Among other things, this work draws on existing materials developed for the WDR 2005, the Doing Business Project, and lessons from FIAS activities and ICAs.

Knowledge of and experience with effective investment climate reform processes in developing countries remains incomplete. Experience indicates that, for some countries, a comprehensive approach to reform is appropriate and effective, while for other countries, notably China and India, incremental improvements “at the margin” appear to help a healthy reform dynamic unfold in a politically sustainable fashion. As the knowledge gap shrinks, it will become clearer whether a typology of country characteristics is useful or whether solution design ultimately is highly country specific and experimental.

Implementation Capacity
On the implementation front, a decentralized concerted effort is under way to strengthen country-specific capability. In turn, implementation experience, including the transaction experience of IFC and MIGA, feeds country knowledge into solution design while maintaining a critical mass of expertise in headquarters. Already, decentralized Bank offices and IFC offices and project development facilities (PDFs) have been staffed up. At the same time, transaction work on both the IFC and MIGA side is being aligned better with advisory work in both organizations—at the level of the operations group in MIGA and the Regions in IFC.

Strategy Processes
Investment climate is critical for all WBG institutions. For the Bank, it is part of country driven processes. For IFC, management recognizes the importance of investment climate and addresses investment climate as a cross-cutting theme in four of IFC’s five strategic priorities. And for MIGA, investment climate is an integral part of its mandate.

When it comes to setting strategy at the country level, management agrees that country specifics will need to be key drivers, with joint CASs the main vehicle for WBG efforts at setting country strategy on IC support. In country dialogue, special efforts are under way to learn from experience in order to better assist governments to enhance stakeholder engagement. In the case of Poverty Reduction Strategies, the dialogue between the private sector and government has been less strong than that with other stakeholders. Hence, current efforts are focused on this area, with the Group supporting dialogue processes in about 10 countries. A review of successes and failures of such dialogue processes in developing countries is currently under way, and the WBG will provide the lessons of experience to interested client countries as they prepare poverty reduction strategies and undertake other stakeholder processes.

Management Systems and Processes for Effective Division of Labor and Collaboration within the Group
The evaluation suggested a better deployment of resources to increase the impact of IC work. The WBG has in process a coordinated set of activities to address this issue. As noted in the evaluation reports, the most significant organizational change aimed at clarifying roles and facilitating coordination has been the creation of the joint PSD Vice-Presidential Unit (VPU) in fiscal 2004. Under the joint VPU, diagnostic work, development of good practices, and work on the political economy is carried out in joint Bank/IFC units in collaboration with both Bank and IFC Regions. This will continue. Implementation of the joint training program will also help strengthen working relationships within the Group.

Beyond this, current efforts are particularly focused on developing a Group capability to carry out freestanding advisory services from diagnostics through solution design to implementation support. As the evaluation points out, the recent emphasis on investment
climate work up to fiscal 2003 had not led to an increase in Bank lending operations dedicated to the investment climate. However, there is now evidence that ICAs and Doing Business Reports have translated into operations. Going forward, while efforts focused on diagnostics and solution design will yield new lending opportunities, lending priorities will have to be decided at a country level. And although investment climate is suited for policy-based lending, the actual or anticipated development financing requirements rationale for such lending may not exist. Thus, management expects that stand-alone advisory services will be an important part of Bank Group work. The basic building blocks are now in place and the first examples exist. Bank diagnostics have helped set the agenda for investment climate reforms in many countries. Selected items have become the subject of ongoing advisory services at the national level, for example, through FIAS. IFC facility staff have provided on-the-ground support to reform processes, notably at the municipal level. And all of this has been coordinated at the regional level between the Bank and IFC.

The evaluation has raised a number of potential concerns about cooperation between MIGA and FIAS. It also discussed the potential conflicts of interest between advisory and transaction staff within the WBG. Management feels that the issues raised by the evaluation are adequately managed. Further codification of collaboration between MIGA and FIAS is being pursued as recommended, notably through a collaboration protocol. Processes have been put in place to review issues of conflict of interest. The evaluation did not turn up evidence of material issues in either area.

In addition to these interagency issues, the evaluation also emphasized the need to find ways to improve coordination within each agency, with particular attention paid to improving coordination among relevant networks within the Bank. On this topic, management notes that the next step for the Bank would be changes pursuant to the work of the Organizational Effectiveness Task Force, which is under way. For both IFC and MIGA, better systems to manage and monitor technical assistance activities are being put in place, consistent with recommendations of the evaluation.

**Donor Coordination**

There is a significant degree of donor collaboration in the field of the investment climate, including the following:

- In implementing IC surveys, staff are collaborating at the regional level with the European Bank for Reconstruction and Development (EBRD), the Asian Development Bank (AsDB), and the Inter-American Development Bank (IADB), and at the country level with bilateral donors.
- FIAS is supported by a multidonor trust fund.
- MIGA receives cofinancing from donors for some of its technical assistance activities.
- The WDR on investment climate built on case studies prepared by the Department for International Development and it benefited from financing from other donors.
- PDFs receive multidonor financing.

Donor coordination is enhanced by donor working groups for PSD in general and for the small and medium-sized enterprise (SME) topic in particular. Looking forward, ongoing discussions with donors suggest interest in participating in the new investment climate training course, in exchanging good practice work, and in further enhancing the measurement agenda.

**Conclusion**

In conclusion, management welcomes the evaluation and recognizes the contributions it has already made in helping to shape a joint Bank Group approach to deal with investment climate issues. Detailed responses to the IEG recommendations for all three units (World Bank, IFC, and MIGA) are provided in the attached annexes.
ANNEX I.B.1: RECOMMENDATIONS FOR THE WORLD BANK GROUP  
(FROM THE JOINT OVERVIEW REPORT)

<table>
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<th>Recommendation</th>
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| **1a Roles of the Bank, IFC, and MIGA**  
Clarify the roles of the Bank, IFC, and MIGA on investment climate activities, bringing corporate strategy and practice into consistency. Improve coordination and consistency across the WBG on investment climate diagnosis, priorities, results focus, strategy, and assistance at the country level.  
Define the respective roles of the Bank and IFC in providing advice on policy and institutional reform, according to the comparative advantages of each institution.  
**Similar recommendation from the IEG Report (Rec. 2a)**  
The WBG should clarify the roles of the Bank, IFC, and MIGA on IC activities, bringing corporate strategy and practice into consistency according to the country- and situation-specific comparative advantages of each institution. | With marked progress made in developing coordination processes since the fiscal 1993–2002 evaluation period, Management believes the roles of the Bank, IFC, and MIGA are now reasonably clear. While it agrees with the importance of coordination, it notes that appropriate structures and processes to facilitate coordination have been set up, both at the organizational and country levels, reflecting insights gained from the joint evaluation reports and related discussions.  
In this context, Management appreciates the report’s acknowledgment of recent initiatives undertaken after the evaluation period by which coordination takes place at the global, regional, and country levels, including: (a) a new joint Bank-IFC PSD Vice Presidency; (b) a joint Operating Protocol to enhance coordination of the FIAS and MIGA work programs; (c) joint IFC/WB CAS preparation with active input by MIGA as well; and (d) regular Investment Climate Country Review meetings cochaired by WBG Senior Management.  
Consistent with the PSD Strategy, the goal of the work on diagnostics, solution design, and implementation is to create a reasonably seamless working relationship between all parts of the WBG that deal with reform of the investment climate. This involves principally the Bank and IFC Regions (including Regional SME facilities) as well as central programs (including FIAS and MIGA).  
For lending activities, coordination between the Bank and IFC has generally worked well, with IFC complementing Bank lending by providing financing as a strategic priority |
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<td>Related recommendation from the IEG Report (Rec. 2a)</td>
<td>in IC-enhancing sectors such as infrastructure and financial markets. In addition, many IFC projects in other sectors are also contributing to improving investment climate through demonstration effects, sustainability, and other impacts on PSD.</td>
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<td>Effective coordination at the individual country level should encompass the following:</td>
<td>Management will monitor and report on coordination in the context of the PSD section of the annual Sector Strategy Implementation Update.</td>
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<td>(i) diagnostic IC needs assessment (e.g., ICA)</td>
<td>Management agrees with the recommendation.</td>
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<td>(ii) WBG IC operational priorities</td>
<td>(i) Regarding diagnostics, coordination is country-driven. The initial emphasis was on scaling up with central support the use of tools such as the IC surveys to provide a better knowledge source for the Bank policy dialogue. Now there is some consolidation (e.g., SME Maps folded into other diagnostic tools, joint trade/IC reports), and while there continues to be central support for the rollout of diagnostics, the deployment of these tools continues to be country driven.</td>
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<td>(iii) broad division of labor within WBG</td>
<td>(ii) When it comes to setting operational priorities, country specifics will need to be key drivers, with joint CASs the main vehicle for WBG efforts at setting country strategy on investment climate.</td>
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<td>(iv) a results-based management framework for alignment of project planning, results measures, reporting and associated unit and individual incentives.</td>
<td>(iii) Division of labor among the different units in the WBG is determined in general by who is best equipped and positioned to undertake a task. For example, central groups like Doing Business and FIAS are focusing on diagnostic tools. On solution design, these central groups as well as MIGA bring to bear global knowledge, including collections of best practice. These efforts are combined with local knowledge of field staff to develop effective solution designs. IFC staff are particularly helpful in informing the diagnostic and policy work from the transaction perspective, while staff closest to the government on specific issues typically lead or play a major role in discussions with the government on the merits of the advice. With regard to implementation, capacity rests mainly in Bank Group field offices as well as PDFs.</td>
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<td>The process for accomplishing the above and ensuring effective coordination should be systematic and formalized for every country, building on the PSD-led IC country review experience. Ensure that these efforts provide a basis for IFC’s inputs to the CAS.</td>
<td>For potential investments supported by IFC or by both the Bank and IFC (including private-public partnerships), simi-</td>
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**Investment Climate Strategies**

**Recommendation**

Formulate a joint Bank, IFC, and MIGA results-based IC strategy for each client country, reflected in the CAS, that uses the resources of each more effectively and track results.

**Management Response**

Management agrees with this recommendation for countries covered by joint CASs, and it will monitor implementation as part of the regular CAS review process. (Over the last three years, slightly more than half of CASs were joint, and that is the planned share going forward.) As the evaluation notes, increasingly the practice for countries covered by joint CASs is to spell out combined Bank and IFC strategies to improve the investment climate as part of the private sector development agenda. Management believes that the current level of joint CASs is appropriate.

For countries without joint CASs, IFC normally provides inputs with regard to PSD issues based on its level of activity.

Regarding results, work is in progress in the context of better results frameworks in CASs. It is anticipated that results-based CASs will be mainstreamed after the upcoming discussion with Executive Directors on experience to date with the pilots.

More broadly, the WBG is providing strong global leadership in the area of IC diagnostics and results measurement. Improved diagnostics such as the ICAs and Doing Business Reports with the strong focus on quantitative indicators, benchmarking across countries and regions within countries, and monitoring progress over time are powerful instruments to spur on and manage reform processes. And FIAS is experimenting with OECD-style regulatory impact assessments, which have been a powerful tool for promoting regulatory scrutiny in industrial countries. Together these efforts are helping to underpin the Bank-wide results measurement framework in the PSD area.
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| **1c** Roles of FIAS and MIGA  
*From the Overview Report (Rec. 1c)*  
The respective roles of FIAS and MIGA and hand-over protocols should be codified to ensure consistent application and smooth transfer of clients from one to another. In view of the partial overlap between services offered by FIAS and MIGA, management should monitor coordination improvement closely to ensure they continue on track.  
*Related recommendation from the IEG Report (Rec. 2b)*  
In view of the partial overlap between services offered by FIAS and MIGA, management should monitor coordination improvements closely to ensure that they continue on track.  
*Related recommendation from the IEG Report (Rec. 3c)*  
MIGA should continue its coordination and cooperation with FIAS and other partners, to ensure that resources are targeted to provide additionality and complementarity. The respective roles of FIAS and MIGA, and hand-over protocols should be codified to ensure consistent application. | Management agrees with this recommendation and is undertaking steps along these lines.  
Management notes that no cases have emerged where there is a material problem in collaboration between MIGA and FIAS and that coordination and cooperation between FIAS and MIGA is codified in the brochure “The World Bank Group Guide to FDI Advisory and Information Services,” which sets out the roles of the various units. A protocol setting out the detailed interface between FIAS and MIGA is being finalized.  
Management intends to continue to monitor coordination between FIAS and MIGA, with the aim of better service for clients. |
ANNEX I.B.2: RECOMMENDATIONS FOR THE WORLD BANK (FROM THE IEG EVALUATION)

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<th>Recommendation</th>
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<tr>
<td><strong>1</strong> Institutions and the Political Economy of Reform</td>
<td>Management agrees with the main thrust of this recommendation, cognizant of the importance of analytical work on institutional arrangements and the political economy of reform. We have accomplished much, particularly on assessments of constraints/incentives and are working on other aspects.</td>
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<tr>
<td><strong>1a</strong> Analytical Work on Institutional Arrangements and the Political Economy of Reform</td>
<td>(i) Guidance note: The lessons from ongoing work addressing institutional arrangements and political economy of reform are being synthesized for dissemination. A training course for WBG staff is being developed based on the work on good practice, institutional arrangements, and political economy; it will be rolled out in four regional sessions. The training program is underpinned by an effort systematically to provide guidance materials on solution design for some 25 subtopics of the IC agenda that cover a wide array of issues, including governance, factor markets topics, judiciary systems, tax policies and administration, and product market issues, such as competition. Solution design materials cover technical as well as political economy aspects of reform.</td>
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<td>Do more analytical work on institutional arrangements and the political economy of reform, involving local organizations in this work.</td>
<td>(ii) Assessments of constraints/incentives: The Doing Business Project produces probably the most comprehensive assessments of the institutional framework of the investment climate, with seven sets of quantitative, objective indicators for 145 countries in 2005. The Doing Business Project also provides a natural window on reform episodes and reforming countries and this will be an important element of the next annual reports. In addition, ICAs and FIAS diagnostic work also contribute to the assessment of country IC conditions.</td>
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<td><strong>1b</strong> Building a Balanced Constituency for Reform</td>
<td>Country case studies: Already, 15 country case studies on reform episodes in particular areas (regulation, labor, land, infrastructure) have been prepared as a background for the WDR 2005. In addition, nine country case studies (six developing and three OECD) on broad-front regulatory reform episodes are being prepared, looking at reform triggers, institutional arrangements, solution design, and stakeholder management.</td>
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<td>From the Joint Report (Rec. 2b)</td>
<td>Management recognizes the importance of building a balanced constituency for reform; however, it disagrees with IEG-World Bank’s finding that the Bank has been timid in dealing with vested interest groups.</td>
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<td>Building a balanced constituency. The WBG and the IMF have been instrumental in supporting government efforts to establish government-business consultation mechanisms on PSD issues to promote reforms. Pilot investor councils were launched in Ghana, Senegal, and Tanzania initially, and in Mali and Uganda more recently. FIAS provided assistance to the government of Turkey as it launched a similar consultative mechanism this year. IFC has long been involved in business forums in Vietnam and Cambodia, and soon in Laos.</td>
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<td>In the case of poverty-reduction strategies, the dialogue between the private sector and government, including on topics such as women entrepreneurs and micro-enterprises, has been less strong than that with other stakeholders. Hence, current efforts are focused on this area, with the WBG supporting dialogue processes in about 10 countries (mainly in Africa and East Asia). A review of successes and failures of such dialogue processes in developing countries is currently under way and the WBG will provide the lessons of experience to interested client countries as they prepare poverty reduction strategies and undertake other stakeholder processes. Work is also under way to create a worldwide database of business associations that can be helpful to this process.</td>
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|  | Dealing with vested interest groups. The issue is the complexity of the reform agenda on investment climate, not timidity in dealing with vested interests. As is common **

**


1c Disseminating Information

Be more proactive in disseminating information—on IC constraints, the country’s reform agenda, the implementation of laws and the achievement of specific targets, and lessons from the reform experience of other countries. The Bank could facilitate research by academics by ensuring better access to IC data and research results.

Management Response

with large and complex issues, there are different views on investment climate that feed into the reform agenda. Stronger implementation support through WBG operations—policy-based lending, advisory assistance, capacity building—should help push the investment climate reform agenda as suggested by the evaluation.

Management agrees with the importance of dissemination and is implementing this recommendation with success through several vehicles. First, there are three flagship reports released this year with extensive outreach efforts that have led to much momentum and focus on the topic:
(a) WDR 2005: A Better Investment Climate for Everyone
(b) Doing Business 2005: Removing Obstacles to Growth
(c) Unleashing Entrepreneurship: Making Business Work for the Poor (UN Commission on the Private Sector and Development) to which the Bank contributed.

Doing Business 2005 alone was quoted in more than 750 media articles worldwide shortly after it was released.

At the country level, IC surveys and assessments have been followed by significant, high-profile outreach efforts in 24 countries, stimulating discussion and efforts to set investment climate reform priorities, and contributing to the design or improvement of 19 active projects and supporting pipeline development of 13 new projects.

In addition:
• The Rapid Response Web site is recognized as the authoritative information source for investment climate matters—it currently receives more than 100,000 unique visitors per month.
• The full Doing Business data sets plus methodology papers are publicly available on the Web site. Some 60 articles were written last year by academics making use of the data.
• The ICAs are public documents, available on the Bank external Web site. The detailed IC survey data are publicly available for researchers, subject to a signed data access protocol, in the hope of generating relevant research. And a Web-based data tool for broad public use is also under development.
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| **1d** Transparency and Openness  
Make a stronger push for transparency and openness—to help create political will where it is weak, to enlist local oversight of potential government inefficiencies and abuses, and to improve the investment climate itself. | Management agrees with the main thrust of this recommendation and is supporting transparency and openness through two pillars: (a) supporting government efforts to engage in dialogue with key stakeholder groups, and (b) supporting efforts to benchmark investment climates across countries and over time and monitor reforms. The substantial progress and efforts on the first front are discussed in Section 1b. In the area of diagnostics and results measurement for key features of the investment climate institutions, the WBG is providing strong global leadership. Improved diagnostics such as the ICAs and Doing Business Reports with a strong focus on quantitative indicators, benchmarking across countries and regions within countries, and monitoring progress over time are powerful instruments for dialogue, transparency, and openness. FIAS is experimenting with OECD-style regulatory impact assessments, which have been a powerful tool for promoting regulatory scrutiny in industrial countries. |
| **1e** Country-Specific Political and Business Cultures  
Ensure that Bank staff develop a deep understanding of and sensitivity to country-specific political and business cultures, as well as key features that define the relationships between business and government. | Management agrees in principle with this recommendation, recognizing that the key to improvement in the IC work of the Bank is progress in dealing with institution-building customized to country conditions and duly cognizant of political opportunities and constraints. Efforts across the WBG will continue to build up field-based staff with local knowledge and to feed transaction experience of IFC-MIGA into reform design. |
| **2** Improve the Focus and Use of Survey-Based Diagnostics  
**2a** Specific Country Needs  
Focus ICAs on specific country needs. Make greater use of existing material and collaborate with other donors doing similar things to avoid duplication of effort. | Management agrees that ICAs need to focus on specific country needs, make full use of existing material, and collaborate/coordinate with others to avoid duplication and ensure synergies. To this end, the ICA Guidelines for task |
## ANNEX I.B.2: RECOMMENDATIONS FOR THE WORLD BANK (FROM THE IEG EVALUATION)

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<td><strong>From the Joint Overview Report (Rec. 2c)</strong></td>
<td>Make better use of survey-based diagnostics, focusing them on specific country needs. Use surveys only as an input to making policy recommendations in order to balance business perspectives with broader economic and social concerns.</td>
<td>team leaders that were endorsed by the PSD Sector Board recommend that ICAs be tailored to specific country needs through augmenting the core survey instrument and making full use of existing material both from inside and outside the Bank. Management is monitoring this as part of its quality review function.Regarding donor collaboration, regionally, staff are collaborating with the EBRD, the ADB, and the IADB and at a country level draw on bilateral donor funding in implementing investment climate surveys. Discussions with AfDB are under way. Careful explanation of business models and management of expectations minimizes the possibility of disappointing clients.</td>
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<td><strong>Targeting Diagnostic Assessments</strong></td>
<td>Take into account the heterogeneity of IC conditions by targeting diagnostic assessments on subnational geographic areas or individual industries.</td>
<td>Management agrees that targeting diagnostic assessments on subnational geographic areas or individual industries may be appropriate at times, but that determination must be done on a country-by-country basis. There is no “one-size-fits-all” template. This is particularly true for solution designs that may emerge from ICAs. As knowledge and experiences with effective IC reform processes in developing countries remain incomplete, it is not yet clear if a typology of country characteristics is useful or whether solution design ultimately is highly country specific and experimental.</td>
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<td>2b</td>
<td>Management agrees that targeting diagnostic assessments on subnational geographic areas or individual industries may be appropriate at times, but that determination must be done on a country-by-country basis. There is no “one-size-fits-all” template. This is particularly true for solution designs that may emerge from ICAs. As knowledge and experiences with effective IC reform processes in developing countries remain incomplete, it is not yet clear if a typology of country characteristics is useful or whether solution design ultimately is highly country specific and experimental.</td>
<td>That said, the WBG is pursing diagnostic assessments on subnational geographic areas or individual industries, where appropriate. For example, Doing Business 2005 first reported regional variations by city in Brazil, and this regional approach now has been extended to Bangladesh, India, and Pakistan. The ICAs generally have made use of subnational variability of investment climate conditions, including in large countries such as Brazil, China, and India. The ICA for Cambodia focuses on dimensions of the investment climate impacting formal and informal firms. The samples of firms for enterprise surveys are regularly stratified by location and industry (and other attributes such as size and ownership). More recent surveys have increased industry coverage beyond the manufacturing sector, for example, to service and rural firms. Background work for the WDR 2005 extended surveying of informal firms.</td>
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2c **Survey-Based Diagnostics**
Recognize that enterprise surveys represent only the views of the business community. Use survey-based diagnostics only as an input to making policy recommendations in order to balance business perspectives with broader economic and social concerns.

Management agrees that it is important to recognize that enterprise surveys provide views of the business community. For example, ICAs complement firm survey findings with other analysis and sources of information. Our surveys also are quantitative oriented and allow for benchmarking across important indicators of the investment climate. The surveys support efforts to engage stakeholders using measured and cross-county comparable indicators of the investment climate.

Management also notes that our support in bringing voice to the private sector concerns and priorities is only through expressed demand for these efforts by our client governments as they undertake stakeholder processes that help balance business perspectives with broader economic and social concerns. As noted above in 1b, in the case of poverty-reduction strategies, the dialogue between the private sector and government has been less strong than that with other stakeholders. Hence, current efforts at supporting government-led consultative mechanisms are focused on this area, and the surveys support these efforts.

3 **Do a Better Job of Prioritizing and Packaging IC reforms in Lending Operations**

3a **Priority to Reforms**
Give high priority to reforms that will build political and civil society commitment to continue the reform process—by focusing on problems that, if fixed, would have immediate positive impacts.

Management agrees that it is important to pay close attention to political economy issues in countries. Reform processes need to be designed case by case at the country level, often in an iterative and experimental fashion. Experience indicates that, for some countries, a comprehensive approach to reform is more effective, while for other countries, notably China and India, incremental improvements with positive but limited impact appear to allow a healthy reform dynamic to unfold in a politically sustainable fashion.

3b **IC-Focusing Adjustment Loans**
Consider packaging a critical mass of microeconomic reforms and components (including civil service reform and training of public officials) into IC-focused adjustment loans, rather than piggy-backing small IC components to macroeconomic adjustment operations.

The choice of Bank instruments to support IC reform (or, for that matter, other development agendas) is determined within the context of country-based processes, taking into consideration various factors, including balance of payment/fiscal considerations.
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<td><strong>3c</strong> Lending Instruments</td>
<td>Choose lending instruments appropriate to support the process of institutional change over a long period (e.g. programmatic adjustment loans). This will help ensure that changes in laws and regulations are actually implemented and are sustained.</td>
</tr>
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| **4** Find Organizational Solutions that Help Integrate Microeconomic and Macroeconomic Reform Agendas | **Responsibility for Integration**
Maintain the responsibility for integration with the country departments, but provide better support from the sector and anchor units, IFC, and MIGA. Clearly define the roles of the sector units in the regions (principally PSD and PREM) to improve coordination and reduce potential conflicts. |
| **4a** | Management agrees that responsibility for integration of the IC agenda in country strategies and programs should remain with country departments. Concerning the WBG at large, support has improved since the creation of the joint PSD VPU and implementation of country review meetings on the investment climate. Under this new structure, diagnostics work, development of good practices, and work on the political economy are, and will continue to be, carried out in joint Bank-IFC units in collaboration with both Bank and IFC regions. Looking forward, implementation of the joint training program focused on developing a Group capability to carry out free-standing advisory services from diagnostics via solution design to implementation support will also help strengthen working relationships within the Group. |
| **4b** Integration of Sectoral Issues | Improve the integration of sectoral issues in proposed reform strategies. Possible options to accomplish this would be to continue to expand the recent practice of holding country-level PSD reviews (for individual countries, country departments, or regions), bringing together staff across sector units (particularly PSD and PREM) as well as the IFC and MIGA; and/or to nominate investment climate “coordinators.” |
| | Management agrees with this recommendation. The sectoral dimensions of the investment climate have been getting more attention recently. Sector-specific diagnostics such as value chain analysis can complement economy-wide views of investment climate constraints. Management agrees that the country-level PSD reviews can help in agreeing on sector priorities. The “new” generation of “competitiveness” loans in LCR—for example, the Brazil growth project and Peru decentralization project—are good examples of where sector priorities in the investment climate (logistics, infrastructure) have been addressed along with policy and regulatory constraints. |
**ANNEX I.B.3: RECOMMENDATIONS FOR THE INTERNATIONAL FINANCE CORPORATION (FROM THE IEG-IFC EVALUATION)**

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<td><strong>1</strong></td>
<td>Management agrees with the importance of investment climate in IFC’s operations. In fact, investment climate is already an explicit cross-cutting theme in four of IFC’s five strategic priorities. For this reason, we do not see the need to add investment climate as a sixth strategic priority for IFC in the Strategic Directions Paper.</td>
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| **Operating Guidelines and Procedures for TAAS** | IFC is undertaking IC work in areas that are critical to its strategic priorities and where it has a comparative advantage. The four IFC strategic priorities that address key IC issues are as follows:  
(i) Address constraints to private sector growth in infrastructure.  
(ii) Emphasize local financial markets development.  
(iii) Focus on frontier markets, e.g., advice on IC issues.  
(iv) Differentiate through sustainability, e.g., linkages, corporate governance, etc. |
| 3a | Management agrees with this recommendation.  
IFC has recognized similar issues following an internal review of its TA operations and is undertaking steps to improve current systems. IFC has recently established quality control mechanism for TAAS through the upcoming PDS-TA |
process should be put in place to ensure that advice provided is of high quality and reflects internationally recognized good practices and standards. Such a process may also enhance coordination efforts across the WBG.

- Incorporate “good practice” measures into IC TAAS operations, within a results-based management (RBM) system, to improve outcomes and impacts on the ground. To support this objective, a program for disseminating IC TAAS “good practices” and lessons learned should be developed. RBM training of staff who provide IC TAAS should help shape the structure and follow-up of operations toward results-driven outcomes.

- Implement IFC-COI training to enable the investment departments, as well as staff and managers who deal with IC TAAS, to deal with potential and perceived COI early on and more proactively, and ensure that current procedures are known and followed. As part of a systematic TAAS approvals process, all IC TAAS operations with potential risk of COI should be screened and where actual, potential or perceived COI exists, referred to the COI office. Where COI-related issues are identified, they should be disclosed and managed according to COI rules and procedures.

**From the Joint Overview Report (Rec 3b)**

As part of the corporate-wide initiative to develop operating guidelines and procedures for TAAS operations, Management should: (i) develop a quality control mechanism for advisory work provided to government clients; (ii) incorporate good practice measures into TAAS operations within an RBM planning, monitoring, and evaluation system; and (iii) implement IFC-wide training in conflict of interest policies to ensure that current procedures are known and followed.

forms and approval process. Each TAAS project will be reviewed and vetted by the relevant regional and relevant industry departments. IFC’s regional directors will have the ultimate approval authority on every TAAS operation. There is also a formal process to seek input from others within IFC, i.e., peer review, at the design stage of the project, and those comments will be visible to all of the reviewers and approvers later in the process. Inputs from outside IFC, including those from the WBG and beyond, will be sought as appropriate through other means.

Quality control mechanisms at completion of TAAS vary, reflecting the wide range of size, scope, design, and form of final deliverable (report, training, capacity building, consulting to improve process/performance, white papers, legislation, etc.). The new quality assurance process at approval should help improve TAAS design and facilitate increased use of best practices. This formal review process could also lead to some consolidation of products and services with more focus and increased size and scope. These steps should lead to a more informed position regarding best practice quality assurance measures before delivery to the client /TAAS recipient.

IFC’s internal review of its TA operations also led to a similar recommendation of incorporating good practice into IFC’s TA activities. IFC has recently completed the design of an RBM-based TAAS evaluation framework. The SME Dept. is currently testing this new framework and expects to launch this within fiscal 2005. Among other items, this framework captured outcomes, impacts, lessons learned, and good practice examples. A formal training was rolled out to help implementers better understand RBM theories and tools. IFC has also recently established a new monitoring and evaluation (M&E) team comprising a Principal and a Senior Evaluation Officer in the SME department to manage the M&E of TAAS. Integral to the mandate of the M&E team is the development of a knowledge management and best practice dissemination framework for its TAAS. The aim is for good practices from the TAAS business (starting PDFs and private enterprise partnerships) to feed into IFC’s front-end work and eventually into the WBG repository for good practice examples, as appropriate.
### Recommendations and Management Response

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<td><strong>Tracking IC Issues</strong>&lt;br&gt;IFC should consider establishing a mechanism to track and follow up on IC issues encountered with a view to supporting its portfolio and potential pipeline companies in addressing these issues, informing IFC’s IC work program, and feeding this information into the work programs of relevant WBG PSD staff charged with improving investment climate and setting CAS priorities.</td>
<td>Management is pleased that the IEG evaluation did not encounter any specific case of conflict of interest in IFC’s IC activities. There are systems in place in IFC, such as separation of the advisory group and the transaction group, to responsibly manage potential or perception of conflict of interest issues. A Conflict of Interest (COI) Office in the WBG is in place where managers and directors can go for advice as appropriate. In addition, the approval process for investment operations prompts transaction staff through the project data sheet (PDS) to identify potential conflict of interest within the WBG. Similarly, the new approval process for TAAS requires staff through the PDS-TA to identify potential conflict of interest. With respect to training, the CIO plans to introduce in the current fiscal year a comprehensive e-learning program for the WBG. Training should help staff spot areas of potential conflict of interest and reflect them accordingly in the relevant PDS for department management’s attention and action. The CIO has already conducted training for IFC staff in a number of hubs (e.g., Moscow, Johannesburg, and Hong Kong) using the proposed e-learning training modules. The e-learning program will give priority to staff in joint Bank-IFC global products group departments and other staff involve in TAAS.</td>
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<td>From the Joint Overview Report (Rec. 3c)&lt;br&gt;Develop a mechanism to track and follow up on IC issues to support IFC’s portfolio and potential client companies, to update IFC’s IC work program, and to inform relevant WBG staff charged with improving investment climate and setting CAS priorities.</td>
<td>Management agrees that tracking IC issues is important and will consider adding a section in the Project Status Report to track significant IC issues as and when they are encountered during the life of a project. These data could then be aggregated at the country level with a view to informing IFC’s TAAS strategy and the WBG’s IC work.</td>
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ANNEX I.B.4: RECOMMENDATIONS FOR THE MULTILATERAL INVESTMENT GUARANTEE AGENCY (FROM THE IEG-MIGA EVALUATION)

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<th>Recommendation</th>
<th>Management Response</th>
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| 1a  
Comparative Advantage and Strategy | Management agrees that it is important to clearly define additionality and complementarity between all parts of the WBG working in investment climate. Since the evaluation, MIGA has taken steps to clarify the role of the agency’s TA relative to the other parts of the WBG. A key step is the development of a protocol setting out the interface between MIGA and FIAS. This protocol is being finalized and will be shared with the Board (please see Management Response to Joint Overview Report Recommendation 1c, Roles of FIAS and MIGA). The protocol will then be integrated into MIGA’s Operational Regulations. This protocol complements the previous brochure developed with the WBG: “The World Bank Group Guide to FDI Advisory and Information Services.” Strengthening coordination with the private sector, other donors, and the rest of the WBG has been an ongoing trend within the TA program. Since the evaluation, MIGA has developed a new knowledge portal for investment promotion (www.fdpromotion.com) as a mechanism for enhancing collaboration and knowledge sharing. MIGA is also concluding collaboration agreements with other multilateral donors providing TA in related areas in order to further integrate MIGA’s TA into a broader framework of IC activities outside the WBG. Management will continue to look for opportunities for integration into joint CAS and other joint strategy development and program design activities across the WBG. In addition, MIGA’s comparative advantage in the provision of technical assistance will be discussed as part of the Agency’s 2005 Strategic Review (see below). |
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<td><strong>1b</strong> MIGA should endorse and implement a clear and coherent strategy for selecting its clients that ensures high effectiveness and development impact. Within this strategy, it should exercise better selectivity of clients to improve the effectiveness of resource use and impact.</td>
<td>Management agrees that it is important to be selective and strategic when developing programs for its clients. Since the evaluation, MIGA has sought to sharpen its policies for TA deployment. This effort will be part of the ongoing Strategic Review, a comprehensive assessment of the strategic direction of the Agency that takes place every five years, as specified in the MIGA Convention, and was to be presented to the Board in calendar 2005. MIGA selects its clients based on their needs and readiness. Beginning in 2000, MIGA instituted a diagnostic needs assessment, which is a tool to assess the readiness of the client IPI to absorb capacity building. MIGA makes a decision on further intervention based on the outcome of the assessment. MIGA requires the needs assessment as a prerequisite to any sustained MIGA intervention. The Strategic Review will further elaborate on the use of the Needs Assessment as a diagnostic tool. MIGA has been coordinating with FIAS to conduct a joint assessment within a broader framework of investment climate assessment and continues to do so.</td>
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<td><strong>1c</strong> This new strategy should integrate TA and guarantee products to reap synergies within the Agency.</td>
<td>Management accepts this recommendation.</td>
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<td><strong>2</strong> Research on Effectiveness of Investment Promotion</td>
<td>Management agrees with the direction of this recommendation. But management believes that the research agenda should seek to build on and expand the initial study of these issues conducted by FIAS in collaboration with MIGA in 2002. There is now increasing evidence from new research work to complement the 2000 FIAS study that well-functioning IPIs are effective in attracting increased levels of FDI to a country. MIGA’s research efforts financed by the administrative budget are intended to augment the Agency’s capacity building and information dissemination programs, and the fiscal</td>
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<td><strong>2a</strong> MIGA should facilitate or commission research to establish whether investment promotion activities have an impact on overall investment flows and the extent to which government commitment is a key determinant of success, in order to assess the likely impact of its TA program.</td>
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## Recommendation

### 3 Funding Sources, Cost Effectiveness, and Coordination

**3a** MIGA should continue to seek additional funding to complement its own resources, and align its work program closer with World Bank/IDA priorities and lending to support capacity building.

Management accepts this recommendation.

MIGA’s Invest in Development Fund (IIDF) was created in fiscal 2004, with MIGA contributing $400,000, along with contributions from a variety of other partners and donors. In addition, MIGA is currently developing a trust fund strategy to cover the activities of the whole Agency. As noted, the Agency has redoubled its efforts to coordinate closely all technical assistance with the WBG and other donors.

Management accepts this recommendation and notes that important steps have been taken since the evaluation to this end.

Effective tracking of costs requires that the right management information systems be put in place to be able to capture costs by tasks and activities. MIGA did not have such a system in place until fiscal 2004. Since then, progress has been made. The biggest component of TA, for example, is staff and consultant time. Recognizing this, MIGA has now introduced the use of a time recording system throughout the newly created Operations Group (which combines technical assistance and guarantees). With this platform in place, MIGA is now in a position for the first time to track progress on tasks against the scope and the budget allocated.

Management accepts this recommendation.

A protocol setting out the interface between MIGA and FIAS is being finalized. The protocol will be integrated into MIGA’s Operational Regulations. (Please see also management response to IEG-MIGA Recommendation 1a.)

**3b** MIGA needs to improve its cost-measurement tools and tracking systems for its TA activities to be able to assess its cost efficiency in the future.

Management accepts this recommendation and notes that important steps have been taken since the evaluation to this end.

Effective tracking of costs requires that the right management information systems be put in place to be able to capture costs by tasks and activities. MIGA did not have such a system in place until fiscal 2004. Since then, progress has been made. The biggest component of TA, for example, is staff and consultant time. Recognizing this, MIGA has now introduced the use of a time recording system throughout the newly created Operations Group (which combines technical assistance and guarantees). With this platform in place, MIGA is now in a position for the first time to track progress on tasks against the scope and the budget allocated.

Management accepts this recommendation.

A protocol setting out the interface between MIGA and FIAS is being finalized. The protocol will be integrated into MIGA’s Operational Regulations. (Please see also management response to IEG-MIGA Recommendation 1a.)

**3c** MIGA should continue its coordination and cooperation with FIAS and other partners to ensure that resources are targeted to provide additionality and complementarity. The respective roles of FIAS and MIGA and hand-over protocols should be codified to ensure consistent application.

Management accepts this recommendation.

A protocol setting out the interface between MIGA and FIAS is being finalized. The protocol will be integrated into MIGA’s Operational Regulations. (Please see also management response to IEG-MIGA Recommendation 1a.)
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<td><strong>4 4a</strong>&lt;br&gt;<strong>Formalize Relationship with Clients</strong>&lt;br&gt;MIGA should formalize its relationship with client countries for in-depth TA through formal contracts, including arrangements for sharing costs. It should clearly define the scope of work, costs, objectives, and indicators of success.</td>
<td>Management accepts this recommendation. Every new project has a scope of work, a budget, objectives, and milestones, as well as a client agreement. In addition, project codes have been introduced across the Agency for TRS, allowing better tracking of costs. (See Recommendation 3.)</td>
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<td><strong>5 5a</strong>&lt;br&gt;<strong>Implement Monitoring System</strong>&lt;br&gt;MIGA should put in place a monitoring system to track the progress and impacts of its TA interventions.</td>
<td>Management accepts this recommendation and is moving toward implementation. However, it should be recognized that the full implementation would involve MIGA budgetary issues and improvements in theory and practical indicators for the intermediate outcomes of MIGA's impact on increased FDI. In the interim, although MIGA's Operations Department does not have a budget specifically for monitoring, the team is tracking individual projects against project milestones and objectives and is working with MIGA's Environment and Policy group to implement a monitoring program. MIGA is implementing a monitoring program to benchmark IPA performance.</td>
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On January 12, 2005, the Committee on Development Effectiveness (CODE) met to discuss the joint IEG-World Bank, IEG-IFC, IEG-MIGA evaluation *Improving Investment Climates: An Evaluation of World Bank Group Assistance*, and this report.

**Background.** A joint IEG Briefing on Investment Climate Evaluation from all three units was presented at an informal CODE meeting on June 7, 2004. Some of the main issues raised during the meeting were: diversity of institutional themes in the regions and within countries; the applicability of OPCS’ thematic definition of Core and Non-Core investment climate (IC) themes; differences in the results of first- and second-generation reforms; adequacy of coordination among the World Bank Group (WBG) units and the overlap of some investment climate activities; and the effectiveness of MIGA’s technical assistance activities. The Board discussed the report entitled *World Development Report 2005: A Better Investment Climate for Everyone* on June 17, 2004. The report followed on from the Private Sector Development (PSD) Strategy, endorsed by the Board in 2002. The Board also discussed *Strengthening the Foundations for Growth and Private Sector Development Investment Climate and Infrastructure Development*, which was further considered by the Development Committee on October 2, 2004. The Bank-IFC Doing Business editions in 2004 and 2005 were useful in identifying constraints of the investment climate and in setting agendas for reforms.

**Management Comments.** Management highlighted that the WBG is a small player in promoting investment climate. Efforts are ongoing in preparing the Doing Business report, IC surveys, and data collection. Management considered that it has the tools available to provide free-standing advice on IC matters, whether or not there is a specific IC-related lending operation in the country concerned. Management also mentioned that there are many synergies among the advisory systems across the WBG, including between IFC and MIGA.

**Overall Conclusions and Next Steps.** Members welcomed the reports, which they found comprehensive, and also appreciated the opportunity to discuss them and the management’s response. They also found the statement of the External Advisory Panel to be very useful. The issues that elicited most interest or concern from members and other speakers were: (1) the
need for a solid results framework to track progress in investment climate and to monitor the effectiveness of WBG activities; (2) coordination across the WBG and within each WBG institution; (3) consideration of IC issues as part of joint CASs; (4) strengthening technical assistance and advisory services (TAAS); and (5) harmonization and coordination with other organizations. Some members asked for a follow-up mechanism to continue the Board’s involvement in the IC work following the recommendations of the joint evaluation.

The following main issues were raised during the meeting:

**Results Framework.** Members stressed the need to make IC strategies more results oriented and to improve monitoring results. One proposed the design of a results framework for IC activities. *Management indicated that the measurement agenda deserves top priority.* In this regard, several speakers urged caution in interpreting and designing measurement indicators, as well as some humility in attributing success to WBG efforts. A member contrasted the modest improvement in investment climate with the significant amount of Bank lending and TA activities in this area.

**WBG Coordination.** Several speakers noted the burden on clients, especially resulting from contradictory or even duplicative advice given by different teams of the Bank Group. Many speakers emphasized the importance of improving coordination across the WBG and within each WBG institution (e.g., between different sector units). They felt that the MR did not fully address these coordination issues. To improve coordination across the WBG and within each WBG institution, there was some sentiment in favor of more decisive measures including the possible consolidation of IC work under one Vice Presidency, and more integration of sectors, regions, and networks within the Bank. Some speakers acknowledged the good progress achieved following the creation of the Office of the Vice President of DVP. A few speakers also suggested that the Organizational Effectiveness Task Force address the issue of coordination within the Group. In the spirit of improving WBG coordination, some members supported the idea for integrated IEG evaluations of joint WBG activities. The DGO noted that the form of joint evaluations by IEG depended on the evaluation topic. For example, the integrated evaluation of private-sector participation in electricity worked well because the topic was narrow relative to the wide scope of IC activities. Some members proposed an integral reform of WBG activities to improve investment climate based on the evaluation findings, to revise Core and Non-Core IC activities, and to better communicate and disseminate information on different instruments and services for promoting investment climate offered by each WBG institution.

**Joint CASs and Investment Climate.** Several speakers encouraged the consideration of IC issues as part of the joint CASs as opposed to separate IC strategies. They also requested that the proportion of joint CASs be increased. *Management clarified that IFC or MIGA engagement in joint CASs is complex and there are capacity constraints.* Some speakers also stressed that the WBG support for investment climate should be country specific and based on good understanding of the local business culture, institutions, and the anatomy of corruption. Several speakers emphasized the need to consider the International Development Association mandate, region specific issues such as SMEs in Africa, challenges of small states, and continuous support to countries with poor investment climate. A member stressed the importance of private sector involvement in preparing PRSPs. *Management agreed on the merits of bringing the private sector into the dialogue of a PRSP or CAS preparation.*

**TAAS.** The TAAS activities, particularly those of IFC (including FIAS) and MIGA, drew many comments as participants sought greater direct and indirect impact, improved division of labor, and rationalization of TAAS funding mechanisms (including IFC advisory services, MIGA Trust Funds, etc.). A few speakers felt that the management response should have elaborated further
on TAAS issues. Incorporation of a result framework in future TAAS was suggested. A member queried whether there was an adequate incentive mechanism to improve TAAS.

**Harmonization and Related Coordination with Other Organizations.** Some speakers supported better coordination of IC efforts between WBG and other organizations, including bilateral donors, and suggested that the forthcoming Paris meeting on harmonization flag the benefits of synergy. Members encouraged the involvement of investment partners in the design of solutions and increased participation and consultation to motivate them. *Management indicated that there are formal ways of working on diagnostics with multilateral development banks and other donors.*

**Limitations in Improving Investment Climate.** Participants noted the relevance of institutional reforms to improve investment climate, as well as the need for continued attention to the policy environment, while cautioning against application of standard models and solutions. Some acknowledged that the political economy of a country—such as limited country ownership, vested interests, incentive systems, and lack of broad support for reforms—may constrain improvements in investment climate. *However, management indicated that in such an environment the Bank can still contribute to the debate.* One member noted the inconsistency between the poor macro progress of investment climate and the good and satisfactory ratings at the micro (i.e., project) level, and queried why the ratings of IC components are worse than the Bank averages.

**IFC.** A few members were concerned about the lack of corporate level TAAS priorities and diffused responsibilities for IFC advisory work across IFC units. One of them recommended IC work as one of IFC’s strategic priorities. A member thought that IFC should not take on an advisory role where it intends to be an investor subsequently because of the potential for a conflict of interest. *Management noted that the conflict of interest is now being effectively managed in the WBG.*

**MIGA.** While welcoming MIGA’s merging of guarantee and TA activities under one group, some members advocated further consolidation such as incorporating MIGA’s IC activities into FIAS. *Management reported that MIGA and FIAS now have an integrated system in place with signed protocols.* A member suggested that due to MIGA’s relative size and limited resources, it should provide advisory services to assist mostly IPIs. *Management noted that the review of MIGA services is part of the current strategic review.* One member noted that MIGA’s presence in a country was an indicator of bad investment climate. *IEG-MIGA responded that MIGA’s guarantees are, on average, in countries with better investment climate than TAAS clients have, and that the average investment climate for countries with MIGA guarantees is similar to the overall investment climate for all developing countries.*

**External Advisory Panel.** Some members agreed with the observations made by the Panel, especially the need to identify incentives for IC reforms, and the small volume of TAAS designed to support IC relative to the volume of lending. They also noted the Panel’s comment that joint WBG evaluations could be better coordinated. A member felt that outside researchers should have greater access to the WBG’s knowledge and data. *Management reported that many researchers do use the Doing Business data extensively.*

*Chander Mohan Vasudev*
Chairman
Foreword

1. This evaluation does not cover the activities of the International Center for Settlement of Investment Disputes.

1. L'expression « Groupe de la Banque mondiale » désigne la BIRD, l'IDA, la SFI, la MIGA et le CIADI ; les termes « Banque mondiale » ou « Banque » désignent uniquement la BIRD et l'IDA.

1. Por Grupo del Banco Mundial se entiende el BIRF/AIF, la CFI, el OMGI y el CIADI; “Banco Mundial” o “Banco” hacen referencia al BIRF/AIF solamente.

Chapter 1

2. An approach paper sets out the evaluation’s scope and design. The IBRD/IDA portfolio analysis covers fiscal 1993–2003; the remaining components of the IBRD/IDA evaluation, which were prepared earlier, cover fiscal 1993–2002. The IFC evaluation covers fiscal 1993–2003 for investment operations and fiscal 1993–2002 for noninvestment activities. The World Bank Group is currently attempting to improve the focus and effectiveness of its IC activities as part of the re-emphasis on the growth agenda. Where relevant, this report notes, but does not evaluate, these recent activities.

3. Following the institutional economics literature, “institutions” here refer to “the rules of the game” that affect investment decisions by influencing transaction costs and risk.

4. This was true for investments approved in the early to mid-1990s and evaluated at operating maturity five to six years later. Improvements in the investment climate were also associated with better development outcomes of IFC investments.

Chapter 2

5. Projects containing core or non-core IC themes as primary or secondary objectives.

6. World Bank analytical and advisory activities comprised an estimated 1.5 percent of the value of IC lending.

7. IFC’s IC-related technical assistance includes both IFC- and donor-funded technical assistance. See IEG-IFC report for details.

8. Management notes that Doing Business is a “time and motion” study that measures the obstacles faced by an entrepreneur performing standardized tasks— for example, starting a business, getting credit, and enforcing contracts. Some of these tasks are measured for a hypothetical firm. The methodology chapter in the annual Doing Business Reports and the methodology papers for each indicator on the Web site exhaustively document the methodology and its limitations. Regarding the informal sector, Doing Business sheds light on how institutional frameworks influence the entrepreneur’s choice of formality/informality. Entrepreneurs choose to remain informal when they perceive that the costs of formality (registration, getting credit, and so on) outweigh the benefits of being formal (property right protection, contract enforcement, and so on). Informality has been an important theme in the first two annual Doing Business Reports.

9. This set of themes is consistent with the methodology used by Operations Policy and Country Services and the PSD Sector Board. “Core” IC themes include regulation and competition policy, corporate governance, legal institutions for a market economy, judicial and other dispute resolution mechanisms, and personal and property rights. “Non-core” IC themes include tax policy and administration, infrastructure services for PSD, export development and competitiveness, trade facilitation and market access, and other financial and PSD.

10. An annex to the main report outlines the country case study methodology.
11. In this evaluation, IEG-IFC focused on IFC’s TAAS that contained an explicit component to advise the government on the legal and regulatory framework or to build the capacity of a regulator or government agency. IEG-IFC excluded TAAS that advised on how to conduct transactions (for example, sales or privatization transactions).

Chapter 3

12. Management has noted that coordination and cooperation between the FIAS and MIGA is codified. The President of the WBG specifically requested preparation of a brochure entitled “The World Bank Group Guide to FDI Advisory and Information Services,” which sets out the roles of the various units. A memorandum of understanding setting out the detailed interface between FIAS and MIGA is being completed. IEG-MIGA welcomes the preparation of this memorandum of understanding.

Annex I.B


15. IFC’s five strategic priorities are to (a) strengthen the focus on frontier markets; (b) differentiate through sustainability competencies; (c) address constraints to private sector growth in infrastructure, health, and education; (d) continue to focus on local financial markets development through institution building and use of innovative financial products; and (e) build long-term partnerships with emerging global businesses to encourage adoption of sustainable business practices and promote south-south transactions. The first four priorities have strong ties to the investment climate.
Part II

World Bank Experience
A country’s “investment climate” (IC) is its environment for private sector activity. The quality of the investment climate is determined by the risks and transaction costs of investing in and operating a business, which in turn are primarily determined by the legal and regulatory framework, barriers to entry and exit, and conditions in markets for labor, finance, information, infrastructure services, and other productive inputs.

Governments influence the quality of their countries’ investment climates through policies, institutions, and their relationship with the private sector. The quality of the investment climate is linked to poverty reduction by the impact of better investment climates on private sector activity, and thus on economic growth and employment.

**Trends in the Investment Climate**
As shown in Independent Evaluation Group’s (IEG’s) *Annual Review of Development Effectiveness 2003*, the investment climates of developing and transition economies have improved modestly in recent years. Broad indicators of the policy and institutional environment—such as the Country Policy and Institutional Assessment (CPIA) rating compiled by the Bank—improved over the past five years in all regions, but particularly in the transition economies. However, looking at the components of the CPIA, it is noticeable that indicators of macroeconomic conditions (macroeconomic management, financial stability, and revenue stability) are higher than for some institutional areas (property rights, public administration, transparency, and rules-based governance). This suggests that institutional issues need attention.

**The Bank’s Strategic Focus**
Under different names, the investment climate was a part of Bank private sector development (PSD) strategies throughout the 1990s. Recently, however, the subject has risen to become one of the two pillars of the World Bank Group’s (WBG’s) corporate strategy for reducing poverty and occupies center stage in the 2002 Private Sector Development Strategy of the WBG. The increased prominence of the investment climate at the corporate level is mirrored in the shift in Country Assistance Strategies (CASs) over the past decade from first-generation to second-generation reforms. This “macro first, micro second” sequencing was not so much a planned strategy as the result of the disappointing supply response to first-generation reforms. Increas-
ingly, the Bank has become aware of the importance of institutional reform to sustain growth. This shift in focus was appropriate and is well supported by the literature.

CASs in all regions show a trend toward greater emphasis on the investment climate. However, the priorities given to different IC topics vary by region. For example, in East Asia, the emphasis has been on corporate governance, corporate restructuring, and financial sector reform. In Latin America and the Caribbean, there has been more attention to regulatory issues and competitiveness. To some extent, these differences reflect the macroeconomic environment, such as in East Asia following the financial crisis. They also reflect the fact that different IC constraints matter to different firms, because firms are diverse.

Nonlending Services
The Bank’s economic and sector work (ESW) has helped motivate many governments to adopt IC reforms. Nevertheless, there are areas where more work needs to be done to provide guidance to clients as well as to Bank staff designing IC interventions. Not enough is known about good practice in institutional design or about the dynamic process of changing institutions. It would be useful to have a typology of country situations and institutional designs that would provide guidance on which types of arrangements work where, how the change process happens, and how it can be supported and sustained. The Bank’s ESW and research have not yet provided enough of this knowledge of institutional design and the process of reform.

Diagnostic work on the investment climate has evolved toward greater use of enterprise surveys to provide information on the constraints to PSD as perceived by firms. The most recent survey instruments do a good job of benchmarking indicators of the quality of a country’s investment climate in a way that allows cross-country comparisons as well as monitoring of changes in individual countries over time. However, some clients have complained that surveys and assessments duplicate earlier work. This duplication is perhaps an inevitable consequence of the Bank’s objective of building a global IC database, but the Bank may need to clarify that objective to clients to manage expectations.

Other problems with IC diagnostics carried out during the review period have been (i) a lack of prioritization of problems and their proposed solutions and (ii) an excessive focus on the manufacturing sector, urban areas, and formal sector firms as opposed to rural areas and the informal sector. These problems are beginning to be addressed in the most recent Investment Climate Assessments (ICAs). Finally, it should be kept in mind that enterprise surveys provide valuable information on the perspectives of the private sector but are an insufficient basis for policy recommendations. The views of business on public policies need to be balanced with other economic and social perspectives.

Lending Operations
A review of lending operations over the past 10 years shows that IC lending, broadly defined, accounts for a large share of the Bank’s portfolio. In other words, supporting improvements in the investment climate is a large part of what the Bank has always done. At the same time, the share of the Bank’s total lending in investment climate shows no observable trend over the past 10 years, although it has varied. Thus, the Bank’s increased strategic focus on improving investment climates has not yet translated into a greater share of the loan portfolio being devoted to this objective.

Over the entire fiscal 1993–2003 period, Core IC projects performed better than the Bank average. Outcome ratings improved only slightly over the period, in contrast to a more significant improvement in the Bank-wide portfolio. Thus, the performance of Core IC projects is falling
relative to the Bank average. An analysis of IEG-World Bank’s reviews of Implementation Completion Reports suggests that more recent IC projects were more heavily focused on longer-term institutional reforms that were more vulnerable to the political economy of reform, implementation and enforcement, and the capacity of public sector agencies.

From different angles, the various components of IEG-World Bank’s evaluation come to the same conclusion: Institutions are key to the quality of the investment climate, and supporting institutional reform is a critical challenge for the Bank. The literature review provides evidence that cross-country differences in the quality of institutions explain a large share of the differences in growth and may even “trump” other growth determinants. The case studies confirm this view by providing examples of countries where the Bank paid insufficient attention to institutional weaknesses, and as a result had little impact on the investment climate. And the slower than average improvement in the IC loan portfolio is explained by the increased concentration of IC projects on complex, politically sensitive institutional reforms that take time to achieve results.

Organizational Issues
The investment climate is a broad topic, and this is reflected in the wide-ranging “ownership” of the Bank’s IC portfolio across networks and sector boards. In fact, more IC projects are assigned to non-PSD networks than to PSD. In a sense, this is a good thing: It shows that IC issues have been mainstreamed in the Bank. But it also means that coordination and teamwork across sector units is needed to design integrated strategies and to balance private sector perspectives with broader economic and social goals. Coordination across the WBG on IC issues was weak during the period of the evaluation, both between the Bank and IFC and across sector units within the Bank. Competition for the IC agenda between PSD and the Poverty Reduction and Economic Management (PREM) units was common and in some cases led to a lack of coordination and information sharing. The burden of integrating different sector perspectives and setting priorities lay with the country departments—but some country departments were more actively involved in managing this integration than others.

The Bank needs to have an organizational structure that facilitates integration across sectors and collaboration among staff. Recently, the joint World Bank-IFC Private Sector Development Vice Presidency has undertaken to improve coordination and reap synergies in IC work across the WBG, for example by holding WBG-wide country review meetings and conducting WBG-wide training in the field. The Vice President of the Bank-IFC PSD vice presidential unit is also Chief Economist of the IFC.

Recommendations
The IEG-World Bank evaluation concludes with the following recommendations to improve Bank support for IC reforms:

- Pay more attention to institutions and the political economy of reform.
- Improve the focus and use of survey-based diagnostics.
- Do a better job of prioritizing and packaging IC reforms in lending operations.
- Find organizational solutions that help integrate microeconomic and macroeconomic reform agendas.
Introduction

A country’s investment climate is its environment for private sector activity. The quality of the investment climate is determined by the risks and transaction costs of investing in and operating a business, which in turn are primarily determined by the legal and regulatory framework, barriers to entry and exit, and conditions in markets for labor, finance, information, infrastructure services, and other productive inputs.

Governments influence the quality of their countries’ investment climates through policies, institutions, and their relationship with the private sector. The quality of the investment climate is linked to poverty reduction by the impact of better investment climates on private sector activity, and thus on economic growth and employment.

Improving the investment climate of client countries is one of the two pillars of the World Bank Group’s1 approach to development effectiveness and is central to the 2002 Private Sector Development Strategy. Despite the centrality of the topic, the PSD Strategy notes that “no rigorous effort has yet been made to analyze the relationship between the Bank’s PSD work in different countries and improvements in the countries’ investment climate...” (World Bank 2002a, p. 37). The IEG-World Bank has touched on some IC issues in earlier sector and corporate evaluations—of Bank support for policy reform (2003 Annual Review of Development Effectiveness), Bank assistance to the transition economies PSD issues in specific sectors (e.g., extractive industries (2003), water supply and sanitation (2003)). In 1998, IEG-World Bank and IEG-IFC conducted an evaluation of the Foreign Investment Advisory Service (FIAS). This broader and more comprehensive evaluation of the Bank Group’s IC work builds on the findings of previous selective evaluations.

The Investment Climate Study is a joint evaluation of the IEG (covering the activities of the IBRD/IDA), IEG covering the IFC, and IEG covering MIGA. The combined findings are summarized in Chapters 1–4 of this report.

Evaluation Scope and Design

The intended chain of causality from World Bank IC activities to economic performance outcomes has three parts:

- The link between Bank activities and the adoption of policy and institutional reforms
- The link between reforms and actual changes in the investment climate
• The link between changes in the investment climate and performance outcomes (firm-level productivity and profitability and economy-wide productivity, investment, income, and employment).

The IEG-World Bank evaluation focuses on the first two links of the chain—from Bank activities to policy and institutional reforms, and for the country case studies, on the relationship between reforms and actual changes in the investment climate. The evaluation relies on a literature review to provide evidence on the relationship between improved investment climates and final economic outcomes.²

The evaluation addresses the following questions:

• **Relevance of Bank assistance:** What relative priority did the Bank attach to addressing IC issues among its total interventions? Were the policy and institutional areas emphasized in Bank operations consistent with current empirical research linking IC indicators with performance outcomes and with the obstacles to investment as perceived by potential investors? Do the survey-based diagnostics used by the Bank provide good information about the quality of the investment climate, and do they lead to sound policy advice?

• **Effectiveness of Bank assistance:** Are Bank activities helping to get IC reforms implemented? Was the Bank effective in motivating client governments to undertake reforms beyond what they would have done in the absence of Bank intervention? Was conditionality in lending operations helpful in supporting reform? What were the outcomes of Bank interventions, in terms of the quality of the investment climate and in terms of investment and growth?

• **Sustainability:** What is required for IC improvements to be sustained? How should reforms be sequenced?

• **Organizational issues:** Does the Bank’s organizational structure support good investment climate work?

This report summarizes the findings of the following evaluation components, some of which appear in complete form as background papers (Annex IIA describes the tools and methods used):

• A review of the literature on the drivers of investment and growth and of the microeconomic factors that determine investment behavior³

• A review of IC issues in Bank strategy documents—institution-wide PSD strategies, Country Assistance Strategies (CASs), and Poverty Reduction Strategy Papers (PRSPs)⁴

• A description and analysis of the portfolio of IBRD/IDA lending operations that support improvements in the investment climate

• A description and analysis of IBRD/IDA non-lending services including economic and sector work and survey-based diagnostic assessments

• Results of structured discussions with Bank staff and international investors⁵

• Client consultations and country case studies for Indonesia, Romania, India, Mozambique, and Peru.⁶

### A Review of Global Trends in the Investment Climate

IEG-World Bank’s *Annual Review of Development Effectiveness* (ARDE) 2003 evaluates the effectiveness of Bank support for policy and institutional reform in borrower countries. The indicators of policy and institutional performance presented in the ARDE can be interpreted as very broad indicators of the quality of the investment climate. The indicators compiled by four organizations—the World Bank’s CPIA, the Heritage Foundation Index of Economic Freedom, the International Country Risk Guide (ICRG), and the Economist Intelligence Unit Country Risk Service—agree that developing countries’ policies have, on average, improved modestly.⁷ Improvement is seen at both low- and middle-income levels (shown as IDA and IBRD country groups in figure 6.1). Although there are some distinctive regional patterns, average ratings for the CPIA have also improved for every one of the Bank’s regions (figure 6.2). Improvements in the investment climate, measured very broadly by the CPIA, were
Figure 6.1: IC Indicators in Developing and Transition Economies (all rated IBRD/IDA countries)

Note: CPIA = Country Policy and Institutional Assessment; ICRG = Implementation Completion Report; EIU = Economist Intelligence Unit.

Figure 6.2: CPIA by Region, 1999 and 2003

Source: World Bank data.
Note: CPIA = Country Policy and Institutional Assessment.
greatest in transition economies—which started the reform effort from a lower base than the average—including some that joined the European Union (EU) on May 1, 2004, and those that aspire to EU accession. Countries whose investment climates deteriorated were more diverse. Five of the 10 countries showing deterioration between 1999 and 2003 were in Latin America and the Caribbean, which suffered macroeconomic crises during the period. Significant reform occurred in environments that were conducive to change, driven either by crisis (macroeconomic crisis or transition from planned to market economies) or opportunity (e.g., EU accession, the chance to join regional agreements, a new regime).

Looking at the components of the CPIA (figure 6.3), it is evident that current ratings are highest in some of the macroeconomic areas that were the target of first-generation policy reforms supported by the Bank: macroeconomic management, trade and foreign exchange regimes, and public debt management. Ratings are lowest in some institutional areas—property rights and governance, transparency, and the quality of public administration—that are commonly termed second-generation reforms. This suggests that the Bank needs to focus its assistance on these institutional issues, which are among the core IC themes that are the subject of this evaluation.

Country risk indicators provide a broad measure of policy and institutional performance. They provide a useful reminder that much remains to be done to improve the investment climate in many developing countries. Until recently there has been a lack of microeconomic data that could be used to compare the quality

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**Figure 6.3: CPIA Components, 1999 and 2003**

<table>
<thead>
<tr>
<th>CPIA components ranked by 2003 level</th>
<th>CPIA rating</th>
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<tr>
<td></td>
<td>1999</td>
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<tr>
<td>Trade &amp; foreign exchange regime</td>
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<tr>
<td>Macroeconomic management</td>
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<td>Management of public debt</td>
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<td>Gender</td>
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<td>Goods &amp; factor markets</td>
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<td>Competition</td>
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<td>Poverty monitoring &amp; analysis</td>
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<tr>
<td>Human resource development</td>
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<td>Revenue efficiency</td>
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<td>Sustainability of reform</td>
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<td>Equity of public resource use</td>
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<tr>
<td>Fiscal policy</td>
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<tr>
<td>Budget &amp; financial management</td>
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<tr>
<td>Social protection &amp; labor</td>
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<tr>
<td>Financial stability</td>
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<tr>
<td>Environment</td>
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<td>Financial sector depth</td>
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<td>Quality of public administration</td>
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<tr>
<td>Transparency</td>
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<td>Property rights &amp; governance</td>
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</table>

Note: CPIA = Country Policy and Institutional Assessment.
of the investment climate, at a detailed level, across countries. To fill this gap, the Bank’s Doing Business Project (discussed in Chapter 8) has just started collecting data on the cost of doing business in more than 130 countries (was to be increased to 145 countries in 2005). The indicators will be updated annually to provide time series data on progress with reform. The project’s first publication on regulation allows cross-country comparisons of the cost of starting a business, hiring and firing workers, enforcing contracts, getting credit, and closing a business (World Bank 2004a).

Doing Business 2004: Understanding Regulation shows that regulation varies widely around the world, but that rich countries regulate business in a more consistent manner than do poor countries. For example, it takes two days to start a business in Australia, but 203 days in Haiti and 215 days in the Democratic Republic of Congo. It costs more than five times per capita income in Cambodia to start a new business, more than 13 times in Sierra Leone. Across all sets of indicators included in the 2004 surveys, Bolivia, Burkina Faso, Chad, Costa Rica, Guatemala, Mali, Mozambique, Paraguay, the Philippines, and Venezuela regulate the most. Australia, Canada, Denmark, Hong Kong (China), Jamaica, the Netherlands, New Zealand, Singapore, Sweden, and the United Kingdom regulate the least.

Doing Business 2004 also shows that heavier regulation is associated with more inefficiency in public institutions and poor enforcement, as well as with worse economic outcomes. The costs of starting a business, going through bankruptcy proceedings, hiring and firing workers, and enforcing commercial contracts are associated with lower enterprise productivity and investment as well as with greater informality. Rigid employment laws are associated with fewer job opportunities for women, and regulatory restrictions on sharing credit information restrict access to credit, particularly for small enterprises. The report recognizes the legitimate need for regulation to deal with market failures. Two examples are credit rights—the legal rights of lenders to recover their investment if the borrower defaults—and the efficiency of enforcing property rights through the courts. Countries that protect such rights achieve better social and economic outcomes (World Bank 2004a, pp. xv–xvi).

The real issue is not “more” or “less” regulation, but the effectiveness of regulation (although some argue that, in some areas, “less” is a good proxy for “effective”). Over-regulation in developing countries comes from two sources: (a) a hangover of the past when the prevailing ethos was that the private sector was exploitative and had to be controlled, and (b) the wholesale adoption of regulatory systems from developed country models without any assessment of whether it was the right institutional model or whether the country had the institutional capacity to implement them. For example, Jamaica imported the British regulatory system in the 1980s with disastrous results and has now shifted to much simpler rules-based regulation with arbitration provided by external courts (World Bank 1997).

The Big Picture: Determinants of Investment and Growth

IEG-World Bank’s 2003 ARDE shows that policies and institutions matter a great deal in determining outcomes of the growth of per capita income and of social indicators. Countries with good policies and institutions, as measured by the CPIA, have the highest per capita income growth rates. To dig deeper into the relative importance of policies and institutions, this evaluation tried to unbundle the determinants of growth. A review of the literature shows that, at the highest level of aggregation, investment and growth are driven by accumulation and innovation, which in turn are determined by three broad variables—geography, policies, and institutions:

Geography includes exogenous factors such as natural resources, distance from important markets, and climate, which help determine relative prices, transportation costs, and market structure.

Policies (sometimes called “integration”) include macroeconomic, trade, and sectoral policies that determine the integration of markets across regional and national boundaries and, hence, also help determine relative prices.
Institutions influence investment decisions by structuring the environment within which transactions occur, thus determining transactions costs and risk of production and exchange. Institutions include the legal and regulatory framework, administrative procedures, property rights, contract enforcement, corporate governance, etc. (box 6.1).

Recent studies have tried to sort out the importance of these three broad IC variables in explaining economic performance at the country level. Most find that institutions “trump” geography and policies in explaining cross-country differences in income. Macroeconomic and structural reforms are necessary conditions for growth and can stimulate an initial growth spurt even in the absence of a sound institutional framework, but modern institutions are needed to sustain growth. Principal among these institutional factors are the security of property rights, the rule of law, and absence of expropriation risk; political factors (political stability, civil liberty, and democracy); and the absence of corruption and graft.9

It is clear that institutions matter a great deal for growth, but less is known about what constitutes “best practice” in institutional design. Different institutional arrangements seem to work in different countries, so it appears that there is no “one size fits all” institutional design. For example, the system of private property rights and Anglo-American corporate governance is not the only institutional arrangement that enforces the principle of protecting property rights. China, with its hybrid system of property rights and a legal regime that is far from the Anglo-American system, has supported a tremendous amount of investment and entrepreneurial activity (IEG 2004a, p. 13, from Rodrick 2003). The literature on the country-specificity of institutions comes to two conclusions. First, certain best practice principles are applicable to all institutional arrangements, such as transparency, accountability, competition, the rule of law, and the protection of property rights. Second, the mechanisms to implement these principles vary from country to country but are not completely unique to each. Between the two extremes of “one size fits all” and “uniqueness” in institutional design, macroeconomic management seems to be closer to a single, well-established model; education, health services, and social protection the most unique; and legal, regulatory, and financial sector models lie somewhere in the middle (IEG 2004a, p. 30).

Box 6.1: Institutions and Organizations

Institutions—often referred to as “the rules of the game” in institutional economics literature—are the human-devised constraints that shape human interaction. They may be formal (statute law, common law, and contracts between individuals) or informal (conventions, codes of conduct, and norms of behavior). They may be created (a nation’s constitution) or simply evolve over time (common law). Taken together, formal and informal rules, as well as the type and effectiveness of their enforcement, determine “how the game is played”—including how markets function.

Organizations are groups of individuals that implement and enforce the rules of the game. They are influenced by institutions and in turn influence how institutions evolve. Organizations include political bodies (such as regulatory agencies) as well as social and educational bodies.

The Determinants of Investment Behavior: Microempirical Evidence

At a microeconomic level, many different factors determine the investment behavior of firms. A more nuanced picture emerges, with considerable difficulty in pinning down a common set of factors influencing the investment climate. Econometric evidence suggests that business fixed investment is influenced by tax policy and fiscal incentives, product market regulations (Alesina and others 2003), and high barriers to entry (Alesina and others 2002). Results from the World Business Environment Survey (WBES) show that taxes and regulations, financing, policy instability and uncertainty, and inflation matter most for company growth and investment (Batra and others 2003). There are important differences across regions: In South Asia, street crime imposes the leading constraint, but in Africa infrastructure is identified as the second-leading problem after financing. In Central and Eastern Europe, inflation ties with taxes and regulations as the leading constraint.

Some overarching issues (e.g., regulatory uncertainty) matter to most firms, but more specific constraints may be ranked differently by different firms. The relative priority of various constraints seems to depend on the size, age, input mix, and mobility of the firm and the industry in which it operates. Foreign investors care about different constraints than domestic investors do because of their greater mobility. Foreign direct investment (FDI) decisions are more heavily influenced by macroeconomic and political risk than are domestic investment decisions. Compared with domestic investment, FDI is more positively associated with privatization, a competitive environment, the level of technological development, and lower regulation; it is less influenced by the availability of domestic credit. Even within countries, firms may be relatively immobile. In India, for example, private sector representatives interviewed for this evaluation indicated that, while streamlining regulations and procedures may facilitate investment in a particular state, differences in regulatory regimes among states would not induce domestic companies to invest in one state over another. Local companies tend to remain where they first began operations, typically in the home town of the owner, and few firms have the capability to operate in multiple states.

The WBES finds that, for most categories of obstacles, SMEs identify themselves as more constrained than larger firms. Firms that are private, smaller, newer, and devoid of FDI and that cater to the domestic market generally tend to report more acute business constraints than do firms that are older or larger, that export, that have FDI, or that are State owned. In facing some obstacles to doing business, medium-size firms identify themselves as equally or even more constrained than do small firms (Batra and others 2003).

As part of this evaluation, interviews were conducted with a small number of multinational corporations headquartered in the United States, Europe, and Japan. Participants were asked to discuss the importance of IC considerations in their investment location decisions worldwide. The interviews confirmed the diversity in the relative importance assigned to these considerations stemming from the diverse needs of the firms (box 6.2). For some, IC conditions take second place to factors such as cheap labor and large markets. Other investors cited physical security, rule of law, and currency convertibility as critical factors determining their investment locations. The cost and time required to register a business were viewed as relatively unimportant by most of these international investors.

Conclusions

Indicators of country-level policy and institutional performance show that the investment climates of developing and transition economies have improved modestly in recent years. Improvement is seen in both low- and middle-income countries and across all Bank regions. The largest improvements were in transition economies—which started from a lower base—including countries that aspire to EU accession. Performance ratings are higher for macroeconomic conditions (macroeconomic management, financial stability, and revenue stability) than for some institutional areas (property
Box 6.2: Diverse Factors Influence Foreign Investment Decisions Because Firms Are Diverse

Interviews with multinational corporations conducted for this evaluation illustrate the diversity of factors that determined each company’s decision to locate or expand an overseas investment. For some firms, the exigencies of doing business—including access to large markets, cheap labor, natural resources, quotas, and sometimes incentives—dominated institutional factors, whether the latter were viewed positively or negatively. For other companies, institutional factors were decisive. Firm needs differed across manufacturing and service specialties, and between manufacturing and services. Some quotations from participants:

“Other things being equal, we are drawn first in our investment decisions to large markets that are under-served and have growth potential. But we can operate in smaller markets as well. For example, the Dominican Republic, though a small market, has been a successful investment for us. The critical factors are that we can set a fair tariff and take money out when we want.” (U.S. telecom company)

“We are constantly weighing risk against reward in a search for new business opportunities, and the factors that enter into these calculations, as well as the weight we assign to them, can vary a lot from one setting to the next. There is no formula. For example, we don’t like labor conditions or the treatment of intellectual property in China, but there is no question we have to produce there. We also produce in some smaller countries—for example, Singapore and Ireland—either because we have confidence in their political and macroeconomic stability or because the advantages of factors such as lower labor costs and investment incentives outweigh our perception of risks.” (U.S. computer and information technology company)

“Strictly speaking, I can’t tell you the principles we use for choosing an investment location because we’ve been shrinking our operations for the past few years, but maybe something is said by how we have consolidated. Our remaining operations tend to be located where labor is cheap and where there is a large internal market. Regrettably, we had to close our production facility in Ireland, even though it had a superior investment climate.” (Japanese information technology company)

“We are the epitome of a ‘reputation-sensitive’ company. We market our products to final customers and we need to be responsive to their mounting concerns, particularly in the areas of environmental and labor conditions. Above all, we have to protect our brand. These are the ‘investment climate’ issues that affect us most directly.” (U.S. footwear and apparel designer and distributor)

“Investment climate conditions do not dictate where we work, but are an important factor when we get there and can affect the time and costs and profitability of individual projects—for example, the time and costs of obtaining licenses and permits, local corruption, quality, availability, and employment conditions of the local labor force.” (U.S. construction and engineering company)

“Investment climate issues are of course important in selecting overseas locations. One of our largest overseas investments is in Singapore, started as a joint venture with the Singapore government as partner. Singapore doesn’t have the cheapest labor or a very large internal market, but labor is competent and reliable, and the government and its policies are stable.” (Japanese chemical company)

rights, public administration, transparency, and rules-based governance), suggesting that these areas deserve attention.

The literature review conducted for this study provides evidence on the factors most important for investment and growth. At a broad level, policies and institutions determine growth outcomes. Macroeconomic and structural reforms are necessary conditions for growth and can stimulate an initial growth spurt even in the absence of institutional reforms, but modern institutions are needed for sustained growth. Certain best practice principles are applicable to all institutional arrangements, such as transparency, accountability, competition, the rule of law, and the protection of property rights. However, the institutional arrangements needed to implement these principles are somewhat country specific. An institutional arrangement that is successful in one country doesn’t necessarily transfer well to another country without modifications, and unorthodox arrangements often work.
The Bank’s Strategic Focus

From First-Generation to Second-Generation Reforms

Although the term investment climate came into use fairly recently, the topic—under such names as “business environment” or “enabling environment”—has been a part of PSD strategy documents throughout the 1990s. The 1989 Private Sector Development Action Plan identified four priority areas for Bank support to promote PSD: (i) improving the business environment; (ii) public sector restructuring and privatization of enterprises, infrastructure, and services; (iii) financial sector development and transfer of resources; and (iv) research and policy work to establish a basis for future Bank operations. Bank assistance to improve the business environment was to take the form of adjustment operations to support policies, regulations, and legal reforms. The strategy also called for an expansion of the Bank Group’s FIAS.

Two years after the PSD Action Plan was adopted, the Bank took stock (World Bank 1991). Efforts to improve the business environment through adjustment operations was the area in which the Bank responded most promptly in terms of its PSD emphasis: Three-quarters of the Bank’s adjustment operations in 1989–90 supported this objective. Components for dismantling barriers to market entry and exit were included in 60 percent of adjustment operations. There was also a large increase in the proportion of investment operations designed to enlarge the range of economic activities open to private agents. Country economic and sector work increasingly gave priority to identifying constraints to PSD and to developing programs to overcome them (World Bank 1991, p. 9).

In the early 1990s, at least as much attention was paid to other PSD topics as was paid to the investment climate. State-owned enterprise (SOE) restructuring and privatization was at the core of Bank assistance to the transition economies. The PSD strategy for IDA countries issued in 1995 emphasized the drain of dysfunctional SOEs on poor economies and advocated privatization in IDA countries (World Bank 1995). The expansion of private investment in infrastructure during the mid- and late 1990s was supported in many countries by Bank operations. Financial sector reform predominated following Mexico’s devaluation in 1994 and the Thai devaluation in 1997. Although directed credit lines were largely abandoned by the 1990s, other forms of direct assistance to firms—particularly in nonfinancial services—continued throughout the decade.

In the second half of the 1990s, the Bank began to shift its focus from first-generation
reforms—macroeconomic stability and trade integration—to second-generation reforms involving improvements in the administrative, legal, and regulatory functions of the State. Greater emphasis was placed on institutional development as well as on addressing the social costs of PSD interventions, such as privatization-related labor retrenchment. Issues of transparency and corporate governance also were highlighted, especially after the East Asia crisis (World Bank, 2001a, p. 3).

The shift from first-generation to second-generation reforms—or the “macro first, micro second” sequencing—was not so much a planned strategy as a result of the disappointing supply response to first-generation reforms. Macroeconomic stability, financial sector reform, privatization, and trade liberalization were recognized as necessary but not sufficient conditions for sustained growth. Increasingly, the Bank became aware of the importance of institutional reforms, sometimes referred to as the “microeconomic foundations of growth.”

**The Investment Climate Takes Center Stage**

The past several years have witnessed a shift in emphasis in the Bank’s PSD strategy toward a clearer and more central role for the investment climate. In part this is due to the declining activity in both privatization and private investment in infrastructure. It also reflects the Bank’s broader corporate agenda: Improving the investment climate is one of two pillars of the WBG’s approach to development effectiveness and one of the “focal points” in the WBG’s corporate agenda.

The emphasis on the investment climate is especially noticeable in the 2002 Private Sector Development Strategy for the World Bank Group (World Bank 2002a, 2003a). The strategy cited several studies that suggest that the development impact of PSD activities in the Bank depends on the overall quality of the investment climate. Also cited is a recent IEG-World Bank review of PSD in IDA countries, which concluded that Bank operations “focused too narrowly on projects and did not tackle such fundamental constraints to PSD as the appropriate role of the State, financial sector reforms; institutional, legal, and regulatory bottlenecks; and the policy environment” (World Bank 2001b). The strategy suggested that the relative neglect of IC reforms was due partly to opposition by vested interests in the countries concerned and partly to the Bank’s continued lending for direct support to firms.

The 2002 PSD Strategy placed special emphasis on improving the investment climate to extend the effective reach of markets (World Bank 2002a). The strategy called for country-level assessments of the quality of the investment climate, undertaken in consultation with the private sector. Enterprise surveys were to be used to identify constraints from the perspective of firms, and to link the policy and institutional environment to the performance of firms. Regular, standardized surveys would allow intercountry comparisons as well as the ability to track the implementation and results of reform over time. ICAs were to be integrated into other economic and sector work (ESW) products such as Country Economic Memoranda and Development Policy Reviews, and would underpin CASs, Comprehensive Development Framework exercises, and PRSPs. Building on these assessments, the strategy expected that policy-based lending would be a major vehicle for advancing IC reform efforts, complemented by technical assistance operations and free-standing advisory services.

More recently, the Rural Development Strategy devoted considerable attention to investment climate issues in the rural sector, outlining necessary policy and institutional reforms such as more secure property rights, market access and free entry, market information, financial services, and rural transport, communication, and power infrastructure (World Bank 2003b). The *Agriculture Investment Sourcebook* (2004), which provided practical guidance for the implementation of the strategy, also dealt with rural IC issues.

**IC Strategies at the Country Level**

IC issues have received increasing attention in CASs over the fiscal 1993–2002 period. The most critical IC issues, and the Bank’s strategic
response, vary significantly by region. Table 7.1 highlights the investment climate issues that received the most attention in CASs as well as the issues that were addressed, de facto, in IC-related lending in the region. The table shows the following regional patterns:

- **Africa:** The CASs emphasized the need to improve the enabling environment for business and make progress on privatization. Projects focus on achieving macroeconomic stability and building investor confidence (changing business perceptions regarding the risk of investing in the region), addressing institutional constraints, and improving the adaptation of private firms to competitiveness challenges.

- **East Asia and the Pacific:** Beginning with the Asian financial crisis, both the CASs and IC lending focused on corporate restructuring and corporate governance issues. IC lending also supported financial sector reform.

- **Middle East and North Africa:** CASs focused on the need to improve competition policy. The lending program targeted macroeconomic stability as a means of reducing uncertainty and addressed the problem of public monopolies.

- **South Asia:** CASs emphasize constraints in the business environment and the need for further privatization. IC lending operations target the problem of pervasive government involvement in the economy.

- **Latin America and the Caribbean:** Major issues identified in the CASs include the lack of global competitiveness and the need for regulatory and judicial reform. IC projects also focus on corporate governance and agricultural sector reform.

- **Europe and Central Asia:** CASs focus on the legal and regulatory framework, labor legislation, and privatization; IC lending covers judicial reform, property rights and land markets, corporate governance, access to finance, and bankruptcy law.

IEG-World Bank’s Country Assistance Evaluations (CAEs) assess the fit between country priorities and the Bank’s assistance strategy. A review of the 42 CAEs completed between 1997 and 2003, which evaluated progress against the latest corresponding CASs, shows that one or more investment climate issues were of high country priority in 28 countries; the Bank assigned high priority to the same issues for 23 of these countries. The most frequent obstacles to achieving better IC outcomes were a lack of government ownership and capacity (e.g., Lithuania) and the hesitancy in completing reforms because of political sensitivities (e.g., Mongolia). Reform efforts were sometimes hindered by a lack of role models to support entrepreneurship (e.g., Mongolia) and participation and partnership of more domestic and donor stakeholders (e.g., Uganda). The Bank was criticized in some CAEs for not giving enough weight to governance issues, weak institutions, and civil service reform (e.g., Ghana, Bolivia). In many cases, the CAEs argue that the Bank’s ideas and policy advice have often been more useful than lending. The Bank’s ESW, policy dialogue, and aid coordination were assessed in several cases to be timely, of good quality, and appreciated by governments (Guatemala, Sri Lanka, Ukraine).

IEG-World Bank’s recent evaluation of Bank assistance to transition economies (IEG 2004b) shows that Bank assistance programs initially reflected the view that privatization must take place quickly, taking advantage of limited reform “windows” to prevent the possibility of reversals. The hope was that new private owners would lobby for further liberalizing reforms and supporting institutions. Few Bank PSD projects in these countries contained specific institutional components, and the majority of regulatory reform and competition policy projects were initiated after privatization in most transition economies, especially in the Commonwealth of Independent States. In hindsight, it is apparent that the Bank, along with other donors, should have tried harder to promote the improvement of the institutional framework for business and investment, as well as and in parallel with privatization (IEG 2004b, pp. 18–19).

The country case studies conducted for this evaluation provide examples of CASs that have been moving from first-generation to second-
Exceptions were found for those countries that experienced macroeconomic crises, where the CASs necessarily focused on restoring macroeconomic stability (for example, Indonesia in the late 1990s).

The country case studies and focus group discussions conducted for this evaluation suggested that the Bank is (or is perceived to be) more focused on promoting foreign investment than domestic investment. In Mozambique, for example, a focus on attracting foreign investment to the capital city of Maputo occurred at the expense of rural development.

### Table 7.1: IC Issues in Country Assistance Strategies, Fiscal 1993–2002

<table>
<thead>
<tr>
<th>Issues addressed in CASs and core IC projects</th>
<th>Africa Region 24 countries/33 CASs</th>
<th>East Asia and Pacific Region 10 countries/14 CASs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investor confidence</td>
<td>Investor confidence</td>
<td>Corporate governance</td>
</tr>
<tr>
<td>Macro stability</td>
<td>Macro stability</td>
<td>Corporate restructuring</td>
</tr>
<tr>
<td>Slow firm adaptation</td>
<td>Slow firm adaptation</td>
<td>Financial sector reform</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other issues emphasized in CASs*</th>
<th>Enabling business environment</th>
<th>SMEs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment climate</td>
<td>Investment climate</td>
<td>Legal and regulatory reform</td>
</tr>
<tr>
<td>Privatization vs. credit to PS</td>
<td>Privatization vs. credit to PS</td>
<td>Transparency</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Other issues mentioned in CASs</th>
<th>Legal and regulatory reform</th>
<th>Public/private partnerships</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitiveness</td>
<td>Competitiveness</td>
<td>Urban/rural development</td>
</tr>
<tr>
<td>Admin barriers/market access</td>
<td>Admin barriers/market access</td>
<td>Infrastructure</td>
</tr>
<tr>
<td>Role of government/bureaucracy/ arrears</td>
<td>Role of government/bureaucracy/ arrears</td>
<td>Competition policy</td>
</tr>
<tr>
<td>Need for private investment</td>
<td>Need for private investment</td>
<td>Access to credit</td>
</tr>
<tr>
<td>Dialogue w/private sector</td>
<td>Dialogue w/private sector</td>
<td>Macro environment</td>
</tr>
<tr>
<td>High interest rates</td>
<td>High interest rates</td>
<td>Competitiveness</td>
</tr>
<tr>
<td>Institutional constraints</td>
<td>Institutional constraints</td>
<td>Private corporate debt</td>
</tr>
<tr>
<td>Infrastructure</td>
<td>Infrastructure</td>
<td>Enabling environment</td>
</tr>
<tr>
<td>Dominance of conglomerates</td>
<td>Dominance of conglomerates</td>
<td>Conglomerates</td>
</tr>
<tr>
<td>Unemployment/land constraints</td>
<td>Unemployment/land constraints</td>
<td>Uneven playing field w/SOE s</td>
</tr>
</tbody>
</table>

**Note:** CAS = Country Assistance Strategy; SOEs = state-owned enterprises; SME = small and medium-size enterprises; FDI = foreign direct investment.

*Issues that were included in the development priorities matrix at the end of the CAS.
example, Bank activities were reasonably successful in developing Mozambique’s investment promotion capacity, and this has helped bring foreign investment into the country. However, most of these investments were “mega-projects” that came in under special negotiated conditions and circumvented many of the administrative barriers faced by local investors. While this strategy did some good by helping Mozambique establish itself as open to
business, small domestic investors still face administrative barriers to doing business, and the degree of linkages between foreign investors and local firms is a matter of debate.

Discussions with Bank staff suggested that some topics have received little attention. IC issues in rural areas, in particular the constraints to nonfarm income-earning activities, have received little coverage because of the mainly urban, manufacturing-sector focus of survey-based diagnostic assessments. Other issues that have received limited coverage are labor laws; competition policy; the informal sector; and land and property rights (particularly in AFR and ECA), though it was acknowledged that these are politically difficult. In general, staff felt that IC issues that involve genuine market failure should receive more attention.14

Translating the Strategy into Operations
Comparing the Bank’s increased strategic focus on second-generation issues in CASs with the trend in the share of IC projects in the portfolio, it appears that the strategic shift toward IC issues has not been implemented in the Bank-wide lending program. Using either a broad or narrow
The increased prominence of the investment climate in sector strategy papers and CASs mirrors the Bank’s shift in emphasis from first-generation to second-generation reforms. This “macro first, micro second” sequencing was not so much a planned strategy as the result of the disappointing supply response to first-generation reforms. Increasingly, the Bank has become aware of the importance of institutional reform to sustain growth, and this recognition is noticeable in the CASs during the period. This shift in focus was appropriate and is well supported by the literature.

The Bank’s increased strategic focus on improving investment climates has not yet translated into a greater share of the loan portfolio being devoted to this objective. Except for an increase in fiscal 2002, the IC share of the loan portfolio, using either a broad or narrow definition of the investment climate, shows no observable trend over the past 10 years.
The Bank is involved in a wide range of analytical and advisory activities on IC issues. Principal among these are ESW on various IC topics and survey-based diagnostics of the constraints of doing business. This chapter briefly describes relevant ESW and then looks in more detail at recent diagnostic work.

**Economic and Sector Work**

Over the past decade the Bank has produced a large number of reports on IC issues. Analysis of investment climate topics is frequently part of economic reports (Country Evaluation Memoranda, Development Policy Reviews) and sector reports (for example, on industrial development, competitiveness, export development, governance, and small and medium enterprise development). In addition to these formal vehicles of nonlending assistance, advice is also provided informally to governments and the private sector through discussions, sharing of information, and in-country seminars.

A keyword search identified more than 2,800 reports and working papers produced since fiscal 1990 that at least touch on IC issues. A much smaller number were primarily directed toward Core IC themes: 307 reports were directed toward one or more Core IC themes during fiscal 1993–2003, with a larger number in the second half of the decade (table 8.1). About 45 percent of these reports were policy research working papers rather than formal ESW. The topics that have received the most attention were those in the legal area (judicial and other dispute resolution mechanisms, legal institutions for a market economy), followed by regulation and competition policy. Of the regionally focused reports, almost 40 percent were in the Europe and Central Asia Region; the lowest numbers were in the Middle East and North Africa and South Asia Regions. In Europe and Central Asia, corporate governance was the most important topic; in Latin America and the Caribbean, regulation and competition policy received the most attention. In Europe and Central Asia and East Asia, property rights were also important.

A recent IEG-World Bank review of the treatment of PSD in 15 CAEs found that, in general, the Bank’s ESW and related advisory services in PSD had generally been effective. The CAEs remarked that the Bank has a comparative advantage in ESW and that good ESW is important to both the clients and donors and has a bearing on the quality of the Bank’s lending. However, the IEG-World Bank review also identified several cases of insufficient ESW, which lowered the quality of the Bank’s strategy and lending work. It also identified cases of
inadequate participation by clients and poor in-country dissemination of the findings, which reduced the effectiveness of many good ESW pieces.

Evidence from the country case studies conducted for this evaluation indicates that the Bank’s ESW on IC issues has helped define the reform agenda and has been appreciated by clients—in fact, they encouraged the Bank to do more (box 8.1). However, some of the officials interviewed suggested that recent reports have presented the same policy recommendations as earlier reports. While recommendations that were not adopted may bear repeating, this feedback suggests that the Bank may need to be more selective and focused in its choice of ESW.

What is striking is that, despite the quantity and quality of investment climate ESW that has been produced by the Bank over the past 10 years, many have observed that “we really don’t know very much” about good practice in institutional design, nor about the dynamics of reforms to improve the investment climate. While basic economic principles are well accepted (for example, the benefits of competition), there is less knowledge about the institutional arrangements to apply these principles (for example, laws governing competition and the organizations that implement them). These institutional arrangements are neither “one size fits all” nor completely country specific. It would be useful for the Bank to develop (perhaps building on the taxonomy used in Part II of this report) a typology of country situations and institutional designs that would provide guidance on which types of arrangements work where, how the change process happens, how it can be supported and sustained, etc.—in other words, an understanding of what types of institutional arrangements are transferable in different country contexts. The Bank’s research and ESW have not yet provided enough of this knowledge of institutional design and the process of reform.

Survey-Based Diagnostics
Over the past decade, the Bank has employed several diagnostic tools to assess the quality of a country’s investment climate and the constraints facing private enterprises:

- Private Sector Assessments (PSAs), many of which were based on enterprise surveys to determine perceived constraints in the business environment
- The WBES and the Firm Analysis and Competitiveness Survey (FACS)\(^\text{17}\)
- The Regional Program for Enterprise Development (RPED) in the Africa Region, which combined enterprise survey data with productivity analysis and sector studies
- FIAS studies of the administrative barriers to doing business\(^\text{18}\)

PSAs were developed in 1991 to strengthen the private sector perspective in the Bank, to provide the basis for Bank Group assistance strategies for PSD, and to encourage stronger WBG collaboration on these issues. The Board mandated the involvement of the IFC, as it was considered to be in closer touch with the private

### Table 8.1: Bank Reports on IC Issues, Fiscal 1993–2003

<table>
<thead>
<tr>
<th>Core IC theme</th>
<th>Fiscal 1990–96</th>
<th>Fiscal 1997–2003</th>
<th>Total</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment climate/business environment</td>
<td>44</td>
<td>49</td>
<td>93</td>
<td>30</td>
</tr>
<tr>
<td>Regulation and competition policy</td>
<td>31</td>
<td>44</td>
<td>75</td>
<td>24</td>
</tr>
<tr>
<td>Property rights</td>
<td>25</td>
<td>30</td>
<td>55</td>
<td>18</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>27</td>
<td>18</td>
<td>45</td>
<td>15</td>
</tr>
<tr>
<td>Legal institutions for a market economy</td>
<td>8</td>
<td>13</td>
<td>21</td>
<td>7</td>
</tr>
<tr>
<td>Judicial and other dispute resolution mechanisms</td>
<td>7</td>
<td>11</td>
<td>18</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>142</strong></td>
<td><strong>165</strong></td>
<td><strong>307</strong></td>
<td><strong>100</strong></td>
</tr>
<tr>
<td>(Unique documents)</td>
<td>262</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
sector, and private sector consultations and surveys were recommended to capture the views of a broad cross-section of the private sector. PSAs were to be country specific and flexible in coverage, but each was to include a description and analysis of the private sector and its role in the economy as well as constraints to private sector development. About 30 PSAs were prepared, most in the early 1990s.

A 2001 IEG-World Bank review of PSD in IDA countries contained a brief evaluation of PSAs (IEG 2001b). The evaluation found that, at their best, PSAs deepened Bank staff and government policy maker understanding of PSD issues and enhanced the dialogue between business and government. They also contributed to country strategy and led to follow-up through project or policy conditionality. However, PSAs varied widely in scope, methodology, and quality. Some staff argued that some PSAs failed to provide substantially new insights into the problems of the private sector or to identify strategic priorities and actionable recommendations for promoting PSD. As market-oriented perspectives on economic development became more mainstream, the cost-effectiveness of PSAs as separate exercises was increasingly questioned. Task managers increasingly preferred more focused analysis on specific issues.

A number of PSA elements became incorporated in subsequent work including the WBES surveys, which used a uniform core question-
naire to measure and compare business environment conditions and constraints in 80 countries and in the West Bank and Gaza. The WBES was launched through the WBG’s Innovation Marketplace in 1998 and reflected collaboration across units of the Bank Group (Development Economics, FIAS, IFC, Poverty Reduction and Economic Management [PREM], PSD, and World Bank Institute) as well as with external organizations (the European Bank for Reconstruction and Development, the InterAmerican Development Bank, and Harvard University). The WBES attempted to standardize the types of analysis carried out by the earlier PSAs to assess conditions for private investment in developing and transition countries, as shaped by local economic policy; governance; regulatory, infrastructure, and financial impediments; and services to businesses. At least 100 firms were surveyed in each country. The WBESs were seen as potentially more cost effective than PSAs, and thus more attractive to operational staff.

Although the WBES has not been evaluated independently by IEG-World Bank, a number of observations in the Bank’s own summary of WBES results are consistent with IEG-World Bank findings on PSAs and more recent survey-based diagnostic instruments. The summary cited, first, the need for better coordination, comparability, and uniformity of the core survey and implementation between partner institutions. Second, it is important to account for inherent biases and measurement errors in any survey of this type. This necessitates care in interpretation and the use of control variables and suggests that survey results should be complemented with other data to assess the investment climate. Even though perceptions matter significantly for firm behavior and decision making, they are only imperfectly related to underlying physical and cost conditions. This underscores the desirability of complementing questions of perception with more quantitative evaluations of a firm’s experience of costs associated with various constraints. Finally, larger and more representative samples, particularly for economy-wide surveys and for core questions, would be desirable (Batra and others 2003, pp. 90–1).

More recently, the PSD Vice Presidency has developed two new diagnostic tools: ICAs (described in box 8.2) and the Doing Business Project (box 8.3). These two instruments are at the core of the Bank’s current analytical work on the investment climate and in particular are providing the means of tracking the performance of IDA countries on achieving PSD targets. The ICAs and Doing Business have tried to address these issues by providing standardized instruments with better quality control by the PSD Sector Board. Measuring the same variables in a consistent way allows benchmarking—comparisons across countries at a particular point in time, as well as tracking changes over time in a particular country. Objective and quantitative measures of the policy environment demonstrate to policy makers that change is possible and give credibility to reform efforts.

The design and methodology of ICAs and the underlying ICSs are better than those of the earlier surveys and assessments. However, there are some issues of relevance and of the use of the information gathered in the ICSs. Interviews and discussions conducted for this evaluation—in the country case studies, international investor interviews, and focus groups of Bank staff—identified the following issues:

• **Duplication of existing work:** In some countries, the nature of IC constraints, and the actions required to solve them, are already known. Often, similar surveys have been conducted by the government, local universities or think tanks, the Bank, or other donors. The benefit of an additional survey may be limited to that of providing comparable data for cross-country comparisons.

In the Indian states of Andhra Pradesh and Karnataka, the nature of IC problems, and the actions required to solve them, were already known. Both state governments had a significant appreciation of the challenges faced by their states in restoring fiscal discipline, improving governance, and addressing constraints to private investment, particularly in the regulatory area. Many potential remedies had been identified, for example, the concept of a single window for license clearances.
One of the Peruvian reviewers of the ICA who was interviewed for this evaluation said, “We have known these things for 10 years—why do we need another report to say the same thing? The World Bank has ignored earlier reports on what needs to be done for the private sector. Why were the issues that had been identified not incorporated into policies?”

- **Survey fatigue**: Related to the issue above, firms sometimes complain that they are repeatedly asked to participate in similar surveys by different organizations. This is particularly a problem in smaller countries with a relatively small private sector.

- **Geographic focus**: IC conditions can vary significantly by geographic area—across states, across municipalities, and even within municipalities. While ICSs routinely show variations in investment climate indicators across geographic regions, there may be a need to focus ICAs at the subnational level, particularly in large countries.20

- **Sector or industry focus**: Similarly, investment climate conditions may vary significantly by industry (for example, telecommunications versus agro-industry), and these differences may not be captured in ICAs. In some countries the main constraints to private sector development may lay outside the scope of ICAs—for example, labor skills.

- **Unprioritized recommendations**: Earlier surveys and assessments often produced long lists of problems and proposed solutions, without a clear set of priorities. This problem is beginning to be addressed in ICAs, which use firms’ rankings or impacts on productivity to set priorities. Nevertheless, feedback from clients suggests that more effort is needed to identify priorities and sequencing:

### Box 8.2: Investment Climate Surveys and Assessments

Investment Climate Assessments (ICAs) are designed to systematically analyze conditions for private investment and enterprise growth. Underpinning all ICAs is a standard core IC survey instrument (ICS), which allows the comparison of existing conditions and the benchmarking of conditions to monitor changes over time. The survey is administered to managers of firms and consists of a core set of questions as well as several modules that can be used to explore in greater depth specific aspects of the country’s investment climate and links to firm-level productivity. The core survey has 11 sections:

- General information about the firm: ownership, activities, location
- Sales and supplies: imports and exports, supply and demand conditions, competition
- Investment climate constraints: evaluation of general obstacles
- Infrastructure and services: power, water, transport, computers, and business services
- Finance: sources of finance, terms of finance, financial services, auditing, land ownership
- Labor relations: worker skills, status and training, skill availability, overemployment, and unionization and strikes
- Business-government relations: quality of public services, consistency of policy and administration, customs processing, regulatory compliance costs (management time, delays, bribes), informality, and capture
- Conflict resolution/legal environment: confidence in legal system, resolution of credit disputes
- Crime: security costs, cost of crimes, use and performance of police services
- Capacity, innovation, and learning: utilization, new products, planning horizon, sources of technology, worker and management education, experience
- Productivity information: employment level, balance sheet information (including income, main costs, and assets).

To date, eight ICAs have been posted on the ICA Web site. Most are conducted at the national level, although the India ICA focused on the state level. The number of firms in the sample has varied widely, in part due to the different size of the countries: from 1,032 in India to 659 in Bolivia, 576 in Peru, 223 in Nepal, 193 in Mozambique, and 98 in Bhutan. More recently (since 2003), rural ICs have been piloted in Sri Lanka, Tanzania, and Nicaragua.
Business leaders in Mozambique who were interviewed for this evaluation said, “The list was presented to government as the things that needed to be fixed. But the list was far too long—government can’t fix everything. There was no credible effort made to prioritize what needed to be fixed first and what needed to be worked on in the longer run.”

The more fundamental problem with ICAs lies in how survey information is used to derive policy recommendations. IC indicators tell the analyst, from the perspective of firms, “what hurts,” or even “what hurts the most, relatively speaking,” but not what to do about it. In other words, they provide description rather than prescription. Examples of constraints typically identified by firms include high taxes, high interest rates, and the high cost of regulatory compliance. This does not necessarily suggest that taxes, interest rates, or regulations should be reduced. Economic and social objectives—fiscal stability, monetary management, environmental protection, labor protection—are the “benefit” side of the cost-benefit analysis that needs to be done to determine the optimal policy stance (see the example in box 8.4). Survey-based instruments are not able to capture both sides of the analysis. In addition, they do not provide an understanding of the root cause of problems such as market failures.

A further implication of the difficulty of drawing policy recommendations from enterprise survey information may be that the reforms that are proposed are relatively straightforward ones, such as reducing administrative barriers (licenses, inspections, etc.). For these types of regulations it is often true that less is better, as the beneficiaries of the barriers—for example, corrupt bureaucrats or incumbent firms—are not perceived to be worthy of continuing to receive benefits. In other words, the solution to the cost-benefit question is relatively straightforward. Again using India as an example, the Bank’s work on PSD issues in Karnataka and Andhra Pradesh has focused primarily on reducing transaction costs associated with regulations and administrative procedures. None of the Bank’s adjustment loans have directly addressed rigidities in labor
markets, despite the widespread view—shared by the Bank—that labor regulations impose greater costs on companies.

**Conclusions**

The Bank’s diagnostic work on the investment climate has evolved toward greater use of enterprise surveys to provide information on the constraints to PSD as perceived by firms. The most recent version of a standardized diagnostic tool, the ICA, does a good job of benchmarking indicators of the quality of a country’s investment climate in a way that allows cross-country comparisons as well as monitoring changes in individual countries over time.

The Bank’s ESW has helped motivate many governments to adopt integrated reform strategies. Nevertheless, there are areas where more work needs to be done to provide guidance to clients as well as to Bank staff designing IC interventions. Not enough is known about good practice in institutional design, or about the dynamic process of changing institutions. It would be useful to have a typology of country situations and institutional designs that would provide guidance on which types of arrangements work where, how the change process happens, how it can be supported and sustained, etc.—in other words, an understanding of what types of institutional arrangements can be “exported” from one country to another. The Bank’s ESW has not yet provided enough of this knowledge of institutional design and the process of reform.

Feedback from clients collected for country case studies suggest that the Bank has not been focused enough or selective enough in its ESW and diagnostic work on the investment climate. Reports sometimes duplicate earlier work, and firm surveys are sometimes very similar to existing surveys conducted by governments, think tanks, or other donors. IC diagnostics sometimes do not take into account the heterogeneity of IC conditions across geographic areas (states and municipalities) and industries. In some cases, the Bank has not focused ESW sufficiently on the highest priority types of investment (for example, domestic versus foreign) or highest priority constraints (for example, labor issues). IC diagnostics often produce long lists of problems and proposed solutions, without a clear set of priorities.

Enterprise surveys provide valuable information on the perspectives of the private sector but are an insufficient basis for policy recommendations. The views of business on public policies need to be balanced with other economic and social objectives.

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**Box 8.4: The Costs and Benefits of Reforming Labor Legislation in India**

The India case study provides an example of an issue that is of concern to firms but that also has broader economic and social implications: labor regulations. Existing labor laws emanate from various acts, including the India Trade Union Act of 1926, Industrial Disputes Act of 1947, Minimum Wages Act of 1948, Companies Act of 1956, and Sick Industries Companies Act of 1985. The 1976 amendment to the Industrial Disputes Act makes layoffs, retrenchment, and closure illegal for industrial concerns with 100 or more employees except with the prior permission of the state government, which is rarely provided. The typical Indian firm reported having 17 percent more workers than it desired and that labor laws and regulations were the main reason why it could not adjust to the preferred level.

While Bank analytical work has identified labor regulations as an important constraint to PSD and asserts that changing labor legislation will have significant economic benefits, it does not present an assessment of the likely impact of reforms on labor or the broader social costs that may arise as a result of worker displacement. Industry favors the use of contract labor to avoid regulations and lower costs, but such workers are generally not afforded the same level of job security, benefits, worker safety, and other protections as those covered by labor laws. As such, greater reliance on contract labor entails social costs. The point of this example is not to question the need for labor reform, but to suggest that further analysis is needed to assess the costs and benefits—both economic and social—of policy reform.
The IC Loan Portfolio

Definition

The definition of the investment climate used in this report to compile the Bank’s loan portfolio is driven by the Bank’s sector and thematic coding system. The Bank’s Operations Policy and Country Services department (OPCS) assigns five themes to each project in the Bank’s Business Warehouse database. Each of these themes is coded as a primary or secondary objective of the project. The system allows one to five primary themes and up to four secondary themes to be assigned to each project.

OPCS and the PSD Board have defined a set of five core and five non-core IC themes, as shown in table 9.1. The numbers in the table are the theme codes used in the OPCS sector/theme coding system. Detailed descriptions of the themes are contained in Annex II.B.

To identify the IC portfolio, this report defines three types of projects:

- **Core IC projects** contain at least one core IC theme that is a primary objective.
- **Non-core IC projects** are not core IC, but contain at least one non-core IC theme that is a primary objective of the project.
- **Secondary IC projects** are defined similarly: At least one core IC theme or non-core IC theme is a secondary objective of the project.

Composition

Table 9.2 and figure 9.1 show that a large share of the Bank’s portfolio is IC lending, broadly defined. Of the 2,891 closed and active Bank projects approved during fiscal 1993–2003, 1,291 (45 percent) had IC objectives related to core or non-core themes. The value of IC projects was nearly $123 billion, representing 52 percent of the Bank portfolio. Core IC projects (those having one or more core themes as a primary objective of the project) amount to 14 percent of the Bank’s portfolio (in terms of the number of projects), and non-core IC projects another 19 percent.

IC components are often included in larger projects (e.g., regulatory reforms in macroeconomic adjustment loans), so the significance of IC lending is smaller than overall lending volumes suggest. The value of IC components (weighted by the importance of objectives using OPCS methodology) was about $55 billion, or 45 percent of the total value of the IC portfolio, and
23 percent of the overall Bank portfolio, over the fiscal 1993–2003 period.

The total value of all IC lending (core IC, non-core IC, and secondary IC) in the Bank’s portfolio experienced a significant increase in 1998–99 along with the Asian financial crisis (figure 9.1). Since then, IC lending has fallen below the levels of the early- and mid-1990s except for a spike in fiscal 2002. As a proportion of overall Bank lending, the value of IC lending has been fairly stable except for fiscal 1998–99 and fiscal 2002 (figure 9.2). These trends are similar for all IC as well as Core IC projects. Within IC lending, the share of Non-Core IC projects declined significantly (from 25 percent of the Bank’s lending in fiscal 1994–98 to 14 percent in fiscal 1999–2003) as the shares of core IC and secondary IC projects increased.

The dominant core theme in the IC portfolio is regulation and competition policy, which includes activities aimed at the elimination of monopolies, simplification of business licensing and registration requirements, reduction of barriers to FDI, development of regulatory frameworks, and enactment of competition policy (figure 9.3). However, the relative importance of this theme has declined slightly with an increase in projects aimed at other core IC themes (judicial and other dispute resolution mechanisms, legal institutions for a market economy, and corporate governance). Among non-core themes, the most important are “other financial and private sector development” and “infrastructure for private sector development” (figure 9.4). The former covers measures to strengthen institutions that support the private sector (investment and export promotion agencies, public-private consultative mechanisms); support restructuring or private enterprises, including corporate restructuring; and promote financial sector development. The latter are infrastructure projects that include components to improve sector regulation.

Increasingly, IC objectives are included as components in adjustment loans. Adjustment loans increased from 32 percent of core IC projects in fiscal 1994–98 to 38 percent in fiscal 1999–2003, compared to an average of 17 percent for all Bank projects over the entire period.

Regionally, core IC projects are concentrated in Europe and Central Asia, Africa, and Latin America and the Caribbean, with the smallest numbers in Middle East and North Africa and South Asia Regions. Compared to the regional distribution of all Bank lending, core IC projects are more heavily concentrated in Europe and Central Asia than in other regions, mainly reflecting post-transition assistance in legal and regulatory reform (figure 9.5). By income group, core IC projects are increasingly concentrated in low-income countries, more so than for all Bank projects (figure 9.6). Although core IC projects are somewhat more concentrated in countries with poor investment climates as measured by the CPIA, it is to a degree similar to all Bank projects.

### Performance

IEG-World Bank rates project performance against stated objectives and assigns ratings to the project’s outcome, institutional development impact, and sustainability. Table 9.3 shows ratings for core IC projects, averaged over fiscal 1993–2003, compared to Bank-wide averages. Over the entire fiscal 1993–2003 period, outcome ratings for core IC projects were better than the Bank average: 81 percent of core IC projects were moderately satisfactory or better.

### Table 9.1: Thematic Definition of Investment Climate

<table>
<thead>
<tr>
<th>Code</th>
<th>Theme</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core IC themes</td>
<td>Judicial and other dispute resolution mechanisms</td>
</tr>
<tr>
<td></td>
<td>Legal institutions for a market economy</td>
</tr>
<tr>
<td></td>
<td>Personal and property rights</td>
</tr>
<tr>
<td></td>
<td>Corporate governance</td>
</tr>
<tr>
<td></td>
<td>Regulation and competition policy</td>
</tr>
<tr>
<td>Non-core IC themes</td>
<td>Tax policy and administration</td>
</tr>
<tr>
<td></td>
<td>Infrastructure services for PSD</td>
</tr>
<tr>
<td></td>
<td>Other financial and private sector development</td>
</tr>
<tr>
<td></td>
<td>Export development and competitiveness</td>
</tr>
<tr>
<td></td>
<td>Trade facilitation and market access</td>
</tr>
</tbody>
</table>
compared to 77 percent for all Bank projects, and the difference is statistically significant at the 5 percent level. There was a marginal improvement in the outcome ratings over the 10-year period: 81 percent of Core IC project outcomes were moderately satisfactory or better during fiscal 1994–98, and 82 percent during fiscal 1999–2003. In contrast, the performance of the overall Bank portfolio improved significantly from 78 percent in fiscal 1994–98 to 83 percent during fiscal 1999–2003.
Figure 9.2: IC Lending, Fiscal 1993–2003 (number and value of loans)

Figure 9.3: IC Lending as a Share of the Bank’s Portfolio, Fiscal 1993–2003
in fiscal 1999–2003. Thus, the performance of the IC portfolio is declining relative to that of the Bank portfolio. The institutional development impact and sustainability of core IC projects were slightly better than the Bank average, but these differences are not statistically significant. Institutional development impact and sustainability remained nearly constant over the period. Projects targeting personal/property rights and corporate governance had somewhat higher outcome ratings than projects covering other themes, but sample sizes are small. Sustainability is rated higher in projects directed at legal institutions for a market economy and corporate governance than in the other core IC themes. Outcome ratings were lower in low-income countries than in middle-income countries (79 percent moderately satisfactory or better in low-income countries, compared to 83 percent in middle-income countries).

Figure 9.4: Core IC Themes in the IC Portfolio

Note: Data represent the number of occurrences of core IC themes in core IC, non-core IC, and secondary IC projects.

IEG-World Bank outcome ratings are assigned to the project as a whole, so the outcomes of individual project components may differ from the overall rating. To check this, IEG-World Bank evaluations were analyzed for 86 completed Core IC projects with significant and correctly coded IC components. The outcomes of the IC components of these projects were examined to determine whether their performance was relatively the same, better, or worse than the overall project. For 80 percent of the projects, the performance of the IC component was the same as the overall project. For the 20 percent that differed, most (15 out of 17) performed worse than the overall project.

Various factors are associated with the worse performance of IC components:
Figure 9.5: Non-Core Themes in the IC Portfolio

Note: Data represent the number of occurrences of non-core IC themes in core IC, non-core IC, and secondary IC projects.

Figure 9.6: Share of Core IC Projects by Region

IC components form a small part of the project: IC components seem to perform worse than the overall project primarily when these components do not constitute the main objective of the project and/or account for a relatively small percentage of project costs. In adjustment operations, IC components are often overwhelmed by macroeconomic adjustment objectives and conditionality; similarly, in investment operations, IC components are often a minor part of the project. Outcomes were more likely to be poor when IC components were not linked with the rest of the project. In Indonesia’s Land Administration Project, there was little interaction between the component involving land management policies and much of the rest of the project.

**Table 9.3: IEG-World Bank Ratings for Core IC Projects, Fiscal 1993–2003**

<table>
<thead>
<tr>
<th>Outcome (moderately satisfactory or better)</th>
<th>Institutional development impact (substantial or better)</th>
<th>Sustainability (likely or better)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Percent</td>
<td>Number of rated projects</td>
<td>Percent</td>
</tr>
<tr>
<td>Core IC</td>
<td>81</td>
<td>210</td>
</tr>
<tr>
<td>Judicial/other dispute resolution</td>
<td>79</td>
<td>14</td>
</tr>
<tr>
<td>Legal inst. for market economy</td>
<td>88</td>
<td>58</td>
</tr>
<tr>
<td>Personal/property rights</td>
<td>91</td>
<td>11</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>80</td>
<td>10</td>
</tr>
<tr>
<td>Regulation &amp; competition policy</td>
<td>81</td>
<td>185</td>
</tr>
<tr>
<td>Overall Bank portfolio</td>
<td>77</td>
<td>1,366</td>
</tr>
</tbody>
</table>

Note: The number of rated projects is not the sum of projects listed by theme, because a project can have more than one theme. For this reason the average ratings for Core IC projects is not a weighted sum of ratings for individual themes.
and the rest of the project, limiting the component’s success.

- **Insufficient supervision:** Related to the above, in some cases the IC components received less attention during supervision than other larger components of the project. In Hungary’s Product Market Development Project (P008482), Bank supervision inputs were much less than planned, and the skills mix of missions was inadequate to oversee the objectives of reducing distribution costs and increasing competitiveness, which may have contributed to their partial attainment and marginal impact.

- **Lack of government ownership and commitment:** In Madagascar’s First Sector Adjustment Credit (SAC I, P001582), lack of government ownership contributed to the slow implementation of reforms for promoting competition in the petroleum and telecommunications sectors. Progress in the land management policies component of Indonesia’s Land Administration Project (P003984) was limited by the failure of the government to remain substantially engaged. In Romania’s PSAL (P064853), the government amended the law for bankruptcy reform, but follow-up action remained pending at the end of the project. In Russia’s Privatization Project (P008810), significant outcomes included institutional strengthening of the Anti-Monopoly Committee and Bankruptcy Agency and adoption of a new bankruptcy law, but weak enforcement, poor incentives, and remaining legal loopholes continue to undermine their impacts. In the China Telecom Project (P003633), the government did not sufficiently address the legal and institutional environment that impeded private sector involvement in the sector.

- **Complex or ambitious project design** seems to make it more likely that IC components will underperform, even if the complexity does not pertain to the IC components themselves. Under Uganda’s Financial Sector Adjustment Credit (FSAC, P002962), a new law related to capital markets was passed, but institutional reforms proved more difficult during appraisal, partly due to an ambitious project design. At the close of Thailand’s Second Economic and Financial Adjustment Loan (EFAL II, P058536), the cabinet of ministers had not approved the framework for accounting and auditing standards and the draft legislation to improve competitiveness in the economy. The government considered the reform program extremely complex, deterring from clarity and overburdening its capacity.

- **Underestimating political and social readiness:** A lack of broad political and social support has inhibited the performance of IC components. In Malawi’s Second Fiscal Restructuring and Development Program (FRDP II, P045030), the privatization of agricultural marketing was on hold and little progress was seen in developing land markets due to complex underlying social and political factors. A turbulent social and political situation made consensus difficult in Indonesia’s Land Administration Project (P003984). In Indonesia’s Second Public Sector Reform Loan (PSRL II, P060258), political interference and allegations of corruption contributed to slow implementation of commercial court and bankruptcy law intended to improve governance and transparency. Moldova’s Rural Finance Project (P035781) did not succeed in establishing an efficient and sustainable financial system, and in the absence of any significant savings mobilization—which is due to low beneficiary participation—the system has evolved into a group lending operation rather than a savings and credit system. Under Uganda’s FSAC (P002962), institutional reforms following the passage of a new law relating to capital markets proved difficult due to resistance to reform.

- **Overestimating institutional capacity:** IC components were adversely affected by a lack of broad institutional capacity. In Romania’s Program Adjustment Loan (PAL, P064853), weak institutional capacity in the audit field undermined efforts to bring accounting standards in line with international accounting standards. Computerization of the customs department and installation of public sector information systems failed in Georgia’s Institution-Building Project (P008413), mainly because the broader institutional and cultural envi-
environment was not conducive. In Guyana’s Financial Sector and Business Environment Project (P034605), the new private sector investment promotion agency was not effective in simplifying the numerous government rules and regulations that severely limited investment and was remiss in providing critical information on its services to investors.

Conclusions
Projects with IC objectives account for a large share of the Bank’s lending portfolio. Projects that have core and non-core IC themes as primary or secondary objectives account for 45 percent of all Bank projects over fiscal 1993–2003, and 52 percent of project value. Core IC projects (those that have one or more of the five Core IC themes as a primary objective of the project) account for 14 percent of all Bank projects. However, the value of IC components is usually less than the total loan amount, averaging 50 percent of value for the core IC portfolio.

With the exception of the expansion in lending during the fiscal 1998–99 Asian financial crisis, the Bank’s lending for IC reforms declined slightly until fiscal 2000 and has increased since then, with a significant spike in fiscal 2002. As a proportion of total Bank lending, however, IC lending has remained fairly stable. Within the IC portfolio, core IC topics have increased relative to non-core topics; within core topics, various regulations and competition policy are the most common objectives. Of non-core themes, infrastructure for PSD and other PSD and finance sector projects are most common.

Regionally, the Core IC portfolio is concentrated in Europe and Central Asia, Latin America and the Caribbean, and Africa; 87 percent are in low- or lower-middle income countries. Increasingly, adjustment loans are the instrument of choice, rising from 23 percent of core IC projects in fiscal 1993 to 31 percent in fiscal 2002. Although core IC projects are somewhat more concentrated in countries with poor investment climates as measured by the CPIA, it is to a degree similar to all Bank projects.

Over the entire fiscal 1993–2003 period, core IC projects performed better than the Bank average: 81 percent of core IC project outcomes were moderately satisfactory or better, compared to 77 percent for all Bank projects. Although this performance improved slightly over the period, the improvement was less than for the Bank-wide portfolio. Thus, the performance of the IC portfolio is declining relative to the Bank-wide average. Moreover, when the outcomes of IC components differ from overall project outcomes, they are often worse. A number of factors contribute to disappointing outcomes: apparent lack of attention and supervision when IC objectives are a minor part of larger projects; lack of government ownership and commitment; complex or overly ambitious project design; lack of overall institutional capacity; and political or social factors that were underestimated at project appraisal.
Implementation and Outcomes at the Country Level

Five country case studies were conducted for this evaluation—for Indonesia, Romania, India, Mozambique, and Peru—covering Bank lending and nonlending activities over the fiscal 1993–2002 period.

Annex II.E contains brief summaries of the case studies and Annex II.A describes the evaluation protocol. This chapter presents the main findings and lessons derived from these case studies with respect to the implementation, outcomes, and sustainability of investment climate reforms. It summarizes what worked and what didn’t, the factors that led to success and failure, and lessons that can be generalized to the Bank’s IC activities. The chapter begins with a brief characterization of each of the countries and the IC strategy the Bank pursued.

Typology of Countries

**Indonesia: Crisis Drives the IC Agenda**
The 1990s were divided into two periods by the East Asia financial crisis, which began in July 1997 with the devaluation of the Thai bhat. In less than two months, Indonesia’s currency depreciated 75 percent against the dollar; the gross domestic product (GDP) fell by 13 percent in 1998. The proximate causes of the crisis were the rapid increase of unhedged short-term private external debt before 1997 and shortcomings in the banking system. The country’s chronically weak institutions, endemic corruption, and political instability amplified the financial crisis because no credible arrangement to deal with the crisis decisively and fairly was offered to restore investors’ confidence. An enterprise survey conducted in 2000 suggested that macroeconomic and policy instability and uncertainty were the leading concerns of Indonesian firms.

Before the crisis, Bank assistance for the investment climate dealt with protecting property rights, facilitating an efficient land market, and developing the accountancy profession. Analytical work emphasized trade and domestic regulations, improving governance, reforming the legal system, privatization, and land administration. After the crisis, the focus of the Bank’s lending operations shifted to macroeconomic stabilization and bank and corporate restructuring.

**Mozambique: A Poor Country with Little Local Capacity**
Despite fast growth during the 1990s, Mozambique remains one of the poorest countries in the world. Per capita income was only $200 in 2001, about 40 percent of the average for Sub-Saharan Africa. Adult literacy is...
only 56 percent, and there is an acute shortage of highly educated workers.

Beginning in the late 1980s and accelerating after the 1992 peace agreement, extensive policy reforms improved macroeconomic management; liberalized prices, exchange rates, and trade; privatized public enterprises; promoted financial deepening; and improved public investment. Even with the progress on first-generation reforms, Mozambique began the 1990s with an extremely poor investment climate. Incentives, institutional arrangements, governance stability, and physical infrastructure had to be either fashioned from whole cloth or rehabilitated. Added to this, a transition from plan to market had to be engineered in the context of the postconflict recovery.

The Bank’s strategy during the 1990s moved from a first-generation set of macroeconomic reforms to second-generation reforms aimed at removing microeconomic barriers to investment stemming from antiquated laws and regulations, inefficient administrative capacity, and corruption.

**Romania: IC Reforms Motivated by Opportunity**

In the early years of transition, a flurry of reform activity was undertaken to promote a more open market economy. But most of the 1990s was characterized by economic and political instability; half-hearted reforms undertaken by successive governments resulted in a weak supply response from the economy. Both domestic and foreign investment were weak, there was little growth, and poverty continued to rise.

The end of the 1990s was a watershed for Romania. Low growth and macroeconomic instability brought governments to office that were committed to reform. Government commitment was “pulled” by opportunity: the prospects of North Atlantic Treaty Organization (NATO) membership and integration with the EU.

The Bank’s assistance during 1999–2002 showed a stronger focus on the investment climate. Recent projects focused on institutional reforms critical for PSD, including the reform of the legal environment for business, the reduction of regulatory burdens, and secured transactions reform to facilitate collateralization of assets for loans.

**India: IC Constraints at the State Level**

India’s economic reforms in the 1990s raised GDP growth to almost 6 percent annually between 1993 and 2003, fueled in part by external debt. Living standards improved markedly, and the number of people living below the national poverty line declined from 45 percent in the 1980s to 25 percent in 2002. Foreign direct investments and portfolio investments responded strongly to the first wave of reforms, and have fluctuated around $6 billion per year. While progress was substantial, economic performance has fallen below the target set by the central government in the years after liberalization—partly due to persistent and growing fiscal deficits, inadequate infrastructure (particularly power), and institutional constraints on private investment. The most important IC constraints are bureaucratic red tape and administrative procedures, inflexible labor markets, persistent trade protection, and lack of access to financing.

IC conditions vary significantly across different states and even within states. The Bank’s recent ICA for India shows that Maharashtra and Gujarat are perceived by firms to be the “best climate” states; Tamil Nadu, Karnataka, and Andhra Pradesh are “good climate states,” Delhi and Punjab are “medium,” and Kerala, West Bengal, and Uttar Pradesh are “poor climate states.” That entrepreneurs actually act on these perceptions can be seen in the investment rates for these states.

Beginning in the mid-1990s, the Bank began to focus greater attention on working with states that were strongly committed to reform. The Bank’s activities have supported broad packages of state-level reform efforts as well as sector-specific programs in power, water, transport, health, and education.

**Peru: Progress in Some Areas, Reversals in Others**

When President Fujimori was elected in 1990, Peru was verging on total disintegration. Hyperinflation, multiple exchange rates, the nationalization of the banking system, and a
A vicious terrorist movement had resulted in economic collapse. The government embarked on a comprehensive economic reform program that introduced market mechanisms into every sector of the economy. The response to these reforms was a surge in growth over 1993–7, a decline in inflation, buoyant foreign investment, and a fall in poverty.

During Fujimori’s second term, however, conditions deteriorated. External shocks, the El Niño effect, and reversals in the reform program all served to weaken the economy, increase uncertainty, and damage the investment climate. A new government was elected in 2001, promising to improve the economy and eradicate government corruption. However, confidence in the new government began to erode almost immediately, and the government has changed its stance on several important issues in response to public opinion. Attitude surveys indicate that the business community does not have confidence in the government, which it views as unstable and anxious to appease populist sentiment at the expense of continuing reform. The result has been a sharp decline in investment.

The Bank has undertaken a series of PSAs since the mid-1990s, but CASs during the 1990s did not focus on IC issues. This changed with the 2002 CAS, which increased the stress on institutional projects, particularly to continue property rights efforts and to modernize the judicial system.

Lessons Learned

IC reform is often driven by crisis or opportunity.

Decisions by policymakers to take measures necessary to improve the investment climate are often motivated by urgency: on the negative side by crisis (macroeconomic, financial, political) or on the positive side by opportunity (the prospect of joining regional trade agreements, taking advantage of new technologies). The Bank has been successful in supporting reforms in both of these situations.

In Indonesia, the motivation was a negative one: the Asian financial crisis that began in 1997. Before the crisis, Bank reports consistently pointed out several structural weaknesses that could impede future private sector-led growth. To overcome these weaknesses, the Bank recommended good macroeconomic management, strengthening the financial sector, reducing international and domestic trade barriers, facilitating private investment, improving governance, reforming the legal system, improving land administration, and reducing excessive state ownership of productive assets. However, when Indonesia was perceived to be performing well and not in need of Bank resources, the Bank lacked leverage with the government to move it toward implementing structural reforms. The Bank’s usually strong influence with government “technocrats,” who had a voice in policy formulation and implementation, was muted during this period, perhaps because the reforms were politically difficult and did not seem critical for Indonesia’s growth.

During the crisis, the Bank had substantial leverage and influence despite frequent changes in governments. The Bank supported macroeconomic stabilization, bank and corporate debt resolution, and structural reforms including competition policy and governance and justice system reforms. Many of the structural reforms recommended by the Bank before the crisis became required policy actions in adjustment loans immediately following the crisis.

Political stability began to recover after the election of President Sukarnoputri. In the new political arrangement, the Soeharto-era “technocrats,” with direct access to the president for decisions, have been replaced by inexperienced politicians with diverse interests and without clear decision rules or hierarchy. Decentralization has further complicated the decision process and created complications for the investment climate. With so many new players and diverse interests vying for decision authority, the Bank’s ability to influence policy has been reduced. While the investment climate has not improved very much, the Bank’s activities have probably prevented it from deteriorating. Eventually, these reforms are likely to improve Indonesia’s investment climate, especially for foreign investment but also for...
domestic investment. For the future, because the Bank has less leverage and influence with the government than during the crisis, it will have to adopt a strategy that is appropriate to the new political landscape and will need to persevere for a longer period to achieve its objectives.

The Indonesia case study offers lessons for Bank strategy and activities in countries where it has less leverage—in large countries where the economy is stable and growing, in democratic countries governed by a coalition of parties in which the decision process is diffuse and complicated, and/or when decisions formerly made by central government are devolved to regional and local authorities. In these countries, stakeholders determined to improve the country’s investment climate play a critical role. The Bank should be prepared to pursue IC reforms directly with several layers of government and indirectly through stakeholders. The Bank should be prepared to exercise patience and persist for long periods to achieve its policy reform objectives.

The Bank’s IC strategy in Romania during the 1990s can be divided into two periods. The early years (1992–98) focused on the movement away from a planned economy to one in which markets determined resource allocation and investment. Macroeconomic imbalances were a major concern. The second period, which had its genesis in a major economic crisis in 1999, was characterized by a much stronger dedication by the government to promoting the private sector as well as a rededication to the reform effort in general. The new government that came into power in mid-2000 adopted an economic program for 2001–4 with the goals of stimulating economic growth, reducing poverty and unemployment, combating corruption, and speeding up EU integration and NATO membership.

Preparation of the PSAL provided an example of how high-quality analytical work and good collaboration among Bank Group units along with other donors can lead to high-quality lending operations. FIAS prepared an Administrative Barriers to Investment report with recommendations encompassing regulatory reform, corruption, company and tax registration, foreign exchange, property rights, standardization, employment, land and site development, and customs and international trade. Based on these recommendations, the government approved an action plan in September 2001 that is now being used to improve the investment climate. The government established an implementation group with broad representation from the Chamber of Deputies, the Chamber of Commerce, nongovernmental organizations, the business community, importers and exporters, and other members of civil society. The Bank worked closely with other donors (International...
Monetary Fund, EU, European Bank for Reconstruction and Development, and bilateral donors), which resulted in the transmission of a consistent message to the government.

The combination of the “push” of macroeconomic crisis, the “pull” of EU accession, the coordinated support of donors, and efforts to build broad support seem to be having a positive, though gradual, effect on the investment climate in Romania. One area of achievement has been increased access to credit as a result of secured transactions reform (box 10.1).

**The Bank’s analytical and advisory work has been key to motivating reform.**

Successful Bank interventions usually have started with high-quality analytical work that provided the policy framework for lending operations. The Bank’s analytical work has often helped to accelerate the process of reform.

In Romania, a comprehensive set of policy recommendations emerged from the FIAS administrative barriers study and other ESW. Based on these recommendations, the government approved an action plan that is now being used as a roadmap for measures to improve the investment climate. Several of those interviewed indicated that the priority given to the investment climate by the government has been a result of the Bank’s enterprise surveys and analysis. Businesspeople and representatives of business groups report that the investment climate is considerably better than it was a few years ago—for example, in the effort required to register a business—and that the involvement of the Bank contributed to this outcome.

### Box 10.1: Romania: Secured Transactions Reform

In 1999 the Bank approved two private sector development loans for Romania: the first PSAL and an accompanying technical assistance loan, the PIBL. One of the most important components of the PIBL was secured transactions reform. The first phase of the project supported the implementation of a Law of Secured Transactions, which was drafted with the support of the Bank. The law incorporated provisions that permitted movable property, both tangible and intangible, to serve as collateral for loans. The second phase of the project involved setting up the filing archive to permit the law to operate by recording pledges of property and establishing priority regarding which creditors have the first rights to repossess and sell the collateral in the event of default. The secured transactions framework had several innovations:

- The law abrogated all existing legislation affecting debt, so that there was no danger of ambiguity regarding the validity of pledges.
- The filing archive in which pledges are recorded is run by an association of lenders, so that the public sector is not involved. It is electronic, and priority is determined by the time when pledges are recorded.
- No documents are necessary to file a security interest. This allows Internet-based filing; this system is currently the only filing archive in the world to have this feature. The result is broadened coverage, especially in the rural areas, and reduced costs.
- No notaries are involved in the process.
- Repossession takes place outside the court system. If repossession is not disputed, the creditor can simply collect the pledged property. In the event of a dispute, upon evidence of the validity of the debt, an officer of the court can seize the pledged property without the necessity of a court hearing. Harsh penalties for wrongful repossession discourage creditors from abusing the system.

The impact of the law on lending has been dramatic. In the 18 months since the reform was implemented, there have been more than 400,000 loans against which security interests have been registered. More than 100 banks have registered security interests in the filing archive. As there are only 38 licensed banks in Romania, the implication is that scores of non-Romanian banks have been lending in the country against collateral and registering their security interests.

Of the security interests that have been registered and are current, nearly 20 percent represent non-bank-secured loans. This is especially beneficial in rural areas that do not have bank offices. In addition, the geographic coverage has been extensive: There have been filings of security interests in 42 of Romania’s 43 counties. In rural areas, credit has been granted against diverse assets including cows and tractors.
In **India**, the Bank made an important contribution by focusing attention on specific issues, while placing them within a broader context. According to government officials involved in the reform process, the Bank helped sensitize the government to the gravity of the problem. The Bank drew attention to the significant cost of not reforming in terms of the ability of the government to address social needs within the states. Those interviewed highlighted the ability of the Bank to present recommendations in terms of an integrated strategy that reflected the significant interactions among different issues faced by the states. Government officials in Karnataka acknowledge that, while the need for regulatory and administrative reforms was broadly recognized within the government, efforts to implement them were sporadic and uncoordinated before the Bank’s analytical work and adjustment operations.

Interviews conducted for several of the country case studies suggest that clients would appreciate even greater emphasis on analytical and advisory work. In **Peru**, government officials indicated that they would like more sector work and technical assistance on IC and financial market issues: “The international financial institutions are becoming more like commercial banks. We ask for advice and they give us money,” one senior government official complained.

**IC conditionality has been important in strengthening the hand of reformers.**

It is important to recognize that a country’s government is not monolithic. At any time, there are individuals within the government—top political leaders, senior government bureaucrats, party officials, and various formal and informal advisors—who will support certain reforms and others who will oppose them. The Bank’s loan conditionality played an important role in the political economy of reform in several case study countries by strengthening the hand of reform-minded policy makers and other stakeholders against those opposed to reform.

In **Romania**, many of those interviewed for this evaluation felt that the Bank’s conditionality has been important in helping reformers get their programs adopted, particularly during the latter part of the 1990s and early 2000s. Conditionality and the need for Bank financing helped prevent backsliding on reforms.

In **India**, the Bank supported investment climate reforms in the states of Karnataka and Andhra Pradesh with state-level adjustment loans. All of these loans contained up-front triggers requiring the state government to take specific actions before loan approval and effectiveness. The adoption of triggers helped ensure the achievement of agreed actions. In Karnataka, the adoption of triggers related to deregulation contributed to the reform effort. The triggers were developed after extensive discussions between Bank staff and government officials. Once in place, they helped ensure that actions were taken by the government even if some groups were opposed to particular reforms, recognizing that the loan might be jeopardized by failure to make adequate progress.

**Local champions often initiate reforms, but broad support is needed to sustain them.**

It is important to have the backing of key politicians to spur reform. However, while much attention is paid to the role of senior political leaders, other stakeholders—professional civil servants, business groups, and the general public—are critical to sustaining reforms.

In Karnataka and Andhra Pradesh (India), political leaders were elected on a reform agenda and took steps on assuming office to institute policy and institutional reforms. The Bank elected to work with these states precisely because officials demonstrated that they were willing to tackle pressing fiscal, governance, and administrative problems. Government officials and business leaders interviewed spoke of their concern over whether reform efforts could be sustained in the event of changes in political leadership. Lacking a strong institutional basis and grass-roots support, the reform agenda is in danger of facing difficulties in the event of electoral shifts. Many people pointed to the need to build support for reforms outside of government. It was suggested that there is a need for strong business associates at the state
level with the capability for careful, objective analysis and the ability to voice concerns in the corridors of government and the court of public opinion.

The Mozambique case study indicates that the Bank did not work vigorously enough to build commitment in the government to manage and implement the reform process. The 1997 Action Plan for reform of administrative barriers was not thoroughly discussed by all the relevant ministries and agencies, nor did the government formally endorse it. The lack of ownership, support, and participation by the respective stakeholders resulted in poor implementation.

**Institutional issues are key.**

The literature review for this evaluation provides evidence that cross-country differences in the quality of institutions explain a large share of the differences in growth, and may even “trump” other growth determinants. The case studies provide examples of countries where the Bank paid insufficient attention to institutional weaknesses and as a result had little impact on the investment climate.

Although the Bank has done much to improve the financial sector in Mozambique, little has been done to address institutional weaknesses that continue to hamper lending to the private sector and investment in equities. Interviews called attention to three important areas where business leaders say the Bank should have been more involved in financial sector reform during the decade: improving financial information, improving contract enforcement mechanisms, and improving the land law and movable assets law to increase the private sector’s collateralizable asset base. It was argued that the Bank’s lack of attention to the underpinnings of financial markets—such as accounting standards and skills—is one of the reasons for continued high interest rates and lack of access to credit.

Bank activities have supported programs in the legal area, but enforcement problems continue to cause banks to require more than 100 percent collateral for most loans.

During the second half of the 1990s, Bank activities in Romania strongly supported efforts to strengthen the country’s nascent institutions to improve the investment climate. Many of these efforts have been successful (for example, secured transactions reform), but others have been less successful because of institutional factors. In contrast to moveable property, the legal status of fixed property (land and buildings) remains unsatisfactory, and the problems are especially difficult in rural areas. The focus of the General Cadastre and Land Registration Project was on technical mapping—rather than ensuring that property owners receive a registered title—and has resulted in little change in the land market. Both domestic and foreign investors continue to complain that uncertainty over land ownership has caused delays and cost increases in investment projects. In some cases, planned investments have been cancelled. The Bank supported changes in the legal framework for business under the PSAL and PIBL, but there was insufficient focus on the institutions necessary to enforce the laws. As a result, the legal system remains weak, and governance is poor.

In Peru, contract enforcement remains lengthy and costly. Businesses still view the legal system as almost irrelevant—they usually confine transactions to those they know well. In surveys of Peruvian businesses, the overwhelming majority claimed that the court system did not adjudicate disputes impartially, delays were long, and judges were untrained in commercial law and open to influence.

IEG-World Bank’s recent Project Performance Assessment Report on three PSD projects in Guyana provides an illustration of Bank efforts to improve the investment climate in a low-income country. The assessment concluded that the Bank did not have a realistic understanding of the structure of institutional dynamics and incentives, the governance context (including a recognition of the implications of the ethnic divide between citizens of African and Indian descent), and management capabilities. As a result, all three projects failed to anticipate the risks of weak ownership, rent seeking, and poor management, which severely constrained the effectiveness of the projects.
The implementation of reforms can get bogged down at lower levels of bureaucracy if incentives haven’t changed.

Professional civil servants are key to the success of reform efforts. The responsibility for the implementation of regulatory and administrative reforms often runs across a large number of government agencies and departments. Senior civil servants must understand, support, and assume ownership of reforms.

Bank investment climate activities in Mozambique beginning in 1996 made relevant contributions to the process of removing microeconomic impediments to investment. FIAS Administrative Barriers to Investment studies (1996, 2001) and ICAs (1997, 2002) helped to identify the reform agenda. To improve private sector capacity to analyze and lobby for reforms, the Bank supported the formation and early operation of the Confederation of Mozambique Business Associations. To improve government capacity to analyze and implement reforms, the Bank provided assistance to establish a private sector development unit in the Ministry of Industry and Commerce, and provided technical assistance to the unit to work with the private sector on administrative and regulatory changes. To facilitate a continuing dialogue between government and business concerning investment climate reforms, the Banks supported an annual private sector conference.

These efforts, though modest in financial terms, helped the government make some improvements in administrative procedures and laws and regulations governing investment. But business leaders interviewed for this evaluation stated that the reforms undertaken to date are far from sufficient to ease the prevailing administrative and regulatory constraints to investment. Reforms require more than rewriting legal and regulatory frameworks. They must be coupled with capacity building to address weaknesses of executing agencies, and efforts to build political consensus and commitment by government leaders to adopt and implement required reforms. And even when there was a desire at the highest levels of government to reform administrative barriers to investment, this desire was not manifested into a shared vision or commitment adopted by all political parties, responsible ministries, and executing agencies. Reform implementation problems partly stemmed from the overlapping structure of government institutions and lack of clarity on responsibilities and accountability. But there also existed a widespread “passive resistance” from unmotivated executing agencies and officials, and corruption at all operational levels. These problems could not have been solved by reforming investment procedures alone—they required complementary civil service reform.

Indonesia’s legal and judicial system has been viewed for decades as unreliable about enforcing rights or resolving disputes. The government initiated a series of reforms since the Asian financial crisis, but follow-through has been disappointing and pessimism has grown about the pace of reforms. A recent assessment by the United Nations Special Rapporteur suggested that progress was poor. Political will to push through the reforms is lacking, and corruption in the institutions that enforce the laws has not been tackled. Indonesia’s political and economic elite benefit from the existing corrupt system and are not eager to change it. Without a powerful constituency, legal and judicial reforms have had limited impact.

The India case study concluded that legal and regulatory reforms should have been supported by efforts to build the capacity of relevant institutions. Most of those interviewed voiced concern about the extent to which reforms had been institutionalized. The concern related less to the particulars of laws and regulations but more to the mindset and capabilities of government agencies and departments. In particular, people cited both problems with lower-level officials and the need for training.

Finally, in Romania, the General Cadastre and Land Registration Project was designed to address the lack of an effective land market that has been identified as an issue throughout the 1990s. The project was intended to support a unified system of land registration in the country, establish a cadastre system to provide up-to-date and unambiguous definitions of existing real estate parcels for land registration, institute a
low-cost and reliable method for land transactions, and facilitate collateralization of this more fundamental and widespread asset. However, the outcome of the loan has been disappointing, in part because judges handling land issues were underpaid, many were unmotivated, and there was evidence of corruption in the system.

Modest, piecemeal efforts are less successful than a “big push” of reforms.

Bank activities in Mozambique have made relevant contributions to the process of removing microeconomic impediments to investment. But business leaders interviewed for this evaluation state that reforms undertaken to date are far from sufficient to ease prevailing administrative and regulatory constraints to investment. They felt that the Bank’s support has been too modest, too piecemeal, and too inconsistent to get the job done. They stressed that, if the Bank were really serious about increasing the pace and scope of these types of reforms, it should have developed a program with the government to make a “big push” to get the necessary changes, as in its adjustment lending for macroeconomic reforms, rather than the “partial program” it put together.

The Bank’s early focus on investment climate issues in Peru was apparent in a series of high-quality analytical reports throughout the 1990s. In fact, many of the later reports identified issues that had been raised in earlier reports: regulation, policy uncertainty, infrastructure, a weak judiciary, underdeveloped financial markets, and poorly protected property rights. Despite successive CASs that established PSD as a priority, a comprehensive strategy for doing this was not prepared. Although critical constraints to PSD had been identified in ESW, they were not pulled together into a cohesive IC action plan. Partly as a result, there has been progress on some IC issues but little or no progress in others.

Conclusions

The country case studies conducted for this evaluation show that investment climate reforms are usually motivated by factors external to the Bank—either by economic or political crisis, or by the prospect of joining regional agreements—but that the Bank has helped governments push reform primarily through its intellectual contributions. Lending conditionality has also helped the process of reform by strengthening the hand of reformers and preventing backsliding. Even in poor, low-capacity countries, the Bank can make progress if the government is committed to reform.

Where results have been disappointing, they have mainly resulted from a lack of implementation of the laws and regulations adopted under Bank-supported reform efforts. Often the Bank has not understood or paid sufficient attention to institutional issues, for example, the skills and incentives that determine the behavior of authorities charged with implementing the reforms. The process of changing institutions takes time, and getting institutions right is highly country specific.

Local champions often drive reforms, but broad support is needed to sustain them. The Bank has been more effective when it used its convening and coordinating role to build support among various segments of society, and engaged in a continuing dialogue with both the public and the private sectors.

In some countries, the Bank’s support has been too modest and piecemeal to make a significant difference in the quality of the investment climate. When the critical constraints to private sector development are pulled together into a cohesive action plan, IC outcomes have been better.
Organizational Issues

Responsibility for the Bank’s IC operations is spread across the institution. IC lending operations in the regions are primarily managed by Finance and Private Sector Development, PREM, and Infrastructure units.

The sector units in the Regions are organized somewhat differently: in some, Infrastructure is combined with Finance and Private Sector Development, and in others Infrastructure is separate; in the East Asia Region, financial sector and private sector development is part of PREM, but in the other regions it is outside of PREM.

The central “anchor” for the investment climate is the Investment Climate Department of the joint World Bank-IFC Private Sector Development Vice Presidency. In this department are three joint Bank-IFC units: FIAS; the Monitoring, Analysis, and Policy Unit in charge of the Doing Business Projects; and the Investment Climate Unit (CICIC), in charge of network responsibilities and the ICA initiative. The PSD Vice Presidency is led by a Bank-IFC Vice President who is also the Chief Economist of the IFC.

Since its creation in 2002, CICIC has focused on the development of standardized IC diagnostic instruments—ICAs and the Doing Business Project. The ICAs have been implemented by the Regions with budget and technical support from CICIC. Planning and quality control of the ICA program is under the management of the PSD Sector Board.

The wide-ranging “ownership” of the Bank’s IC portfolio is apparent in the assignment of projects to individual networks and sector boards. In fact, more core IC projects are assigned to non-PSD networks (particularly Infrastructure, PREM, and Financial Sector) than to PSD. Only 17 percent of core IC projects were managed by the PSD Sector Board over fiscal 1998-2003 (table 11.1). The PREM share of core IC projects has increased over the past 10 years. The PSD Board manages even fewer of the non-core IC projects, since most of the “infrastructure services for PSD” projects are handled by the Infrastructure network, “tax policy and administration” by PREM, and “other financial and private sector development” by the Financial Sector network. ESW on investment climate issues is similarly spread across a wide range of networks.

Discussions with clients and staff conducted as part of this evaluation identified a number of specific organizational issues that have affected the quality of the Bank Group’s work on the investment climate. They concern the division of labor across sector units within Regions; the respective roles of the Regions versus central units; and the roles of the Bank and IFC.

Within Regions, linkages among sector units on IC issues have been weak. With the exception of the East Asia Region, PSD and PREM are separate departments that compete to some
degree for the PSD agenda. In many regions (for example, Europe and Central Asia and increasingly Latin America and the Caribbean), first-generation reforms are no longer the focus of country assistance strategies, either because macroeconomic stability has been restored or because the solutions to macroeconomic problems are well known. Along with the shift toward second-generation reforms in CASs, PREM has taken more responsibility for covering microeconomic and institutional topics and including them in adjustment loans, which are often managed by PREM staff. It is not surprising that the competition between PSD and PREM units has become pervasive and has led in some cases to a lack of coordination and information sharing.

The lack of coordination between PSD and PREM on IC operations has been a problem because of the need to integrate macroeconomic and microeconomic concerns. The burden of integrating different sector perspective and setting priorities now lies with the Country Departments—but some country departments have been more actively involved in managing this integration than others.

The broad nature of the IC topic—and the need to balance private sector interests with broader economic and social goals—requires the Bank to have an organizational structure that facilitates integration across sectors and collaboration among staff. Recently, the joint World Bank-IFC Private Sector Development Vice Presidency has undertaken to improve coordination and reap synergies in IC work across the WBG, for example by holding WBG-wide country review meetings and conducting WBG-wide training in the field.

A second issue has been the role of central units compared to the Regional units. Currently, CICIC is mainly involved in designing and supporting the implementation of IC diagnostics—the task of collecting descriptive information on the investment climate. As mentioned in previous chapters, the Bank’s knowledge in some areas—“best practice” institutions, the political economy of reform, and how to facilitate indigenous reform processes—seems to have been lacking. This suggests that the anchor could take a larger role in building and disseminating knowledge in these areas.24

The third issue deals with the respective roles and comparative advantages of the Bank and IFC (and to a lesser degree MIGA) on IC activities. This issue is discussed in Chapters 1–4 of this report.

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### Table 11.1: Network Assignment of Core IC Projects

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<td>Infrastructure</td>
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<td>Financial Sector</td>
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<td>7</td>
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<td><strong>100</strong></td>
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24
1. Pay more attention to institutions and the political economy of reform.
   a. Do more analytical work on institutional arrangements and the political economy of reform, involving local organizations. This could include (i) a guidance note with a typology showing what types of institutional arrangements work in different country circumstances; (ii) assessments of a country’s institutional capacity constraints, incentives, barriers to changing behaviors, and training needs, to help design IC assistance and monitor progress; (iii) country case studies of IC reform successes and failures to gain a better understanding of how reform processes are motivated and sustained, and the role of different stakeholder groups.
   b. Be less timid in dealing with vested interests and in building a balanced constituency for reform. Make better use of the Bank’s convening power to bring the government together with the business community, as well as with consumer and labor groups and local think tanks.
   c. Be more proactive in disseminating information—on IC constraints, the country’s reform agenda, the implementation of laws, the achievement of specific targets, and lessons from the reform experience of other countries. The Bank could facilitate research by academics by ensuring better access to IC data and research results.
   d. Make a stronger push for transparency and openness—to help create political will where it is weak, to enlist local oversight of potential government inefficiencies and abuses, and to improve the investment climate itself.
   e. Ensure that Bank staff develop a deep understanding of and sensitivity to country-specific political and business cultures, as well as key features that define the relationships between business and government.

2. Improve the focus and use of survey-based diagnostics.
   a. Focus ICAs on specific country needs. Make greater use of existing material and collaborate with other donors doing similar things to avoid duplication of effort.
   b. Take into account the heterogeneity of investment climate conditions by targeting diagnostic assessments on subnational geographic areas or individual industries.
   c. Recognize that enterprise surveys represent only the views of the business community. Use survey-based diagnostics only as an input to making policy recommendations to balance business perspectives with broader economic and social concerns.

3. Do a better job of prioritizing and packaging IC reforms in lending operations.
a. Give high priority to reforms that will build political and civil society commitment to continue the reform process—by focusing on problems that, if fixed, would have immediate positive impacts.
b. Consider packaging a critical mass of microeconomic reforms and components (including civil service reform and training of public officials) into IC-focused adjustment loans, rather than piggy-backing small IC components to macroeconomic adjustment operations.
c. Choose lending instruments appropriate to support the process of institutional change over a long period (e.g., programmatic adjustment loans). This will help ensure that changes in laws and regulations are actually implemented and are sustained.

4. Find organizational solutions that help integrate microeconomic and macroeconomic reform agendas.

a. Maintain the responsibility for integration with the country departments, but provide better support from the sector and anchor units, IFC, and MIGA. Clearly define the roles of the sector units in the Regions (principalily PSD and PREM) to improve coordination and reduce potential conflicts.
b. Improve the integration of sectoral issues in proposed reform strategies. Possible options to accomplish this would be to continue and expand the recent practice of holding country-level PSD reviews (for individual countries, country departments, or regions), bringing together staff across sector units (particularly PSD and PREM) as well as the IFC and MIGA; and/or to nominate IC “coordinators.”
Evaluation Framework
The chain of causality from Bank IC activities to economic performance outcomes, illustrated below, has three main parts:

1. Between Bank activities and the adoption of policy and institutional reforms
2. Between reforms and actual changes in the investment climate
3. Between changes in the investment climate and performance outcomes (firm-level productivity and profitability, and economy-wide productivity, investment, income, and employment).

The ICS focuses on the first parts of the chain—from Bank activities to IC outcomes—relying on a literature review to provide evidence on the relationship (3) between improved investment climates and final economic outcomes.

The evaluation addresses the following questions:

- **Relevance of Bank assistance**: What relative priority did the Bank attach to addressing IC issues among its total interventions? Were the policy and institutional areas emphasized in Bank operations consistent with current empirical research linking IC indicators with performance outcomes, and with the obstacles to investment as perceived by potential investors? Do the survey-based diagnostics used by the Bank provide good information about the quality of the investment climate, and do they lead to sound policy advice?

- **Effectiveness of Bank assistance**: Are Bank activities helping get IC reforms implemented? Was the Bank effective in motivating client governments to undertake reforms, beyond what they would have done in the absence of Bank intervention? Was conditionality in lending operations helpful in supporting reform? What were the outcomes of Bank interventions, in terms of the quality of the investment climate and in terms of investment and growth?

- **Sustainability**: What is required for IC improvements to be sustained? How should reforms be sequenced?

- **Organizational issues**: Does the Bank’s organizational structure support good investment climate work?

The evaluation comprises the following components:

- A review of the literature on the drivers of investment and growth and of the microeconomic factors that determine investment behavior
• A review of IC issues in Bank strategy documents—institution-wide PSD strategies, CASs, and PRSPs
• A description and analysis of the portfolio of IBRD/IDA lending operations that support improvements in the investment climate
• A description and analysis of IBRD/IDA non-lending services including economic and sector work and survey-based diagnostic assessments
• Results of discussions with Bank staff and international investors
• Client consultations and country case studies for India, Indonesia, Mozambique, Peru, and Romania.

Literature Review
A literature review provided a conceptual framework for the ICS. Theoretical and empirical literature on the investment climate, produced both inside and outside the Bank, was reviewed. Specifically, the literature review focused on the following topics:

• The relationship between economic growth and poverty reduction
• The relationship between the quality of the investment climate and investment flows, both domestic and foreign
• Aspects of the investment climate that make the most difference to investors, both domestic and foreign
• The importance of the investment climate as a determinant of investment, relative to other factors (e.g., macroeconomic and political risk, labor costs, global investment strategies)
• Policy and institutional reform strategies that have had the most success in improving the investment climate.

The review was prepared in November 2003 by Tyler Biggs (consultant) and is available as a background paper for this report.

International Investor Interviews
Interviews with large multinational investors were held in Washington, D.C., Tokyo, London, and Brussels between early November 2003 and mid-January 2004. The interviews were conducted by Benjamin Rowland (consultant). The participants were chosen by the consultant and several others, including Thomas Niles and Steven Canner of the U.S. Council for International Business (USCIB); Gilles Garcia, private sector outreach officer in the World Bank’s Paris office; Jonas Moberg and Gina May of the Prince of Wales International Business Leaders’ Forum (IBLF) in London; Carlos Gonzales-Finat of the Union of Industrial and Employers’ Confederations (UNICE) in Brussels; and Y. Yoshimura and K. Omori of the World Bank’s Tokyo office, with additional help from the staff of the leading Japanese industry association, Nippon Keidanren. USCIB, IBLF, and UNICE kindly provided the use of their facilities for the meetings.

The main criteria for the selection of participants were: headquarters-based executives with a good knowledge of the overseas investment strategies and procedures in their respective companies; a willingness to be open and candid; and the ability to participate fully in meetings conducted in English. Although detailed prior knowledge of the World Bank and its programs was not intended to be a requirement for participation, familiarity with the Bank and its goals proved to be fairly strong. For example, two of the corporate respondents, one in Washington and one in Tokyo, were former WBG staff members, and at least four others, one in Washington, two in Tokyo and one in Europe, had negotiated or done business with the Bank in areas such as finance, procurement, and partnering.

To establish a common threshold level of knowledge about the Bank’s IC programs and the design and aims of the IEG-World Bank evaluation, all participants received briefing materials about 10 days before the meetings. These materials included (1) a discussion of the scope and definition of the IEG-World Bank evaluation, together with an attempt to place the evaluation subject matter in the context of the broader range of activities undertaken by the Bank Group in the name of private sector development; (2) a summary statistical analysis of the Bank’s IC loan portfolio; (3) examples of the two new diagnostic instruments (the ICAs and the annual Doing Business Survey) developed to carry out the Bank’s recently initiated Private Sector Develop-
ment Strategy; and (4) several questions to help guide the discussions.

A summary description of the corporate and industry-association participants is provided in table II.A.1. Aggregate revenues for the corporate participants are approximately $735 billion. Total employment is approximately 1.4 million. Nine of the 17 participating companies are included in the 2003 World Investment Report (produced by the United Nations Conference on Trade and Development [UNCTAD] (World Bank 2003c) list of the 100 largest non-financial transnational corporations.

Participants were asked the following discussion questions:

- Which country-level factors do you consider when making international investment decisions?
- How important are “investment climate” considerations in your investment decisions?
- Which IC considerations (if any) do you include in screening for investment locations? How much weight do you give to them?
- Are the IC activities that are the focus of WBG lending and advisory services the most im-

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<th>Table II.A.1: Participants in International Investor Interviews</th>
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<tr>
<td><strong>Sector and company</strong></td>
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<td>Computer and information technology</td>
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<td>Leading computer company U.S.</td>
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<td>Leading computer company Japan</td>
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<td>Infrastructure</td>
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<td>Gas U.K.</td>
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<td>Water and sewer U.K.</td>
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<td>Water and sewer U.K.</td>
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<td>Investment Fund U.S.</td>
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<td>Integrated oil company Europe</td>
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<td>Mining U.K.</td>
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<td>Mining U.K.</td>
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<td>Construction/Engineering</td>
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<td>Industrial construction U.S.</td>
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<td>Shipbuilding Netherlands</td>
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<td>Pharmaceutical</td>
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<td>U.K.</td>
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<td>Apparel/Footwear</td>
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<td>Nippon Keidanren Japan</td>
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<td>Prince of Wales International Business Leaders’ Forum U.K.</td>
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<td>UNICE Belgium</td>
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<td>European Services Forum Belgium</td>
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<td>European International Contractors Germany</td>
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<td>USCIB U.S.</td>
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important ones, from the vantage point of your company’s location decisions?
• Can you provide examples of how IC improvements have affected the costs and risks in the developing countries where you invest? Do the improvements affect your company’s bottom line?
• Is the quality of existing firm-level and country IC data (from private or other multilateral institution sources) a deterrent to making good investment decisions in developing countries for your company? Do the new World Bank instruments, i.e., the ICAs and the annual Doing Business survey, fill a gap?
• Were you aware of WBG activities in the area of IC reform? Would more information about these activities (e.g., activity details, participating countries) affect your investment location decisions?
• Is the PSD IC strategy, with its emphasis on generating internationally comparable survey data, and a common assessment methodology for the Bank’s operating regions, the best use of Bank Group resources to “lower the transaction costs and risks of investing in and operating a company”? (Alternatives might include a stronger emphasis on implementing the Bank Group’s policy advice, measures to improve [increase] direct lending to and risk taking on behalf of the private sector, etc.)
• Has the presence of IFC as a direct investor taking private sector risk in specific companies and sectors served as a demonstration effect or influenced your company’s perception of investing in a particular country?
• Are you familiar with MIGA’s instruments that target improving the investment climate?
• Have you ever used, or considered using, MIGA products or services (e.g., political risk insurance or information services for potential foreign investors such as IPAnet and FDI Xchange)? If so, have you found these products or services effective and useful?
• How would you rate these MIGA products and services compared with similar products from other providers (e.g., political risk insurance from national or private investment insurers, information services from commercial providers, or other international organizations)?
• When considering or undertaking an investment in a developing country, have you used the services of investment promotion agencies? If so, have you found these agencies’ assistance to be effective and useful?
• Other topics?

**Bank Group Staff Discussion Groups**

IEG-World Bank, IEG-IFC, and IEG-MIGA held joint discussion groups with Bank staff to get their feedback on WBG IC activities. Invited staff were task managers of PSD projects, PSD specialists, country economists, and IFC investment officers. Two discussion groups were held: one on February 3, 2004, for the Africa, East Asia and Pacific, and Latin America and the Caribbean Regions; and one on February 10, 2004, for the Europe and Central Asia, Middle East and North Africa, and South Asia Regions. The results of the discussions are summarized in a background paper by Ramachandra Jammi (IEG).

Participants were provided with background materials in advance of the meeting, which included (a) the objective and components of the evaluation, (b) the working definition of the investment climate, (c) a description of the IC portfolio, (d) project descriptions from IEG-World Bank evaluation summaries, and (e) findings from IEG-World Bank CAEs. Participants are listed below:

- Magdi Amin EASFP
- Bernard Drum EASFP
- Charles Feinstein LCSFP
- Arvind Gupta EASPS
- Gaiv Tata DECWB
- Albert Zeufack EASPR
- Ahmad Ahsan SASPR
- Irina Astrakhan ECSPF
- Harry Broadman ECSPE
- Kutlay Ebiri CEUST
- Jim Emery CASFC
- Neil Gregory CSASC
- Peggy Henderson CMEDR
- Gregory Jedrzejczak ECSPF
- Arthur Karlin COSDR
- Mihaly Kopany TUDRU
- Melanie Mbuyi AFTPS
- Mohua Mukherjee AFTOS
- Vijaya Ramachandran AFTPS
The discussion questions were as follows:

Relevance:

- Have IC issues been given enough priority—relative to macroeconomic, rural, social, and human development issues—in the countries you are familiar with?
- Have the IC issues chosen for emphasis in Bank country strategies reflected the most important constraints to investment and enterprise performance?

Instruments:

- Have the instruments of Bank assistance (adjustment loans, technical assistance, diagnostic studies, etc.) been appropriate to country needs?
- Should IC constraints be tackled in stand-alone projects, as opposed to being components of larger structural adjustment loans?

Diagnostics:

- Did the Bank’s diagnostic work (PSAs, ICAs, and other economic and sector work) provide a sound basis for policy dialogue and operations?
- How might these instruments be improved?

Outcomes:

- What factors seem to have led to good outcomes, or poor outcomes, in Bank IC projects?
- Can we expect good IC outcomes in countries with poor macroeconomic conditions?

Organizational structure:

- Are the mandates of the various Bank Group units dealing with the investment climate clearly defined in theory and in practice?
- Are there overlaps or gaps in responsibility?
- Do the Bank, IFC, and MIGA operate in areas of their comparative advantage, and are synergies being utilized?
- Has Bank-IFC coordination on PSD strategies in CASs worked well?
- Have there been areas of conflicting objectives between the Bank and IFC in policy or regulatory issues?

Human resources:

- What kinds of expertise are needed in the Bank to design and implement high-quality assistance on IC issues?
- Are these resources available?

Country Case Study Protocol

Activities to Be Included

The set of World Bank activities included in the evaluation, covering the fiscal 1993–2002 period, were taken from the previously constructed databases of lending operations and nonlending services. The set of activities included individual lending operations (closed as well as ongoing projects), surveys/assessments, ESW, advisory services, training and knowledge dissemination, and partnerships. The review also included activities undertaken by the Bank/IFC SME Department. Other IFC and MIGA activities were not specifically evaluated in the case study, but issues of coordination between the Bank and IFC/MIGA were covered.

Unit of Analysis

The unit of analysis was the country. However, it proved useful to focus on particular organizations (e.g., a foreign investment promotion institution) or policy (e.g., commercial transactions law) as an embedded unit of analysis. This was appropriate when the institution or policy received sustained attention from the Bank over a period of time.

External Sources of Information

Prior to the mission, the following information will be collected:

- Strategic documents: the CASs covering the period, as well as any relevant policy notes (e.g., dealing with private sector development)
- Project documentation: For each lending operation, the Memorandum of the President and the Appraisal Report
• **Existing evaluation material:** Quality Assurance Group reviews and Project Supervision Reports; for completed projects, the Implementation Completion Report (ICR) and Evaluation Summary and, where applicable, the Project Performance Assessment Report; CAEs

• **ESW and surveys/assessments:** surveys/assessments produced during the period (PSAs, FACs, WBES, ICSs, ICs); relevant economic and sector work (e.g., reports on private sector development, or PSD chapters in Country Economic Memoranda)

• **Investment climate indicators:** Existing data on the constraints to PSD, the cost of doing business, and country risk indicators

• **Economic outcome indicators:** annual data on domestic and foreign investment, the share of private sector activity in GDP, private sector employment, productivity growth (if available), exports, GDP growth, and poverty indicators, from 1990 through the most recent year available.

**Persons to Be Interviewed**

In headquarters, relevant staff and managers were interviewed to gain their perspectives on the objectives and targets of activities, how activities were implemented, and the results of the interventions.

In the field, persons interviewed included relevant government officials (policymakers and management in institutions receiving assistance) as well as representatives of the private sector to gain their perspectives on constraints to PSD during the past 10 years, the relevance of policy and institutional reforms undertaken by the government, the effects of those reforms, and the remaining reform agenda.

**Evaluation Questions and Methodology**

The questions addressed in the case study and sources of information used to form conclusions are shown in table II.A.2. Note that “outcome” refers to the efficacy of Bank strategy and activities and includes Institutional Development

<table>
<thead>
<tr>
<th>Questions</th>
<th>Sources of information</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Relevance</strong></td>
<td>• Literature review</td>
</tr>
<tr>
<td>Did the IC themes chosen for emphasis in Bank strategy reflect the most important constraints to investment, employment, and growth of the private sector?</td>
<td>• CASs, sector strategies</td>
</tr>
<tr>
<td>Did Bank diagnostic work lead to the choice of relevant objectives for lending operations?</td>
<td>• IC indicators</td>
</tr>
<tr>
<td>Were the instruments chosen appropriate to country needs at the time?</td>
<td>• Surveys/assessments, ESW</td>
</tr>
<tr>
<td><strong>Outcome (including institutional development impact)</strong></td>
<td>• Project documentation</td>
</tr>
<tr>
<td>Were changes in the quality of the investment climate associated with changes in economic outcomes (foreign and domestic investment, productivity growth, sectoral and GDP growth)?</td>
<td>• Evaluation material</td>
</tr>
<tr>
<td>Were the policy and institutional reforms adopted associated with changes in transactions costs and risks? Were private sector perceptions of risk improved?</td>
<td>• Headquarters and field interviews</td>
</tr>
<tr>
<td>Were the adopted reforms actually implemented and sustained? Were necessary complementary actions taken?</td>
<td></td>
</tr>
<tr>
<td>Did the Bank have an influence on the government’s decisions to adopt policy and institutional reforms?</td>
<td></td>
</tr>
<tr>
<td>Were there other plausible explanations for outcomes, apart from Bank activities?</td>
<td></td>
</tr>
</tbody>
</table>

Table II.A.2: Evaluation Questions and Methods
Impact. Bank Group performance should cover the effectiveness of the institution’s organization, knowledge sharing, etc. in contributing to intended outcomes.

Outline of the Case Study

I. Country Context
   A. Trends in Investment, Employment, and Growth
   B. Trends in the Quality of the Investment Climate

II. Bank Activities to Improve the Investment Climate
   A. Strategic focus
   B. Lending operations
   C. Nonlending services

III. Relevance of Bank Activities
IV. Outcome of Bank Activities
V. Sustainability
VI. WBG Performance
VII. Borrower Performance
VIII. Lessons for the Future

Table II.A.2: Evaluation Questions and Methods (continued)

<table>
<thead>
<tr>
<th>Questions</th>
<th>Sources of information</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Sustainability</strong></td>
<td></td>
</tr>
<tr>
<td>What was the degree of government commitment to reform, and did the Bank correctly assess this commitment?</td>
<td>Headquarters and field interviews</td>
</tr>
<tr>
<td>Was there sufficient government ownership of reforms?</td>
<td></td>
</tr>
<tr>
<td>Were the concerns of civil society (particularly the private sector) recognized and taken into account?</td>
<td></td>
</tr>
<tr>
<td>Have the policy and institutional reforms been sustained? Do the relevant institutions have enough capacity to continue their work?</td>
<td></td>
</tr>
<tr>
<td>Were temporary subsidies reduced or eliminated? Were implicit budget subsidies (e.g., to newly privatized firms) reduced or eliminated?</td>
<td></td>
</tr>
<tr>
<td><strong>Bank Group performance</strong></td>
<td></td>
</tr>
<tr>
<td>Was relevant information about constraints to private sector development shared among the various WBG units involved in improving the investment climate?</td>
<td>Headquarters and field interviews</td>
</tr>
<tr>
<td>Were activities undertaken by various units well coordinated?</td>
<td></td>
</tr>
<tr>
<td>Did the various units undertake activities that were in their comparative advantage?</td>
<td></td>
</tr>
<tr>
<td><strong>Borrower performance</strong></td>
<td></td>
</tr>
<tr>
<td>Did the government own the process of reform and take a leadership role in the preparation, implementation, and evaluation of the project?</td>
<td>Headquarters and field interviews</td>
</tr>
<tr>
<td>Were counterpart funds provided as required?</td>
<td></td>
</tr>
<tr>
<td>Did the government sustain the necessary policy and institutional framework required to sustain the impact of the project?</td>
<td></td>
</tr>
</tbody>
</table>

Note: ESW = Economic and sector work.
Core IC Themes

32. Judicial and Other Dispute Resolution Mechanisms

Includes activities aimed at:

- Improving the efficiency of the courts, simplifying court procedures, improving capacity of court personnel, and modernizing case management and court administration
- Supporting the rehabilitation of courts and the provision of information technology
- Strengthening institutions responsible for budget, planning, human resources, and court facilities; and those involved in rendering, publishing, and enforcing judgments
- Improving the independence and accountability of the judiciary
- Improving compensation, appointment, promotion, discipline, and removal procedures
- Strengthening judicial and court personnel training programs/institutes
- Publication of court decisions and statistics
- Support for watchdog civil society organizations
- Building legal framework for complementary resolution of disputes
- Supporting alternative dispute resolution (ADR)
- Supporting arbitration, mediation, conciliation, mini-trials, small claims courts, and other dispute resolution mechanisms
- Supporting indigenous customary and traditional methods of dispute resolution.

34. Legal Institutions for a Market Economy

Includes activities aimed at:

- Identifying vulnerabilities in existing frameworks having a negative impact on economic growth
- Assessment of prevailing legal and regulatory frameworks
- Establishing and strengthening the legal and regulatory frameworks and legislative process related to economic and commercial activities to promote PSD and economic growth in a fair and competitive economy
- Assistance with formulation of appropriate policies
- Assistance with study, formulation, and revision of laws related to such matters as banking, insolvency, contracts, property, commercial transactions, competition, trade and the private provision of public infrastructure services, including telecommunications, water supply, electrical power, and transportation
- Assistance with the application and implementation of relevant legislation
- Improving capacity of institutions responsible for the regulation of private sector activities, including commercial banks, secured transactions, capital markets, and the private provision of infrastructure services
- Assistance with regulatory frameworks for the above and related matters
- Research and dissemination of results thereof regarding policy directions
- Training of staff, externally and internally
- Clarifying and strengthening personal and property rights, including gender-based, children’s, indigenous peoples, and other human rights, social protection, labor, health, civil rights, and criminal law
- Supporting with land titling, family and succession laws, other property laws
• Creating and maintaining land, personal property security, and intellectual property registers
• Supporting institutions responsible for clarifying and strengthening such rights
• Landlord-tenant courts and ADR.

Excludes business-related laws that would be coded under Legal Institutions for a Market Economy.

38. Corporate Governance

Includes activities that focus on:

• Rights of shareholders
• Equitable treatment of shareholders
• Treatment of stakeholders
• Disclosure and transparency
• Duties of the board
• Assessment of corporate governance institutional frameworks and practices through the preparation of country assessments.

Excludes activities related to corporate social responsibility issues.

40. Regulation and Competition Policy

Activities that promote deregulation and enhancement of competition and improve the legal and regulatory framework for financial and private sector development

Includes activities aimed at:

• Elimination or weakening of state monopolies in various sectors
• Simplification of business licensing and registration requirements
• Removal or reduction of barriers to FDI
• Enactment or refinement of competition policy, including its legal basis
• Development of regulatory framework, including legislation and regulatory capabilities, for private provision of infrastructure
• Strengthening the supervision and regulation of financial institutions and markets
• Regulating the provision of electronic financial services (e-finance)
• Regulation of microfinance institutions.

Non-Core IC Themes

28. Tax Policy and Administration

Includes activities aimed at improving the effectiveness, efficiency, and fairness of public revenue systems, including tax policies and tax and customs administration at national and subnational levels of government. This category includes activities related both to the economic analysis of tax policies and to the design and functioning of institutions related to tax and customs administration (as well as the links between policies and institutions, and between tax and customs).

Excludes activities related to the economic analysis of individual tariff policies (which falls under Trade and Integration) or activities that involve minor changes in tax rates or coverage or changes in revenue administration that are not intended to affect or address systemic issues of revenue policy or administration.

39. Infrastructure Services for Private Sector Development

Includes activities aimed at:

• Development of infrastructural services such as transport, information technology and communications, energy and water, where the objective is to improve the conditions in which private businesses operate (e.g., a rural electrification program that aims to facilitate the growth of rural enterprises)
• Improving logistics and distribution systems
• Supply chain infrastructure
• Customs facilities and procedures.

Excludes infrastructure projects that have objectives other than PSD, such as a rural electrification program whose main goal is to improve
living conditions for the rural population, not facilitate growth of rural enterprises.

44. Other Financial and Private Sector Development

Includes activities that:

- Help establish or strengthen institutions that provide support to the private sector (e.g., establishing or strengthening investment promotion agencies, export promotion agencies, or technology development institutions, capacity building of private sector collective bodies and development of public-private consultative mechanisms).
- Support development of nongovernmental service delivery mechanisms, such as output-based aid schemes involving private provision.
- Small-scale contracting to private providers and nongovernmental organizations (e.g., under social funds) may be included if the development of private sector or nongovernmental organization provision is an explicit objective. If there is a strong SME development objective, it may be classified under SME Support.
- Support restructuring of private enterprises, such as corporate restructuring.
- Address multiple subthemes in promoting financial sector development (e.g., for work in diversifying financial systems, developing domestic debt markets, advising governments with small financial systems, designing new financial instruments for managing risk, and systemic restructuring policy advice).

45. Export Development and Competitiveness

Activities that focus on the determinants of export growth and external competitiveness in developing economies

Includes activities aimed at:

- Trade liberalization (e.g., benefits of unilateral tariff reform, pattern of Effective Rates of Protection, and impact on foreign direct investment)
- Promoting nontraditional exports
- Countering anti-export bias
- Export promotion and marketing activities
- Market liberalization and access in services
- Diagnostic country trade studies
- Aspects of “new” trade agenda at the national level, such as competition policy, product standards, and the linkage between exports and labor or environmental issues
- Implementation challenges (e.g., timetable for phasing in tariff reductions, handling of sensitive industries, dealing with fiscal impact of tariff reduction)
- Business facilitation.

49. Trade Facilitation

Activities that focus on increasing the volume of international trade by reducing the costs and increasing the efficiency of transporting traded goods to consumers

Includes activities with the following as either primary or secondary objectives:

- Modernizing and/or reforming customs operations and administration
- Streamlining and modernizing border-crossing procedures and documentation requirements
- Regional (cross-border) programs that strengthen mechanisms of interaction and cooperation among border agencies (and between border agencies and the trading community) in order to increase the efficiency of border operations
- Reducing corruption and smuggling and enhancing security at border crossings
- Enhanced transport and supply chain security
- Improving trade and transit logistics (i.e., port, maritime, air, and multimodal transportation)
- Expanding access to transportation modes (air, land, and sea) for firms and other business
entities whose primary goal is to engage in external trade

- Expanding access in landlocked countries to ports and other border posts
- Increasing the quality and efficiency of transportation infrastructure—roads, railroads, ports, and airports—with a direct impact on lowering the costs of transporting goods to/from borders
- Support for information technology infrastructure to enhance e-commerce usage within the trading community
- Regulatory and administrative reform and harmonization to expand trade.
### ANNEX II.C: THE INVESTMENT CLIMATE IN SECTOR STRATEGY PAPERS

<table>
<thead>
<tr>
<th>Report title and date</th>
<th>Investment climate messages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>PSD strategy papers</strong></td>
<td></td>
</tr>
<tr>
<td>“Private Sector Development Action Plan” (1989) and “Progress Report on the Private Sector Development Action Plan” (1990)</td>
<td>Improving the business environment is one of four priority areas identified for promoting PSD. Bank assistance will take the form of adjustment operations to support policies, regulations, and legal reforms; FIAS to be expanded. Financial sector development, a related area, is also given priority.</td>
</tr>
<tr>
<td>“Private Sector Development Strategy: Directions for the World Bank Group” (April 2002) and “World Bank Group Private Sector Development Strategy: Implementation Progress Report” (May 2003)</td>
<td>The current sector strategy highlights the fundamental importance of the investment climate. The strategy suggests that IC issues be part of systematic and regular analysis in preparation of country strategies and that policy-based lending operations and capacity-building efforts, particularly to reduce unjustified obstacles to private business and to establish secure property rights for poor people, be continued.</td>
</tr>
<tr>
<td><strong>Sector strategy papers</strong></td>
<td></td>
</tr>
<tr>
<td>Energy: 1993 Policy Paper</td>
<td>Regulatory processes must be established that are transparent and clearly independent, and that avoid government interference in the day-to-day operations of power firms.</td>
</tr>
<tr>
<td>Energy: “Renewing Our Energy Business: Draft Strategy for Discussion” (January 2001)</td>
<td>Promoting PSD in the energy sector requires the creation of objective, transparent, nondiscriminatory regulatory mechanisms, expanding competition and cross-border trade, and catalyzing private investment. Bank assistance will be in the form of loans and nonlending services in support of ongoing reform programs.</td>
</tr>
<tr>
<td>Social Sectors: “Sector Strategy: Health, Nutrition, and Population” (1997)</td>
<td>To promote private participation in health services, the paper recognizes that weak institutional capacity to deal with regulatory problems often causes governments to become excessively involved in the direct production of health services.</td>
</tr>
<tr>
<td>Rural Development: “From Vision to Action” (1997) and “From Vision to Action: Update” (July 2000)</td>
<td>Facilitating PSD in rural areas is key to improving well-being in rural areas and considers the creation of a regulatory framework that allows for the development of a competitive private sector and efficient markets as a mandatory first step in private sector development. Emphasizes the business environment in rural areas, public infrastructure, and public services.</td>
</tr>
<tr>
<td>SMEs: SME Department “Strategy, Business Plan, and Budget” (May 2000)</td>
<td>Establishing the business environment conducive to SME development is listed as one of the four pillars of the WBG strategy. It is crucial to tackle those factors that discriminate against small firms as well as the broader issues that affect all firms.</td>
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<table>
<thead>
<tr>
<th>Report title and date</th>
<th>Investment climate messages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Urban Development: “Cities in Transition: A Strategic View of Urban and Local Government Issues” (March 2000)</td>
<td>To foster competitive firms of all sizes, the paper emphasizes the importance of the enabling and institutional framework, including a legal and regulatory framework that establishes business incentives and imposes minimal transactions costs; land, real estate, and transport planning; and the rule of law and property rights protection.</td>
</tr>
<tr>
<td>Other PSD papers</td>
<td></td>
</tr>
<tr>
<td>“Private Sector Development in Low-Income Countries” (1995)</td>
<td>Identifies four key areas for improving the business environment: strengthening the legal and judicial system, reducing the barriers to competition and improving regulation; supporting entrepreneurial development; and promoting global integration through foreign direct investment and regional integration to complement trade reform.</td>
</tr>
<tr>
<td>“Private Sector Development Strategy: Issues and Options” (May 2001)</td>
<td>The paper is the outcome of a discussion process within the WBG dating back to mid-2000 and culminating in a discussion with the Executive Directors of the WBG on May 23, 2001. The paper is focused on six major themes, including the creation of an investment climate that promotes growth and provides opportunity for the poor.</td>
</tr>
<tr>
<td>Region/Country (CAE year)</td>
<td>CAE findings</td>
</tr>
<tr>
<td>--------------------------</td>
<td>--------------</td>
</tr>
<tr>
<td><strong>Africa</strong></td>
<td></td>
</tr>
<tr>
<td>Burkina Faso (2000)</td>
<td>Adjustment lending addressed public sector reform and the environment for growth and private sector development. Slow but significant progress has been made in privatizing public enterprises, but the program has not been adequately supported by the promotion of new private sector activities or by the removal of economic, institutional, legal, and regulatory bottlenecks to domestic and foreign investment. Trade reform was undermined by the proliferation of tax and tariff exemptions, but is now proceeding swiftly with the introduction of the subregional WAEMU free trade and the common external tariff.</td>
</tr>
<tr>
<td>Cameroon (2001)</td>
<td>The Bank and IFC contributed to improve the environment of the private sector. They played an important role in promoting privatization and insuring that the process was conducted in a reasonably transparent manner. The government recognizes that this is probably the major impediment to increased private investment, and is preparing to deal effectively with the problem. The Bank played a role in bringing corruption to the forefront and contributed to reducing one of the main sources of corruption, by promoting privatization and ensuring that the privatization process is conducted with sufficient transparency.</td>
</tr>
<tr>
<td>Côte d’Ivoire (1999)</td>
<td>Improving the competitive position of the Ivorian economy and improving the private sector environment was the focus of Bank lending during the fiscal 1994-96 period, with almost half of Bank commitments going to macroeconomic adjustment credits. Lending has been particularly successful in the series of recent adjustments loans and credits aimed at restoring Côte d’Ivoire’s competitive position: financial sector adjustment loan for restoring the health of the financial sector, Poverty Alleviation Strategy Coordinating Office for simplifying and rationalizing the regulatory framework, economic recovery credit for supporting the recovery of the private sector, and PSD for creating a more friendly private sector environment. The success of these operations was predicated on a consistent strategy that was supported by sequences of credits and nonlending activities. The Bank has to assist the government in creating an attractive environment for domestic and foreign private investors by simplifying and rationalizing the system of taxes and regulations, by reducing corruption, improving the functioning of the judiciary system, and pursuing the privatization drive.</td>
</tr>
<tr>
<td>Eritrea (2002)</td>
<td>A major restructuring of Eritrea’s external regime is required, in an atmosphere in which both foreign and domestic investor confidence has been severely shaken. The government’s privatization and PSD efforts have slowed, investors have shied away, and many local entrepreneurs who had invested before the conflict suffered substantial losses and faced difficulties in resuming production and export activities. Enabling legislation in a number of important areas has also been delayed by the government’s preoccupation with the war. The Bank should assist the authorities develop a time-bound concrete program of critical investments and policy adjustments to be pursued over the coming three years that recognize the constraints to development associated with war devastation, geographical factors, social fragmentation, governance challenges, and policy weakness.</td>
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<table>
<thead>
<tr>
<th>Region/Country (CAE year)</th>
<th>CAE findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ethiopia (1997)</td>
<td>As defined in the policy matrix of the last CAS in 1997, PSD should be conceived broadly to include regulatory reforms, relaxation (if not the abolition) of the investment code, development of private markets for land leases of both short and long duration, trade liberalization, elimination of controls on foreign exchange transactions, and financial sector liberalization. The progress benchmarks listed in that CAS for these items have not been fully met in many cases. The frustrations of the private sector color its perception of the usefulness of the Bank. The client survey of 1997 indicated that 88 percent of the private sector group did not think the Bank was adequately supporting PSD, and no one in that group responded favorably when asked if he/she was satisfied with the Bank (56 percent reacted unfavorably, and the rest were noncommittal). There remains much to be done in bringing about a competitive economy, and the critical success indicators of private investments—whether domestic or foreign—are not showing improvements. There has been insufficient progress in removing fundamental institutional and policy constraints. The Bank should now focus on a strategy for removing the remaining impediments to private sector development, including faster liberalization of the financial sector.</td>
</tr>
<tr>
<td>Ghana (2000)</td>
<td>While private sector investment increased from extremely low levels, it is still inadequate, constrained by incomplete implementation of reforms to improve governance and redefine the role of the state and by continuing episodes of macroeconomic instability. Emphasizing private sector-led growth was appropriate, given the failures of public sector-led growth in the first two decades after independence. Improvements in public sector capability and better governance were expected to facilitate private sector growth and poverty alleviation, but governance issues were not treated with enough weight to make an important difference. Improved private sector investment will depend substantially on the government’s ability to improve fiscal discipline through the 2000 election period and on its even-handed application of laws and regulations.</td>
</tr>
<tr>
<td>Kenya (2001)</td>
<td>The government undertook reforms for improving economic governance. The private sector sees improvements in the climate for private investment. Lack of ownership and poor dialogue are now viewed as less important in moving the reform agenda forward than lack of human and financial resources.</td>
</tr>
<tr>
<td>Lesotho (2001)</td>
<td>An improved environment for growth and PSD depends on enhanced political stability, better governance, and deeper parastatal reform of the state sector. Prospects for all of these improvements are uncertain. The Bank would probably have contributed more to the emergence of an efficient private sector had its assistance been preceded or accompanied by the array of interlocking legislative, regulatory, institutional, and financial measures critical to the creation of more congenial environment for private sector investment as well as improved water supply and electricity services. In the years following the CAE, a well-functioning government has displayed commitment to improving governance (e.g., the successful prosecution of powerful international firms on bribery charges related to the Lesotho Highlands Water Project). Also in the last 4 years, Lesotho has been able to take advantage of the U.S. Africa Growth and Opportunity Act initiative, as a result of which there have been significant investments in the garment industry. Lesotho has created more employment than any other African country in this area. Much of this investment was possible because of previous PSD projects that were supported by the Bank and a continuing dialogue on issues affecting investment, particularly utilities. The Bank has also completed an Integrated Framework study (with other donors; technical assistance is forthcoming) and more recently, a PSD strategy was prepared to address some of the legislative, regulatory, and institutional issues affecting the investment climate.</td>
</tr>
<tr>
<td>Malawi (2000)</td>
<td>With Bank support, price and regulatory obstacles to agricultural production were removed, and further improvements were made in the environment for production and exports. However, due to external shocks and periodic fiscal indiscipline, macroeconomic stability was not sustained, resulting in crowding out of credit to the private sector and inflation. Bank assistance for infrastructure development had limited results, efficiency in the financial sector was not increased, the poor competitive environment was not improved, and most capacity-building measures had limited long-term impact.</td>
</tr>
<tr>
<td>Region/Country (CAE year)</td>
<td>CAE findings</td>
</tr>
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<td>---------------------------</td>
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</tr>
<tr>
<td>Mozambique (1997)</td>
<td>The Bank should remain the lead agency in assisting the government as it continues to develop the policies and capacities for economic governance, trade policies, and financial sector reform and development. The Bank has demonstrated comparative advantage in economic governance assistance and in policy-based adjustment lending. However, the Bank’s development effectiveness has been limited by weaknesses in aid coordination as well as excessive focus on investment projects and traditional technical assistance at the expense of capacity building and results-based sector-wide programs.</td>
</tr>
<tr>
<td>Tanzania (2000)</td>
<td>Among the more obvious constraints in PSD was a complex and burdensome administrative and regulatory structure. Of the four countries where “roadmap” exercises were carried out—Ghana, Namibia, Tanzania, and Uganda—Tanzania had the most extensive and time-consuming and least transparent regulatory framework. In 1996, the Warioba Commission documented incidences of corrupt practices in the judiciary, civil service, customs service, and issuance of licenses and permits for all types of business operations. It concluded that the spread of corruption was not due to the absence of appropriate policies, institutions, rules, regulations and procedures, but rather to the non-observance of established rules and the ineffectiveness of the established institutions. Rationalizing taxes and regulations and infrastructure development are key for private sector development. Support for the indigenous private sector will create a broader constituency for reform. Bank efforts in these areas should be closely coordinated with IFC and MIGA, and PSD should be made an integral part of the CAS.</td>
</tr>
<tr>
<td>Togo (2000)</td>
<td>Restructuring and privatizing the banking system without further delay would remove an obstacle to the expansion of the private sector. Financial restructuring should be supported by a radical reform of the judiciary system, which is in a crisis stage.</td>
</tr>
<tr>
<td>Uganda (2001)</td>
<td>By fiscal 1995, when the government’s ability to maintain macroeconomic stability was no longer seriously questioned, policy makers turned to issues that they had addressed in a primarily macroeconomic context in the past—institutional development in all areas of public sector management and the creation of a favorable environment for PSD. The agenda in each of these areas is still largely unfinished. To promote PSD, the government is attempting to complete its privatization program, promote transparency, free public resources for services, enforce financial sector reforms, reduce intermediation costs, improve access to financial and infrastructure services, and promote corporate governance. Reforms in these areas are more sectoral, microeconomic, and complex; they require time, tailoring to specific contexts, a holistic approach, and careful sequencing. Moreover, unlike past macroeconomic reform, which created relatively few losers (given the post-war Ugandan context), they require the participation and partnership of many more domestic and donor stakeholders, who do not necessarily have uniform views on reform.</td>
</tr>
<tr>
<td>Zambia (2002)</td>
<td>The country made substantial progress in creating an enabling environment for private investment through legal and regulatory reform and reduction of state intervention in various factor and product markets. The Bank played a critical role in this progress. By the end of 1999, nearly all nonmining commercial and manufacturing entities had been privatized—unquestionably a fundamental change in the institutional structure of the economy. However, the economic impact of this has been small, and less than it could have been had the country moved swiftly to privatize the copper mines, which was the most critical reform to restore short-term, export-led growth in the 1990s. Simultaneously, to benefit all privatized and new private entities, and provide an environment more conducive to diversification, the Bank would have needed to take a more intensive approach to improving the investment climate. In June 2004, an ICA for Zambia was completed and has already started to inform PSD operations in the country. The IC questionnaire was modified to explore key sectors like tourism and mining, so that it would be more relevant to country operational support.</td>
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<table>
<thead>
<tr>
<th>Region/Country (CAE year)</th>
<th>CAE findings</th>
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<tbody>
<tr>
<td><strong>Zimbabwe (2003)</strong></td>
<td>Relative to the CAS and other relevant objectives, the outcomes of Bank assistance are rated unsatisfactory and institutional development as negligible. While the Bank’s program helped to liberalize trade, reform agricultural marketing arrangements, deregulate domestic investment, and establish a fund to mitigate the social impact of adjustment, the assistance did not support macroeconomic stability. Given the current political situation, a resumption of normal Bank lending should be conditional on credible and upfront measures to achieve macro stability, fundamental governance reforms, etc.</td>
</tr>
<tr>
<td><strong>East Asia and the Pacific</strong></td>
<td>A Technical Assistance Credit (TAC) for US$17 million approved in November 1994 aimed to enhance the government’s economic management capacity, re-establish legal institutions, and promote private sector development. The government viewed TAC as a complex project with too many components. Implementation of the legal reform and private sector development component was delayed for two years by coalition government politics. IDA could also provide assistance for small-scale enterprise development, particularly for exports. Finally, IDA could assist the government in creating a business environment hospitable for investment, especially by expatriate Khmers and other foreign investors. Because of the prolonged trauma experienced by Cambodia’s population, the level of insecurity is high. Although many measures are needed for several years to quell insecurity, IDA can assist by rehabilitating legal institutions and promoting legal reforms.</td>
</tr>
<tr>
<td><strong>Mongolia (2002)</strong></td>
<td>The Bank made a positive contribution to progress in the 1990s, including an easier transition, improved macro-economic management, and an improved legal and regulatory framework. At the same time, efforts to help remove some key policy and institutional impediments to sustain growth met with less success; key elements of the enabling environment for private sector investment are still lacking. Factors inhibiting a greater Bank contribution include (in general) limited linkage between the lending program and recommendations from ESW and political sensitivity and anticipated adverse short-term consequences, which caused hesitancy to complete some reforms.</td>
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<td><strong>Papua New Guinea (2000)</strong></td>
<td>The outcome of Bank assistance to Papua New Guinea over the past decade is assessed as unsatisfactory, institutional development impact modest, and sustainability uncertain. To assist Papua New Guinea in the future, the Bank should (i) sustain its nonlending services and establish a field presence, even though minimal lending is expected; (ii) collaborate with the government and other donors to help develop a long-term strategy to support capacity-building and the consistent implementation of key reforms; and (iii) assist in public dissemination of country assistance objectives to broaden consensus and build ownership of reforms. Subsequent to the CAE, the Bank’s field presence has been strengthened through the appointment of a country manager in Port Moresby. The Bank has also sustained non-lending services, and collaboration with donors has strengthened across a number of fronts.</td>
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<td><strong>Philippines (1998)</strong></td>
<td>As economic recovery and structural adjustment unfolded in the 1990s, Bank strategy became more balanced. The Bank lifted its sights to long-term growth issues such as capital market development. It sought to improve the enabling environment for the private sector with similar instruments through advice on and lending for reforms in the incentive framework for foreign investment, the regulatory framework for private sector activity, export development and diversification, ongoing deregulation (especially in transport and industry), basic infrastructure investment, and ongoing financial sector reform, particularly to develop the market for long-term finance. In 1994, under the Private Sector Infrastructure Initiative, the Bank began assistance to address comprehensively a series of issues (including legal, regulatory, promotion, competition, risk unbundling, and mitigation) emerging from increasing private sector participation in infrastructure. The EIL extended and deepened the sequence of economic reforms, as in the process of tariff reform and import liberalization that had been included in earlier Bank operations—Structural Adjustment Loans I and II, the Agriculture Sector/Inputs Loan, and the Economic Recovery Loan (ERL, which supported a major tax reform as well).</td>
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### Region/Country (CAE year) | CAE findings
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**Thailand** (2000) | The East Asian financial crisis opened a window of opportunity for reforms, which would not have been politically feasible during the boom years. The Bank could take advantage of this opening to assist the authorities in improving governance and legal provisions. The Bank should be selective and focus its interventions in areas where there is a strong support for reforms. Reducing red tape and corruption in customs services would improve Thailand’s competitiveness. Barriers that have now disappeared may, however, reappear when the crisis is over.

**Vietnam** (2001) | Until recently, the climate has not been conducive for PSD—administrative bottlenecks, delays, and overlapping responsibilities, poor regulatory environment, unclear legal framework and absence of enforcement, high transaction costs, for example, in telecommunications and shipping, unequal playing field with State-owned enterprises, a weak financial sector, and perceptions of corruption have discouraged potential investors. The passage of a new Enterprise Law in 2000 has improved the climate, but official attitudes toward PSD have been ambivalent. Establishing a sound legal and regulatory framework is underway, but still not in place. Many obstacles to improving labor productivity in rural areas relate to policy issues. Areas for future focus might be policies that promote land markets, greater freedom of crop selection, and a level playing field for private rural enterprises. Most Bank reports emphasized policies to address existing constraints: land use rights and title registration; mortgage rights; accelerating reforms of State-owned enterprises; banking sector reforms; import tariff and other trade reforms; private provision of infrastructure. The Bank has also helped to provide substantial technical assistance, often financed through grants (UNDP, PHRD, IDF, ASEM), for improving the legal environment, such as the new Enterprise Law. Initiated by the Bank and IFC in 1998, the Business Forum has become an important vehicle for ongoing dialogue between the Government and the private sector; it is now managed by the IFC. Initially comprised of foreign investors, the Forum gradually drew in domestic entrepreneurs. In the years following this CAE, the situation has been changing very fast in Vietnam. Over the last few years, FDI as a share of GDP in Vietnam has been on par with China, and total investment in the economy is a blistering 36 percent. Official attitudes towards PSD have been changing. High-level policy-maker support for PSD has improved the momentum of pro-PSD reforms. The Constitution was changed in 2002 to formally recognize the private sector as an important pillar of the economy. Also in 2002, the Party declared openly that the private sector is an important contributor to economic growth, and party members were at the same time allowed to own private businesses. World Trade Organization accession is now the major energizing force for reform in Vietnam. Also, from the perspective of Vietnam, investment climate is about business development including State-owned enterprises, not just PSD or privatization. Vietnam, like China, has chosen to retain a large number of enterprises in the State sector. Developing effective approaches to improve corporate governance, harden the budget constraint, and monitor the performance of State-owned enterprises has to be an important aspect of IC analysis. Another focus important for Vietnam is nonfarm activities in rural areas.

**Latin America and the Caribbean**

**Ecuador** (2001) | Faster growth will require improvements in the investment climate through privatization, deregulation, and transparent rules for competition. Corruption has also hampered the climate for growth, distorting incentives, depriving the government of badly needed revenues, and undermining public security. A modern legal framework for the development of capital markets and new kinds of financial institutions was passed but remains largely on paper. Formal labor markets remain highly regulated, and private investors remain uninterested in increasing their commitment, so long as the macroeconomic and political climates remain uncertain.

**El Salvador** (2002) | Over the last decade, the Bank supported the government’s efforts in competitiveness to promote PSD, agricultural reform, and land titling. ESW was relevant to the country assistance strategy. It provided a coherent framework to establish priorities and to guide lending and economic policy advice. One discussed short-term measures for dealing with the liberalization of markets. Bank assistance promoted stability and growth, a more effective public sector,
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<td><strong>El Salvador (2002)</strong></td>
<td>competition, and PSD. While the risks associated with exchange rate policy have fallen sharply after the Legislative Assembly passed the law of monetary integration, insecurity and high crime rates persist, thereby discouraging domestic and foreign investment. Bank assistance helped reshape economic institutions and organizations and supported good policy management and better use of private and public resources. Freer markets and fewer regulations have increased transparency, have reduced opportunities for graft, and increased competition. Low import tariffs and the absence of non-tariff barriers reduced graft and eased the reforms in customs administration. A good legal and regulatory framework for the electricity and telecommunications sector contributed to the successful privatization of the electricity distribution system and to competitive markets in telecommunications.</td>
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<td><strong>Guatemala (2002)</strong></td>
<td>The environment for PSD has deteriorated. Political divisions within the party in government, weak financial institutions, fiscal deficits, and changing business rules have dented business and investor confidence. Political tensions and weak economic fundamentals reduce investment and constitute the major constraints to private sector activities. Several publicized governance issues have exacerbated the perception of high regulatory risks and instability of private contracts. Guatemala needs to strengthen its institutions for the country to achieve and sustain high growth rates. Property rights continue to be weak, and excessive regulation of domestic commerce and foreign trade burdens private enterprises, which then seek to avoid the burden by paying bribes to civil servants. Crime rates (kidnappings, robberies) are high compared with other countries in Central America (except El Salvador). Bank ideas and policy advice have sometimes contributed more to the country's development than the money lent. The Economic Modernization Loan helped shape the liberalization of trade, the sale of state-owned companies, and the management of taxes, budget, and treasury. The liberalization of trade reduced the discrimination against agriculture, forced the industrial sector to be more efficient, and reduced the incentives in customs to engage in corrupt activities.</td>
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<td><strong>Argentina (2000)</strong></td>
<td>The Bank's ESW on Argentina has been of very high quality. It could be argued that much of this work is somewhat superfluous, as local research institutions can and do produce reports of the same quality. In view of the sophistication of Argentina's policy makers and research establishment, ESW should increasingly be in the form of short policy notes to assist in deliberations with the authorities and engage the broader society in dialogue and in a process of &quot;learning together.&quot; Specific technical assistance and specialized advice also are likely to be of high value.</td>
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<td><strong>Bolivia (2000)</strong></td>
<td>The key to PSD in Bolivia is to formulate and implement a comprehensive strategy to improve the transparency and legitimacy of the legal and regulatory environment, overhaul the judicial system, radically restructure the civil service, and improve tax compliance. The Bank's diagnosis correctly emphasized the excessive role of the state and its lack of effectiveness and the poor environment for private investment as the main structural explanation for low domestic savings, investment, and growth. Although the Bank's ESW had correctly diagnosed that weak institutions and excessive productive capacity in the hands of the public sector were the main constraints to growth and poverty alleviation, the Bank's assistance did not immediately address these constraints. This reduced the relevance and efficacy of the Bank's early lending and nonlending strategy. The Bank's own diagnosis had suggested that privatization was essential, but obtaining government commitment to this was not achieved at this time. The Bank must help Bolivia remove its remaining governance and institutional constraints against PSD and continue to develop its capital market. High-quality ESW lost efficacy because sound policy analyses did not translate into policies adopted by the government or into project design and conditionality agreed with the Bank. The clear need for macroeconomic stability and to restore balance of payments viability led to efforts being initially directed at highly inefficient state enterprises. This meant that creating a suitable environment for PSD did not proceed as expeditiously as possible. The CAE recommends that the Bank should (a) give higher priority to promoting PSD by developing the financial sector and helping the government accelerate reforms of the judicial system and of the civil service; (b) in partnership with the government, place a high priority on improving the quality of governance and necessary public regulation.</td>
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<td>Brazil (2003)</td>
<td>The Bank can still play a relevant role in a middle-income country such as Brazil. The Bank is most relevant as a source of knowledge and technical assistance. There is also scope for improving Bank support to PSD. The Bank might consider assistance to judicial reform, as the judiciary has been identified as a bottleneck in PSD strategies produced by the Bank and domestically. The Bank is already providing some initial assistance through ESW. More assistance to regulatory agencies is also needed, especially at the level of states, to reduce the lingering uncertainties and encourage public sector investment.</td>
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<td>Chile (2002)</td>
<td>The Bank played a key supportive role, with money and advice, in helping Chile out of the mid-1980s crisis and in the economic transformation that followed. The institutional change that the assistance supported promoted PSD and better governance, financial accountability, and financial management. While Chile now has good access to international capital markets, systemic shocks could reduce that access, encumbering Chile’s ability to achieve its development objectives. Consequently, it may be beneficial to maintain an active Bank program in Chile. Some lessons stand out from the Bank’s experience in Chile: The Bank can be more effective in promoting development if it supports programs and projects in countries committed to stable macroeconomic policies; when the Bank lacks sufficient information about the consequences of legislative and regulatory reforms, it should promote and support pilot tests and small demonstrations of the proposed reforms; good results from pilot tests become a powerful tool to convince stakeholders of the benefits of reforms. In a country with sophisticated economic management, the Bank should abstain from insisting on reforming policies if ownership for reforms is weak.</td>
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<td>Costa Rica (2000)</td>
<td>The government of Costa Rica has continued to implement its reform program at its own pace, without much financial assistance from the Bank. It has continued to make progress in opening up trade and diversifying exports while maintaining political stability. Foreign investors complain of excessive bureaucracy, expensive labor costs, and too much government involvement in the economy. In spite of this, foreign private investment continues to expand due to Costa Rica’s relative political stability, commitment to economic openness, excellent educational system, market access, and high-quality labor force. The government, however, has dealt decisively with the problem of corruption and Transparency International has ranked Costa Rica second (i.e., low perception of corruption) among all Latin American countries and 27th in the world.</td>
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<td>Dominican Republic (2003)</td>
<td>During the past 10 years the Bank has had little contact with the Central Bank, the country’s central policy-making body. More recently, it has tried to step up that contact, but it has yet to establish a continuous dialogue with the authorities in areas where the Bank can offer expertise. As a result of this, the Bank has missed the chance to provide advice at times when the country embarked on important reforms, such as the privatization of public enterprises. The Bank should help the country broaden its structural reform agenda to encompass agriculture, including trade, land, water, and price reform, and to remove barriers to entry and competition in domestic activities.</td>
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<td>Mexico (2001)</td>
<td>Overall, the policies and programs with which the Bank has been associated in Mexico over the decade are likely to be sustainable. The open, market-oriented economic policies pursued since fiscal 1989 have helped to generate rapid recovery from the disastrous 1994–5 crisis. The banking system is regaining strength, in part due to the participation of foreign management and equity, a better legal framework, and more effective supervision. Mexican government officials indicated that engagements with Bank staff during the design and implementation of a project sometimes have had value added in these ways: providing direct technical assistance and useful policy advice; providing an objective, outsider’s perspective on problems; communicating the lessons from international experience; using the Bank’s “convening power” to bring about more productive dialogues among Mexican stakeholders; inducing greater coordination among units of government that normally do not communicate well with each other; insisting on technical norms for resource allocations that might otherwise be subject to excessive discretion; and injecting a greater</td>
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<td>Mexico (2001)</td>
<td>Nevertheless, on balance, interviews with Mexican government officials suggest that the value of the Bank’s lending operations during the past decade has been highly variable and, as a trend, diminishing over time. As a result, it has been increasingly difficult to identify implementing agencies that regard the embedded technical assistance from working with the Bank as worth the “hassle factors.”</td>
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<td>Paraguay (2001)</td>
<td>The ongoing political uncertainty is exacerbating Paraguay’s underlying governance problems. Policy making is not always transparent. The country’s legal and institutional framework is weak, leading to evasion and selective enforcement of laws and regulations. The Bank is only the fourth largest official lender in Paraguay. Over the past few years, the Bank has consistently urged reform of the state, especially privatization of state enterprises and improved governance. These recommendations have been generally ignored by government but are frequently referred to in the press.</td>
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<td>Peru (2002)</td>
<td>The reforms of the early 1990s, in which the Bank played a significant role, totally altered the environment for PSD and set off rapid private investment growth. As the decade progressed, two primary obstacles to private investment, the unpredictability of the judiciary and tax instability, became more pronounced and, together with growing political tension, put a damper on private investment after 1997.</td>
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<td>Uruguay (2000)</td>
<td>The authorities have moved toward increasing private sector participation in activities traditionally provided by the public sector. They have opened markets to competition by the private sector and eliminated monopolistic privileges enjoyed by public enterprises in those cases where this can be done within the existing legal framework. They are also preparing legislation to open the markets to competition in cases where changing the existing legislation is needed.</td>
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<td>Europe and Central Asia</td>
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<td>Albania (2000)</td>
<td>IDA saw rapid privatization of small and medium-scale firms and the creation of a “private sector-friendly” legal and regulatory environment as simultaneous processes. Entrepreneurial dynamism is very strong in Albania, but the need for a regulatory environment that is transparent and uniformly applied has now become acute. Vibrant private sector initiative is a powerful development ingredient, but in the absence of some basic ground rules, transaction costs escalate rapidly and anarchy ensues. The balance in the lending program has been good, and the adjustment operation supported a complete liberalization of the agricultural price and incentive framework. Adjustment credit also supported revised land legislation that authorized the leasing and sale of agricultural land. Full development of a land transfer system is still pending, however, as the land titling and registration system is only about 10 percent completed. Land fragmentation and the division of family farms into many parcels will present a future obstacle in trying to raise farm incomes and operational efficiency. Land holdings are small and fragmented. This will be a constraint to the transition from the current, largely subsistence farming to a market oriented, commercial agriculture. An active land market needs to develop to facilitate consolidation.</td>
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<td>Azerbaijan (2000)</td>
<td>Complex regulations, corruption, and lack of access to finance have hampered private business development. In ESW, greater emphasis on PSD through an analysis of the business environment would have been a useful addition. Progress in governance reform and PSD was slow. Nonetheless, a policy dialogue with the government was established and the groundwork prepared for future reforms. IDA could also do more to improve the environment for PSD and to strengthen the social safety net for those expected to be made redundant as the public sector is restructured and privatized.</td>
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| Bulgaria (2002)          | A number of reports point out in some detail the administrative obstacles to doing business and the weak enforcement of laws and regulations. Bulgaria lagged behind most other EU candidate countries in a number of areas related to the business climate. The Ministry of Finance would like the Bank’s help to improve the investment climate for the private sector rather than support for public investment by line ministries. Between 1991 and 1997, with Bank assistance, a basis for privatization was laid, a new commercial banking law was promulgated, and the Central Bank made efforts to improve supervision. Between 1998 and 2000, laws and regulations for private sector activity, legal and institutional
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<td>Bulgaria (2002) (continued)</td>
<td>The newly privatized banks operating in the absence of an adequate judicial and legal framework are not yet engaging in lending to the private sector. The development of private capital markets is lagging, complicating policy for pension fund investment. In December 1998, FIAS initiated a major study on administrative barriers to investment in Bulgaria, at the request of the Bulgarian Foreign Investment Agency. Though the FIAS study made a number of important recommendations, the follow-up and implementation have been hampered by changes in the Bulgarian counterparts behind the study.</td>
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<td>Croatia (2001)</td>
<td>The main objectives of the CAS were to redefine the role of the state, reform public finance, encourage private sector-led growth (including privatization and bank reform), and upgrade infrastructure. The proposed program was largely relevant and well designed. With hindsight, a notable weakness was the absence of focus on governance. This was understandable, given that at that time governance was not the priority it is now in the Bank. A PSA would have been useful to formulate reforms of the enabling environment for private enterprises, as has been done in other transforming economies. The main strategic objectives of the new CAS are appropriate: reduce the size of the public sector and increase efficiency, improve governance, create the conditions for competitive sector real development, and contain poverty.</td>
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<td>Kazakhstan (2001)</td>
<td>The Bank’s early private sector strategy consisted of macroeconomic stabilization and structural reforms (price and trade liberalization, privatization, enterprise restructuring, passage of laws and regulations for private sector activity, financial sector reform) to develop competitive markets. The IBRD strategy was relevant, but in hindsight, the relevance would have been greater if more attention had been devoted to privatization procedures and to strengthening of the judicial framework early in the transition. Following the second CAS (fiscal 1998), the legal and judicial framework were priorities in the Legal Reform Project (fiscal 1999). A new and unique feature of the CAS was the formation of a joint IBRD-IFC-MIGA Rapid Response Team to provide quick turnaround advice on urgent policy issues for the promotion of an enabling climate for the private sector. The CAS should link WBG support to progress on improving the environment for the development of the private sector, in particular with regard to the clarity in the legal and regulatory framework, judicial reform, transparency in privatization, and a reduction in the arbitrary enforcement of tax laws.</td>
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<td>Kyrgyz Republic (2001)</td>
<td>IDA appropriately focused its assistance from the outset on stabilization, liberalization, privatization, and institutional reform geared to moving the country from a command to market economy. The Privatization and Enterprise Adjustment Credit (whose main objectives were to increase the speed and improve the quality of privatization of small, medium, and large-scale enterprises and to support substantial trade and price liberalization measures to improve PSD) was considered only marginally satisfactory because the objective of attracting strategic investors was not realized, serious corporate governance issues were not addressed, negligible enterprise restructuring followed privatization, and many of the large loss-making enterprises intended to be liquidated or restructured continue to be a drag on the economy. The Kyrgyz Republic came to be regarded by IDA as a star performer in policy reform relative to other former Soviet Union countries. IEG-World Bank has found, however, that satisfactory covenant compliance in Kyrgyz has not always meant satisfactory development outcomes. Some progress was made in tax reform and in establishing a new legal framework for private enterprise, including foreign investment. A new legal framework and system of rural finance for private agriculture was put in place and private ownership of land is now permitted. All of these reforms were supported by IDA operations.</td>
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<td>Lithuania (2003)</td>
<td>Apart from supporting the macroeconomic framework, the Bank’s adjustment lending (especially SAL II) supported voluntary compliance in tax administration, implementing new auditing and accounting laws to improve corporate governance, a revised bankruptcy law, removing bottlenecks in land markets and sale of goods, and removing barriers</td>
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<td>Lithuania (2003) (continued)</td>
<td>to the functioning of land markets. While most key conditions in this regard were met, their implementation was challenging, and the record suggests that broad-based government ownership and capacity to implement parts of the package were lacking. After Lithuania’s accession to the EU in May 2004, improving the business environment was an area of comparative advantage for the Bank, should the country seek the Bank’s assistance.</td>
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<td>Russia (2002)</td>
<td>In the key reform areas of PSD, the 1990 joint study recommended clarification and legal protection of property rights as a necessary first step. De-monopolization and the enforcement of hard budget constraints were noted as crucial measures for restructuring existing enterprises, transferring underutilized assets to new enterprises, and increasing competition. An effective legislative and judicial basis, institutional capacity, and political commitment for the rule of law, corporate governance, and competition policy were also viewed as urgent. The study’s priorities reflected the broad consensus on these fundamental issues among government reformers, the academic community, and international financial institution officials. The study, however, gave insufficient emphasis to public governance and bureaucratic harassment issues, which proved central to the investment climate and the entry and growth of new enterprises. Bank assistance for improving the enabling environment had limited results through 1998, with little progress in establishing a conducive policy and institutional framework for enterprise restructuring, corporate governance, competition, new entry, and private investment. On the other hand, the Bank helped prepare legislation and establish institutions conducive to PSD (e.g., the Anti-Monopoly Commission, the Federal Energy Commission).</td>
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<td>Ukraine (2000)</td>
<td>From a development outcome perspective, the efficacy of the Bank’s country assistance efforts has been unsatisfactory. Recognizing the difficult political environment, the Bank’s strategy was a graduated assistance program, increasing with the intensity of the perceived reform effort. The “graduated response” approach was probably the best option, given the lack of full government commitment to reform across all sectors. But despite Bank efforts to create a shared vision, the principles of a market economy are not yet accepted enough by policymakers and civil servants. All country strategies continually refer to the need to strengthen public administration institutions and reform laws and legal procedures. Nevertheless, no comprehensive legal reform agenda was mapped out by the Bank although certain laws were identified as necessary to support the development of a market economy (progress in this was sought under a variety of sector adjustment operations). A new civil code, a bankruptcy law, banking regulations, secured transactions, contract, and company law were all identified as crucial. Yet it was becoming increasingly apparent that excessive regulation, bureaucratic intervention, and corruption were perverting the desired outcomes from the liberalization agenda. In conjunction with the authorities, the Bank did attempt to create a more comprehensive legal reform agenda in the context of a legal reform project. Progress was thwarted by waning support from the Ministry of Justice, and elements have now been subsumed into a proposed larger technical assistance project. The Bank recognized that while privatization was a necessary condition for vigorous PSD, it was not a sufficient condition. Substantial changes in the environment for PSD would be necessary, including regulatory reform, tax reform, legal reform, and capital market development. But once macroeconomic stabilization was in progress, the Bank pressed forward with privatization and decontrol of domestic and international trade; the Bank would deal with other liberalization issues later. Part of the reasoning for this strategic approach was that while the reforms were important, they would not be forthcoming until a constituency largely consisting of the new owners of privatized enterprises was developed. Progress has been made in putting in place the laws necessary for a market-based economy. But many anomalies and omissions remain. Progress has been most extensive in banking and securities law. Basic facilitation laws such as bankruptcy and collateral laws and a uniform civil code have not fully emerged as yet. Many donors have been involved in this process that has created problems of consistency between laws enacted. Even with good laws, application and enforcement in Ukraine are highly deficient. However, the key part of the Bank’s intervention is not the resource transfers, but the policy dialogue, underpinned by ESW, and the Bank coordination of donor efforts to effect change and policy reform. If the Bank had not been engaged, policy reform in certain key areas would have been much slower. Privatization in particu-</td>
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<td>lar would not have proceeded as swiftly, and the progress achieved in trade and price liberalization might not have occurred. While much remains to be done in agriculture, what has been achieved has created a foundation for further reforms.</td>
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<td>Middle East and North Africa</td>
<td>According to the 1992 Country Strategy Paper, the Bank hoped to make a number of policy-based loans in support of privatization and removing barriers to the private sector. The 1994 country strategy recognized Egypt's reticence to borrow from IBRD but still hoped to provide support to the now-slowed reform program. The focus was similar to the previous strategy, but with more modest goals for lending and greater emphasis on nonlending support and Institutional Development Fund grants. For example, in two focus areas, export-led growth and private sector development, operations did not materialize. More recently, as the momentum for reform has increased, the Bank has not been involved in areas where it might have had some impact: private sector development, financial sector reform, targeted poverty alleviation. Although some government officials expressed the view that no support from IBRD is necessary in this area, other officials suggested that they would welcome such support.</td>
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<td>Morocco (2001)</td>
<td>In the area of PSD, a PSA Update (1999) noted that after a decade of efforts at stabilization, liberalization, and deregulation and the launching of the privatization program, the response of the private sector has fallen short of the high expectations generated by the achievements of the 1980s. It concluded that further reforms are needed, of both policies and institutions. One of the suggested reforms, to improve the judicial system, is included in a Legal and Judicial Development Loan (fiscal 2000). FIAS has been discussing with the government three possible advisory projects designed to improve the FDI investment environment in the country: the development of a strategy and possible establishment of an investment promotion agency; a feasibility study for the establishment of an export processing zone; and a review of the investment incentives system. The slow rate of privatization more broadly calls for particular efforts, whether through analytical and advisory activities/assistance (AAA) or lending, to improve the environment for PSD. Any future adjustment loans should be smaller in size and conditioned on substantive and irreversible progress on a focused set of key reforms.</td>
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<td>West Bank and Gaza (2002)</td>
<td>As private investments failed to materialize, the Bank placed greater emphasis on creating an enabling environment. A wide range of projects was approved to provide financing and remove regulatory obstacles to the private sector, including: housing finance, microenterprise finance, an industrial estate in Gaza, and finance for the Palestinian Authority's contribution to the MIGA guarantee fund. The Bank provided support to institutional development, broadly defined, including improvements to the legal framework, financing qualified Palestinian expatriates to improve public sector management, and strengthening the nongovernmental organization sector in service delivery. A third major theme of the Bank's strategy was support for private sector development. In this regard, the Bank (as well as IFC and FIAS) and other donors have provided assistance on a wide variety of measures, including legal and regulatory changes, risk insurance funds, guarantees, development of an industrial zone, improvements in housing finance, support for microfinance, as well as support for basic infrastructure and laying the groundwork for future participation by the private sector in the provision of water and energy. Much remains to be done even to harmonize the legal and regulatory environment.</td>
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<td>Yemen (2001)</td>
<td>Apart from the petroleum sector, private FDI has been negligible. A 1997 report by the FIAS noted that impediments to private investors related to governance issues. Following unpleasant experiences, IFC and other international banks were reluctant to do business in Yemen; between 1987 and 1997, IFC had no new investments or lending commitments there. Private businessmen also report problems doing business common in other countries. IDA has given too little attention to identifying and assisting the government to remove constraints to private investment and growth; sector work and lending assistance have shown inconsistencies.</td>
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<td><strong>South Asia</strong></td>
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<td>Bangladesh (1998)</td>
<td>Despite more than 15 years of policy dialogue, the enabling environment for PSD is still deficient. The pace of reform of the policy environment has been slow, and the successes that have occurred (ready-made garments) cannot be attributed to government or IDA. The quality and depth of the ESW undertaken by the Bank certainly diagnosed the problems and constraints. However, there was a chronic overestimation of government ownership of the reform process, given strong and highly politicized labor movements, a central bureaucracy seeking to maintain centralized control and a complex array of policy distortions and regulations. Throughout much of the 1980s, genuine government commitment to and a vision of an industrial sector driven by market forces was absent. By and large the relevance, timing, and quality of sector work has been good. Undoubtedly the situation improved in the 1990s, with more aggressive trade policy reform following good IDA ESW and more intense policy dialogue on trade liberalization issues. IDA’s move to SECALs with broad sector reform agendas has been appropriate, and while not fully successful has generated a momentum for more economy-wide liberalization and created a growing constituency for wider reform. As has been manifested in the 1990s, a stronger focus on key sector and subsector policy reforms and actions is a more effective way of using IDA resources in the sector.</td>
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<td>Maldives (2000)</td>
<td>None of the two Country Economic Memoranda of the 1980s identified PSD as a priority. None of the Bank’s projects contained components aimed at improving the competitive environment or liberalizing markets. In particular, as discussed above, despite a significant involvement in fisheries, the Bank did not press for greater competition or for phasing out the direct public sector role. In retrospect, a more appropriate strategy is likely to have been to enable competition and market forces as far as possible, while strengthening government’s regulatory and oversight capacity and targeting direct safety net transfers to the most vulnerable.</td>
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<tr>
<td>Nepal (1999)</td>
<td>In retrospect, in the 1990s, the Bank focused too much on implementing its investment projects in infrastructure, agriculture, and power in a very difficult environment and not enough on helping ensure the presence of a conducive policy environment to support both sustainable public investment as well as much greater private sector activity. The critical obstacle to agricultural growth and diversification represented by lack of rural roads was also not fully integrated into the Bank’s agriculture strategy. Until road access improves, access to markets and inputs, linkages with agro-industry, and the inflow of food will remain limited. Strong commitment by the government between 1991 and 1994 resulted in significant progress in liberalizing the trade and price regime and removing regulatory barriers to investment. An emphasis should be placed on defining and realizing a conducive policy environment for increased private sector activity and improved access to social services. ESW should support reform in the financial sector, an improved competitive environment through privatization of key enterprises, and intrasectoral reorientation of public expenditures toward basic social services.</td>
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<tr>
<td>Sri Lanka (2001)</td>
<td>The Bank rightly operated on the belief that, even with the lingering conflict, there was nonetheless room for reforms to strengthen macroeconomic management, openness, financial institutions, private sector development, safety nets, and the civil service. It constantly reminded the government of the reform agenda in its ESW, policy dialogue, and aid coordination activities, which have been timely, of good quality, and appreciated by successive governments.</td>
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Note: In many cases, the assessments made by the CAEs have been overtaken by subsequent developments, especially since the Bank’s IC-related activity has been more intense in recent years. Significant developments have been highlighted (in italics) wherever applicable.
Mozambique

Background
After gaining independence from Portugal in 1975, Mozambique entered a period of post-independence conflict. By the time the peace agreement was signed in 1992, real per capita GDP had declined by half compared with pre-independence levels, much of the country’s human and physical infrastructure had been destroyed, and 5 million people had been displaced. The country began a period of transition to democracy and a market-based economy, supported by substantial aid from the Bank and other donors. Extensive policy reforms, beginning in the late 1980s, improved economic management; liberalized prices, exchange rates, and trade; privatized public enterprises; promoted financial deepening; improved public investment; and increased FDI. Growth and investment increased significantly, though much of this growth was due to several foreign “mega-investments” in the capital city and southern provinces that are expected to provide relatively few jobs.

The government has made considerable progress in improving various aspects of the investment climate in the past decade, particularly considering where the country started. The advent of peace and two successful elections have significantly reduced political uncertainty. Economic reforms have increased macroeconomic stability and improved the business environment. Institution-building efforts have helped to strengthen public administration and promote FDI. Infrastructure investments in roads, ports, and telecommunications have begun to lower business costs. And some inroads have been made in developing technical capacity in government and in private business.

Despite this progress, however, Mozambique still has much to do to create the IC conditions necessary for broad-based economic growth and poverty reduction. Significant political risk remains, and geographic dualism is a potential threat to political stability. Despite progress in reforming administrative barriers to investment, the country is still one of the most difficult places to do business in the world. The leading constraints are entry procedures for new firms, constraints to hiring and firing workers, high real interest rates and limited access to credit, and impediments to labor-intensive FDI.

Bank Strategy and Activities
The Bank’s strategy for Mozambique stressed the investment climate from the beginning. The emphasis on particular aspects of the investment climate changed, however, as the country’s political conditions changed and the transition progressed from plan to market. The Bank’s strategy during the past decade has been to move from a first-generation set of macroeconomic reforms to second-generation reforms aimed at removing microeconomic barriers to investment, stemming from antiquated laws and regulations, inefficient administrative capacity, and corruption.

The Bank’s IC lending program since 1992 has included a series of Economic Recovery Credits (fiscal 1992, 1994, 1997) that supported financial sector reform, foreign exchange liberalization, privatization, the removal of remaining price controls, bank privatization, and trade reform. The Economic Management Reform Credit (fiscal 1998) supported improved tax and
trade policies and administration. A fiscal 1994 Financial Sector Capacity Building Project concentrated on privatizing State-owned banks as well as training central and commercial bank staff. The fiscal 2000 Enterprise Development Project provided direct support to firms in the form of cost-sharing grants for training as well as SME financing. In addition, there were several infrastructure projects (Roads and Coastal Shipping I and II, Maputo Corridor Revitalization Technical Assistance, and Railway and Port Restructuring Project).

Nonlending services included private sector conferences and competitiveness advice; ESW on land policy, legal and judicial reform, financial sector development, regional trade and energy issues, and constraints to PSD; an enterprise survey by the RPED; and assistance in building statistics capacity. FIAS studies on administrative barriers to investment (1996, 2001) were followed by two ICAs (1997, 2002).

Broadly, Bank activities focused on securing first-generation and second-generation reforms have been timed and sequenced well—based on strategic necessity, sound economic principles, and prevailing social and political conditions. This prioritization of IC reforms was necessary in Mozambique, as it is in most countries, because of the urgency of problems as seen by investors and because of the feasibility of changes. Macro price, trade, and financial sector reforms and privatization were crucial to economic stability and efficiency of aggregate resource allocation, and thus had to be the first priority. Second-generation reforms, such as removing administrative and regulatory barriers to investment, were bound to be a complex and long-term process, particularly in light of Mozambique’s economic and political history. Moreover, microeconomic reforms such as these would not have much impact on investment in the face of poor macroeconomic incentives.

It is likely that economic recovery and growth might have been stronger had the pace of reform been faster. However, the pace was mostly set by the government, reflecting its judgment about political feasibility and its caution as it made the transition to a market economy where economic management was different. Gradualism contributed to a stronger sense of Mozambican ownership of the reform process, despite the government’s need to rely on external advice and technical assistance. Greater ownership has enabled government to be persistent in the transition over the decade.

**Outcomes**

Bank lending and nonlending activities have been quite important in improving many aspects of the investment climate in Mozambique. Bank support has been at the center of all of Mozambique’s first-generation reforms, which, among other things, have improved macroeconomic stability, increased economic integration with world markets, improved operation of financial markets, reduced State involvement in production, strengthened FDI promotion and facilitation, and improved infrastructure. Just about all observers would agree that these reforms are permanent: Mozambique has successfully transitioned to a point where reforms will be sustained in the long run.

Despite successful progress in improving important aspects of the investment climate, an objective assessment of the outcome of these activities by most of the people interviewed for this evaluation is that it has been less robust than expected. A large part of the growth and poverty reduction that did take place during the decade can be attributed to post-war bounce-back and large aid inflows. Bank activities to reform the investment climate surely have spurred growth, but, thus far, it looks like they have had their primary effect on foreign “mega” investors, which have provided the majority of investment capital, outpacing local investors by four to one.

Mozambique still has inadequate infrastructure and capability problems in public administration and private business. Institutional weaknesses have received some attention, but the Bank’s efforts have been too modest, too piecemeal in the legal area, and insufficient in the area of reforming administrative barriers to secure much change. Business leaders interviewed for this evaluation stressed that, if the Bank were really serious about increasing the pace and scope of these types of reforms, it
should have developed a program with the government to make a “big push” to get the necessary changes, as in its adjustment lending for macroeconomic reforms, rather than the “partial program” it put together.

Studies that focused on government red tape—such as FIAS’s *Administrative Barriers to Investment* in 1996, the manufacturing survey in 1997, and others—detailed a long list of problems. Business leaders say, “This list was presented to government as the things that needed to be fixed. But the list was far too long—government can’t fix everything. There was no credible effort made to prioritize what needed to be fixed first and what needed to be worked on in the longer run.” Similar comments were received about the Bank’s annual private sector conference, begun in 1996: Local observers noted that there was not enough focus at the time on selected priority reform issues, action plans for organizing to implementing these reforms, monitoring arrangements, and mechanisms of accountability for success or failure.

In all procedural areas examined by the review, the investment process was hindered by fundamental weaknesses of the current civil service system. Reform implementation problems partly stemmed from the overlapping structure of government institutions and lack of clarity around responsibilities and accountability. But there also existed a widespread “passive resistance” from unmotivated executing agencies and officials and corruption at all operational levels. These problems cannot simply be resolved by reforming investment procedures alone. They require a complementary civil service reform.

Although Bank activities have done much to improve the financial sector, including assistance to set up a stock market, little has been done to address institutional weaknesses that continue to hamper lending to the private sector and investment in equities. Interviews in Mozambique called attention to three important areas where business leaders say the Bank should have been more involved in financial sector reform during the decade: improving financial information, improving contract enforcement mechanisms, and improving the land law and movable assets law to increase the private sector’s collateralizable asset base.

**Lessons**

*• Even under difficult conditions—such as in Mozambique, where poor economic, social, and political conditions influenced what the Bank was able to do—Bank activities can make important intellectual and financial contributions to improving the investment climate, if the government is committed to reform and economic development. The Bank’s non-lending intellectual and coordinating contributions can be as important as its financial contributions.*

*• Successful first-generation macro reforms are necessary but not sufficient for sustained private sector-led growth. Institutional weaknesses in the form of administrative and regulatory barriers and poor property rights, as well as inadequate infrastructure and capability problems in public administration and private business, can continue to constrain growth.*

*• Removing administrative and regulatory barriers is a complex and long-term undertaking. Administrative procedures and regulations are tied up with a country’s social, political, and economic systems. Hence, reform requires more than rewriting legal and regulatory frameworks. Reform efforts must be coupled with a convincing analysis of the costs and benefits of reform, together with an exercise to set reform priorities, capacity building to address weaknesses of executing agencies, and efforts on the ground to achieve political consensus and commitment by government leaders to adopt and implement required reforms.*

*• Second-generation reform programs may need a big push to get the necessary changes, just as was the case for first-generation macroeconomic reforms. Partial programs may fall well short of achieving their objectives.*

*• In cases where comprehensive reform programs are politically impossible, greater effort may be needed to prioritize what needs to be fixed first and what needs to be worked on in...*
the longer run. There may need to be more focus on a few problems that, if fixed, could have immediate positive effects, in order to build political support for further reforms.

- Reform efforts need people on the ground to help build required political commitment. There may be “passive resistance” from unmotivated executing agencies and officials and corruption at all operational levels. These problems cannot simply be resolved by reforming investment procedures alone. They may require a complementary civil service reform, which must be part of the whole institutional reform effort.

- Free markets work best, but they often need a little tweaking. This is especially true in the areas of technology transfer and training, where unfettered markets fail to provide socially optimum levels of investment. There may be a need for interventions to assist firms in these areas by way of vocational and in-firm training and cost-sharing subsidies for technology transfer to increase the possibilities for a growth response to investment climate reforms. To be a successful public investment effort, cost-sharing grants must go to projects that generate broad economic benefits, not simply private benefits.

Indonesia

Background

The 1990s were divided by the East Asia financial crisis that began with the devaluation of the Thai bhat in July 1997. In less than two months between the end of November 1997 and the end of January 1998, the Indonesian rupiah depreciated by 75 percent against the dollar, far exceeding the exchange rate depreciations in Thailand and Korea. Indonesia’s GDP fell by 13 percent in 1998, and inflation peaked at 80 percent in 1998-99. The proximate causes of the crisis were the rapid increase of unhedged short-term private external debt before 1997 and existing recognized shortcomings in Indonesia’s banking system. The country was also hit by the worst drought of the century, a collapse in regional demand, and the lowest international oil prices in decades. The country’s critically weak institutions, endemic corruption, and political instability amplified the financial crisis because no credible arrangement to deal with the crisis decisively and fairly was offered to restore investors’ confidence.

Economic growth rebounded earlier than expected and inflation came down rapidly. GDP growth increased to between 3 and 5 percent per year between 2000 and 2002. Indonesia is, however, the only crisis country that has not yet reached pre-crisis levels of GDP, which remain about 10 percent below the 1997 level.

Poor governance in the public sector has had serious consequences for Indonesia’s private sector. Extensive corruption has raised the cost of doing business, from approvals and investment clearances to customs, taxation, and purchase of public services. Many smaller businesses, unable to pay the cost of corruption, have remained in the informal sector.

The crisis had a profound effect on the banking system. Many insolvent banks were closed or nationalized, and as a result, State-owned banks control about 70 percent of bank deposits. Banks have hesitantly begun to lend again, although mainly for consumer finance.

The widespread international impression is that Indonesia’s investment climate is deteriorating and now ranks among the worst in the world. The country continues to face fundamental problems such as inefficiency, corruption, bureaucratic delays, uncertain labor relations, violence and crime, a weak legal and judicial system, and excessive taxation by some local governments. An enterprise survey conducted in 2000 suggested that macroeconomic and policy instability and uncertainty are the leading concerns of Indonesian firms.

Bank Strategy and Activities

Before the crisis, Bank reports consistently pointed out several structural weaknesses that could impede future private sector-led growth. To overcome these weaknesses, the Bank recommended maintaining good macroeconomic management, strengthening the financial sector, reducing international and domestic trade barriers, facilitating private investment, improving governance and reforming the legal system, improving land administration, and reducing
excessive state ownership of productive assets. Two projects dealt with protecting property rights, facilitating an efficient land market, and developing the accountancy profession.

Although these analyses were appropriate for Indonesia at the time, they lacked depth in one crucial respect. Weaknesses in the financial sector were well analyzed, but the obvious connection to weaknesses in the corporate sector was not explored. It was well known that insider lending, stemming from joint ownership of banks and corporations, caused some of these bad loans. Borrowing was collateralized by inflated asset values and facilitated by weak accounting practices, which were not investigated. Thus, a comprehensive framework for Bank Group assistance to the financial and corporate sectors was missing. In addition, the Bank's analyses did not establish reform priorities and were not backed by project lending for core investment climate issues, except for property rights. Although important, land registration and accounting profession reforms were not as critical as financial and corporate sector, trade, and competition policy reforms, for example. In addition, since Indonesia’s growth relied more on domestic investment than foreign investment, the Bank’s assistance strategy should have focused more on issues relevant to reviving domestic investment.

This situation changed dramatically during the crisis period, 1998–99, when the Bank enjoyed substantial leverage. The Bank’s assistance strategy focused on macroeconomic stabilization and bank and corporate restructuring, as was appropriate under the circumstances. The strategy was put into operation with balance of payments support and technical assistance loans. The Bank’s pre-crisis analysis of the financial sector was used to design laws, regulations, and institutions to resolve the banking and corporate debt crisis. Many of the structural reforms recommended by the Bank before the crisis became required policy actions in adjustment loans immediately following the crisis.

Outcomes
Before the crisis, Indonesia’s macroeconomic management and growth performance were perceived as excellent, despite many problems with its investment climate. After the crisis, macroeconomic stability has been restored, although risks of deterioration remain. This achievement has assisted the evolution of democracy and devolution of authority to regional governments, which are moving toward a stable polity. The banking crisis has been stabilized, but not yet resolved. Resolution of corporate debt has seen more progress, but important issues remain. Important trade and regulatory reforms were implemented during the crisis period, although some have recently been reversed. Insubstantial progress has been made in governance and legal and justice sector reforms. Also, there is little progress in privatization or private participation in infrastructure.

Assessing the impact of these changes on Indonesia’s investment climate is difficult. Domestic and foreign investment have remained low since the crisis, and several investment climate surveys show a deterioration. However, this outcome can be explained by Indonesia’s macroeconomic and political instability from 1997 through 2001, which affected both sources of investment. Moreover, foreign investment has also been affected by poor economic performance in source countries. With better macroeconomic management and political stability for the past two years, some observers believed that 2003 will prove to be a turning point in business confidence in Indonesia. They see signs of increasing domestic and foreign investment. Thus, the timing of surveys to gauge investment climate is important. Moreover, surveys measure corruption and regulatory impediments, which may not be the most important determinants of investment climate, especially for domestic investment.

Have the Bank’s analytical and advisory activities and lending services had any impact on Indonesia’s investment climate? Before the crisis, when Indonesia was perceived to be performing well and not in need of Bank resources, the Bank lacked leverage with the government to move it toward implementing structural reforms. The Bank’s usually strong influence with government “technocrats,” who had a voice in policy formulation and implementation, was muted during this
period, perhaps because the reforms were politically difficult and did not seem critical for Indonesia’s growth. Nevertheless, the Bank’s method of influencing policy through dialogue with government technocrats was well established. In turn, these technocrats were subject directly to presidential decisions.

During the crisis, the Bank had substantial leverage and influence despite frequent changes in governments. In the new political arrangement, the Soeharto-era technocrats, with direct access to the President for decisions, have been replaced by inexperienced politicians with diverse interests and without clear decision rules or hierarchy. Decentralization has further complicated the decision process and created complications for the investment climate. With so many new players and diverse interests vying for decision authority, the Bank’s ability to influence policy has been reduced.

According to the President of the International Chamber of Commerce, nothing the Bank has done has affected their interests. At best, the Bank’s activities have prevented deterioration in the investment climate. This judgment is harsh for two reasons. First, the Bank has contributed to macroeconomic stabilization, which has facilitated political stabilization, perhaps the two most important determinants of investment climate. Second, it may be too early to assess the impact of the Bank’s activities. The reforms it is supporting will be implemented over a long period, especially as its leverage and influence has declined. Eventually, these reforms are likely to improve Indonesia’s investment climate, especially for foreign investment but also for domestic investment.

The sustainability of Indonesia’s IC reforms depends on the government’s commitment, other stakeholders’ lobbying efforts, and donor community influence. While many reforms were implemented during the crisis period, the reformist zeal has cooled after achieving macroeconomic and political stability. In fact, the government has backtracked on some earlier reforms. With elections due in the near future, it is not possible to judge whether the new government will support investment climate reforms. Because the Bank Group has less leverage and influence with the government than during the crisis, it will have to adopt a strategy that is more effective in the new political landscape and persevere for a longer period to achieve its objectives.

Lessons

The Bank’s leverage tends to decrease in large countries where the economy is stable and growing. Moreover, the Bank’s influence also decreases when democratic countries are governed by a coalition of several parties, because the decision process becomes diffuse and complicated. These complications multiply if some former central government decisions are devolved to regional and local authorities. In these circumstances, stakeholders in improving the country’s investment climate play a critical role. The Bank’s strategy and services should focus on one or two of the most critical constraints to investment. In addition, the Bank should be prepared to pursue those structural reforms directly with several layers of government and indirectly through stakeholders. The Bank should be prepared to exercise patience and persist for long periods to achieve its policy reform objectives.

There are many components of investment climate. Some are more important than others in facilitating private investment, and some can be reformed more quickly than others. In addition, these components can affect domestic and foreign investment differently. The Bank’s assistance strategy should focus on the IC components that influence the kind of investment that is most critical to attain sustained growth. For example, if domestic investment is critical for the next five years, then the Bank should emphasize IC components that influence that kind of investment the most. The Bank should not get distracted and expend resources on components that have long-term ethical value but do not affect investment.

Romania

Background

Romania’s transition to a market economy began in 1989 with the overthrow of the
Ceausescu dictatorship. As a result of the policies that Ceausescu had followed during the 1980s, the country was largely autarkic, with imports comprising less than 10 percent of GDP. In addition, extensive centrally planned investment in heavy industry, the output of which amounted to nearly 50 percent of GDP, provided a legacy of large plants with outdated and inefficient capital stock. Agriculture had been collectivized into vast state farms and was similarly inefficient.

In the early years of transition, a flurry of reform activity sought to promote a more open market economy. But most of the 1990s were characterized by economic and political instability. The half-hearted reform activities of successive governments resulted in a weak response from the economy. GDP growth over the 1990s was mostly low or negative, and highly variable.

The investment climate at the outset of transition was therefore difficult and relatively hostile to business. Macroeconomic and political instability created substantial uncertainty, the State remained heavily involved in the economy, and the financial system was not able to finance new investment. Prices were decontrolled slowly, and there were severe restrictions on foreign investment. Combined with high rates of inflation, the private sector faced especially distorted price signals. As a result, both domestic investment and FDI were weak. For most of the decade, there was very little growth, and the incidence of poverty continued to rise.

**Bank Strategy and Activities**

The Bank’s IC strategy and activities can be divided into two periods: 1992–98, and 1999 onward. The early years were characterized by projects that focused on support for the movement away from a centrally planned economy, where most decisions related to economic issues were the purview of the state, to one in which markets determined resource allocation and investment. IC lending focused on structural adjustment and financial market development. The Bank also undertook a number of transportation projects during the fiscal 1992–98 period that amounted to more than $700 million.

The initial focus of Bank strategy—achieving macroeconomic stability, freeing up prices, and encouraging privatization—was appropriate. In hindsight, the Bank’s strategy overestimated the commitment of successive governments to reform and underestimated the difficulties of attaining some degree of macroeconomic stability.

The period around the end of the 1990s was a watershed for Romania. Economic crisis resulting from low growth and macroeconomic instability brought governments that were finally committed to reform. The new government that came to power in mid-2000 adopted an economic program for the 2001–4 period whose major goals were stimulating economic growth, reducing poverty and unemployment, combating corruption, and speeding up EU integration and NATO membership. Encouraging the private sector became a focus of policy, and the Bank was asked for help to implement reform.

The Bank responded strongly with a high lending strategy scenario that was embodied in the 2001 CAS. The strategy evidenced further evolution of the approach toward investment climate reform from one that was based on macroeconomic conditions to one that was institutionally oriented. The Bank’s investment climate strategy focused on governance, anticorruption, and the business environment. Successive PSALs and PIBLs supported the government in its efforts to reorient policies toward promoting the private sector.

An important component of the first PSAL was the secured transactions reform that attempted to improve access to credit by the poor by lowering interest rates, increasing the size of loans, and lengthening the terms of repayment. The first phase of the project was the implementation of a Law of Secured Transactions. The law was drafted with the support of the Bank and incorporated provisions that permitted movable property, both tangible and intangible, to serve as collateral for loans. The second step involved setting up the filing archive to permit the law to operate by recording pledges of property and establishing priority regarding which creditors have the first rights to repossess and sell the collateral in the event of default.
More recent investment climate loans, not yet closed, include:

- The 2001 Rural Finance Loan ($80 million) to provide financial services to a previously underserved section of the economy
- The 2001 Second Private Sector Adjustment Loan ($300 million) that continues the PSAL I efforts to support enterprise, utilities, and financial sector privatization, along with improvements in the business environment by reducing administration barriers and other regulatory burdens, and ensuring the appropriate social protection and poverty-reduction measures are in place
- The 2001 Second PIBL ($18.6 million). Like the PIBL I, the loan provides technical assistance to ensure a competitive financial sector, privatization of State-owned enterprises, a more efficient energy sector, creation of a business environment conducive to private sector growth, institutional and governance reform, and the necessary measures to ensure social protection.

Nonlending services for the investment climate during the fiscal 1998–2002 period included a 1999 FIAS report that identified the most important obstacles to business growth (incorporated in the conditionality of PSAL I and PSAL II), a 2002 report on the legal framework for PSD, and a 2001 report on credit constraints that formed the basis for the financial market components of PSAL I and PIBL I.

Outcomes

Infrastructure. Despite the emphasis on infrastructure in Bank lending, according to private sector representatives interviewed for this evaluation, in the end these projects did not have a noticeable impact on the quality of Romania’s infrastructure. Representatives complained about the high costs that poor infrastructure created for their businesses and said that they had seen little improvement over the past eight or nine years. Infrastructure data show little improvement over the decade, although it is possible that improvements were made at the margin and do not show up in the data.

Privatization. Compared to the situation at the start of transition, when the State dominated the economy, substantial progress has been made in privatizing SOEs. However, the most important SOEs have remained in State hands for a large portion of the decade. Some of the privatization projects financed by the Bank—the 1994 Financial and Enterprise Sector Adjustment Loan and many of the infrastructure projects with privatization components—did not achieve their privatization goals.

Trade policy. Romania made initial strides in liberalizing its trade regime and removing the distortional instruments of the previous regime. The 1994 Financial and Enterprise Sector Adjustment Loan made an important contribution in assisting the government in the trade area, although many of its other components were not successful. In the latter half of the decade, the country focused on making the changes necessary to harmonize its trade system with the EU, and significant progress was achieved.

Secured transactions. The introduction of secured transactions reform in 2001 had a dramatic impact on lending. In the 18 months since the reform was implemented, there have been more than 400,000 loans against which security interests have been registered. Of these, nearly 20 percent represent non-bank-secured loans. This is especially beneficial in rural areas that do not have bank offices. In addition, the geographic coverage has been extensive: There have been filings of security interests in 42 of the country’s 43 counties. More than 100 banks have registered security interests in the filing archive. Since there are 38 licensed banks in the country, the implication is that scores of non-Romanian banks have been lending against collateral and registering their security interests.

By contrast with moveable property, the legal status of fixed property (land and buildings) is unsatisfactory, and the problems are especially difficult in rural areas. The focus has been on technical mapping—rather than ensuring that property owners receive registered titles—and has resulted in little change in the land market.
Both domestic and foreign investors continue to complain that uncertainties over land ownership have delayed and increased the costs of projects. In some cases, planned investments have been cancelled.

**Legal and regulatory framework.** PSAL I assisted rationalizing taxation and improving the capacity of bankruptcy-related institutions as well as other regulatory impediments to business. All of these actions were relevant and important. There has been follow-up of these efforts in the new PIBL, which has assisted the government in formulating an action plan in which major impediments to business have been identified and for which a timetable for corrective measures has been established. Substantial progress has been made in completing the action plan. However, businesses complain that the government is exacerbating uncertainty by continually issuing decrees, many of which are contradictory.

While many changes were made to the legal framework for business, there was insufficient focus on the institutions necessary to enforce the new laws. The legal system remains weak, and governance is poor. Corruption continues to be seen as a major obstacle by firms.

**Financial sector.** Many Bank projects during the 1990s had components that dealt with the banking sector, its privatization, supervision, and regulation. These efforts were, however, severely limited by the government’s reluctance to privatize the large State banks as well as restructure their debt. Even with secured transactions reform, the ratio of private sector credit to GDP is still very low.

**Conditionality.** Conditionality has been important in assisting reformers in implementing their programs. The latter part of the period stands in marked contrast to the first part in this regard. Many of the investment climate loans of the first eight years of the period had weak conditionality or the conditionality was not enforced—for example, macroeconomic stability was a condition of many of the loans, yet Romania had only recently started to attain stability. Whether this would have influenced the ultimate outcome is uncertain, but the Bank continued to lend for IC activities in spite of little progress being made in many areas.

**Economic and sector work.** The successful IC activities in the past few years appear to have been based on more intensive ESW. The quality of this work has been high, and this has contributed to recent operations (the PSAL and PIBL) and persuaded the government of the need to focus on IC reforms. Several of those interviewed indicated that the priority given to the investment climate by the government has been a result of the Bank’s enterprise surveys and analysis.

**Information.** The Bank is now devoting substantial resources to collecting and publishing information on the investment climate. In the case of Romania, evidence of inaccuracies was found. Given the importance of this data, better coordination between the teams collecting the data and the Romania country team would be helpful.

**India**

**Background**

In the wake of a severe balance of payment crisis, India embarked on a process of economic reforms in 1991. Reform efforts were marked by a reduction in the role of government in the economy and greater emphasis on the private sector, relying on market forces as a means of ensuring economic efficiency and growth. The Government of India took steps to dismantle many industrial controls, privatize public sector enterprises, encourage FDI, liberalize trade policy, and strengthen the banking system.
These and other reforms seem to have met with some success. Between 1992 and 1993 and 2002 and 2003, GDP grew at an average annual rate of 5.9 percent—slightly higher than the 5.8 percent rate of growth recorded in the 1980s that was fueled, in part, by significant external debt.\(^2\) Growth was particularly high in the service sector, where the annual average growth rate reached 7.6 percent between 1992 and 1993 and 2002 and 2003. Inflation has also fallen from the double digits in the mid-1990s to an average of 5.8 percent in the past three years.

FDIs and portfolio investments responded strongly to the first wave of reforms in the early 1990s. Since then, annual investments have fluctuated around $6 billion, with the exception of 1998-99 when portfolio investments suffered a net reduction.

While progress has been substantial, economic performance has fallen below the government target set in the years after liberalization. Part of the reason may be attributed to the slowdown in worldwide economic growth and drought conditions in certain parts of the country that limited agricultural output. However, some critics have pointed to trade liberalization as a major culprit, highlighting the impact of imports on domestic industries. Others, including the Bank, have pointed to the slow pace of reforms and difficulties in implementing certain policy changes. The remaining concerns stand out:

- Government debt continues to accumulate, and servicing that debt puts upward pressure on interest rates.
- While reforms in telecommunications have met with success, access to reliable power at reasonable costs remains a prime concern.
- Institutional constraints on private investment inhibit small firms from investing beyond the stipulated limits, expanding their operations, and taking advantage of efficiencies arising from economies of scale.
- Existing bankruptcy laws make it very hard for companies to restructure their business.
- While the central government has reduced licensing requirements, state governments still require numerous licenses, permits, and other clearances before allowing businesses to start operations. In addition, companies must deal with various state officials on an ongoing basis with respect to applications, inspections, and reporting requirements.
- Labor legislation limits the actions of companies and imposes certain rigidities in labor markets. According to the Bank’s ICS, hiring and firing of workers was named as one of the biggest constraints in doing business in India.
- Import licensing has been abolished and some import tariffs were reduced in the early 1990s, but on average, tariffs on imports remain high relative to other countries.
- While capital markets have been the subject of substantial reforms, small businesses are still constrained by the lack of commercial credit.

**Bank Strategy and Activities**

The Bank has been a consistent advocate for greater economic liberalization in India. In the late 1980s, the Bank issued a number of reports calling for deregulation of industry and substantial trade reform to increase economic efficiency and boost economic growth. While noting that sound macroeconomic policy was essential, the Bank also argued that significant improvements in economic performance could not be achieved without substantial changes in policies, laws, and regulations that limited the development of the private sector.

Beginning in the mid-1990s, the Bank began to focus greater attention on working with states that were strongly committed to reform. This was first made explicit in the 1997 CAS and further reinforced in the 2001 CAS. The strategy centered on supporting fiscal and governance reforms, promoting private sector-led growth, and addressing the critical need for education, health, and improved infrastructure. The Bank’s strategy was to work with selected state governments on deregulation and improvement of the investment climate, while continuing to engage the central government through policy dialogue and advice on reforms that fall within its purview.

In keeping with strategic principles of selectivity, pragmatism, and reliance on partnerships, the CAS indicated that the Bank would
work primarily with those states that had chosen to embark on a comprehensive program of reforms, expressed interest in entering into a partnership with the Bank, and had relatively high poverty rates. Uttar Pradesh, Andhra Pradesh, and Karnataka were the first three states designated as “focus” states by the Bank. Bank support was provided for broad packages of government reforms as well as sector-specific programs targeted to power, water, transport, health, and education. As of November 2003, one adjustment loan had been extended to Andhra Pradesh and two had been provided to Karnataka.

The reforms that the Bank has supported in the two states are related to improving the climate for private investment to the extent that reforms lead to an increase in the level of resources and/or a more efficient use of resources devoted to the development of social and physical infrastructure. Interviews with government officials and members of the business community highlighted the critical importance of improving roads, port facilities, water systems, and power supplies to the private sector. The Bank’s support for efforts of the states to minimize regulations and streamline procedures is consistent with the expressed interests of government and business. Numerous studies have called attention to the need to dismantle the complex system of licensing, reduce ongoing reporting requirements, and deal with burdensome inspections from multiple government agencies.

The Bank’s work on PSD issues in Karnataka and Andhra Pradesh has focused primarily on reducing transaction costs associated with regulations and administrative procedures. However, there are other regulatory barriers that impose greater costs on companies, particularly those that deal with labor. None of the adjustment loans have directly addressed rigidities in labor markets, despite the widespread view—shared by the Bank—that labor regulations pose a significant constraint to private investment.

Many of those interviewed in Karnataka and Andhra Pradesh noted the absence of attention paid to the agricultural sector in adjustment operations. Approximately 70 percent of the workforce in the two states is employed in the agricultural sector. People pointed out that reforms concerning agricultural markets and land tenure are critical and likely to have much more of an impact on living standards than those dealing with industry in the near term. While reforms in the agricultural sector have been the subject of Bank reports, adjustment operations in the two states have not yet taken on these issues.

**Outcomes**

Implementation of various components has not always proceeded as smoothly or as rapidly as envisioned. Both state governments have taken significant steps forward on regulatory and administrative reforms. However, questions remain as to whether reforms have led to changes in actual behavior and are sustainable. Many of those interviewed suggested that reforms had not percolated down to lower-level officers, where changes in behavior are likely to be harder to effect. People expressed concern with the capacity of institutions to undertake needed changes and alter the “mindset” of officials.

Government officials and business leaders also spoke of their concern over whether reform efforts could be sustained in the event of changes in political leadership, particularly in Andhra Pradesh, where the agenda is seen as being driven primarily by political leaders. Lacking a strong institutional basis and grassroots support, the reform agenda may face difficulties in the event of electoral shifts.

Moreover, the impact on private investment is uncertain. Discussions with representatives of the business community suggested that the type of regulatory and administrative reforms that have been adopted so far would do little to affect the level and pattern of investment. The decision to start or expand a company is driven foremost by conditions in end use and factor markets, rather than the number of days that it takes to obtain clearances or the effort required to comply with inspections. Moreover, managers stated that while streamlining regulations and procedures may facilitate investment in a particular state, differences in regulatory regimes among states would not induce companies to invest in one
state over another. Those interviewed suggested that relatively few firms have the capability to operate in multiple states—companies tend to stay put wherever they first began operations, which is typically in the home town of the owner. Larger firms that consider investment outside of their home states seek financial incentives offered by state governments.

The Bank played an important role in focusing governments’ attention on specific issues, while placing them within a broader context. Officials in Karnataka acknowledged that while sought-after changes were broadly recognized within the government, efforts to implement reforms were “sporadic and uncoordinated” before the adjustment operations. The Bank sensitized governments to the gravity of the problem, especially with respect to fiscal matters and power sector reform, and drew attention to the significant cost of not reforming in terms of the ability of governments to address social needs within the states. In addition to the “intellectual clout” of the Bank, the adoption of triggers related to deregulation in Karnataka contributed to the reform effort.

**Lessons**

- Champions are needed to initiate and drive reform, but broad support is needed for success. Senior civil servants must understand, support, and assume ownership for reforms.
- The success of reforms is dependent on the ability of agencies and departments to implement them. It would be useful to include an analysis of the institutional capacities within government to effect change to identify potential barriers to proposed reforms and plan accordingly (e.g., training).
- Some of the regulatory changes advocated by the Bank, particularly those dealing with labor, are more politically sensitive because they are not costless. It would be useful to develop a more compelling argument for these types of reforms based on an objective analysis of the social benefits and costs of proposed regulatory changes.
- While industry surveys are clearly important, the views of industry should be only one of the inputs used in the calculus of whether particular policies are merited. The investment climate is not just what is good for industry from industry’s perspective—it needs to reflect broader concerns.
- The investment climate varies significantly by industry. Those interviewed would like to see more in-depth industry studies that lead to a specific and actionable policy agenda.
- The ICA instrument could be improved. Those interviewed would prefer hard data on actual cost differentials rather than subjective perceptions of firms. In addition, they indicated that it was difficult to determine which policies where most effective in terms of actually increasing the investment flow.
- Changes within government are necessary but not sufficient to ensure sustainability. It is important to create public demand for change to sustain reform process and ensure implementation. Strong business associations can play an important role in advocating for reforms and monitor progress. The Bank could do a better job of interacting with industry representatives.
- Conditionality provides a basis for ongoing dialogue with senior government officials and can serve to secure the support of individuals within agencies and departments that may be reluctant to implement required changes. Triggers should shift over time from focusing on the institution of reforms to the achievement of desired performance improvements such as the reduction in the length of time required to obtain clearances, the frequency of inspections, and the cost of regulatory compliance.

**Peru**

**Background**

When President Fujimori was elected in 1990, the country was verging on total disintegration. Hyperinflation, multiple exchange rates, the nationalization of the banking system, and a vicious terrorist movement had resulted in economic collapse. The impact on the private sector was catastrophic: Antibusiness legislation and endemic corruption caused a collapse of
business activity. Sharp increases in poverty pushed many into the informal sector, which employed more than 50 percent of the economically active population in low-productivity and low-wage occupations.

The new government embarked on the most comprehensive economic reform program in the country’s history. Market mechanisms were introduced in every sector of the economy. Macroeconomic policies were directed at stabilizing prices in the face of rampant inflation, large-scale privatizations were announced, negotiations with foreign creditors were opened, and the exchange rate was unified. Labor market rules were changed, foreign investment restrictions were liberalized, intellectual property rights were strengthened, government spending was cut, and attempts were made to increase tax revenues. The result was a retreat from hyperinflation as price stability began to be restored. Foreign capital returned to participate in the privatization program.

During Fujimori’s second term, however, conditions deteriorated. External shocks, the El Niño effect, and reversals in the reform program all served to weaken the economy, increase uncertainty and damage the investment climate. The government’s privatization program came to a virtual halt as the government increasingly bowed to public pressure.

President Toledo came to power in April 2001 promising to improve the economy and eradicate government corruption. However, the moribund state of the economy made the task especially difficult and confidence in the government began to erode almost immediately. In particular, policy reversals have added to uncertainty. Attitude surveys indicate that the business community does not have confidence in the government, which it views as unstable and anxious to appease populist sentiment at the expense of continuing reform. The result has been a sharp decline in investment.

**Bank Strategy and Activities**

The 1994 CAS laid the foundation for lending and nonlending services over the 1995–97 period. The CAS focused on the objective of poverty reduction through private sector-driven, environmentally sustainable growth as well as investments in public goods such as infrastructure, education, and health. The Bank aimed to assist the government in decentralizing, increasing its capacity, and reducing its role in the economy. Improving government efficiency was central to this effort. The Bank would cooperate with the International Monetary Fund in assisting Peru in maintaining macroeconomic stability.

The 1997 CAS evaluated earlier Bank interventions and concluded that they had been successful with the exception of activities related to building institutions. The CAS pointed out that these efforts had been less successful because strengthening institutions requires much longer and is intertwined with political issues. Although the CAS stated that PSD was important, it did not have an IC focus. In contrast, the 2002 CAS shifted attention to the investment climate with an institutional focus, proposing continued property rights efforts as well as actions to modernize the judicial system.

Bank activities during the fiscal 1993–2002 period included the following:

- The $22.5 million Judicial Reform Project in 1997. The project’s overall aim was to improve the execution of justice and create an environment for conflict resolution. But due to political maneuvering surrounding the efforts by Fujimori to secure the right to run for a third term in office, the project did not proceed.
- The 1999 Financial Sector Adjustment Loan ($300 million), intended to strengthen the government’s capacity to manage the impact of future economic shocks on the financial system, promote the longer-term development and resiliency of the system, and enhance its contribution to the overall growth and stability of the economy.
- The Urban Property Rights Project, a $38 million loan approved in 1998 and still active, aimed to formalize transfer of land in urban areas on which the poor had built dwellings.

The Bank engaged in a substantial amount of ESW on IC issues during the period under review. In 1993, a report on measures needed to establish
a competitive market economy was published. In 1994, a PSA was completed, outlining issues pertaining to the investment climate and containing policy recommendations designed to deal with some of the problems the private sector faced. A secured transactions analysis in 1997 made recommendations on ways to improve the functioning of Peru’s underdeveloped financial markets. In 2003, an ICA was published that analyzed problems faced by the private sector based on a standardized enterprise survey.

**Outcomes**

Many of the “contextual” IC variables improved in Peru over the course of the period under review: macroeconomic stability was restored, progress was made in privatization and infrastructure, and the trade environment was drastically improved. Among the Core IC variables, there has been progress in some areas and little or none in others.

- **Legal system, governance, and property rights.** The attempt to improve Peru’s legal system through the Judicial Reform project failed, at least in part because of the judicial instability associated with President Fujimori’s attempt to secure a third term in office. The Urban Property Rights project appears to have been successful and has made an important contribution to poverty alleviation through the wealth and labor market effects that it engendered. However, financial market reform to allow mortgages of the newly titled property has yet to occur.

- **The financial sector.** Access to credit for many businesses is still limited. The ratio of private sector credit to GDP in Peru lags behind that of many other countries and is lower than that of many poorer countries in other parts of the world. Experience in Peru contrasts markedly with Bank efforts in Romania, where successful secured transactions reform has resulted in a large increase in access to credit for the private sector.

- **Foreign investment** also remains at chronically low levels. Peru initially saw an encouraging increase in FDI levels in the mid-1990s, but the external shocks of El Niño and the Asian and Russian crises scared off investors, and protracted political issues have kept foreign investors away.

- **Regulation.** Labor regulations reduce flexibility and encourage informality. It is estimated that the regulation imposes a tax on employers of 50 percent of wages. Business registration has improved, but it still takes a long time to register (83 days, down from 289). Bankruptcy still takes too long (2–3 years) to resolve.

- **Contract enforcement** remains length and costly. Businesses still seem to view the legal structure as almost irrelevant—they usually confine transactions to those whom they know well. In surveys of Peruvian businesses, the overwhelming majority claimed that the court system would not adjudicate disputes impartially, delays were long, and judges were untrained in commercial law and open to influence.

**Lessons**

Unlike in many other countries, the Bank’s early focus on microeconomic IC issues was apparent in a series of high-quality analytical reports throughout the 1990s. In fact, many of the later reports identified issues that had been raised in earlier reports: regulation, policy uncertainty, infrastructure, a weak judiciary, underdeveloped financial markets, and poorly protected property rights. This suggests that either there was some repetition in this work or that the priority IC issues had not been addressed.

Despite successive Bank CASs that established PSD as a priority, a comprehensive strategy for doing this was not prepared. Although critical constraints to PSD had been identified in ESW, they were not pulled together into a cohesive IC action plan that could be reviewed and updated on a regular basis.

Evidence from interviews conducted for this evaluation suggests that the Bank is not communicating sufficiently with either the public or the private sector. The private sector does not see the Bank as considering its view important in terms of project efforts and complained of rarely being consulted.
Part III

IFC Experience
Summary

This report is part of a joint Independent Evaluation Group (IEG) evaluation of World Bank Group (WBG) investment climate activities based on an Approach Paper issued to the Board Committee on Development Effectiveness (CODE) in November 2002, to help inform pursuit of the WBG’s Private Sector Development (PSD) Strategy (April 2002).

The objective of the IEG-International Finance Corporation (IFC) review is to inform IFC’s strategy for addressing investment climate (IC). IFC has been increasing its IC activities, mostly through non-investment operations, yet no evaluation has been done to date to take stock of the overall IFC IC experience from fiscal 1993–2002 and lessons learned. Similarly, the Bank has been increasingly active in IC operations both unilaterally and bilaterally with IFC. The study also aims to draw lessons from the Bank, IFC, and Multilateral Investment Guarantee Agency (MIGA) coordination on IC activities.

Productive private sector investments create jobs and contribute to economic growth, helping to reduce poverty and improve people’s lives. But the private sector invests and thrives only where it can use resources efficiently, and a favorable investment climate is an important factor in that determination. The importance of investment climate for firm performance is also evident in IFC investment operations. IFC achieved higher development and investment outcome success rates when the investment climate improved from high risk to middle risk between approval and evaluation; when the investment climate deteriorated, success rates dropped below average. IFC also achieved better investment outcomes in countries with good investment climates at either the time of approval or evaluation. That is, both the quality of investment climate and its direction of change affected IFC investment outcomes, suggesting a robust positive relationship between the investment climate and investment success. Moreover, certain aspects of investment climate were most highly correlated with investment success: trade openness, a dynamic banking and finance sector, effective government regulation, and the absence of black markets.

Improving investment climates of client countries features as one of IFC’s three main activities described in its articles of association. Section (iii) of Article I (Purpose) calls for IFC to “help create conditions conducive to the flow of private capital,” in direct reference to improving investment climates as a distinct activity from catalyzing and financing investments. In this
## Definitions

### Investment operations:

**Company:** The entity implementing the project and, generally, IFC’s investment counter-party; for financial markets operations, it refers to the financial intermediary (or fund manager), as distinct from its portfolio of International Finance Corporation (IFC)-financed subproject companies.

**Investment:** IFC’s financing instrument(s) in the evaluated operation: loan, guarantee, equity, underwriting commitment, etc.

**Operation:** IFC’s objectives, activities, and results in making and administering its investment.

**Project:** The company objectives, capital investments, funding program, and related business activities being partially financed by IFC’s investment selected for evaluation.

*Example:* “Through this operation IFC provided $55 million for the company’s $100 million cement manufacturing expansion project in the form of a $20 million A loan, a $30 million B loan from commercial banks, and a $5 million equity investment.”

### Financial markets projects:
All projects where the company is a financial intermediary or financial services company, including agency lines and private equity investment funds.

### Nonfinancial markets projects:
All other projects; sometimes referred to as “real sector” projects.

### Non-investment operations:

**Outcomes of non-investment operations:** Outcomes refer to implementation of recommendations or advice.

**Impacts of non-investment operations:** Impacts refer to the changes that occurred following the implementation of recommendation.

*Example:* A technical assistance operation recommended that the country amend the leasing law to incorporate best practices in similar markets in the region. Outcome—the country amended the leasing law in accordance with the recommendation. Impact—the leasing industry became attractive to potential sponsors as evidenced by new companies that were established following the amendment of the leasing law.
context, IFC has provided Technical Assistance and Advisory Services (TAAS) to governments to help them shape the conditions for promoting private investment and foreign direct investment (FDI). In doing so, as a company financier IFC is able to bring to bear its detailed knowledge of policies and institutions that either facilitate or hinder sustainable growth of private enterprises.

IFC has long recognized investment climate as important in achieving its performance objectives but has only recently made improving investment climate a distinct activity for achieving strategic objectives. In its current corporate strategic directions paper, IFC includes scaling-up advice to country governments on general IC issues and privatization as a means to strengthen the focus on frontier markets. Despite the increased importance of IC activities in recent years, IC TAAS work has been encouraged not in its own right but as an instrument for growing a pipeline of viable investment opportunities in pursuit of the frontier and small- and medium-sized enterprise (SME) strategies. In that context, IC TAAS work in IFC has been seen as the servant of work on investment operations, because until now, only investment operations have been tracked in IFC’s performance measures and related incentives.

IFC helps improve investment climates through its non-investment TAAS operations and as a consequence of its investment operations. Although all successful investment projects may have positive impacts on investment climate, IFC investments in high-impact strategic sectors (infrastructure, financial, and social sectors) contribute most significantly and directly to improving investment climates. These projects directly address some of the major factors that contribute to making investment climates conducive to private investments. Private sector activities in other sectors also have byproduct impacts on investment climate, both positive and negative. On the positive side, successful private sector operations have demonstration effects both as role models for existing local companies and in stimulating new investments. Such a response indicates that the investment climate is improving or that the private sector has found ways to adapt to existing IC conditions. On the other hand, unsuccessful private sector operations, or those that depend on or help to sustain distortions for their success, can have a negative demonstration effect, suppressing private sector optimism or slowing down the momentum of reforms and stifling competitive dynamism.

IFC’s IC-related TAAS focus on identifying and removing specific constraints to private investment (usually by sector) and other bottlenecks (institutional, administrative) that constrain it. The main clients for IC TAAS are governments, but some activities have been directed at private sector clients, for example, to build their capacity to engage in policy reform dialogue with the government. IFC conducted 655 IC TAAS operations for a total cost of $167 million during fiscal 1993–2002, of which more than 90 percent was donor funded and the remainder funded by IFC. This amount represents 38 percent of all IFC TAAS activities in volume terms during that period. Private Enterprise Partnership (PEP), IFC, and donor-supported TAAS programs in the countries of the former Soviet Union accounted for about half of IC TAAS in volume terms. The amount of IC TAAS grew both in terms of volume and the number of projects over the past decade. Sharp growth in sector-specific advice reflects IFC’s corporate-level focus on pursuing strategic sector investments, particularly in financial sector advisory operations.

The evaluation of 38 IC TAAS operations in the five field-visit countries found the following:

- Quality of execution was good—92 percent of stakeholder survey responses rated it satisfactory or excellent.
- Outcomes showed attrition—48 percent thought that less than half of the recommendations or substance of the advice was implemented.
- Impacts are less clear—only 29 percent saw major improvements in issues addressed by the assignments; 31 percent could not give an opinion, largely because it was too soon to see the impacts.
There are many factors at work that contribute toward the attrition of outcomes and impacts. Establishing causality links between the technical assistance execution quality, outcomes in terms of implementation of recommendations, and impacts on the ground is problematic. Changes in policies, laws, and practices—or changes not happening—often result from numerous actions by various stakeholders and other internal and external forces.

IFC has recently introduced a number of changes in the incentives framework and organizational structure in support of taking a more strategic approach to achieving its objectives and pursuing IFC’s IC mandate. In an effort to move IFC away from an investment volume culture to one where the quality of development impact, profitability, client service, and internal corporate responsiveness matter more, departmental scorecards were introduced in 2001 and refined in 2002 to reflect the new structure with regional investment departments in charge of country programs. In line with the new organization and the IFC-wide strategy for frontier markets, the SME facilities were placed under control of the regional departments in 2003. Also in 2003, the WBG created a new joint Vice-Presidency responsible for WBG PSD strategy and the IFC Chief Economist function. Building on the WBG’s April 2002 PSD Strategy, creation of this new Vice Presidency is designed to help achieve strategic integration between Bank and IFC approaches to PSD and to help improve investment climates.

Moreover, the past year has witnessed two important initiatives: (i) formulation of a more strategic approach to developing and delivering technical assistance, including the creation of the Funding Mechanism for technical assistance to ensure sustainability and predictability of IFC’s funding for TAAS; and (ii) establishment of a monitoring and evaluation system within a results-based management (RBM) framework for IFC’s rapidly expanding TAAS business line. Senior management has endorsed the recommendations for these initiatives, and implementation is expected to take place in fiscal 2005. With these improved processes, the results-based approach to planning, executing and evaluating IFC’s TAAS, the incentives in place, and an organizational structure geared mainly to better focusing IFC’s resources and activities on country needs and IFC’s strategic priorities, IFC’s effectiveness in influencing investment climate will likely increase. The results of these changes will need to be carefully monitored with a view to appropriate fine-tuning.

Recommendations
IC work is a major component of IFC’s TAAS, and for this reason, any recommendation specific to investment climate will bear on IFC’s other TAAS. Given that this report is limited to IFC’s experience in investment climate and does not cover non-IC TAAS, it offers recommendations for management in addition to existing or forthcoming findings or recommendations from relevant working groups, studies, and literature on all non-investment operations.

Raise the profile of investment climate work. First, IFC management should elevate investment climate to an explicit strategic priority and central theme of its TAAS work. In defining how IFC will deliver its technical assistance, the regional investment departments should determine the appropriate mix of broad IC assessments, sector-specific advice, and capacity building relevant to each country’s IC needs and situation.

Enhance synergies in IC activities among different WBG units. Second, the WBG should clarify the roles of the Bank, IFC, and MIGA on IC activities, bringing corporate strategy and practice into consistency according to the country- and situation-specific comparative advantages of each institution. Effective coordination at the individual country level should encompass: (i) diagnostic IC needs assessment; (ii) WBG IC operational priorities; (iii) broad division of labor within WBG; and (iv) a common RBM framework for alignment of project planning, results measures, reporting, and associated unit and individual incentives. The process for accomplishing the above and ensuring effective coordination should be systemized and formal-
ized for every country, building on the PSD-led IC country review experience. The Foreign Investment Advisory Service (FIAS) and MIGA coordination efforts should be closely monitored to ensure they continue on track.

**Develop guidelines and procedures for TAAS operations.** Third, as part of the corporate-wide initiative to develop operating guidelines and procedures for TAAS projects, management should also consider addressing the following issues: (i) develop a quality control mechanism for advisory work that is provided to government clients; (ii) incorporate “good practice” measures into IC TAAS operations, within the RBM project planning and monitoring and evaluation (M&E) system, to enhance prospects of successful outcomes and impacts on the ground; and (iii) implement IFC-wide conflict-of-interest (COI) training to enable departments to deal with potential and perceived COI early and more proactively and ensure that current procedures are known and followed.

**Identify and track IC impacts.** Fourth, IFC should consider developing a mechanism to track and follow up on IC issues encountered in its investment operations with a view to supporting its portfolio and potential pipeline companies in addressing them, informing IFC’s IC work program, and feeding this information into the work programs of relevant WBG PSD staff charged with improving investment climate and setting country assistance strategy (CAS) priorities.
Introduction and Context: Why Is the Investment Climate Important to IFC?

“Spreading best practices to emerging markets is critical to creating the business-friendly environment that attracts investors and fosters poverty-reducing growth for countries. And firms are one of the major carriers of best practices.”

—IFC’s Chief Economist and WBG Vice President Michael Klein

Objectives

This report is part of a joint IEG evaluation of WBG IC activities to help inform pursuit of the WBG’s PSD Strategy (April 2002). It is based on an Approach Paper issued to the Board Committee on Development Effectiveness (CODE) in November 2002. The objective of the IEG-IFC review is to inform the IFC’s strategy for addressing investment climate. IFC has been increasing its IC activities, mostly through non-investment operations, yet no evaluation has been done to date to take stock of the overall IFC IC experience and lessons learned. Similarly, the World Bank has been increasingly active in IC operations both unilaterally and bilaterally with IFC. The study also aims to draw lessons from the World Bank, the IFC, and MIGA coordination on IC activities.

To achieve these objectives, the study addresses four main evaluative questions, along with subsidiary questions for each.

a. What has been IFC’s strategic approach to improving the investment climate? How did IFC implement its strategy for investment climate?

b. What is the interrelationship between IFC’s investment operations and investment climate?

c. To what extent have IFC’s non-investment operations helped improve investment climate? What are IFC’s non-investment IC operations and how significant are these operations within IFC’s overall non-investment operations? What has the quality of IFC’s assistance been? What have the outcomes and impacts been?

d. What are the implications for current and future IFC IC activities? What has worked, what has not, and why?

What Is the Investment Climate, and How Is It Operationalized in IFC?

Productive private sector investments create jobs and contribute to economic growth, helping to reduce poverty and improve people’s lives. But the private sector thrives only where it can use
resources efficiently, and a favorable investment climate is an important factor. Investment climate comprises country-specific risks and transaction costs of investing in and operating a private sector enterprise. It is driven by, among other factors, the legal, judiciary, and regulatory framework (both sector-specific and broader policies); barriers to entry and exit; market conditions for labor, finance, information, and infrastructure services; and other productive inputs. Governments can influence investment climate through prudent macroeconomic management, trade and investment policies that promote a level playing field, strong institutions, and good relationships with the private sector.

A good investment climate is important in achieving the Millennium Development Goals (MDGs) and for the success of IFC’s operations. Evidence presented in IEG-IFC’s 2002 review of evaluation findings shows that countries that have improved their investment climates over the past decade have better chances of achieving the MDGs. The fiscal 2003 and 2002 Annual Reviews also show that outcomes of IFC’s investment operations tend to be better in countries with improving investment climates. IEG-IFC’s recent individual country evaluations have also stressed the importance of good investment climate in expanding IFC’s investment operations and yielding sustainable profit contributions.

Recognized as one of the two main pillars of the WBG poverty-reduction strategy, improving investment climates is central to the current WBG PSD Strategy and IFC’s corporate strategy. The current WBG PSD Strategy indicates that “IC issues are part of a systematic and regular analysis in preparation of country strategies and will be considered routinely in the Bank Group’s country assistance strategies.” IFC’s corporate strategy focuses its priorities on frontier markets, strategic or high-impact sectors (domestic financial markets, infrastructure, information and communications technology, health and education), and support for SMEs. IFC recognizes that improving IC is a key factor in achieving its frontier markets and SME strategies. In its current corporate strategy paper (IFC 2004), IFC includes scaling up its provision of diversified advisory services and business capacity building to help improve investment climate to support strengthening its strategic focus on frontier markets (see box 14.1).

Investment climate has long been a key theme for IFC. At its inception nearly 50 years

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**Box 14.1: IFC’s 2004 Strategic Directions Address IC to Achieve Strategic Priorities**

IFC has identified five strategic priorities to increase its development impact, grow its portfolio, further strengthen its financial position, and improve market responsiveness. They are as follows: (1) strengthen the focus on frontier markets with emphasis on the SME sector; (2) build long-term partnerships with emerging global players in developing countries; (3) differentiate through sustainability; (4) address constraints to private sector investment in infrastructure, health, and education; and (5) continue to focus on the development of domestic financial markets through institution-building and the use of innovative financial products.

For many years, one of IFC’s main strategic priorities has been to focus on frontier countries. While IFC has continued to make progress in this area, it is becoming increasingly clear that to meet the challenges in these markets, IFC will have to work on two fronts. First, it will need to scale up its provision of TAAS, and second, it must take a more proactive approach to project development. IFC’s TAAS will continue to focus on both governments and private industry to improve the framework for investment and increase the capacity of businesses (mostly SMEs) to thrive and grow.

The objective of advice to governments is to create an environment for successful private sector projects, including IFC investments. It includes the work of FIAS and the SME Project Development Facilities on IC issues, work of the Advisory Services Department on privatization transactions, and Financial Markets Advisory services work on creating viable financial systems.

*Source: IFC Strategic Directions, April 2004.*
ago, IFC’s Articles of Association identified the importance of improving the investment climate in client countries as one of the three main activities by which IFC shall carry out its purpose of promoting economic development:

*The purpose of the Corporation is to further economic development by encouraging the growth of productive private enterprise .... In carrying out this purpose, the Corporation shall:

- assist in financing the establishment, improvement and expansion of productive private enterprises
- seek to bring together investment opportunities
- seek to stimulate, and to help create conditions conducive to, the flow of private capital ... into productive investments.*

IFC’s mandate as described in Section (iii) above of Article I, that is, “help create conditions conducive to the flow of private capital” refers directly to improving the investment climate. In this context, IFC has provided TAAS to governments aimed at helping them shape the conditions to facilitate private investment and foreign direct investment (FDI). IFC draws from its experience in the country as a company financier, which has enabled it to acquire detailed knowledge of policies and institutions that either facilitate or hinder the establishment or growth of private enterprises.

**Good and Improving Investment Climates Boost IFC’s Investment Project Outcomes**

IFC achieved better outcomes in countries where the quality of investment climate improved, and in countries with generally good investment climates, based on the 5-year evaluation data covering 1998–2002 for projects approved 1993 to 1997. This is consistent with the findings in IEG-IFC’s fiscal 2003 and 2002 reviews of evaluation findings using Expanded Project Supervision Report (XPSR) data covering 3-year periods, 1999–2001 and 2000–2, and findings in other IEG-IFC reports and analysis (see box 14.2). Annex III.A discusses the main measures of investment climate used by IEG-IFC and offers a comparison of selected indices.

**Dynamic analysis.** Success rates for both development and investment outcomes were higher when investment climates improved (as measured by Institutional Investor Country Credit Risk Rating (IICCR) for the dataset). In countries where the investment climate deteriorated, development and investment outcomes were significantly worse than the IFC average. Table 14.1 shows that where investment climate changed from poor to good between approval and evaluation, development outcome (DO) had a 76 percent success rate. When the quality of investment climate deteriorated, the success rate dropped to 41 percent. Investment outcomes (IO) were positive in 64 percent when investment climate improved and only in 32 percent when it deteriorated.

**Static analysis.** Similarly, countries with good investment climate at approval have on average yielded significantly better outcomes (see figure 14.1), using a broader measure of investment climate (Heritage Foundation/Wall Street Journal Index [HFO/WSJ]). Forty-nine percent of investments in countries with good investment climate over the review period achieved win-win outcomes (square 1 on right-hand box). This compares to only 39 percent of investment projects done in countries that had poor investment climate at the time of approval (square 1 on the left-hand box). Only 23 percent of projects done in good IC countries yielded low outcomes in both dimensions, so-called lose-lose outcomes (square 4 of right-hand box), compared to a higher lose-lose outcome rate of 34 percent among projects done in countries with poor investment climate. The differences of good and poor IC countries at approval are significant at the 0.02 confidence level.

A closer look at the outcome success rates shows that IFC’s IO success rates drive the higher win-win outcomes in the static analysis. IO had higher success rates in countries with good IC either at approval or at evaluation (table 14.2), and these differences are statistically significant. Projects in countries with good
IEF-IFC’s annual review in fiscal 2002 found that frontier markets tend to feature high corruption, poor governance, and political instability. Findings suggest that steady improvement in these countries’ investment climates is essential for the frontier strategy’s sustainability.

In the next year’s analysis, IEG-IFC showed that IFC has been making ever-greater efforts to find viable projects in a shrinking population of frontier countries, where there has been a significant reduction both in private capital flows and gross domestic product (GDP) absorptive capacity. In spite of these efforts, the concentration of IFC’s new commitments in high-risk countries declined somewhat between 1998 and 2003 as countries graduated. IFC is therefore complementing its investment operations with TAAS aimed at capacity building and generating a pipeline of viable investment opportunities for the future.

**China:** IEG-IFC evaluation findings show that the quality and pace of reforms, particularly in the corporate and financial sectors, is critical to the success of IFC operations in China. Regulations constrain IFC’s ability to use quasi-equity instruments, which complicates equity exits and reduces aggregate returns below sustainable levels.

**Brazil:** According to IEG-IFC evaluations, poor IFC equity outcomes were in part attributable to a difficult investment climate and notably weak corporate governance that minority investors face.

**Russia:** IEG-IFC evaluations found that a very difficult investment climate and few opportunities prompted IFC to place a strategic focus on improving investment climate through technical assistance—mainly in privatization and capital markets—before expanding investment operations. By moving quickly and effectively to address strategic, high-priority technical assistance needs in the initial years, IFC contributed materially to Russia’s transition process and earned a high level of goodwill. Given the generally poor performance of IFC investment outcomes in Russia up to 2001 (when this study was completed), this cautious investment strategy appears to have paid off well, particularly in comparison with EBRD results for the same period (1992–2001).

**Transition Economies:** IEG-IFC analysis found that difficult business environments served up few bankable investment opportunities for IFC not served by EBRD and prompted an emphasis on advisory assistance, especially in countries of the former Soviet Union, to pave the way for investment operations. Moreover, IFC investment and development outcomes were directly correlated with various indicators of investment climate (IICCR and HFO/WSJ) for this country group.

**Extractive Industries:** IEG-IFC’s analysis showed that development results of EI projects were significantly better in countries with good government effectiveness, political stability, and regulatory quality, and that investing in countries with poor governance has not on average been financially attractive for IFC. In fact, none of IFC’s 10 most successful EI investments were in a country with high levels of corruption. IFC’s equity returns were worst in countries with the poorest control of corruption and the best in countries with the highest control.
investment climates at approval had much better financial results for IFC than those in countries with poor investment climates. Similarly, projects in countries with good investment climates at evaluation performed financially better for IFC than in those with poor investment climates. For DO, though the success rates in countries with good IC are slightly higher, the difference is not statistically significant. This is possibly because IC indicators do not capture environmental, health, safety, and social performance, which is one of the four subindicators of DO. IEG-IFC’s recent impact review of China explores the main causes in more detail (IEG 2004b).

Some aspects of investment climate matter more than others. Good investment outcomes are also

---

**Table 14.1: Better Outcomes with Improving Investment Climate, Worse with Deteriorating Investment Climate**

<table>
<thead>
<tr>
<th>Movement in country risk group (IICCR at approval and evaluation)</th>
<th>Number</th>
<th>Percent</th>
<th>Development outcome success rate (%)</th>
<th>Investment outcome success rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improved from high risk to medium/low risk</td>
<td>45</td>
<td>14</td>
<td>76</td>
<td>64</td>
</tr>
<tr>
<td>Stayed medium/low risk</td>
<td>168</td>
<td>53</td>
<td>60</td>
<td>54</td>
</tr>
<tr>
<td>Stayed high risk</td>
<td>83</td>
<td>26</td>
<td>58</td>
<td>46</td>
</tr>
<tr>
<td>Deteriorated from medium/low risk to high risk</td>
<td>22</td>
<td>7</td>
<td>41</td>
<td>32</td>
</tr>
<tr>
<td><strong>Overall</strong></td>
<td><strong>318</strong></td>
<td><strong>100</strong></td>
<td><strong>60</strong></td>
<td><strong>52</strong></td>
</tr>
</tbody>
</table>

*Note: The population of this analysis includes 318 projects evaluated during 1998 and 2002. The significance level of DO for the improved group is 98 percent and 94 percent for IO. The significance level of DO for the deteriorated group is 94 percent, 95 percent for IO.*

---

**Figure 14.1: Projects Done in Good IC Countries Have Significantly Better Outcomes**

Good IC countries at approval have yielded significantly better outcomes
(318 evaluated projects approved in 1993–1997)

![Diagram showing investment outcomes]

*Note: There were five XPSRs in countries with no HFO/WSJ IC rating. Poor IC is a rating > 3.*
associated with some aspects of investment climate more than others. At the level of the 10 sub-indices of HFO/WSJ, four are strongly correlated with investment outcomes: (i) trade openness, (ii) a dynamic banking and finance system, (iii) effective government regulation, and (iv) the absence of black markets (see figure 14.2). The trade subindex is an indicator of a country’s trade openness as measured by its weighted average tariff. Lower tariffs are associated with good IC ratings. IFC’s projects in an open trade regime have access to cost-competitive inputs and output markets that are appropriate to their operations and reward relative efficiency. The banking and finance subindex is an indicator of the government’s involvement in the financial sector. Less intervention is a positive IC factor. IFC’s projects operating in a good, dynamic banking and finance environment have access to domestic finance at market cost that is not driven up to uncompetitive levels by government deficit financing. The government regulation subindex is an indicator of the extent to which business regulations are clear and uniformly applied. Straightforward and consistently applied regula-

<table>
<thead>
<tr>
<th>Investment Climate</th>
<th>Investment climate at approval</th>
<th>Investment climate at evaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percent</td>
</tr>
<tr>
<td>Good</td>
<td>112</td>
<td>36</td>
</tr>
<tr>
<td>Poor</td>
<td>201</td>
<td>64</td>
</tr>
<tr>
<td>Overall</td>
<td>313</td>
<td>100</td>
</tr>
</tbody>
</table>

Note: The total number of projects evaluated during 1998 and 2002 is 318. The quality of investment climate is measured by HFO/WSJ, with poor IC assigned a rating greater than 3. This analysis excludes five projects in countries without HFO/WSJ ratings. The differences of outcomes at approval are significant at the 99 percent level, and at evaluation at the 98 percent level.
tions that reduce the scope for corruption, rent-seeking, and bureaucratic harassment warrant a good IC rating. IFC’s projects operating in transparent and predictable regulatory environments are better able to respond to opportunities and risks as they emerge and are less subject to uncertainty and corruption. The black markets subindex is an indicator of the extent of the informal or underground economy, including illegal trading activities such as smuggling. Countries with low black market activities have good IC ratings. IFC’s projects in low black market economies are able to compete on a level playing field.

IFC clients confirm the importance of investment climate but also point to business opportunities that influence their decision to invest. Box 14.3 summarizes the main finding of IEG-IFC interviews with IFC investor clients in five country field visits. Findings from IEG-IFC’s field visits are consistent with the IC issues that have emerged in different studies. A Bank study covering 80 countries and one territory found that taxes and regulations are the leading IC constraints worldwide (Batra and others 2003). However, among developing countries (excluding China and transition Europe), corruption was the number one concern. Not many of the IFC clients IEG visited in the five countries for this study explicitly mentioned corruption as an issue. When asked about this issue, most foreign companies indicated that they are bound by their own codes of conduct, which prohibit them from participating in corrupt practices. Some have gone to court rather than yield to what appears to be harassment or extortion. However, SMEs are likely to be more affected by corruption. Because they are thinly staffed and managed, the pressure to yield to corruption is higher, according to some companies involved in providing services to SMEs.

Box 14.3: Importance of the Quality of the Investment Climate for IFC Client Investors

For this study, IEG-IFC interviewed IFC clients with mature projects in five countries (Egypt, Mozambique, Peru, Romania, and Vietnam). IEG-IFC asked what positive and negative factors in investment climate they have encountered in their operations.

On the positive side, they were unanimous in indicating that the investment climate was acceptable although they thought it could be better. They came to the country or undertook a project primarily in response to the business opportunities under the existing IC conditions. They saw opportunities in terms of access to domestic and foreign markets, strategic location, and favorably priced production inputs such as raw materials and labor. Most indicated that the existence of good and efficient physical infrastructure was necessary for them to take advantage of the opportunities in the country. While they appreciate investment incentives, the clients IEG-IFC interviewed did not think that those incentives tilted their decision to undertake the projects.

On the negative side, many respondents expressed frustrations with the quality of the regulatory framework, bureaucratic processes, weak institutions, inefficient judicial system, and underdeveloped financial markets infrastructure. The experiences include the following:

• A securities brokerage company was upbeat when the country passed legislation to allow the establishment of securities brokerages. However, due to slow progress in the enabling regulation to allow firms to go public, the number of listed companies remained small by any standard (21 companies).
• SMEs complained of what appears to be harassment through oversupervision leading to many hours of management time spent dealing with government inspectors from different ministries, including ministries of finance, economy, health, labor, environment, the tax bureau, and local government agencies and police.
• A medium-sized company reported the inefficiencies of the institutions managing the value-added tax system. While the regulation calls for a 45-day processing of value-added tax refund, actual processing can take up to nine months. This increased the working capital financing cost of the company.
• An agribusiness company had to pay up to 28,000 farmers in cash for their harvest because of weak banking infrastructure, leading to unforeseen additional working capital cost and risk to the company.
• A manufacturing company pointed to the lack of enabling guidelines on new legislation. This resulted in inconsistent interpretation of the law even between the concerned local and national agencies.
Do IFC’s Investment and Non-Investment Activities Improve Investment Climates? A Conceptual Model

IFC’s activities can affect investment climate through two main channels: non-investment operations including TAAS and investment operations. The potential outcomes and impacts of these activities on investment climate are illustrated in figure 14.3.

Non-investment operations. IFC activities with an explicit objective to improve investment climates are usually undertaken to help establish conditions for potential downstream private sector investment—including IFC investments—or as part of executing program mandates or agendas (FIAS, SME department, PSAS, PEPs, IFC’s frontier strategy). Most such IC work takes the form of non-investment operations, or TAAS, and focuses explicitly on improving the investment environment by identifying specific legal and regulatory constraints to investment (usually by sector) and other bottlenecks (institutional, administrative or other) that impede investment; recommending policy and/or legal changes (including drafting of legislation); and building government and private sector capacity to improve IC conditions. Broad IC advisory services, such as provided by FIAS, can help improve the investment climate generally, hence benefiting existing IFC investments and facilitating increased investment activity. On the other hand, more targeted sector policy or legal/regulatory advice can help prepare sectors for potential IFC investment project follow-on. However, the link between sector IC TAAS and follow-on investments is not always clearly defined or a direct motivator. For example, IFC’s technical assistance program in the countries of the former Soviet Union (pre-2000 PEP) contained little or no direct link to IFC investment: In an environment where IFC saw few immediate bankable investment opportunities, strategic priority was placed on assisting governments in moving forward with privatizations and related transition reforms needed to improve investment climates. IFC can also affect investment climate by coordinating with the Bank on IC diagnosis to inform joint country assistance strategies (CASs) and private sector assessments (PSAs). This activity is briefly addressed in Section C of this chapter and in Chapters 1–4 of this report.

Investment operations. While improving the investment climate is not necessarily a direct and explicit objective of investment operations, they affect investment climate in varying degrees. As highlighted in the 2005 World Development Report A Better Investment Climate for Everyone, specific investment transactions can “complement investment climate improvements by mobilizing a supply response and testing and demonstrating investment climate improvements” (World Bank 2005). And transac-
tions that support infrastructure development, increase the level of skills and knowledge, and establish new financial intermediaries can contribute to the investment climate more directly, especially in pioneering and bottleneck-relief situations.

The relative importance of investment operations as a channel for improving investment climate emerges dramatically when compared in US dollar terms (see figure 14.4). More than 99 percent—or $32 billion—of IFC’s total IC-impacting activity during the evaluation review period (fiscal 1993–2002) was through investment operations compared to $167 million that was expended on executing non-investment TAAS operations. These figures reflect IFC’s emphasis on investment operations as its primary line of business. In line with IFC’s relative emphasis on investment operations, the remainder of this report is organized as follows: Chapter 15 explores how IFC’s investment operations improve investment climates, and provides findings and evidence of the related outcomes and impacts; Chapter 16 describes how IFC set out to improve investment climates through non-investment and TAAS activities and investigates the outcomes and impacts of IC TAAS operations; and Chapter 17 presents a summary of the report’s main findings and recommendations.

Figure 14.4: Investment Operations Dominate IFC IC Activities in Terms of US Dollars

Note: Other sectors include oil, gas, and mining; chemicals; food and beverages; and agriculture.
IFC’s Investment Operations Show Wide Impacts on Investment Climate

Methodology and Limitations

IEG-IFC’s evaluation drew from IFC’s investment and non-investment operations over the fiscal 1993–2002 period. For investment operations, the study (i) considered IFC investment approvals and commitments data and information through the formal review period and including fiscal 2003 and (ii) drew from the 318 XPSRs prepared from calendar 1998 to 2002 for projects randomly selected from the fiscal 1993 to 1997 disbursed approvals population.

IEG-IFC focused on the PSD impact (and its components), an indicator in IFC’s XPSR evaluation framework, as a proxy of a project’s contribution to improving investment climate. Annex III.B has the detailed description of XPSR indicators and methodology, and Annex III.C contains details regarding the PSD impact indicator. There is significant convergence between the XPSR PSD impact indicator and the various components of investment climate, i.e., positive PSD component impacts contribute to overall investment climate improvements. To supplement the XPSR findings, IEG-IFC visited mature investment projects in five countries: Egypt, Mozambique, Peru, Romania, and Vietnam. IEG-IFC selected these five country field visits based on, among other factors, volume of IFC’s operations, IEG-Bank’s case study selection, and regional diversity. IEG-IFC posed three key questions to the project companies it visited: (i) What factors in investment climate have affected the project’s operations? (ii) What IC obstacles has the project encountered? (iii) What have the project’s contributions been to improving the investment climate? The study does not attempt to show causality between IFC activities and changes in the overall investment climate, as represented by a broad indicator or measure of investment climate. Many factors contribute to overall IC improvement, e.g., rule of law, corruption, property rights, trade policies, etc., and many of these factors are beyond the scope of IFC’s IC activities or ability to influence. With more complete data on the relationship between IFC investment operation impacts and investment climate, one might be able to make stronger claims.
How IFC’s Investment Operations Address Investment Climates

IFC helps improve investment climates through its non-investment operations and as a consequence of its investment operations. In investment operations, IFC supports commercially viable projects with expected developmental impacts and where there is a substantive IFC role. Impact on PSD is one of the key development impacts of IFC’s projects that is systematically addressed both at appraisal and evaluation. As mentioned above, this study uses the project’s rated impacts on PSD as a proxy indicator for it impacts on investment climate. While PSD impact is not synonymous with IC impact, many of the PSD impact indicators tracked by IFC contribute to improving investment climate, albeit in varying degrees.

IFC approved US$36.2 billion investments in 2,945 projects for its own account over the fiscal 1993–2003 period. Half of the volume (US$18.6 billion) was in IFC’s high-impact strategic sectors (as defined currently and since the strategic sector focus began in 1998), comprising infrastructure (utilities, transport, and information), financial markets, and social sectors (see figure 15.1). These sectors are a strategic priority for IFC because of their potentially high impacts in promoting sustainable PSD and economic growth. Yet the strategy to pursue investments in these sectors is not explicitly motivated by the specific objective of improving investment climate per se. Instead, improving investment climate is a byproduct of a broader strategic investment objective of maximizing IFC’s contribution to development by investing in sectors (and countries) where it can achieve greater economic impacts and high multiplier effects.

IFC’s high-impact strategic sectors, particularly infrastructure and financial markets, comprise critical elements of investment climate. High-quality, widely available, and reasonably priced infrastructure services are important parts of a good investment climate. Private sector projects in infrastructure such as those supported by IFC are designed to meet rising demand or relieve supply shortages. Access to finance at reasonable cost is likewise crucial to having a favorable investment climate. IFC’s projects in financial markets are by design

Figure 15.1: Increasing IFC’s Investment Approvals in High-Impact Strategic Sectors

![Graph showing increasing IFC's investment approvals in high-impact strategic sectors from 1993 to 2003.](image-url)
aimed at increasing access to finance by introducing new financial services or expanding existing availability to meet rising demand.

Reflecting the Beyond 2000 strategic shift that took place starting in 1998, the migration of investment projects into the high-impact strategic sectors is also shown in figures 15.2 and 15.3. The percentage of commitments in strategic sectors increased from 37 percent between fiscal 1993 and 1998, to 54 percent of all investments committed between fiscal 1999 and 2003. In terms of annual averages, US$622 million was committed in strategic sectors in fiscal 1993–98, rising to nearly US$1.2 billion in fiscal 1999–2003. Investment commitments in other sectors shrank both as a proportion of all IFC commitments and in absolute terms. In line with Management’s strategic goal of delivering enhanced development impact per investment dollar committed, IEG-IFC’s synthesis analysis of XPSR findings, presented in the next section of this chapter, finds that high-impact strategic sector investments have had better than average development and investment outcomes.
Similarly, reflecting the frontier market focus initiated by IFC Management in Beyond 2000 in 1998, the share of IFC’s investment approvals for projects in poor investment climate countries increased from about US$ 1.1 billion (52 percent of total) in fiscal 1993 to about US$ 2.3 billion (57 percent) in fiscal 2003 (figure 15.4), even though the number of countries in the poor-IC country group has been shrinking over time. In terms of annual average investment commitments over the two periods considered in figures 15.5 and 15.6, the annual average increased in absolute terms from US$1 billion between fiscal 1993 and 1998 to US$1.2 billion between fiscal 1999 and 2003. Yet the share of projects committed in poor IC countries declined somewhat from 61 percent to 57 percent between the two periods.

**Figure 15.4: IFC’s Investment Approvals in Poor IC Countries Have Grown**

**Figure 15.5: Distribution of IFC’s Investment Commitments: Good vs. Poor Investment Climate**

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a. Good IC countries are countries with an HFO/WSJ rating of 3 and below; poor IC countries are countries with an HFO/WSJ rating of greater than 3.

b. 28 countries were not rated by HFO/WSJ during the fiscal 1993–98 period and 11 countries were not rated during the fiscal 1999–2003 period.
The challenge of finding viable business opportunities in frontier and poor IC countries is considerable, given the shrinking population of frontier countries with diminishing GDP and FDI absorptive capacities. IEG-IFC’s 2003 review of evaluation findings illustrates the shrinking population of high-risk countries as defined in IFC’s frontier strategy (IICCR score of 30 or less) (IEG-IMF 2004). Similarly, while poor IC countries as defined in this paper are not fully synonymous with frontier countries as defined in IFC’s strategy, a similar shrinking trend is observed using the HFO/WSJ. For example, of the 48 IFC client countries rated by HFO/WSJ as poor investment climate (i.e., score of above 3) in 1995, only 38 remained in the poor IC group by 2003, with 13 having “graduated” to good IC and three countries falling from good to poor investment climate.

Relative GDP and FDI concentrations in high-risk countries are a proxy for such countries' share of investment project opportunities. Figures 15.7 and 15.8 show that in high-risk countries in both periods IFC’s approvals have

![Figure 15.6: Distribution of IFC’s Investment Commitments: Good vs. Poor Investment Climate and Unrated Countries](chart)

- Good IC countries are countries with an HFO/WSJ rating of 3 and below; poor IC countries are countries with an HFO/WSJ rating of greater than 3.
- 28 countries were not rated by HFO/WSJ during the fiscal 1993–98 period and 11 countries were not rated during the fiscal 1999–2003 period.

![Figure 15.7: IFC Approvals Concentration in High-Risk Countries Has Declined Less than FDI and GDP Concentrations](chart)

- Countries with IICCR of 0–30.
been much more concentrated than either GDP or net FDI and IFC’s concentration ratio in the most recent period grew to almost twice that of GDP and 3.5 times that of FDI. These data are evidence of IFC’s frontier strategy pursuit in channeling support to countries with poor investment climate, where it can have the greatest impact.

High-Impact Strategic Sector Investments Have the Strongest Direct Impacts on Investment Climate

IFC investments in strategic sectors contribute most significantly and directly to improving investment climates. These projects directly address the major drivers of making investment climates conducive to promoting private investments. As discussed in the World Development Report 2005, A Better Investment Climate for Everyone:41

- **Well-functioning financial markets** link firms to lenders and investors willing to fund their ventures and share some of the risks. They reduce firms’ reliance on internally generated cash flows and allow cash-strapped entrepreneurs to grow their firms, giving them access to external equity and debt. Well-functioning financial markets impose discipline on firms, driving efficiency both directly and by facilitating new entry into product markets. And they create opportunities for firms and households to manage risks. As a result, financial market development leads to faster growth in productivity and output. But inadequacies can create barriers to opportunities and increase costs for firms. These inadequacies are significant in developing countries (figure 15.9).

- **Good infrastructure** connects firms to their customers and suppliers and helps them take advantage of modern production techniques. Firms with access to modern telecommunications, reliable electricity supply, and efficient transport links stand out from firms without them. They invest more, and their investments are more productive. Yet in most developing countries, firms must cope with infrastructure that fails to meet their needs. The problems expressed by firms vary by region, with Africa and South Asia having poorer infrastructure than Eastern and Central Europe (figure 15.9).

- **The availability of skilled and healthy workers** shapes the decisions of firms to adopt new technologies, expand, or enter new markets. Many firms in developing countries rate skill shortages as a major constraint on their operations (figure 15.10).
Several studies, business surveys, and literature reviews show that the quality and quantity of infrastructure is an important consideration for investment decisions. IFC’s projects in strategic sectors bridge the infrastructure gap that the public sector and existing private participants are unable to fill. In power, a number of IFC’s projects provided a quick solution to chronic supply shortages, ending electricity-related business interruptions and restoring a healthy supply-demand balance. In telecoms, IFC’s projects provide businesses with communication infrastructure, allowing them to access new product and input markets. IFC’s
road, port and transport projects provide improved logistical infrastructure, lowering the cost of shipping goods to end users. In financial markets, IFC’s projects help increase access to finance and introduce new financial instruments in the sector. Investments in health and education enhance the skills and quality of local workers.

In addition to making significant direct contributions to key aspects of investment climates, IFC’s investment projects in strategic sectors have yielded significantly better development and investment outcomes (box 15.1), making IFC management’s decision to focus on these high-impact sectors justifiable from a development impact perspective.

**Projects with Demonstration Effects Have Indirect Impacts**

Investment climate affects and is affected by business activities. Investors take on risks that have the potential to generate a host of benefits to the economy and society, especially pioneering investments. Still, tracking the impacts of a private sector project on investment climate is extremely difficult.

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**Box 15.1: Strategic Sector Investments Have Yielded Significantly Better Outcomes**

Overall, the evaluated operations approved between 1993 and 1997 in today’s strategic sectors have yielded significantly better DOs and IOs than operations in other sectors. As shown in the figure below, 50 percent of strategic sector operations evaluated over the review period achieved win-win outcomes, i.e., good development outcomes as well as good investment results for IFC (square 1 on right hand box). This compares to only 38 percent of all other operations achieving win-win outcomes (square 1 on left hand box). Similarly, only 23 percent of strategic sector operations yielded low outcomes in both dimensions, so-called lose-lose outcomes (square 4 of right hand box), compared to a higher lose-lose outcome of other operations. These differences are significant at the 0.06 level, or 94 percent. These results are consistent with findings in IEG-IFC’s 2003 review of its evaluation findings for evaluated operations approved between 1995 and 1997.
In IFC, an indirect indicator of its investment projects’ impacts on investment climate is the PSD impact rating included in IEG-IFC’s project evaluation (XPSR) system. The PSD rating considers a project’s impacts beyond the project company. Like all DO indicators, PSD is rated on a with vs. without project basis. IFC applies an additionality test in deciding whether to finance a project—e.g., if a project is unlikely to go ahead on sound terms without IFC involvement—which enhances the likelihood that these projects will achieve good PSD ratings. A project earns a rating of satisfactory or better if it has demonstrable positive impacts on PSD, less than satisfactory if there are inconsequential or negative impacts on PSD. Please see Annex III.C for a complete description of a project’s PSD impacts and the rating benchmark.

For the purpose of relating it to the investment climate, this study classifies the components of the PSD impact indicator into two main IC impact categories: public sector–driven components, and private sector–driven components. The subindicators under each component are shown in table 15.1. PSD is the highest rated DO subindicator among the 318 projects from the 1993–97 approvals population. Of these projects, 233 (73 percent) had positive PSD impacts, reflecting the many positive externalities associated with sustainable private investments. Yet despite the high level of PSD impact which may contribute to investment climate at the micro level, it is difficult to show causality between IFC activities and changes in the overall investment climate besides demonstration effects or linkages, e.g., as represented by a broad indicator or measure of investment climate. In the absence of better data to capture the relationship between PSD impact and IC improvements, only associative assertions can be made.

Overall, IFC achieved PSD impact ratings of satisfactory or better in 73 percent of its evaluated investment operations. Regionally, Latin America and Caribbean Region performed best, with 84 percent of its projects’ PSD impacts rated satisfactory or better. The Sub-Saharan Africa Region and Southern Europe and Central Asia Region achieved levels comparable to the IFC average (75 percent and 73 percent, respectively), and Central and Eastern Europe Region and East Asia Pacific Region achieved slightly lower satisfactory rates of 68 percent and 70 percent, respectively. The Middle East and North Africa and South Asia Regions had lower than average rates (both 61 percent).

Project size appears not to have influenced the ability of a project to have positive PSD impacts. However, the nature and depth of impacts could differ. A leasing operation may be small in terms of project cost but it provides access to finance, mostly to SMEs, an underserved but important business segment in many developing countries. On the other hand, a large power generation project has a wide reach and directly contributes to improving infrastructure, likewise an important factor in investment climate.

**Demonstration Effects Dominate PSD Impacts**

Demonstration effect is the most common contributor of positive PSD impacts; 72 percent

<table>
<thead>
<tr>
<th>Table 15.1: Breakdown of PSD Impact (XPSR) into Various IC Components</th>
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<tbody>
<tr>
<td><strong>Public sector-driven IC components</strong></td>
</tr>
<tr>
<td><strong>Legal and regulatory changes/policy reforms</strong></td>
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<tr>
<td><strong>Physical and non-physical infrastructure</strong></td>
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<tr>
<td><strong>Robust private sector</strong></td>
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of 233 projects with satisfactory or better PSD impacts served as a role model or led to related investments (see figure 15.11). This observation is supported by a logistic (logit) regression analysis, which showed that a project is five times more likely to achieve an excellent PSD impact rating (1 percent significance level) if it has a positive demonstration effect.

While demonstration effects can indeed be significant for some projects, less important for others, and negative for some, one shortcoming of measuring this impact is linked to its qualitative nature. It is difficult to set up parameters a priori regarding any given project’s potential demonstration effect, against which it can be measured later. For example, a project to invest in the first hotel in a new tourism destination may be expected to have a demonstration effect downstream as other hotels follow, but it would be too difficult to measure that expectation at project approval. Any rigorous assessment of demonstration effect would have to be conducted on an ex post basis.

Pioneering or first-of-a-kind projects by definition have strong demonstration effects. Projects can be the first in a newly created subsector such as in leasing or housing finance. For example, IFC financed the first company to obtain a license after the enactment of a leasing law in an Asian country. Following the early success of this company, 10 other companies have established leasing operations in the country.

Projects can also be the first private investment in a newly opened sector such as infrastructure. An early entrant mobile phone company in a Latin America and the Caribbean Region country prompted other international operators to enter this market, leading to expanded coverage, service improvements, increased reliability, and lower telephone tariffs. The successful structuring and implementation of the first of five road privatizations in another Latin America and the Caribbean Region country played an important role in informing and influencing other future road privatizations in

**Figure 15.11: Demonstration Effects Are the Most Common Indirect Impacts on Investment Climate (all 233 projects evaluated in XPSRs from 1998 to 2002)**

- Demonstration effects
- Linkages
- Training
- Technology transfer/know-how
- Competition
- Local entrepreneurship
- Domestic capital/financial market
- Management skills
- Physical infrastructure
- Legal framework
- Private ownership
- Governance
- Resource allocation/mobilization
- SMEs’ access to financing

Frequency of occurrence (percent)
the country and became the model for road concession privatizations. The strong performance of the first independent power producer (IPP) in another Latin America and the Caribbean country attracted 13 other IPPs in the country.

Projects can be pioneering in terms of bringing new financiers to the country or to a sector, or in terms of debt or equity structure. A financial markets project in a Middle East and North Africa country played a major catalytic role in attracting long-term foreign funding to this country. The success of this project stimulated eight other local banks to introduce similar financial products to provide financing to SMEs. A project in Latin America and the Caribbean demonstrated that limited recourse debt financing could be arranged for a large privately sponsored infrastructure project on the basis of strong local off-take arrangements and strong sponsor support. The successful international financing of a social sector project in South Asia has aroused the interest of local commercial banks that previously considered education companies as not bankable.

Demonstration effects are not limited to pioneering projects. Investments in non-pioneering sectors can spur interest from existing and new players in the market or country. In catalyzing a competitive response, a hotel project in Africa inspired other area hotels to refurbish, raising the standards of the tourism infrastructure in the area. A financial markets project in Middle East and North Africa Region led other banks to offer similar and more innovative products in the market. A general manufacturing project in Eastern Europe attracted companies from the sponsors’ home country to set up operations in this transition country.

Strong demonstration effects can also have unforeseeable negative consequences. In the electricity sector (IEG 2003), early success of pioneering power generation projects led to an influx of private participants to the sector. On the positive side, power shortages were resolved quickly and efficiently, leading to the stability of the power infrastructure in the short to medium term. However, in some cases, such success reduced the pressure on country leadership and policy makers to pursue further reforms in other parts of the system that the private sector was counting on when they made the decision to invest. Because of stalled reforms, the transmission and distribution subsectors were unable to meet the needs of the expanded generation capacity. As a result, power plants were not operated at their optimal dispatch levels even as other parts of the country continued to suffer from supply shortages.

Failing projects do not serve as positive demonstration effects, and this can result (but not always) in less-than-satisfactory PSD ratings. For example, IFC financed a business concept—rice milling—that was not sustainable in an African country in the wake of subsequent trade liberalization. The failure of the project, especially within such a short time after implementation, discouraged similar potential foreign investments.

Other factors driving positive PSD impacts include the following:

- Projects with downstream and upstream linkages help create or expand a sustainable network of business infrastructure that the private sector needs in day-to-day operations; 44 percent of the projects with satisfactory or better PSD impacts had strong business linkages. A petrochemical project in Latin America and the Caribbean Region prompted the creation of 30 downstream companies and US$150 million in new investments.
- Projects that contribute toward the skills and knowledge of the local workforce can enhance human capital, helping to improve the investment climate; 44 percent of projects with satisfactory or better PSD impact provided transferable skills training, while 39 percent had transfer of know-how and 22 percent led to enhanced management skills. It is common for project companies to provide training to the employees who will do the job. However, some companies go beyond the necessary. An extractive industries project in Africa provided classroom and on-the-job training to nonemployees to expand the pool of administrative employees from whom the company could draw in the future.
Projects that help build efficient and reliable physical infrastructure can enhance investment climate; 21 percent of projects with positive PSD impacts created physical infrastructure that is accessible to the public. While most of these projects are in the infrastructure sector, there are also industrial projects that include infrastructure components. A cement project in Eastern Europe upgraded the local port and modernized the road leading to this port. As a result, the port provides cost-effective services to exporters and importers in that city.

Creating a transparent and predictable legal framework is the job of the public sector. However, the private sector can play a role through general public/private consultations, lobbying, negotiations for specific projects, and demonstration effects of successful investments. The sponsors of a financial markets project in the ECA region successfully lobbied the Central Bank to improve banking regulations and introduce reforms. To pave the way for the establishment of a financial markets project in Asia, the sponsors and IFC arranged for technical assistance to draft the regulations and supervisory framework for the new subsector (leasing). A food and beverage project in Central Asia was the first foreign investment in the country outside the extractive industries sector. This project triggered new legislation, including the reduction of notary fees to international levels and introduction of international accounting standards. A pioneering telecom project in Latin America and the Caribbean was consulted by policy makers on various telecom issues, which has contributed to bringing the country’s regulations in line with international standards.

Investment Projects with Positive PSD Impacts Appear to Have a Greater Influence on Investment Climates in Countries with Difficult Conditions

While overall PSD success rates in different country conditions are virtually the same, projects with positive PSD impact appear to have a more significant influence on investment climate in countries with difficult conditions. Figure 15.12 shows a higher occurrence of the different PSD impact subindicators in IFC’s projects in countries with poor investment climate (based on HFO/WSJ rating of 3 or greater), most of which are also countries IFC formally categorizes as frontier, i.e., high risk and low income. Significant demonstration effects are more common in these countries, both because IFC-financed projects tend to be of relatively large investment scale and visibility in these countries and because potential investors are alert to success stories, which do not necessarily come as often as they do in countries with better investment climates. Significant project impacts on the development of human capital through training, transfer of technology/know-how, and improvement of management skills as well as financial and physical infrastructure impacts also occur to a greater extent in difficult countries. These suggest that IFC’s strategy to tilt its efforts and resources toward frontier countries has a direct positive effect in influencing investment climate.

IFC Projects with Poor Business Performance Are an Obstacle to Improving Investment Climate

Slightly more than a quarter of evaluated projects from 1993 to 1997 had less-than-satisfactory PSD impacts. A project with no sustainable positive or with adverse impacts on PSD is rated less than satisfactory. Adverse impacts include some or all of the following elements: negative demonstration effects due to poor business performance; poor company reputation associated with a negative effect on private enterprises; project-induced or reintroduced restrictions on competition (including protection, uneven treatment of competitors, formation of a cartel, etc.), delays of reforms or entry by private enterprises, introduction of laws and regulations worsening the investment climate, etc.

Poor business performance is a major obstacle to a project’s potential for positive and sustainable PSD impacts. Of the 84 projects with less than satisfactory PSD impacts, 80 (95 percent) had poor project business performance. The projects that had negative PSD impacts despite good operating results suffered
from the failure of full privatizations and from sending the wrong signal that SME financing was not viable, given that the bank abandoned SME lending in favor of traditional borrowers.

Projects with negative impact on investment climate included a cement company in South Asia that contributed to excess supply in the domestic market. This led to unsustainably low prices that encouraged the formation of a cartel. A project in South Asia that failed due to sponsor issues resulted in a negative perception of emerging joint ventures in the social sector. A financial markets project in Eastern Europe engaged in less than good-practice leasing operations, undermining the success of the project and the leasing sector in general.
IFC’s Non-Investment Operations Have a Direct Impact on Investment Climates

Methodology and Limitations

The study did not comprehensively evaluate non-investment IC activities. Unlike investment operations, there is no existing robust evaluation database or comprehensive evaluation system for IFC’s non-investment activities.

IC TAAS operations for this study were defined as those operations containing an explicit component that advises the government on the legal and/or regulatory framework (e.g., privatization/concession law, sector regulations, etc.) or builds capacity of the regulator or government agency above and beyond conducting the specific transaction. Hence, projects that advise on transactions only (sales or transfers to the private sector) are not included. On the other hand, TA that aims to build the capacity of private sector groups to engage in dialogue with the government for policy advocacy to improve investment climates and/or educate groups of private investors on new legislation/policies or best practices in corporate governance and accounting practices is included. IEG-IFC built a database of all qualifying IC TAAS operations, but given the inconsistent, poor quality of data and information available, project costs presented in this report are not entirely reliable.

For this reason, the evaluation of non-investment operations is limited to 38 IC-related mature operations in the five field-visit countries. A logical framework-based evaluation template was used to rate IFC’s IC activities on: (i) inputs and outputs—overall quality of TA assignment and its execution (relevance; clarity of objectives/targets; responsiveness to client needs; technical/financial competence; and client acceptance of recommendations); (ii) outcomes—implementation of recommendations; and (iii) impacts—changes on the ground attributable to or consistent with the outcomes of TA and advisory work (see Annexes III.D and III.E for evaluation rating template and criteria). IEG-IFC sought the perspective of IFC clients, IFC staff, stakeholders from the private sector, government agencies, and multilateral and bilateral donors (including Bank staff). IEG-IFC made its own rating synthesis judgment based on all the ratings received.
IEG-IFC has made some adjustments to improve data quality, but figures should nonetheless be interpreted with these caveats in mind.

Given sample shortcomings (not randomly selected and small population), evaluation findings are not representative of the overall non-investment IC activities in IFC and can only offer quantitative and qualitative insights into the non-investment operations in the countries visited. However, IEG-IFC complemented these findings by drawing from various evaluations, surveys and assessments that have been done by TA provider units, such as investment departments, FIAS, PEP and the Project Development Facilities (PDFs).

For joint IFC/Bank department work, IEG-IFC took the lead in evaluating FIAS and SME department IC TAAS activities. FIAS, created by IFC in 1985, was evaluated by IEG-IFC in 1998, and IEG-IFC has recently completed an evaluation of the SME facilities. In line with the broad division of labor as defined by the PSD strategy, IEG-World Bank took the lead in identifying and assessing core IC-related activities undertaken by the newly established joint Bank/IFC PSD Vice-Presidency, notably Investment Climate Assessments (ICAs), investment climate surveys, Doing Business, and various coordination initiatives across the WBG by the joint Investment Climate Department (CIC).

**Improving the Investment Climate Receives Increased Emphasis, but Not as a Strategic Priority**

Having featured explicitly in IFC’s 1956 Articles of Association, improving investment climate has also been recognized more recently as an important factor in IFC’s pursuit of its strategic priorities. But has improving investment climate achieved the same level of strategic importance in IFC as the other two purpose activities, financing private sector enterprises and bringing together investment opportunities?

The IFC 1993 Business Plan and Budget Framework alluded to IC issues in assessing the impacts of the macroeconomic environment on IFC’s investment activities: “A third important influence of the economic environment is the impact of structural changes in the balance between the public and private sectors and the openness to trade of developing economies” (IFC 1993). The strategy for fiscal 1994 recognized that the “business environment for private investments in developing countries” was an important factor influencing IFC’s ability to deliver its investment program. A low level of emphasis continued up to the April 2000 IFC Strategic Directions, which pointed out that “IFC is in a position to complement the Bank’s efforts to improve the enabling environment for the private sector, by bringing to bear—through the country assistance strategy process—the key lessons of its transaction experience” (IFC 2000, p. i).

Subsequent IFC strategies focused more on IC activity. IFC first proposed “strengthening its investment and advisory work in support of investment climate improvements in member countries” (IFC 2001, p. 1) in 2001, and then again in 2002, 2003, and 2004. In March 2002, IFC’s Strategic Directions Paper acknowledged the “relative scarcity of good investment opportunities in many frontier markets” and stressed complementing investment work with extensive TA to “support government efforts to develop SMEs, improve the investment climate, and undertake privatizations” (IFC 2002, p. 2). Further, improvements in IC featured prominently in the PSD Strategy Paper (April 2002), linked explicitly with creating an environment of opportunity that can help provide poor people with a route out of poverty (World Bank 2002a). In a move that formally recognized the strategic importance of investment climate, the WBG announced in 2003 the creation of a new joint Vice-Presidency responsible for WBG PSD strategy and the IFC Chief Economist function. As part of this decision, the joint WBG CIC was created to standardize IC diagnostic tools, including the development of surveys for cross-country comparisons and monitoring investment climate over time by country. This places a major emphasis on systematizing and coordinating investment climate work across the WBG.

Yet despite the increased importance of IC activities in recent years, improving investment climate has not been an explicit IFC strategic priority in itself but a consequence of, and a
means of achieving, IFC’s strategic investment priorities. IC TAAS has been an instrument used to achieve investment objectives in pursuit of the frontier and SME strategies.

**IFC Emphasized Coordination with the World Bank to Help Improve Investment Climates...**

IFC’s overarching approach to investment climate for the most part of the review period was to take specific actions designed to improve coordination with the Bank, which was explicitly charged with “the leading role in establishing the enabling environment in countries with limited opportunities for IFC financing” (World Bank 1999). As articulated in the various strategy documents, IFC’s role was to complement the Bank’s efforts to improve investment climate through the CAS. In this way, IFC was to inform the direction of the country dialogue in order to enhance the quality of economic reforms supported by the Bank Group. IFC has first-hand knowledge of current issues in private sector investments and direct experience and expertise in sector-specific issues that can inform the WBG’s policy advice. Conversely, IFC’s ability to finance viable projects would benefit from the Bank’s successful efforts to help improve the quality of the investment climate at the country level. IFC’s actions to improve coordination with the Bank on IC-related themes emphasized increased joint work—either through the PSA or CAS level, or through joint departments that would improve coordination and exploit synergies. Major attempts to address IC issues as noted in past strategy documents include the following:

- **Joint World Bank-IFC PSAs.** In the 1993 Progress Report on PSD, 19 joint PSAs were initiated. In IFC’s 1994 three-year business plan, more than 25 countries were earmarked for joint PSAs. The 1996 three-year plan programmed and approved a further increase in the level of joint work with the Bank on PSAs, CASs, and sector work. Thereafter, emphasis on joint PSAs subsided as the preparation of joint CASs became more central to Bank/IFC coordination from 1997 onward.

- **Joint World Bank-IFC CAS.** The first series of joint CASs was executed in fiscal 1997 in Mexico, Poland, Egypt, and Brazil. In fiscal 1998 and 1999, 13 joint CASs were done each year, followed by an annual average of 16 in subsequent years until present. Many of the Category A CASs contain jointly formulated private sector strategies (frequently attached as an annex to the CAS), while the less intensely collaborated Category B CASs focus more on identifying areas for coordination and outline IFC’s investment/TA strategy and work program in broad, general terms. The split between Category A and B CASs is roughly half and half.

- **Joint World Bank-IFC Departments.** A joint Bank-IFC Director for East Asia was given the mandate for all PSD activities in 2000. Putting together the regional staff working on PSD and investment operations was thought to lead to better coordination. However, this pilot program was overtaken by a reorganization in IFC in fiscal 2002 that redeployed most investment staff to sector specialist departments based in headquarters, and the program was abandoned largely because the Bank and IFC incentives were not consistent. Also, in 2000, a joint WBG PSA Services Group was created, combining the central PSD function from the Bank, FIAS, and IFC’s former Corporate Financial Services (subsequently called PSAPT)—which provides advisory services for privatization transactions and corporate restructurings. In 2003, a joint WBG PSD Vice Presidency was formed. At the same time, the name of PSAS changed to CIC, and the IFC privatization transaction group was taken out of the department and took over the PSAS name. CIC has developed tools to diagnose, benchmark, and monitor investment climates and has become a focal point for coordination between the Bank and IFC on IC matters. Box 16.1 presents a brief overview of these new tools and coordination efforts, which are discussed in more detail in Chapter 5. In addition, a joint IFC/World Bank SME Department was established in 2000, and its mandate includes addressing IC issues relating to SMEs. In 2003, the SME facilities (TA support) were taken out of the joint SME department and transferred to IFC’s regional investment departments with a dotted line to the SME department. Finally,
Joint Bank/IFC Global Product Groups were created in 2001 and remain in place.

- **Other WBG Coordination.** An IFC manager joined the World Bank’s PSD Sector Board in 1996, and participation continues. MIGA/IMS and FIAS developed a new protocol in 2002 that entails systematic exchange of project information with a view to conducting joint projects in appropriate areas. The FIAS/MIGA protocol is currently being updated.

The division of labor between the Bank and IFC with respect to the IC agenda is described differently in recent documents. Both the Bank and IFC indicate that they provide advice for policy reform, but the PSD strategy sees IFC as focusing on demonstration projects and institution building rather than on policy reform. According to the April 2002 WBG PSD Strategy:

IBRD/IDA shall focus on investment climate and related institution building, improvements of governance, legal and regulatory systems, financial sector policies, and public financing. IFC shall pursue demonstration projects that promote the credibility of government policies, provide additional financial services in local markets and provide political risk protection to co-financiers. Its strategy is to deploy its instruments such that they support relevant institution building, particularly in the financial sector and for small and medium enterprises.

According to the April 12, 2001, IFC Strategic Directions Paper:

IFC is to promote and support TA and

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advisory activities to improve investment climate, including appropriate institutional and policy reforms.

Subsequent Strategic Directions Papers from 2002 to 2004 also proposed strengthening IFC’s investment and advisory work in support of investment climate improvements in member countries as part of its focus on frontier markets and SMEs. IFC’s Strategy for Africa (August 2003) stresses increasing efforts to improve the investment climate, including TAAS to governments on IC issues, closer coordination with the Bank and activities to strengthen private sector dialogue with government regarding policy and regulatory reform. Moreover, new SME facilities created post-2002 promote business environment enabling activity—including advisory services to governments to improve investment climates—as an important pillar of these facilities’ strategies and business plans.

. . . And Engaged Directly in Providing Investment Climate Policy Advice

IFC has been increasingly engaged in the provision of technical assistance and advisory services, enabling it to play a “highly focused role in key areas, such as privatization and promotion of FDI as well as in helping governments establish the enabling framework for activities such as leasing and stock exchanges” (IFC 2000, p. i). Specific actions outlined in various strategy documents to strengthen the provision of these selective services include the following:

• **Donor-funded TA.** IFC has increasingly tapped Technical Assistance Trust Funds, PEP, and other donor-funded facilities to finance advisory services aimed at improving investment climate, especially for financial markets subsectors, including leasing, housing finance, and stock exchanges.

• **FIAS.** The 1993 and 1994 three-year plans proposed expanding FIAS activities. Endorsement of continuing the FIAS program was also articulated in business plans for other years in the review period.

• **Corporate governance.** IFC established a corporate governance program in 2001. Central to IFC’s mission to promote sustainable private sector investment in developing countries, the objective of this work is to add value to clients (e.g., enhance access to capital) and help IFC manage risks.

IFC addresses investment climate through the advisory and TA activities of its investment departments (both directly and with support from donor funds via Technical Assistance Trust Funds (TATF), PEP, and SME facilities) and non-investment departments (FIAS, SME department, and Private sector advisory services [PSAS]). For this study, IEG-IFC compiled a database of TA and advisory operations executed between fiscal 1992 and 2002 that have (or contain at least one component with) an objective of improving investment climate. Depending on the nature of the operation, IEG-IFC assigned them to one or more of three categories: Category 1—assistance on broad IC issues; Category 2—sector-specific assistance; and Category 3—capacity building. IEG-IFC excluded direct assistance to individual firms in the IC database.46 Table 16.1 provides examples of IC service products and highlights the major providers of these services from among the different departments and groups within IFC.

The predominant counterpart client for IFC’s IC TA is government, whose involvement is key to changing the policy and institutional framework. IEG-IFC estimates that 70 percent of all IC TAAS operations involved policy, legal or regulatory advice to government (Categories 1 and 2), and an additional 24 percent involved stand-alone capacity building of government agencies.47 Activities that build the private sector’s capacity to engage in constructive policy dialogue with the government are also included in IEG-IFC’s IC database; however, support to private sector groups represents only 6 percent of operations.

**IFC’s IC TAAS Accounts for Nearly 40 Percent of all TAAS, and Has Been Growing**

IC TAAS within total IFC TAAS. Over the period fiscal 1993–2002, IFC conducted some 655 IC TA
operations for a total cost of $167 million, or 38 percent of IFC’s total TA volume, roughly 40 percent in terms of number of operations (see figure 16.1). PEP, IFC’s donor-supported TA program in the former Soviet Union, accounted for about half of the total volume in dollar terms of IFC’s IC technical assistance program.

The number of IC TAAS operations grew significantly (figure 16.2), particularly after 1997, and the volume varied over the past decade (see figures 16.3 and 16.4). High IC TAAS volume in the early 1990s was largely attributable to the PEP program, which had several very large IC TA projects in support of privatization and land reforms. Excluding two large land reform projects done by PEP in 1993 and 1996 (one for nearly $28 million in Russia and another in Ukraine for about $11 million), the annual average between 1993 and 1997 was 40 projects for a total of $10 million; this increased to 92 projects totaling $16 million between 1998 and 2002.

TATF-funded IC TAAS activity grew sharply from 1997, which reflects IFC’s strategy of focusing on high-impact strategic sectors and frontier markets, where up-front TA is frequently required. From 2000, modest increases were attributable to SME department and IC TAAS operations by the SME department. Some of this growth was countered by an apparent decline in TATF; however, TATF financing supported roughly half of the IC TAAS operations done by the SME department, and the figures presented here are adjusted for this overlap.

The FIAS program expanded steadily over the period from roughly $2.5 million per annum to deliver 30 IC projects in 1993, to just under $5 million p.a. to deliver about 50 projects in 2002. While the FIAS program accounted for roughly the same volume spent on IC TAAS as financed

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**Table 16.1: IC Non-Investment TAAS: Defining Characteristics**

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
<th>TA provider*</th>
</tr>
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<tbody>
<tr>
<td>1. Assistance on broad IC issues</td>
<td>1. Assessment of overall investment climate (diagnostics of policy and/or regulatory framework, administrative barriers, enterprise surveys, etc.)</td>
<td>FIAS, SME department, IFC regional departments, including PEP</td>
</tr>
<tr>
<td>2. Sector-specific assistance</td>
<td>2. Advice on specific legislation or sector policy/regulations (sector assessments of constraints, policy framework, privatization advice, and assistance on drafting/amending laws)</td>
<td>IFC regional departments, including PEP and SME facilities; Global Financial Markets (and former Central Capital Markets), industry departments (e.g. Infrastructure), FIAS, PSAS (formerly CFS and PSAPT), SME Department</td>
</tr>
<tr>
<td>3. Capacity building</td>
<td>3. Capacity/institution building aimed at independent sector-specific regulators (to execute mandates effectively), government agencies (to implement reforms or apply new laws), and private sector groups (to educate the business community on the opportunities and constraints arising from policy changes, new legislation, or best practice, and to develop sustainable policy advocacy mechanisms with policy makers)</td>
<td>IFC Global Financial Markets Group (e.g., corporate governance); IFC regional departments, including PEP and SME facilities; FIAS; SME department; PSAS</td>
</tr>
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a. TA provider refers to departments and units that develop and execute advisory assignments. For the purposes of this study, we consider TATF as a funding vehicle that assists in securing project funding through facilitation and approval.

b. Examples include workshops and training programs to introduce the broader domestic private sector (not just IFC clients) to concepts contained in new laws that they may not be familiar with, such as leasing (Ukraine/Russia, PEP), secured finance (Albania, SME/SEED), or international best practice standards in business practices, such as corporate governance (e.g., Brazil) and international accounting standards to groups of firms.

c. The study recognizes that the same or similar assistance may have been given at the firm level instead of wholesale at the business association level. However, because of data constraints, the study excludes firm-level assistance. With respect to the type of assistance, the study considers only the programs that contain direct and significant policy advocacy components.
IFC’s non-investment operations have a direct impact on investment climates.

Figure 16.1: The Number of IC Operations Is Increasing within Total Non-Investment Operations

Figure 16.2: FIAS Projects Represent the Bulk of IC TAAS Operations by Number

Note: PSAS = private sector advisory services; SME = small and medium-size enterprises; FIAS = foreign investment advisory services; PDF = project development facility; TATF = Technical Assistance Trust Fund; PEP = private enterprise partnership.
Figure 16.3: Volume Varied over Time with PEP’s Large Project Size Dominating

Note: PSAS = private sector advisory services; SME = small and medium-size enterprises; FIAS = foreign investment advisory services; PDF = project development facility; TATF = Technical Assistance Trust Fund; PEP = private enterprise partnership.

Figure 16.4: Excluding PEP Volume Shows Upward Trend

Note: PSAS = private sector advisory services; SME = small and medium-size enterprises; FIAS = foreign investment advisory services; PDF = project development facility; TATF = Technical Assistance Trust Fund; PEP = private enterprise partnership.
through TATF (cumulating $33.5 million for the former and $35.6 million for the latter), FIAS completed the greatest number of projects (387) among all providing units over the review period. This compares to an estimated 211 IC TAAS operations financed through TATF and 23 financed through PEP over the review period.

Annex III.F contains a more complete description of aggregate IC TAAS (number of operations and volume in US$) by category, sector, region, and frontier-country focus. Box 16.2 summarizes some of the main aspects of IC TAAS contained in that Annex. Given the size differences and varied approaches to structuring and executing IC TAAS across programs and providing units, it is difficult to make comparative inferences on a global basis, hence each TA providing unit is discussed separately in that Annex. The Annex provides descriptive highlights of IC TAAS by investment departments (through TATF, PEP, and SME facilities) and non-investment departments (FIAS, PSAS, and SME department), with examples of types of advisory services provided by each unit.

**Funding Came Mostly from Donors, Yet Source Breakdown for IC TAAS Is Difficult to Assess**

It is difficult to determine with accuracy the sources of funding of the IC TAAS on a global level. Since the IC TAAS database was compiled separately for the analytical purposes of this study, existing aggregate figures available for donor and IFC contributions cannot be projected onto the IC TAAS population. Each project has different sources of funding from various donors, and the degree of IFC support varies by project and program. Some facilities account for IFC contribution as part of total project costs (e.g., FIAS, SME facilities), some do not (e.g., TATF-funded, PEP), and others vary from project to project (SME department, PSAS). Virtually all of the estimated $167 million cited above comes from donor funds, with IFC’s share of this amount estimated at $14 million.\(^ {50}\)

In addition to the $167 million figure, IFC provided administrative support of an estimated $11 million to PEP over the review period.\(^ {51}\)

IFC’s net contribution to PSAS over the review period was $6.6 million, and IEG-IFC estimates that only a fraction of this amount supported IC TAAS, as not all PSAS projects contained IC components, and the projects that did would have had only a portion explicitly focusing on improving legal and regulatory environment.\(^ {52}\)

Donor funding for IFC’s TA work involves a balance between IFC’s objectives and the donors’ objectives. Inevitably, this imposes some limitations on the work that IFC can undertake under a given mechanism. Some donors require that IFC hire consultants who are nationals of the donor country (e.g., TATF). Other donors support regional facilities where the funding is untied with regard to the consultants’ nationalities, but can only be used in a defined geographical area (e.g., the PDFs and the PEP program). The same is the case for thematic trust fund facilities (e.g., business enabling environment [BEE] and FIAS). IFC’s IC work has been affected by these limitations, just as is the case with other kinds of TAAS activities. At the same time, although the agreements between the donors and IFC impose limitations, donor resources have been and will remain critical for maintaining and improving IFC’s TA work.

**Recent steps taken by IFC.** As part of the Donor-Funded Operations Initiative and the **FY05 Strategic Directions**, management is setting up the Funding Mechanism for TAAS to which IFC will allocate a portion of its profits, with the objective of ensuring the sustainability and predictability of its funding sources for TAAS, while donor funding will continue to play a critical and valued role. This is part of a set of TAAS initiatives meant to develop a strategic approach to developing, executing, monitoring, and evaluating IFC’s TAAS operations.

**IFC’s Non-Investment Operations (IC TAAS) Yield Positive IC Results**

As mentioned above, IEG-IFC evaluated IFC’s non-investment IC activities in five field-visit countries for this study. For this purpose, IEG-IFC developed a template for evaluating IC TAAS projects based on (i) outputs—overall quality of design and execution of TA assignment, (ii) outcomes—implementation of TA assignment recommendations, and (iii) impacts—changes on the ground associated with the implementa-
Consistent with IFC’s frontier strategy, most IFC investment climate TAAS was done in countries with poor investment climates.

The East Asia and the Pacific and Sub-Saharan Africa Regions received the highest number of IC TAAS operations; yet in terms of US$ volume, the lion’s share went to Central and Eastern Europe ($100 million, compared to regional average of $11 million).

Most IC TAAS operations were in Categories 2 and 3 (sector specific and capacity building); these segments accounted for most IC TAAS growth, particularly since 1997.

Financial sector (investment departments through TATF) and investment policy/legal framework (FIAS) were the dominant Category 2 advisories in terms of numbers of operations.

Privatization advisories (mostly PEP) absorbed the most resources to finance only 27 projects.
tion of TA recommendations. IEG-IFC received 75 responses from 55 respondents on 38 assignments. IEG-IFC interviewed and/or surveyed people familiar with specific assignments such as government counterpart clients, task managers, investment officers, partners, consultants, business associations, and donors. IEG-IFC asked each respondent to rate IFC’s IC work on a four-point scale and assigned a numerical score for each rating as follows: Unsatisfactory—1; Partly Unsatisfactory—2; Satisfactory—3; and Excellent—4. Annex III.E contains detailed definitions and criteria for the rating scale. Box 16.3 provides a brief overview of the ratings criteria.

The study presents the evaluative ratings for non-investment operations in two ways summarized in the following two charts: (i) by

Box 16.3: Overview of IC TAAS Evaluation Ratings Criteria

1. **Overall quality of assistance** is a synthesis of ratings for the following:
   - **Relevance**—a satisfactory rating signifies that assistance addresses major priority issues, and an excellent rating means that it introduces a major new insight regarding other issues. Less than satisfactory suggests that assignment overlooks major priority issues.
   - **Clarity of targets, objectives and limitations**—satisfactory suggests that project objectives and targets are clear and comprehensive, and an excellent rating means that a performance monitoring system is also set up. Less than satisfactory is given where only some or no clear objectives/targets are outlined.
   - **Client responsiveness**—satisfactory is given where a good level of responsiveness and timely delivery of service/report is achieved, and excellent denotes extreme client satisfaction with IFC responsiveness. Less than satisfactory is assigned where one or more shortfalls in responsiveness or time of delivery was experienced.
   - **Technical/financial competence**—satisfactory is given for competence with regard to accurate facts, logical analysis, and recommendations based on findings, and an excellent rating is given for very high competence. Less than satisfactory suggests deficiencies in one or more major areas.
   - **Acceptance of recommendations**—satisfactory ratings are given where more than half to 75 percent of the major recommendations made were implemented, partly unsatisfactory is given for partial implementation, or less than half. Unsatisfactory is given when almost none of the major recommendations are implemented.

2. **Outcomes** consider the degree to which client countries implemented recommendations. An Excellent rating means nearly full implementation (75 percent to 100 percent); satisfactory ratings are assigned where more than half to 75 percent of the major recommendations made were implemented, partly unsatisfactory is given for partial implementation, or less than half. Unsatisfactory is given when almost none of the major recommendations are implemented.

3. **Impacts** attempt to measure results on the ground, which are typically longer-term outcomes. Excellent ratings are given in cases where major improvements are made and outcomes achieved are best practice or regional/global role models. A satisfactory rating is given where major improvements are made and issues/problems addressed were resolved adequately. A partly unsatisfactory rating suggests that a few improvements were made but targeted outcomes were not fully achieved. Unsatisfactory suggests that almost no impact was made, the situation was made worse, or additional problems were created.

   Establishing causality links from the TA execution quality, outcomes in terms of implementation of recommendations, and impacts on the ground is not straightforward. More often than not, changes in policies, laws, and practices are the result of numerous influences by various stakeholders and other internal and external forces. Consequently, there are problems of attribution. Moreover, given that improving the investment climate is a long-term, multifaceted process and impacts may take a while before they emerge, it takes time to not only make legislative changes, but also draft corresponding regulations and ensure the appropriate implementation of laws including changing the attitudes and incentives of administrative officials charged with enacting new procedures. These and other issues, along with related good practice measures that IFC can take to enhance its ability to achieve outcomes and impacts, are discussed in more detail in the report’s section on outcomes and impacts.

*Note: See Annex III. F for details.*
responses—in percentage shares of assigned ratings—figures 16.5 and 16.6; and (ii) by projects—in rating scores—figure 16.7. Note that due to the small sample size and other technical weaknesses associated with compiling and reporting survey information, the results presented are not necessarily fully representative of all IC TAAS. Responses from government officials represent 44 percent of total responses (33 of 75), and ratings for this group were similar to the larger sample’s ratings (see figures 16.5 and 16.6). For quality of assistance, government officials rated IFC’s work slightly higher than the rest, with more frequent ratings of excellent (27 percent, compared to 16 percent for the entire sample). Government officials tended to agree with the rest (nongovernment) of the sample regarding the degree to which IFC recommendations were implemented, with moderately higher claims of overall implementation. Yet government officials were much more positive about results on the ground, rating impacts more frequently as satisfactory or excellent (42 percent) than the rest of the sample (29 percent).

**Stakeholders Rate Quality of Assistance and Execution of IC TAAS as Very Good**

Overall quality of assistance and execution is a synthesis rating of five subindicators: (1) relevance; (2) clarity of objectives/targets; (3) responsiveness to client needs; (4) technical/financial competence; and (5) client acceptance of recommendations. Responses were nearly unanimous in expressing full satisfaction with overall quality: 76 percent of all responses rated the IFC IC technical assistance quality of assistance satisfactory and 16 percent rated it excellent (figure 16.5). The overall average score for the IC TA quality of assistance at the project level is 3.1, or above the satisfactory benchmark (see figure 16.7). In general, ratings responses did not contain significant variations and there appear to be no important performance differences among the different types of projects evaluated (e.g., by Category 1, 2, 3 department or funding vehicle).

Concerning the subindicators under Overall Quality of Assistance, IEG-IFC’s field visit–based evaluation yielded the following ratings and observations:

**Figure 16.5: Survey Responses Show Satisfactory or Better Overall Quality of Assistance, but Outcomes and Impacts Received Lower Ratings or Were Not Rated**

![Bar chart showing survey responses for overall quality of assistance, outcomes, and impacts](chart.png)

Note: All IC advisory projects conducted by IFC are considered here, including those done by IFC regional departments, industry departments (through TATF), FIAS, PSAS, and MPDF. Percentages are based on the actual number of responses given for each question—where applicable, some respondents answered with “No opinion possible.”
Figure 16.6: Responses from Government Officials Resemble Responses from Others, but with More Optimistic Views of Results on the Ground

IFC’s IC TAAS operation ratings
(based on 33 government official’s responses)

Source: IEG-IFC survey.

Figure 16.7: Ratings at the Project Level Indicate High Work Quality on All Counts

Average score of 38 IC operations

Source: IEG-IFC survey.


**Relevance.** This category received very high ratings, with 37 percent of responses claiming that IFC’s assistance addressed major priority issues and introduced major new insights regarding one or more issues, and 60 percent of responses indicating that assistance addressed major priority issues to a large extent. The overall average score based on the project level for Relevance was 3.3, the highest average ratings under Quality of Assistance. The most common rationales for the satisfactory or better rating on relevance were the fact that the assistance dealt with follow-on assignments, loan conditions of multilateral financial institutions (MFI), issues the private sector was lobbying, and/or government priorities. IEG-IFC found a high level of perceived relevance among government counterparts, yet in a few cases other stakeholders perceived the TA operation to be less relevant to the country situation. For example, government counterparts of a TATF-funded project to develop the secondary mortgage market in a Latin America and the Caribbean country viewed this work as highly relevant given that it was in response to a loan condition from an MFI. However, some private sector financial institution respondents opined that the assignment was ahead of its time, given that the primary mortgage market was still in an infancy stage. Meanwhile, other stakeholders familiar with the project believed that the TA was not entirely irrelevant, even if market conditions were premature, insofar as the TA may have served as a long-term strategic map for housing market (primary and secondary) development in the country, with IFC perceived as an early agent of change.

**Clarity of Objectives/Targets.** Overall, respondents reported clear and comprehensive project objectives and targets (satisfactory rating) in 84 percent of responses. Clients said that IFC delivered what it said it would, and their expectations were generally met and occasionally exceeded. While 8 percent of responses gave excellent ratings, IEG-IFC notes that none of the projects evaluated for the country case studies actually contained explicit RBM frameworks, which was a criterion for an excellent rating. Although different from formal RBM frameworks, the FIAS projects rated as excellent did incorporate specific recommendations that included building monitoring and evaluation systems and specific targets to gauge reform performance over time (see Annex III.I for overview of RBM framework).

**Responsiveness to Client Needs.** On the whole, clients viewed the speed and timeliness of IFC’s response as more in line with commercial standards than those of donor providers of advisory services. A few cases of long waiting periods for delivery of advice were cited. Many respondents contrasted IFC with the Bank, expressing frustration with the Bank’s limited ability to respond to requests from government clients to provide TA in specific areas that were not included in the CAS lending and nonlending program. In many instances, IFC TA assignments filled gaps where the Bank could not be more responsive to the PSD needs of government clients in the short to medium term.

**Technical/Financial Competence.** While almost all responses rated the technical and financial competence of IFC’s TAAS teams and advice good or very high (90 percent) with regard to accuracy, logical analysis and recommendations based on findings, numerous clients expressed a desire to make more use of regional and other developing country good practice experiences. Overall, the role of IFC in managing the TA was appreciated and seen as valuable, especially in light of the transaction experience IFC brings to the table. IFC staff’s up-to-date, hands-on experience was seen as complementing the expert advice of external consultants who may be very knowledgeable on theories and practices but may not have current experience. Notwithstanding these high marks, a frequently heard criticism was that experts were typically brought in from industrialized nations with models and practices that were not entirely appropriate for local conditions and circumstances. In a number of cases, clients and stakeholders thought that TA teams had a prepackaged solution before they could have a full understanding of the local conditions. Moreover, clients occasionally drew attention...
to the lack of in-depth local knowledge needed to make the most of a TA operation and to IFC’s inability to present the report in the local language. This is particularly an issue where TA-funded consultants, and to some extent IFC sector specialists, have weak country knowledge. The extensive use of well-screened local consultants was identified by PEP staff as one of the key factors that contribute to its project successes by allowing the project teams to build both effective working relationships and credibility in the local community.

• **Acceptance of Recommendations.** Clients generally expressed high levels of acceptance of recommendations made by IFC, with 29 percent of responses showing acceptance of nearly all (75 percent to 100 percent) major recommendations made, 47 percent accepting more than half, and 17 percent of clients accepting fewer than half of major recommendations made. Meanwhile, 5 percent of responses indicate major recommendations were not accepted. The average score based on the project level was 3.0, suggesting that overall, the majority of IFC’s recommendations were accepted. Many respondents said that they placed a high value on IFC’s private sector perspective and experience and saw IFC as a valued partner in creating conditions promoting private investment. Clients also noted that while they largely accepted IFC’s recommendations, translating acceptance into implementation required a local champion and broad political support, and that IFC’s ability to exert influence over the various external factors was indeed limited.58

While IEG-IFC found only minimal quality issues in the small evaluated sample, it observed that in many instances the IO/Task Manager was the only IFC representative responsible for finalizing consultants’ inputs and for presenting final reports and recommendations to government officials under the IFC logo.59 Without any well-structured quality control mechanism in place to review advice or reports for a significant amount of advisory work delivered to clients on its behalf, IFC runs a reputational risk in the event that the advice is either inappropriate or is of poor quality. This issue should be addressed as part of a forward-looking strategy to develop and strengthen IFC’s IC technical assistance line of business.

Other sources of information support IEG-IFC’s general finding that clients value the quality of IFC’s work. While supplemental independent evaluations of quality of IFC’s TA are not available for a sample that represents all different types of IC TA assignments, FIAS’s work quality has been assessed through IFC and IEG client surveys a number of times over the past several years (see box 16.4 for a brief description of FIAS advisory services products). When clients were asked to rate the quality of FIAS’s advice, the 1998 IEG-IFC evaluation produced the following responses.60 100 percent said the technical competence was either excellent or good; 91 percent rated FIAS either excellent or good with regard to responsiveness to client needs; and 82 percent said they thought FIAS’s timeliness was either excellent or good, while 19 percent rated it fair. Moreover, the 1998 IEG-IFC evaluation found that nearly two-thirds of FIAS’s clients had had repeat assignments, which implies a relatively high level of satisfaction. Box 16.5 presents key evaluative findings of the strong points and criticisms of FIAS from the 1998 IEG-IFC study. With regard to overall client acceptance of recommendations, FIAS’s Project Impact Monitoring (PIM) system, which evaluates all projects conducted between fiscal 1999 and 2002, shows that only 2.2 percent of FIAS’s recommendations were outright rejected by clients, the remainder being accepted either in full or in part. (Annex III.G summarizes the PIM system and highlights major findings; IEG-IFC did not validate these self-evaluation findings.)

IFC’s Advisory Client Surveys done in fiscal 2002 and 2003 reported that all clients surveyed were satisfied with the assistance they received from FIAS.61 All respondents valued FIAS as a neutral partner with global reach, strong technical competence and cross-country experience that designs, executes and delivers its advisory projects well, based on a strong client focus and good communications skills. Figure 16.8 provides more detailed information, ranking the
### Box 16.4: Overview of FIAS Advisory Services

FIAS offers a range of services to help governments attract FDI. Some common areas of assistance are:

**Diagnostics**—Identify a country’s main policy impediments to productive FDI. The issues typically identified include prohibitions on foreign investment in sectors or locations; restrictions on the share of foreign ownership in the equity of domestic companies; difficult administrative approval processes; restrictions on repatriation of dividends and capital; taxes; the character and functioning of legal systems; and problems foreign firms have in gaining access to land and bringing in technical and managerial staff.

**Legal and Regulatory Environment**—Review a country’s legal and regulatory environment and recommend measures in such areas as screening procedures, restrictions on the percentage of shares owned by foreigners, currency convertibility, access to land, and investment protection under national laws and international conventions.

**Administrative Barriers**—Analyze administrative barriers to both investment and subsequent production. These detailed flow-charts pinpointing problems help governments identify and eliminate counterproductive procedures, and streamline the necessary regulations that remain. FIAS has included a “self-assessment” approach to reviewing administrative barriers to investment in client countries. Under this approach, a counterpart team in the government will utilize FIAS-developed templates to collect the basic institutional information on administrative procedures for business establishment and operation in the country, following the existing norms and regulations.

**Investment Incentives**—Analyze incentives to ensure they are cost-effective.

**Investment Promotion**—Help countries design promotion institutions, adapting models that have proven effective elsewhere. It also helps these agencies formulate promotion strategies that identify competitive advantages and target specific opportunities. Strategies can be conceived on national, regional, or sectoral levels.

**Source:** FIAS Web site, www.fias.net.

### Box 16.5: Strengths and Weaknesses of FIAS Assistance

As part of the 1998 IEG-IFC study, evaluation panels composed of FIAS clients, IFC staff, and Bank staff were asked to rate FIAS’s work in selected countries.

The strong points of FIAS’s work noted:

- Authoritative, objective advice: FIAS’s advice is based on a broad range of international experience.
- Service and client orientation: Clients report that FIAS staff are agile and quick to respond to requests in a manner that serves clients well.
- Practical, pragmatic advice: FIAS’s advice is seen as sensible and action-oriented.

Criticisms of FIAS included:

- Inflexible approach: A few see FIAS as wedded to a model and reluctant to recommend second-best solutions to accommodate local constraints. This may reflect the flipside of FIAS’s strength in international best practice.
- Boiler-plate or cookie-cutter reports: Bank and IFC staff criticized reports as being too general or not tailored to a specific country. Only a small number of clients made this criticism, most of whom read only one report and acknowledge that reports which espouse general, efficacious principles can be helpful in building local support for reforms.
- Uneven quality: Some respondents noted uneven quality of FIAS’s staff or products, yet others have expressed satisfaction with every product type.

**Note:** In 2000, FIAS joined the PSD Vice Presidency, which changed to PSD VP in fiscal 2004. FIAS indicated that it has responded to the criticisms but IEG-IFC has not done a follow-up.
different aspects of FIAS’s performance in individual advisory projects, also comparing the most recent results for fiscal 2002 with those from the fiscal 1999–2001 survey. Clients rated FIAS highest on its international experience, ability to communicate findings and recommendations, project design, role as an objective partner, and client focus. On the lower end, FIAS was most criticized for insufficient project follow-up, perceived lack of innovation, weak links with IFC, and aspects related to project funding. Details of survey findings can be obtained through IFC’s Operational Strategy Department.

TATF project completion report findings generally support the positive assessment of IFC’s IC TA outputs, bearing in mind the upward bias of self-assessments and imperfect matching of the rating criteria between this indicator and IEG-IFC’s overall quality of assistance rating. While TATF’s PCR system may not offer independent assessments of the quality of IFC’s assistance, it does reflect the views of informed IFC staff who are in a position to provide insights into how well a TA assignment went. Of the total 86 task managers who provided ratings for IC TA under the PCR category overall success of the TA operation, 52 percent gave projects a rating of excellent and 33 percent good; while 10 percent of projects were assigned a partly unsatisfactory rating, and 5 percent were rated poor.

**Implementation of Recommendations Was Mostly Satisfactory, Yet Changes on the Ground Take a Long Time and Depend on Other Factors** Establishing causality links between TA execution quality, outcomes in terms of implementation of recommendations, and
impacts on the ground is not straightforward. More often than not, changes in policies, laws, and practices are the result of numerous factors and influences by various stakeholders and other internal and external forces. Perhaps a given policy change by the government, or new managerial practice in some firm, would have been adopted anyway, even in the absence of IFC’s TAAS. As such, attribution cannot be made with certainty. However, one can check whether the changes made were consistent with the recommendations or training provided by the TAAS and assess the client’s perception of the importance of IFC’s role in achieving these changes. If one finds that nothing has been done or the changes made ran counter to what had been recommended by the TAAS activity, one would know with certainty that the TAAS was not utilized in the way intended.

Despite the issue of attribution, catalyzing positive changes is not entirely out of IFC’s control. First and foremost, IFC has control over the quality of its advice, which is an important factor in determining the level of acceptance and implementation of recommendations by clients. Beyond the quality of assistance, there are other steps that IFC can take to enhance its ability to influence results and impacts. During the course of this study, stakeholders and clients provided very useful insights regarding what IFC could have done differently to be a more effective agent of change, or in other instances, which factors appeared to contribute to its success in achieving impacts. Many of these lessons learned are widely applicable, while others are project specific. The most important themes that emerged from discussions with stakeholders on projects evaluated by IEG-IFC include:

a. Strong client ownership
b. Stakeholder involvement
c. Project follow-up with focus on implementation and capacity building.

Box 16.6 presents good practice elements and strategies in more detail. These elements are also discussed in the paragraphs below, synthesized from IEG-IFC’s field visit evaluation ratings and observations and experiences from programs and evaluations of FIAS, PEP, and the SME facilities. Several of these elements were tackled in the 2005 World Development Report, particularly the importance of ensuring country ownership, engaging stakeholders and a broader group of actors to help build consensus and better policy approaches, and the importance of adapting proposals to local conditions, capacities, and priorities (World Bank 2005).

Other useful suggestions from stakeholders when asked what IFC could do to improve the outcomes and impacts of its non-investment IC work included the following:

- Do not underestimate the value of local participation. Do not go to the country with a solution looking for a problem. Hear the issues first from the locals before coming up with a solution. Involve the private sector.
- Be sensitive to local culture. Some advice and recommendations were rejected not because they were bad, but because of the presentation.
- Provide for capacity building following complex advice. Many local institutions may not have the institutional capacity to implement the recommendations.
- Get the views of the private sector when monitoring the outcomes and impacts of advisory projects.
- Improving investment climate is a complex task that takes time. A programmatic long-term approach incorporating results-based management is key.

**About Half of the Recommendations and Advice Were Largely Implemented...**

As might be expected, overall results ratings—outcomes: implementation of recommendations and impacts: changes in invest percent of responses indicate at least some extent of implementation of IFC’s recommendations: 46 percent of responses indicate that IFC’s advice was implemented to a large extent (rated satisfactory or better), and 29 percent said they were implemented in part or less than half (partly unsatisfactory), while 19 percent (rated unsatisfactory) indicated that almost none of the...
major recommendations had been implemented (see figures 16.5, 16.6, and 16.7).

Respondents cited a number of factors that have positively influenced the implementation of recommendations/advice, including the following:

- A powerful and proactive private sector lobby working through well-organized business associations
- Strong implementation assistance from locally based donor agencies
- Public/private partnership through regular dialogues and joint working groups
- Narrowly focused advice/recommendations that are relatively easy to implement
- A committed local champion and reformer with wide influence and support
- World Bank and other MFIs’ loan conditionalities (however, this is not a substitute for local buy-in and ownership of reforms).

On the other hand, barriers to implementing the IFC recommendation/advice despite the perceived good execution quality of TA include:

- Lack of or weak institutional capacity and resources
- Political infighting among affected government ministries and agencies
- Influential opposing interest groups
- Complexity of the advice/recommendations

Project follow-up for implementation. Follow-up programs are critical for implementation of reforms and achieving results on the ground. Strong local presence and/or network is needed to keep issues alive and the reform process moving forward. Due to limited resources and mandate, IFC does not always have the capacity to take on a leading role in implementation, yet it can do more by way of coordinating/sharing TA outputs and building partnerships with donors that have a strong local presence (including the Bank and multi- and/or bilateral donors) and resources needed to implement recommendations. By doing this IFC could plant the seeds to keep the issues alive and on the broader agenda for reform/implementation. Follow-up programs that appear to be particularly effective are those that contain a strong local presence, which helps to build credibility at the country level and forges close relationships with local counterparts and stakeholders, e.g., the Vietnam Business Forum. As one respondent said, “Major policy initiatives must be led locally. You can’t subcontract out an entire reform.” Often, donors with substantial resources and strong local presence are in a good position to bring about change. Lending conditionality can also produce the leverage needed to foster changes. However, IFC and World Bank staff and TA recipient clients interviewed stated that lending conditionality has often not been as successful in terms of achieving meaningful changes and producing changes on the ground as one might have anticipated, because it is not a replacement for true reform ownership/buy-in. Interviewees cited conditionality that were either too general to be effective agents of change (e.g. produce a draft law or sector study), or too specific and, hence, easily waived for disbursement.

### Box 16.6: Strategies to Boost Prospects of Achieving Better Results in TA Activities

During the course of IEG’s study, interviews with major stakeholders of IFC’s IC TA projects yielded useful information and perceptions on ingredients needed to enhance prospects of implementation of recommendations and achieve results on the ground. IEG-IFC’s findings can be summarized into three major groups of good practice:

**Appropriate client selection for a TA recipient is very important.** Client commitment to the issue should be high and the client should be seen as a likely effective champion with staying power and the political clout needed to induce change in the appropriate areas, i.e., motivated and capable of moving the process toward successful implementation.

**Stakeholder involvement is key to building local ownership and moving the process of implementation forward.** IFC can do a lot to build stakeholder involvement during a TA or advisory assignment. Examples include promoting ownership across relevant government agencies (beyond the client counterpart); private sector stakeholder participation and support; and early and active involvement of donors (multilateral and bilateral agencies). In addition to bringing in stakeholder views from the beginning of a TA operation (diagnostic stage), attempts should be made to reach out and include them in subsequent discussions, for example, through translation into local language, broad dissemination of report or findings, invitations to workshops to discuss findings/recommendations, and encouragement to become partners in dialogue with government through the formation of special committees and forums charged with designing action plans for follow-up and implementing reforms.

**Project follow-up for implementation.** Follow-up programs are critical for implementation of reforms and achieving results on the ground. Strong local presence and/or network is needed to keep issues alive and the reform process moving forward. Due to limited resources and mandate, IFC does not always have the capacity to take on a leading role in implementation, yet it can do more by way of coordinating/sharing TA outputs and building partnerships with donors that have a strong local presence (including the Bank and multi- and/or bilateral donors) and resources needed to implement recommendations. By doing this IFC could plant the seeds to keep the issues alive and on the broader agenda for reform/implementation. Follow-up programs that appear to be particularly effective are those that contain a strong local presence, which helps to build credibility at the country level and forges close relationships with local counterparts and stakeholders, e.g., the Vietnam Business Forum. As one respondent said, “Major policy initiatives must be led locally. You can’t subcontract out an entire reform.” Often, donors with substantial resources and strong local presence are in a good position to bring about change. Lending conditionality can also produce the leverage needed to foster changes. However, IFC and World Bank staff and TA recipient clients interviewed stated that lending conditionality has often not been as successful in terms of achieving meaningful changes and producing changes on the ground as one might have anticipated, because it is not a replacement for true reform ownership/buy-in. Interviewees cited conditionality that were either too general to be effective agents of change (e.g. produce a draft law or sector study), or too specific and, hence, easily waived for disbursement.
Change in government administration
- Delayed completion of TAAS
- Negative tone of the advice, putting the affected ministries on the defensive
- New developments or changes in government priorities, overtaking the IFC recommendations/advice
- Poor dissemination of the positive outcomes expected from the implementation of advice.

IEG-IFC’s 1998 evaluation of FIAS showed slightly higher implementation results, with 87 percent of respondents saying they implemented FIAS’s advice (16 percent in full; 58 percent in large part; and 13 percent in part). Notwithstanding a slightly less mature crop of projects and a different rating scale, FIAS PIM system outcomes over fiscal 2001 and 2002 reinforce the general direction of IEG-IFC’s findings. The average implementation score for fiscal 2001 projects was 2.73 on a scale of 1 to 4, where 4 represents fully implemented, 3 partially implemented, 2 accepted but not implemented, and 1 is rejected. For fiscal 2002 projects, the score was slightly lower at 2.61, and a first assessment of fiscal 2003 projects indicates a score of 2.38. This trend in higher implementation rates as time passes reflects the notion that policy reforms take time to be implemented, and hence success rates may increase over time.

More narrow sector or policy specific advice (e.g., drafting laws) appears more effective in terms of achieving results judging from the evaluation of 38 assignments in the five field-visit countries. Category 2 assignments have better than average performance in terms of delivering outcomes and impacts (see table 16.3). However, the study is unable to clearly distinguish the difference in outcomes and impacts for each category of IC work because of the small sample size of Category 1 and 3 operations.

Data from FIAS’s PIM system also offer evidence that outcome success rates for more narrowly defined or sector specific TA (Category 2) are higher than broader TAAS (Category 1). FIAS fiscal 2001 and 2002 projects that fell into IEG-IFC’s Category 2 had slightly higher average

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<tr>
<th>Table 16.2: Evaluation of IFC’s IC Technical Assistance</th>
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<td><strong>Number of responses</strong></td>
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<tr>
<td>Quality of assistance</td>
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<td>Outcomes/implementation of recommendations</td>
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<td>Impacts (changes in IC related to the TA)</td>
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Source: IEG-IFC survey.

Note: All IC advisory projects conducted by IFC are considered here, including those done by FIAS, PSAS, and MPDF.

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<thead>
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<th>Table 16.3: Quality of IC Advisory Work Rated Very Good, but Outcomes and Impacts Not as Good</th>
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<td><strong>Overall score</strong></td>
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<td>Number of projects</td>
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<td>Quality of assistance</td>
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Source: IEG-IFC survey.
scores of 2.8 compared to the Category 1 average of 2.6. It makes intuitive sense that more specific, narrowly defined TA interventions showed higher outcome ratings when compared in the same time frame with broader advisory assistance. It takes more time, effort and resources to move forward agendas of change on a broad, economy-wide level, and to show corresponding results on the ground.68

Project follow-up appears to be an important factor for enhancing outcome success prospects. The most common response heard to IEG-IFC’s question regarding what IFC could have done differently to enhance the likelihood of implementing recommendations was more proactive follow-up on behalf of IFC to assist in implementation. Recognizing that effective implementation is ultimately up to the government and for the most part out of IFC’s direct control, many government clients nonetheless stated that they simply did not have the capacity to implement recommendations without some form of follow-up assistance.

Insufficient project follow-up was also one of the weakest characteristics of FIAS service delivery, as pointed out in IFC’s advisory services client survey. Data from FIAS’s PIM also show that ratings for implementation of recommendations were higher where projects were followed up by a second or third advisory project (post-diagnostic).69 IEG-IFC’s 1998 evaluation of FIAS partially attributed its high levels of implementation to the fact that nearly two-thirds of FIAS’s clients had had repeat assignments. In addition, strong client commitment was cited as a major contributor to FIAS’s high success ratings—the fact that FIAS advises only after a government formally requests assistance and, in most cases, agrees to finance part of the costs. Hence, in the end, FIAS’s role is more to assist those governments that have a predisposition to act on its advice rather than try to convince governments to undertake unpopular reforms. These findings reinforce client and stakeholder feedback to IEG-IFC during this evaluation regarding the importance of strong client commitment and project follow-up.

As noted in box 16.7, IFC does not necessarily have to follow up on projects to produce desired outcomes in terms of implementation of reform and results on the ground. In fact, IFC may not always be in a position to develop appropriate follow-up implementation programs due to lack of resources, insufficient expertise or other constraints; however, efforts to coordinate advisory work with other donors, including the World Bank and other multilateral and bilateral agencies with active interests in the sector/country, and involve them in the implementation process, can potentially produce handsome pay-offs in terms of successful outcomes. Box 16.7 presents an example where FIAS, the World Bank and SEED worked together with donors and local stakeholders to move forward the reform process of streamlining business registration in Bosnia and Herzegovina (BiH). While concrete results on the ground had not yet been achieved in the case of BiH at the time this report was written, the example demonstrates how moving forward the process of reform requires substantial follow-up, as well as time, appropriate technical skills, resources, and political will.

The PEP model incorporates many elements of “good practice” as identified by stakeholders and discussed above, including substantial program follow-up and local stakeholder involvement.70 While no comprehensive, independent evaluation has been made of PEP to date, anecdotal evidence and program progress reports made to donors document high levels of implementation and substantial results on the ground for PEP.71 PEP has developed a results-based approach to the planning, monitoring, and evaluation of all projects. For each project, PEP defines the goals, objectives and activities, with desired results stated in specific and measurable terms. Next, PEP designs the monitoring process to track actual results during the life of the project, starting with capturing baseline data at inception and conducting midpoint evaluations to review and modify, if needed, project priorities, and performs a final evaluation to assess the effectiveness and efficiency of the project, capture the lessons learned, and assess the potential for replicating the project elsewhere. Below are examples of IFC’s IC TAAS program in
the former Soviet Union countries based on a 2002 IFC Board report. Box 16.8 provides a brief overview of PEP’s comprehensive approach to delivering TAAS.

Box 16.8: PEP’s Approach to Improving Investment Climate

PEP’s approach to delivering TAAS takes a holistic and programmatic view, with each project containing three main components:

(i) policy diagnostic to identify the problems and make specific recommendations
(ii) public relations to educate the public/stakeholders and promote reforms
(iii) training on the implications of new laws and policies (conceptual and practical) for potential beneficiaries and users.

As a result of the approach to combine policy advice with training and capacity building, most PEP investment climate TA projects were classified as both Category 2 and 3, as per IEG’s theme classification described in table 16.1.

- In cooperation with local partners, PEP helped introduce new legislation and improve existing laws affecting leasing in Russia, Ukraine, Georgia, Armenia, the Kyrgyz Republic, Tajikistan, and Uzbekistan. In Russia, Georgia, Armenia, and the Kyrgyz Republic, the legislatures passed the proposed laws. The improvements in legislation have resulted in the launch of leasing activities by the Russian subsidiaries of several international banks, including an IFC investment company in the sector.

- In Belarus, PEP’s advocacy for regulatory reform contributed to a significant simplification of taxation procedures and a limitation on the government’s ability to confiscate private property.

- In Ukraine, joint policy work with IBRD led to a decrease in inspections from an average of 76 per year to 14 and a decrease in required licenses from more than 100 to 64. PEP also participated in drafting six pieces of recently

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Box 16.7: Working Together: Donor Coordination Efforts to Streamline Business Registration in Bosnia

FIAS has been actively involved in efforts to improve the investment climate in Bosnia and Herzegovina (BiH) for over five years. In 1998, it helped draft the foreign investment law; two years later it provided assistance to develop an institutional framework for the newly created Foreign Investment Promotion Agency. As a continuation of this work, FIAS issued a report in March 2001 documenting various administrative barriers to investment in BiH. The report included an assessment of the business registration process, noting the complexity, cost, and time involved in starting a new firm, and called on the government to harmonize laws and procedures between the two entities within BiH and simplify the overall business registration process as a matter of priority.

These and other recommendations regarding constraints to investment were accepted by the government and incorporated into the Bank’s Business Environment Adjustment Credit. As part of the process to define the specific elements of the proposed Credit, including the precise actions to be taken by the government as a condition of the loan, Southeast Europe Enterprise Development (SEED) assumed responsibility for organizing and supporting a working group composed of representatives from government, private sector and international donors to consider steps to simplify the business registration process. SEED was particularly well placed to take on this role, because of its local presence, close relations with the private sector, and being part of the WBG. As part of the action plan, the working group obtained TA from DFID and the Norwegian government for developing a detailed plan to revamp and implement a new business registration system.

DFID has assumed direct responsibility for working with the government to revise the business registration process, and SEED continues to provide support. By government request, FIAS launched a project in late 2002, in partnership with SEED, to build the capacity of the government to implement these and other reforms identified in FIAS’s 2001 report and to monitor the performance of impacts on the ground through the use of periodic investor surveys.

Despite the progress in moving the process forward, more than two years after the FIAS report was delivered there has been little change in the business registration process in BiH so far. Under BAC conditionality, specific targets for reducing the steps to register a business will need to be achieved before the end of fiscal 2004.

Source: Evaluation of SEED, Nexus Associates.
adopted legislation regulating the issuance of securities and conduct of shareholders' meetings.

- In Armenia, PEP drafted the law on joint stock companies and the law on limited liability companies, adopted in late 2001. PEP also supported the establishment of the first shareholders' rights organization. The association's members numbered about 500, and in 2001 the association responded to requests for advice from about 1,500 shareholders.

In contrast to PEP, IC TA activities undertaken by the SME facilities over the review period have been limited. Recent evaluative assessments of the facilities were not able to conclude how effective these activities were and whether their benefits justified the costs:

Programs to improve the business enabling environment can potentially help even more companies. The facilities have devoted a small share of their resources to these programs. Their efforts have brought about some changes in leasing regulations and may have had some influence on attitudes. No information, however, is available on the number of SMEs reached.

Findings from recent evaluations of SEED and Mekong Project Development Facility are summarized below. Even where it appears that successful outcomes have been achieved in terms of implementation of recommendations, evidence of impact on the ground appears limited. In the case of SEED, it may be too early to detect impacts on the ground, given that the facility had existed for only three years at the time of the evaluation.

- **SEED.** A recent IEG-IFC–managed independent evaluation report on SEED (Nexus Associates 2003) identifies a number of projects aimed at legal and regulatory reform and concludes that in some cases, the assistance provided by SEED and ensuing dialogue have led to changes in specific laws and regulations. The major success in this regard has been the introduction of leasing legislation in the former Republic of Macedonia and Serbia and Montenegro. In both instances, SEED marshaled technical expertise to deal with substantive issues related to proposed reforms. However, while legislation has been passed, the report indicates that the impact on SMEs has yet to be felt, suggesting that it will take time for leasing companies to be established. In addition, despite important efforts, projects intended to build the capacity of business associations to engage in constructive policy advocacy dialogue with the government on issues facing investors have not yet yielded much success.

- **MPDF.** An IEG-IFC–managed independent evaluation conducted in June 2002 (Nexus Associates 2002) examined the outcomes of private sector discussion reports. The evaluation describes the 12 reports published by MPDF on private sector development issues in Vietnam, Cambodia, and Laos as well written and generally well received by stakeholders and concludes that the series has contributed to the policy debate within the WBG and governmental bodies. The report noted that “while a direct impact on policies is difficult to trace, one World Bank manager, who considered the reports to be very useful and encouraged MPDF to continue this program, argued that the reports provide ‘grist for the mill’ and ‘helped to change attitudes.’” The evaluation report also concluded that MPDF should broaden its view of SME policy advocacy, in close coordination with the Bank, by assuming “a more active role in influencing the debate through various forums, including the publication of PSD series, briefings for key policymakers and regular discussions with representatives of the WBG and other international donor organizations” with regard to the SME business environment reform agenda.

But Impacts on the Ground Were Harder to Detect

IEG-IFC country field visits indicate that achieving longer-term impacts through changes on the ground is even more elusive than achieving outcomes in terms of implementation of recommendations. Thirty-one percent of respondents had no opinion on this matter.
Only 1 percent of responses gave an excellent rating, indicating that major improvements were made beyond issues targeted by the TA. In one project, the reforms in the regulatory framework played a significant role in the successful privatization of a utility company, resulting in improved and more efficient physical infrastructure. Only 28 percent of responses indicate that major improvements were made which resulted in adequate resolution of targeted problems/issues. Moreover, 21 percent of responses indicate that few improvements were visible and that the targeted issue/problem was not sufficiently addressed or adequately resolved. Nineteen percent noted either no change or a negative impact since the end of the TA. A negative impact implies that the situation related to the TA had been made worse, or additional problems emerged. For example, a private sector survey respondent for an IFC IC TA to promote the secondary mortgage market in a Latin American country rated the impact on the ground unsatisfactory. In his words: “The mortgage market has not grown since the TA, and counter to IFC’s advice, the government introduced subsidized interest rates and credit guarantees, which have introduced market distortions that have made the situation more problematic.”

Discussions with IFC clients and stakeholders cited many factors at work that appear to contribute to poor impacts. The most frequently heard comment was that considering that improving the investment climate is a long-term, multifaceted process, impacts may take a while to emerge. Respondents stressed that it takes time to not only make legislative changes, but also draft corresponding regulations and to ensure the appropriate implementation of laws including changing the attitudes and incentives of administrative officials charged with enacting new procedures. One respondent commented that 10 percent of change needed is often in the legal framework, while 90 percent is in the detail at the bureaucratic level.

Similarly, respondents urged IFC not to stop its involvement after the completion of an advisory project—but to play a more active role overseeing the implementation process or managing the process of change by better explaining the benefits of reform to all stakeholders; involving private/public sectors in dialogue; setting targets and milestones for reform implementation; and monitoring and reporting results on the ground.

While some degree of insight may be gained from various anecdotal examples, such as IFC’s experience with Vietnam’s Business Forum (see box 16.9), the small sample size of IEG-IFC’s evaluation limits our ability to draw conclusions from the data gathered regarding impacts. Further, unlike Outcomes—Implementation of Recommendations, there are no other evaluative assessments of IFC’s IC technical assistance available that provide reliable and useful information regarding Impacts—Changes on the Ground from which to draw in this evaluation. Compiling even basic data on impacts is difficult to do, and programs that assess impacts are rare.

One good indicator to measure impact of TA on the ground is whether interested investors were able to undertake an investment project following an IC TAAS-related project, with or without IFC. While this is not systematically tracked across IFC, an example of sector-specific TA (Category 2) that was followed up by an IFC investment and increased activity by third-party investors is a leasing project in Vietnam. IFC started a TA operation on leasing in Vietnam in 1991 when it advised the authorities on developing the appropriate legal framework for licensing, regulation, and conduct of leasing activities. The TA operation included seminars and workshops in Korea and Vietnam and drafting of regulations. This led to opening the leasing industry to interested investors from the private and public sectors. In 1997, IFC helped establish the first leasing company in Vietnam by providing financial support. Since its inception, this leasing company has provided approximately US$35 million in lease financing to nearly 250 companies. These financial leases have enabled local enterprises to acquire a wide variety of capital goods, including machinery, office, and plant equipment. Today, the leasing market in Vietnam comprises 10 financial institutions with total leasing operations valued at about $100 million.
Recent steps taken by IFC. A systematic approach undertaken by the WBG’s PSD Vice Presidency to measure investment climate conditions through firm-level surveys and Doing Business are providing a set of standard, tangible indicators to measure impacts of broad IC initiatives over time. The availability of this information should help facilitate the monitoring and evaluation of operations under IFC’s new RBM TAAS framework.

Issues Related to Planning and Coordinating IC TAAS

Nearly 60 IFC staff (investment officers, strategists, economists, sector specialists, and investment policy officers) were asked in interviews and focus groups about how IC advisory work was developed, carried out, and coordinated with the World Bank and within IFC. In addition, two focus groups also included 16 Bank staff working in the area of PSD from the Regions of Latin America and the Caribbean, Africa, East Asia and the Pacific, Europe and Central Asia, Middle East and North Africa, and South Asia, and from Development Economies and TUDUR (Urban Unit). Some of the major themes and issues that surfaced throughout interviews with IFC staff, as well as in the joint IFC-Bank staff focus groups, are presented below. Bank-IFC coordination is further explored in the joint IEG overview report.

In general terms, coordination on the ground between the World Bank and IFC is said to be largely uneven and ad hoc. At the IFC country team level, there is a perception that IFC’s efforts to improve investment climates through the CAS mechanism are not effectively translated into the Bank’s lending...
and nonlending programs, and hence have little impact on the ground. A possible exception is FIAS’ analytical work, especially its studies of administrative barriers to investment. While no data are available to assess the degree to which these recommendations have become part of Bank lending projects, FIAS staff pointed to a number of cases where Bank conditionalities included findings and recommendations from FIAS reports, especially in countries that lacked substantive PSD analytical work. In many of these instances, FIAS is said to have provided deeper analytical work than what was available.

On a project basis, cooperation between the institutions is also said to be ad hoc and largely dependent on personal relations. Some claim to have established good coordination and achieved productive joint outcomes, while others cite a lack of responsiveness or interest of one or the other party. By and large, IFC staff interviewed for the study indicated that they take a proactive role in pushing for IC reforms if their Bank counterparts are unable to provide timely TA in a particular area. Given the 3- to 4-year shelf life of CASs, Bank staff are less able to respond quickly to fast changing business environments and opportunities. Hence Bank staff have limited flexibility and administrative budget resources to address changing IC issues. IFC prepares annual work programs and strategies for operationalizing the CAS priorities at the country level and therefore can respond to a fast changing environment. Reflecting its market-driven business model, IFC has more flexibility and is strongly motivated to push IC reform, especially where potential follow-up investments are a possibility.

IFC investment staff and sector specialists charged with managing TA noted that before moving forward with conducting the TA, the standard procedure was to check with their counterparts in the Bank to see if experts were able to provide assistance to government clients. While reasons for not taking on many of the TA assignments of interest to IFC vary by country and product, Bank counterparts are said by IFC staff to have been generally pleased that IFC was able to provide targeted, timely assistance to government clients. Both IFC and Bank staff commented on the large and complex IC agenda, and room for both IFC and the Bank to provide advice to governments. Discussions in two joint Bank-IFC focus groups of well-informed IC TAAS staff members confirmed this, as both IFC and Bank staff raised the issues related to the slow pace of WB provision of policy advice on investment climate, and inability of the Bank to allocate resources to investment climate policy advice work.

IFC specialists indicated that where the Bank and IFC have collaborated at the sector level, the Bank typically focused on broader aspects of policies and institution building (e.g., assisting the government in developing a bond market, which includes broader issues like fiscal policy management, with a focus on government issuance) and IFC took a more targeted slice of the market where it has a comparative advantage by way of skills and/or experience (e.g., advising on the corporate bond market segment). Some interviewees shared concerns regarding the lack of a real-time, private sector-informed perspective in Bank policy advice, while in the words of one person interviewed, “As a market participant, IFC has real insight and expertise on the workings of particular markets.” In such cases, IFC typically takes the lead by hiring and supervising consultants using donor funding to provide sector-specific policy advice, usually in coordination and with the support of IFC staff’s counterpart in the Bank.

The study found that within IFC, investment climate TAAS work is not strategically planned and is largely driven by the investment departments in their quest to make needed sector-specific improvements to the IC to develop a pipeline of projects which they can potentially finance. In transition and frontier countries where the private sector is small and IFC’s prospects for financing projects are limited, IFC tended to do more IC TAAS to create general opportunities for private participation, with less of an emphasis on paving the way for specific future IFC projects. Non-investment departments (e.g., FIAS, PSAS, SME department, etc.) have developed projects and programs relatively
independently from each other, from IFC regional departments, and from the World Bank country departments. Two years past the 2002 reorganization, there is no country-level program manager with accountability for planning, prioritizing, coordinating/overseeing implementation of IFC’s IC work. Monitoring and Evaluation (M&E) in IC TA is relatively new and likewise not well coordinated among the different TA providers.

Recent steps taken by IFC. Over the past year, there have been efforts across IFC to improve the strategic planning, coordination, and M&E of IFC’s TAAS work. Within IFC, there are currently two initiatives under way to develop a more systematic approach to developing, executing, monitoring and evaluating IFC’s TAAS lines of business:

- First, as part of the Donor-Funded Operations initiative, regional investment departments will now be responsible for formulating TA strategies to fit country needs, and Management will set priorities and strategic directions for the development of the TAAS lines of business. Regions will be responsible for approving all operations that come out of any TAAS unit (including non-investment departments like FIAS and PSAS) and defining how IFC will deliver all TAAS in an effort to maximize the development impact of IFC’s combined TA and investment activities.

- Second, a working group has been set up to establish a results-based management evaluation system for all IFC’s TAAS operations (see Annex III.I for a summary overview of a results-based management framework). This comprehensive system will provide a consistent and comparable framework across all types and providers of IFC TAAS. A draft framework has been developed and is currently being tested. In addition to improving the way IFC plans and coordinates TAAS at the project level within the Corporation, more strategic planning and aggregating performance patterns and lessons from project completion reports should help priority setting and coordination across the Bank Group.

In addition, as discussed above and in the IEG-World Bank report, the newly created joint PSD Vice Presidency has made significant strides in a short time in introducing tools for more focused IC work and improving coordination between the IFC and the Bank.

Overlap between FIAS and MIGA

Both FIAS and MIGA are involved in investment promotion advisory work, an integral part of the WBG’s IC activities. With regard to the gray area of potential overlap in services offered, FIAS tends to be involved more on the macro scale: FIAS helps countries design investment promotion agencies (IPAs), adapting models that have proven effective elsewhere. It also helps these agencies formulate promotion strategies that identify competitive advantages and target specific opportunities. MIGA focuses on capacity building assistance to specific IPAs, to equip them with best practice knowledge, tools, and techniques to strengthen their capacity to attract and retain foreign direct investment. To this end, MIGA provides both “hands-on” operational assistance to IPAs and a range of investment information services to assist member countries and firms contemplating direct investments. But according to a recent paper commissioned by FIAS, the current division of labor between FIAS and MIGA includes some areas in which both play a role — for example, assistance in designing marketing strategies and business plans. Annex III.J discusses the areas of overlap in more detail. This may lead to gaps or overlaps in providing advice to governments and create confusion among WBG clients about who is providing which services. While the range of products offered by both MIGA and FIAS may appear wide, as discussed in Annex III.J, the actual volume (in US$ and numbers of projects) of work done by FIAS in investment promotion products over the evaluation period has been low (just over 20 percent of total advisory services), declining sharply to 11 percent since fiscal 2001 (only four to eight projects per year).

The division of labor between FIAS and MIGA’s TA activities was addressed in the 2002 WBG Private Sector Development Strategy. This
strategy mentioned that MIGA and FIAS had developed a protocol encompassing an exchange of client requests for TA, agreements on the division of labor between both institutions, and regular (quarterly) meetings among managers and staff to harmonize work plans and joint activities. The strategy paper prescribed continuity rather than new directions for MIGAs and FIAS’s TA programs and their organizational alignment. Management is currently updating the FIAS/MIGA protocol. As a result of efforts to improve coordination between FIAS and MIGA, nearly half of the number of FIAS projects done in the gray area involves joint missions with MIGA staff and/or some form of MIGA involvement.

Neither IEG-IFC nor IEG-MIGA encountered major issues on the ground regarding the division of labor between FIAS and MIGA on investment promotion work in the five countries visited for this study. In fact, in one country, they found that the coordination between the two institutions appeared to have worked well. The IEG-MIGA IC evaluation also explored the overlaps and coordination between MIGA and FIAS in two country case studies. The two cases indicated that while there were no major conflicts, cooperation could have been better between FIAS and MIGA to provide more effective and strategic client services as “the World Bank” (see Part IV). However, neither study is able to make a conclusive finding on the FIAS-MIGA coordination or appropriate division of labor in line with expertise. While this study cannot take a view on the effectiveness of coordination, some people interviewed in the field and within the WBG who are familiar with both believe that synergies between FIAS and MIGA could be improved if the division of labor was more clearly delineated, or even if the two groups were merged under either FIAS or MIGA.

Managing Conflict-of-Interest Concerns in IC TAAS

This study’s scope did not extend to a thorough review of the WBG’s COI system and procedures. While the IEG-IFC team did not encounter any specific complaints or allegations of COI in the field, there is a concern within parts of the Bank Group that IFC’s dual role as advisor to governments on legal and regulatory matters and as a direct (prospective and existing portfolio) investor could result in potential or perceived conflicts of interest and requires careful management.

Most of IC TAAS appears not to be conflicted, or may contain at most a potential or perceived COI. For example, broad IC assessments (Category 1) address general constraints to private investment and advocate increased competition economy-wide, such advice is not linked to the financial interest of any particular investment project. Similarly, sector-specific advice focuses on improving conditions to encourage private investment in the sector by removing constraints or establishing the needed legal/regulatory framework based on international best practices. This type of advice is typically not linked to an existing IFC project and would equally benefit subsequent private investments, including a potential downstream IFC investment project once appropriate conditions are established in the sector. However, potential COI could arise where IFC is pursuing a project in parallel with providing TA on sector policies/regulations. Under these circumstances, COI rules require that the advisory work be undertaken by a separate and independent team from any IFC investment team for a potential project and that the potential COI and proposed mitigation measures be disclosed to the government client. The TA/advisory team would be expected to provide stand-alone, independent advice based on international best practice and experience, and without regard to the possibility that IFC might eventually become a lender to or investor in a project beneficiary. Annex III.K provides more discussion on the COI framework.

While the current COI guidelines and procedures may offer a robust framework for dealing with potential COI, it is difficult to determine how effective actual implementation of this system has been for IC TAAS activities falling outside the Global Product Groups and PSAS. As the COI office deals with other projects on a voluntary basis, it is not clear how many projects with potential COI were executed without following the COI rules. The COI Office
is in the process of initiating an IFC-wide training on conflict identification and mitigation. Still, some staff interviewed by IEG-IFC were not familiar with specific COI procedures and guidelines. Moreover, since March 2003, the COI Office has not been fully staffed, which has limited its effectiveness in outreach.

The COI office was not in existence over most of the period reviewed by IEG-IFC, and IEG-IFC cannot make any inferences about the possible instances or the extent to which potential COI cases may have arisen. However, it appears that virtually none of the PEP IC technical assistance (mostly privatizations, land reforms, corporate governance) contained linkages to IFC investments. The only two PEP IC technical assistance projects that resulted in IFC investment project follow-ups were in leasing in Russia and Ukraine, and these two activities were sequenced and led by separate teams. The leasing sectors in both these countries also experienced important increases in non-IFC-related private investments following the TA. Of the 16 PSAS advisory projects included in the IC TAAS database, one was followed up by an IFC investment, which was managed according to COI rules: The investment took place in sequence and was processed by a separate team. While incomplete and not representative, available data from TATF’s PCRs also shed some light on the relationship between IC TA and specific IFC projects (current or future). From the sample of IC TA assignments that contained linkages information, it appears that most IC TA had no linkages with IFC investment projects. Out of the 124 TATF-funded operations with PCR information available, 54 percent had no linkage with IFC investments, and one operation was in support of an existing investment project,79 while 24 percent (30 operations) claimed that IFC investment operations followed the TA. PCRs are usually collected at the closure of the TA activities and therefore the data on investment linkages may not be 100 percent correct, since the investments may take place (or may collapse) after the PCRs were collected. The Global Financial Markets database, which tracks and updates TA linkages with IFC investments more closely, identified two follow-up IFC investment projects out of the crop of 44 recently completed (between 2001 and 2004) enabling environment TAAS operations. The small number of follow-on investments is undoubtedly a reflection of the time required to implement reforms and provides evidence of the sequencing of TA and investments that typically occurs.
Summary and Recommendations

Summary
The quality of investment climate affects IFC’s investment project outcomes. IFC achieved better investment outcomes in countries with good investment climate based on the 5-year evaluation data covering 1998–2002.

IEG-IFC also found that where IC changed from poor to good between approval and evaluation, both the development and investment outcomes had higher than average success rates (76 percent and 64 percent, respectively, compared to IFC averages of 60 percent for DO and 52 percent for IO). When investment climate deteriorated, the development and investment outcome success rate dropped to below average levels (41 percent and 32 percent, respectively). This finding is consistent with the findings in IEG-IFC’s fiscal 2003 and 2002 reviews of evaluation findings using XPSR data covering 3-year periods, 1999–2001 and 2000–2, and findings in other IEG-IFC reports and analysis. As part of the analysis done for this study, IEG-IFC also found that good investment outcomes are more strongly associated with certain components of IC indicators: (i) trade openness; (ii) a dynamic banking and finance sector; (iii) effective government regulation; and (iv) the absence of black markets.

IFC’s business model is geared toward creating sustainable projects with demonstration effects so that private investors will follow. Improving investment climates may not be an explicit objective of IFC’s investments, but it is implicit in IFC’s purpose, mission, and frontier strategy. IFC investments in strategic sectors (infrastructure, financial, and social sectors) contribute most significantly and directly to improving investment climates. These projects directly address some of the major factors that contribute to making investment climates conducive to promoting private investments. Several studies, business surveys, and literature reviews show that the quality and quantity of physical infrastructure is an important consideration for investment decisions. IFC’s projects in strategic sectors bridge the infrastructure gap that the public sector and existing private participants are unable to fill. In financial markets, IFC’s projects help increase access to finance and introduce new financial instruments in the sector. In the social sectors, IFC’s projects help enhance the quality of human resources in the local market.

Private sector activities have byproduct impacts on investment climate, both positive
and negative. On the positive side, successful private sector operations have demonstration effects and stimulate follow-on investments, indicating that the investment climate is improving or that the private sector has found ways to adapt to existing investment climate conditions. On the other hand, unsuccessful private sector operations or those that depend on distortions for their success can have a negative demonstration effect, subduing private sector optimism or slowing down the momentum of reforms.

IFC activities with an explicit objective to improve investment climates are usually undertaken to help establish conditions for potential downstream private investment, including IFC-financed projects, or as part of advisory assignments. Investment departments tended to undertake TA necessary for ground-laying work to develop and open up sectors, or for reform needed to pursue investments in a sector. However, the link between sector-specific IC TAAS and IFC follow-up investments is not always clearly defined or a direct motivator. In transition and frontier countries where the private sector is small and IFC’s prospects for financing projects are limited, IFC focuses more on IC TAAS to create opportunities for private participation in general. Non-investment units undertake IC work as part of their strategy or mandate (e.g., PEP, FIAS, and SME Department), or as project-specific follow-on advisory transactions (e.g., PSAS privatization transactions). IFC’s IC TAAS activities in poor IC countries have been on the rise as IFC pursues its frontier markets and SME strategy, a trend that pre-dates, but supports the IEG-IFC Annual Review fiscal 2003 recommendation to tilt IC TAAS toward this group of countries. The evaluation of 38 non-investment operations in the five field-visit countries shows that:

- **Quality** was good—92 percent of responses rated it satisfactory or excellent—*but*—
- **Outcomes** could be better—46 percent thought that more than half of the recommendations or substance of the advice was implemented.

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**Figure 17.1: Range of Impacts on the Investment Climate of IFC’s Investment Operations**

Note: See Batra and Mody 2003. The paper attempts to create a “parsimonious but useful index of investment climate.” This proposed index includes the following subindicators: (1) Macroeconomic Environment; (2) Country Risk; (3) Policy and Institutions (including access to finance); (4) Policies to Enhance Competition; (5) Infrastructure; and (6) Human Development. Along the lines of this index, IEG considers the PSD impacts of its investment operations under the following subindicators: Demonstration Effects/Follow on Investments—Policies to Enhance Competition; Physical Infrastructure—Infrastructure; Financial Infrastructure—Policy and Institutions (Access to Finance); Quality of Workforce/Technical Know-How—Human Development; Policy Reforms/Regulatory Changes and Competent and Efficient Institutions—Policy and Institutions and Policies to Enhance Competition.
Impacts are less clear—only 29 percent saw major improvements in issues addressed by the assignments; 31 percent could not give an opinion, largely because it was too soon to see the impacts.

The most important themes that emerged from discussions with stakeholders on projects evaluated by IEG-IFC include the following:

(i) **Client ownership is essential.** Strong client commitment to reform and a political champion with staying power are needed for inducing change.

(ii) **Stakeholder involvement is key throughout execution.** Major stakeholders (across public sector, private sector and donor community) should be involved early on. Proactive outreach and engagement of stakeholders throughout execution (e.g., dissemination in local language, participatory workshops, etc) and shared commitment to action plan are critical to moving the reform process forward in a sustainable fashion.

(iii) **Project follow-up is critical for outcomes success.** Implementation is enhanced through follow-up projects and capacity building components. Strong local presence and/or network is needed to keep issues alive and the reform process moving forward. Partnerships with donors and other stakeholders based on a shared vision of desired outcomes and impacts, are very important for leveraging reform efforts.

**Recommendations**

This report comes at a time when IFC management is undertaking a strategic review of IFC’s noncommercial TAAS operations, including donor-funded operations, and establishing a results-based approach to planning, executing and evaluating IFC’s TAAS. IC work is a major component of IFC’s TAAS and for this reason, any recommendation specific to investment climate will bear on IFC’s other TAAS. Given that the report is limited to IFC’s experience in investment climate and does not cover non-IC TAAS, it offers recommendations for management in addition to existing or forthcoming findings or recommendations from relevant working groups, studies, and literature on non-investment operations. This study also recognizes the efforts of the WBG PSD Vice President to raise the profile of investment climate and to improve WBG coordination in the post-evaluation period.

IEG-IFC makes four clusters of recommendations derived from the findings in the preceding chapters. The recommendations are supported by suggestions for implementation.

**Raise the Profile of IC Work**

Improving investment climate is one of the WBG’s two strategic pillars for poverty reduction. It is also at the core of IFC’s mandate, yet it has not taken full center stage in IFC’s strategy. Article 1 (Purpose) of IFC’s Articles of Agreement states that, among others, IFC will seek to stimulate and help create the conditions conducive to the flow of private capital. The quality of investment climate is also important for IFC’s investment project outcomes and its ability to pursue the frontier and SME strategies. IFC has long recognized investment climate as important in achieving its strategic objectives but has only recently made improving investment climate an instrument to do so. To date, non-investment IC work in IFC has been seen as less important than investment operations. However, despite the paucity of self-evaluation reports and this report’s only partial evaluation findings on IC TAAS, this study nonetheless shows that IC TAAS can be an effective tool in improving investment climate and in paving the way for increased private sector activities.

As part of the TAAS strategic review, IEG-IFC suggests that management consider prioritizing investment climate as a central TAAS theme and elevating IC TAAS to equal footing with investment operations in terms of relevance and importance to pursing its frontier strategy. Neither one by itself is sufficient, and synergies between the two lines of work can help improve prospects for successfully implementing the frontier strategy, and enhancing IFC’s investment project outcomes. Productive private sector investments create jobs and contribute to
economic growth, helping reduce poverty and improve people’s lives. But the private sector will only go to where it can use resources efficiently, and a sound investment climate is an important consideration and outcome driver.

While IFC may have several comparative advantages in IC work, such as field presence and its affiliation with the Bank, this report found that IFC’s up-to-date transaction experience is most valuable in its IC work. For this reason, it is important that IFC continue to inform its IC work with real-time relevant transaction experience. Ideally, IFC staff with appropriate and current transaction experience should undertake or oversee IFC’s IC work, especially for sector-specific TAAS. However, under the current incentive structure, investment officers and specialists are encouraged to focus on investment transactions and not to be fully engaged in TA implementation and follow-up.

Recommendation 1: Management should consider elevating investment climate to an explicit strategic priority for IFC and a central theme of its TAAS work. The regional investment departments should define the IC agenda and appropriate product mix of broad IC assessments, sector-specific advice, and capacity building mix relevant to each country’s IC needs.

Elevating investment climate to a corporate strategic priority in IFC should give it the high profile and management attention it deserves. Moreover, IFC should be more proactive and persistent in engaging in dialogue with Bank and government counterparts, in both formal and informal contexts, with respect to improving the investment climate in client countries. Once that has emerged as a strategic priority, appropriate measures of improving investment climate should be tracked in the departmental scorecards. As part of the strategic review and planning of TAAS and building on the Africa Department’s recent initiative, an IC focus person at the country level within the regional departments should ideally be responsible and accountable for planning (strategy), coordination, execution, quality control, follow-up actions, monitoring, and evaluation.

Enhance Synergies in IC Activities among Different WBG Units

The April 2002 WBG PSD Strategy defines the broad division of labor but is not a sufficient basis for guiding day-to-day interactions as issues arise, particularly with respect to the provision of policy advice to governments. As a result, actual coordination is ad hoc at best and is driven more by individuals’ attitudes, resources, and individual unit priorities and incentives, than by a shared vision for improving investment climates. A delineation of standard operating procedures and commitment to adhere to them should help. Of perhaps greater importance is addressing the issue of non-coherent objectives across the units.

Participation in joint CASs and in WBG PSD strategy preparation has been the principal vehicle for coordinating IFC’s IC activities with the Bank. IFC strategists/economists at the investment department and corporate levels are the primary participants in preparing the joint CASs, while Investment Officers and sector specialists who bring to bear their transaction experience are often in charge of executing IFC’s IC work. Given the 3- to 4-year cycle of CASs, Bank staff are limited in their ability to anticipate and respond quickly to fast-changing business environments and opportunities, whereas IFC can more easily process IC operations. Reflecting its business model, IFC is more flexible and is strongly motivated to push IC reforms, especially where potential follow-up investments are a possibility. Moreover, the study found a general perception within IFC that the joint CASs (and PRSPs) have not been the most effective instruments for focusing attention on WBG priorities for improved investment climate on the ground. Staff interviewed expressed frustration with the seemingly piecemeal approach and slow implementation pace of policy changes aimed at improving investment climate (through mostly microeconomic reforms) at the country level. Regardless of the extent to which this perception accurately reflects reality, it underlines the need for the Bank Group to revisit certain aspects of coordination and align short- and medium-term management and team objectives of both institu-
tions to optimize efforts for achieving the Bank Group’s strategic IC agenda.

The recent appointment of a WBG PSD Vice President who is also the IFC Chief Economist has helped improve coordination through facilitating collaboration between TA providing units. The WBG PSD Vice President has convened country review meetings on investment climate that bring together staff across the Bank Group for a discussion on the challenges and approaches to improving IC on a country-by-country basis.

**Recommendation 2a:**
*The WBG should clarify the roles of the Bank, IFC, and MIGA on IC activities, bringing corporate strategy and practice into consistency according to the country- and situation-specific comparative advantages of each institution. Effective coordination at the individual country level should encompass the following: (i) diagnostic IC needs assessment (e.g., ICA); (ii) WBG IC operational priorities; (iii) broad division of labor within WBG; and (iv) a results-based management framework for alignment of project planning, results measures, reporting, and associated unit and individual incentives. The process for accomplishing the above and ensuring effective coordination should be systematic and formalized for every country, building on the PSD-led IC country review experience. Ensure that these efforts provide a basis for IFC’s inputs to the CAS.*

Keeping in mind that what gets measured gets done, examples of possible IFC measures to shape incentives structures for promoting IC improvement and effective coordination include tracking evaluated success rates for TAAS project outcomes in IFC departmental scorecards and recognizing/rewarding cross-institutional coordination by tracking responsiveness ratings by counterparts across relevant parts of the WBG (along the lines of IFC’s current tracking of internal client responsiveness).

At the same time, it would not be most efficacious to introduce the measures in IFC unless the same measures were also tracked by other parts of the Bank Group.

Both FIAS and MIGA are involved in investment promotion advisory work, an integral part of the WBG’s investment climate activities. FIAS is involved more at the macro level while MIGA focuses on capacity building assistance to specific IPAs. FIAS provides investment promotion diagnostics and policy advice as part of its broader IC activities. It brings to bear best practice models from its global and broad IC experience. The study cited a range of potential overlap in the types of advisory products and services provided to investment promotion agencies by FIAS and MIGA. However, despite the apparent wide range of gray overlap areas, the actual volume of FIAS advisory work done in investment promotion products over the period has been low, declining sharply to 11 percent since fiscal 2001 (only four to eight projects per year).

IEG-IFC did not encounter any major issues on the ground regarding the division of labor between FIAS and MIGA on investment promotion work in the five focus countries for this study. The study cannot make a conclusive finding on FIAS-MIGA coordination; in one country IEG-IFC found that the coordination between the two institutions appears to have worked well, whereas the IEG-MIGA study found instances where coordination could have been better. Management has taken steps to improve coordination between FIAS and MIGA, and nearly half of the FIAS projects done in the gray area involve joint missions with MIGA staff and/or some form of MIGA involvement. Despite increased coordination, knowledgeable people on the ground and within the WBG interviewed for this study believe that synergies could be improved if coordination efforts were strengthened.

**Recommendation 2b:**
*In view of the partial overlap between services offered by FIAS and MIGA, Management should monitor coordination improvements closely to ensure that they continue on track.*

**Develop Operating Guidelines and Procedures for TAAS Operations**
IFC has been increasing its non-investment TAAS operations, yet it has no standard operating...
guidelines or procedures for these operations. This study recognizes that there is an ongoing project in IFC to develop an M&E system for TAAS. While the rationale for an M&E system for TA and advisory assignments is clear, this study highlights the need to keep track of and evaluate IC TAAS components of privatization and other advisory assignments separately from the overall advisory assignment, which may be larger and contain transaction-specific TA as well. The operating guidelines and procedures should be a tool for undertaking all TAAS, including IC TAAS, and assist Management in controlling and maintaining consistent work quality and in accounting for results. It should also help ensure that any actual, potential, or perceived COI are dealt with through the COI Office.

**Recommendation 3:**
As part of a corporate-wide initiative to develop operating guidelines and procedures for TAAS, management should consider addressing the following issues:

- Develop a quality control mechanism for advisory work that is provided to government clients. A peer-review process should be put in place to ensure that advice provided is of high quality and reflects internationally recognized good practices and standards. Such a process may also enhance coordination efforts across the WBG.
- Incorporate good practice measures into IC TAAS operations, within an RBM system, to improve outcomes and impacts on the ground. To support this objective, a program for disseminating IC TAAS good practices and lessons learned should be developed. RBM training of staff who provide IC TAAS should help shape the structure and follow-up of operations toward results-driven outcomes.
- Implement IFC-wide COI training to enable the investment departments, as well as staff and managers that deal with IC TAAS, to deal with potential and perceived COI early and more proactively, and ensure that current procedures are known and followed. As part of a systematic TAAS approvals process, all IC TAAS operations with potential risk of COI should be screened and where actual, potential, or perceived COI exists, referred to the COI office. Where COI-related issues are identified, they should be disclosed and managed according to COI rules and procedures.

**Identify and Track IC Impacts**
IFC’s investment operations contribute to improving investment climates, while existing projects regularly encounter IC issues. To date, there is no database in IFC that tracks the impacts of its projects on investment climate to enable IFC IC TAAS staff to use them in advising other countries on the benefits of relevant needed changes. Nor is there a systematic process in place to feed IFC investment portfolio IC issues and IFC project pipeline experience (e.g., projects that did not go ahead because of an unresolved IC issue) into the WBG IC strategy or CAS agenda.

**Recommendation 4:**
IFC should consider establishing a mechanism to track and follow up on IC issues encountered with a view to supporting its portfolio and potential pipeline companies in addressing these issues, informing IFC’s IC work program, and feeding this information into the work programs of relevant WBG PSD staff charged with improving investment climate and setting CAS priorities. IFC should consider creating an IC subcategory when identifying a project’s potential development impact at entry. IFC should put this information in a database and use it as an input to the proposed holistic approach to IC activities at the country level. IFC could start with the information it tracks under the Sustainability Framework to extract data on a project’s potential impacts on investment climate.
The study (Beach and Miles 2004) uses the HFO/WSJ Index of Economic Freedom as the primary indicator of a country’s IC quality. HFO/WSJ defines economic freedom as the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself.80 HFO/WSJ is a composite of 50 variables divided into 10 subindices: Freedom of Trade; Fiscal Burden of Government; Government Intervention; Monetary Policy; Foreign Investment; Banking and Finance; Wages/Prices; Property Rights; Regulations; and Black Markets (see below for detailed description). It is based on a five-point rating scale where 1 is the best or most free and 5 is the worst or most oppressed. IEG-IFC considers countries with a rating of 3 or below as having a good investment climate, while those with rating of 4 or 5 are deemed to have a poor investment climate.

IEG-IFC uses HFO/WSJ in the absence of a uniform WBG indicator of investment climate with wide country (157) and sufficient period coverage (1995–2003). The IICCR—a measure of country sovereign risk and thus only a proxy of investment climate—has been traditionally used by IEG-IFC as an indicator of investment climate (in line with IFC’s corporate strategy to define high-risk countries). IEG-IFC uses HFO/WSJ in this report because it covers more aspects and types of business and investment issues faced by the private sector. Recent research indicates that most major IC indices are strongly positively correlated81 and IEG-IFC’s comparative analysis supports this (see below). Moreover, HFO/WSJ data are easily accessible and have clear and transparent criteria for deriving each of the subindices, which allows for more detailed and targeted assessment of the impact of different IC components/areas on IFC’s project outcomes.

Description of the HFO/WSJ Index of Economic Freedom

In the late 1980s, HFO/WSJ produced the Index of Economic Freedom as a tool for policy makers and investors. The goal then was, as it is today, to develop a systematic, empirical measurement of economic freedom in countries throughout the world. The Index, however, is more than just a dataset based on empirical study; it is a careful theoretical analysis of the factors that most influence the institutional setting of economic growth. Moreover, although there are many theories about the origins and causes of economic development, the findings of this study are straightforward: Countries with the most economic freedom also have higher rates of long-term economic growth and are more prosperous than those with less economic freedom.

The 2004 Index of Economic Freedom measures how well 161 countries score on a list of 50 independent variables divided into 10 broad factors of economic freedom. Low scores are more desirable. The higher the score on a factor, the greater the level of government interference in the economy and the less economic freedom a country enjoys.

To measure economic freedom and rate each country, the authors of the Index studied the independent economic variables falling into the following categories, or factors, of economic freedom:

- Trade policy
- Fiscal burden of government
- Government intervention in the economy

ANNEX III.A: HERITAGE FOUNDATION/WALL STREET JOURNAL INDEX OF ECONOMIC FREEDOM AND COMPARISON WITH SELECTED INDICES
• Monetary policy
• Capital flows and foreign investment
• Banking and finance
• Wages and prices
• Property rights
• Regulation
• Informal market activity.

Weighting
In the Index of Economic Freedom, all 10 factors are equally important, as the level of economic freedom in a country are weighted equally to determine that country’s overall score.

This is a common-sense approach. It is also consistent with the purpose of the Index: to reflect the economic environment in every country. The Index is not designed to measure how much each factor adds to economic growth; that is ably done in the many empirical studies of economic growth. Rather, the authors of the Index identify institutional factors that, taken together, determine the degree of economic freedom in a society. It is this institutional environment that allows economies to grow.

While the approach appeals to common sense, recent research on the determinants of growth indicates that some factors are statistically more important than others. However, Professor Richard Roll illustrates that equally weighting the Index factors reveals as true a picture of economic freedom in a country as the best weighting system that statistics can devise. In any event, it is clear that for a country to succeed in achieving long-term growth and economic well-being, it must perform well in all factors.

The Grading Scale
Each country receives its overall score based on the simple average of the individual factor scores. Each factor is graded according to a unique scale. The scales run from 1 to 5: A score of 1 signifies an economic environment or set of policies that are most conducive to economic freedom, while a score of 5 signifies a set of policies that are least conducive to economic freedom.

In addition, following each factor score is a description—“better,” “worse,” or “stable”—to indicate, respectively, whether that factor of economic freedom has improved, worsened, or stayed the same compared with the country’s score in the previous year.

Finally, the 10 factors are added and averaged, and an overall score is assigned to the country.

The four broad categories of economic freedom in the Index are:

• Free—countries with an average overall score of 1.99 or less
• Mostly Free—countries with an average overall score of 2.00–2.99
• Mostly Unfree—countries with an average overall score of 3.00–3.99
• Repressed—countries with an average overall score of 4.00 or higher.

Factor scoring is straightforward and consistent across countries. If a country’s banking system received a score of 3, for example, this means that its banking and financial system displays most of the characteristics for level 3, such as substantial government influence on banks; government ownership or operation of some banks; significant government influence on credit allocation; and significant barriers to the formation of domestic banks.

Period of Study
For the 2004 Index of Economic Freedom, the period of study covered the second half of 2002 through the first half of 2003. To the extent possible, the information considered for each factor was current as of June 30, 2003.

It is important to understand, however, that some factors are based on historical information. For example, the monetary policy factor is a 10-year weighted average inflation rate from January 1, 1993, to December 31, 2002. Other factors are current for the year in which the Index is published. For example, the taxation variable for this Index considers tax rates that apply to the taxable year 2003.

Occasionally, major economic events occur that cannot be factored into the scores because the Index is published several months after the cutoff date for evaluation. In the past, such occurrences have been uncommon and
confined to one region of the world. The Asian financial crisis, for example, erupted as the 1998 Index of Economic Freedom was ready to go to print. As a result, the effects of policy changes in response to that crisis were not considered in that year’s scoring; however, they were considered in later editions. In the country write-ups, the authors and editors also note major events that might have a substantial impact on a country’s score in the future.

Sources
In evaluating the criteria for each factor, a range of authoritative sources has been used. For example, a statement about the level of corruption in a country’s customs service may be followed by a supporting quote from a source of demonstrated reliability. There also are innumerable lesser sources of information, including conversations with government officials and visits to Internet sites. These sources are indicated in the narrative where appropriate.

For more information on how each factor is graded, please contact the Heritage Foundation or visit http://www.heritage.org.

Comparative Analysis of HFO/WSJ and Selected Indices
There is a wide variety of indicators that describe different aspects of a country’s IC quality including: The HFO/WSJ Index of Economic Freedom, Transparency International’s Corruption Perception Index, IICCRs, Euromoney’s Country Risk Rankings, IMD’s World Competitiveness Yearbook, Global Competitiveness Report, Economic Creativity Index, the PRS Group’s International Country Risk Guide (ICRG), A.T. Kearney’s FDI Confidence Index, A.T. Kearney’s Globalization Index, the WBES, the World Bank Institute’s Worldwide Governance Research Indicators Dataset, PriceWaterhouseCoopers’ Opacity Index, Standard and Poor’s Sovereign Ratings List, Moody’s Sovereign Ratings List, United Nations Development Programme’s Human Development Index, the Fraser Institute’s Economic Freedom of the World (EFW) Index, the Environmental Sustainability Index, the 'Luck School of Business' (Dartmouth College) Emerging Market Access Index, Freedom House’s Country Ratings, and Transition Report.

Index of Economic Freedom by the HFO/WSJ is used in this study as a measure of investment climate for several reasons:

• HFO/WSJ has wide country coverage (101 countries in 1995 and 155 countries in 2002).
• HFO/WSJ has annual data available from 1995. Many other series are not available for years prior to 1998, rendering them unusable for the analysis of relative performance of IFC projects and country portfolios over the period of evaluation for this review. For example, A.T. Kearney’s FDI Confidence Index started in 1998 and covers 64 countries, and A.T. Kearney’s Globalization Index started in 2001 and covers 62 countries. There are other indicators such as IICCR, EFW, Euromoney and ICRG that have information available as far back as 1995, but they were not used as the primary indicator of investment climate in this study for reasons cited in the points below. Regarding EFW, country information and time coverage is limited, with information available every five years and the latest information available in 2001, but not 2002.
• HFO/WSJ’s definition of economic freedom (see above) represents a broader array of institutional factors determining the quality of the investment climate compared to other indicators with similar country coverage that focus on narrow investment climate aspects. For example IICCR, Moody’s, and Standard and Poor’s focus on country sovereign risk; Transparency International on corruption; Price WaterhouseCoopers on unclear rules/procedures; Freedom House on political rights and civil liberties; ICRG gives heavier weight to political risk than financial and economic risk. Euromoney captures a narrower aspect of investment climate, with three main components including analytic (economic performance and political risk), debt, and access to international financing indicators. IICCR, traditionally used by IFC as part of its frontier country definition, does not fully measure investment climate. Instead, it is an index that measures sovereign risk. Despite this shortcoming, this report uses IICCR as a proxy of IC
change, since it is a more volatile variable than HFO/WSJ, which, given its broad base of input variables, is slower to change over time.

- HFO/WSJ has a strongly correlated relationship with IFC’s investment outcomes in the evaluated sample (as well as the sample used in IEG-IFC’s impact review of China). Moreover, various components of the HFO/WSJ index have shown close correlation to IFC’s Investment Outcomes and IFC’s Project Business Success (a DO indicator).

- With some exceptions, there tends to be a high correlation among many of the IC indicators in terms of country groupings (World Bank 2003; IEG-IFC’s Annual Reviews for 2002 and 2003; and IEG-World Bank 2003).

Indexes for which information is available as far back as 1995 are compared in a correlation matrix (see correlation matrix below). While a high EFW score indicates a higher level of economic freedom, a high IICCR score indicates less chance of default, and high ICRG and Euromoney scores indicate lower political, financial and economic risk, a high score of HFO/WSJ signifies a set of policies that are less conducive to economic freedom. For comparison purposes, HFO/WSJ was converted by subtracting (to take the inverse). As a result, a high positive converted HFO/WSJ score indicates an economic environment more conducive to economic freedom, and HFO/WSJ becomes positively correlated with EFW, IICCR, ICRG, and Euromoney. HFO/WSJ is highly correlated with Euromoney, IICCR, ICRG, and EFW. At these levels of correlation (75 percent and above), each indicator could be expected to give similar results when used as an explanatory variable in a regression equation. While they are closely correlated, the IICCR indicator is much more volatile than HFO/WSJ, which is relatively more stable over time. Hence, IICCR is a better directional indicator of IC quality change in relation to past project outcomes and prospectively, as discussed in the main report.

<table>
<thead>
<tr>
<th>Correlation of Indices (percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1995</strong></td>
</tr>
<tr>
<td>----------------------------------</td>
</tr>
<tr>
<td>HFO/WSJ</td>
</tr>
<tr>
<td>EFW</td>
</tr>
<tr>
<td>IICCR</td>
</tr>
<tr>
<td>ICRG</td>
</tr>
<tr>
<td>Euromoney</td>
</tr>
</tbody>
</table>

*Note: HFO/WSJ = Index of Economic Freedom, by the Heritage Foundation and Wall Street Journal; EFW = economic freedom of the world, by the Fraser Institute; IICCR = institutional investor’s country credit rating, by Euromoney Institution Investor, plc; ICRG = international country risk guide, by the PRS Group, Inc.; Euromoney = country risk rankings by *Euromoney Magazine*. *
ANNEX III.B: EXPANDED PROJECT SUPERVISION REPORTS: PERFORMANCE RATINGS FOR DEVELOPMENT OUTCOME AND INVESTMENT OUTCOME

IFC introduced what became the current Expanded Project Supervision Reports (XPSR) evaluation system in 1996. Investment staff evaluate investment operations and IEG-IFC validates evaluation findings to ensure corporate-wide consistency in judgment and interpretation. Every year, IEG-IFC selects a random stratified sample from among investments approved five years prior to evaluation that have reached early operating maturity.

IFC’s investments are evaluated under eight or nine performance indicators: four indicators of development outcome; one or two indicators of IFC’s investment outcome (loan and/or equity); and three indicators of IFC’s work quality. The outcomes and underlying indicators are rated on the following scales:

- The project’s development outcome is rated on a six-point scale from highly unsuccessful to highly successful. The bottom three ratings (mostly unsuccessful and worse) together are described as “less than successful” outcomes; the top three (mostly successful or better) as “successful” outcomes.
- The other two performance dimensions (IFC’s investment outcome and IFC’s work quality), and all indicators, are rated on a four-point scale: unsatisfactory, partly unsatisfactory, satisfactory, and excellent. Unsatisfactory and partly unsatisfactory ratings together are described as “low” ratings; satisfactory and excellent ratings as “high” ratings.

This study measures contribution to improving investment climate through impacts on private sector development (see Impact on PSD below and separate note on PSD impacts). Previous IEG-IFC studies and reports already found a strong positive association between work quality and outcomes.

**Development Outcome**

Four indicators measure distinct aspects of each operation’s fulfillment of IFC’s Article 1 purpose and contribution to its mission. The DO rating, a bottom-line assessment of the operation’s results on the ground relative to what would have occurred without the project, considers the performance of four subindicators, (i) business success, (ii) economic sustainability, (iii) environmental effects impacts on PSD, and (iv) PSD. The development outcome rating is not a mechanical weighting of the four subindicators. Instead it is determined case by case, considering the relative importance of each indicator in the specific operation and what would have been necessary for the operation to merit the next higher or lower DO rating.

**Project business success.** This measures the project’s actual and projected financial impact on the company’s financiers, i.e., lenders and equity investors. Investors have diverse goals, but ultimately there is only one bottom line: financial returns. Sufficient financial returns are necessary to attract and reward private investment. Rating standards are based on the project’s real after-tax financial rate of return (FRR) relative to the company’s real after-tax weighted average cost of capital. Where FRR cannot be calculated, e.g., for financial markets operations, project business
success is measured based on achievement of objectives and the extent projects contribute to the company’s profitability.

**Economic sustainability.** This is based on the project’s net quantifiable social benefits and costs, as measured in the real economic rate of return. Not all development aspects can be quantified, and therefore this indicator also considers qualitative aspects, including the extent to which a project has contributed to IFC’s mission—helping to reduce poverty and improve people’s lives. In addition, the indicator identifies who benefits (or suffers) from a particular project based on the net present value of benefits to people other than the project’s owners and financiers—typically taxpayers/government, consumers, workers, suppliers, competitors and the local community. It also specifies the project’s contribution, where applicable, to international development goals. Taxes generated by a project would be counted as an economic benefit, but the evaluation would not address whether additional tax revenue is likely to further the country’s development.

**Environmental effects.** “Environment” includes the physical environment and social, cultural, health, and safety impacts over the project’s life. Performance is evaluated relative to relevant WBG policies and guidelines and local standards.

**Impact on PSD.** This is based on the project’s impacts beyond the project company. Impacts on private sector development include factors that influence or form part of the investment climate. This study uses this subindicator as a proxy measure for the project’s impacts on investment climate. Please see Annex III.C on this subindicator.

**Investment Outcome**
Where IFC has both a loan and an equity investment, the rating is a synthesis of the separate ratings for the two investments. The ratings address the gross contribution of the investments, i.e., without taking into account transaction costs or the cost of capital. Where there is only a loan or equity, the synthesis rating follows the rating of the underlying instrument.

**Loans.** Rating is based on the extent loans have been and are expected to be paid as scheduled.

**Equity.** Rating is based on the extent the investment’s realized and/or unrealized return is greater than the (actual or notional) fixed rate equivalent loan interest rate plus an equity risk premium.
IFC’s Purpose, specified in Article I in IFC’s Articles of Agreement, is “encouraging the growth of productive private enterprise,” and to that end IFC shall “seek to stimulate and to help create conditions conducive to the flow of private capital, domestic and foreign, into productive investment.” This indicator addresses to what extent the project has contributed to IFC’s purpose, i.e., helping create conditions conducive to private investments, beyond the project company.

Indicators
Positive project-induced impacts include:

For both nonfinancial and financial markets projects

- broad demonstration effects in the local economy; follow-on investments by other investors; quality, reputation, and business practices as a positive corporate role model and quality investment asset
- significant upstream and downstream supply linkages to local private businesses
- introduction of new technology/know-how
- development of management skills
- employee training
- enhanced private ownership
- stronger local entrepreneurship
- greater competition and competitiveness
- domestic capital market development (e.g., pioneering listing on a stock exchange or significant increase of listed value; first-of-a-kind financing instrument; introduction of international accounting standards or enhanced disclosure standards)
- development of infrastructure available to others
- corporate governance and transparency
- reforms in legal and regulatory framework and its administration (e.g., a pioneering transaction stimulated policy makers to enact legislation and implementing guidelines for similar transactions; or executing a mortgage on land facilitated the debate that led to more transparent regulations on property or land-use rights).

For financial markets projects

- deepening of domestic financial markets through enhanced competition, new products, improved services
- easier access to financing domestic investors (particularly SMEs), introduction of international accounting standards and/or enhanced disclosure standards
- resource allocation efficiency and resource mobilizations.

Negative impacts include:

- adverse demonstration effects due to poor performance; poor company reputation leading to a negative effect on private enterprises
- project-induced restrictions on competition (including protection, uneven treatment of competitors, forming of a cartel, etc.)
- delays of reforms or entry by private enterprises, introduction of laws and regulations worsening the investment climate.

Evaluation Standard

- Excellent: Considering its size, the project considerably improved investment climate or otherwise made a substantial contribution to the
growth of private enterprises or efficient financial markets

- Satisfactory: The project had some but no major positive impacts
- Partly Unsatisfactory: The project had some negative impacts, which, however, are not expected to be of long duration or broad applicability (e.g., a failed project without substantial negative demonstration effects)
- Unsatisfactory: Substantial negative impacts of broad applicability and/or expected to be of long duration.
ANNEX III.D: NON-INVESTMENT EVALUATION RATING TEMPLATE  
(FOR IC TAAS OPERATIONS)

<table>
<thead>
<tr>
<th>Country:</th>
<th>Project Name:</th>
<th>Date Rating Obtained:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Source of Rating (Contact Person, Task Manager, Others-Specify):</th>
<th>IFC Dept. in Charge:</th>
</tr>
</thead>
</table>

I. **Rating Matrix:**

<table>
<thead>
<tr>
<th>Overall Quality Assistance</th>
<th>Unsatisfactory</th>
<th>Partly Unsatisfactory</th>
<th>Satisfactory</th>
<th>Excellent</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Relevance</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
</tr>
<tr>
<td>b. Clarity of targets, objectives, and limitations</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
</tr>
<tr>
<td>c. Responsiveness to client needs</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
</tr>
<tr>
<td>d. Technical and financial competence</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
</tr>
<tr>
<td>e. Client’s acceptance of recommendations</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
<td>❏</td>
</tr>
</tbody>
</table>

II. **Key Rationale for Ratings**

1. **Overall Quality Assistance**
   a. Relevance
   e. Client’s acceptance of recommendations
   b. Clarity of targets, objectives, and limitations
   c. Responsiveness to client needs
   d. Technical and financial competence

2. **Outcomes**
   c.  

3. **Impacts**
   c.  

III. Lessons
   a.  
   c.  

Prepared by: Date:
## Annex III.E: Rating Benchmark for Non-Investment Operations

<table>
<thead>
<tr>
<th></th>
<th>Unsatisfactory</th>
<th>Partly unsatisfactory</th>
<th>Satisfactory</th>
<th>Excellent</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Overall quality of assistance</strong></td>
<td>Synthesis (not average) of the below rating criteria</td>
<td>Synthesis (not average) of the below rating criteria</td>
<td>Synthesis (not average) of the below rating criteria</td>
<td>Synthesis (not average) of the below rating criteria</td>
</tr>
<tr>
<td><strong>a) Relevance</strong></td>
<td>Assistance does not address priority issues</td>
<td>Assistance overlooks one or two priority issues</td>
<td>Assistance addresses priority issues to a large extent</td>
<td>Assistance addresses priority issues and introduced major new insight regarding one or more issues</td>
</tr>
<tr>
<td><strong>b) Clarity of targets, objectives, &amp; limitations (Use of results-based framework)</strong></td>
<td>No clear objectives/targets outlined at onset of project; no performance monitoring criteria established</td>
<td>Some project objectives/targets outlined</td>
<td>Clear and comprehensive project objectives and targets are defined</td>
<td>Very clear project objectives and targets are set out, and a performance monitoring system is set up</td>
</tr>
<tr>
<td><strong>c) Responsiveness to client needs</strong></td>
<td>Significant delays in client responsiveness and delivery of services (formal and informal)</td>
<td>One major shortfall in either time of delivery of services or responsiveness to client requests</td>
<td>Good overall level of responsiveness to client requests and timely delivery of services/reports</td>
<td>High level of client orientation and responsiveness. Client expressed extreme satisfaction.</td>
</tr>
<tr>
<td><strong>d) Technical/financial competence</strong></td>
<td>Low level of technical/financial competence with substantial deficiencies in terms of accuracy of facts, logical analysis and recommendations</td>
<td>Level of technical/financial competence is deficient in one major area</td>
<td>Good overall level of technical/financial competence with regard to accurate facts, logical analysis, and recommendations based on findings</td>
<td>Very high level of technical/financial competence</td>
</tr>
<tr>
<td><strong>e) Acceptance of recommendations</strong></td>
<td>None of major recommendations accepted</td>
<td>Fewer than half of the major recommendations accepted</td>
<td>More than half of major recommendations accepted (up to 75 percent)</td>
<td>Nearly all major recommendations fully accepted (75 percent to 100 percent)</td>
</tr>
<tr>
<td><strong>2. Outcomes (Implementation of recommendations)</strong></td>
<td>Almost none of the major recommendations implemented</td>
<td>Fewer than half of the major recommendations implemented</td>
<td>More than half of major recommendations implemented (up to 75 percent)</td>
<td>Nearly all major recommendations fully implemented (75 percent to 100 percent)</td>
</tr>
<tr>
<td><strong>3. Impacts</strong></td>
<td>Almost none or negative impact (situation made worse or additional problems created)</td>
<td>Few improvements made, but issues/problems targeted to be addressed not resolved adequately (e.g., reduction in number of days from 120 to 90 to register business, but target of 40 not met)</td>
<td>Major improvements made; issues/problems targeted to be addressed resolved adequately.</td>
<td>Major improvements beyond issues targeted; outcome achieves best practice/regional or global role model</td>
</tr>
</tbody>
</table>
Breakdown of IC TAAS by Category

Overall, 27 percent of IC TAAS operations by number have general IC assessments (broad IC assistance, or Category 1), and 43 percent of IC TA operations were Category 2 (sector-specific advisories). The remaining 30 percent were Category 3. Moreover, 11 percent of the projects categorized as 1 and 2 also contained capacity building Category 3 components. Figures III.F.1, III.F.2, and III.F.3 show trends in numbers of operations and US dollar volumes over time. Due to the relatively small size of Category 1 operations, they accounted for only 12 percent of total IC TAAS volume. Categories 2 and 3 claimed the remainder in terms of dollars spent, each accounting for roughly half.

Most of the growth in terms of number of IC TAAS operations was in advice on specific legislation/sectors (Category 2) and capacity-building activities (Category 3). Growth in the Category 1 segment over time reflected the expansion of FIAS diagnostics and administrative barrier studies to investment projects, as well as more recent SME mapping studies. More recent IC TA projects have had a higher incidence of incorporating capacity building components as part of either sector-specific assistance or broad IC policy advisory work (and hence of qualifying for inclusion under both Categories 2 and 3, or Categories 1 and 3). More recent operations also took the form of capacity building alone, as was the case for many SME IC technical assistance projects that aimed to strengthen the private sector’s knowledge of new legislation or good corporate governance, and its capacity to engage with government to conduct policy advocacy.

Figure III.F.1: All Categories Increased after 1997, with Category 2 and 3 IC TAAS Experiencing Sharp Growth
Breakdown of Category 2 (Sector Specific)

By number of operations, most IC TAAS in Category 2 focused on financial sector advice and investment policies/laws (see figure III.F.4). All IC TAAS done in the financial sector was executed by investment departments and funded mostly through TATF. The FIAS program was responsible for delivering most of the advisory support in investment policies and laws. FIAS also carried out most of the investment incentives operations. In terms of volume, privatization advice clearly dominated, led by the PEP program (see figure III.F.5). Yet a breakdown of privatization advisory projects by number...
(figures III.F.6 and III.F.7) shows that there were few in number: PEP executed 9; PSAS carried out 13 Category 2 projects and only two were done by investment departments with TATF support.

**Concentration in Frontier Countries**

In line with IFC’s frontier strategy, most of IFC’s non-investment IC operations was done in countries with poor investment climates (see figures III.F.8 and III.F.9). Figure III.F.10 shows the breakdown by instrument/provider of TA in percentage terms. Regarding countries without an IC rating, a majority of these (nearly 80 percent) are countries that would normally fall under poor investment climate.

The East Asia and Pacific and Sub-Saharan Africa Regions were the top receivers of IC TAAS (see figures III.F.11 and III.F.12) in terms of number of operations, thanks mostly to the large number of FIAS projects done in these regions and more recent SME department activities. However, in terms of volume of US dollars spent,
the Central and Eastern Europe Region claimed $100 million compared to a regional average of about $11 million for the others. PEP was responsible for about a quarter of the number of all operations that went to that Region, yet for nearly 90 percent of the volume. East Asia and the Pacific, Sub-Saharan Africa, and the Southern Europe and Central Asia Regions received $17 million, $16 million, and $15 million, respectively. The South Asia Region received the least in terms of both number of operations and volume, with $3 million spent on 27 operations. Similarly, IC TAAS activity in the Middle East and North Africa and Latin America and the Caribbean Regions was below regional averages.

**The Role of IFC’s Investment Departments in Providing IC TAAS**

In terms of volume, IFC’s investment departments took the lead in initiating and carrying out
IC TAAS activity. These departments (through PEP, PDFs, and TATF) mobilized about $118 million, or 70 percent of the total $167 million IC TA, to fund approximately 260 IC-related TAAS operations. However, their share drops to only 35% by project number (see figures III.F.13 and III.F.14). Given the size differences and varied approaches to structuring and executing IC TAAS across programs and provider units, it is difficult to make comparative inferences on a global basis, hence each TA providing unit is discussed briefly in the paragraphs below.

**PEP**

The PEP (and pre-2000 PEP) program provided the lion’s share of IFC’s IC TA during the review
period, at nearly $90 million ($84 million if adjusted for overlaps with TATF in the pre-2000 years). About 90 percent of PEP programs included a component aimed at improving the investment climate in the former Soviet Union countries. PEP takes a holistic approach to providing TA to clients (see box III.F.1). Such a comprehensive approach places PEP’s average cost at $2.4 million per project above all other IC TA providers across IFC. 

After completing large privatization projects, the post-2000 PEP program cut the average IC project cost from the pre-2000 average of $2.6 million to $1.5 million. Supporting government privatization programs was the most important type of IC TAAS undertaken by PEP (see figures III.F.15 and III.F.16), especially in the earlier years of the program’s existence. Two sizeable land privatization and reform projects in Russia and the Ukraine accounted for a combined $42 million. Five projects were in support of SMEs, and four others had objectives of improving corporate governance standards through a combination of improving legislation and regulations, direct company training and capacity building (Categories 2 and 3).

**Box III.F.1: PEP’s Approach to Improving Investment Climates**

PEP’s approach to delivering TA takes a holistic and programmatic view, with each project containing three main components:

(i) policy diagnostic to identify the problems and make specific recommendations;
(ii) public relations to educate public/stakeholders and promote reforms; and
(iii) training on the conceptual and practical implications of new laws and policies for potential beneficiaries and users.

As a result of the approach combining policy advice with training and capacity building, most PEP IC TA projects were classified as both Category 2 and 3.

**TATF Support of Investment Departments**

IFC provides TA funding using grants from bilateral donors under the TATF Program. The TA assignments under TATF are developed and task managed directly by IFC’s operations staff. TATF funding of IC operations over the evaluation period totaled $35.6 million, or roughly 26 percent of the total TATF program over the same period. The total number of assignments funded over the period was 279, yielding an average assignment cost of $128,000. Yet because of the nature of nationality tied funding and other donor-specific requirements, many IC TA operations have had more than one assignment.
Taking this into account, IEG-IFC estimates the average cost per overall operation to be approximately $169,000.

TATF-funded IC advisory work focused mostly (40 percent by both volume and number) on advising policy makers on specific laws or sector policies and regulations (Category 2).\(^88\) The financial sector dominated as 40 percent of all TATF IC, or $13.5 million, went to advise governments on financial sector policies and legal/regulatory frameworks. Box III.F.2 provides some examples of typical TATF-funded financial sector projects. Sector-specific advice was accompanied by capacity building components in 29 percent of assignments, an occurrence that became more common after 1998. Stand-alone capacity building projects accounted for 26 percent of all assignments, while only 14 percent focused on broader-based IC reform agendas, such as diagnostics.

**SME Facilities**

The role of the facilities in providing IC TAAS was limited during the review period: in total, four facilities spent about $2.9 million on IC projects.\(^89\) While improving the IC was not an explicit strategic objective of the MPDF, it nonetheless mobilized the largest amount of all the facilities in support of TA funding for IC activities, $2.5 million. This assistance went mostly toward supporting the Vietnam Private Sector Forum and toward assessing IC issues and needed reforms through a series of papers that were discussed with government, private sector, and the Bank. SEED—the only facility which placed an explicit strategic focus on improving investment climate for SMEs—allocated less than $350,000 to IC activities over the review period, in part due to its recent establishment in 2000. In coordination with the SME department, SEED focused its IC efforts on improving legislation, mostly in leasing, and on advocating various reform initiatives in support of SMEs, namely through workshops and private/public dialogue. The SPPF delivered six small IC TA projects in tourism and fisheries totaling $85,000, and APDF carried out an SME-focused IC TA in Ghana for $50,000.

There is evidence that the facilities have become more active in the area of improving IC in the period following the review (2003), as BEE

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### Box III.F.2: Examples of TATF-Funded Financial Sector Projects Aimed at Improving the Investment Climate

In Turkey, IFC provided TA in 1999 to draft new insurance legislation and supporting regulations based on the European Union model of insurance regulation. The primary legislation and supporting regulations covered both life and non-life insurance. **Total donor funding:** $208,550

In Romania, IFC helped the government in 1998 to develop the structure, responsibilities and operating guidelines for the regulatory apparatus of the Pension Supervision Agency, and establish best practice guidelines for the operation of new pension management companies. Assistance was also provided to develop investment policies for these new management companies. **Total donor funding:** $471,000

In Mexico, IFC examined the existing legal and regulatory framework for securities markets and recommended specific improvements in the National Banking and Securities Commission’s supervisory practices. The assignment helped the Mexican government formulate its policies and develop its securities markets. **Total donor funding:** $15,000

In Egypt, IFC provided TA focusing on removing impediments to local bond market development by (a) providing international perspective and expertise on removing impediments in a safe and prudent way; (b) helping regulators draft documents, procedures, regulations, etc. needed for the market; and to a lesser extent helping ensure that regulators and market participants are communicating effectively to move the process forward. **Total donor funding:** $141,000

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Source: TATF project descriptions.
features more dominantly in the newer facilities’ (socioeconomic development fund, Caribbean Project Development Facility, and Latin America and the Caribbean) mandates. There is overlap between BEE and investment climate as defined in this report since BEE can also include a range of activities designed to improve investment climates, such as more general capacity building of business associations. It also undertakes a broad range of business development services, which are not included in this report’s definition of investment climate. So far, resource allocation to BEE activities for the newer facilities is estimated at approximately 15 percent of total facility expenditures.

The Role of Independent Departments: FIAS, PSAS, and SME

The non-investment departments—FIAS, PSAS, and the SME department—executed IC TAAS activities worth just over $50 million during the review period, representing 31 percent of all IC TAAS in dollar terms. In terms of number of operations, however, the non-investment departments executed 65 percent.

FIAS

Of all the TA-providing units that operate in relative independence of the regional departments, FIAS was the most active in the area of IC. Having completed 387 IC TA assignments during the review period, FIAS had the lowest average cost per project of all IC TA providers in IFC: $87,000. The volume and number of its projects grew proportionately from roughly $2.5 million to deliver 30 IC projects in 1993 to just under $5 million to deliver about 50 projects in 2002. Roughly half of FIAS’s budget was paid by donors (14 donors have contributed to FIAS’s Trust Fund), and the other half by the IFC and World Bank, of which IFC contributed two-thirds (approximately $11 million over the review period) and the Bank one-third.

Virtually all of FIAS’s projects were in support of improving investment climate, and the small unit generated more than half of IFC’s IC TAAS operations on a number-of-projects-basis per annum. FIAS projects tend to be standardized, discrete interventions involving a field visit with a team of consultants, followed by the production of a written report and then by the presentation and discussion of that report and its recommendations in the country with clients and major stakeholders (see box III.F.3 for an overview of FIAS product lines). However, where governments are receptive, FIAS attempts to build assistance programs aimed at identifying and implementing reforms downstream of initial diagnostic work. Nearly half (44 percent) of FIAS projects are categorized as 1, and these types of advisory projects focus on diagnostics, legal and regulatory environment assessments, and administrative barriers to investment. Just over a quarter were categorized as 2, including advice on formation of investment promotion legislation, investment incentives regimes, and other more narrowly focused or sector-specific assignments. The amount of projects qualifying as Category 3 has increased significantly over the past decade due to two main factors: (i) increased incorporation of capacity building elements in Category 1 and 2 advisory projects, and (ii) introduction of implementation projects that focus on building government and private sector capacity to move forward the reform process. The implementation projects are designed to follow up on and build on recommendations proposed in previous FIAS reports.

PSAS

PSAS provides assistance to governments in executing privatization transactions, many of which contain some form of advice to governments on the legal or regulatory framework in the sectors to be privatized. PSAS projects are paid for by a combination of client fees and budget support from IFC and other donors, including TATF.90 IFC’s net contribution (after reimbursements) over the review period was $6.6 million (equalling the cumulative operating loss over review period). IEG-IFC estimates that roughly 25 percent of all PSAS transactions with mandates signed over the review period contained IC components, and that these projects totaled just over $13 million.91 However, due to the emphasis on structuring and executing transactions, only a portion of this amount
would have explicitly contributed to improving the legal and regulatory environment.

Given the sector-specific nature of PSAS advisory work, about 80 percent of all IC projects have sector-specific legal/regulatory/policy advice components (Category 2). The remaining 20 percent are capacity building projects (Category 3). Nearly half of the sector-specific assistance projects also had a capacity-building aspect. About 70 percent of all IC qualifying PSAS projects were done in the infrastructure sector.

**SME Department**
Total IC TA generated by the headquarters SME department amounted to $4.24 million for 25 operations. Almost half of the operations were capacity building (Category 3), reflecting the strategic importance of SME department efforts to upgrade skills levels and standards of practice and to strengthen the private sector’s ability to organize and conduct constructive dialogue with the government on policy issues. Thirty-two percent of projects aimed at providing sector-specific advice (Category 2). The majority of these projects was in the financial sector and contained capacity building elements in addition to the central policy/legal advice. Twenty-eight percent of the projects were broader assessments of the investment climate (Category 1) and were often supported by public/private sector dialogue components on the issues identified (Category 3).

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**Box III.F.3: Overview of FIAS Advisory Services**

FIAS offers a range of services to help governments attract FDI. Topics for assistance include:

**Diagnostics**—Identifying a country’s main policy impediments to productive FDI. The issues typically identified include prohibitions on foreign investment in sectors or locations; restrictions on the share of foreign ownership in the equity of domestic companies; difficult administrative approval processes; restrictions on repatriation of dividends and capital; taxes; the character and functioning of legal systems; and problems foreign firms have in gaining access to land and bringing in technical and managerial staff.

**Legal and Regulatory Environment**—Reviewing a country’s legal and regulatory environment and recommending measures in such areas as screening procedures, restrictions on the percentage of shares owned by foreigners, currency convertibility, access to land, and investment protection under national laws and international conventions.

**Administrative Barriers**—Analyzing administrative barriers that slow investment and subsequent production. These detailed flowcharts pinpointing problems help governments identify and eliminate counterproductive procedures and streamline the necessary regulations that remain. FIAS has included a self-assessment approach to reviewing administrative barriers to investment in client countries. Under this approach, a counterpart team in the government will utilize FIAS-developed templates to collect the basic institutional information on administrative procedures for business establishment and operation in the country following the existing norms and regulations.

**Investment Incentives**—Analyzing incentives to ensure that they are competitive and cost effective.

**Investment Promotion**—Helping countries design promotion institutions, adapting models that have proven effective elsewhere. It also helps these agencies formulate promotion strategies that identify competitive advantages and target specific opportunities. Strategies can be conceived on national, regional, or sector levels.

Introduction

FIAS’s PIM system was introduced in fiscal 2001. Within the system, FIAS task managers track for each project the implementation of major recommendations by the client government. This note presents the results of the first FIAS self-assessment of the PIM system.

Under the system, task managers review their projects once a year over three years and rate each recommendation on a scale from 1 to 4, with

- 4 = recommendation fully implemented
- 3 = recommendation partially implemented
- 2 = recommendation accepted, but not implemented
- 1 = recommendation rejected.

In addition, task managers also weigh the relative importance of each recommendation with respect to its expected impact on a country’s overall investment climate and ability to attract investment. The weights are on a scale from 1 to 3:

- 3 = very important
- 2 = important
- 1 = less important.

The combination of the implementation rating with an importance weight allows for the calculation of weighted scores, where the implementation progress on individual recommendations is adjusted by the relative importance of each recommendation. Consider the project described in table III.G.1, resulting in two recommendations to the government, one judged to be critical for the investment climate while the other one is deemed less important. Now assume that the government rejects the important one but fully implements the less important one fully. If we now calculate the simple average, the project would receive a score of 2.5 (i.e., \([1+4]/2\)). However, considering the different importance of both recommendations, the weighted score would be only 1.75 (calculated as \([3 \times 1]/[3+1] + [1 \times 4]/[3+1]\)), providing a more accurate project implementation rating.

Data are now available for the first years of projects completed in fiscal 2001 and 2002, allowing for the calculation of weighted implementation ratings for each project. The self-assessment therefore limits itself to these two fiscal years, but information for fiscal 2003 is provided where possible based on a first evaluation provided by Task Managers. It provides more detailed and systematic information compared to previous attempts. But it should be kept in mind that this is, after all, a self-assessment of the performance of FIAS and consists of evaluations done by FIAS task managers that will remain subjective despite quality control efforts by FIAS management.

Overall Impact

In fiscal 2001–3, FIAS completed a total of 146 advisory projects worldwide. The current score for fiscal 2001 projects is 2.73 on our scale of 1 to 4, and slightly lower at 2.61 for fiscal 2002.
projects. A first assessment of fiscal 2003 projects indicates a score of 2.38. This trend of improving recommendation implementation as more time elapses since project inception is common to policy advisory work, reflecting the fact that policy reforms take time to implement.

It is important to note that many of these projects, even fiscal 2001 operations have not yet completed their full three-year review cycle, and further improvements should be expected. But the largest gap is clearly after the first year, when government clients are typically initiating policy reforms, resulting in limited implementation impact immediately following the completion of an advisory project.

Overall, 30.4 percent of FIAS recommendations were considered fully implemented by clients, and another 33.6 percent were partially implemented. In 33.8 percent of the cases, clients accepted our recommendations but (so far) failed to follow up with any implementation activity. Only 2.2 percent of FIAS recommendations were outright rejected by clients. Yet breaking down these results between the two fiscal years shows a striking difference, again reflecting the fact that it takes time for clients to act on FIAS recommendations and initiate a policy reform process. For fiscal 2001 projects, 40.8 percent of the recommendations are partially implemented and only 27 percent are accepted but not implemented; for fiscal 2002 projects, on the other hand, this relationship is reversed, with 26 percent partially implemented and 40.9 percent not yet acted on by clients.

**Impact by Region**

In terms of a regional breakdown, Sub-Saharan Africa was the most important geographic region for FIAS with 28 advisory projects, followed by East Asia and the Pacific with 27 projects and Europe and Central Asia with 19 projects. Latin America and the Caribbean as well as the Middle East and North Africa follow with 11 projects each.

The three largest regions are also the best performers, with average impact scores of above 2.7 and percentage shares of recommendations fully or partially implemented above 65 percent. LAC, on the other hand, performed significantly worse, although it was considered the best performer, with 71 percent of recommendations fully or partially accepted in the last self-assessment covering fiscal 1999–2001. Many countries in this region face political and economic instability combined with general public dissatisfaction regarding privatization and liberalization policies pursued in the past, leaving governments hesitant to initiate private sector policy reforms. However, the implementation ratio is expected to improve in all regions with the maturing of advisory work.

**Impact by Income Grouping**

Low- and lower-middle income countries accounted for more than 82 percent of all advisory projects done in fiscal 2001–2. The remaining assistance went to a select number of upper middle-income countries and to two high-income countries.

Comparing these different income groupings by impact score as well as by percentage shares of recommendations implemented, it is interesting that FIAS advisory assistance seems to be more effective in poorer countries. Low-income countries showed the best average project impact score of 2.75 (ignoring the results for the two high-income countries), with close to 70 percent of FIAS recommendations fully or partially implemented. In lower middle-income countries, the impact score declines slightly to 2.63 and an implementation share of 65 percent. But for upper middle income countries the score drops to 2.4, with only slightly more than 40 percent of FIAS recommendations being pursued by clients. The reason behind these trends could be that FIAS is better equipped to assist its lower income clients, as well as that poorer countries have a stronger sense of urgency in implementing reforms to catch up in their ability to attract private investment.

**Impact by Product**

An interesting question is whether FIAS’s impact might vary across its product spectrum, implying that some advisory products might be more useful to clients than others.

The comparison of products (administrative barrier studies, diagnostics, investment pro-
motion agencies and strategies, investment legislation and corporate income tax and tax incentives) with respect to the implementation actions taken by clients shows that the project impact rating as well as the implementation share remains strong across different products. Noteworthy is that the share of fully implemented recommendations is particularly high in our law and tax projects, while administrative barriers tend to be slightly less successful. A closer look at the differences between the fiscal 2001 and 2002 project results is revealing. Administrative barrier studies and diagnostics tend to deal with a broader range of policy recommendations that take time to implement. Considering fiscal 2001 projects alone, the respective shares of fully and partially implemented recommendations are 72.2 percent and 77.6 percent. For these products, a marked improvement over the next year should be expected.

This issue does not seem to be a serious factor in FIAS work on IPAs, investment legislation or tax, where recommendations tend to be easier to implement for these products, or where FIAS assistance supports an ongoing technical initiative, such as drafting of legislation or a tax reform program. This also explains the relatively large share of full implementation, as detailed technical advice typically is incorporated entirely.
Results-based management (RBM) is defined as a management strategy focused on performance and achievement of outputs, outcomes and impacts. RBM is a system to improve program and management effectiveness and accountability and is oriented toward achieving results. It uses results as a basis for planning, management and reporting, and aims to improve performance by comparing and analyzing actual results against planned results through regular monitoring, evaluation, reporting, feedback and adjustments. A simple RBM process is presented in figure III.H.1.

Basic principles and practices of an RBM approach include the following:

- Strengthening partnership, participation, and teamwork at all levels and stages
- Working with stakeholders to make a comprehensive situation analysis
- Jointly defining the results we contribute to and the results we are accountable for
- Identifying a set of qualitative and quantitative indicators with baselines and targets for all planned results
- Defining the strategies to achieve these results
- Regular monitoring to track progress toward achieving these results
- Evaluation of performance to assess what works and what does not work, and why
- Reporting on performance to enhance accountability and communication with partners
- Feeding lessons learned back into improving performance and refining results, indicators, and strategies.

Figure III.H.1: Simple RBM Model

Regular monitoring and evaluation

Regular feedback and adjustment

Planned results

Actual results

Sources: OECD (see http://www.oecd.org/dataoecd/16/25/1886519.pdf) and United Nations (see http://accsubs.unsystem.org/ccaqfb-intranet/RRB-RBM/ResultsBasedMgt.htm).
Recently FIAS commissioned a discussion paper to examine overlaps between its services and those by MIGA, among other objectives (Wells 2004). The table below summarizes the possible activities under Investment Promotion Products (IPP), as defined in that report. FIAS activities usually encompass rows 1 to 4 of the table. However, as shown in the table, interviews with staff from both units indicate that the borderline between FIAS and MIGA activities is not so clear in practice:

*For years, the allocation of tasks to FIAS and MIGA has appeared arbitrary and vague to many. Professionals in FIAS and MIGA agree that (rows) 7 and 8 are the territory of MIGA, rather than FIAS. There are, however, occasional exceptions…*

the Sydney office of FIAS carries out some activities of (rows) 5 through 7 in a few small countries in the Pacific. It is clear that (rows) 5 and 6 sometimes attract FIAS and sometimes MIGA; MIGA claimed part of (row) 4 as its territory as well.

While the range of potential overlap appears wide, the actual proportion of projects done by FIAS in the so-called gray areas of investment promotion strategy and institution over the review period was low—roughly 20 percent (21 percent in terms of total number of projects and 23 percent of total project cost). The fiscal 2001–4 period shows a decline in this segment to about 11 percent of all advisory projects (only an estimated four to eight projects per year).

**ANNEX III.I: OVERLAP BETWEEN FIAS AND MIGA**

<table>
<thead>
<tr>
<th>FIAS</th>
<th>MIGA</th>
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<tr>
<td>2</td>
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</table>
| 3    | 3    | Development of national investment strategies, including investment law, approaches for reforming other laws, approvals processes, tax structure and administration, etc.  
Advice on location of investment promotion activity within government  
Creation of legal framework for effective policy advocacy |
| 4    | 4    | Creation of basic design (governance structure, for example) of proposed investment promotion unit to be responsible for marketing function |
| 5    | 5    | Assistance in designing marketing strategy of responsible investment promotion unit  
Diagnostic studies of promotion institutions |
| 6    | 6    | Assistance in designing initial business plan of responsible unit |
| 7    | 7    | Help in developing budgets and detailed organizational charts of marketing unit  
Assistance in developing target sectors  
Provision of training to marketing unit, help in Web site design, tracking systems, benchmarking, etc. |
| 8    | 8    | Working with and providing capacity building assistance to investment promotion organizations in carrying out their activities |
This study’s scope did not extend to a thorough review of the WBG’s COI system and procedures. While the IEG-IFC team did not encounter any specific complaints or allegations of COI in the field, there is concern within parts of the Bank Group that IFC’s dual role as advisor to governments on legal and regulatory matters and as a direct (prospective and existing portfolio) investor could result in potential or perceived conflicts of interest that require careful management. Concerns have also been expressed inside and outside the WBG where IFC and Bank departments have merged, so that the same organizational unit could be engaged in advising governments on privatization and regulatory strategies/issues while also discussing private sector investments in the same sector. On the other hand, IFC staff has noted that many Part II clients (especially IDA countries) have expressed frustration in that the WBG fails to provide client countries with the package solutions they need—and are requesting—in complex areas such as infrastructure, involving at once reform advice, transactional advice, and financing. While IEG-IFC’s reports did not look into advisory work done by Bank staff in joint departments, four sector-specific advisories done by the IFC staff in joint industry groups and their predecessor departments qualified for inclusion in the IC TAAS database.93

To address COI concerns in the context of the merged departments, WBG adopted COI guidelines and formed an independent COI office to deal with actual, potential and perceived conflicts in a systematic fashion for the Global Product Groups and PSAS.94 The office deals with actual, potential, and perceived COIs for other departments in the WBG on a voluntary, case-by-case basis. The COI rules and procedures in place since 2000 help staff and managers identify and effectively manage potential conflicts of interest.95 The COI framework typically involves disclosure to concerned parties and sets out measures to manage any actual, potential or perceived conflicts of interest arising from the dual roles of the Bank and IFC:

- Disclose potential conflict issues fully to all affected parties before acceptance of the proposed assignment.
- Obtain fully informed and freely given consents from affected parties, when appropriate, before acceptance of the proposed assignment.
- Assign staff to teams in such a way as to avoid members overlapping between assignments for clients with divergent interests, as appropriate.
- Implement guidelines for the treatment of confidential client information.
- Where possible, sequence assignments to minimize the extent of the conflict.

Where a COI cannot be resolved, the rules specify that an assignment is to be declined.

The rules and procedures currently in place align well with generally prescribed standard practices for identifying and managing COI in financial institutions.96 In the identification of COI, an important first step is to determine whether the conflict is actual, potential, or perceived. In the words of an expert in COIs in the financial services industry: “Despite the prevalence of potential conflicts of interest in the financial services, the occurrence of actual conflicts has been minimized by relatively effective preventative strategies. These strate-
gies are embodied in much of the regulation of the financial services industry and in accepted industry practices. They can be conveniently classified under the headings of competition, disclosure, rules and policies, and structural changes” (Boatright 2002). Box III.J.1 sets out these classifications in more detail.

All privatization advisory assignments undertaken by PSAS and all GPG advisory mandates must undergo “conflict screening” by the relevant department in consultation with the COI Office and are managed according to the established IFC principles and procedures on the matter. For PSAS advisories, for instance, a “Chinese wall” is placed between advisory teams and investment teams, by separating functional units and preventing transmission of information across units. The COI Office states that there have been very few incidences of actual COI in IFC’s experience, with most situations falling under the category of potential or perceived (i.e., reputation risk). Potential conflicts can arise in situations where IFC takes on an advisory role in the privatization of a sector and/or gains sensitive market information, and subsequently IFC would be willing to finance an investment project. In these situations, IFC’s policies specify clearly that IFC cannot enter into financing discussions with interested third-party investors until after a public authority has made a bidding selection.

Most of IC TAAS appears not to be conflicted at all, or may contain at most a potential or perceived COI. For example, broad IC assessments (Category 1) address general constraints to private investment and advocate increased competition economy-wide—such advice is not linked to the financial interest of any particular investment project. Similarly, sector-specific advice focuses on improving conditions to encourage private investment in the sector by removing constraints or establishing needed legal/regulatory framework based on international best practices. This type of advice is typically not linked to an existing IFC project and would equally benefit subsequent private investments, including a potential downstream IFC investment project once appropriate conditions are established in the sector. However, potential COI could arise where IFC is pursuing a project in parallel with providing TA on sector policies/regulations. Under these circumstances, COI rules require that the advisory work be undertaken by a separate and independent team from any IFC investment team for a potential project, and that the

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Box III.J.1: Strategies for Managing Conflicts of Interest

Preventative strategies as embodied in much of the regulation of the financial services industry and in accepted industry practices include the following:

**Competition**—Intense competition for clients among financial service providers creates a powerful incentive to avoid actual conflicts of interest and the appearance of conflicts. Results are critical in competition, and any sources of inefficiency must be eliminated. Where competition thrives, service provision must be based on “best practice execution” rather than other institutional interests.

**Disclosure**—Disclosure as a strategy for managing conflicts of interest is generally understood as the disclosure of adverse interests. In addition, conflicts of interest can be avoided by making known an institution’s policies and procedures for dealing with conflicts.

**Rules and policies**—Specific rules and polices serve to reduce COI, whether disclosed or not, by prohibiting conduct that constitutes or facilitates conflicts. These rules and policies may address COI directly by prohibiting the kind of conduct that constitutes or facilitates COI.

**Structural changes**—Because so many COIs result from combining different functions in one institution, these conflicts could be reduced by structural changes that separate these functions into distinct units and teams, and limit the flow of information (Chinese wall). Addressing the problem of COI by such radical structural changes is probably unwarranted, however, because of the many advantages of such combinations. The trend in the financial services industry is toward more rather than less integration.

*Source: Boatright (2002, pp. 231–5).*
potential COI and proposed mitigation measures be disclosed to the government client. The TA/advisory team would be expected to provide stand-alone, independent advice based on international best practice and experience and without regard to the possibility that IFC might eventually become a lender to or investor in a project beneficiary.
Part IV

MIGA Experience
Introduction

Background

Investment climate (IC) refers to a country’s environment for private sector activity. It is determined by risks and costs associated with investing in and operating a private business to the extent those risks and costs are affected by government policies.

Determinants of investment climate are, *inter alia*, the legal and regulatory framework, barriers to entry and exit, and conditions of markets for labor, finance, information, infrastructure services, and other productive inputs. Improvements in investment climate are largely in the realm of governments, which can influence macroeconomic management, trade and investment policies, and strengthen institutions and the rule of law.97

Investment climate has been recognized by the World Bank Group (WBG) as an important factor for development since the 1990s and has become a priority objective in recent years. The Bank’s Private Sector Development (PSD) Strategy (2002) identified investment climate as the primary determinant of the development impact of PSD operations. Furthermore, recent research suggests that there is a positive relationship between a country’s welfare and improvements in its investment climate.

While foreign direct investment (FDI) flows depend on many factors,98 broad IC issues appear to be an important consideration in the decision-making of potential investors. FDI flows are important for their potential contribution to a country’s growth and development through employment and training opportunities, steady incomes, the transfer of know-how and technology, stimulation of local enterprises, efficiency gains through increased competition, and demonstration effects that may lead to follow-up investments. Thus, they contribute to PSD and a reduction of poverty in many ways.

The Multilateral Investment Guarantee Agency’s (MIGA) mandate is to enhance the flow of investments for productive purposes to developing countries “on the basis of fair and stable standards for the treatment of foreign investment.”99 As a facilitator of FDI, MIGA is therefore not only a player within the Bank’s PSD agenda, but its business is directly affected by the investment climate of host countries. MIGA guarantees can mitigate political risks, a subset of investment climate. In turn, host countries’ investment climates also determine MIGA’s operating environment for its guarantees and TA activities.
Poor or deteriorating investment climate can diminish the development impact of MIGA projects and have repercussions on the Agency’s financial performance and sustainability (particularly through increased project risk or claims triggered by host country action or inaction). In addition to offering guarantees to private investors in developing countries, MIGA works with public sector agencies providing technical assistance (TA) to build capacity in local investment promotion agencies and to offer information dissemination services.

**Objectives and Evaluation Questions**

This report is part of a joint evaluation of WBG IC activities conducted by the Independent Evaluation Group (IEG) of the World Bank, IFC, and MIGA. The objective of IEG-MIGA’s evaluation is to assess the effectiveness of MIGA’s activities in addressing IC issues and in fulfilling its development mandate.

IEG-MIGA’s evaluation focused mostly on MIGA’s TA activities, particularly its capacity building activities, during the fiscal 1998–2003 period. For guarantee projects, it did not have a large enough sample of evaluated projects to assess systematically their impact on investment climate. However, the report includes an overview of MIGA’s guarantee portfolio that discusses trends and MIGA’s performance with respect to priority areas, and reflects findings from nine guarantee projects issued in fiscal 1996–98 with respect to these projects’ impact on PSD. The impacts of MIGA’s information dissemination services and mediation activities have not yet been evaluated.\(^{100}\)

Since the evaluation of TA activities began only in fiscal 2004, this evaluation report presents findings from its two pilot evaluations and a review of all MIGA TA activities to date, within the limitations of available data. For the TA activities, the report is organized around the following evaluative questions:

- Did MIGA focus its TA on the right issues (*relevance*)?
- Was MIGA’s TA effective (*outcome and impact*)?
- How were MIGA’s TA activities funded (*efficiency and institutional sustainability*)?
- What has MIGA’s role been within the WBG (*additionality and complementarity*)?

IEG-MIGA used the logic model presented in figure 18.1 to evaluate MIGA’s TA activities, assessing inputs, activities, outputs, outcomes, and impact. While relatively more information is available for assessing outputs and outcomes of MIGA’s TA, the link between impacts (changes in FDI flows) and outcomes (i.e., the last link in figure 18.1) becomes weaker, due to the interference from other variables; thus, a strong causality is difficult to establish. The *impacts* of MIGA’s activities were assessed within these limitations.

**Components of the Evaluation**

The findings from the guarantees evaluation are based on IEG-MIGA evaluations of guarantee projects insured in fiscal 1996–98.\(^{101}\) In addition, IEG-MIGA reviewed documents from MIGA’s underwriting department for a portfolio overview. The evaluation of TA activities is based on:

- A review of MIGA’s TA activities focusing on the evolution, relevance, effectiveness, and effi-

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**Figure 18.1: Logic Model for Assessing the Effectiveness of MIGA’s TA**

<table>
<thead>
<tr>
<th>Inputs</th>
<th>Activities</th>
<th>Outputs</th>
<th>Immediate effects</th>
<th>Intermediate outcome</th>
<th>Final impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>MIGA staff and consultants</td>
<td>Technical assistance</td>
<td>Plans Materials Methods Skilled staff</td>
<td>Changes in practices and systems</td>
<td>Improved service delivery</td>
<td>Increased FDI</td>
</tr>
</tbody>
</table>
ciency of MIGA capacity building activities. This review took stock of MIGA's TA portfolio during the fiscal 1998-2003 period, identifying trends and issues.

- Two country case studies (for El Salvador and Romania) evaluating MIGA capacity building programs for investment promotion intermediaries.¹⁰²

The findings of the TA evaluation are based on a literature review and a review of documents, including previous external assessments of MIGA's TA activities; back-to-office reports from MIGA's Investment Marketing Services Department (MIGIM), budget information, and other internal documentation; MIGA Quarterly Executive Vice President and annual reports; MIGIM's self-evaluation reports for a small number of country cases; other MIGA publications; and interviews with current and former MIGIM senior management and staff, as well as other MIGA and WBG departments. The two case studies involved staff interviews, a review of files and relevant WBG documents (e.g., CASs), a field mission, and a survey administered to foreign investors that had used the services of investment promotion intermediary. The methodology IEG-MIGA developed for these case studies is consistent with the one used by IEG-World Bank to evaluate Bank TA activities and is described in more detail in Annex IVA.
MIGA has a specialized role within the WBG with the specific objective to promote FDI flows to developing countries.103

MIGA’s IC-related activities include: (i) political risk guarantees; (ii) technical assistance and advisory services (TAAS) and information dissemination tools; and (iii) legal and mediation services.

Guarantees against political risks are aimed at facilitating FDI flows into developing countries by reducing specific risks of insured investments. Guarantees can make certain aspects of investment climate more manageable and may indirectly have an impact on investment climate, e.g., by changing investors’ perceptions of country risk or having a demonstration effect (and paving the way to other investments).

MIGA offers specialized TA, primarily targeted to Investment Promotion Intermediaries (IPIs), working with host governments. Currently, the range of TA activities for IPIs includes needs assessments, strategic planning, preparation of marketing plans and promotional materials, Web site development, development of information systems, and staff training, which are mostly provided free of charge to the recipients.

In addition to TA activities, MIGA provides an expanding set of online information dissemination tools that provide customized information about investment opportunities, business environment analyses, and FDI-related research on developing countries. The evaluation of these information services began in fiscal 2005.

Finally, MIGA mediates a small number of disputes between investors and member countries for investment projects not covered by a MIGA guarantee. MIGA’s legal department is also involved in claims avoidance activities related to disputes involving MIGA guarantees, which can affect a country’s overall investment climate.

In Which Types of Investment Climate Was MIGA Active?

The following section analyzes the categories of countries in which MIGA has been active through political risk guarantees and TA activities. The Heritage Foundation/Wall Street Journal Index of Economic Freedom (HFO/WSJ) was used because it captures well the elements of IC as defined for the purposes of this evaluation, and was available with a consistent definition over time for many countries; it is also highly correlated with other measures.104 Based on this index, MIGA guarantee projects over the fiscal 1998–2003 period have mainly been concentrated in developing countries with
scores reflecting relatively restricted ("mostly unfree") investment climates (see figure 19.1). This indicates that on average MIGA guarantees were in countries where the types of risks MIGA covers existed. Investors in better IC countries were hence less likely to seek MIGA insurance; and low levels of MIGA insurance in countries with "repressed" investment climate may have been due to low investor interest in those countries (and possibly deselection of risky projects by MIGA).

On average, MIGA TA activities during fiscal 1998–2003 were in countries with worse ICs than for guarantee activities. TA activities were also more likely than guarantee projects to be conducted in countries classified as having "repressed" and "mostly free" economies (see figure 19.1), whereas MIGA's guarantee projects were overwhelmingly located in "mostly unfree" investment climates. Within its TA products, countries that received limited assistance on average have had worse investment climates, and countries receiving in-depth assistance had investment climates better than the countries served by MIGA guarantees. This implies that overall IC conditions in a country have been relevant for MIGA in its decision to offer more in-depth assistance to countries.

Over the period 1998–2003, for political risk guarantees, MIGA has become increasingly more active in countries with "mostly unfree" investment climates: the (unweighted) average IC score of countries where MIGA guarantees were issued has increased. (See figure 19.2. Higher scores indicate more restricted investment climates.) This reflects a shift in MIGA’s portfolio toward postconflict countries and projects in Africa.

**Review of MIGA Guarantee Activities**

To achieve its objective of encouraging the flow of productive foreign investments to developing countries, MIGA began issuing guarantees to foreign investors against certain types of political risks in 1990. Currently, MIGA offers coverage against the following risks: expropriation, war and civil disturbance, currency transfer restrictions (including inconvertibility of funds), and breach of contract.

Within the Berne Union (the association of currently 51 investment insurers and export credit agencies, which offer political risk insurance), MIGA is the seventh largest insurer, providing about 8 percent of outstanding coverage (2003). MIGA defines its role as complementary to other insurers by providing

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**Figure 19.1: Concentration of MIGA Guarantee and TA Activities, 1998–2003**

<table>
<thead>
<tr>
<th>Investment climate</th>
<th>FDI associated with MIGA guarantees</th>
<th>Distribution of in-depth TA activities (3 or more activities)</th>
<th>Distribution of limited TA activities (1–2 activities per country)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free</td>
<td>28%</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Mostly free</td>
<td>32%</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Mostly unfree</td>
<td>38%</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Repressed</td>
<td>0%</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
counter-cyclical capacity, forging partnerships with private and public insurers (through coinsurance and reinsurance), and focusing on certain priority areas. These priority areas were identified in the most recent strategic review (in 2000) as: (i) projects in International Development Association (IDA)-eligible countries, particularly in Africa; (ii) investments between developing countries; (iii) small and medium size enterprises (SMEs); and (iv) complex infrastructure projects. As part of the WBG, MIGA has a development mandate that sets it apart from commercial insurers and requires its projects to have a development impact and to be sound from an environmental and social perspective.

Since 1990, the Agency has supported 453 projects in 85 developing countries. In support of these projects, MIGA has issued 711 contracts of guarantee for a total gross exposure of $12.8 billion. Of these contracts, 316 (44 percent of contracts, equivalent to 41 percent of original exposure) were active on June 30, 2004. MIGA estimates that the projects it has supported have resulted in FDI of $51 billion, on average four times the amount MIGA insured for all guarantees since 1990. This ratio has declined since 2000 and in 2004 stood at 1.3. However, this ratio would be lower if only those projects where MIGA played a crucial role were considered, since some projects would probably have gone forward regardless of MIGA coverage. There are no measures that accurately track the additionality of MIGA insurance across the portfolio.

Trends in the portfolio composition indicate that MIGA has made some progress toward priorities in its strategy formulated in 2000. MIGA’s guarantee portfolio is concentrated in infrastructure (38 percent of gross exposure as of June 30, 2004)—one of the priority areas identified in MIGA’s strategy, the financial sector (35 percent), and in manufacturing and agribusiness (9 percent). The balance is in mining and oil and gas (11 percent), and tourism and services (7 percent) (see figure 19.3). Geographically, MIGA has increased its exposure in Africa—another strategic priority—to 13 percent of the net portfolio. Europe and Central Asia has recently overtaken Latin America and the Caribbean as the largest region in MIGA’s portfolio, accounting for 37 percent and 30 percent, respectively. The balance is in East Asia and the Pacific (15 percent) and Middle East and North Africa (7 percent) (see figure 19.4).

As of June 2004, one-third of MIGA’s outstanding portfolio was in IDA-eligible countries, three of which (Mozambique, Bosnia and Herzegovina, and Serbia and Montenegro) are among the largest 10 countries in terms of exposure in MIGA’s active portfolio.

As shown in figure 19.5, MIGA does play a role in supporting investments in countries that are
Figure 19.3: Sectoral Distribution of MIGA Guarantee Portfolio (gross), June 2004

Figure 19.4: Regional Distribution of MIGA Guarantee Portfolio (net), June 2004

a. Percentages add up to more than 100 percent because of multicountry agreements.
not major destinations for FDI. The 10 largest
developing country recipients of FDI account
for 71 percent of total FDI to developing
countries, whereas these same countries only
accounted for 42 percent of the FDI associated
with MIGA guarantees in 1998–2003.111

Although investors from European countries
and the United States are MIGA’s biggest clients,
MIGA’s guarantees can serve investors from both
developed and developing countries. Promot-
ing South-South investments (and investors)
has been one of the stated strategic priorities for
MIGA since 2000 (and an area in which MIGA has
a comparative advantage, given the absence of
national insurance agencies in many developing
countries and the reluctance of private insurers
to serve these clients). As of December 2003,
investors from developing countries (originat-
ing from 13 countries) accounted for 13 percent
of the overall exposure.112

While MIGA guarantees are designed to
mitigate political risks, which is a subset of IC
issues, they do not directly affect the regulatory
and legal framework and practices in the
country. Guarantees have the potential to
improve investment climate indirectly by
helping to increase the role of the private sector
in a country. Successful private investments can
do so through demonstration effects that
encourage other investors (foreign or local) to
invest in the country, through infrastructure
projects (addressing an important impediment
of investment climate), and through backward
and forward linkages, which stimulate local
enterprise development. However, MIGA’s
guarantees do not address IC policy issues
directly as MIGA usually works with foreign
private investors and not with host governments
on policy reforms and institutional issues, which
generally fall under the purview of the Bank.

Objective and precise indicators for the
impacts of guarantee projects on PSD, includ-
ing demonstration effects, and investment
climate are difficult to define, and measuring
these impacts is inherently difficult due to
methodological limitations. Evidence regarding
the PSD impact of a limited number of MIGA
guarantee projects evaluated by IEG-MIGA
shows mixed results.113 MIGA has clearly played
a positive role in supporting first or early invest-
ments in some sectors and countries, and some
of these projects have led to follow-up invest-
ments. In a majority of evaluated projects, the
impact is considered to be low, because the
projects have either had financial problems,
caused by sector or systemic crises, or regula-
tory and management problems. Furthermore,
MIGA’s projects are mostly small in comparison
to the size of their host economies; thus, their
impact is generally modest. Additionally, MIGA
does not normally have leverage to influence
the business environment and the country’s IC
policies and regulatory framework. On the
other hand, the ultimate market test for MIGAs
guarantee products is the demand for MIGA insurance from foreign investors. This suggests that the Agency meets those needs and plays a role in facilitating private sector projects (mainly by reducing risks and associated costs or by providing comfort in a difficult business environment).

*MIGA Legal and Mediation Services.* MIGA offers its good offices to mediate a small number of investment disputes between host countries and foreign investors, providing guidance to claimants and member countries. MIGA seeks to resolve disputes before they require arbitration. In Ethiopia, for example, MIGA is offering its services at the request of the government to help resolve claims dating from expropriations in the mid-1970s, which have proved to be obstacles to new FDI. Apart from its mediation work, MIGA is involved in dispute resolution related to its guarantees, working with host countries and investors to avoid claims situations.
An Evaluation of MIGA’s TA Activities

Overview of MIGA’s TA Activities

MIGA’s activities are governed by the 1985 Convention that established it as an agency of the WBG. Articles 2(b) and 23 of the Convention (see Annex IV.B) set out the Agency’s mandate to provide technical assistance to member countries to encourage FDI flows. This responsibility that was fulfilled, in part, by MIGA’s Investment Marketing Services Department (MIGIM) during 1998–2003, which focused on a narrow subset of a wider range of activities encompassed by the Convention. In May 2004, MIGA was reorganized, merging the activities of the Underwriting and Investment Marketing Services Departments into one department, called the Operations Group.114

Article 2(b) of MIGA’s Convention states that the Agency, in addition to providing investment guarantees, has the mandate to “carry out appropriate complementary activities to promote the flow of investments to and among developing member countries.” This mandate is elaborated in Article 23(a), which requires MIGA to carry out research and undertake TA activities to promote investment flows and disseminate information on investment opportunities in developing member countries to improve the environment for FDI flows to these countries (see Annex IV.B). This means that MIGA—through its TAAS—was designed to play a role in improving the investment climate in developing countries. MIGA’s TA mandate is further supported by the Agency’s Operational Regulations, which authorize MIGA to conduct programs in research, information dissemination, TAAS, and consultations with and among its members on investment policies and programs.

MIGA’s interpretation and operationalization of its TA mandate have evolved over time (see box 20.1). In 1998, MIGA commissioned an external review of its TA activities, which mainly focused on the outcomes of the TA activities at the level of IPIs but did not explore the next level of the impact of IPIs on FDI flows. This external review recommended that MIGA (i) expand its TA services through a tailored country-by-country, needs-based approach; (ii) coordinate its operations more tightly with those of FIAS and other units of the WBG; (iii) change its funding strategy to include higher contributions from MIGA’s administrative budget without requiring full recovery of program delivery costs, (iv) access donor funding and create trust funds, and (v) change its staffing to include a
larger share of senior staff on a full-time, on-budget basis, with expertise in investment promotion. Based on the findings of this review and ensuing MIGA Board directives, MIGA sought to improve the relevance and effectiveness of its TA products and services by offering more in-depth and longer-term activities, thus better serving MIGA’s developing member countries. MIGA also articulated a mission for itself—“to strengthen the capacity of investment promotion intermediaries to attract and retain foreign direct investment” in its mission statement (see box 20.2). Since 1998, MIGA has provided both “hands-on” operational assistance to IPIs and a range of evolving investment information services to assist member countries and firms contemplating direct investments in developing countries.

The division of labor between FIAS and MIGA’s TA activities was addressed in the 2002 WBG PSD Strategy (World Bank 2002). The PSD strategy document noted that MIGA should provide “focused political risk guarantees, institution-building and investment promotion assistance.” Advisory services for PSD are located in the Bank and the IFC (in the form of joint departments) and, separately, in MIGA. The division of labor between FIAS and MIGA was described as follows: “FIAS provides policy advice to governments on how to attract foreign investors in ways that benefit the host country. MIGA/IMS tends to operate downstream from FIAS helping countries promote investments based on the policy and institutional framework promoted by FIAS.” This strategy also mentioned that MIGA and FIAS had developed a protocol encompassing an exchange of client requests for TA, agreements on the division of labor between both institutions, and regular (quarterly) meetings among managers and staff to harmonize work plans and joint activities. In addition, to facilitate consistency and cooperation within the Bank Group, MIGA staff was expected to continue to participate in PSD sector board meetings. The strategy paper thus prescribed continuity rather than new directions for MIGA’s TA program and its organizational alignment.
During 1998–2003, MIGA’s TA services and products can be categorized into three broad areas:

- **TA to IPIs for institutional strengthening and capacity building**—Strategy development (such as needs assessments, strategy and action plans, investor targeting, marketing plans) and promotion support tools (investor information system; IT system tools; contact relationship management; promotional materials; Investor Toolkit; and associated training)

- **Information dissemination**—Online investor information services, including a clearinghouse of investment environment information (IPA.net), an e-mail dissemination service on investment opportunities and investment environment information (FDI Xchange), an information and marketing service for privatization opportunities (Privatization Link and Privatization Link Russia), and several e-publications

- **Investment facilitation**—Regional investor conferences and seminars, primarily in mining and tourism.

Capacity building formed the core of MIGIM’s TA program and thus became the primary focus of this evaluation. The information dissemination tools, an expanding area for MIGA, have not yet been evaluated by IEG-MIGA, but are discussed in reference to their complementary role in supporting other TA activities. MIGA’s support for Investment Facilitation has, in recent years, shifted away from traditional investor conferences of earlier years, and increasingly toward online information dissemination tools and services (FDI Xchange, PrivatizationLink, and PrivatizationLink Russia).

The following sections discuss the evaluation findings of the overall relevance, effectiveness, and funding of MIGA’s TA activities over the period 1998–2003, in light of MIGA’s development mandate and in meeting the needs of its developing member countries.

**Relevance of MIGA’s TA Activities**

The relevance of MIGA’s TA activities can be defined broadly in terms of its ability to meet the needs of its target clientele. Since all developing member countries are prospective recipients of MIGA’s TA programs, MIGA’s challenge has been to balance the need to maximize the impact of its limited resources with the fulfillment of its development mandate. At the same time, MIGA’s Convention specifies the areas of technical assistance on which MIGA should focus (Annex IV.B).

**Strategy**

MIGA’s TA activities, as well as its strategy, have evolved significantly over time. There have been important changes in the relative mix of these activities, their duration, extent of client targeting, countries of coverage, methods of delivery, and degree of cooperation with other donors. This evolution has in part been in response to Board directions following the external review in 1998 but has also been shaped by internal factors, such as the availability of budget resources, senior management priorities, staff skill mix, and external factors, such as external funding sources and demand by client countries.

*MIGA Review 2000* (the most recent strategic document for MIGA) proposed to focus TA activities on capacity building of IPIs that generates actual investment flows, and continued upgrading of knowledge activity through Internet-based services. Since then MIGA has not prepared a comprehensive strategy for the agency to define the roles of TA and guarantee activities to fulfill its development mandate and explore any possible synergies.\(^{115}\)

**Criteria for Client Selection**

The *MIGA Review 2000* identified the following criteria for prioritizing client countries: (i) existence of an attractive legal and regulatory framework for FDI, (ii) commitment and ability of client agency to absorb assistance, (iii) priority of the country for MIGA, the Country Assistance Strategy (CASs), and Comprehensive Development Framework, and (iv) the ability of the country to copay for services or mobilize funding.

In the fiscal 2003–5 work program, MIGA modified and expanded these criteria for prioritizing its TA services among countries and organi-
izations to focus on: low-income countries; countries with a reasonably attractive investment environment; strong government commitment to the goal of attracting FDI, including the demonstration of such commitment by providing adequate funding for an IPI; and the ability to absorb support. Countries that do not meet all criteria could still be considered for TA, but the range of services might be more limited.

Based on these criteria, MIGA developed a tiered assistance approach, although this was never formally adopted as the basis of client selection. However, in 2000 MIGA began to prioritize countries in which to offer its TA, taking into account several indicators ranging from FDI performance to macroeconomic data to IC indicators to prioritize needs assessments. The results of needs assessments have been used by MIGA to decide which further interventions were warranted, if any, in light of the country conditions and needs, and the capacity of the existing investment promotion intermediary (IPI). MIGA does not have a formal system in place to review prospective TA projects at the time of project selection similar to the management review for prospective MIGA guarantee projects. MIGA's objective was to offer in-depth services wherever warranted by the findings of the needs assessment, subject to the availability of funds.

The tiered approach broadly categorized the investment promotion intermediary marketplace into three groups of countries, with a different menu of services targeted toward each country category (see table 20.1). “Priority countries,” or Tier 2 countries, were those deemed to have a reasonably attractive investment environment, have established but underdeveloped investment intermediaries, and lack the necessary resources to pay the full cost of advisory services.

The tiered approach seemed to recognize the need to appropriately target MIGA's TA services and to incorporate empirical evidence on best approaches in order to maximize potential developmental impacts. It also appears to be consistent with some findings of a recent FIAS study (see box 20.3), as some of the criteria introduced by MIGA (especially the quality of overall investment climate) are cited among the most important factors for developing an effective institutional framework for investment promotion. However, this approach was not formally adopted, and MIGA did not limit itself to working within this framework.

Other factors affecting MIGA country selection. In practice, MIGA's TA program has been partly driven by factors other than a consistent,

<table>
<thead>
<tr>
<th>Tier 1: Countries structured to attract FDI flows</th>
<th>Typical MIGA TA service offerings</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Attractive investment climate and institutional structure</td>
<td>• Capacity building on cost-recovery basis</td>
</tr>
<tr>
<td>• Good practice in investment promotion</td>
<td></td>
</tr>
<tr>
<td>• Effective investment intermediary structures</td>
<td></td>
</tr>
<tr>
<td>• Effective use of private sector advisory services</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tier 2: Priority capacity building countries</th>
<th>Typical MIGA TA service offerings</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Acceptable investment climate</td>
<td>• Tailored capacity-building programs</td>
</tr>
<tr>
<td>• Underdeveloped investment intermediaries</td>
<td></td>
</tr>
<tr>
<td>• Lack of resources</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Tier 3: Countries developing FDI attraction capacity</th>
<th>Typical MIGA TA service offerings</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Lack of attractive investment environment</td>
<td>• Regional workshops and conferences</td>
</tr>
<tr>
<td>• Lack of investment intermediaries</td>
<td>• Selected capacity building</td>
</tr>
</tbody>
</table>
adopted strategic framework. As a result, some resources and activities have been directed to countries that appear to fall outside the target strategy described above. Among the factors that more strongly influenced country/client selection in practice were ad hoc requests for assistance from member governments (especially for needs assessments); and availability of external donor funding to complement MIGA’s limited administrative budget for TA to offer larger scale, in-depth activities.

Furthermore, MIGA’s strategic selection criteria for TA have been adjusted frequently; these were modified again in MIGA’s fiscal 2004–6 budget document, which, in addition to the earlier criteria, introduced “sufficient investor interest to provide an active market for MIGA guarantees” as a new criterion and emphasized closer collaboration and complementarity with the WBG and its strategies. If implemented, the latter could help achieve better selectivity and consistency with the WBG.

**Portfolio of MIGA TA Products**
The following four categories broadly define the functions and roles of IPIs (Wells and Wint 2000):

- **Image-building activities** create the perception of a country as an attractive site for FDI
Based on general promotional techniques, such as advertising and media campaigns and public relations events.

- **Investment generation** targets specific sectors, country markets, and companies to create investment leads.
- **Investor facilitation and servicing** refers to services provided to assist an investor in analyzing investment decisions and in establishing and operating a business.
- **Policy advocacy** consists of activities through which the IPI supports initiatives to improve the quality of the investment climate and represent the views of the private sector.

While IPIs perform a wide array of functions, not all have been found equally effective in promoting inward investment flows (see box 20.3). A recent FIAS study (Morisset and Andrews-Johnson 2003) argues, based on empirical analysis, that policy advocacy might have the strongest impact on FDI inflows, followed by image building and investor servicing. Investment generation activities were found to be the least effective function, particularly in countries with relatively poor investment climates and/or low levels of economic development. These results suggest that in general, IPIs’ effectiveness varies with the IC conditions. Therefore the role of MIGA TA in improving investment climate has depended largely on the IPI’s characteristics and potential, as well as country conditions. The following section provides an overview of how well MIGA’s TA products have matched IPI needs.

In the past, MIGA did not clearly define and differentiate its TA products. Since 1998, MIGA has broadened its portfolio of TA products and services aiming at more tailored, hands-on assistance for its clients. More recently, MIGA has begun using a TA matrix to define the different types of TA it offers to IPIs, which fall in three categories:

- **Strategic Direction.** This includes institutional needs assessments, organizational strategy development and implementation plans, and promotional and marketing strategies (accounting for 45 percent of TA activities for IPIs).
- **Promotional Tools.** This includes development of investor information and tracking systems, installation and implementation of information technology tools, development of promotional materials, and promotional skills training (49 percent of TA activities).
- **Investment Promotion.** This includes assistance to IPIs for organizing investor conferences and promotional events, and development and implementation of systems and procedures for investment promotion (6 percent of TA activities).

The main categories and subcategories of MIGA TA activities are described in detail in Annex IV.C.

**Development of standardized products.** MIGIM has developed more standardized products, including (i) a needs assessment framework, a diagnostic tool to evaluate the capabilities and constraints of IPIs; (ii) an Investment Promotion Toolkit, covering best practices in investment promotion; (iii) an Investor Tracking System, a contact management software package; and (iv) IPAWorks, a template for Web site development.

More recently, more complex standardized products have also been added. For example, in early 2003, MIGA conducted a pilot benchmarking study to determine and compare operating costs and conditions in six Asian countries for two industry sectors—electronics and shared services. This was expected to become a standardized analytical tool to be used by IPIs to collect information on local costs and the business environment. In addition, a standardized methodology for sector-specific investor targeting strategies and marketing plans is also being developed, which would provide the basis for IPI investment generation programs.

In practice, needs assessments have been the most broadly used TA product MIGA offers to its clients. As a diagnostic tool, it has constituted the first contact with the client in response to a new request for MIGA services. A needs assessment is a one-time, short intervention, but it may serve as the first stage of a more in-depth and continued TA program if the client decides to pursue further assistance from MIGA. Thus,
with a smaller group of clients, MIGA has been engaged in more in-depth assistance activities consisting of one or more of the activities noted above.

**Relevance of MIGA’s TA Activities to Investment Promotion Intermediaries**

MIGA’s range of TA products and services is largely oriented to building capacity in three of the four core functional areas of IPIs, image building, investment generation, and investor facilitation and servicing, but not policy advocacy. In MIGA’s diagnostic work with IPIs, identifying their institutional capacity gaps, it has tended to focus on areas in which MIGA provided TA. Thus, some key issues (such as the IPI’s overall importance or relevance in FDI promotion within the government’s structure) may not have been addressed when they fell outside the focus of MIGA’s TA services.

The two TA evaluation case studies, while not sufficient to reach broad generalizations, provide useful insights. IEG-MIGA found that in these cases MIGA’s work was relevant and responsive as it provided its services at the expressed invitation of the governments. In both cases, MIGA’s TA was welcomed by the investment promotion agencies (IPAs) and praised by their staff as pivotal for establishing/developing the IPA. MIGA appeared to have responded to needs of these organizations as they arose. In one case, the IPA was willing to defray some of the cost of the services provided by MIGA. In the other, MIGA’s cautious and flexible approach was appropriate and borne out by frequent changes in the institutional framework for investment promotion in the country. In both cases, MIGA helped bring a broader perspective to investment promotion. By focusing on developing an appropriate strategy, establishing a solid organization, and strengthening operations, MIGA’s services appear to have been relevant to the specific needs of the organizations.

There is extensive literature on the relation between FDI and growth (and between growth and poverty reduction), one of the pillars of WB assistance to developing countries. Most of the research confirms the positive relation between FDI and growth, depending on the nature of the investment and host country conditions. Insofar as MIGA’s TA builds capacity and improves the quality of investment promotion intermediaries, the Agency is responding to a need in particular considering increased competition between countries for FDI.

MIGA’s TA was relevant to host countries and to IPIs in helping leverage their positions within the institutional framework for FDI promotion in the country. However, because IPIs are not responsible for the development of policies affecting FDI and have thus limited policy impacts on investment climate, MIGA’s assistance has been only indirectly relevant to directly improving IC. Furthermore, the size of MIGA’s TA team and the resources available relative to the Bank, as well as MIGA’s specific role within the WBG, limit MIGA’s specific effectiveness in addressing IC policy issues. These constraints have led others to suggest that IC issues should be handled by the other members of the WBG that have a comparative advantage to address them.

**Effectiveness of MIGA’s TA Activities**

The effectiveness of MIGA TA activities is assessed within the framework presented in figure 18.1, which includes immediate effects (changes in practices and systems of the IPA), outcomes (improved service delivery by the IPA), and impacts (increased FDI as a result of improvements in the IPA). As noted earlier, this last link in the chain of causality is tenuous. This section briefly discusses evidence from the literature on this link, then it focuses on whether MIGA targets its TA services at the right countries (i.e., where it can have the greatest developmental impact), and assesses the client perceptions of MIGA TA. Finally, the section assesses the effectiveness of MIGA TA activities, based on findings from two case studies, focusing mainly on the first two components of the chain of causality.

**Link between investment promotion and FDI flows.** Over the past 10 years, IPIs have proliferated in developing countries, partly in recogni-
tion of the fact that countries are competing for foreign investment, and partly by the apparent success of efforts by some developed countries and regions to attract FDI. Activities to promote a country appear to have a role to play in this competition, along with fiscal and regulatory incentives by the host country. In particular, promotional activities can address market failures, such as imperfect information among investors on investment conditions and opportunities of potential locations, and can help reduce investors’ transaction costs and risks. Little empirical analysis has been done on the effectiveness of investment promotion for FDI flows, and investment decisions are influenced by many intervening variables, which are difficult to isolate. Nevertheless, recent research shows a positive relationship between promotion and FDI flows. Research also suggests that the existing investment climate, the level of economic development, and the size of a country influence the outcome of promotion activities (see box 20.3).

**Effectiveness of Strategic Approach**

During fiscal 1998–2003, MIGA provided technical assistance to 63 countries, while others benefited from regional capacity building and investment promotion events. The number of recipient countries is smaller when compared to the 1993–7 period, mostly due to phasing out of multicountry, one-time activities (such as conferences) in favor of more customized and/or in-depth interventions.

**Recent allocation patterns (fiscal 2002–3).** To assess MIGA’s most recent activities in terms of their strategic effectiveness, the list of client countries was mapped against two of the selection criteria listed in MIGA’s fiscal 2003–5 work program, i.e., countries with a reasonably attractive investment environment and low-income countries. IEG-MIGA measured these criteria by using the Heritage Foundation/Wall Street Journal Index of Economic Freedom, and the list of IDA-eligible countries, respectively. The data indicate that the majority (23 of 41) of countries receiving MIGA TA in 2002 and 2003 were rated as “mostly unfree” economies, and another 13 were “mostly free” economies. MIGA TA was also offered in five countries with “repressed” economies with unattractive investment environments that would appear to fall outside its targeting strategy. This means that about 88 percent of MIGA TA activities were offered in countries presumed to have a reasonable investment environment. Figure 20.1 shows the distribution of MIGA TA by country group, differentiating limited interventions such as needs assessments (defined as countries where MIGA offered one or two activities) compared with those where MIGA offered more in-depth interventions (three or more activities per country).

Seventy MIGA member countries are IDA-eligible countries. In 2002–3, MIGA provided some form of TA to 26 of them. Mapping both the investment environment and the low-income criteria, half (21 of 41) of the countries that received TA during this period have met both criteria, thus ensuring greater effectiveness and impact. Among the in-depth interventions, the share of assistance to countries meeting both priority areas assessed was 84 percent (16 of 19). This also suggests that, in absence of a clearly articulated strategy, MIGA needs assessments have served as a useful tool for selecting in-depth interventions.

The available data did not permit the calculation of the actual share of technical assistance (in terms of outputs or value of inputs) MIGA provided to different categories of countries. Thus, it was difficult to determine whether a higher or lower share of actual assistance may have been directed to priority countries once the value of technical inputs (or outputs) is taken into consideration.

**Longer-term allocation patterns (1998–2003).** Between 1998 and 2003, the majority of countries (41 of 63) received limited assistance in one to two different TA subcategories. More than one-third of the countries (22) received assistance in a wider range (three or more) of TA subcategories (see figure 20.2). Over the 1998–2003 period, MIGA was more likely to offer limited assistance, such as needs assessments, to countries with unfavorable investment environments.
“mostly unfree” economies, MIGA offered TA to 34 countries, of which 10 were in-depth interventions. Among the 21 TA clients with “mostly free” economies, there were 8 in-depth interventions, a somewhat higher share. Analysis using the HFO/WSJ Index shows that over the 1998–2003 period, MIGA in-depth TA was offered in countries with IC levels similar to those of recipients of MIGA guarantees; in-depth TA was offered in countries with better IC levels than for recipients of basic diagnostic TA interventions.\(^{126}\)

While a sizeable proportion of basic TA activities has been directed toward countries that do not fit well with the stated targeting strategy and that are unlikely to be able to address fundamental problems in a country’s investment environ-

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**Figure 20.1: Distribution of MIGA TA Activities in 2002–3**

![Figure 20.1: Distribution of MIGA TA Activities in 2002–3](chart1)

**Figure 20.2: Number of MIGA TA Activities per Country (1998–2003)**

![Figure 20.2: Number of MIGA TA Activities per Country (1998–2003)](chart2)
ment, MIGA’s recent in-depth operations have been targeted reasonably well. Given that MIGA’s stated country targeting strategy for TA has changed over time, was not clearly articulated until 2002, and underwent modifications a year later, it is not surprising that stated priorities and actual clients served somewhat diverged over the 1998–2003 period. The high number of countries served reflects MIGA’s objective to respond to as many client requests as possible, at least with some basic diagnostic service.

Trend toward more in-depth interventions. Following one of the recommendations of the 1998 external review, MIGA has shifted its TA from multicountry, one-off events (such as regional workshops and seminars) to more tailored, in-depth TA programs for individual clients. The number of TA activities gradually increased between 1998 and 2003, while the number of beneficiary countries declined. This indicates a greater concentration of efforts per country, as the average number of TA activities per active country increased from 0.55 in 1998 to close to 2.4 in 2003. An indication of the greater depth of MIGA TA activities is provided in Annex IV.F, which presents a breakdown of these activities by country and by type.

While there is clearly a trend toward greater concentration of interventions per country, the numbers presented in the previous paragraph need to be treated with caution, due to the lack of any consistent and clear definition of what constituted an “activity.” MIGA TA activities have not been differentiated clearly for internal monitoring purposes. The number of activities was measured by the frequency of staff trips to client countries. Staff Back-to-Office Reports have formed the main basis of accounting. In some cases, this information has been adjusted by staff to take account of activities/projects not reflected in the Back-to-Office Reports. This definition of “activity” does not allow for easy classification of trips linked to a single project or capacity-building activity and thus makes it difficult to track TA activities in a consistent way or monitor results. A work plan to track work flow, milestones, and costs was introduced in fiscal 2004; and more specific and meaningful definitions of products and TA projects will be required in the future to evaluate objectively the impact of MIGA’s key TA products and assistance strategy, as well as to further improve internal measuring of activities.

Client Perceptions of the Quality of MIGA TA

With regard to client perceptions of MIGA’s work, the most recent available information comes from a survey of its TA clients undertaken by MIGA in 1999. These surveys showed a generally high degree of satisfaction with the quality of MIGA’s technical assistance (i.e., input, activities, and output categories in figure 18.1). The results of the IPI Survey, presented in MIGA Review 2000, indicate that perceptions of MIGA’s performance were high compared to other TA providers (both private and donors, see figure 20.3).

Overall, MIGA TA was rated highest in terms of client satisfaction among selected public (donor) and private technical assistance providers (see table 20.2), although the differences in ratings vis-à-vis the next best competitors were relatively small. In terms of specific areas of competence, MIGA assistance was rated highest in terms of investor networking and cost of service (its services are highly subsidized and often provided free of charge to clients). It also rated relatively high on knowledge and expertise in investment promotion, the ability to provide practical solutions, and understanding of the role of technology in investment promotion.

Outcomes and Impacts of Two Evaluated MIGA TA Projects

IEG-MIGA has carried out TA evaluations in two countries in fiscal 2004. While the two case studies are not necessarily representative of the 63 MIGA TA interventions during 1998–2003, they provide some useful insights. This section presents the findings from the two case studies (in El Salvador and Romania) with regard to the effectiveness of MIGA assistance to IPIs for capacity building. Annexes IVD and IVF present summaries of the two case studies, and Annex IVA describes the methodology used for evaluating both activities.

Conditions for MIGA’s Engagement and Nature of TA. The two cases differ with respect to depth and
duration of MIGA’s involvement; the nature of assistance; the country’s commitment to implementation; investment climate; and institutional framework, and thus, in outcomes and impacts of MIGA’s assistance.

In El Salvador, a country that has been pursuing a comprehensive reform program (supported by the Bank), with PSD and improving the investment environment as important government priorities, MIGA has been able to provide longer-term and more in-depth assistance. In Romania, MIGA’s involvement and input were much more limited, due largely to country conditions. While MIGA provided an initial needs assessment (a diagnostic tool to assess the infrastructure in place for investment

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### Figure 20.3: Client Satisfaction Ratings of TA

![Client Satisfaction Ratings of TA]


Note: Scores range from 1 to 10, with 10 being the most favorable.

### Table 20.2: Survey Results on Performance of MIGA TA Activities*

<table>
<thead>
<tr>
<th>Rank/ Importance to IPIs</th>
<th>Selection criteria</th>
<th>MIGA TA</th>
<th>Public A</th>
<th>Public B</th>
<th>Public C</th>
<th>Private</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Understanding of country needs</td>
<td>8.25</td>
<td>8.53</td>
<td>7.44</td>
<td>8.00</td>
<td>8.20</td>
</tr>
<tr>
<td>2</td>
<td>Knowledge and expertise</td>
<td>8.86</td>
<td>8.94</td>
<td>7.89</td>
<td>7.83</td>
<td>8.60</td>
</tr>
<tr>
<td>3</td>
<td>Practical solutions</td>
<td>8.54</td>
<td>8.19</td>
<td>7.25</td>
<td>7.80</td>
<td>8.60</td>
</tr>
<tr>
<td>4</td>
<td>Cost of service</td>
<td><strong>8.10</strong></td>
<td>7.15</td>
<td>8.00</td>
<td>7.80</td>
<td>7.25</td>
</tr>
<tr>
<td>5</td>
<td>Investor networking</td>
<td><strong>8.33</strong></td>
<td>7.82</td>
<td>7.86</td>
<td>6.67</td>
<td>8.00</td>
</tr>
<tr>
<td>6</td>
<td>Understanding of technology</td>
<td>9.00</td>
<td>8.63</td>
<td>8.00</td>
<td><strong>8.60</strong></td>
<td>8.20</td>
</tr>
<tr>
<td>7</td>
<td>Experience/track record</td>
<td>8.31</td>
<td>8.50</td>
<td>7.88</td>
<td>6.83</td>
<td>8.75</td>
</tr>
<tr>
<td>8</td>
<td>Responsiveness</td>
<td>8.23</td>
<td><strong>8.29</strong></td>
<td>7.00</td>
<td>8.00</td>
<td>7.60</td>
</tr>
<tr>
<td>9</td>
<td>Existing relationship</td>
<td>7.73</td>
<td><strong>7.80</strong></td>
<td>7.44</td>
<td>7.17</td>
<td>7.50</td>
</tr>
</tbody>
</table>


Note: IPIs = Investment Promotion Intermediaries.

* Scores range from 1 to 10, with 10 being the most favorable. Figures in bold represent category leaders; figures in italics represent scores higher than 8.50.
promotion and the capacity of the country to attract FDI), thereafter the institutional structure for investment promotion underwent frequent changes, and the roles and responsibilities of different agencies dealing with aspects of investment promotion were never defined clearly. Accordingly, MIGA did not continue its assistance beyond the initial stage.

Outcomes. Based on in-country interviews, in both cases MIGA's recommendations and assistance were considered very useful by IPI staff and induced changes in capabilities and practices of the IPI. However, MIGA had a more substantial and longer-term involvement in El Salvador, and the outcomes have also been more discernable and positive than in the case of Romania.

In El Salvador, MIGA has helped since 2000 to strengthen the capacity of the then newly established IPI (PROESA), which implemented many of MIGA's recommendations and adopted the basic approach to investment promotion propagated by MIGA. PROESA staff also received significant training. An IEG-MIGA survey and field interviews show that the government and foreign investors view the IPI very positively. PROESA has established itself as a highly professional agency, mounted a major image building campaign ("El Salvador Works"), provided services to about 90 potential investors, and generated a number of concrete FDI leads. The vast majority (84 percent) of investors interviewed were satisfied with the IPI's assistance. Furthermore, most investors (93 percent) considered PROESA's services to be of "good" or "excellent" quality.128

MIGA played an instrumental role as an advisor during the early phase of PROESA's operations, addressing concerns of its board and succeeding in sustaining government support. MIGA staff established strong relationships with PROESA staff and board members. PROESA staff noted the responsiveness of MIGA's team and the high quality of their assistance. This assistance was widely credited with helping PROESA establish credibility and legitimacy within the government and with investors, and allowed the new agency to get a head start. MIGA was credited for providing a "blueprint" for the nascent institution and helped with its implementation.

While there were few benefits from MIGA's work in Romania in the early phase (2000–1) because its initial recommendations were not implemented, the eventual formation of the Romanian Agency for Foreign Investment (ARIS) is attributed to MIGA's advocacy for an independent IPI. In the later phase (2002–3), MIGA's re-engagement and work with ARIS, which consisted mainly of a needs assessment and a draft strategic plan, resulted in several positive outcomes. At the same time, MIGA did not emphasize sufficiently several important issues ARIS faced: weak relationships with other government entities with similar responsibilities and a poor governance structure, which severely hampers its effectiveness. The institutional framework in Romania for issues relating to investment promotion has changed frequently, and several government entities have been competing with ARIS in implementing aspects of its investment promotion mandate. ARIS does not have any links with the Business Environment Department in the Ministry of Economic Development and Prognosis, an entity supported by FIAS. The case of Romania is illustrative of the difficulties MIGA can encounter in its engagement with a country and the dependence of the success of its interventions on the capacity and willingness of the host country to implement recommendations. Given these findings, MIGA's cautious approach, by offering only limited services in Romania, was appropriate and borne out by subsequent events.

ARIS is perceived by some stakeholders as struggling to gain credibility, having little visibility, and lacking needed resources and structures. Nevertheless, even within the limitations of the existing institutional framework, MIGA's assistance seems to have had some positive outcomes in terms of ARIS's effectiveness in serving its clientele. A small sample of foreign investors rated ARIS's overall effectiveness quite high, and about half stated that ARIS's services were of major importance in their decision to locate in Romania (yet a strong majority of respondents stated that they would have invested in Romania without ARIS's services).
Impact. A recent FIAS study concluded based on empirical evidence that there is a positive relationship between investment promotion and FDI (Morisett and Andrews-Johnson 2003). However, when assessing the impact of MIGA’s interventions on increased FDI flows to the host countries (or improvements in the investment climate), it is important to consider the limited role of IPIs. They can help shape the image of a country, but their mandate does not encompass the responsibility for policies affecting FDI. Investment decisions are influenced by many factors outside the control of IPIs, such as the macroeconomic situation, the legal and regulatory framework, and conditions on factor and final markets. It is therefore difficult to measure any direct improvements in FDI flows as a result of MIGA’s TA.

IEG-MIGA’s surveys of IPI clients for the two country cases did not show strong evidence that the IPIs have had any significant impacts on investment decisions by the time of this evaluation. Broad majorities of respondents (79 percent and 90 percent, in El Salvador and Romania, respectively) indicated that they would have invested in the country even in the absence of an IPI. According to responses of surveyed investors, the IPIs’ main added value was in helping to reduce the time required to start operations—thus reducing the cost of doing business—(50 percent of respondents) and increasing the likelihood of the success of the investment in the country (50 percent)—which involved closing the information gap. However, investments take time, and it may therefore be too early to determine the impact of these IPIs on FDI flows.

The evaluation found that investment flows in El Salvador were mainly driven by reform policies, trade liberalization initiatives, and privatization efforts by the government, which reduced costs and minimized risks. The government took specific steps to create a more favorable investment climate. Foreign investors stated that they were drawn to El Salvador because of the political and currency stability, and its physical infrastructure. According to the investors surveyed, investment promotion efforts were not in themselves a determinant. In Romania, investor interest resulted mainly from the prospect of EU accession, and related improvements in the business environment and macro economic performance.

Sustainability. In terms of the sustainability of the impacts of MIGA assistance, both IPIs depend on visibility, credibility, and support from the highest level of government and the private sector. In the case of El Salvador, the IPI appears to have political support, but it currently lacks budget autonomy and many of its staff move to take jobs with foreign companies. The Romanian IPI has inadequate funding and staffing, and it is still struggling to gain credibility and support from the private sector and to define its role among various government agencies. To date, the sustainability of impacts of MIGA’s technical assistance is therefore considered likely in El Salvador, but modest in Romania.

Resources for MIGA’s TA Activities
This section addresses the resources available and funding mechanisms for MIGA TA activities. It also considers the degree to which MIGA TA activities complement or leverage other donor and nondonor-related activities, including those of MIGA’s guarantees other WBG and donor agencies, as well as private sector providers.

Resources and Cost Efficiency of MIGA TA
MIGIM was structured as a relatively small department, consisting of 23 staff, 17 of whom are at the professional level and 10–20 of whom are consultants. Until MIGA’s reorganization in May 2004, this group had been responsible for the delivery of both TA and online information services; within this group, the team responsible for capacity building activities consisted of nine staff.

During 1998–2003, MIGA recruited experienced investment promotion practitioners to bring high-caliber experience to its clients, as recommended in the 1998 external review. Given the small size of its core staff, the role of external consultants in delivering MIGA’s TA products and services has been growing. Until recently, most external consultants have been recruited on an individual basis. However, as
MIGA has moved its TA toward the development and implementation of larger-scale, multicountry and field-based initiatives, MIGA has also begun to outsource entire initiatives, projects, or large components of projects to private consulting firms.

The cost efficiency of MIGA’s TA activities is difficult to evaluate, as there are little internal data available on the actual costs of delivery of its various products and services. Although from the client’s perspective MIGA offers low-cost access to TA (since cost recovery from clients for capacity building activities—fees or reimbursement of expenses—account for less than 0.5 percent of total TA resources), it is not clear whether MIGA is a cost-efficient provider of TA, given the lack of cost information. The delivery of assistance free of charge also means that MIGA’s capacity building programs do not face a true market test. Proper project management and monitoring will require a more effective and consistent approach to project accounting. In this regard, MIGA has started in fiscal 2004 to track the staff time spent on a project.

**Funding Sources for MIGA TA**

MIGIM’s administrative budget has risen from $2.7 million in fiscal 1998 (or 10 percent of MIGA’s budget) to $5.1 million in fiscal 2004 (15 percent of MIGA’s total budget)—in line with a recommendation of the 1998 external review. MIGIM’s administrative budget has been funded mainly through premium income from MIGA’s political risk guarantees. Between fiscal 1998 and 2003, MIGIM’s total funding (including trust funds and partner contributions) has gradually increased from US$4.7 million to more than US$7.1 million per annum. Cumulatively, between fiscal 1998 and 2003, MIGIM’s administrative budget accounted for approximately 58 percent of total resources available for TA activities, which have been supplemented by external funds from donors. The share of external funding from trust funds and partner contributions has been volatile over the last five years, averaging 42 percent.

MIGIM’s modest administrative budget and the limited availability of additional funding sources have been important factors in determining the direction of its TA activities. While the administrative budget has covered the cost for all the needs assessments, MIGA seeks funding for more intensive TA programs from donors or support from existing Bank programs, and, in rare cases, MIGA has funded in-depth interventions from its own budget. However, in most cases where external funding is not available, it is not able to offer an in-depth support program. During 1998–2003, MIGA was able to leverage its own budget by US$14.2 million in external funding, consisting of trust funds, grants, and partner contributions during 1998–2003. Revenues from MIGA TA products and services—including both capacity building and information products and services—funded less than two percent, equivalent to US$0.8 million, of MIGIM’s total resources for the same period.

Virtually all of MIGIM’s trust fund and grant resources were tied to providing technical assistance in specific countries (see table 20.3). Funding from trust funds or partner/client contributions has also had an impact on the allocation of MIGA’s regular administrative budget as it has been used to supplement off-budget funds, covering MIGA staff and, in some cases, travel expenses of externally funded...
projects. While external funding has enabled MIGA to leverage its limited resources and to provide in-depth and sustained TA to some countries, trust funds have also limited its selectivity to maximize its developmental impact. Table 20.4 shows some evidence that MIGA’s TA activities may have been partly driven by the availability of external funding, as there is

<table>
<thead>
<tr>
<th>Funding source (Year of disbursement)</th>
<th>Funding amount (US$)</th>
<th>List of eligible countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country-specific funding</td>
<td>$6,155,000</td>
<td>Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Bosnia-Herzegovina, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Macedonia, Malta, Moldova, Poland, Romania, Russian Federation, Serbia and Montenegro, Slovak Republic, Slovenia, Tajikistan, Turkey, Turkmenistan, Ukraine, Uzbekistan</td>
</tr>
<tr>
<td>MIGA-Swiss Trust Fund (ECA) (FY98)</td>
<td>$213,000</td>
<td>Albania, Armenia, Azerbaijan, Belarus, Bulgaria, Bosnia-Herzegovina, Croatia, Cyprus, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Macedonia, Malta, Moldova, Poland, Romania, Russian Federation, Serbia and Montenegro, Slovak Republic, Slovenia, Tajikistan, Turkey, Turkmenistan, Ukraine, Uzbekistan</td>
</tr>
<tr>
<td>MIGA-Swiss Trust Fund (Africa) (FY02)</td>
<td>$1,730,000</td>
<td>Ghana, Mozambique, Senegal, Tanzania</td>
</tr>
<tr>
<td>Indo-China (PHRD TF) (FY98–00)</td>
<td>$450,000</td>
<td>Lao PDR, Cambodia, Vietnam</td>
</tr>
<tr>
<td>Miyazawa Initiative (PHRD TF) (FY00–02)</td>
<td>$714,000</td>
<td>Indonesia, Korea, Malaysia, Philippines, Thailand</td>
</tr>
<tr>
<td>Promote Africa (PHRD TF) (FY98–02)</td>
<td>$2,550,000</td>
<td>Angola, Botswana, Burkina Faso, Cameroon, Côte d’Ivoire, Eritrea, Ethiopia, Ghana, Malawi, Mali, Mozambique, Namibia, Nigeria, Senegal, South Africa, Tanzania, Uganda, Zimbabwe</td>
</tr>
<tr>
<td>Russia PLink (CIDA TF) (FY99–01)</td>
<td>$498,000</td>
<td>Russia</td>
</tr>
<tr>
<td>Product-specific funding</td>
<td>$200,000</td>
<td>n/a</td>
</tr>
<tr>
<td>FDI Xchange (Japan TF) (FY03)</td>
<td>$200,000</td>
<td>n/a</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>$6,355,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: Internal MIGIM documents.

Table 20.4: MIGA in-Depth TA by Region

<table>
<thead>
<tr>
<th>Region</th>
<th>Number of in-depth interventions (1998–2003)</th>
<th>Percentage of total in-depth interventions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sub-Saharan Africa</td>
<td>8</td>
<td>38</td>
</tr>
<tr>
<td>Asia and Pacific</td>
<td>7</td>
<td>33</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>1</td>
<td>5</td>
</tr>
<tr>
<td>Middle East and North Africa</td>
<td>2(^a)</td>
<td>10</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>3</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>21</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

Note: In-depth interventions are defined as comprising three different MIGA TA activities or more (see Annex IV.F).  
\(a\) One case involved cofinancing by the host government.
a relationship between the number of MIGA in-depth interventions in each region and the size of trust funds available for that region, as shown in table 20.3.

**MIGA’s Role within the WBG and Collaboration with Other Agencies**

MIGA is one of many organizations providing TA to developing countries in the area of investment promotion. MIGA’s TA activities were conceived to complement MIGA’s guarantees operations and the activities of the Bank, IFC, and other development agencies.134 Its comparative advantage vis-à-vis other providers of advisory services in the area of investment promotion is not clearly defined. MIGA has collaborated with a wide range of WBG entities—such as FIAS, the PSD department, and others. Figure 20.5 provides an overview of the current broad division of roles of the various institutions.

To ensure that all member countries benefit from MIGA products and services, MIGA has provided TA to some countries that have not yet benefited from MIGA’s guarantee operations,135 with the implication that these TA activities would be less selective and directed outside its strategic priorities. While MIGIM has worked with MIGA’s Underwriting Department in some countries and Regions (e.g., in Sub-Saharan Africa), in practice, there has been little complementarity between the two products, and guarantees and TA activities were handled by two separate departments (until May 2004). MIGA has not formulated a strategy that would better integrate or complement the delivery of TA and guarantees products. There is no evidence that MIGA TA activities have contributed to the generation of guarantees business, or vice versa, and current TA activities have a limited potential to make the IC more conducive for MIGA guarantees. In fact, there

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**Figure 20.5: Role of MIGA TA in Promoting FDI within WBG**

Steps in enhancing FDI flows

- Creating a conducive environment for FDI
- Formulating the national investment promotion strategy
- Attracting investors and anchoring FDI within domestic economy

Key issues and concerns

- Business climate for FDI
- Administrative barriers to FDI
- Legal environment for FDI
- Benchmarking sector competitiveness
- Costs/benefits of investor incentives
- Competition policy to attract FDI
- FDI statistical database
- Contribution of FDI to economic development
- Role of IPA vs. others
- IPA structure, function, core activities
- IPA strategies and business plans for IPIs
- Business-government partnerships to facilitate FDI
- Targeting IP efforts
- Investor research/surveys
- Use Internet and IT for investor outreach
- Investor servicing and aftercare
- Backward linkages into the local economy and policies to strengthen these linkages
- Corporate social responsibility among foreign investors
- Investment dispute resolution through mediation or arbitration

Source: MIGIM data.

a. World Bank/IFC Foreign Investment Advisory Service.
b. MIGA Investment Marketing Services.
c. MIGA Investment Dispute Mediation Services.
d. IFC SME Department.
e. International Center for Settlement of Investment Disputes.
are important differences between MIGA's products; both are distinct, have different clients, and are served by different tools in different ways, and at different times.

According to management and staff Back to Office Reports, MIGIM has actively sought to promote MIGA guarantee products and services both to client IPIs and prospective investors (although direct investor contacts have decreased as MIGIM moved away from supporting investor conferences). MIGIM has also raised awareness of MIGA guarantees via its online and direct outreach to potential investors, including PrivatizationLink, FDIExchange, and IPAnet.

Relationship between MIGA TA and FIAS. Since their demerger in 1993, FIAS and MIGIM have operated as two separate entities offering TA in the area of investment promotion. FIAS typically concentrates on national strategies and policies to encourage FDI; it provides technical assistance to improve the overall investment climate and assistance in developing the legal and institutional framework for the establishment of IPIs. MIGA works on implementation with established IPIs (e.g., on their organizational development and investment promotion efforts). FIAS’s client is usually a ministry; MIGA is the investment promotion intermediary. Staff skills of the two institutions also differ; FIAS staff often have a policy focus, while MIGA TA staff have a stronger background in investment promotion/marketing. A possible classification of TA in investment promotion, based on an internal FIAS paper is presented in table 20.5.

This paper defines investment promotion activities as columns 4–8. FIAS activities usually encompass activities in columns 1–4 in table

### Table 20.5: Possible Activities under Investment Promotion Products

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8+</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Diagnostic work</td>
<td>Admin. barriers studies</td>
<td>Development of national investment</td>
<td>Creation of basic design (governance</td>
<td>Assistance in designing marketing</td>
<td>Assistance in designing initial</td>
<td>Help in developing budgets and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>strategies, including perhaps investment</td>
<td>structure, for example) of proposed</td>
<td>strategy of responsible unit.</td>
<td>business plan of responsible unit.</td>
<td>detailed organizational charts of</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>law, approaches for reforming other</td>
<td>unit to be responsible for marketing</td>
<td></td>
<td></td>
<td>marketing unit.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>laws, approvals processes, tax structure</td>
<td>function.</td>
<td></td>
<td></td>
<td>out their activities.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>and administration, and so on.</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td>Advice on location of promotion activity</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td>within government.</td>
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<td></td>
<td></td>
<td></td>
<td>Creation of legal framework for</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td>investment promotion.</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td>Creation of framework for effective</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td>policy advocacy.</td>
<td></td>
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</tr>
</tbody>
</table>

Typical FIAS scope

Possible FIAS scope

Typical MIGA scope

Possible MIGA scope
20.5 (which include most of the activities directly linked to investment climate, e.g., administrative barriers, legal and regulatory framework). Hence, addressing IC issues is clearly in FIAS’s purview, which is also underscored by its mission statement:

FIAS helps governments in improving their business environment so that they can attract and retain more and more beneficial FDI.\(^{156}\)

By contrast, MIGA’s main sphere of activity has been in columns 5–8. Its mission is defined as follows:

[MIGA] provides tailored advice and capacity-building assistance to investment promotion intermediaries.

The existence of two separate entities dealing with TA for investment promotion is related to institutional history. Both MIGA and FIAS have evolved and specialized over time and have achieved name recognition for their products, as well as attracted a clientele. In addition, MIGA was mandated by its Convention to provide TA to promote investment flows to developing countries, in addition to its guarantee business.

The current division of labor between FIAS and MIGA includes some areas in which both may play a role. The internal FIAS report highlighted the need for better communication and coordination between these two units on ongoing activities and research. However, in recent years, the coordination and cooperation between MIGA and FIAS have become much more effective. MIGA and FIAS have, over time, attempted to establish their respective functional roles and responsibilities in providing technical assistance to support investment promotion, as outlined in figure 20.5 above. In practice, MIGA and FIAS have agreed to “hand off” clients to one another.

Both MIGA and FIAS have increased their roles in coordinating their TA activities with other Bank units, particularly the PSD units. However, by and large, they continue to plan

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**Box 20.4: MIGA and FIAS: How Does Cooperation Work on the Ground?**

In the case of El Salvador there was a clear-cut division of labor between FIAS and MIGA. The country had a clear reform agenda, starting in the early 1990s, and sought support from the WBG for reforms and institutional development. Both FIAS and MIGA were active in the country, albeit at different times and with clearly different mandates. Each focused on different tasks, working with two different entities (the one stop shop in the Ministry of Economy in the case of FIAS and the IPA in the case of MIGA). Both entities have distinct mandates that do not overlap, one being a public sector institution, and the other a private sector-led promotion agency. The roles of FIAS and MIGA appear to have been separate and in line with the division of labor between the two organizations. FIAS finished its work in El Salvador in 2000, well before MIGA work started in earnest. While there was no conflict or overlaps or gaps in the delivery of services, there also appears to have been very little coordination between the institutions, as both seemed to have responded to client requests separately.

The case of Romania is illustrative of potential gaps in delivering services across the WBG, and of difficulties in operating in a country with insufficient institutions for FDI promotion. MIGA has provided technical assistance in specific areas to the IPA, although the most pressing needs for improving FDI were in the area of legal and/or institutional development, which fall under the purview of FIAS. Both FIAS and MIGA were involved in Romania but each through a different ministry. While FIAS was engaged in investment climate work in Romania, it did not assist the national IPI to improve the agency’s institutional framework for investment promotion and facilitation. While MIGA management recognized the weaknesses that the IPI faced institutionally, it did not actively involve FIAS to bring in the necessary technical assistance.

These two cases indicate that while there are no major conflicts, cooperation can be improved between FIAS and MIGA to provide more effective and strategic client services under the umbrella of the WBG.

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a. Based on discussions with MIGA management.
and implement their activities independently of each other. A concern expressed by both MIGA and FIAS management is MIGA’s lack of sufficient resources to follow up with client organizations that FIAS has supported.

From the perspective of a client country, the existence of two separate units can lead to confusion over which services are provided by whom. It may also lead to overlaps or gaps in the conception and delivery of services to clients, although no such evidence was found in IEG-MIGA’s evaluation. Finally, there is also a risk that the WB may be suboptimizing its resources and provide suboptimal (compartmentalized) services to its clients. Therefore, the increased coordination and cooperation between the two departments should be formalized, including protocols for the handover of clients.

Cooperation between MIGA and Other World Bank Units. Given that MIGA is highly specialized and its activities are generally small, its overall effectiveness and impact needs to be seen in the context of the WB. In the 1998–2003 period MIGA increased its collaboration with other Bank departments, including coordinating activities or directly participating in investment promotion components of private sector development projects. MIGA started in fiscal 2003 to participate in the formulation of CAS and Poverty Reduction Strategy Papers (PRSPs) for selected countries.

More recently, MIGA has increased its efforts to build more effective linkages with WB programs, and it participates in the PSD sector board. In 2003, MIGIM was involved in work with other parts of the Bank Group to explore an integrated and improved approach to encouraging FDI. As a result of these discussions and internal strategic planning, MIGA defined an approach for its involvement in the CAS. As a result of these discussions and internal strategic planning, MIGA defined an approach for its involvement in the CAS. Its fiscal 2004 work plan was developed with an explicit effort to coordinate better its future technical assistance activities with the CAS to leverage Bank Group resources and maximize the developmental impact of its activities.

While the extent of MIGIM’s cooperation with other departments of the WB has gradually increased since 1998, the ad hoc nature of much of this collaboration and the lack of effective mechanisms to channel these relationships have not always enabled MIGIM to fully leverage Bank Group resources. Moreover, MIGIM’s resource constraints have been a significant cause of concern in terms of its ability to collaborate and support investment promotion activities in client countries.

MIGIM Collaboration with Other Development Agencies. In addition to WBG entities, MIGIM has collaborated with a number of other organizations that are involved in investment promotion, including the United Nations Development Programme, United Nations Conference on Trade and Development, United Nations Industrial Development Organization, United Nations Economic Commission for Africa, and the World Association of Investment Promotion Agencies.

To some extent, MIGA also competes with specialized consulting firms in offering its TA activities. However, as mentioned above, its services are highly subsidized and provided to the clients essentially free of charge. It is not clear how MIGA TA differentiates its services from those that could be provided at similar quality (and maybe more cost-effectively) by consulting firms and other organizations. There are no rules that explicitly require MIGA TA activities to complement these firms’ services, rather than compete with them. At the time of this evaluation, when operating as a consulting and training organization, MIGA did not conclude formal contracts or agreements with its clients incorporating an explicit scope of work, objectives, budget, and cost-sharing arrangements.

Monitoring and Evaluation of MIGA’s TA Activities

MIGA prepared an internal document outlining a monitoring and evaluation framework to track progress of its TA activities in 2001, but at the time of this evaluation, MIGA had not established a monitoring system for TA activities. MIGA continues to have difficulties in defining its TA activities, and there is little information available on the cost of delivering
TA. Until 2001, monitoring and evaluation (M&E) occurred primarily through BTORs, with significant shortcomings in the accounting of activities. The proposed framework envisaged a fully integrated system consisting of project planning records, activity completion records, follow-up surveys, and selected ex post evaluations. Subsequently, a few project-specific self-evaluations were carried out, mainly focusing on outputs and immediate effects of MIGA TA activities, without making progress in implementing the fully integrated system. In addition, data were collected for internal reporting purposes; however, some of the information and indicators are not conducive to building an effective M&E system. As MIGA improves the targeting of regions and countries for its TA program and develops clear criteria for project objectives, milestones, responsibilities, and cost assignments, it should adopt a fully integrated M&E system as envisaged in 2001. In fiscal 2004, MIGA undertook some preliminary work for developing an M&E strategy and related indicators for its TA activities, and has implemented a work plan to track project milestones.
Findings and Recommendations

Mandate

MIGA plays a specialized role within the WBG and its mandate is focused on facilitating FDI flows to developing countries. This mandate does not explicitly incorporate the objective of improving Investment Climates for its guarantee activities. MIGA’s guarantees and TA activities are provided in accordance with the WBG’s PSD Strategy.

MIGA’s guarantees can mitigate some aspects of IC relating to political risks, a component of investment climate. Although MIGA’s involvement may not improve investment climate directly, its guarantee projects have the potential to affect IC indirectly through demonstration effects and linkages that stimulate local enterprises. These impacts are difficult to quantify. Evidence from a small sample of evaluated guarantee projects suggests that demonstration effects have been modest.

MIGA’s TA capacity–building activities can be effective in strengthening PIs and improving their effectiveness. The impact of MIGA’s TA on investment climate (and FDI flows) is difficult to establish. MIGA TA does not normally address the policy, legal, and regulatory framework, which is under the purview of other members of the WBG.

MIGA guarantees have been concentrated in countries with “medium-quality” investment climates. For its TA activities, MIGA has been active, on average, in countries with worse investment climates than for guarantees; but more in-depth TA, beyond needs assessments, has gone to countries with investment climates better than those of guarantee recipients.

Strategy

MIGA’s strategies for selecting clients for its TA activities have changed frequently, and a significant share of diagnostic MIGA TA activities has been directed to countries outside MIGA’s strategic priorities. During 2002–2003, in-depth TA has been concentrated in countries covered by the stated strategic priorities—those having reasonable investment environments and low incomes.

Any divergence from MIGA’s stated strategy and its current portfolio of TA clients is due to several factors, including MIGA’s objective to respond to as many requests for assistance as possible, and its funding structure. External funding is important for leveraging MIGA’s own limited resources for TA, and lack of resources—
combined with tied funding—constrain MIGA’s strategic selectivity.

Within its mandate, between 1998 and 2003, MIGA focused and diversified its products and services. It concentrated its activities for a subset of clients for which it carried out more intensive, longer-term activities.

MIGA does not have a strategy that integrates the delivery of its guarantee and TA activities. There has been little complementarity between TA and guarantees in practice under the former organizational structure, where two separate departments handled these two products.

Recommendation 1: Comparative Advantage and Strategy

- MIGA should define clearly its comparative advantage in providing TA and focus on areas where it can provide additionality and complementarity to the WBG, other donors, or the private sector.
- MIGA should endorse and implement a clear and coherent strategy for selecting its clients that ensures high effectiveness and development impact. Within this strategy, it should exercise better selectivity of clients to improve the effectiveness of resource use and impact.
- This new strategy should integrate TA and guarantee products to reap synergies within the Agency.

Effectiveness

Given the many variables influencing FDI, empirical evidence linking investment promotion to higher FDI flows is limited. According to a recent empirical study by FIAS, the investment promotion activities are positively related to FDI flows.

Findings from two evaluation case studies of MIGA TA activities suggest that the outcome of MIGA’s TA (in terms of improved quality of services of the IPI) has been positive. The impact of IPIs on actual FDI flows in these two cases was difficult to determine and has so far been limited—and may never be known. The evaluation found that most of MIGA’s recommendations were relevant for the agencies they worked with, but that implementation by the IPI varied.

Investors stated that IPIs have contributed to a reduction in transaction costs (e.g., time, cost of information, and red tape) and improved the likelihood of their investment’s success.

Evidence from the two case studies and a review of past MIGA TA activities also suggests that MIGA has been more effective when engaged with committed governments (e.g., where the IPI had direct support from and was reporting to the President/Prime Minister, increases in FDI flows were government priorities, and the IPI was adequately funded).

Recommendation 2: Research on Effectiveness of Investment Promotion

MIGA should facilitate or commission research to establish whether investment promotion activities have an impact on overall investment flows and the extent to which government commitment is a key determinant of success, in order to assess the likely impact of its TA program.

Resources and Efficiency

MIGA leverages its modest internal budget with external resources (trust funds and partner contributions) primarily to deliver in-depth TA assistance programs. MIGA’s limited TA resources and its dependence on tied external funding have influenced the range and direction of its TA program and have had implications for the implementation of a client targeting strategy.

While MIGA offers its assistance essentially free, little is known on its cost effectiveness, because cost information at the activity level is not available for past years.

MIGA cooperates with many partners inside and outside the WBG in the delivery of its TA program. Coordination and cooperation between MIGA and FIAS have improved over the past years. While there is potential for overlap between the mandates and activities of FIAS and MIGA, this evaluation has found no evidence that this has had a major impact on the delivery of the work to the client. The WBG PSD Strategy did not provide new directions for FIAS-MIGA collaboration, but prescribed continuity. Codifying the division of labor between FIAS and MIGA and establishing protocols for handing over
clients can ensure continued good coordination. This will also help clarify the roles and services of the different institutions for the Bank’s clients.

**Recommendation 3: Funding Sources, Cost Effectiveness, and Coordination**

- **MIGA should continue to seek additional funding to complement its own resources, and align its work program closer with IBRD/IDA priorities and lending to support capacity building.**
- **MIGA needs to improve its cost measurement tools and tracking systems for its TA activities to be able to assess its cost efficiency in the future.**
- **MIGA should continue its coordination and cooperation with FIAS and other partners, to ensure that resources are targeted to provide additionality and complementarity. The respective roles of FIAS and MIGA, and handover protocols should be codified to ensure consistent application.**

**Operational Issues**

MIGA does not have an explicit policy on cost sharing with clients and does not usually conclude contracts with them. It does not define ex ante the scope of work and objectives for its program in a client country.

**Recommendation 4: Formalize Relationship with Clients**

MIGA should formalize its relationship with client countries for in-depth TA through formal contracts, including arrangements for sharing costs. It should clearly define the scope of work, costs, objectives, and indicators of success.

**Monitoring**

MIGA has not established a monitoring system for its TA activities, and its measurement of projects is insufficient. While a few ad hoc self-evaluations have been undertaken by MIGA and some progress was made in fiscal 2004, it has yet to implement a systematic, integrated monitoring system to track project progress, outcomes, responsibilities, and costs over the TA project cycle. This becomes more important as MIGA continues to move into more in-depth, longer-term assistance programs.

**Recommendation 5: Implement Monitoring System**

MIGA should put in place a monitoring system to track the progress and impacts of its TA interventions.
General Framework
The technical assistance provided by MIGA to IPAs can take any number of forms and includes the following (see figure 18.1 on page 258):

- Needs assessments
- Strategic planning
- Preparation of marketing plans and promotional materials
- Web site development
- Development of information systems
- Staff training.

The nature and magnitude of technical assistance delivered to individual IPAs varies. Some interactions are short-lived focusing on one particular aspect of an IPA's operations; others extend over a long period and are designed to address the organization as a whole. Regardless of these differences, TA is intended to strengthen the capacity of IPAs and increase their effectiveness in terms of attracting greater FDI to relevant countries.

The evaluation of MIGA’s TA includes an assessment of the outcome, impact, and efficiency of an intervention. Determining whether the technical assistance provided by MIGA actually yielded intended outcomes involves making statements concerning causality. The fundamental tenet of impact assessment is the need to compare the observed situation with the intervention to what would have been had there been no intervention at all, i.e., the counterfactual. The difference in resulting outcomes between these two states constitutes the impact of the program as illustrated in figure IV.A.1. While the counterfactual cannot be observed or known with complete certainty, the concept of comparing observed outcomes to this hypothetical state underlies all valid approaches to assessing impacts. Valid comparisons imply that the net effect of interventions is isolated from all other extraneous or confounding factors that influence defined outcomes.

For MIGA TA, IEG-MIGA assessed both the impact of technical assistance on the IPA and the

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**Figure IV.A.1: The Impact of an Intervention**

![Impact of an Intervention](image)
improved effectiveness of the IPA in influencing investment decisions of particular companies.

For this study, IEG-MIGA evaluated two TA projects. One case was selected because it had been identified as a joint country case study by IEG-World Bank and IEG-IFC for this evaluation. The other was selected from IEG-MIGA from a group of projects where MIGA had done in-depth and long-term interventions that would be suitable to test this TA evaluation approach. Each case study had the following two components as described in table IV.A.1.

<table>
<thead>
<tr>
<th>Component</th>
<th>Description</th>
<th>Data requirements</th>
</tr>
</thead>
</table>
| Expert opinion           | This component would trace the link between TA and subsequent changes in the capacity of the IPA through in-depth interviews and direct observations. The study would examine the extent to which the organization improved along dimensions included in the MIGA needs assessment from the TA received. The expert would assess the IPA’s existing capacity and compare it to the results of the initial needs assessment prepared by MIGA. The expert would attribute changes in capacity based on in-depth interviews with MIGA TA and IPA staff as well as a review of materials and other deliverables prepared by MIGA staff as part of the TA. | • Results of the initial needs assessment  
• Description of the technical assistance provided to the IPA  
• Materials provided to the IPA  
• Current needs assessment |
| Investors’ perceptions   | This component would involve a survey of companies with which the IPA had interactions to obtain information on their satisfaction with IPA services and the degree to which these services influenced their subsequent investment decisions.                                                                                                                                                                  | • Complete list of potential investors with which IPA interacted  
• Survey                                                                                                                                                                                                                                                                   |
Article 2 (b). Objectives and Purposes
The objectives of the Agency shall be to encourage the flow of investments for productive purposes among member countries, and in particular developing member countries, thus supplementing the activities of the IBRD […], the IFC, and other international development finance institutions.

To serve this objective, the Agency shall:

(b) Carry out appropriate complementary activities to promote the flow of investments to and among developing member countries.

Article 23. Investment Promotion
(a) The Agency shall carry out research, undertake activities to promote investment flows and disseminate information on investment opportunities in developing member countries, with a view to improving the environment for foreign investment flows to such countries. The Agency may, upon the request of a member, provide technical advice and assistance to improve the investment conditions in the territories of that member. In performing these activities, the Agency shall:

(i) be guided by relevant investment agreements among member countries;
(ii) seek to remove impediments, in both developed and developing member countries, to the flow of investment to developing member countries; and
(iii) coordinate with other agencies concerned with the promotion of foreign investment, and in particular the IFC.

(b) The Agency also shall:

(i) encourage the amicable settlement of disputes between investors and host countries;
(ii) endeavor to conclude agreements with developing member countries, and in particular with prospective host countries, which will assure that the Agency, with respect to investment guaranteed by it, has treatment at least as favorable as that agreed by the member concerned for the most favored investment guarantee agency or State in an agreement relating to investment, such agreements to be approved by special majority of the Board; and
(iii) promote and facilitate the conclusion of agreements, among its members, on the promotion and protection of investments.

(c) The Agency shall give particular attention in its promotional efforts to the importance of increasing the flow of investments among developing member countries.
### Portfolio of MIGA’s TA Activities

<table>
<thead>
<tr>
<th>Activity</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strategic direction</strong></td>
<td></td>
</tr>
<tr>
<td>Needs assessment</td>
<td>Formal institutional assessments using MIGIM’s comprehensive Needs Assessment Framework. Informal assessments may also be conducted where an in-depth assessment is either unnecessary or inappropriate.</td>
</tr>
<tr>
<td>Strategy development</td>
<td>Encompasses several different TA interventions depending on needs and capabilities of client, including in-depth strategic planning exercises and the development of a formal strategic plan document; formal and informal strategic planning tools and methodologies to assist in defining institutional and promotional strategies.</td>
</tr>
<tr>
<td>Implementation plan</td>
<td>Operational business/corporate plans that specify objectives, organizational structure, promotional targets, and budgetary requirements and impact expected from promotional activities.</td>
</tr>
<tr>
<td>Investor targeting</td>
<td>Training for conducting investor targeting studies and market intelligence.</td>
</tr>
<tr>
<td>Marketing plans</td>
<td>Studies and/or training in design of generic and sector marketing plans.</td>
</tr>
<tr>
<td><strong>Promotional tools</strong></td>
<td></td>
</tr>
<tr>
<td>Investor information system</td>
<td>Design, development, and implementation of publications, including both paper and electronic based systems and materials, to provide factual information to investors.</td>
</tr>
<tr>
<td>Information technology tools</td>
<td>Information technology strategy development, Web site design and implementation (IPA Works); assistance in use of other IT tools, including PrivatizationLink and PrivatizationLink Russia, and FDI Xchange.</td>
</tr>
<tr>
<td>Contact relationship management</td>
<td>Needs assessment, installation, and implementation of customized contact relationship management software to enable investor tracking.</td>
</tr>
<tr>
<td>Promotional materials</td>
<td>Assess need for and assist in development of promotional materials, including country brochures, sector brochures, country or sector videos, Web site content, information packets, promotional stand design, press kits, etc.</td>
</tr>
<tr>
<td>Investor toolkit/training</td>
<td>Training to develop promotional capacity using MIGIM’s Investor Toolkit framework.</td>
</tr>
<tr>
<td>Investor services and</td>
<td>Assistance to IPA management and staff to design and implement quality investor servicing capability and aftercare services.</td>
</tr>
<tr>
<td>aftercare training</td>
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<tr>
<td>IT skills training workshops</td>
<td>Training on use of information technology for promotion and organization support.</td>
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<tr>
<td><strong>Investment promotion</strong></td>
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<tr>
<td>Investor conferences</td>
<td>Assistance in organization and promotion of investor conferences; often region or sector based.</td>
</tr>
<tr>
<td>Procedures, systems and</td>
<td>Design, development and implementation of procedures and methodologies, including day-to-day procedures for reporting, evaluation results, organizing investor site visits, site visit reports, etc.</td>
</tr>
<tr>
<td>methodology</td>
<td></td>
</tr>
<tr>
<td>Missions, fairs, and</td>
<td>Assistance in organization, participation, and follow-up of promotion outreach activities such as inbound or outbound missions, participation in trade fairs or regional investment conferences.</td>
</tr>
<tr>
<td>shows</td>
<td></td>
</tr>
<tr>
<td>Promotion using foreign</td>
<td>Assistance in effective use of foreign relations offices (e.g., commercial offices within embassies) to extend outreach and develop promotion networks. Includes development of effective relationships, delegation of responsibilities, and coordination and communication requirements.</td>
</tr>
<tr>
<td>relations offices</td>
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<tr>
<td>Establishing and managing</td>
<td>Assistance in selection of office locations, staffing, organization of office and staff, budget requirements, monitoring and evaluation of results, training of promoters.</td>
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<td>foreign offices</td>
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<tr>
<td>Sector-specific marketing/missions</td>
<td>Assistance in design, development, implementation and follow-up of missions in specific sectors.</td>
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<tr>
<td>Subsector-specific marketing/missions</td>
<td>Assistance in specialized subsector promotion activities and missions.</td>
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</table>

Source: MIGIM internal documents.
After an absence of 10 years due to civil war, the IBRD resumed lending to El Salvador in 1991, including a US$16 million competitiveness enhancement loan in 1995, which provided assistance in formulating the country’s 1999 Investment Law. This law affords equal treatment to domestic and foreign investors, including full protection of property rights. During the 1990s, FIAS provided advice on legislation related to foreign investment, helped to design strategies to promote investment, and assisted in the establishment of a one-stop shop in the Ministry of Economy—Oficina Nacional de Inversiones (ONI)—to facilitate the approval and registration of investments.

Successive Salvadoran governments have pursued policies of economic and trade liberalization. Important milestones were the Free Trade Zones Law (1998), the Law of Reactivation of Exports (1990, amended 1999), and the Monetary Integration Law (2000), all of which have helped to make the country a more attractive investment destination. Free trade agreements, such as the Caribbean Basin Initiative, the Central American Free Trade Agreement, and several bilateral agreements, have made the country a more interesting destination for foreign investors.

The government of El Salvador approached MIGA in fall 1999 for assistance with launching PROESA, the country’s investment promotion agency. The idea of creating such an agency grew out of the Bank’s competitiveness enhancement project. MIGA staff first visited El Salvador in the spring of 2000 to assess whether and how MIGA could provide assistance. Since late 2001, MIGA has been involved in a capacity-building program with PROESA, which included the following components:

- **Advice and counsel**: Through frequent MIGA staff visits to El Salvador, MIGA has offered guidance on issues ranging from governance and organizational management to specific aspects of operations. MIGA helped PROESA define an appropriate investment promotion strategy and validate plans developed by its staff.

- **Investment promotion training**: MIGA conducted several training workshops for Board Directors, PROESA staff, and stakeholders, addressing topics such as investment promotion strategies, selection of sectors, company targeting, lead generation, direct mail, telemarketing (cold calling), presentation skills, Web site development, trade fairs, aftercare services, and contact management software. MIGA’s Investment Promotion Toolkit was used in this training.

- **Installation** of contact management system including staff training.

**Outcomes**

Assistance provided by MIGA was considered very helpful, and more importantly, PROESA has followed many of the recommendations offered by MIGA. PROESA staff, Board members, and others interviewed during the field mission appreciated MIGA’s responsiveness and quality of its work. The value of MIGA’s advice and counsel was noted, particularly in the early stages when PROESA was struggling with internal management issues. PROESA has adopted the investment promotion strategy recommended by MIGA. Foreign investors interviewed as part of the case study expressed favorable opinions about the quality of PROESA’s work and offered examples where PROESA was helpful.
Impact
While the assessments of MIGA’s work and PROESA have been almost uniformly positive, interviews conducted with foreign investors indicated that while PROESA had been helpful and, in some cases, improved the chances of success in the projects and helped reduce the time required to open operations, it had not played a major role in their decision to invest in El Salvador. Almost 80 percent of surveyed company representatives responded that they probably or definitely would have invested in El Salvador in the absence of PROESA.

The final impacts of MIGA’s interventions have to be qualified by the variety of variables that influence FDI flows and the changes in IC. The following paragraphs therefore present some macro trends for El Salvador, without claiming any relationship of those impacts with MIGA’s work.

El Salvador attracted FDI of $960 million between 1999 and 2003 (September). A significant share of this investment has been associated with privatization of State-owned enterprises (primarily communications and utilities companies). Over this five-year period, annual FDI flows fluctuated between $150 and $250 million, with investment levels slowing down in the past two years.

The IC—as expressed by the HFO/WSJ Index—improved from 2.4 (1998) to 1.95 (2001) before deteriorating somewhat to 2.25 in 2003 (higher ratings correspond to lower IC). These ratings nevertheless put El Salvador into the “mostly free” category of the index, achieving one of the best scores for Latin America.

MIGA’s Effectiveness
MIGA seemed to have played an instrumental role in addressing the concerns of the Board and sustaining the government’s commitment to PROESA, despite some of the problems faced in the early stages of its operations. The quality of MIGA’s work and its being part of the WBG were considered to be reasons for the positive assessment of MIGA’s involvement, which “helped PROESA establish credibility and legitimacy.” On the other hand, in the absence of MIGA assistance, PROESA would have likely retained assistance from private consultants offering these services, possibly with similar outcomes, albeit at a higher cost.

MIGA-FIAS Coordination
Both FIAS and MIGA were active in El Salvador. Both focused on different tasks, working with two different entities (ONI and PROESA). Both entities have distinct mandates that do not overlap, one being a public sector institution, and the other a private sector led promotion agency. The roles of FIAS and MIGA appear to have been separate and in line with the division of labor between the two organizations. FIAS finished its work in El Salvador in 2000, well before MIGA work started in earnest. There appears to have been very little coordination between both institutions, suggesting that their involvement was basically demand-driven. But given their different tasks and roles this did not result in overlaps or gaps in the delivery of services.
Although Romania has lagged behind other countries in Central and Eastern Europe in FDI flows, foreign investor interest has been increasing in recent years due to favorable macroeconomic performance, improved investment credit ratings and risk assessments, and the prospect of European Union (EU) accession. A 2002 survey of the business environment conducted by the World Bank and the EBRD showed Romania’s business climate had improved slightly. The EU singled out administrative barriers, the lack of implementation of newly enacted legislation, and administrative capacity as major weaknesses.

MIGA Technical Assistance

The institutional framework for investment promotion in Romania was subject to frequent reorganizations. The Romanian Development Agency (RDA), active since 1991, merged with the SME Agency in 2000 and saw its responsibilities diluted in 2001 only to be redefined again in 2002, becoming ARIS. These changes have complicated MIGA’s work with Romania, which began in early 2000 with an assessment of RDA’s institutional capacity and development needs. Installing the appropriate structure for investment promotion and capacity building initiative have comprised the key focus of MIGA’s work since.

In 2001, MIGA recommended that Romania should establish a quasi-autonomous IPA accountable to a public/private sector Board. Later in 2001, the government fundamentally restructured the investment promotion program, but not along the lines proposed by MIGA. MIGA assessed the set-up again and concluded that establishing an autonomous IPA was “somewhat premature” and instead recommended a 2- to 3-year approach for establishing a “virtual investment promotion agency” with an independent Board. After the establishment of ARIS in June 2002, MIGA made recommendations regarding capacity needs, a draft investment strategy and action plan, and assisted with an application for an EU assistance program to help skills development and capacity building within ARIS.

Outcomes

ARIS senior management unequivocally praised MIGA’s assistance. MIGA’s support of a quasi-autonomous IPA was regarded as “pivotal” to making the case leading to the eventual establishment of ARIS. MIGA was also cited as particularly helpful in getting the World Bank to finance ARIS’ information technology requirements at a time when such funding was urgently needed. ARIS regards MIGA’s FDIxchange as “extremely useful” in gathering intelligence on FDI trends and competitor capabilities. PrivatizationLink was also cited as a key resource, which contributed to several recent privatization transactions. The institutional needs assessment of ARIS was also regarded as “very useful,” helping ARIS to understand strengths, weaknesses, and priorities.

Impact

A survey of 15 foreign investors assisted by ARIS showed that the majority of firms rated ARIS very highly and viewed them as an effective IPA, but there is little evidence that ARIS ultimately affected their investment decision.

A major determinant of FDI flows to Romania is the prospect of EU accession and perceived progress toward that goal. Hence, the FDI numbers for Romania are used for context only
and not as a measure of MIGA’s success or failure. While Romania’s per capita FDI stock was relatively small at EUR 418, compared with Poland’s EUR 1,257 as of December 2003, in recent years, Romania has seen substantial FDI flows from OECD countries, which are attracted by its well educated, low-cost workforce. Annual average FDI inflows have increased from $770 million during 1991–2002 to over $1 billion during 2001–3.

In terms of changes in the investment climate, evidence from indices has been mixed. Romania’s rating in the Business Environment and Enterprise Performance Survey improved over 1999–2003, albeit from a very low level. Major shortcomings identified in the surveys were in taxation, corruption, and finance. By contrast, the Heritage Index for Romania deteriorated over the same period.

**MIGA’s Effectiveness**

While few of MIGA’s recommendations were implemented prior to the establishment of ARIS, it is difficult to assess MIGA’s effectiveness during this period due to the frequent institutional changes. Interviews with stakeholders showed that ARIS suffered from weak relationships with other government agencies and a poor governance structure, suggesting that MIGA’s assessment may not have placed enough emphasis on these critical factors. Many government agencies compete with ARIS in implementing various aspects of the investment promotion mandate. For example, ARIS is not linked with the Business Environment Department of the Ministry of Development, currently supported by FIAS and working to improve the business environment and simplify administrative barriers to investment. ARIS’s Advisory Board also lacks a public-private Board of Directors with representatives drawn from key ministries (commonly seen in other IPAs) and has been ineffective, leaving the organization without sufficient credibility and resources. Thus, MIGA’s draft strategic plan would appear to have not addressed these issues adequately. Greater cooperation with FIAS would have been useful and possibly led to better outcomes.

**MIGA Guarantees**

MIGA has issued guarantees totaling $344 million in Romania for 11 projects. The first guarantee was issued in 1997, and guarantee issuance has become more intensive since 2001. Eight of the 11 projects are in the financial sector, covering the establishment of branches of, for the most part, Austrian banks, or shareholder loans to already existing branches. The other projects are a brewery, an infrastructure project, and a health services provider. In all, MIGA’s insurance has been associated with FDI of $410 million. MIGA’s first banking project was underwritten in 1997, just as the government had begun a reform of the banking sector. Governance and the government’s commitment to private sector development was weak, so the risks to new entrants were considered high. In the past years, the banking sector has been strengthened by the expansion of activities by major foreign banks and privatization of State-owned banks. Their loans are almost exclusively denominated in foreign currency.

IEG-MIGA conducted interviews with four banks benefiting from MIGA guarantees in Romania, one from Greece and three from Austria. These banks have introduced modern banking facilities (including Internet banking) that are improving the efficiency of the banking sector. While overall bank lending to the private sector is on the rise, it remains constrained by country portfolio risk concerns. In this regard, MIGA guarantees have reduced the cost of providing investment funds to the Romanian banking sector by eliminating concerns of the parent bank about the possible need to increase provisioning for these loans. Discussions with the Austrian parent banks indicated that they were highly appreciative of MIGA guarantees, as they would have to either reduce their exposure in Romania, take larger provisions on their own books to cover the possible losses, or run the risk of receiving lower credit ratings—thereby making borrowing more expensive. Some of the banks active in Romania have used MIGA repeatedly to cover investments in other countries in Central and Eastern Europe to pursue a regional expansion strategy, which has been assisted by MIGA.
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<th>Region/Country</th>
<th>Needs assessment</th>
<th>Strategy development</th>
<th>Implementation plan</th>
<th>Investor targeting</th>
<th>Marketing plans</th>
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### Strategic direction

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## Strategic direction

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<th>Region/Country</th>
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**Sources:** MIGA Quarterly EVP Reports (fiscal 2000, Q1 to fiscal 2003, Q3), MIGA Annual Reports (fiscal 2000–2), and MIGIM Back-to-Office Reports (fiscal 2000–3).
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- Investor conferences
- Missions, fairs & shows
- Prom. with foreign relations offices
- Establishing & managing foreign offices
- Sector specific marketing/missions
- Subsector-specific marketing

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Chapter 6

1. The World Bank Group refers to IBRD/IDA, the IFC, and MIGA; the “World Bank” or “Bank” refers to IBRD/IDA only.

2. The evaluation does not cover small- and medium-scale enterprises (SME) or financial sector issues in depth, as these are being addressed in other ongoing IEG evaluations.

3. Available as a background paper for this report.

4. Summarized in Annexes II.B and II.C.

5. The results of international investor meetings are available as a background paper for this report.

6. The country case studies are available as background papers and are summarized in Annex II.E. The case study countries were chosen to achieve a diversity of regions, income levels, and economic systems, along with a significant volume of World Bank investment climate activity. The case study methodology is described in Annex II.A.

7. IEG (2004a), p. 6. The CPIA assesses borrower countries’ policy and institutional frameworks annually with regard to their capacity to foster poverty reduction, sustainable growth and the effective use of development assistance. The CPIA is currently being redesigned to better differentiate sub-themes such as the “business environment.” The Heritage Foundation Index measures developed and developing countries’ performance with respect to 50 policy dimensions. The International Country Risk Guide Risk Rating System is a proprietary service that rates the risks faced by investors in a country based on political instability, economic vulnerability, and ability to meet financial obligations. The Economist Intelligence Unit Country Risk Service is a proprietary service that rates risks faced by investors in a country, designed for commercial bankers, institutional investors, and corporate executives who invest in emerging markets.

8. The Investment Climate Surveys and Assessments represent another effort to improve on cross-country indicators of the quality of the investment climate.


11. Batra and Mody (2003). It should be noted, however, that FDI may fluctuate in a country for reasons that have nothing to do with its investment climate—for example, economic cycles in source countries (particularly for investments in emerging market economies) and commodity prices (particularly for investments in Africa).

12. Summarized in a background paper for this report. Annex II.A contains information on these interviews and their participants.

Chapter 7

13. For a review of WBG PSD activities in the 1990s, see World Bank (2001a).

14. More recently, the PSD Network has been piloting rural Investment Climate Assessments in collaboration with the Agriculture and Rural Development Network. Labor and property rights issues are to be covered in Doing Business 2005, and informal sector studies were commissioned by the 2005 World Development Report. In addition, it should be noted that land and property rights issues have been dealt with in research by the Development Economics and Environmental and Socially Sustainable Development departments, and competition policy in the Latin America and the Caribbean Region.

Chapter 8

15. IEG (2001a). Note that there have been few Quality Assurance Group evaluations of IC-related ESW,
particularly of survey-based diagnostic instruments such as Private Sector Assessments.

16. Based on the literature review as well as input from the external advisory panel for this evaluation.

17. The findings of the WBES surveys are summarized in Batra et al. (2003).

18. FIAS was the subject of a 1998 evaluation by IEG IFC, and is covered in the IEG part of this evaluation.

19. The findings of the WBES surveys are summarized in Batra et al. (2003).

20. The recent state-level ICAs in India are an example of recent efforts to do this.

Chapter 9

21. However, it should be noted that the assignment of themes to projects in the portfolio under the current Bank coding system is somewhat arbitrary and may not be 100 percent accurate. Sample checks carried out by IEG showed that the potential for misclassification is greatest for non-core IC projects.

22. IEG assigns ratings according to the following criteria. Outcome measures the extent to which the project’s major relevant objectives were achieved, or are expected to be achieved, efficiently. Institutional development impact measures the extent to which a project improves the ability of a country or region to make more efficient, equitable, and sustainable use of its human, financial, and natural resources through: (a) better definition, stability, transparency, enforceability, and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives from these institutional arrangements. Institutional development impact includes both intended and unintended effects of a project. Sustainability measures the resilience to risk of net benefits flows over time. Note that IEG outcome ratings measure the degree of achievement of project objectives due to the project as well as to factors external to the project—in other words, outcomes are not necessarily attributable to the project alone.

Chapter 10

23. The Bank and the Government of Romania have agreed to and begun implementation of the restructuring the General Cadastre and Land Registration Project to ensure its meeting the development objectives. The restructuring includes the integration of land registration and cadastre tasks into one function in one new agency and a redesign of the capacity building component of the project.

Chapter 11

24. Work conducted in fiscal 2004 and planned for fiscal 2005 included country case studies of investment climate reforms; using lessons and research from the FIAS program to compile best practice in policies and institutions; and a focus on reform episodes in the next Doing Business report.

Annex II.E

25. For fiscal 2003–4, economic growth is estimated to reach a record high of over 7 percent, largely because of a good monsoon.

Chapter 14


27. The MDGs are eight internationally accepted broad objectives designed to reduce the proportion of people in poverty by 2015. See http://www.developmentgoals.org/About_the_goals.htm.

28. There is a strong correlation between countries’ progress toward the MDGs and their perceived risk for investors as measured by the IICCR. Under IFC’s own categorization, ratings of less than 30 constitute a high-risk environment; IICCR ratings of 30 to less than 45, a medium-risk environment, and rating of 45 or greater, a low-risk environment. The average likelihood of achieving the MDGs was calculated for eight different MDGs and weighted by countries’ respective populations. The average country risk score for countries that are thought possible or likely to achieve the MDGs is 42 (equivalent to a medium-risk environment), whereas the average score for countries considered unlikely or very unlikely to achieve the MDGs is 27 (equivalent to a high-risk environment).

29. See IEG's Annual Review of IFC's Evaluation Findings for fiscal 2002 and 2003. This and other studies with themes relating quality of IC to IFC performance and outcomes are discussed in box 6.2 of this report.


31. The formal Articles of Agreement governing the IFC were drafted by the World Bank in 1955. IFC officially came into existence in the summer of 1956.

32. This study uses IICCR to track changes in investment climate, given that IICCR is a more volatile IC
indicator than HFO/WSJ. The increased volatility allows us to capture changes in investment climate in shorter periods. For a more detailed analysis comparing the volatility of IICCR and HFO/WSJ indicators, please see Annex 4 in the IEG-IFC’s impact review of China, March 2004.

33. HFO/WSJ index is a broader, more stable measure of investment climate, in contrast to IICCR, which captures a narrower slice of investment climate (country sovereign risk) and is more volatile from year to year. See Annex III.A for an explanation of indexes used to measure IC.

34. DO is a synthesis rating of four subindicators: project business success; economic sustainability; impact on private sector development; and environmental impacts.

35. IEG-IFC’s impact review of China, Annex 4 has further details.

36. Four subindices of Heritage Foundation/Wall Street Journal Index are strongly correlated at 5 percent significance level or better at evaluation. In the impact review of China, which conducted a similar analysis for a different sample of XPSRs, the subindices of Trade and Banking and Finance were also strongly statistically significant, and this supports the robustness of these two variables. However, while Regulation and Black Market had the correct signs, they were not found to be statistically significant.

37. The “regulation” subindex is strongly correlated with IO at evaluation but not at approval.

Chapter 15

38. For the investment climate study, IEG World Bank did five country case studies: India, Indonesia, Mozambique, Romania, and Peru.

39. Examples of broad IC indicators include HFO/WSJ Index of Economic Freedom, the Frazer Institute’s Index of Economic Freedom, Euromoney’s Country Risk rating, Institutional Investors Country Credit rating, AT Kearny’s FDI Confidence Indicator, etc.

40. Poor IC countries include those with scores greater than 3 HFO/WSJ.


42. See literature review “The Investment Climate and Private Sector Development” prepared by Tyler Biggs, 2003. This was prepared as a background paper for the joint IC report. See also Lee, Kyu Sik Alex Anas, and Gi-Taik Oh, “Costs of Infrastructure Deficiencies in Manufacturing in Indonesia, Nigeria and Thailand,” World Bank Policy Research Working Paper, 1996.

43. These projects were evaluated five years after approval, i.e., from 1998 to 2002. A stratified random sample was selected from each year’s approval population and was evaluated by IFC’s investment department under the oversight of IEG.

44. Using a step-wise approach where the regression model started with all variables and sequentially removed all variables that are not significant at a 10 percent significance level.

Chapter 16

45. These are operations undertaken during the review period, approved two years before evaluation, i.e., fiscal 1993–2001 approvals, and where IEG was able to track IFC’s counter parties in the client/host countries.

46. IEG focused on including TAAS operations that are of a public good nature. A public good is one where one cannot exclude others from benefiting if the product is supplied to at least one person/firm, and use of the item by one person/firm does not make it impossible for others also to benefit from it. However, some firm-specific TA products may partially take on the characteristics of a public good, such as advice to a firm that leads to new best practice that others then copy.

47. Note that 30 percent of all operations were stand-alone Category 3 (containing no overlaps with operations in Categories 1 or 2). Of this amount, 79 percent involved government and 21 percent involved private investor groups.

48. This figure is adjusted to remove overlaps in funding reported by the three main contributing vehicles: TATF, PEP, and PDFs. However, in the section below and Annex III.F, which describe each program’s IC TA volume, figures are not adjusted for overlaps.

49. Overlaps in financing with TATF are adjusted in figures 16.1–16.3.

50. IFC’s contribution includes $11 million made to FIAS over the review period; an estimated $1.6 million in administrative support for IC TA work done by the SME department in fiscal 2001–2; and an estimated $700,000 in support of SME facilities’ IC TA program. For South Pacific Project Facility (SPPF), most IC TA was financed with IFC funding. For SEED and MPDF, about 18 percent of their IC TA was financed by IFC.
51. IFC’s contribution to all PEP (including pre-2000 PEP) over the review period is as follows: fiscal 1993–95 $500,000; fiscal 1996–8 $900,000; fiscal 1999–2000 $1.2 million; fiscal 2001–2 $8.4 million. Total PEP donor funding in fiscal 2001 and 2002 was $27 million from Canada, Finland, the Netherlands, Norway, Sweden, Switzerland, the United Kingdom, and the United States.

52. PSAS projects are paid for by a combination of client fees and budget support from IFC and other donors, including TATF. IFC’s contribution of $6.6 million reflects PSAS’s cumulative operating loss over the review period. For projects that qualify as investment climate, nearly $2.7 million of TATF funds supported PSAS projects.

53. Some respondents represented more than one project.

54. That is, gave ratings of satisfactory or better.

55. To arrive at this score, IEG first assigned numerical values to project ratings based on a 4 point scale: 1 = unsatisfactory; 2 = partly unsatisfactory; 3 = satisfactory; and 4 = excellent. Project averages were then taken for each project. IEG derived an overall average from these figures, as well as group averages for the three different categories that IC TA operations were split into for comparative reasons.

56. Criteria for excellent rating include: project objectives and targets are very clear, and a results-based management (RBM) system is set up. RBM is a system to improve program and management effectiveness and accountability and is oriented toward achieving results. It uses desired results as a basis for planning, management and reporting, and aims to improve performance by comparing and analyzing actual results against planned results through regular monitoring, evaluation, reporting, feedback, and adjustments.

57. The overall average score based on project scores for responsiveness was 3.2. Sixty-three percent of respondents said they received good overall levels of responsiveness from IFC to their requests, and timely delivery of services/reports, and 27 percent described IFC’s responsiveness as high, or rated it excellent. In contrast, 10 percent of clients said there was major shortfall in either time of delivery of services or responsiveness to client requests that resulted in a partly unsatisfactory rating.

58. Having recognized IFC’s limited ability to control the implementation process, clients and stakeholders nonetheless outlined how IFC could enhance the success prospects for the implementation process. This is discussed in the next section.

59. This is not the case for PSAS and FIAS, which both have up-front quality control mechanisms in place.

60. In August 1997, IEG sent questionnaires to 119 people in 73 countries and received 33 responses from 29 countries—a response rate of 28 percent of the clients and 40 percent of the countries surveyed. See “An Evaluation of the Foreign Investment Advisory Services,” CODE98-56, for detailed information.

61. IFC Advisory Services Client Survey responses were too few to provide meaningful information for TATF and PSAS projects. For FIAS, a small sample size—21 responses of 56 surveys sent out in 2002, and 12 responses of 38 sent out in 2003—also suggests that interpretations of these results need to be approached with caution, since respondents might tend to be more favorably inclined toward FIAS than nonrespondents. Nonetheless, the data provide an interesting perspective and feedback about FIAS by clients.

62. Respondents were asked to rate FIAS performance “poor,” “fair,” “good,” “very good,” or “excellent” in each category. For this comparison, weighted averages were calculated based on a rating from 1 (“poor”) to 5 (“excellent”). Note that this scale is different from the scoring scale of 1–4 used elsewhere in this report.

63. It is worth noting that despite continued low ratings on project follow-up, performance of project follow-up improved by 23 percent in the fiscal 2002 survey over the previous year’s survey.

64. As the PCRs are self-assessments of not-yet-mature projects and are typically completed within one month of project completion or delivery to the client, they are not evaluations of outcome or impact. For the overall success of TA operation rating, task managers are asked to assign a rating that gives a synthesis, bottom-line judgment that takes various factors and components into consideration, including accomplishment of scope; achievement of objectives; preparation quality; funding; consultant selection and performance; and client satisfaction. See TATF PCR instructions for details.

65. Of the total 278 TATF projects that fall into the IC category, 165 had PCRs (59 percent) and half provided ratings for the overall success of TA operation.

66. This bears keeping in mind that “there is nothing more difficult to take in hand, more perilous to conduct, or more uncertain in its success, than to take the lead in the introduction of a new order of things. Because the innovator has for enemies all those who
have done well under the old conditions, and lukewarm
defenders in those who may do well under the new”
(Niccolo Machiavelli, *The Prince*).

67. Through FIAS’s PIM system, task managers re-
view their projects once a year for three years and
rate the implementation of each recommendation on
a scale from 1 to 4, where 4 = recommendation fully
implemented; 3 = recommendation partially imple-
mented; 2 = recommendation accepted but not im-
plemented; and 1 = recommendation rejected. In
addition, task managers also weigh the relative im-
portance of each recommendation by its expected
impact on a country’s overall investment climate and
ability to attract investment. The weights are on a
scale from 1 to 3, with 3 = very important; 2 = im-
portant; and 1 = less important. Final ratings repre-
sent a weighted average of the recommendations in
terms of their importance. FIAS’s PIM system does
not attempt to measure impact of reforms on the
ground; however, it has developed a series of imple-
mentation projects that are centered around moni-
toring performance of reform implementation, with
impacts on the ground measured through investor
and government surveys at the core.

68. It is interesting to note that despite divergence
in implementation rating averages between these two
groups, ratings provided by clients with regard to ac-
ceptance of recommendations did not show major dif-
fences between broad TA projects (Category 1) and
specific ones (Category 2).

69. Projects that were followed up with second proj-
ects or were part of country programs had an average
implementation score of 2.86, while projects with no
follow-up scored an average of 2.47.

70. PEP’s approach combines advisory work on
legal and regulatory aspects with significant stake-
holder involvement through partnerships with the
private sector, government and donors; program-
matic follow-up by way of capacity building and train-
ing; and extensive use of local consultants and
expertise.

71. For more information on assessing PEP’s out-
comes, see IFC board report IFC/R2002-0191, “Prop-
osed Continued IFC Participation in the Private
Enterprise Partnership”; IEG’s “Country Impact Re-
view of Russia,” CODE 2002-0026; April 29, 2002; and
PEP progress reports made to donors.

72. See “Proposed Continued IFC Participation in the
Private Enterprise Partnership” IFC/R2002-0191, pages
5–8 and Annex 1, for a complete list of projects and out-
comes/results.

73. This reflects in part the fact that until their re-
cent mainstreaming/integration into the reporting
structure of the regional investment departments, the
SME facilities concentrated their skills and activities
mainly on helping SMEs raise financing for expansion
projects. IC-related activities were varied and of sec-
ondary importance.

74. See IEG’s forthcoming evaluation of SME
facilities.

75. Findings set out in these paragraphs are de-
rived from independent evaluations, which have been
contracted out by IEG and paid for by the facilities, by
an independent consulting firm, Nexus Associates.

76. The evaluation cites a very fluid political process
in the region, with some associations not wanting to
assume this role until they establish a stronger mem-
bership base. Moreover, the sustainability of some as-
 sociations is questionable given weak financial
 situations.

77. It should be noted that at the time of these in-
terviews in October 2003, the Inter-American Devel-
opment Bank was preparing a housing sector loan
that, among other things, included plans to change the
distortionary subsidy scheme of a government sup-
ported housing finance company.

78. See “World Bank Group PSD Strategy,” April
2002. The PSD strategy document noted that MIGA
should provide “focused political risk guarantees, in-
stitution-building and investment promotion assis-
tance.” Advisory services for PSD are located in the
Bank and the IFC (in the form of joint departments)
and, separately, in MIGA. The division of labor be-
tween FIAS and MIGA’s Investment Marketing Ser-
vices Department was described as follows: “FIAS
provides policy advice to governments on how to at-
ttract foreign investors in ways that benefit the host
country. MIGA/IMS tends to operate downstream from
FIAS helping countries promote investments based
on the policy and institutional framework promoted
by FIAS.”

79. Out of 176 IC TA operations funded by TATF, 52
percent did not have PCRs completed. The one TA op-
teration with linkage to an investment project intended
to advise the Slovakian government on legal barriers
to SME lending, since an IFC investment to support a
$30 million agency line for SMEs was never disbursed
and finally cancelled.
Annex III.A


81. See Batra and Moody, “Investment Climate Indicators,” 2003, which analyzes 21 databases of IC indicators, uses the principal components method of information from these indices to construct an index, and compares the constructed index and other indices. Also, see IEG’s Annual Review of Development Effectiveness: The Effectiveness of Bank Support for Policy Reform, Report 28296, March 2004 (pp. 6–7 and Annex B).

Annex III.F

82. PEP countries formally include Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan. For the purposes of this study, all IC TA undertaken before 2000 by IFC in the countries of the former Soviet Union will be referred to as pre-2000 PEP.

83. This average does not include two large land reform projects.

84. These funds must be used for fees and travel of consultants, not IFC staff. Use of these funds is subject to donor and TATF approval and is influenced by donor preferences regarding types of activities and countries or regions. The funds are frequently tied to the use of consultants who are nationals of a particular donor country.

85. TA under this program includes feasibility and prefeasibility studies, project identification studies, strengthening the environment for PSD, capacity building for private businesses and government agencies, and privatization. To be considered an IC operation, a project must contain an explicit component that advises the government on the legal and/or regulatory framework (e.g., privatization/concession law, sector regulations, etc.) or builds capacity of the regulator or government agency above and beyond conducting the specific transaction. Hence, projects that advise only on transactions (sales or transfers to the private sector) are not included.

86. This figure is not adjusted to exclude overlaps with other TA-providing units within IFC that have received cofinancing through TATF. IEG estimates that approximately $11.4 million in TATF IC funds went to support these other programs. Overlap with PEP accounts for $5.9 million; with PSAPT for $2.7 million; with the SME department for $2.6 million; and with FIAS for $173,000.

87. Such as funding limits by region, country, project size, or activity.

88. Nearly 60 percent of all TATF TA assignments have sector-specific IC components.

89. Four PDFs provided IC TA: MPDF, SEED, SPPF and APDF.

90. For projects that qualify as IC, nearly $2.7 million of TATF funds supported PSAS projects.

91. Only a portion of this dollar amount actually contributes toward improving IC, with the bulk spent on structuring and executing the transaction.

Annex III.G

92. These PIMs, along with Project Briefs and Project Completion Reports, are available to donors for all projects on the FIAS Web site (www.fias.net).

Annex III.J

93. These TA operations include the following: Improving the Investment Climate for Sustainable Mining in China, Sustainable Development of the Mining Sector in Lao, Study of the Business Environment for Information and Communication Technology Businesses in Kyrgyz Republic, and Investment Opportunities in the Information Technology and Internet Sectors (Côte d’Ivoire, Ghana, Nigeria, and Senegal).

94. This office reports to the two general counsels of the WBG (Bank and IFC).

95. Before the COI Office was established, there was no systematic screening, and IFC’s principles and policies provided guidelines for provision of advisory services. While these principles and policies were discussed to some extent in a 1995 IFC policy paper (see “Collaboration with Private International Financial Institutions: Practices and Policies,” IFC, November 1995), the primary focus of that report was to clarify IFC’s policies with respect to privatization and corporate restructuring. The report addressed the issue of potential displacement by IFC of other private financial institutions providing similar services. During this period, IFC was under criticism from private financial institutions for overlap and unfair competition in the provision of advisory services (see, for instance, GAO Report to Congressional requesters: World Bank: US Interests Supported, but Oversight Needed to Help Ensure Improved Performance, September 1996, Chapter 2 [GAO/NSIAD-96-212]). In addition to clearly setting out the conditions for IFC’s acceptance of remunerative government advisory mandates to remove poten-
tial for displacement, the report pointed out that a substantial majority of the advisory mandates undertaken by IFC were non-remunerative, and as such generally involved no competitive bidding with alternative private advisors.

96. For more detailed treatment of COI, see Boatright 2002. Chapter 11 explores different types of COI in financial services and proposes strategies for managing them.

**Chapter 18**

97. For a description of the definition, scope, and division of labor of IC activities of the WBG, see Part I, Chapter 1 of this report.

98. See literature review on investment climate conducted by IEG-World Bank, which is summarized in Part I, Chapter 1.

99. MIGA Convention, Preamble.

100. IEG-MIGA began evaluating MIGA’s information services in fiscal 2005 and MIGA’s mediation services in fiscal 2006.

101. IEG-MIGA’s methodology for evaluating guarantee projects is described in its *2004 Review of Development Effectiveness in MIGA*.

102. These two country case studies are the first MIGA TA projects that were independently evaluated.

**Chapter 19**

103. MIGA Convention, Article 2.

104. There are several indices measuring aspects of IC quality; one is economic freedom by the Heritage Foundation/Wall Street Journal (HFO/WSJ) Index of Economic Freedom (2004). This evaluation used the Heritage Index and the World Bank composite index on regulatory quality and also uses other measures. A recent IEG World Bank report that reviewed indices for measuring investment climate found a close correlation, and all have shown an improving trend over the past four years. See *Annual Review of Development Effectiveness 2003: The Effectiveness of Bank Support for Policy Reform*, 2004, p. 5 ff. The HFO/WSJ Index measures how well 161 countries score in 50 independent variables divided into 10 broad factors (trade policy, fiscal burden, government intervention, monetary policy, capital flows and foreign investment, banking and finance, wages and prices, property rights, regulation, and informal market activity). The 10 factors are weighted evenly, as each is considered by the Index to be equally important. Each factor is graded from a scale of 1–5, with higher scores representing greater levels of government interference in the economy and a worse investment climate.

105. The average HFO/WSJ Index score for countries in which MIGA guarantees were issued in fiscal 1998–2003 (weighted by the amount of FDI facilitated in each country) was 3.18 (equivalent to “mostly unfree”); for TA activities in the same period the score was 3.28. Within the TA activities, the score for countries only receiving needs assessments was 3.41, while the score for countries receiving more in-depth assistance (benefiting from three or more activities) was 3.20. Individual scores for in-depth TA ranged from 2.13 (mostly free economies) to 4.53 (repressed). (Higher scores indicate worse investment climate.)

106. See MIGA Convention Article 11. MIGA requires host country approval before it can issue a guarantee, to inform the country (which is also a MIGA shareholder) of the potential investment. In addition to MIGA, the IBRD offers Partial Risk Guarantees (mostly for infrastructure projects) that require a sovereign counter-guarantee. IFC offers partial credit guarantees to enhance the structure for debt instruments. In terms of the coordination of WBG guarantee instruments, the WB’s PSD Strategy has prescribed the following hierarchy of instruments: markets first, MIGA/IFC instruments second, and Bank guarantees last. However, applying this hierarchy in practice has been difficult. Therefore, the paper notes that discussions among WBG staff to avoid duplication or competition of instruments have taken place with the result that Bank Partial Risk Guarantees should be used when “one or several of its features […] are critical from a risk management and/or market point of view to achieve private financing objectives” (see *Private Sector Development Strategy—Directions for the World Bank Group*).

107. According to records from the Berne Union, MIGA’s share of outstanding liabilities was 7.9 percent (2001), 8.4 percent (2002), and 8.2 percent (2003). These numbers do not include political risk insurers that are not members of the Berne Union (such as Lloyd’s of London), whose impact would diminish MIGA’s market size and ranking.

108. Gross exposure is MIGA’s outstanding maximum aggregate liability. Net exposure is the gross exposure less reinsurance.

109. The leverage ratio is defined as the quotient of estimated FDI facilitated by MIGA guarantees and the net guarantee coverage issued.
110. IEG started measuring whether MIGA support was critical or not in its ex post project evaluations beginning in fiscal 2003. At present, the stock of completed evaluations is too small to make statistically significant inferences or propose an adjusted indicator.

111. The top 10 developing countries in terms of receiving FDI during 1998–2002 were China, Brazil, Singapore, Argentina, Poland, Czech Republic, Korea, Chile, Thailand, and Venezuela (all eligible MIGA Category 2 countries) (Source: International financial statistics, International Monetary Fund).

112. The cumulative total FDI associated with MIGA guarantees to investors from developing countries since was approximately 7 percent (1990–2004).

113. Based on nine guarantee projects evaluated in fiscal 2003. More than half of the projects were rated less than satisfactory. See IEG-MIGA (2004).

Chapter 20

114. Information dissemination services, previously part of MIGIM, were moved to the External Outreach and Partners Group.


116. According to MIGA TA staff, MIGA aimed at targeting 70 percent of its assistance to countries in the second tier, within this framework. Starting in FY04, MIGA has offered needs assessments to all client countries requesting assistance.

117. Nonetheless, there were pressures from MIGA management and the Board of Directors to ensure that the services it provides were effective and producing results.

118. Based on interviews with MIGIM management.

119. The more recent criteria include (i) sufficient investor interest to provide an active market for MIGA guarantee products; (ii) presence of an active, complementary PSD work program; (iii) a particular focus on low-income countries and Africa; and (iv) involvement in those countries where MIGA’s services can have a direct impact, based on WBG strategy as articulated in the CAS.

120. However, MIGA staff have observed that IPIs are not normally positioned to do policy advocacy, as their mandates are often narrower and focused on promotional activities, and they do not have policy-oriented staff, nor are they within the government structure. Thus, they may not be well equipped to fulfill this function. A stronger policy advocacy role for IPIs could also give rise to conflicts of interest.

121. As of October 2004, the World Association of Investment Promotion Agencies (WAIPA) had 164 members. There are more than 160 national and 250 subnational IPAs worldwide.

122. Frequently cited examples are Ireland, Scotland, and Singapore.

123. This figure does not include developing countries that MIGIM may have visited or interacted with during the course of its non-TA activities, such as MIGIM participation in World Bank (Group) Country Assistance Strategies or pre-assistance government consultations.

124. Note that three of the countries categorized as “repressed” are postconflict countries.

125. This is consistent with the finding that countries that received only needs assessments had on average worse IC scores compared to those that received more in-depth assistance.

126. See endnote 103 and Figure 19.1.

127. As part of the MIGA Review 2000, MIGA commissioned an independent research firm to undertake an analysis of MIGA’s “public value.”

128. IEG surveyed 62 IPI clients in El Salvador (34 responses) and 15 in Romania (10 responses).

129. Surveys administered to current general managers/directors of companies, who may not have been the ones making the initial site selection decisions for the firms.

130. MIGA’s total staffing is 120, including 77 professional staff.

131. MIGIM management has identified its experienced and specialized staff as one of its comparative advantages.

132. In nominal terms, not adjusted for inflation.

133. Partner funding includes both cash and in-kind contributions. Partners include other donor organizations and development banks (e.g., World Bank, United Nations Development Programme, United States Agency for International Development, United Nations Office for Project Services, Inter-American Development Bank, African Development Bank, Organisation for Economic Co-operation and Development, United Nations Industrial Development Organisation) and exclude client and client government contributions.

134. MIGA, Operational Regulations.
135. Of the 63 client countries receiving MIGA TA, 47 (75 percent) have also hosted MIGA guarantee projects since inception of the Agency. While in ECA, LAC, and MENA, most TA clients also had guarantees, most of the TA-only clients were in Africa (9), followed by Asia and Pacific (6).

136. The WBG Guide to FDI Advisory and Information Services.
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