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Presentations to the 50th Meeting of the Development Committee

Washington, D.C.—April 27, 1995

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Joint Ministerial Committee of
the Boards of Governors of
the World Bank and the International Monetary Fund
on the
Transfer of Real Resources to Developing Countries
(Development Committee)
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Established in October 1974, the Development Committee is known formally as the Joint Ministerial Committee of the Boards of Governors of the World Bank and the International Monetary Fund on the Transfer of Real Resources to Developing Countries. The Committee's members, usually Ministers of Finance, are appointed in turn for successive periods of two years by one of the countries or groups of countries represented on the Bank's or the Fund's Board of Executive Directors. The Committee is required to advise and report to the Boards of Governors of the Bank and the Fund on all aspects of the broad questions of the transfer of real resources to developing countries, and to make suggestions for consideration by those concerned regarding the implementation of its conclusions.

The International Bank for Reconstruction and Development (IBRD) and its affiliate, the International Development Association (IDA), together constitute the World Bank. The International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA) are other affiliates of the IBRD.

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C O N T E N T S

F O R E W O R D

The Development Committee held its 50th meeting in Washington, D.C. on April 27, 1995.

There was one main item on the agenda: Financing of Infrastructure in Developing Countries. The Committee based its discussion on a joint issues paper, on reports prepared by the World Bank and the IMF and on other supplementary papers.

The main agenda item gave the Committee an opportunity to focus on the provision of finance for infrastructure in developing countries which have been investing an average of 4% of their GNP, about $200 billion a year, in infrastructure. Ministers acknowledged that the present and future demand for basic infrastructure services is unlikely to be met by current public sector methods--characterized in many developing countries by inefficient operation, unresponsiveness to users and poor financial management. The Committee recognized that improvement will require developing countries to have more business-like management, charge realistic prices for services rendered, be more attentive to maintenance, and encourage more private sector involvement in the provision of infrastructure and in its financing. Ministers agreed that these reforms will promote the development efforts of developing countries. The poor stand to gain directly and quickly from better delivery of infrastructure services which, in turn, will also contribute to the improvement of environmental conditions. The Committee urged the donor countries to help the poorest countries in this area and asked that the multilateral institutions to play a catalytic role in raising funds from a wider range of private sector sources.

Ministers also took note of the progress on several issues which were outlined in the reports of the Managing Director of the IMF and the President of the World Bank: the impact on developing and transition countries of recent trends in the world economy; resource flows and transfers; the special program of assistance for Africa; implementation of the debt strategy; IBRD/IDA commitments and disbursements; the World Bank's poverty reduction strategy and information disclosure policy.

In view of the broad interest in these subjects, the presentation made to this meeting of the Committee is now made available in this pamphlet in three languages--English, French and Spanish--for a wider audience.

Peter Mountfield
Executive Secretary
May, 1995

REPORT BY LEWIS T. PRESTON
PRESIDENT OF THE WORLD BANK

April 27, 1995

I. Introduction

1. Last year marked the fiftieth anniversary of the Bretton Woods institutions. The world has changed a great deal in the past 50 years. During the past decade alone we have witnessed a significant transformation in the way nations organize their economic activity, and private flows have become the largest source of finance for developing countries. Economic activity throughout the world is rapidly becoming integrated, forming a truly global economy. These changes have increased both the scale and complexity of the development agenda, radically altering the context in which the World Bank Group carries out its activities. In response, the Bank Group has been changing as well. Increasingly, our task is that of a partner helping countries design and implement policies that open up markets and strengthen economies, in order to improve the quality of life and increase prosperity for people everywhere, especially the world's poor.

2. In this context, the 1995 spring meeting of the Development Committee focuses on effective ways of financing infrastructure. The staff paper on the subject concludes that if the world is to meet the present and future demand for infrastructure services, countries must change the ways they do business: they must be more attentive to maintenance, be more responsive to users, charge realistic prices for services rendered, and encourage more competition and private sector involvement in the provision of infrastructure and in its financing. The Bank Group can be an effective partner in helping member countries close the gap between demand for and supply of infrastructure services by offering policy advice, mobilizing financial resources from both private and public sources, and disseminating the results of international experience. If together we can mobilize adequate resources for infrastructure investments, we shall be promoting the development effort.

II. Recent Developments in the Global Economy: Implications for Developing Countries and Countries in Transition

3. My October 1994 report to you noted that the external environment for developing countries looked more favorable than at any time in the past decade. That assessment still holds and, if anything, is more bullish. World trade is growing at nearly 7 percent per year; recovery in the industrial countries is firm and widespread; OECD growth in 1994, at 2.9 percent, was over half a percentage point greater than the Bank forecast a year ago; and commodity prices have surged. Growth in the industrial countries is expected to run at about 3 percent in 1995-2004, while inflation is expected to stay just below 3 percent. Although interest rates are higher than was expected a year ago, they are no higher than the average of the past eight years. The present industrial recovery should be sustainable and should contribute to a stable environment for developing countries.

4. Globalization is a major factor underlying this scenario. World merchandise exports have risen from 11 to 18 percent of world GDP over the past decade. Services have increased from 15 percent of world trade to over 22 percent since 1980. Worldwide, one of every seven equity trades involves a foreigner as a counterparty. The pace of globalization quickened in

1994: the growth of world trade has almost doubled from the 4 percent per annum attained during the 1991-93 recession, and it is expected to grow at 7 percent through 1996. The ratification of the Uruguay Round by the major trading nations will fuel this surge, particularly in the trade in manufactures. The Uruguay Round is expected to boost developing countries' incomes by $60-100 billion annually (equivalent to 1.3-2.0 percent of their GDP). At the conference on the impact of the Uruguay Round on developing countries held at the World Bank in January, one of the major conclusions was that gains would have been significantly larger had the signatories taken the opportunity to liberalize trade in agriculture more aggressively. Some of these additional gains can still be realized if countries set their tariffs well below the maximum tariffs to which they committed themselves in the Round. A summary of the main conclusions of the conference appears in the Bank's *Global Economic Prospects and the Developing Countries, February 1995*.

5. Another feature of the current scene is the boom in commodity prices. The Bank's index of non-oil commodity prices rose by 19 percent in real terms in 1994, the largest yearly increase since 1977. For the top 20 gainers in the developing world, terms-of-trade gains will average as much as 5 percent of their collective GDP. But we do not expect the boom to last and already there are signs of weakness in these markets: commodity prices dipped during the fourth quarter of 1994. Prudent management of the windfall gains will be critical to adjust to lower prices. The temptation to use the windfall to increase current consumption, delay reforms, or embark on low-return investments in the public sector will be strong, and should be resisted.

6. The enhanced role of the developing countries as both agents and beneficiaries of change is an important feature of the ongoing global economic change. A growing number of developing countries are embracing outward-oriented reforms that contribute to globalization and expand opportunities to share in its benefits. By promoting domestic efficiency and productivity and by providing an environment that is friendlier to exports and foreign investment, these reforms lie at the heart of the countries' improved economic prospects. The growth of developing countries and their increasing integration into world trade and finance benefit industrial countries. Gains to industrial countries from increased trade integration with developing countries are potentially larger than from additional integration among industrial countries, as discussed in the recent *Global Economic Prospects* paper.

7. The economic recovery in the industrial countries is spurring world demand for capital and pushing interest rates up: real long-term interest rates have risen a full 200 basis points in the G-7 countries over 1994. There is a concern that interest rates may rise to levels that would choke off investment demand and bring the recovery to a halt. This scenario is improbable. The demand for capital is likely to be met by higher savings, which are expected to rise in both developing and industrial countries. The outlook is for capital markets to remain relatively tight in the years ahead, but not tighter than at present. Interest rates could fall if fiscal consolidation in Europe proceeds at the somewhat faster pace required by the Maastricht timetable and if the United States' growing political consensus on reduced deficits translates into concrete actions.

8. Even with a favorable external environment, the performance of individual countries will differ depending on their ability to manage opportunities and challenges in a more globalized environment. The continued success of the most outward-oriented developing countries will be premised on maintaining macroeconomic stability, encouraging domestic savings and investment, and providing an incentive structure that promotes competitiveness and attracts international business. On the other hand, economies that remain relatively closed risk becoming increasingly marginalized; the stream of process and product innovation fed by international trade and investment will continue to pass them by. The current favorable environment provides a window of opportunity for accelerating structural reforms that will underpin their growth prospects in the long run.

9. Turning now to the performance of developing countries in 1994 and prospects for the future, we note that the growth of low- and middle-income countries, excluding Eastern Europe and the former Soviet Union (FSU), averaged 4.9 percent in the past year. Those developing countries that are better integrated into the global economy have benefited most from the more favorable environment:

- **East Asia** continues to turn in a strong performance, reflecting buoyant domestic demand and strong export growth, boosted by large capital inflows. This region also is likely to continue exploiting global trade and investment opportunities to the fullest. Regional growth is expected to ease from 9 percent in 1991-94 to a still remarkable 7-8 percent in 1995-2004, as growth in the population and labor force slows and possibilities for technological catch-up with industrial countries narrow.

- **South Asia** also did well in 1994 in terms of both output growth and private capital inflows. Over the next decade the region is likely to see sustained growth in excess of 5 percent, provided reforms to enhance economic liberalization and the role of the private sector are quickened and fiscal deficits are reduced.

- In **Latin America**, growing current account deficits and the downturn in private flows have exposed some serious weaknesses, as the recent crisis in Mexico exemplifies. Growth in some major economies of that region is likely to be constrained in the medium term by the need for adjustment in the current account deficits and tight monetary policies.

- Boosted by gains in terms of trade, growth in **Sub-Saharan Africa**, at 2.2 percent in 1994, was significantly stronger than in previous years, but still not enough to raise living standards. Economic growth in the region is projected to be nearly 4 percent per year in 1995-2004 if countries take advantage of the more favorable external environment to strengthen economic and political reform.

- In **Europe and Central Asia**, economic performance in the countries in transition has become more differentiated, with the early and stronger reformers beginning to pull ahead and showing signs of sustained growth. Performance in the FSU remains weak, with output falling further by as much as 13 percent. In a favorable scenario, policies and performance could converge more closely in the second half of the 1990s, and

growth could move toward 5 percent a year. But significant challenges confront the region: major difficulties in achieving macroeconomic stabilization, severe internal political conflict, a large unfinished agenda for structural overhaul, the potential for sharp increases in unemployment, and rising requirements for foreign finance.

- Growth in the **Middle East and North Africa** averaged less than 1 percent per year over the last decade. Contributing to this result were falling oil prices, war, large and ineffective public sectors, and failure to achieve private-sector-led diversification. Regional growth may improve to a little over 3 percent per year in 1995-2004 if efforts at stabilization and structural adjustment are strengthened, more peaceful regional political conditions are achieved, and oil prices rise.

10. Thus, the overall outlook is positive, but there are significant downside risks to this scenario. Industrial countries could fail to make headway on fiscal consolidation and policy slippages could occur in the developing countries. Under this pessimistic scenario, if monetary policy in industrial countries is tightened further to curb inflation and interest rates rise sharply, growth could slow down. Moreover, countries that squander the proceeds of the boom will suffer disproportionately as they are penalized by domestic and foreign investors. Even if industrial countries avoid a boom-bust cycle and achieve a "soft landing," policy slippages leading to a loss of financial market confidence in selected developing countries could reverse private flows to emerging markets and result in a "contagious" series of balance-of-payments crises. Sound economic management would reduce both the intensity of financial markets' temporary loss of confidence and the number of countries affected, underscoring the importance of the policy framework.

11. If developing countries are to realize fully the potential gains inherent in today's improved economic environment, they need to keep policy reform at the top of the agenda. While the Uruguay Round offers the possibility of substantial gains to every country, its universal and smooth implementation is by no means assured. When the process of change involves both gainers and losers and exacts adjustment as the price for the benefits it offers, protectionist pressures are never far beneath the surface. Such pressures from the industries and groups that will need to adjust to stronger international competition will continue to test the firmness of policymakers' commitment to open markets.

12. Globalization has brought new opportunities and new challenges. Greater integration into the world economy raises the payoffs to increased competitiveness, but also compounds the losses from failure to act. More and more, policymakers are confronted with the need to maintain the confidence of both international and domestic markets. In this setting, sound economic policies command a rising premium. The countries best placed to benefit from the new opportunities offered by globalization are those that are successfully transforming their policies and structures to support outward-oriented growth.

III. Recent Trends in Resource Transfers to Developing Countries and Countries in Transition

13. Nothing has changed more rapidly in the 1990s than the financing structure for development. Aggregate net flows to developing countries have more than doubled in the past five years, and private sector financial flows have quadrupled. In 1994, for the fifth year in a row, net total resource flows to developing countries from the developed world reached a record level—an estimated $227 billion (see Annex Table 1). As in previous years, the increase was due entirely to growth in private sector flows, and this increase was divided fairly evenly between foreign direct investment and private loans. As my last report to you mentioned, private flows have acquired an enormous importance, accounting for three-quarters of all financial flows. The scale and pace of that change have caught policymakers, financial institutions, and the developing countries unprepared. The massive flow of capital to the developing countries is an important and desirable development; however, there is room for concern about the reliability of these flows and their impact on recipient countries' fiscal and monetary management.

Private Sector Flows

14. Although private capital flows to developing countries—at $173 billion—set another record high in 1994, they are increasing at a much slower pace—4 percent in 1994, compared to 61 percent in 1993. Moreover, flows to some of the larger Latin American countries fell in 1994. The deceleration is due in part to fewer bond issues and lower portfolio flows, reflecting the rise in OECD interest rates and a period of turbulence in bond markets in early 1994.

15. Private capital flows continue to be directed to a score of middle-income countries in East Asia and Latin America and to two large low-income countries, China and India. The various types of flows have been distributed quite differently across Regions. Nearly one-third of equity investments have gone to Mexico, and an additional 40 percent have gone to Brazil, Argentina, Korea, and Malaysia. China accounts for 40 percent of total direct foreign investment. Portfolio debt flows were strongly concentrated in Mexico, Brazil, Argentina, and Venezuela, and in East Asia.

16. The recent crisis in Mexico has heightened concerns about the sustainability of private capital flows. While the rise in interest rates contributed to the Mexican crisis, most of the underlying causes are specific to that country. Declining savings rates, overborrowing in foreign currency by the corporate sector, and real exchange rate appreciation contributed to mounting current account deficits that were increasingly financed through short-term portfolio flows. The measures now being taken by the authorities, and the support these measures have received from the international community, are helping Mexico cope with this crisis.

17. Will the Mexican crisis precipitate a generalized reversal of private flows? Market behavior and year-to-year variations are always difficult to predict. Those countries that are relatively more dependent on short-term flows will continue to be affected by the considerable inherent volatility of capital markets and will have to manage adroitly the associated macroeconomic effects—appreciation of the real exchange rate and inflationary pressures. The

question of whether the flows are sustainable in the medium to long term is better addressed by looking at the structural factors underlying the recent surge in private financial flows.

18. In the past decade, structural changes in the economic management of developing countries have brought about systematic progress in stabilization, trade liberalization, privatization, and substitution of regulatory oversight for direct administrative controls over financial sectors. These changes have been underpinned by an explicit redefinition of the role of government and a recognition of the importance of what the private sector offers in terms of efficiency, innovation, and competitiveness. This new environment has increasingly attracted private investors. To be sure, the market-based approach to development is not irrevocably rooted everywhere, and political backlash is a risk in some countries. An across-the-board reversal, however, is difficult to envisage; and without such a reversal, foreign investor interest will remain strong.

19. There have also been major structural changes in the global financial markets. Globalization of investment funds, the steady opening of domestic financial markets in developing countries, easier access to industrial capital markets, and the variety of instruments have contributed to the expansion of the investor base.

20. In addition to these structural changes, the nature of the flows, the kinds of investors that are being attracted to developing countries, and the globalization of financial markets suggest that a general reversal is unlikely:

- more than 40 percent of private capital flows are in the form of foreign direct investment, which is driven by structural rather than temporary changes in the world economy;
- most debt-creating flows are no longer in the form of commercial bank loans, but in the form of bonds issued by a limited number of developing country issuers perceived as creditworthy by market participants; and
- emerging markets' securities remain underrepresented, relative to the size of these markets, in the asset portfolios of foreign institutional investors.

21. In short, the globalization of financial markets is an important and beneficial development that is likely to continue. The Mexican crisis is, however, likely to usher in a more cautious attitude on the part of investors and to dampen the growth in private sector flows. With projected rapid growth and substantially improved policy framework, developing countries will remain attractive to investors, even as growth in OECD countries recovers. However, adjustment and restructuring remain essential for any country that wishes to compete internationally and assure sustainable growth in a global economy that puts an ever higher premium on innovation, skills, and flexibility. The global market is unforgiving: it generously rewards efficient policies but swiftly punishes inefficiency and failures to act.

Official Flows

22. The composition of aggregate resource flows to developing countries by income group has now become a function of access to international capital markets. On the whole, the middle-income countries enjoy market access. Among low-income countries, China and India have recently raised substantial resources from the international capital markets, but the smaller low-income countries continue to depend on official sources of financing. Flows from official sources declined in 1994, from $56.3 billion in 1993 to $54.4 billion in 1994 (at constant prices and exchange rates). Official development assistance (ODA), which accounts for about 80 percent of all net official flows, increased by $300 million, or less than one percent, to $44.6 billion (at constant prices and exchange rates).[1]

23. This is the third year in a row that ODA has held at around $44 billion. The immediate outlook is not for increasing aid but, at best, for continuing present levels. As I have mentioned in previous reports to the Development Committee, this situation is particularly troubling because low-income countries, except for India, China, and Indonesia, rely overwhelmingly on official assistance to finance their development. Increasing the effectiveness of that assistance must be a top priority for both donors and recipients. But a higher level of ODA is needed to improve living standards in the poorest countries in the world and to support the courageous reform process now under way in Africa and elsewhere. Therefore, we must continue our efforts to maintain and, whenever possible, expand ODA flows to help poor countries promote sound development programs and policies.

IV. The World Bank and IDA: Resource Transfers and Current Mobilization Efforts

Bank/IDA Commitments and Disbursements in FY94 and the First Half of FY95

24. Against this background, I am pleased to report that Bank support for the development efforts of the poorest countries remains strong. While IDA commitments totaled $6.7 billion (SDR 4.7 billion) in FY94, compared to $6.8 billion (SDR 4.8 billion) in FY93, IDA disbursements in FY94 totaled $5.5 billion, up from $4.9 billion in FY93. Disbursements in the first half of FY95 totaled $2.9 billion, compared to $2.4 billion for the first half of FY94.

25. IBRD commitments and disbursements, on the other hand, fell in FY94 relative to FY93—commitments by $2.7 billion (to $14.2 billion), and disbursements by $2.5 billion (to $10.4 billion). The pace of disbursements has accelerated in FY95: for the first half of the fiscal year, IBRD disbursements amounted to $6.6 billion. This compares with $5.0 billion in the first half of FY93 and $5.2 billion in the first half of FY94.

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[1] Bank statistics on ODA may differ from those of the OECD. Several factors account for the differences: Bank estimates include all of Eastern Europe and the FSU as recipients, and also flows to developing countries from non-DAC members. OECD estimates include flows to high-income countries and technical cooperation grants.

26. In FY94, IBRD commitments declined primarily because of a sharp fall in adjustment lending from $3.9 billion in FY93 to $570 million in FY94. This fall reflected both a long-term declining trend in adjustment lending (owing to improvements in the policy environment of many IBRD borrowers) and short-term volatility arising from unexpected country-specific factors (mainly macroeconomic and political developments in some transition economies). The surge in private capital flows also lowered some borrowers' demand for IBRD lending.

27. In turn, IBRD disbursement slowed in FY94 primarily because of the decline in commitments of fast-disbursing adjustment lending and, in some countries, delays in tranche releases of existing adjustment operations. Disbursements for investment lending operations have remained largely flat, affected by the weak disbursement performance of a few countries and by efforts to restructure portfolios, including cancellations. Net flows declined in FY94 as a result of the lower level of gross disbursements and a high level of prepayments. Excluding prepayments, net flows amounted to $239 million.

28. The process of agreeing with donors on IDA's Eleventh Replenishment is now under way. A meeting of IDA Deputies on February 9-10, 1995, discussed the major development challenges facing IDA recipients and the key operational policies guiding IDA activities. Another meeting is scheduled to begin on April 24. The fiscal constraints that a number of donors are experiencing will make replenishment difficult, but we are reassured by the strong support for IDA on the part of donor and recipient countries alike.

29. IDA's commitment authority remains adequate for near-term requirements. Management is, however, closely monitoring developments related to delays in availability of major donors' contributions.

Progress under the Special Program of Assistance (SPA) for Low-Income Countries Undertaking Structural Reforms in Sub-Saharan Africa

30. The Special Program of Assistance (SPA) is a good example of the Bank's role as a partner in development. The SPA mobilizes quick-disbursing balance-of-payments support for low-income, debt-distressed countries implementing adjustment programs. Most low-income countries in Sub-Saharan Africa suffered during the 1980s, but those that implemented adjustment programs consistently grew almost twice as fast as those that did not. In the mid-1990s, the differences in performance among African countries are more stark than ever. At one extreme are those that are mired in civil strife; at the other are those that are beginning to reap the benefits of the significant progress they have made on economic reform. No fewer than 21 African countries are now growing in per capita terms, and in roughly one-half of these countries GDP has grown at annual levels of 4-5 percent. These changes, all the more noteworthy given that they are occurring against the backdrop of a democratic political transition, call for a range of approaches in the assistance strategies to these countries.

31. Donors have responded to African reform initiatives with substantial increases in net transfers of resources, largely on concessional terms. Under Bank leadership, donors have been supporting the SPA since 1987. Under the third three-year phase of the SPA which began in 1994, 17 donors have pledged $6.7 billion in balance-of-payments support to date.

Resources will, however, remain extremely tight, and donors will need to be ever more selective in allocating resources to countries that are committed to undertaking the necessary reforms and are producing results.

32. The challenge for Africa is to accelerate progress in areas critical to sustainable economic growth and poverty reduction—education, health and population, agriculture, environment, reduction of gender inequities, private sector development, infrastructure services, and institutional capacity building.

Efforts to Reduce the Debt Burden

33. Reducing the debt burdens of severely indebted poor countries remains an essential aspect of the donor community's overall effort to support economic growth and improve living standards in these countries. The Bank's responses include (i) support for policy reform; (ii) IDA credits; (iii) extraordinary IDA allocations for countries engaged in debt workouts; (iv) Fifth Dimension allocations (see para. 36); (v) funding from the Debt Reduction Facility to reduce commercial debt (see para. 37); and (vi) technical assistance for debt management. These instruments are highly effective in reducing the debt burden when tailored to the needs of each country and I am pleased to report that the Bank continues to make progress in helping member countries reduce their debt burdens. IBRD debt, in particular, is being rapidly reduced and now accounts for only about 3.4 percent of the total outstanding debt of the 33 most severely indebted low-income countries. With the provision of new financing solely on IDA terms and support from the Fifth Dimension program, the overhang of IBRD debt will be rapidly reduced. Within six years, IBRD debt will be virtually eliminated for nearly all of the 19 IDA-only countries that today have IBRD debt.

34. The joint paper by the staffs of the Bank and the Fund entitled "Multilateral Debt of the Heavily Indebted Poor Countries" analyzed the debt issues of highly indebted poor countries. Its main conclusions are as follows:

- For a majority of highly indebted poor countries, *multilateral* debt is not a significant burden if they maintain appropriate domestic policies and receive adequate financing; however, external debt and debt service are serious problems for many of them.

- Economic growth is the key to the lasting solution to these countries' debt problems. Consequently, sound domestic policies and adequate financing are necessary. In particular, the highly indebted poor countries require that concessional lending be sustained at present levels and terms, and that all future multilateral financing be on terms similar to IDA terms.

- World Bank (IBRD and IDA) debt is a very small proportion of the total debt in the vast majority of these countries. The Bank has adequate instruments and flexibility to ensure that its debt is not a constraint to the development of the few countries in which its debt is significant. Nevertheless, a careful case-by-case assessment is appropriate. Both the Bank and the Fund are well placed to conduct this assessment in the context of preparing Policy Framework Papers and Country Assistance Strategies.

35. The Committee of the Whole had a constructive discussion of this paper on March 13. Questions focused on whether the scenarios for multilateral debt sustainability in the paper were too optimistic, in terms of both performance of these economies and availability of concessional flows. Directors asked that Bank staff explore alternative scenarios. Directors also called for an analysis of possible modifications to existing instrumentalities, including changing IDA lending terms and expanding the Fifth Dimension program. These analyses will soon be available for Board consideration. Bank management pointed out that IDA is a closed financial system and that there can be no additional funds in any of the options that are being explored. Any additional IDA lending (or softening of IDA lending terms) to any particular member country would entail a reduction of lending to another IDA borrower. The question is how best to use the available resources to help our poorest countries.

36. Through the Fifth Dimension program the Bank Group provides additional IDA allocations to IDA-only countries that have outstanding IBRD debt, are current on their debt service to the Bank, and have an IDA-supported adjustment program. These allocations are in proportion to the IBRD interest due in that year (in recent years covering over 90 percent). The Fifth Dimension program is financed out of IDA reflows. In FY94, the program provided supplemental IDA allocations totaling $265 million to 16 countries; supplemental allocations of $241 million to 19 eligible countries are planned for FY95.

37. The Bank's Debt Reduction Facility for IDA-only countries has continued to provide low-income countries with grant funds to reduce their commercial debt that is public, external, noncollateralized, and unguaranteed. The Facility is financed through contributions from IBRD's net income and from donors. To date seven operations have been completed (Niger, Mozambique, Guyana, Uganda, Bolivia, Zambia, and Sao Tome and Principe), which utilized $59 million in IBRD resources from the Facility and $60 million in cofinancing to extinguish $832 million in principal. The average discount has been about 86 percent of face value. Seven additional operations are now under preparation (Nicaragua, Sierra Leone, Albania, Tanzania, Ethiopia, Mauritania, and Guinea).

38. I welcome the progress made by Paris Club creditors in providing more substantial concessional debt relief for severely indebted, low-income countries. The new "Naples terms" agreed in December 1994 provide, for most such countries, for a 67 percent reduction of debt and service in net present value (NPV) terms, instead of the 50 percent available under "London terms." Also, when countries have established a good track record, the Paris Club will be prepared to reschedule on concessional terms the entire stock of eligible debt, rather than just payments falling due. In January and February, the Paris Club agreed reschedulings covering payments falling due for Guinea (with 50 percent NPV reduction) and for Cambodia, Guinea-Bissau and Togo (with 67 percent NPV reduction). It also agreed a stock of debt reduction for Uganda (with 67 percent NPV reduction).

V. The Poverty Challenge

39. Reducing poverty is *the* challenge for the governments of developing countries and for the World Bank. A billion people still live on less than one dollar a day. Eight million children

die every year from easily preventable diseases. One hundred million girls never get the chance to go to school. With 3 billion people about to be added to the world's population in the next generation—95 percent of them in poor countries—and incomes in the richest countries growing nearly three times faster than those in the poorest countries, poverty remains the greatest global challenge.

40. We have learned a great deal during the past 50 years about how to meet that challenge, and as a result poverty reduction receives much more systematic attention. We have learned about the importance of open markets and policies that generate labor-intensive growth; about the importance of investing in people—education, health, nutrition, family planning—so that many more can contribute to growth and enjoy its rewards; about the crucial role that the private sector can play in generating growth; about the importance of strong institutions, good governance, and ownership of programs; about the links between environmental protection and poverty reduction; and about the need for broad participation in economic development.

41. From these broad principles a strategic framework has emerged that increasingly guides the Bank's poverty reduction effort. The strategy relies on two mutually reinforcing approaches: labor intensive growth and investment in people. Accordingly, the Bank's lending for human resources development tripled in the past decade, from 5 percent of total lending in 1981-83 to 15 percent in 1991-94. This strategy is supplemented by the following elements:

- *Targeting and safety nets.* Careful targeting is essential to ensure that resources reach those most in need. In FY94, approximately three-quarters of adjustment operations were focused on poverty reduction, and about one-quarter of the Bank's investment lending supported specific, targeted programs aimed at poverty reduction.

- *Environmental sustainability.* For poverty reduction to be lasting, it must be environmentally sustainable. The most common environmental problems—dirty water, inadequate sanitation, and soil erosion—hit the poor the hardest. Lending for environmental purposes is currently the fastest-growing segment of the Bank's portfolio.

- *Population.* In many developing countries, reducing the rapid rate of population growth is important for poverty reduction and vice-versa. Bank lending for population and reproductive health activities reached $423 million in FY94.

- *The role of women.* Investing proportionally more in women is crucial in the effort to reduce poverty. Improving girls' access to education is probably the single most effective antipoverty policy in the world today. Almost one-half of Bank-supported projects in FY94 had components aimed specifically at including and benefiting women, up from only 10 percent five years ago.

- *Governance.* Good governance is essential for poverty reduction. In the 1990s, the Bank has attached increasing importance to helping its borrowers to improve the governance of their economic systems.

- *Participation.* Participation can be highly effective in helping communities overcome the shortcomings of very different kinds of economic and governance systems. The Bank is encouraging governments to involve local communities in project design and implementation. There is also an increasing trend toward applying participatory approaches at the policy level, where they can have maximum impact.

- *Partnership.* Strengthening coordination and partnerships among developing country governments, the private sector, nongovernmental organizations, bilateral donors, the UN system, and the Bretton Woods institutions is critical for more effective poverty reduction.

- *Knowledge.* Improved knowledge about and measurement of poverty increase the effectiveness of poverty reduction strategies. Poverty assessments provide the analytical base for linking the Bank's assistance strategies and poverty reduction efforts. We have now conducted poverty assessments in 39 countries, and we expect to have concluded 104 by the end of FY 96. Our country strategies and lending programs are changing as a result.

- *Implementation.* Poverty reduction requires hard work and perseverance. In recent years, the Bank has taken a number of steps to improve the implementation, and thus the development impact, of the operations it funds—more emphasis on the quality of initial project design, supervision, country management of the portfolio, and restructuring of projects.

42. Events such as last year's Cairo Conference on population and this year's World Summit on Social Development in Copenhagen have also given us the opportunity to demonstrate the Bank's focus on poverty and human resource development. The Fourth UN World Conference on Women to be held in Beijing in September 1995, for which the Bank will also prepare a background paper, will help reiterate the Bank's messages on gender and contribute to focusing on these issues from the gender perspective.

VI. Disclosure

43. An important way for the Bank to help its members and strengthen its partnership in development is to be an open institution. We have learned that the quality of our development work—and that of our partners—is enhanced by the availability of timely and relevant information about what the Bank is doing and proposes to do in the future. As reported to you at the fall 1993 meeting, on August 26, 1993, the Bank's Executive Directors approved far-reaching changes in our information disclosure policy. This decision was prompted by the desire to stimulate useful, well-informed debate on development issues, broaden understanding of development, and nurture public support for activities that promote progress in developing countries. We have recently reviewed our experience in the first year of implementing the disclosure policy, and the results so far are encouraging.

44. The substantially more open information policy greatly increased the range and number of documents available to the public. To meet the Bank's commitment to global accessibility

to the information, a Public Information Center (PIC) was established at headquarters in January 1994, and was soon followed by PIC field offices in London, Paris, Tokyo, and most recently, Jamaica.

45. World Bank resident missions are an especially important component of the PIC network, ensuring that relevant documents are available to affected peoples and local organizations in borrowing countries. The resident missions are linked to the PIC by electronic mail, with the result that the time required to transmit orders and some documents is minimal. Each resident mission stocks a full set of the publicly available documents for its country and provides a point of easy access to any of the other information available throughout the Bank. In one particularly entrepreneurial mission, the Indonesian resident office, the PIC and local NGOs are cooperating to help communities outside Jakarta gain access to Bank information. The PIC automatically supplies all documents, and the resident mission assists the NGOs in delivering them to outlying areas.

46. Access to many Bank documents is now within easy reach of people around the world, and public response has been positive: requests for information from the PICs have grown at an average of 15 percent per month since January 1994. As of December 31, 1994, the Bank had received 17,000 requests, mainly from the business community and, to a lesser extent, from public agencies and NGOs.

47. The Bank is now clearly a far more open organization than it was a year ago. Staff have responded well to the demands of the new policy, and government officials have worked closely and constructively with operations staff to ensure implementation of the policy. However, we can build on the past year's experience to enhance the effectiveness of the program, particularly in our outreach in developing countries. For example, the Bank will work closely with governments to ensure that key documents are available in a form that can be broadly understood in project areas. I am confident that our progress in applying our much-enhanced disclosure policy will continue to strengthen the effectiveness of our common work.

VII. Concluding Remarks

48. The past decade has witnessed a profound change in the organization of economic activity in many countries around the world, the emergence of the private sector as the main provider of funds to the developing countries, and the successful conclusion of the Uruguay Round with concomitant opening of trade in services and agricultural goods. The Bank—with the ultimate objective of raising living standards and increasing prosperity for people everywhere—has been responding to these changes and modifying the ways it does business. The Bank Group has become more open and participatory, and its role is increasingly that of a partner helping countries implement policies that open up markets and strengthen economies to compete in world trade. I am confident that the Bank Group, together with its member countries, can meet the enduring challenge of poverty by building upon lessons learned and adapting approaches to take advantage of new opportunities brought about by global changes and the favorable economic environment that we are likely to experience during the next few years. [1]

[1] This report was drafted by Pedro Belli, Economic Advisor (OPRPG), in consultation with staff members of other departments of the World Bank.

Annex Table 1. Long-Term Aggregate Net Flows of Resources to Developing Countries
($ billion, 1994 prices) [1]

Type of Flow	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994 [2]
Official Development Finance	43.0	49.5	54.2	50.2	46.3	45.9	59.2	63.2	50.7	56.3	54.4
ODA	27.2	34.8	37.1	38.8	39.7	39.8	45.8	48.9	43.4	44.3	44.6
Official Grants (3/4)	16.2	19.2	20.3	19.6	20.1	20.7	29.4	33.3	30.1	31.5	30.5
Official Concessional Loans	11.1	15.6	16.7	19.2	19.7	19.1	16.5	15.6	13.3	12.8	14.1
Official Nonconcessional Loans	15.8	14.7	17.1	11.4	6.6	6.1	13.4	14.3	7.3	12.0	9.8
Private Flows	45.7	43.5	27.5	29.2	38.2	45.2	46.5	64.4	103.5	166.4	172.9
Private Loans (5)	33.4	28.6	13.8	11.4	13.9	13.8	15.4	19.0	41.8	47.7	55.6
Foreign Direct Investment (6)	12.1	14.8	13.0	16.9	23.1	27.7	27.3	37.6	47.4	69.6	77.9
Portfolio Equity Investment (7)	0.2	0.2	0.8	0.9	1.2	3.8	3.9	7.7	14.3	49.0	39.5
AGGREGATE NET FLOWS	88.7	93.0	81.7	79.4	84.5	91.0	105.7	127.5	154.1	222.7	227.3
Memorandum Items: (9)											
Interest Payments	72.1	77.1	72.1	66.8	71.2	64.7	60.7	61.7	57.8	60.2	64.5
Profits on Foreign Direct Investment	16.0	15.5	14.5	14.5	14.6	18.6	18.2	19.0	21.4	24.4	25.4
Private Grants (3)	3.3	3.8	4.2	4.6	4.7	4.3	5.0	5.3	5.8	6.6	7.0
Related Data:											
IMF - Net Flows (8)	4.6	-0.2	-4.1	-7.3	-6.0	-2.5	0.1	3.2	1.2	0.8	0.5
Technical Cooperation Grants (3)	9.5	12.8	11.6	12.6	13.4	13.1	14.5	15.6	18.0	17.8	17.1
World Bank - Net Flows	7.7	6.9	7.1	5.5	3.2	3.1	5.2	2.6	0.1	2.9	-0.7
IDA - Net Flows	3.2	3.6	3.9	4.4	4.0	3.6	4.2	4.4	4.8	4.7	5.3

as of March 22, 1995

1. This table covers 154 developing countries for which data are reported in the 1994-95 edition of the World Debt Tables.
2. International Economic Department, Debt & Finance Unit projections.
3. OECD data (through 1993).
4. Excludes technical cooperation grants.
5. Includes bonds.
6. IMF balance-of-payments data, which include reinvested profits, supplemented by World Bank estimates and OECD data.
7. World Bank staff estimates, which are derived from reported market transactions and are often available only on a gross flow basis.
8. Includes IMF Trust Fund, SAF, and ESAF.
9. The World Bank and IDA net flows are on a calendar year basis. The historical data differ from more widely reported fiscal data only because of the different aggregation period.

THE WORLD ECONOMIC SITUATION AND ECONOMIC TRENDS IN DEVELOPING COUNTRIES
STATEMENT BY MICHEL CAMDESSUS
MANAGING DIRECTOR OF THE INTERNATIONAL MONETARY FUND

April 27, 1995

Growth in the developing countries as a group is projected to slow somewhat this year and then pick up to about 6 percent in 1996, similar to the average growth rate from 1992-94. The slowdown in 1995 is concentrated in the Western Hemisphere and mainly reflects the Mexican financial crisis and its repercussions, which have clouded the short-term outlook for some countries (see table). However, the substantial progress made by many developing countries to foster macroeconomic stability and implement structural reforms is expected to permit robust growth to be sustained over the longer term.

Economic Policies and Changes in Market Sentiment

The recent turmoil in some emerging country financial markets serves as a powerful reminder of the speed with which perceptions about a country's situation can change, and of the heavy costs of allowing economic imbalances to persist until financial markets force necessary policy adjustments. At the same time, recent events should not detract from the fundamental improvements in economic policies and performances in many developing countries during the past decade. The beneficial effects of policies to reduce distortions and to stimulate incentives and competition through price liberalization, privatization, and opening to trade and foreign direct investment have been most striking in the rapidly growing developing countries of east Asia. But fundamental changes in economic policies have also occurred, or are under way, in the rest of Asia, Latin America, Africa, and the Middle East, with the list of successfully reforming countries growing steadily year by year throughout the developing world.

The slowdown in capital flows to developing countries, which already had begun prior to the financial crisis in Mexico, represents a major shift in investment patterns following the surge of capital flows during 1990-93. A key factor behind this surge was the encouraging long-term growth prospects of many of the recipient countries. But cyclical factors, notably weak growth and investment demand in the industrial countries and generally low or declining interest rates, also played an important role. In addition to substantial inflows of foreign direct investment, large portfolio investments also flowed into many developing countries, including some where economic fundamentals may not have fully warranted the enthusiasm of foreign investors. Since early 1994, the pickup of activity in the industrial countries has increased demand for funds and put upward pressure on interest rates, and this has been an important cause of the slowdown in capital flows to the developing countries. The easing of portfolio flows has been reflected in equity prices in these markets, which generally declined starting in the fall of last year (see chart).

Major Economic Indicators

(Annual percent change, except where noted)

	1992	1993	1994	1995	1996
World					
Real GDP growth	2.0	2.5	3.7	3.8	4.2
Trade Volume	5.1	3.8	9.4	8.0	6.8
Trade Prices					
Fuel	-0.5	-11.5	-4.1	9.4	-0.1
Nonfuel primary commodities[1]	-0.2	-3.7	12.3	8.0	-1.1
Manufactures	3.6	-5.8	2.8	6.6	2.0
Six-month dollar LIBOR (percent)	3.9	3.4	5.1	6.8	7.0
Industrial countries					
Real GDP growth	1.5	1.2	3.0	3.0	2.7
Inflation	3.3	3.0	2.4	2.6	2.7
Import volume growth	4.3	1.5	10.5	7.8	5.0
Developing countries					
Real GDP growth	5.9	6.1	6.3	5.6	6.1
Per capita GDP growth	3.6	4.3	4.3	3.6	4.1
Inflation	35.9	43.0	48.0	17.5	8.9
Inflation (median)	9.8	9.0	10.1	8.0	5.0
Current account (in billions of U.S. dollars)	-73.5	-98.3	-91.0	-85.4	-90.8
Current account (in percent of GDP)	-1.7	-2.1	-1.8	-1.5	-1.4
Export volume growth	9.6	9.0	10.4	9.1	10.7
Import volume growth	12.6	10.4	8.7	8.6	11.2
Terms of trade	-0.7	-1.1	-0.3	0.6	-0.3
Export unit value	-0.3	-1.9	1.5	3.3	1.5
Import unit value	0.4	-0.9	1.9	2.7	1.8
Debt (in billions of U.S. dollars)	1447	1559	1623	1716	1797
Debt (in percent of exports)	127.1	127.8	118.7	111.2	104.4
Debt service (in percent of exports)	15.4	14.8	15.8	14.3	12.5
By region					
Africa					
Real GDP growth	0.8	0.7	2.7	3.7	5.3
Per capita GDP growth	-1.9	-1.8	-0.3	1.6	2.2
Inflation	29.7	26.8	33.6	21.4	10.0
Current account (in percent of GDP)	-2.4	-2.4	-3.4	-3.4	-3.0
Export volume growth	1.0	4.2	0.1	2.4	5.2
Import volume growth	1.8	-0.2	-2.9	6.1	1.5
Terms of trade	-6.3	-5.0	-7.3	0.9	-0.0
Debt (in percent of exports)	246.2	258.9	264.5	249.7	240.9
Asia					
Real GDP growth	8.2	8.7	8.6	7.6	7.3
Per capita GDP growth	6.5	7.1	7.0	5.9	5.7
Inflation	7.1	9.4	13.5	9.9	6.6
Current account (in percent of GDP)	0.1	-0.7	-0.5	-0.8	-0.9
Export volume growth	12.3	11.0	13.4	11.1	11.3
Import volume growth	13.3	13.8	13.1	11.8	12.9
Terms of trade	1.0	0.4	0.4	0.2	-0.4
Debt (in percent of exports)	67.5	69.0	63.9	61.5	59.9
Middle East and Europe					
Real GDP growth	5.5	3.7	0.7	2.9	4.7
Per capita GDP growth	-0.3	1.7	-2.1	0.4	1.0
Inflation	25.4	24.5	32.3	22.5	10.9
Current account (in percent of GDP)	-4.0	-3.6	-2.1	-1.8	-1.5
Export volume growth	8.3	4.4	4.3	2.6	13.6
Import volume growth	8.9	4.2	-6.6	5.7	13.8
Terms of trade	-3.0	-2.9	-2.4	1.2	-0.1
Debt (in percent of exports)	143.8	153.5	145.5	134.0	116.5
Western Hemisphere					
Real GDP growth	2.7	3.2	4.6	2.3	3.7
Per capita GDP growth	0.7	1.3	2.6	-0.3	1.9
Inflation	152.6	212.3	225.8	36.1	14.2
Current account (in percent of GDP)	-2.9	-3.3	-3.0	-1.9	-1.7
Export volume growth	6.2	8.9	9.4	10.1	7.8
Import volume growth	21.4	9.8	13.7	-0.6	5.9
Terms of trade	-1.1	-2.6	2.7	1.5	-0.7
Debt (in percent of exports)	276.4	274.6	255.3	237.4	228.2

[1] In U.S. dollars. Averages weighted by 1979-81 commodity shares in exports of developing countries or groups of countries.

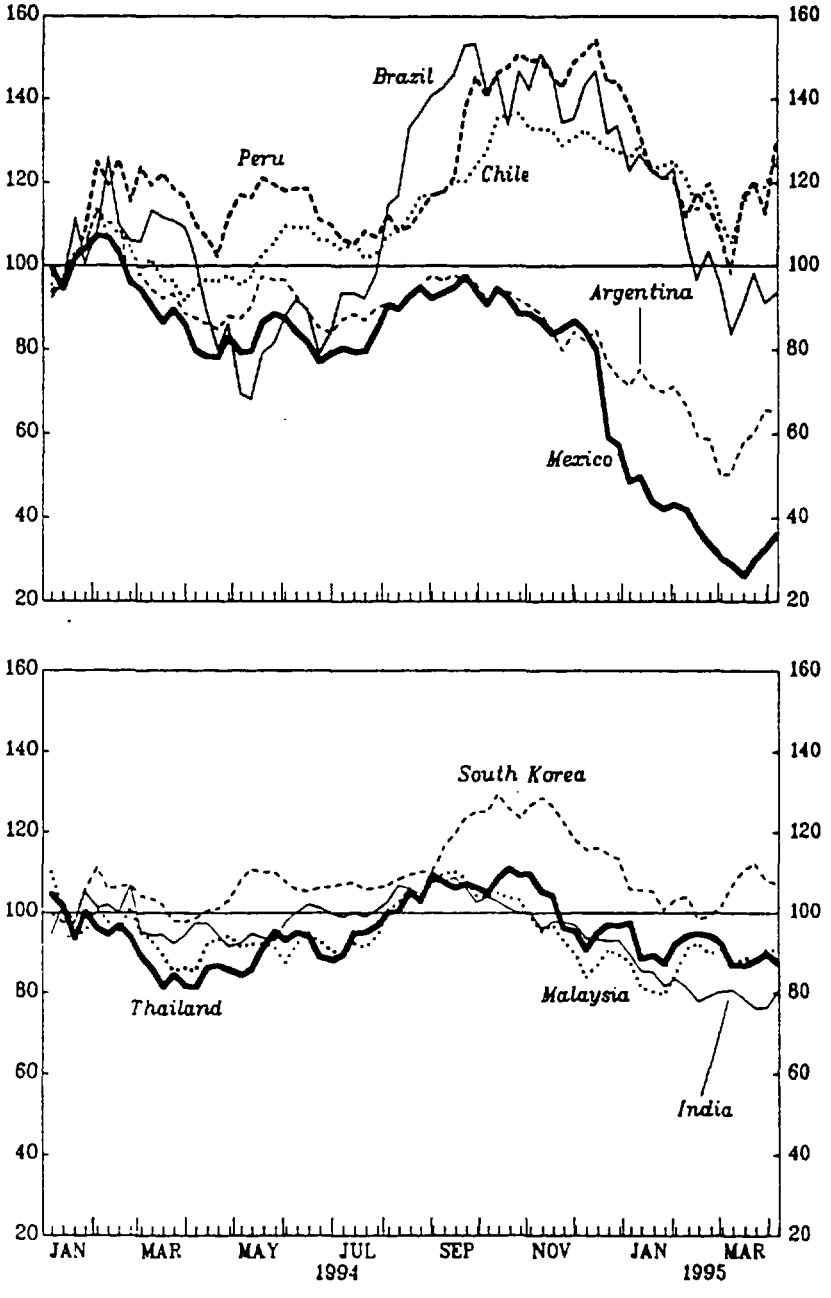
In Mexico, concerns about the external current-account deficit and political developments contributed to substantial reserve losses at times during 1994, eventually leading to the devaluation of the new peso in December and triggering a severe crisis of confidence. The resolution of the crisis has required major policy changes and adjustment to the new environment of lower capital inflows. Conditional financial assistance from multilateral and bilateral sources should facilitate orderly adjustment in Mexico and help to contain the systemic repercussions of the crisis.

Contagion effects of the crisis were felt in asset markets in other emerging market countries, although significant spillover effects appear to have been limited to a few countries, primarily in Latin America. Some of the affected countries will need to strengthen their macroeconomic fundamentals. These adjustments may have adverse effects on activity in the near term but will permit higher and more sustainable rates of economic growth in the medium term. Developing country growth could be more adversely affected, however, if inadequate policy adjustments in some of the emerging market countries were to result in a reappraisal of their longer-term growth prospects, with a large and sudden slowdown in capital flows.

All developing countries have to respond to important policy challenges, including those posed by large and potentially reversible capital flows. The divergences in growth performance and stages of development give rise to very different priorities and policy challenges across individual countries, even though the basic requirements of market-oriented, outward-looking policies are common to all countries. For the strongest performers among the developing countries, these challenges include the need to avoid overheating and to strengthen efforts in the areas of deregulation and privatization. For many other countries where performance has not been so strong, trade liberalization and structural reform need to be speeded up to enhance resource allocation, while fiscal and monetary policies need to consolidate progress toward greater macroeconomic stability and external viability. Progress in these areas would strengthen domestic saving, investment, and long-term growth. As emphasized in the Interim Committee's Declaration on "Cooperation to Strengthen the Global Expansion" adopted at its last meeting in Madrid, external viability and growth in developing countries need to be extended to the poorest countries through steadfast implementation of strong programs of macroeconomic adjustment and structural reform, supported by a flexible approach to official debt reduction for low income countries. In many of these countries, governments and donors will need to strengthen the efficiency and development orientation of public expenditure, in particular by making adequate resources available for basic social services.

With the ratification of the Uruguay Round agreement and the establishment of the World Trade Organization (WTO), a critical element of the cooperative strategy is now in place. As of January 1, 1995,

Selected Developing Countries: Equity Prices
(In U.S. dollars; January 1994 = 100)



Source: International Finance Corporation, Emerging Markets data base.

81 countries and regional bodies from all regions of the world, accounting for over 90 percent of world trade, had ratified the final Act. A number of other countries are in the process of domestic ratification of the agreement and negotiation of their WTO membership.

External Environment

Recent changes in financial market sentiment toward some emerging market countries contrast with the otherwise generally favorable external conditions facing developing countries. The strengthening of growth in the industrial countries is an important factor underlying the improved outlook for many developing countries. In addition, the cyclical recovery of commodity prices has helped to strengthen economic conditions in countries that are heavily dependent on commodity exports. In a number of these countries, the revenue gains from higher commodity prices could help strengthen fiscal adjustment and build up reserves, provided that policymakers ensure that spending from these higher revenues does not lead to excessive demand pressures.

World economic activity grew by 3¾ percent in 1994, in line with its long term trend of 3½ to 4 percent. Output is projected to expand by 3¾ percent in 1995 and by over 4 percent in 1996. With a continuing pickup of economic activity in Japan, robust recoveries in continental Europe, and particularly buoyant economic conditions in North America and the United Kingdom, output in the industrial countries advanced by 3 percent in 1994. Although the pattern of growth across industrial countries is likely to change, average growth is projected to remain close to 3 percent in 1995-96. Aggregate growth in the developing countries is projected to slow marginally this year to 5½ percent but with continuing improvements in economic conditions and policies, it should revert back to over 6 percent in 1996.

All of the countries in transition have implemented market-oriented reforms, some early on and boldly, others more recently and tentatively. In countries that implemented more radical stabilization and reform programs, such as Albania, Estonia, Lithuania, and Poland growth is projected to reach or exceed 5 percent in 1995. By contrast, measured output continues to decline in the Transcaucasian and central Asian countries, where the pace and scope of reforms have been less bold. The prospects for a turnaround in economic activity in Russia depend on the successful implementation of the economic program for 1995 which sets both fiscal and monetary policy on a course consistent with rapid macroeconomic stabilization.

The volume of world merchandise trade expanded by an impressive 9½ percent in 1994, well above its long-term average of around 5 percent during the past two decades. The increase in world trade reflects largely the substantial increase in import demand in industrial countries associated with robust recoveries in continental Europe and North America. The growth of world trade is projected to moderate somewhat in 1995-96. With an increasing number of countries reducing trade barriers, however, the long-run growth of trade should be sustained above the average experienced in

recent years. The volume of developing country exports expanded by over 10 percent in 1994, and export growth is projected to remain at about this level in the medium term, largely due to increasing intra-regional trade in the developing world.

The aggregate terms of trade facing developing countries declined only marginally by ¼ of 1 percent in 1994, representing a welcome moderation in the trend decline experienced in the past. Prices of non-oil commodities increased substantially during 1994 as a result of the global recovery, and in February this year, the IMF's world export-weighted index was 10 percent higher than a year earlier. In early 1995, oil prices picked up somewhat, as demand from the United States and Asia increased substantially; the projected firming of oil prices will help to improve the terms of trade of fuel-exporting countries. The terms of trade for all developing countries as a group is expected to stabilize in 1995-96 as further strengthening of developing country export prices helps to offset projected increases in import prices.

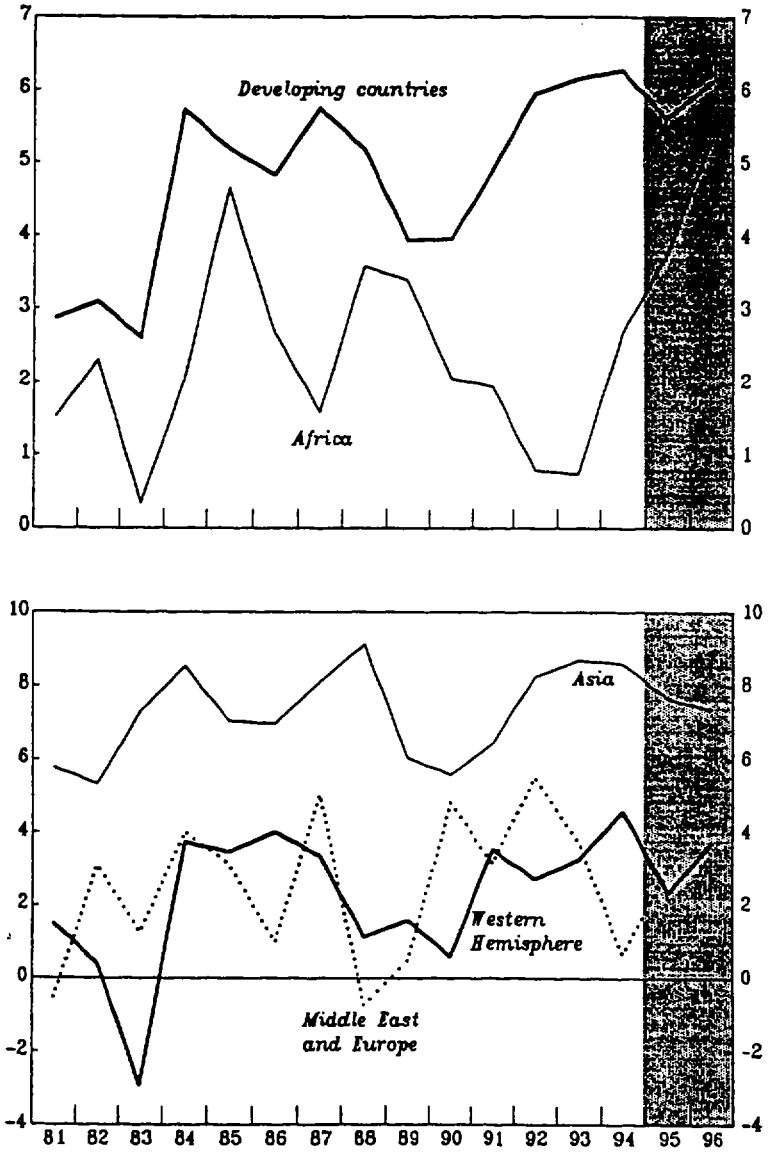
Much of the rise in long-term interest rates in the largest industrial countries during the past year or so was attributable to the strengthening of growth prospects and inflation expectations. More recently, long-term interest rates in several of the larger countries have leveled off or declined, as the credibility of commitments to resist inflationary pressures appears to have strengthened. But long-term interest rates have risen or remained very high in several other industrial countries in response to exchange market pressures, often associated with weak public finances. There has also been a sharp weakening of the U.S. dollar and many other currencies against the yen and the deutsche mark. Stronger efforts to restore fiscal balance in these countries would undoubtedly help to achieve greater stability in exchange markets.

Economic Trends in the Developing Countries

The fundamental improvements that have occurred in recent years in economic policies in the developing countries have been reflected in average economic growth of almost 6 percent during 1991-94, well above the average annual growth rate of about 4 percent in the decade to 1990 (see second chart). During the period ahead, growth is expected to be sustained at close to 6 percent, despite some slowdown in 1995 associated with the projected decline in capital flows and the need to strengthen economic fundamentals in some countries. Regional divergences in growth rates are expected to narrow over the medium term, as policies and reform efforts strengthen in some of the weaker performing countries--primarily, but not only, in Africa--but significant disparities are likely to persist.

Following the financial crisis in Mexico and the repercussions in a number of countries in the region, average growth in the countries of the *Western Hemisphere* is projected to slow to 2¼ percent in 1995 and then pick up to 3¾ percent in 1996. Output in Mexico is expected to fall by 2 percent in 1995, but as financial conditions stabilize, activity is assumed to pick

Developing Countries: Real GDP[1]
(Annual percent change)



[1] Shaded areas indicate IMF staff projections.

up again in 1996. In Brazil, output growth exceeded 5 percent in 1994 and is expected to remain robust if monetary and fiscal policies are adjusted to consolidate progress toward greater financial stability. Growth in Argentina is expected to slow significantly in 1995-96, partly due to a decline in capital flows and the resulting adjustment in domestic demand. Chile, which has been less affected by the crisis in Mexico, is expected to experience continued solid growth. In Venezuela, the earlier financial crisis and the exchange and price controls that were imposed in mid-1994 have had adverse effects on private sector confidence and investment; a further decline in output is expected in 1995.

Average growth in *Asia* was stronger than expected in 1994, with a number of economies beginning to show signs of overheating. With some slowdown in portfolio capital flows to the region, and in view of a tightening of financial policies in response to capacity constraints, growth is expected to moderate to 7½ percent in 1995 from about 8¾ percent in 1993-94. In China, where output growth slowed only slightly in 1994 to 12 percent, a strengthening of stabilization efforts would help to achieve a more sustainable pace of expansion of about 9 percent in 1995 and to reduce inflationary pressures. Strong increases in investment demand in Korea boosted real GDP by over 8 percent in 1994. Strong investment demand also contributed to buoyant growth in Malaysia, the Philippines, and Thailand in 1994, and the expansions in these countries are expected to be sustained at or close to the growth rates experienced recently. In India, the recovery gathered momentum in 1994, with the economy growing by 5 percent. The challenge for the Indian authorities is to ensure that continued fiscal consolidation helps to reduce the burden on monetary policy of containing inflationary pressures, to lower public indebtedness, and to bolster national saving.

The outlook for *Africa* has improved with the recent implementation of structural reforms and stabilization programs in a number of countries. Assuming prudent macroeconomic policies and continuing reforms, average output growth in Africa is projected to rise to 3¾ percent in 1995. Although setbacks are likely in some countries and economic conditions remain difficult in many others, risks of widespread policy slippages--as often experienced in the past--appear to be receding. An increasing number of countries in the region are now seeking to maintain competitive exchange rates, reduce macroeconomic imbalances, and implement structural reforms. In South Africa, growth is projected to average 3 percent in 1995-96, compared to 2¼ percent in 1994, but the problem of high unemployment remains a major policy challenge over the medium term. In Nigeria, the economic and financial situation deteriorated further in 1994, owing to large fiscal imbalances and the maintenance of the exchange rate and interest rates at unrealistic levels; there is a danger of further fiscal slippages if a budgeted increase in oil revenues does not materialize. In Algeria, activity in 1994 was weaker than anticipated, in part due to continuing political instability, but also reflecting strong stabilization efforts and a decline in agricultural production as the drought continued for a second year. Further trade and foreign exchange market reforms,

however, are expected to raise Algeria's growth in 1995-96 to around 5 percent.

Many countries of the *CFA franc zone* are now beginning to see the benefits from the much-needed currency adjustment in early 1994 and the accompanying reform efforts. One of the most important changes in the economic situation in these countries is that opportunities for investment and exports have increased. With support from multilateral and bilateral donors, and continued efforts to prevent inflation from eroding competitiveness, growth in the CFA region is expected to reach an average of 5 percent in 1995-96, a striking change after a decade of stagnation. The overall outlook among the African countries that had arrangements at the end of 1994 under the IMF's enhanced structural adjustment facility (ESAF) remains encouraging. Growth in these countries is expected to average 5½ percent in 1995-96. Uganda, for example, has made great strides in restoring macroeconomic stability, with the current recovery expected to strengthen in 1995-96 as macroeconomic policies strengthen further.

Growth in the *Middle East and Europe* declined to only ¾ of 1 percent in 1994, largely as a result of developments in Turkey, but is projected to recover to 3 percent in 1995 and to approach 5 percent in 1996. The severe financial crisis in Turkey during the first half of 1994 contributed to a sharp decline of output. The outcome of the stabilization program adopted in mid-1994 has so far been mixed: external performance has improved but inflation has returned to monthly rates of 5-6 percent, indicating the need for a further strengthening of stabilization policies. Economic prospects for the oil exporting countries in the region continue to be heavily dependent on oil market developments: oil prices fell in 1994, but the assumed strengthening in 1995 should help to ease fiscal and external imbalances in some of the larger oil exporting countries. The favorable impact on the terms of trade will be mitigated, however, by the depreciation of the dollar against other major currencies and by increases in non-oil commodity prices.

Median <u>inflation</u> in the developing countries is projected to decline to 8 percent in 1995, and to fall further to 5 percent in 1996. Under the assumption that macroeconomic adjustment programs remain on track, average inflation, which remained relatively high during most of 1994, is also expected to fall markedly in 1995. The substantial improvement expected this year reflects strong stabilization programs already under way in a number of the larger developing countries. In Brazil, for example, the current stabilization program has reduced monthly inflation from more than 40 percent in June 1994 to an average of less than 1½ percent per month in the first quarter of 1995. The strengthening of stabilization efforts in China is projected to reduce inflation from over 20 percent in 1994 to an average of under 10 percent in 1995-96. In African countries that had arrangements under the IMF's ESAF at the end of 1994, inflation is expected to fall from over 20 percent in 1994 to below 10 percent in 1995. In the CFA countries, despite policy slippages in some cases, much of the gain in

external competitiveness following the January 1994 devaluation has been maintained and inflation is expected to decline this year and in 1996.

The large increases in capital flows to developing countries in recent years, mainly to Asian and Latin American countries, have been associated with widening current account deficits in most regions, although many countries have been relatively successful in sterilizing a substantial proportion of the capital inflows and in building up reserves. Net capital flows to the Western Hemisphere are expected to slow the most in the wake of the crisis in Mexico. There may well be some lag in trade flows, however, and projected current account deficits do not fully reflect the likely decline in capital flows. Recent increases in commodity prices and strengthened competitiveness are important factors in the current account improvements projected for African countries, especially for the CFA countries. The external surplus in Egypt is expected to decline further in 1995-96, reflecting in part a real appreciation of the currency. The assumed strengthening of oil prices in 1995 and stronger fiscal adjustment efforts should also contribute to improvements in external positions among the oil exporting countries.

Aggregate measures of developing country indebtedness and debt burdens continue to improve, although the rise in interest rates during 1994 has increased debt-service-to-export ratios for sub-Saharan Africa and for countries in the Middle East and Europe. For 1995-96, however, both the debt-to-export and debt-service-to-export ratios are projected to decline for all countries. A more flexible approach to official bilateral debt reduction for low-income countries by the Paris Club, under the "Naples" terms agreed in December 1994 and consistent with the Interim Committee's Madrid Declaration, is expected to reduce debt burdens for low-income countries. Cambodia was the first country to be offered a 67 percent net present value reduction in eligible debt service by the Paris Club in January 1995; subsequently, a number of other countries, Chad, Guinea-Bissau, and Togo in February, and Bolivia and Nicaragua in March, were offered similar terms, whereas Guinea received a 50 percent reduction in January. Furthermore, in February, Uganda was the first country to receive a stock of debt operation under Naples terms, involving a 67 percent reduction in the net present value of eligible debt. The new Naples terms should help to reduce debt and debt-service payments of most low-income countries to more sustainable levels, provided that new debt instruments offered to these countries contain similar concessional elements.

In the past six months, progress has continued to be made with debt-restructuring agreements in connection with the London Club and on a bilateral official basis. These include the commercial bank restructuring agreement with Ecuador involving $4.5 billion commercial bank debt and $2.9 billion in interest arrears. Algeria is also negotiating with commercial banks to restructure $4.2 billion debt. Haiti has settled its debt arrears to multilateral lenders, but arrears to the United States and other bilateral lenders remain to be cleared. South Africa wrote off a $200 million debt owed by Namibia. Talks with regard to the commercial bank

debt of Peru and Panama are continuing. Negotiations are also continuing with Nigeria and Venezuela regarding arrears and the management of outstanding debt.

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In recent years a large number of developing countries have enjoyed sustained periods of high growth. For many of these countries, success has been accompanied by substantial inflows of private capital and has brought new policy challenges. These inflows have boosted investment and growth in many countries and have contributed to a more efficient international allocation of resources. At the same time, as recent events have underscored, the globalization of capital markets can rapidly transmit disturbances across countries. In this new environment, stricter policy discipline is required to guard against adverse and swift market reactions. Experience indicates that delayed adjustment, forced by the markets, can be more disruptive and costly than measures promptly taken. At the same time, efforts to raise domestic saving through stronger fiscal adjustment efforts and structural reforms to mobilize and enhance private saving can help insulate countries against disturbances from elsewhere.

Further trade liberalization and structural reforms will also be necessary to take full advantage of the opportunities offered by the Uruguay Round agreement, especially the increased access to industrial country markets. To support and promote stronger reform efforts among the countries that have experienced declining living standards, especially in sub-Saharan Africa, official and private creditors will need to ensure that excessive debt-service obligations do not weaken incentives to strengthen reform and stabilization programs.

STATEMENT BY THE CHAIRMAN OF THE INTERGOVERNMENTAL GROUP OF TWENTY-FOUR ON INTERNATIONAL MONETARY AFFAIRS
N'GORAN NIAMIEN, MINISTER DELEGATE TO THE PRIME MINISTER IN CHARGE OF ECONOMY, FINANCE, COMMERCE AND PLANNING OF COTE D'IVOIRE
Washington, D.C. - April 27, 1995[1]

Mr. Chairman, let me congratulate you on your election to the Chairmanship of the Development Committee. We have valued the mission that you have and we believe that your distinguished qualifications will allow you to guide the proceedings in the interest of all countries.

Mr. Chairman, the Group of Twenty-Four, which I have the honor of chairing on behalf of my country, Côte d'Ivoire, has endorsed the wise choice of the topics on the agenda of the Development Committee, which has emphasized the financing of infrastructure in developing countries.

As to the recent trend to transfer real resources for development purposes, we are concerned by the fact that the net transfers from the World Bank Group have been negative in 1994. That is why we strongly suggest that this trend be reversed. We, therefore, would like to make an urgent appeal to the donors for a replenishment of IDA's resources as soon as possible. This is of primary importance in the financing of development.

Mr. Chairman, the heavy debt burden today is one of the major obstacles to the growth process of developing countries. Although we are pleased by recent initiatives with regard to the bilateral debt, such as the application of the Naples Terms of the Paris Club, more ambitious initiatives must be implemented to find a global and clearer solution to the debt problem. In this spirit, we would like to repeat our hope that the Paris Club substantially reduce this stock of debt.

As to the multilateral debt, its increased share of the debt service in developing countries represents a major source of concern. It is, therefore, urgent as well to establish within the multilateral institutions new mechanisms or strengthen the existing mechanisms in order to alleviate this burden.

Mr. Chairman, another major obstacle to growth in developing countries is the lack of or mismanagement of basic infrastructure. To this end, we hope that the multilateral institutions, particularly the World Bank Group, may implement new initiatives for the purpose of financing infrastructure in our respective countries. We also hope that these institutions may have a more active role in the strengthening of the management capabilities for infrastructure.

Mr. Chairman, the countries and the Group of Twenty-Four that I represent have adopted resolutions on different topics, and we hope they will be taken into account during the debate of the Development Committee.

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[1]The English translation of the statement is based on the transcript of proceedings of the Plenary Session of the Committee's meeting.

THE FINANCING OF INFRASTRUCTURE IN DEVELOPING COUNTRIES[1]

Why is infrastructure a subject worth discussion by ministers? As is evident in the accompanying paper, infrastructure is essential for development, but it is costly, its provision needs reform in many countries, and finance is central to improving efficiency and meeting demand for infrastructure services. In reviewing the papers that deal with the financing of infrastructure in developing countries, ministers may wish to focus on the following issues.

Issues for Discussion

1. **Price reform** is critical to mobilize resources for infrastructure finance and to reduce the heavy burden of public subsidies in many countries. It will also help to achieve efficiency and environmental objectives. How can price reform be achieved in ways that are socially and politically feasible in ministers' own countries, and what can be done to facilitate it?

2. **Public finance** for infrastructure, including taxation and debt, should have a more limited role as private finance and price reform increase in importance, but will remain necessary for some infrastructure activities. Subsidies will also continue to be needed for essential services that are commercially unattractive. What experience have the ministers' countries had in allocating tax revenues for infrastructure development (including at subnational levels of government) and in designing effective subsidies for the poor?

3. Activities that foster **adequate maintenance and efficient operation** of existing infrastructure facilities often have higher returns than investment in new facilities. What experiences have ministers had in implementing sustainable programs to fund infrastructure maintenance? What can the international institutions and donor countries do to foster better maintenance?

4. **Private financing** of infrastructure is growing briskly, but is still a small share of the resources needed. What steps have ministers found useful in attracting private finance for infrastructure and in which sectors, and how much room is there for growth of such financing in their countries?

5. Appropriate **risk allocation and risk sharing** between public and private partners through guarantees is needed, but guarantees for commercial risk should be avoided. Many ministers have experience in managing and allocating risk between public and private partners. What lessons do they draw from this experience about the role for guarantees in infrastructure finance?

6. The **Bank Group** is focusing its support to infrastructure on improving sector policies, facilitating financing, and increasing efficiency and private sector involvement in service provision. In addition, Bank Group members are collaborating more to increase their catalytic role in the infrastructure sectors. Based on ministerial experience, what specific suggestions are there for ways to enhance Bank Group effectiveness in improving infrastructure performance?

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[1]This paper was prepared by Gregory Ingram (RAD) and Christine Kessides (TWUDR) of the World Bank, in consultation with Chanpen Puckahtikom (PDRD) of the IMF, and with contributions from several staff members of the World Bank and the International Finance Corporation. (DC/95-2; March 28, 1995)

1. The growing demands for higher quality infrastructure services in all developing countries are adding urgency to the search for new sources of finance and new modes of provision. Governments face a challenging agenda to transform incentives and institutional arrangements so that the public and the private sectors can become more effective partners in developing infrastructure that serves the objectives of economic growth, poverty reduction, and environmental sustainability. The Bank Group and the Fund can provide an integrated array of instruments to assist countries in mobilizing infrastructure finance and promoting its efficient use. By focusing on the financing of infrastructure, this paper builds on the *1994 World Development Report, Infrastructure for Development.*

THE NEED TO DO THINGS DIFFERENTLY

2. Reliable power, transport, and telecommunications are essential for countries to modernize production, attract foreign investment, and compete in global markets. Basic infrastructure services—such as clean water, sanitation, safe waste disposal, and transport—improve the health and raise the productivity of the poor. And appropriately designed and efficiently run transportation, water, sanitation, and power can contribute to more environmentally sustainable human settlements, particularly in urban areas.

3. To achieve these benefits, developing countries have been investing an average of 4 percent of their GDP in infrastructure, about $200 billion a year. The large investments in infrastructure have allowed service capacity to increase faster than population growth (particularly in water supply, telecommunications, and power). But the unmet demand for basic services remains huge: one billion people lack access to safe water, and close to two billion lack adequate sanitation or electric power.

4. Both the supply and the quality of infrastructure services are inadequate to meet current demands in most developing countries and in the transition economies—and effective demand for infrastructure services will continue to grow. Projections indicate that the demand for infrastructure investment in the East Asia and Latin American regions could easily reach 6 percent of GDP for several years, and that economically justified infrastructure investment in many developing countries is well above recent levels. Private financing sources will need to be tapped to meet these growing investment demands in many countries. Moreover, the projected increase in demand for infrastructure is unlikely to be met by traditional approaches of provision, which have been characterized by three pervasive failures.

5. ***First, inefficient operation.*** The most costly and widespread cause of poor system operation—as seen in high loss rates of power and water, and frequent breakdowns of vehicles and equipment—is inadequate maintenance. This ultimately results in reduced service quality, increased costs for users, and unnecessary expenditure on new investment to replace existing capacity. Low and middle income countries could save more than $55 billion a year (a quarter of their annual infrastructure investment) by providing adequate maintenance and efficient operation of roads, power, water, and railways.

6. ***Second, unresponsiveness to users.*** Inefficient operation means unreliable service, and reliability is a critical aspect of user satisfaction too often ignored. In addition, providing service to new users who

are willing and able to pay is often excessively delayed. For example, of 95 developing countries in 1992, 37 had a waiting period of six years or more for telephone service.

7. ***Third, financial inefficiency and fiscal drain.*** The average revenues are less than production costs for all developing country infrastructure services except long distance telecommunications, and the structure of tariffs often creates undesirable incentives. Underpricing leaves too few resources for expanding coverage and improving service quality. It also leads to overuse of services, because low prices prompt high consumption. And it demands enormous subsidies to infrastructure providers. In many countries, the inability or unwillingness of governments to fund inefficient public service providers is a critical impetus to reform.

INSTITUTIONAL ARRANGEMENTS—THE KEY TO PERFORMANCE

8. The efficiency and quality of infrastructure services vary greatly within and across developing countries. The 1994 WDR found that the performance of infrastructure stems not from general economic conditions but from the institutional environment, which often varies across sectors within countries. The main determinants of good performance—and bad—are the institutional arrangements and incentives for providing infrastructure services.

9. Reforming infrastructure service provision requires three changes: more consistent application of commercial principles, broader use of competition, and greater involvement of users. These changes can be pursued through four main institutional options: i) reforming public sector provision by commercialization and corporatization, ii) shifting the operation of publicly owned facilities to the private sector through such arrangements as leases and concessions, iii) privatizing both operation and ownership with appropriate regulation, or iv) facilitating provision of services by communities themselves.

10. Countries across the spectrum of development are experimenting with these options in different ways for different services. The challenge is to expand the range of activities in which competition and commercial incentives can be exploited to foster more efficient and reliable service provision and expanded service coverage. Competition can be introduced through quite different approaches, varying with country capacity and the economic and technical characteristics of the activity. For those components of the infrastructure sectors that do not entail natural monopoly (as in the new, value-added telecommunications services), competition can be fostered freely in the market among multiple providers. Where a natural monopoly exists due to significant economies of scale or high sunk costs (as in municipal water supply), the right to exercise the monopoly can be granted through competitive bidding—"competition for the market." And in some activities, competitive pressures can be created by providers offering alternative services, such as competition between trucking and rail carriers in the same region. To develop fully the opportunities for competitive and commercial provision of infrastructure, the government must focus its efforts—whether through finance, ownership, or regulation—more effectively on protecting society against potential abuses of natural monopoly and on ensuring that the goals of social equity and environmental sustainability are served.

11. For power and telecommunications, many countries are "unbundling" the formerly monolithic public sector providers. In East Asia, for example, countries are inviting private entrants into generation and even distribution, leaving the natural monopoly of transmission under mainly public ownership or sometimes under a long-term contract with private operators. Many countries are also opening value-added telecommunications services to entrepreneurs. In Latin America, several countries have transferred entire power and telecommunications entities to private owners to break with the poor public management and financing of the past. Divestiture to private owners has in most cases dramatically increased investment and efficiency, but sustaining such improvements requires the discipline of competition,

supported by effective regulation focused on issues that cannot be solved by the market—such as access to network facilities or preventing abuse of monopoly power. Countries must learn from the regulatory experiments now underway and adopt regulatory approaches matching their institutional capacities.

12. For ports, railways, airports, and urban transport—and for urban water supply and sanitation—countries have adopted a wide range of public-private partnerships. Most popular are contracts (leases, concessions, and service franchises) in which governments retain ownership of the facilities. Countries have also been making incremental reforms, such as corporatizing public entities. Evidence from these reform experiences shows that the pressure of competition in the financing and provision of infrastructure services improves performance through increased efficiency and responsiveness to users.

13. Most of the road system in any country, apart from the very limited share financeable from direct tolls, will remain under public ownership, financing, and management. The challenge is to ensure adequate maintenance and accountability to users through such mechanisms as road boards, financed by user charges. For other infrastructure involving small, highly dispersed investments—such as rural roads, water supply and informal sanitation—the government's role is equally important. Local communities can often participate in financing and operating many of their own services, usually with some support—technical assistance, training, and limited credit for up-front investments—from governments or nongovernmental organizations.

AN AGENDA FOR CHANGE

14. ***Price reform.*** Realistic pricing is basic for running infrastructure on commercial principles, promoting competition among suppliers, providing funds for investment, and attracting new investors and operators. On average, tariffs cover only 30 percent of the production costs for water, 60 percent for power, and 80 percent for gas. In some cases tariffs are distorted, exceeding costs for some uses while being far below costs for others.

15. Although it may be difficult, raising tariffs can have a profound impact on public budgets by reducing infrastructure's claim on public funds. The transfers have been very large. The annual costs not recovered from users in developing countries is estimated to be $90 billion for power, $18 billion for water supply, and $15 billion for railways. The total—$123 billion—represents nearly 10 percent of government revenue in developing countries and more than 2 percent of their gross domestic product.

16. Mobilizing revenues through tariffs and user charges that cover the costs of efficient production allows both public and private infrastructure providers to be financially independent from government agencies, reducing political interference. Providers become more responsive to their customers, who can signal their preferences for services through their willingness to pay. And restructuring tariffs to cover costs also stimulates firms and households to use fewer services and reduce waste. All this translates into lower consumption, lower growth of needed capacity expansion, and lower financing requirements for new facilities. And for such sectors as electric power, it can lessen the environmental impacts of meeting demand.

17. Closing the gap between prices and costs will also go a long way toward addressing social concerns. The poor will lack access as long as resources are insufficient to expand services. There remain limited areas of infrastructure—such as rural roads or flood control works—where externalities abound and user charges are not practical or could not accurately represent the full costs and benefits of services. And there are instances where governments need to assist users unable to pay for basic services. These exceptions, discussed below, pose special challenges for public policy.

18. ***Private sector involvement.*** Countries that have attracted private sector investment and management into infrastructure have realized substantial benefits almost immediately. Hungary's telephone system, after its privatization in late 1993, has been expanding faster than that in any other country in Eastern Europe. Côte d'Ivoire's urban water supply system, under a private operating contract for more than two decades (and as a concession since the late 1980s), has higher connection rates, internal efficiency, service reliability, and cost recovery than those in most neighboring countries, yet it has comparable tariffs. When Argentine railroads were privatized through concessions, the new railways carried the same traffic with only a third of the labor force. Service improved, freight rates fell, and the government subsidy dropped from $800 million to $150 million, going only to rail services still in the public sector. Brownouts in the Philippines, contributing to economic crisis in the late 1980s, have almost ceased since more than 3,000 megawatts of private generating capacity were added through independent power projects, beginning in 1988.

19. Inviting private management through concessions or divestiture introduces new entrepreneurial skills and new technology. In Côte d'Ivoire, expatriate managers have trained and been replaced by local personnel in a short period, and the domestic capital market has become the main source of investment finance. Prices of services have also declined where the private operators have achieved efficiency gains (such as reducing unaccounted for water), and efficiency has improved for both public and private providers when the operators are subject to competition (as in power generation). There is also ample evidence that private infrastructure projects are completed faster and with lower cost overruns than comparable public projects, yielding savings which often compensate for the higher costs of private finance. The reliability and diversity of services offered to customers typically improves as well with the entry of competing providers.

20. There are major differences among countries and the various infrastructure sectors in the extent of private interest and in the instruments used. Some 40 countries have opened value-added or overseas telecommunications services to competitive private entry—niche markets that enjoy high growth potential, limited risk, short payoff, and aggressive marketing by suppliers. An increasing number of countries are transferring their main (local) telecommunications entities to private owners, sometimes with defined periods of exclusive service during which the companies are required to expand coverage. Several countries permit private independent power projects to sell through the main transmissions grid in competition with other generating companies, or to contract with a single purchaser under take or pay contracts. Toll road projects are becoming increasingly common, notably in China, Hungary, Indonesia, Malaysia, Mexico, and Thailand. Malaysia has privatized a container port, and leases or concessions for port operation are in place in Chile, China, Colombia, Gambia, Ghana, and Venezuela. Railway concessions are under way in Argentina and in advanced preparation in Côte d'Ivoire. Lease, concession, and build-operate-transfer (BOT) arrangements in water supply and sewage treatment are operating in Argentina, Guinea, Mexico, Malaysia, and Sierra Leone—and under preparation in Peru and Poland, among many other countries.

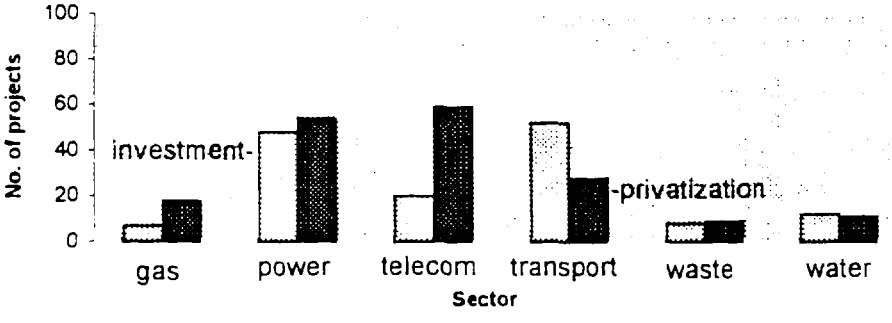
21. ***Private financing.*** Though negligible in the late 1980s, private financing in one form or another now accounts for about 7 percent of infrastructure project finance in developing countries, and may reach 15 percent by 2000. With bilateral and multilateral foreign aid accounting for another 12 percent of annual investment, governments thus put up 80 percent—or more. Although an increasing share of the domestic savings needed to finance infrastructure provision can come from private sources as domestic capital markets develop, governments will continue to be the major source of funds for infrastructure as well as a conduit for many donor resources, particularly for the poorest countries.

22. Privatization (including both the sale of public assets to private entities and concession agreements) has produced significant public revenue and fostered new sources of finance for infrastructure. Of the $95 billion obtained by developing countries from privatizing public enterprises from 1988 through 1993, about $32 billion came from infrastructure privatizations in 38 countries. Foreign investment has been much more significant in Latin America (accounting for 56 percent of proceeds from divestiture) than in East Asia (2 percent). Privatization can be important in developing local stock markets and broadening domestic capital markets. For example, corporate shares of infrastructure companies accounted for more than a third of the capitalization of the Argentine stock market in 1993. From 1989 through 1993, the equity value of capital markets in developing countries more than doubled, and the share of infrastructure stocks in this capitalization increased from 3 percent to 22 percent. Financial sector reform is often required to deepen local capital markets and enable privatized infrastructure entities to raise investment funds by issuing shares and debt. Widespread stock ownership can also enhance political support for privatization.

23. The mobilization of internal revenues—stemming from a sound pricing policy—is another source of finance for investment. Since telecommunications investments generate relatively rapid returns, they can often be financed in large part from internal corporate profits, with additional financing raised on capital markets without recourse to government guarantee. For other sectors, the sheer size, potential risk, and delayed revenue streams of major investments requires more structured finance from project sponsors or other sources, such as leasing companies.

24. Transport and power have been the main targets of private investments, while telecommunications and power have been the main focus of privatization (figure 1). Latin America, followed by East Asia

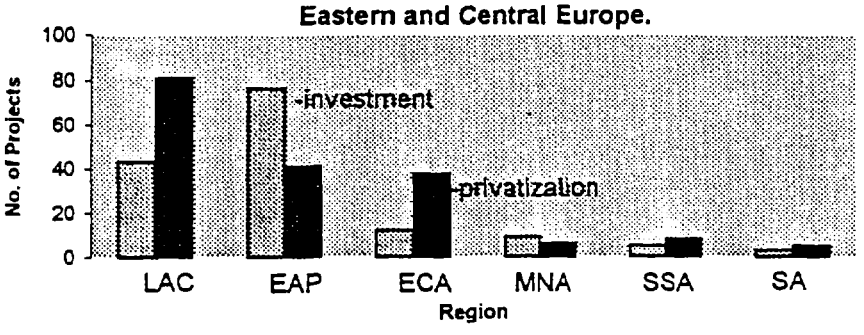
Figure 1. Most private investment projects and privatizations are in power, telecoms, and transport...



Note: Number of actual projects or transactions, 1984-94
Source: "The Emerging Infrastructure Industry," World Bank, 1995

and East and Central Europe, have had the bulk of the infrastructure privatizations, while East Asia is the dominant recipient of private investments (figure 2). However, the pipeline of planned investment projects is growing rapidly in South Asia.

Figure 2: ...and are located in Latin America, East Asia, and Eastern and Central Europe.



Note: Number of actual projects or transactions, 1984-94

Source: "The Emerging Infrastructure Industry," World Bank, 1995

25. As with all foreign direct investment (where half went to five countries in 1989 to 1993), private international flows for infrastructure have been concentrated in relatively few (mainly middle income) countries, but they are spreading to all groups of countries. Both project debt financing and foreign direct investment—which is often linked to a management interest in the project—are less volatile than portfolio equity investments (such as country funds, foreign depositary receipts, and foreign purchase of shares). Expressions of interest by private promoters and by governments are outpacing the number of completed deals, and private direct investment funding is more readily available than long-term debt. The past few years have witnessed the creation of numerous private funds devoted to infrastructure investment, either for specific sectors or specific regions. But there have been few disbursements, reflecting the shortage of bankable projects and prohibitively high cost of long-term debt finance.

26. To break the logjam of potential transactions and to capture the desired benefits of private financing for developing countries, several constraints and preconditions must be addressed. These imply complementary, not sequential actions:

- *Ensure macro stability.* A basic precondition for increasing domestic saving and for mobilizing any significant private funding, domestic or foreign, is macroeconomic stability—including low inflation and a relatively stable exchange rate. This in many cases requires reductions in public sector expenditure, particularly by eliminating the open-ended burden of subsidizing inefficient infrastructure services, such as power, railways, public transport, and water supply.

- *Fix the policy and regulatory framework.* The critical constraints in the policy and regulatory framework affecting the sector must be alleviated. At the most basic level, this involves creating a suitable legal framework for business practices, including to ensure contract enforcement, promote competition, and put public providers on a level playing field with private operators. For infrastructure, the reform agenda is especially demanding: it includes creating a predictable, nonpolitical tariff regime, restructuring the sector to permit competition as appropriate, and creating the necessary regulation—either through contractual arrangements or statute—to promote good performance of operators when competition is weak or absent.

- *Streamline processes and controls.* Potential private investors often confront a maze of detailed administrative and regulatory controls on matters ranging from foreign exchange to the choice of technology and the use of labor. The necessary decisions of government counterparts may be subject to bureaucratic delays. Governments need to reduce these transactions costs by

streamlining mechanisms for processing investment proposals, and by moving from the prolonged, project-by-project negotiation of individual contracts toward reliance on more transparent, standardized conditions that can be applied to all potential investors. The use of model contracts and standard bidding documents, and the development of cross-sectoral concession laws (as recently done in Hungary and Chile) are measures that can reduce the costs and time involved in transactions.

- ***Unbundle and reallocate risks.*** In traditional infrastructure finance, the public sector has assumed all the risks—actual and perceived. Since many of these are not reflected in the cost of sovereign financing, public borrowing often appears less expensive initially but may entail larger claims on public resources later. It is critical to identify the risks governments should bear—such as ensuring the policy regime and the performance of public partners—and to place on the private partner the commercial risks, including project performance and market demand. This "unbundling" of risks permits specific risks to be mitigated and any instruments of comfort, such as guarantees, to be narrowly targeted—thus reducing the price premium on private financing and lowering the government's contingent liabilities.

- ***Attract private financing.*** To mobilize private funding requires well-designed financing strategies, frequently accompanied by financial sector reform. Foreign and domestic sources of finance will need to be tapped, but economies have limited capacity to obtain funds from abroad, especially debt finance. And balance of payments constraints mean that an ongoing infrastructure program will normally need to be sustained by domestic funds. Institutional investors, such as pension funds, may become the main source of long term credit. In some countries, restrictions on the investment funds may need modification to permit this.

These actions often must be complemented by the transformation of existing enterprises into commercially viable entities—which typically requires compensating released redundant workers, resolving existing payment arrears, divesting non-core activities, and establishing accounts using generally accepted practices. Such changes are needed to implement commercial principles of operation in public enterprises to prepare them for partnerships with private firms, unbundling of activities, and eventual privatization.

27. ***The role of the public sector.*** The public sector is now—and for the indefinite future in most countries will continue to be—the main source of funding for most infrastructure projects. This is particularly so in roads, sanitation, water works, general-use railways, ports and airports, urban transit, power transmission, and large-scale generation. Some developing countries may also choose to retain a dominant public role in infrastructure, as many industrial countries have done. Japan, Singapore, Korea, and western European countries have developed infrastructure within the framework of public financing by emphasizing commercial practices. They have relied on realistic tariffs or user charges (with well-defined subsidies, if any, limited to distributional objectives). And they have given financial autonomy to providers, permitting them to raise investment funds from capital markets. Some countries have established special infrastructure banks or funds, and Japan has mobilized long-term investment resources through postal savings. But there is wide scope for misallocation when such public sector funds are allotted on political rather than economic terms.

28. The government has two fundamental responsibilities in infrastructure. The first is to create a sound environment for the efficient mobilization and allocation of resources, whether from the private sector or the public. The second is to correct for market failures—by ensuring that resources are directed to essential activities that may not be sufficiently attractive to private finance, preventing the abuse of

monopoly power, protecting access of the poor to essential services, and correcting for such externalities as environmental impacts.

29. Governments' first concern should be to ensure the basic conditions for mobilizing infrastructure finance as outlined above—in particular, macroeconomic stability, appropriate tariff policy, and reduction of unnecessary risk factors. However, even as they adopt sound policies in these areas, many developing and transitional economies do not yet have domestic capital markets to raise investment funds, and some governments are not sufficiently creditworthy for external borrowing. An increasing number of middle-income and transition countries have still been able to attract private investments for their most urgent (and commercially profitable) projects. The Philippines' success in developing private power generation strengthened its domestic capital markets and enhanced its creditworthiness. Creating a few small, well-structured private projects can have a strong demonstration effect for potential private investors and build credibility for reform. In some of the poorest countries with very limited prospects for attracting private financing in the near term, benefits of improved efficiency and increased service flows can be obtained by focusing efforts on the establishment of commercial principles, supplemented by reforms in procurement and contracting practices that foster competition and develop the domestic private sector. Many activities (such as road maintenance and solid waste collection) can be contracted out to the private sector with public financing; contracts can also be extended to introduce improved management practices through management contracts or leases.

30. All governments need to design appropriate public resource mobilization strategies for the development of infrastructure not amenable to cost recovery. When direct user fees are difficult to collect (rural roads) or when the social benefits of providing services exceed the private benefits (sanitation), public financing will be necessary. To the extent possible, such activities should be financed from charges or taxes paid by the community that receives most of the benefits—as with property taxes to finance local improvements. To ensure that adequate investment occurs in socially useful but financially unprofitable activities, subsidies are often justified but should be provided in ways that encourage cost efficiency and do not require the government to incur construction and operating risk. For example, a concession can be awarded to the bidder requiring the least subsidy to deliver a specified service.

31. For some activities, revenues are most efficiently mobilized through taxation. For example, in many countries, a share of fuel and vehicle tax revenues is designated as road user charges and finances road maintenance. Although formal earmarking limits fiscal flexibility, in some countries it may be a necessary measure to ensure that high-return maintenance activities are adequately funded. It is critical that earmarked funds are managed to ensure efficient use and accountability—as through road boards that involve broad-based participation of users and other stakeholders.

32. Many countries are devolving expenditure responsibilities for local or regional infrastructure services to local or regional governments. To ensure that this shift leads to more effective resource allocation, the fiscal authority to mobilize revenues for these services needs to be assigned as well. And it is important that mechanisms of public financing—such as intergovernmental transfers and official external finance—foster incentives to direct adequate funding to maintenance, not just to new investment.

33. Whether an infrastructure service is financed by tariffs and user charges or by public taxation, ensuring access for the poor is a distinct, and important, policy issue—especially for such basic services as clean drinking water, environmentally safe sanitation, public transport, and "lifeline" levels of domestic energy or public telephones. The prevailing mode of public enterprise delivery of many infrastructure services, including their low cost recovery, is often rationalized as a way of ensuring widespread availability and affordability. The performance of these entities has too often shown them to be serving

and subsidizing the better-off users, while the poor typically have little access to public service and incur higher expenditures to meet their needs from alternative sources.

34. Lowering service charges for all users is therefore inefficient, inequitable, and fiscally unsustainable. Governments need instead to promote competition, operational efficiency, and user responsiveness by suppliers as the most effective means of extending services to the poor. Where particular user groups are unable to pay for essential services, subsidies are best targeted to them, or tariffs structured so that the basic levels of consumption are affordable—as through "increasing block" power and water tariffs. Chile has an exemplary scheme of targeted subsidies for water supply.

35. When communities finance and provide their own infrastructure—as when rural and urban settlements install and operate wells, low cost sanitation, local roads, and power generators—experience shows that sustained success requires broad-based community participation from the earliest stage in choosing the technology, sharing the financing, or contributing in kind. The support of government or non-governmental organizations, through technical assistance, training, or limited subsidies is often important.

36. Governments also have the responsibility to ensure that infrastructure promotes environmentally sustainable development and to minimize the adverse consequences of infrastructure expansion. Environmental concerns, including public safety, can be met by a variety of instruments: the participation of government agencies in the initial planning and public discussion of proposed investments; carefully defined subsidies for certain environmental improvements; and regulatory measures, particularly those that give service providers and users economic incentives favoring good environmental outcomes. The assembly of sites and rights-of-way for infrastructure frequently displaces people. Of the 146 World Bank projects involving resettlement between 1986 and 1993, more than three quarters were infrastructure projects. Resettlement is most successful when needs are addressed early and plans are modified to minimize displacement.

37. ***Donor policies.*** What does this reform agenda mean for international donors? Their policies and practices need to shift from a focus on financing new facilities to maintaining existing infrastructure and fostering institutional reform. Bilateral aid, in particular, is often subject to full or partial tying of aid, reducing its effectiveness. In recent years, between two-thirds and three-quarters of official development assistance for infrastructure has been fully or partially tied, compared with less than 20 percent for official development assistance going to areas other than infrastructure. Reforms and practices that build long-term sustainability of infrastructure and strengthen the governments' capacity to cooperate in new ways with the private sector may require changes in the form and duration of support from donors. The Sub-Saharan Africa Transport Policy Program is an example of collaboration among donors and recipient governments for road sector reform, railway restructuring, road safety, and urban transport—linked to coordinated financial support for long-term development programs.

ROLES FOR THE BANK AND THE FUND

38. The Fund and the Bank Group promote the stable economic policy environment and suitable policy framework needed to sustain the financing of infrastructure and deliver its benefits. Infrastructure projects are typically large, take a long time to construct, and produce returns over many years. Economic stability eases the financing requirements of such long-lived projects by reducing their risk and promoting the availability of domestic funds for longer term investments.

39. Sound macroeconomic and structural policies—such as those promoted by the Fund and Bank Group in the fiscal and monetary areas; an open exchange, trade, and investment regime; efficient banking and financial systems and factor and goods markets—are thus important in establishing the environment to support longer term investments and critical to fostering the growth of private involvement in infrastructure. Such policies increase the developmental impact of infrastructure—studies have found that poor economic policies can reduce the returns to infrastructure projects by half or more. Sound policies also promote adequate maintenance so that infrastructure facilities are not subject to rapid deterioration, even during periods of economic adjustment when investment in new facilities may be curtailed.

40. Bank Group members have common objectives in infrastructure—to improve sector policies, increase efficiency, facilitate financing, and increase private sector involvement. But each member of the group has different instruments to achieve these objectives. The rapidly changing situation in infrastructure—the growth of demand for investment, the growth in private financing, and the increasing role of the private sector in provision—is requiring the members of the Bank Group to join forces to increase their catalytic role. The Bank Group's share of overall infrastructure financing is less than $10 billion a year, or less than 5 percent of total infrastructure investment in developing countries. To increase its impact, this lending must leverage additional investment and be accompanied by policy reforms that improve sector performance.

41. ***IBRD/IDA.*** Across all infrastructure sectors, IBRD/IDA lending and policy advice will foster the development of core policy, regulatory, and legal frameworks to facilitate commercial principles of operation and private sector involvement in infrastructure. IBRD/IDA is also supporting domestic capital market development, which has an important role in financing growing investment needs. In infrastructure sectors where commercial provision is most straightforward (as in telecommunications and power), IBRD/IDA lending and policy advice aims to facilitate the transition to greater private sector provision, increased competition, and a reduced government role in direct service provision and management. Policy advice focuses on the development of appropriate sector policy frameworks and on the formulation of regulatory frameworks for economic, environmental, and safety objectives. For other sectors (such as roads, water and sanitation) IBRD/IDA lending supports sector reform involving the application of commercial principles (including financial autonomy) to public service providers, broadened competition and private involvement where feasible and appropriate, and the involvement of users. In all sectors, IBRD/IDA project financing reinforces and complements sectoral reform and promotes the transfer of appropriate technology. Many countries benefit from IBRD/IDA efforts to coordinate the programs of donors to focus on common objectives and thereby increase the effectiveness of aid. Moreover, in low-income countries the Bank emphasizes capacity building programs to increase sector expertise and strengthen implementation of reforms.

42. In addition to helping countries reduce risk by formulating sound and transparent sectoral policies, the Bank expanded its Guarantee Program in late 1994 to mitigate the risk borne by debt finance. The program addresses policy risk (covering government nonperformance of sector policy commitments) and credit risk (covering longer term payments to extend the term of financing). These guarantees are partial, require government counter-guarantees (unlike MIGA and the IFC), do not cover equity (unlike MIGA), and are for new investment in countries that can borrow from the Bank. Guarantees can be given on a stand-alone basis or in conjunction with a Bank loan, and the guarantee fees do not vary by country and are structured so that the net cost to the country for a Bank loan or guarantee is the same. So far, partial risk guarantees have been used to help finance the Hub Power Project in Pakistan, and partial credit guarantees have been used to extend the financing term for the Yangzhou Thermal Power Project in China and the Leyte-Luzon Geothermal Project in the Philippines.

43. *IFC.* Finance for infrastructure is the fastest growing element in IFC's portfolio, accounting for nearly a quarter of new approvals. Much of this finance has taken the form of IFC participation in individual transactions (for power, telecommunications, transport, gas, and water and sanitation). IFC also participates in several infrastructure investment funds that mobilize resources from major financial centers for on-lending and equity investment. Recent activities to mobilize new sources of capital have involved underwriting international equity placements (for a power utility in India and a telecom company in Chile), co-managing the placement of international bonds (for a toll road in Mexico), and developing a pilot securitization program to package and sell a portion of its loan portfolio on the private market.

44. The activities of IFC have helped develop local capital markets through issuing equity on local stock markets, placing equity directly with such private financial companies as pension funds, placing debt financing with local commercial banks, and obtaining debt finance through locally issued bonds. IFC also advises governments on restructuring and divesting infrastructure utilities (the power sector in Trinidad and Tobago, Peru, and Colombia) and on regulatory frameworks.

45. *FIAS.* The Foreign Investment Advisory Service provides technical assistance and policy advice to developing countries that are seeking ways to increase private sector involvement in infrastructure finance and service provision. It analyzes country experience with foreign direct investment in infrastructure and advises countries on the policy, regulatory, and institutional framework required to promote and implement such investments. Most recently, FIAS has advised China on the policy and regulatory reforms required to speed up the implementation of private sector infrastructure projects.

46. *MIGA.* The Multilateral Investment Guarantee Agency encourages foreign investment in developing countries by providing political risk insurance against the risks of currency transfer, expropriation, and war and civil disturbance. Under certain conditions, MIGA may cover risks of breach of obligations by the host government—coverage especially sought by investors in infrastructure projects. MIGA's guarantees cover equity and quasi-equity (e.g., both loans and loan guarantees by shareholders) investments and third party loans, and a counter-guarantee from the host government is not required. Since beginning its operations in 1989, MIGA has issued over 130 guarantees in support of approximately US$7 billion of foreign investment. Although the majority of these projects have been outside of infrastructure, in the past two years MIGA has seen a growing demand for guarantees from private investors in infrastructure. MIGA's Board of Directors has approved participation in power projects having a total cost of US$3.6 billion in less than two years. In the second half of 1994, MIGA issued 28 guarantees totaling US$312 million of coverage, of which infrastructure projects (all in power) accounted for 11 guarantees and one-third of that coverage. MIGA also provides investment marketing services to both investors and countries to promote private investment opportunities, and technical assistance to resolve legal impediments to investment flows to developing member countries.

47. In the past, the Bank and the IFC pursued parallel investments in countries. Today and increasingly in the future, the trend is toward a fuller collaboration up-front among the Bank Group institutions to achieve more integrated and complementary programs—typically involving a mix of financing and guarantee programs. Jamaica's Rockfort power project combined IBRD financing with MIGA guarantees, and Honduras's Elcosa power project combined IFC financing with MIGA guarantees. A power project under preparation in the Dominican Republic is likely to combine Bank financing with a Bank guarantee of aspects of the country's policy framework for the power sector. The Uch power project in Pakistan is likely to involve financing from IFC and an IBRD partial policy risk guarantee. These collaborative efforts are attracting the interest of private investors, increasing the amount and term length of private financing in infrastructure projects, and increasing the leverage of the Bank Group's financing and policy advice.

World Development Report 1994
Infrastructure for Development

Executive Summary

Overview

Developing countries invest $200 billion a year in new infrastructure—4 percent of their national output and a fifth of their total investment. The result has been a dramatic increase in infrastructure services—for transport, power, water, sanitation, telecommunications, and irrigation. During the past fifteen years, the share of households with access to clean water has increased by half, and power production and telephone lines per capita have doubled. Such increases do much to raise productivity and improve living standards.

These accomplishments are no reason for complacency, however. One billion people in the developing world still lack access to clean water—and nearly 2 billion lack adequate sanitation. In rural areas especially, women and children often spend long hours fetching water. Already-inadequate transport networks are deteriorating rapidly in many countries. Electric power has yet to reach 2 billion people, and in many countries unreliable power constrains output. The demands for telecommunications to modernize production and enhance international competitiveness far outstrip existing capacity. On top of all this, population growth and urbanization are increasing the demand for infrastructure.

Coping with infrastructure's future challenges involves much more than a simple numbers game of drawing up inventories of infrastructure stocks and plotting needed investments on the basis of past patterns. It involves tackling inefficiency and waste—both in investment and in delivering services—and responding more effectively to user demand. On average, 40 percent of the power-generating capacity in developing countries is unavailable for production, twice the rate in the best-performing power sectors in low-, middle-, and high-income countries. Half the labor in African and Latin American railways is estimated to be redundant. And in Africa and elsewhere, costly investments in road construction have been wasted for lack of maintenance.

This poor performance provides strong reasons for doing things differently—in more effective, less wasteful ways. In short, the concern needs to broaden from increasing the *quantity* of infrastructure stocks to improving the *quality* of infrastructure services. Fortunately, the time is ripe for change. In recent years, there has been a revolution in thinking about who should be responsible for providing infrastructure stocks and services, and how these services should be delivered to the user.

Against this background, *World Development Report 1994* considers new ways of meeting public needs for services from infrastructure (as defined in Box 1)—ways that are more efficient, more user-responsive, more environment-friendly, and more resourceful in using both the public and private sectors. The report reaches two broad conclusions:

- Because past investments in infrastructure have not had the development impact expected, it is essential to improve the effectiveness of investments and the efficiency of service provision.
- Innovations in the means of delivering infrastructure services—along with new technologies—point to solutions that can improve performance.

This Report marshals evidence in support of these conclusions—identifying causes of failure and examining alternative approaches. The main messages and policy options are summarized in Box 2.

Box 1 What is infrastructure?

This Report focuses on *economic infrastructure* and includes services from:

- Public utilities—power, telecommunications, piped water supply, sanitation and sewerage, solid waste collection and disposal, and piped gas.
- Public works—roads and major dam and canal works for irrigation and drainage.
- Other transport sectors—urban and interurban railways, urban transport, ports and waterways, and airports.

Infrastructure is an umbrella term for many activities referred to as "social overhead capital" by such development economists as Paul Rosenstein-Rodan, Ragnar Nurkse, and Albert Hirschman. Neither term is precisely defined, but both encompass activities that share technical features (such as economies of scale) and economic features (such as spillovers from users to nonusers).

Infrastructure's role and record

The adequacy of infrastructure helps determine one country's success and another's failure—in diversifying production, expanding trade, coping with population growth, reducing poverty, or improving environmental conditions. Good infrastructure raises productivity and lowers production costs, but it has to expand fast enough to accommodate growth. The precise linkages between infrastructure and development are still open to debate. However, infrastructure capacity grows step for step with economic output—a 1 percent increase in the stock of infrastructure is associated with a 1 percent increase in gross domestic product (GDP) across all countries (Figure 1). And as countries develop, infrastructure must adapt to support changing patterns of demand, as the shares of power, roads, and telecommunications in the total stock of infrastructure in-

Box 2 Main messages of *World Development Report 1994*

Infrastructure can deliver major benefits in economic growth, poverty alleviation, and environmental sustainability—but only when it provides services that respond to effective demand and does so efficiently. Service is the goal and the measure of development in infrastructure. Major investments have been made in infrastructure stocks, but in too many developing countries these assets are not generating the quantity or the quality of services demanded. The costs of this waste—in forgone economic growth and lost opportunities for poverty reduction and environmental improvement—are high and unacceptable.

The causes of past poor performance, and the source of improved performance, lie in the incentives facing providers. To ensure efficient, responsive delivery of infrastructure services, incentives need to be changed through the application of three instruments—commercial management, competition, and stakeholder involvement. The roles of government and the private sector must be transformed as well. Technological innovation and experiments with alternative ways of providing infrastructure indicate the following principles for reform:

- *Manage infrastructure like a business, not a bureaucracy.* The provision of infrastructure needs to be conceived and run as a service industry that responds to customer demand. Poor performers typically have a confusion of objectives, little financial autonomy or financial discipline, and no "bottom line" measured by customer satisfaction. The high willingness to pay for most infrastructure services, even by the poor, provides greater opportunity for user charges. Private sector involvement in management, financing, or ownership will in most cases be needed to ensure a commercial orientation in infrastructure.
- *Introduce competition—directly if feasible, indirectly if not.* Competition gives consumers choices for better meeting their demands and puts pressure on suppliers to be efficient and accountable to users. Competition can be introduced directly, by liberalizing entry into activities that have no technological barriers, and indirectly, through competitive bidding for the right to provide exclusive service where natural monopoly conditions exist and by liberalizing the supply of service substitutes.
- *Give users and other stakeholders a strong voice and real responsibility.* Where infrastructure activities involve important external effects, for good or bad, or where market discipline is insufficient to ensure accountability to users and other affected groups, governments need to address their concerns through other means. Users and other stakeholders should be represented in the planning and regulation of infrastructure services, and in some cases they should take major initiatives in design, operation, and financing.

Public-private partnerships in financing have promise. Private sector involvement in the financing of new capacity is growing. The lessons of this experience are that governments should start with simpler projects and gain experience, investors' returns should be linked to project performance, and any government guarantees needed should be carefully scrutinized.

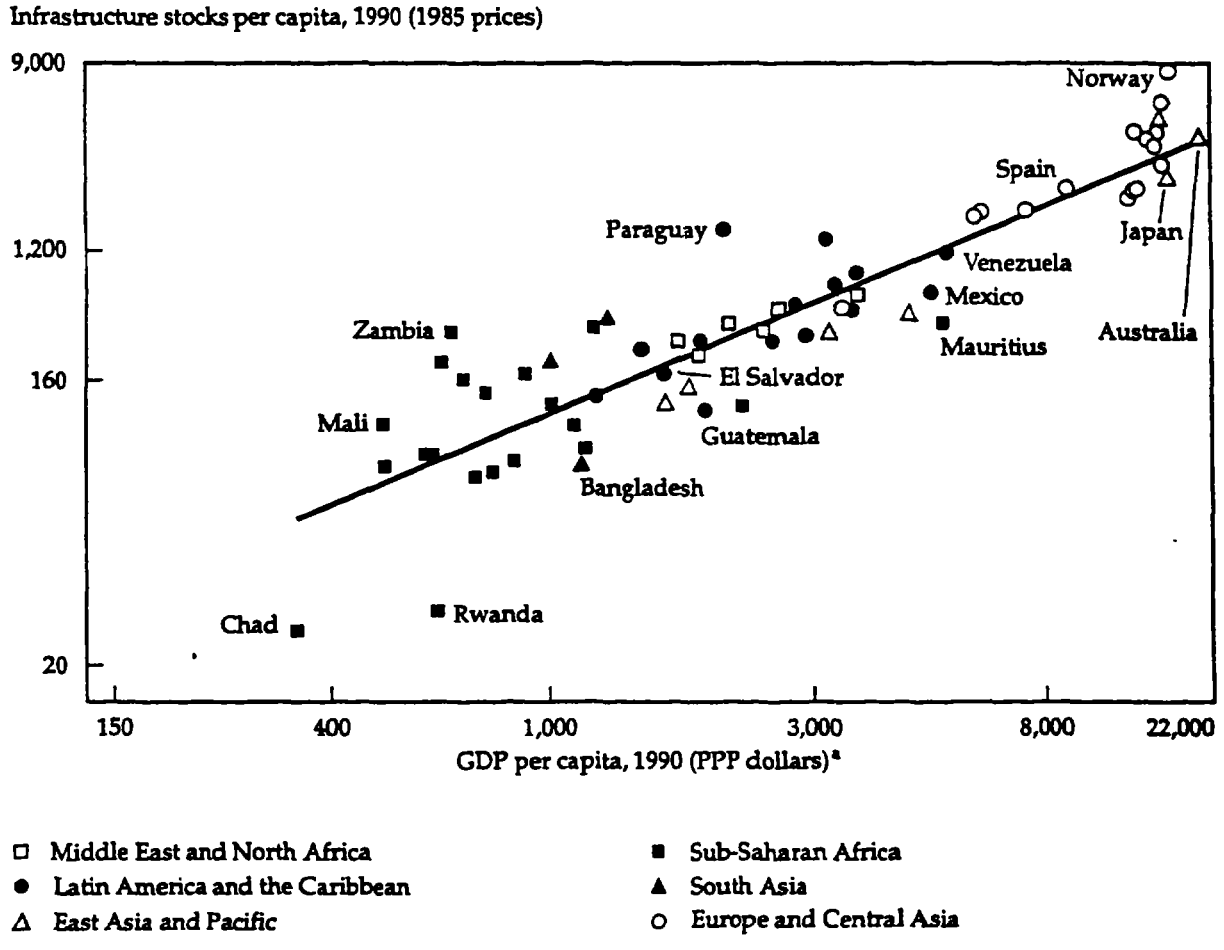
Governments will have a continuing, if changed, role in infrastructure. In addition to taking steps to improve the performance of infrastructure provision under their direct control, governments are responsible for creating policy and regulatory frameworks that safeguard the interests of the poor, improve environmental conditions, and coordinate cross-sectoral interactions—whether services are produced by public or private providers. Governments also are responsible for developing legal and regulatory frameworks to support private involvement in the provision of infrastructure services.

crease relative to those of such basic services as water and irrigation (Figure 2).

The kind of infrastructure put in place also determines whether growth does all that it can to reduce poverty. Most of the poor are in rural areas, and the growth of farm productivity and nonfarm rural employment is linked closely to infrastructure provision. An important ingredient in China's success with rural enterprise has been a minimum package of transport, telecommunications, and power at the village level. Rural enterprises in China now employ more than 100 million people (18 percent of the labor force) and produce more than a third of national output.

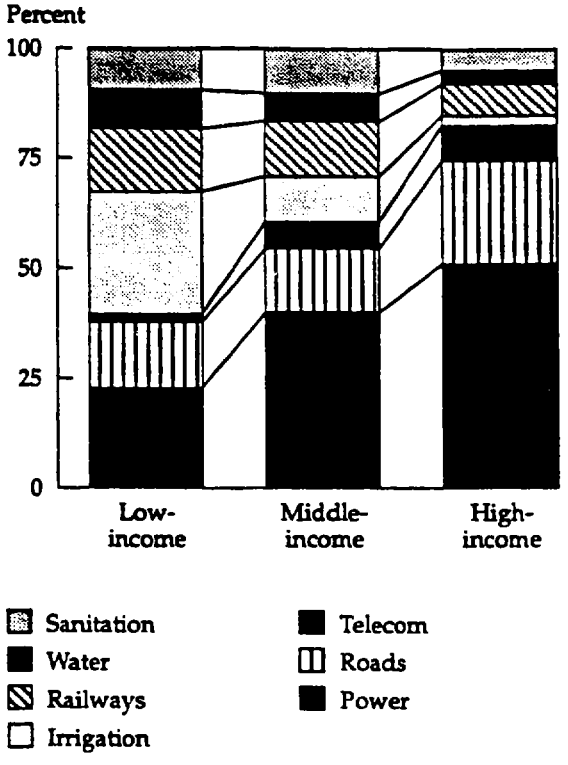
Infrastructure services that help the poor also contribute to environmental sustainability. Clean water and sanitation, nonpolluting sources of power, safe disposal of solid waste, and better management of traffic in urban areas provide environmental benefits for all income groups. The urban poor often benefit most directly from good infrastructure services because the poor are concentrated in settlements subject to unsanitary conditions, hazardous emissions, and accident risks. And in many

Figure 1 As a country's income grows, the amount of infrastructure increases.



Note: Axes are logarithmic; infrastructure includes roads, rail, power, irrigation, and telephones.
a. Purchasing power parity (PPP) dollars are valued in Summers and Heston 1985 international prices.
Source: Ingram and Fay, background paper; Summers and Heston 1991.

Figure 2 The composition of infrastructure changes with country income level.



Source: Ingram and Fay, background paper.

rapidly growing cities, infrastructure expansion is lagging behind population growth, causing local environments to deteriorate.

In developing countries, governments own, operate, and finance nearly all infrastructure, primarily because its production characteristics and the public interest involved were thought to require monopoly—and hence government—provision. The record of success and failure in infrastructure is largely a story of government's performance.

Infrastructure's past growth has in some respects been spectacular. The percentage of households and businesses served has increased dramatically, especially in telephones and power (Figure 3). The per capita provision of infrastructure services has increased in all regions; the greatest improvements have been in East Asia and the smallest in Sub-Saharan Africa, reflecting the strong association between economic growth and infrastructure.

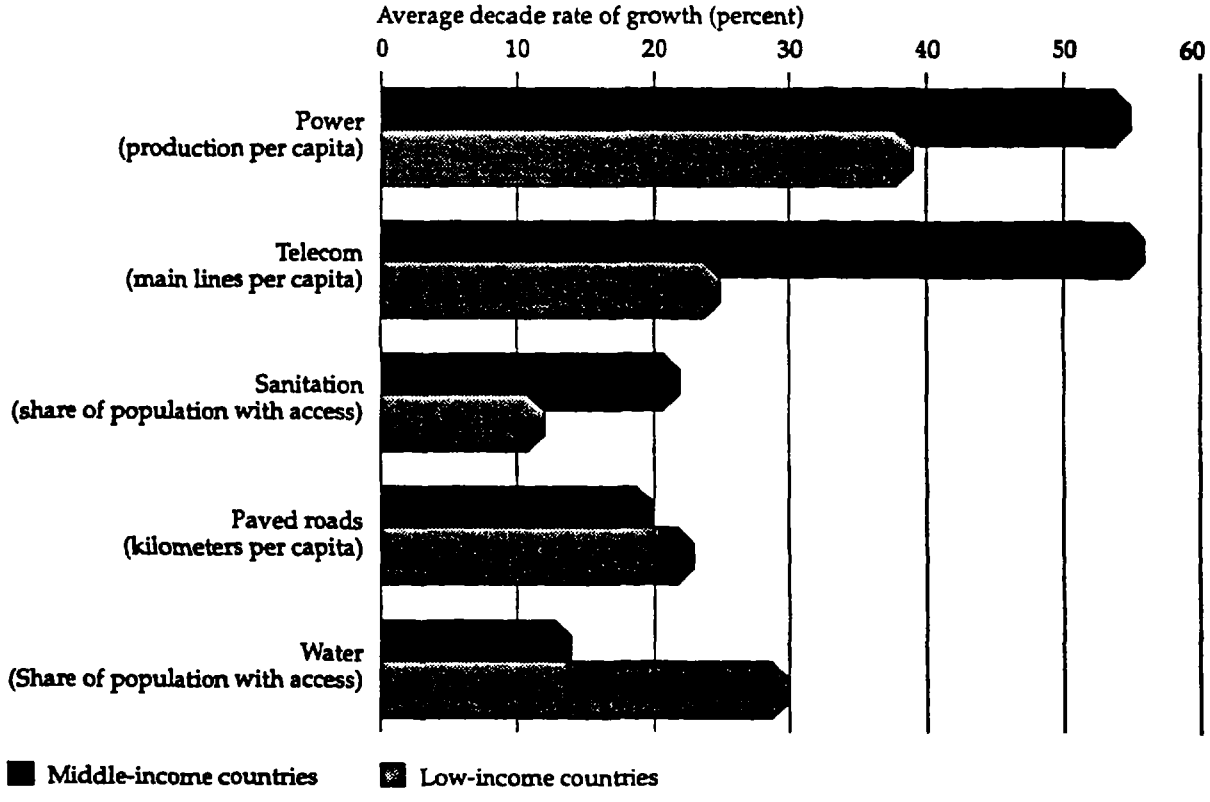
In other important respects, however, the performance has been disappointing. Infrastructure investments have often been misallocated—too much to new investment, not enough to maintenance; too much to low-priority projects, not enough to essential services. The delivery of services has been hampered by technical inefficiency and outright waste. And too few investment and delivery decisions have been attentive to meeting the varied demands of different user groups, or to the consequences for the environment.

Inadequate maintenance has been an almost universal (and costly) failure of infrastructure providers in developing countries. For example, a well-maintained paved road surface should last for ten to fifteen years before needing resurfacing, but lack of maintenance can lead to severe deterioration in half that time. The rates of return from World Bank–assisted road maintenance projects are nearly twice those of road construction projects. Timely maintenance expenditures of $12 billion would have saved road reconstruction costs of $45 billion in Africa in the past decade. On average, inadequate maintenance means that power systems in developing countries have only 60 percent of their generating capacity available at a given time, whereas best practice would achieve levels over 80 percent. And it means that water supply systems deliver an average of 70 percent of their output to users, compared with best-practice delivery rates of 85 percent. Poor maintenance can also reduce service quality and increase the costs for users, some of whom install backup generators or water storage tanks and private wells.

Failings in maintenance are often compounded by ill-advised spending cuts. Curbing capital spending is justified during periods of budgetary austerity, but reducing maintenance spending is a false economy. Such cuts have to be compensated for later by much larger expenditures on rehabilitation or replacement. Because inadequate maintenance shortens the useful life of infrastructure facilities and reduces the capacity available to provide services, more has to be invested to produce those services. Donor objectives (such as seeking contracts for capital-goods supply or consultancy services) may also play a part in the preference for new investment over maintenance. In many low-income countries, donor financing underwrites nearly half of all public investment in infrastructure.

Project investments misallocated by many countries have created inappropriate infrastructure or provided services at the wrong standard. Demands of users for services of varying quality and affordability go unmet even when users are willing and able to pay for them. Low-income communities are not

Figure 3 Infrastructure has expanded tremendously in recent decades.



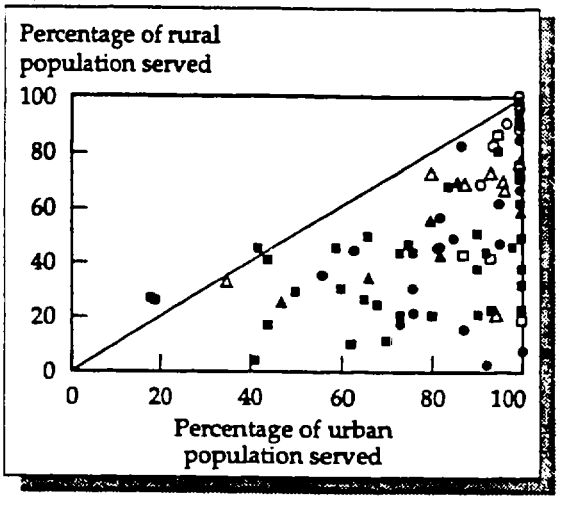
Note: Based on telecom, sanitation, and water data for 1975–90, and road and power data for 1960–90.
Source: Appendix tables A.1 and A.2.

offered suitable transport and sanitation options that provide services they value and can afford. Premature investments in capacity—especially in water supply, railways, power, ports, and irrigation—have often absorbed resources that could otherwise have been devoted to maintenance, modernization, or improvements in service quality. Because many infrastructure investments are immobile and serve local markets, excess capacity cannot serve other markets—and it remains underused. In some cases, large public projects have been overambitious, placing a costly burden on the economy.

Waste and inefficiency claim a large share of resources that could be used for delivering infrastructure services. A review of power utilities in fifty-one developing countries showed that technical efficiency has actually declined over the past twenty years. Older power plants consume between 18 and 44 percent more fuel per kilowatt-hour than do plants in power systems operating at best-practice levels—and have transmission and distribution losses two to four times greater. Port facilities in developing countries, on average, move cargo from ship to shore at only 40 percent the speed of the most efficient ports. Labor misallocations present another source of inefficiency. Overstaffing is far too common in many activities, especially railways, while others, such as road maintenance, warrant greater use of labor-based methods.

These failings in investment and operating efficiency are not compensated for by success in addressing poverty or environmental concerns—for here, too, the infrastructure record is weak. Badly designed and managed infrastructure is a major source of environmental degradation in both urban and rural areas. The poor often consume fewer infrastructure services and pay higher prices than do the nonpoor. For example, households obtaining water from vendors pay much more than those households connected to water systems. In most

Figure 4 Urban populations have better access to safe drinking water than rural populations.



□ Middle East and North Africa
● Latin America and the Caribbean
△ East Asia and Pacific
■ Sub-Saharan Africa
▲ South Asia
○ Europe and Central Asia

Source: Appendix table A.2.

countries, rural areas receive fewer infrastructure services than do urban areas (with the obvious exception of irrigation), even in such essential services as drinking water (Figure 4). But countries that have made concerted efforts to provide infrastructure in rural areas—for example, Indonesia and Malaysia—have succeeded in reducing poverty dramatically.

Given this mixed performance, improvements in investment and operation are required as a matter of urgency. In addition, the demands on infrastructure are growing. More competitive global trade requires more reliable and sophisticated transport, power, and telecommunications. Governments facing increased fiscal stringency can no longer sustain open-ended financing of infrastructure. And societies today hold infrastructure to higher environmental standards, as evidenced by sections of *Agenda 21*, the primary policy document agreed to by countries at the 1992 United Nations Conference on Environment and Development.

Diagnosing the causes of poor performance

The problems of insufficient maintenance, misallocated investment, unresponsiveness to users, and technical inefficiencies present daunting challenges for future reforms—challenges compounded by new demands and constrained resources. The solutions lie in the successes and failures of policy and in the lessons from recent policy experiments.

There is great variation both within and across countries in the efficiency of providing infrastructure services. Moreover, good performance by a country in one infrastructure sector is not necessarily associated with good performance in other sectors. Some developing countries—and not always the richer ones—perform at high levels. Côte d'Ivoire meets the 85 percent best-practice standard in water supply, while in Manila only about 50 percent of treated water is delivered to customers. In railways, the availability of locomotives is high where maintenance is good: at any given time, India has 90 percent of its locomotives available. Availability is low where maintenance is neglected: 50 percent in Romania and 35 percent in Colombia, compared with a developing country average of about 70 percent. For telephones, call completion rates are 99 percent in the best-performing countries, 70 percent in the average developing country, and far lower in some. These findings indicate that the performance of infrastructure derives not from general conditions of economic growth and development but from the institutional environment, which often varies across sectors within individual countries.

Therefore, to understand what accounts for good performance—and bad—requires understanding the institutional arrangements for providing infrastructure services and the incentives governing their delivery. This Report identifies three reasons for poor performance.

First, the delivery of infrastructure services usually takes place in a market structure with one dominating characteristic: the absence of competition. Most infrastructure services in the developing world are provided by centrally managed monopolistic public enterprises or government departments. Almost all irrigation, water supply, sanitation, and transport infrastructure is provided in this manner. Until a few years ago, telephone services in most countries were the responsibility of a state-owned post, telephone, and telegraph enterprise. The bulk of power has also been provided by a public monopoly. As a result, the pressure that competition can exert on all parties to perform at maximum efficiency has been lacking.

Second, those charged with responsibility for delivering infrastructure services are rarely given the managerial and financial autonomy they need to do their work properly. Managers are often expected to meet objectives at variance with what should be their primary function—the efficient delivery of high-quality services. Public entities are required to serve as employer of last resort or to provide patronage. They are compelled to deliver services below cost—often by not being allowed to adjust prices for inflation. The other side of the coin is that public providers are rarely held accountable for their actions. Few countries set well-specified performance measures for public providers of infrastructure services, and inefficiency is all too often compensated for by budgetary transfers rather than met with disapproval.

Third, the users of infrastructure—both actual and potential—are not well positioned to make their demands felt. When prices reflect costs, the strength of consumer demand is a clear signal of what should be supplied. Through the price mechanism, consumers can influence investment and production decisions in line with their preferences. But prices of infrastructure services typically do not reflect costs, and this valuable source of information about consumer needs is lost. For example, power prices in developing countries have generally fallen, while costs have not. As a result, prices now cover only half the supply costs, on average. Water charges and rail passenger fares typically cover only a third of costs. Excess consumer demand based on below-cost prices is not a reliable indicator that services should be expanded, although often it is taken as such.

Users can express preferences in other ways, such as local participation in planning and implementing new infrastructure investments. But they seldom are asked, and investment decisions are all too often based on extrapolations of past consumption rather than on true assessments of effective demand and affordability.

Individually, each of these three points is important. Together, they go a long way toward explaining the disappointing past performance of much infrastructure. Rival suppliers and infrastructure users might have exerted pressure for better services, but they were prevented from doing so. Governments—by confusing their roles as owner, regulator, and operator—have failed to improve service delivery.

New opportunities and initiatives

Creating the institutional and organizational conditions that oblige suppliers of infrastructure services to be more efficient and more responsive to the needs of users is clearly the challenge. But is it possible? Three converging forces are opening a window of opportunity for fundamental changes in the way business is done. First, important innovations have occurred in technology and in the regulatory management of markets. Second, a consensus is emerging on a larger role for the private sector in infrastructure provision, based in part on recent experience with new initiatives. Third, greater concern now exists for environmental sustainability and for poverty reduction.

New technology and changes in the regulatory management of markets create new scope for introducing competition into many infrastructure sectors. In telecommunications, satellite and microwave systems are replacing long distance cable networks, and cellular systems are an emerging alternative to local distribution networks. These changes erode the network-based monopoly in telecommunications and make competition possible. In power generation, too, combined-cycle gas turbine generators operate efficiently at lower output levels, while other innovations are reducing costs. New technology makes competition among suppliers technically feasible, and changes in regulations are making competition a reality by allowing competitive entry in activities such as cellular phone service or power generation. Technical and regulatory change in other infrastructure sectors—ranging from transportation to water supply and drainage and irrigation—also make them more open to new forms of ownership and provision.

Alongside such changes are new perceptions of the role of government in infrastructure. An awareness is growing in many countries that government provision has been inadequate. Brownouts and blackouts in power systems, intermittent water supplies from municipal systems, long waiting periods for telephone service connection, and increasing traffic congestion provoke strong reactions. Reforms in some industrial countries have increased the competition in telecommunications, in road freight and airline transport, and in power generation—proving that alternative approaches are possible. The poor performance of planned economies has also provoked a reassessment of the state's role in economic activity.

These developments have led governments to search for new ways to act in partnership with the private sector in providing infrastructure services. Most dramatic have been the privatizations of such enterprises as the telephone system in Mexico and the power system in Chile. Elsewhere, various forms of partnership between government and the

private sector have evolved. Port facilities have been leased to private operators—the Kelang container facility in Malaysia being among the first. Concessions have been granted to private firms, particularly in water supply; Côte d'Ivoire is one of the earliest examples. Contracting out services, as Kenya has done with road maintenance, is well under way in many countries. Private financing of new investment has grown rapidly through build-operate-transfer (BOT) arrangements under which private firms construct an infrastructure facility and then operate it under franchise for a period of years on behalf of a public sector client. This approach has been used to finance the construction of toll roads in Mexico and power-generating plants in China and the Philippines.

An increasing regard for the environmental sustainability of development strategies and a deepening concern for poverty reduction after a decade of stagnation in many regions of the world also give impetus to infrastructure reform. Creating pressures for change, environmental issues are coming to the fore in transport (traffic congestion and pollution), irrigation (increased waterlogging and salinity of agricultural land), water supply (depleted resources), sanitation (insufficient treatment), and power (growing emissions). At the same time, a decade of reduced economic growth—especially in Latin America and Sub-Saharan Africa—shows that poverty reduction is not automatic and that care must be taken to ensure that infrastructure both accommodates growth and protects the interests of the poor.

Options for the future

To reform the provision of infrastructure services, this Report advocates three measures: the wider application of commercial principles to service providers, the broader use of competition, and the increased involvement of users where commercial and competitive behavior is constrained.

Applying commercial principles of operation involves giving service providers focused and explicit performance objectives, well-defined budgets based on revenues from users, and managerial and financial autonomy—while also holding them accountable for their performance. It implies that governments should refrain from ad hoc interventions in management but should provide explicit transfers, where needed, to meet social objectives such as public service obligations.

Broadening competition means arranging for suppliers to compete for an entire market (e.g., firms bidding for the exclusive right to operate a port for ten years), for customers within a market (telephone companies competing to serve users), and for contracts to provide inputs to a service provider (firms bidding to provide power to an electric utility).

Involving users more in project design and operation of infrastructure activities where commercial and competitive behavior is constrained provides the information needed to make suppliers more accountable to their customers. Users and other stakeholders can be involved in consultation during project planning, direct participation in operation or maintenance, and monitoring. Development programs are more successful when service users or the affected community has been involved in project formulation. User participation creates the appropriate incentives to ensure that maintenance is carried out in community-based projects.

These elements apply whether infrastructure services are provided by the public sector, the private sector, or a public-private partnership. To this extent, they are indifferent to ownership. However, numerous examples of past failures in public provision, combined with growing evidence of more efficient and user-responsive private provision, argue for a significant increase in private involvement in financing, operation, and—in many cases—ownership.

All countries will not be able to increase private involvement at the same rate. Much depends on the strength of the private sector, the administrative capacity of the government to regulate private suppliers, the performance of public sector providers, and the political consensus for private provision. With this in mind, the Report sets out a menu of four main options for ownership and provision:

Option A. Public ownership and operation by enterprise or department
Option B. Public ownership with operation contracted to the private sector
Option C. Private ownership and operation, often with regulation
Option D. Community and user provision.

Far from exhaustive, these four options merely illustrate possible points in a broader array of alternatives.

Option A: Public ownership and public operation. Public provision by a government department, public enterprise, or parastatal authority is the most common form of infrastructure ownership and operation. Successful public entities run on commer-

cial principles and give managers control over operations and freedom from political interference, but they also hold managers accountable, often through performance agreements or management contracts. And they follow sound business practices and are subject to the same regulatory, labor law, accounting, and compensation standards and practices as private firms. Tariffs are set to cover costs, and any subsidies to the enterprise are given for specific services and in fixed amounts. Water authorities in Botswana and Togo and national power companies in Barbados and Thailand perform well. The highway authorities in Ghana and Sierra Leone and the restructured road agency in Tanzania are promising examples of this approach. But few successful examples of Option A persist because they are vulnerable to changes in governmental support. Many public entities perform well for a time and then fall victim to political interference.

Option B: Public ownership with private operation. This option is typically implemented through lease contracts for full operation and maintenance of publicly owned infrastructure facilities, or through concessions, which include responsibility for construction and financing of new capacity. Arrangements between the owner (government) and the operator (firm) are set out in a contract that includes any regulatory provisions. The private operator typically assumes all commercial risk of operation and shares in investment risk under concessions. Leases and concessions are working well for railways in Argentina; for water supply in Buenos Aires and Guinea; and for port facilities in Colombia, Ghana, and the Philippines. Concessions also include contracts to build and operate new facilities under the BOT arrangement and its variants. Proliferating in recent years, concessions to build and operate facilities include toll roads in China, Malaysia, and South Africa; power plants in Colombia, Guatemala, and Sri Lanka; water and sanitation facilities in Malaysia and Mexico; and telephone facilities in Indonesia, Sri Lanka, and Thailand. Each has brought private financing to support new investments.

Option C: Private ownership and private operation. The private ownership and operation of infrastructure facilities is increasing—both through new entry by private firms in infrastructure markets and through divestiture of public ownership of entire systems. Private ownership is straightforward when services can be provided competitively, and, in many infrastructure sectors, it is possible to identify such activities and to allow private provision. For example, twenty-seven developing countries allow cellular telephone service to be competitively provided, and many others allow private firms to construct electricity-generating plants and sell power to the national power grid. Where competition among suppliers is possible, private ownership and operation require little or no economic regulation beyond that applied to all private firms. The necessary competition can also occur across sectors—between road and rail, or between electricity and gas. For example, because it competes with suppliers of other energy sources, the private gas company in Hong Kong has no special economic regulation.

Where systems are being fully or partly privatized and there is no cross-sectoral competition, regulation of both private and public providers may be required to prevent the abuse of monopoly power. Experience with regulation and with systemwide privatization in developing countries is still very new. The Chilean form of regulation, which involves regular, automatic price adjustments and a well-specified arbitration system, appears to be working well. And systems that have been privatized have been very successful at expanding service. Venezuela's telephone company expanded its network by 35 percent in the first two years after its privatization; Chile's by 25 percent a year, Argentina's by 13 percent a year, and Mexico's by 12 percent a year.

Option D: Community and user provision. Community and user provision is most common for local, small-scale infrastructure—such as rural feeder roads, community water supply and sanitation, distribution canals for irrigation, and maintenance of local drainage systems—and it often complements central or provincial services. Successful community provision requires user involvement in decision-making, especially to set priorities for expenditures and to ensure an equitable and agreed sharing of the benefits and costs of service provision. Technical assistance, training, and compensation of service operators are also very important. When these elements are present, community self-help programs can succeed over long periods. A community organization in Ethiopia devoted mainly to maintaining roads (the Gurage Roads Construction Organization) has worked well since 1962 because it sets its own priorities and allocates its own financial and in-kind resources.

Financing: essential for all options. Implementing the foregoing institutional options and mobilizing funds to expand and improve services require carefully designed financing strategies. Foreign and domestic sources of finance will need to be tapped, but there are limits to the capacity of any economy to obtain funds from abroad, especially debt finance. Balance of payments constraints, and the limited

tradability of infrastructure services, mean that for most countries an ongoing infrastructure program has to be sustained by a strategy for mobilizing domestic funds.

Private financing in one form or another at present accounts for about 7 percent of total infrastructure financing in developing countries (the share may double by the year 2000), while bilateral and multilateral foreign aid accounts for around another 12 percent. Although an increasing share of the domestic savings needed to finance infrastructure provision can come from private sources, governments will continue to be a major source of funds for infrastructure, as well as a conduit for resources from the donor community. As transitional measures to provide long-term financing where sufficient private support is not likely to be forthcoming, governments are revitalizing existing lending institutions for infrastructure and creating specialized infrastructure funds.

In the future, governments will often need to be partners with private entrepreneurs. The task for both the public and private sectors is to find ways to route private savings directly to those private riskbearers that are making long-term investments in infrastructure projects—projects that have varying characteristics and for which no single financing vehicle is appropriate. Official sources of finance, such as multilateral lending institutions, can facilitate the process by supporting the policy and institutional reforms needed to mobilize private financing and use it more efficiently.

Implementing reform

Just as the differences across infrastructure sectors imply that no single option can be applied to all sectors, infrastructure provision must be tailored to country needs and circumstances, which vary widely. To see how, consider a middle-income country with a thriving private sector and well-developed institutional capability, and a low-income country with a small private sector and relatively undeveloped institutional capacity.

Middle-income countries with good capacity. The four major options can all work well in these countries. The broad reform instruments for such countries are clear: apply commercial principles, increase competition, and involve users. These actions lead to an increase in private involvement and finance, and to a reduction (or decentralization) of activities remaining with government. Some countries are following this path for a wide range of sectors, and many more for only a few sectors, especially telecommunications, power, and roads.

Activities that can be competitively provided should be separated and opened to private suppliers and contractors. Where possible, entire sectors—telecommunications, railways, power generation—can be privatized, but with regulatory oversight. Sectors that are unlikely to be privatized (such as roads) can be operated on commercial principles, using contracting for construction and periodic maintenance. Leasing or concessions can be used to operate facilities that may be difficult to privatize for strategic reasons, such as ports or airports. Moreover, technical and managerial capacity at the provincial and local level is likely to be sufficient to realize the benefits of decentralization. Responsibility for local services—such as urban transport, water supply, sanitation, and local roads—can be turned over to local governments.

Low-income countries with modest capacity. In these countries, commercial principles of operation can form the basis for reform in several sectors. Commercial approaches can be supplemented with reforms in procurement and contracting practices that foster competition and develop the domestic construction industry. Many activities (such as road maintenance and the collection of solid waste) can be contracted out to the private sector. Contracting can have a salutary effect on all infrastructure because, as experience shows, public providers become more efficient when they are exposed to competition from private contractors.

Concessions or leasing arrangements are proven ways for a low-income country to draw on foreign expertise, as are the various BOT options that can be used to increase the capacity of systems. Concessions and leases have been widely used in water supply, ports, and transport sectors. BOT schemes have been extensively used in middle-income countries, and their application is now spreading to low-income countries. These arrangements help develop local expertise and foster the transfer of new technology, but they do not require the establishment of independent regulatory bodies because regulatory procedures are specified in the underlying contract.

Community approaches, with technical and financial support, can be efficient and sustainable in supplying services using intermediate technologies in rural areas and in the low-income settlements that often develop outside existing urban service areas. Competition is possible in many activities but may be impeded by unnecessary regulations. Trucking and many types of urban passenger transport can be provided privately, under regulations that deal only with safety and service standards.

Some countries may benefit from arrangements that increase the effectiveness of aid by coordinating

the efforts of donors to focus on common objectives. For example, the Sub-Saharan Africa Transport Policy Program coordinates donor assistance for road maintenance and in several countries has supported the establishment of road boards that oversee execution of road maintenance. More generally, external assistance should aim to build institutional capacity in those countries where it poses a serious constraint. Well-designed programs of training and technical cooperation, as well as efforts to collect and disseminate information on policy options and performance across countries, can supplement donors' advice and financial assistance in creating an appropriate enabling environment for successful reform and development of infrastructure.

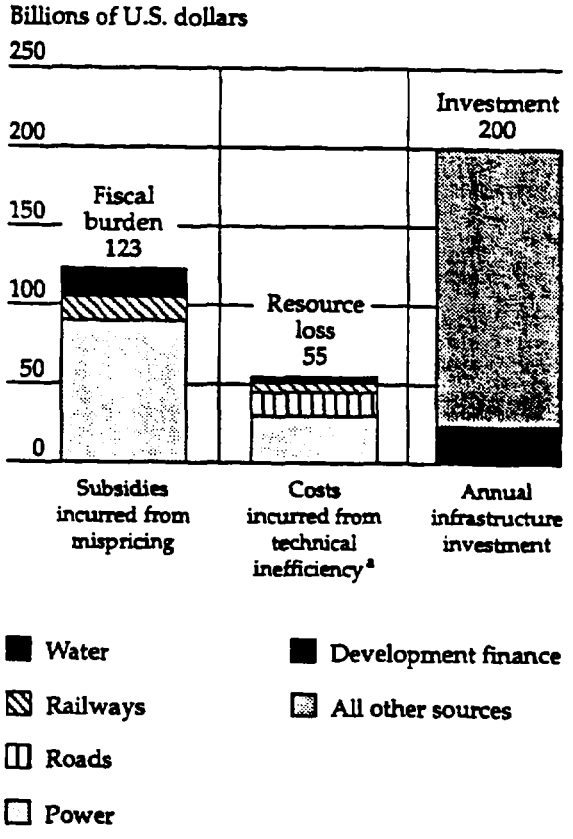
Potential payoffs from reform

Because of the great variation in performance, the payoffs from increasing the efficiency of infrastructure provision will differ from country to country and from sector to sector. But the rewards are potentially large across the spectrum, making the commitment to reform imperative and worthwhile.

Reform will produce three types of gains: reduction in subsidies, technical gains to suppliers, and gains to users. It is possible to make rough estimates of the first two types of gains. The first source of gains is the reduction in the fiscal burden of service provision—costs not recovered from users. Although a conservative estimate can be made for only three sectors (power, water, and railways), the total savings are nearly $123 billion annually—nearly 10 percent of total government revenues in developing countries, 60 percent of annual infrastructure investment, and approximately five times annual development finance for infrastructure (Figure 5). Eliminating underpricing would not produce a net resource savings to the economy (as the costs would be covered by users), but the fiscal relief would be substantial.

The second source of gains is the annual savings to service providers from improved technical efficiency. The savings possible from raising operating efficiency from today's levels to best-practice levels are estimated at around $55 billion a year—pure savings equivalent to 1 percent of all developing countries' GDP, a quarter of annual infrastructure investment, and twice annual development finance for infrastructure. Looked at another way, if the annual technical losses of $55 billion could be redirected for three years—at current costs of roughly $150 per person for water systems—the 1 billion people without safe water could be served.

Figure 5 Annual gains from eliminating mispricing and inefficiency are large relative to investment.

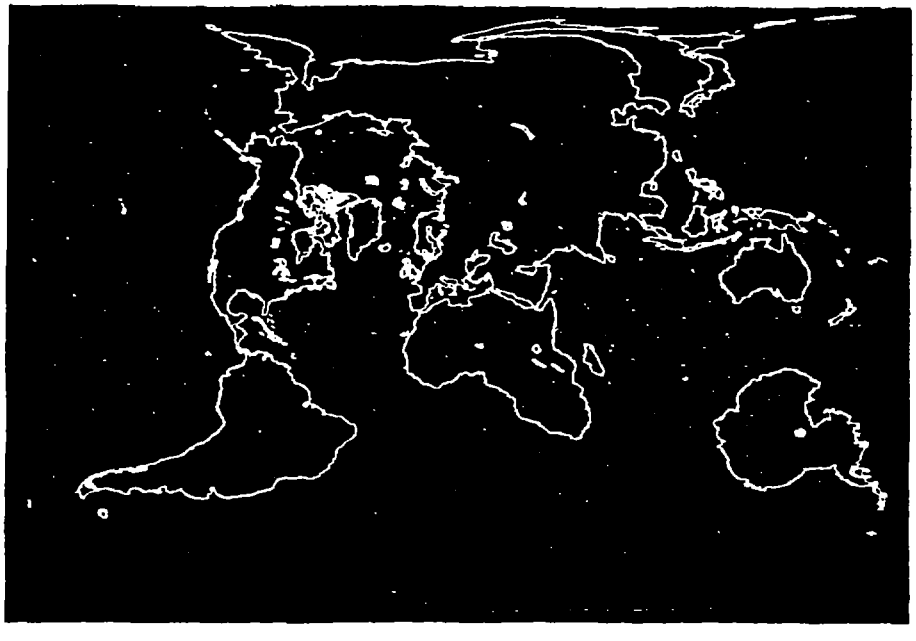


a. Costs for the water sector are due to leakages; for railways—fuel inefficiency, overstaffing, and locomotive unavailability; for roads—added investment caused by poor maintenance; for power—transmission, distribution, and generation losses.
Source: Ingram and Fay, background paper; Appendix table A.4.

The payoffs from better infrastructure services go beyond reducing technical inefficiency and financial losses. Improvements in productivity and pricing would permit more effective delivery of service in response to demand. They would also enhance the growth and competitiveness of the economy. And they would allow vastly greater mobilization of resources for needed new investments—by generating higher revenues and by creating a policy environment conducive to the inflow of new investment resources.

This Report's agenda for reforming the incentives and institutional frameworks in infrastructure poses major challenges—but promises major bene-

fits. The way ahead is one of continuing innovation and experimentation, and both industrial and developing countries will learn from each other. In some countries, the challenge is to keep pace with rapid economic growth and urbanization. In others, it is to restore growth in ways that also provide greater opportunities to the poor. Everywhere, the emphasis needs to be on improving environmental conditions. Increasingly, infrastructure needs to match new demands as developing countries become more closely integrated into the global economy. Infrastructure is no longer the gray backdrop of economic life—underground and out of mind. It is front and center in development.



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INFRASTRUCTURE FINANCING IN A POST-ADJUSTMENT ECONOMY

Paper by the Treasury and External Finances Directorate of the Ministry of Finance and External Investment, the Kingdom of Morocco

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INTRODUCTION

When independence came to Morocco the Government found itself the sole economic actor in a position to deal with the necessity to equip the country with the basic infrastructures essential to its economic and social development.

As a result, public financing of infrastructure projects rose steadily, from an annual average of US$35 million over the period 1960-64 to nearly US$800 million in 1988-92. Owing however to the financial difficulties with which Morocco had to contend in the early 1980s and the consequent adoption of a structural adjustment program in September 1983, the authorities had to slow this trend so as to be able to restore the country's macroeconomic viability and financial equilibria.

Despite the substantial infrastructure investment effort accomplished so far, financed almost entirely by the public sector, the needs in this area continue to be high in view of the twin objectives of setting the economy on the path to high growth and rehabilitating rural and social-sector infrastructures.

The needs in the area of essential services such as water, electricity, transportation, health care and education are expected to grow steadily, at an average annual rate of 7-12 percent, depending on the sector and the region, owing to the necessity to: (i) cope with population growth and people's expectations in terms of quality and diversity of services; (ii) satisfy the exigencies of economic growth, and (iii) remedy the inadequacies of the existing services.

The magnitude of the infrastructure needs in some sectors is illustrated by the following examples:

- Construction of a dam a year in order to improve Morocco's food self-sufficiency, involving total financing estimated at nearly US$200 million a year over 12 years.

- Maintenance and rehabilitation of the road network, involving total financing of US$100-150 million a year.

- Construction of nearly 3,700 km of paved rural access roads, calling for investment of the order of US$100 million a year over about 30 years.

- Construction of a minimum of 40-50 km of expressways a year over the next 20 years, necessitating incremental annual investment of US$100 million, added to expenditure of nearly US$250 million a year for road infrastructure.

- Strengthening Morocco's installed electric power generating capacity to enable it to meet the needs of economic growth and speed up the rural electrification programs; this would call for annual investment of about US$600 million up to the year 2000.

- Upgrading and strengthening the telecommunications networks, at an annual cost of nearly US$400 million.

- Expanding potable water supply capacity, requiring annual investment of the order of US$200 million.

Implementation of these investments poses the crucial problem, however, of how to finance plant construction, management and maintenance at a time when the Moroccan economy is being called upon more than ever to consolidate the structural adjustment gains by containing the budget deficit and finding new sources of financing that do not create public debt. The financial difficulties of the early 1980s demonstrated the limits of public investment financed out of the national budget and recourse to public external borrowing.

In these circumstances, the task is to reconcile the requirements arising out of the need to consolidate the gains deriving from adjustment and the reforms undertaken with those of sound and sustained growth. This makes it necessary to find supplemental and/or alternative financing sources, to enable Morocco to satisfy its infrastructure needs, through strengthened financial cooperation with both multilateral and bilateral donors, especially in the sense of improvement of their conventional financing terms and the development of innovative instruments that increasingly involve the private sector, both domestic and foreign.

I. SCALE OF AND LIMITS ON PUBLIC INFRASTRUCTURE FINANCING IN MOROCCO

To be able to judge the scale of the infrastructure financing effort accomplished by the Government and the limits on such financing, we need first of all to examine the achievements in the various sectors, the financing resources mobilized and the resulting debt problems and public deficits.

A. Scale of Public Infrastructure Financing

Despite the constraints imposed by adjustment, over the period 1983-93 public investment expenditure totaled nearly US$17 billion, with an annual average of about US$1.5

billion, more than half of which was allocated to the departments responsible for basic infrastructure construction.

On average over the period, these expenditures represented over 32 percent of total GFCF and 7 percent of GDP.

In addition, in 1988-93 direct investment by the public enterprises and establishments totaled over US$6 billion, an average of about US$1 billion a year, not counting the plant subsidies under the budget received by these establishments during the period.

Thanks to these investment efforts, substantial progress was accomplished in the area of basic infrastructure, as the following examples show:

- The road network includes about 30,000 km of paved roads.

- Port infrastructure has been considerably strengthened: it now comprises 24 ports, 9 of which handle 98 percent of Morocco.s foreign trade traffic, i.e. a commercial traffic of 40 million tons a year.

- The water works infrastructures built give access to over 11 billion m3 of water out of an estimated harnessable total of 21 billion m3/year, comprising 76 percent surface and 24 percent underground resources. In addition, the volume of water harnessed serves to generate 2,570 GWh of electric power and to irrigate 850,000 hectares of land.

The magnitude of these investments prompts us to examine the methods of financing the public authorities have had to mobilize for their execution and therefore to cover the budget deficit, bearing in mind that investment expenditure is the biggest component of the deficit.

An analysis of overall investment financing is valid also for infrastructure investment since this is its basic component and accounts for the greater part of external financing.

The Treasury situation over the years 1983 to 1993 reflects two separate periods: the first, covering 1983-86, characterized by public dissaving, and the second, beginning in 1987, by the appearance of public savings which helped finance part of the investments carried out.

Over the first period, infrastructure investment was financed essentially out of external assistance. From 1987 onward it was financed partly out of public savings.

Owing to the combination of high infrastructure investment and weak public saving, external assistance was the main source of infrastructure financing. This was funded by recourse by the Government to loans of various kinds and debt rescheduling, which constituted a major source of financing of the investment budget between 1982 and 1992. The

external loans consisted in particular of bilateral assistance obtained from fraternal and friendly countries, including the Gulf countries, France, the United States, Germany, Japan, Spain and Italy. This assistance took various forms: supplier's credit (port facilities), purchaser's credit, mixed loans with a concessional component, and commercial loans, for the financing of, in particular, the electric power, rail transport and telecommunications sectors. They also included financing obtained from the international financial institutions, including the World Bank, the African Development Bank and the Arab and Islamic Development Funds.

The compensation or off-setting formula has also been experimented with in the case of certain countries of eastern Europe and has helped to finance the execution of infrastructure products and to cover the related expenditures in counterpart for exports of Moroccan products. It has been used to finance projects of construction and rehabilitation of ports in northern Morocco, notably Nador, Larache and Asilah with the help of a Romanian company which carried out the port works against the export of phosphates to Romania. The scheme has also been tried out with China, for the construction of a sports complex in Rabat.

The use of this financing formula, which is incidentally complex and unorthodox in terms of GATT rules, remains exceptional and of limited scope: while it makes it possible to reduce payments in foreign exchange, it does nothing to solve the budget problem since it transfers the burden of paying the compensation proceeds to domestic suppliers to the general national budget.

B. Limits on Public Financing

The limits on public infrastructure financing became evident following, in particular, the institution of an ambitious public investment program during the second half of the 1970s and the economic downturn, which severely hit Moroccan phosphate exports, whose prices fell from US$68 per ton in 1974 to US$30 in 1976.

These factors, among others, were largely responsible for the sharp rise in Morocco's external debt and the development of unsustainable budget deficits.

1. Rapid growth of the external debt

Morocco's outstanding external debt grew from the equivalent of 20 percent of GDP in 1974 to over 100 percent in the mid-1980s, while debt-service ratio rose from 7 to over 40 percent of goods and services export receipts.

As a result, Morocco's external debt burden became intolerably heavy, to the point that payments fell into arrear, a situation that paved the way for the cycle of external debt reschedulings. Six rescheduling agreements were concluded with official creditors between 1983 and 1992 and three with international commercial banks.

This excessive debt situation inevitably exerted heavy pressure on the Treasury's financing capacity and thereby led it to reduce budgetary investment expenditure to enable it to comply with the country's obligations.

2. Budgetary constraints

Over the period 1983-93. a series of measures were taken to reconcile the exigencies of economic growth in terms of basic infrastructure construction with the national budget constraints in terms of Treasury financing capacity.

The measures implemented to that end include, *inter alia*:

- reduction in total investment expenditure, including cuts in investments in infrastructure projects in the social sectors (health, national education. etc.);
- lengthening of original investment project execution periods;
- reduction of the subsidies to public establishments that have large infrastructure expenditures (railways, potable water supply, electric power, etc.).

3. Cumbersome public management

Sluggishness of public management is also a serious constraint on efficient allocation of public resources and continued public financing of the infrastructure sectors under optimum conditions in terms of cost, quality and execution time. Three types of problems can be cited to explain the shortcomings of public management of infrastructures: (i) rigid tariff-setting, and below-cost prices; (ii) dependence of the public enterprises on subsidies and government guarantees in order to raise domestic and external financing for infrastructure projects, and (iii) sluggishness in administrative supervision.

C. Reforms Undertaken during the Adjustment Period

Aware of the limits on public infrastructure financing, the authorities have undertaken a vast reform program of rehabilitation of the public finances. These reforms have covered, *inter alia*, rationalization of budgetary expenditure management, involvement of the private sector in the provision of management of certain public services, and reduction of the budget dependence of the major public enterprises.

1. General structural reforms

Since the structural adjustment policy was first put in place in 1983 the Government has taken a number of measures designed to optimize public expenditure in light of the Treasury's financing capacity.

In the case of the public enterprises, a general reform program, supported by the World Bank, was launched in the mid-1980s with the aim of redressing the situation of the public enterprises by rationalizing their investments, adapting their tariff-setting systems, raising their productivity and improving their self-financing capacity. A process of redefinition and rationalization of relations between government and public enterprises was undertaken, and program contracts (*contrats-programmes*) were concluded with the major public establishments

heavily involved in infrastructure construction. These program contracts lay down the performance goals to be achieved by the establishments in question and lighten *a priori* administrative supervision.

In parallel with the macroeconomic stabilization efforts carried out throughout the 1980s, the public authorities took important liberalization measures to facilitate the financing of private investment, particularly its long-term financing.

Thus, as part of the general financial market reform, the stock exchange was given a modern legislative framework and its management was entrusted to the private sector. The purpose was to provide wider access by public and shareholders to the securities market through better dissemination of information, diversification of financial instruments and proper protection of savers. This reform was particularly timely in that it took place just following initiation of the privatization process, in which the ordinary shareholder and the stock exchange have begun to play an important role.

Similarly, a negotiable securities market will be set up with the object of creating a true non-compartmentalized monetary market accessible to all economic operators and offering them a diversified range of financial instruments and a means of flexible cash-flow management and more suitable financing of their investments. The ultimate purpose of this product is to develop disintermediation, allowing borrowers to contact investors directly in order to mobilize financing on competitive and therefore easier terms.

The Treasury bonds auction market has been thoroughly redesigned, particularly to make it more transparent and widen access to it to include all potential investors.

The introduction of negotiable securities and revitalization of the Treasury bonds auction market will foster the emergence of a secondary securities market. The development of transactions within this market will enhance the liquidity of these securities and favor interest-rate formation through the free play of supply and demand. These reforms will facilitate local financing of infrastructures under the responsibility of both government and private sector.

2. Morocco's experience with withdrawal of government from the provision and management of public services

As part of the process of withdrawal by government, undertaken in the wake of the structural adjustment policy, more and more has been done to involve the private sector in the financing, provision or management of certain public services. The following are examples of experience with this process:

(1) The restructuring of port activities undertaken from 1982 and the creation of the Port Operations Office (*Office d'Exploitation des Ports--ODEP*) at the end of 1984. These developments have reduced the Government's involvement in the sector while substantially improving the service offered to the users and lowering goods transit costs. This evolution was made possible by entrusting

commercial operation of the ports to an industrial and commercial public establishment given financial autonomy and placed under a single jurisdictional authority. This appropriate status also enables ODEP to entrust certain commercial activities to the private sector. For example, the operation of marinas and certain port activities in the commercial ports (handling, dredging, maintenance, etc.) are entrusted to private enterprises. In addition, although ODEP is responsible solely for operation of the infrastructures assigned to it by the authorities, it has been able to contribute to the execution of a number of infrastructure projects, notably those concerning the specialization of facilities (containers, roll-on/roll-off systems, and so on). This contribution by ODEP permitted financing of the port infrastructures built between 1985 and 1993 to the tune of over 40 percent, thanks to the fees charged on port activities, notably port dues on vessels and cargo.

(2) Opening of the urban mass transit market to the private sector from 1985. This has permitted a sharp increase in transit stock fleet to meet the real needs of the population.

(3) The granting of a concession to operate the Casablanca-Rabat expressway, following its construction by the Government, to the Moroccan National Expressways Company (*Société Nationale des Autoroutes du Maroc--ADM*), a private-law company established in June 1989. ADM also holds the concession to build and operate the Rabat-Larache expressway (150 km), currently under construction. This project is to be financed 30 percent out of the concession company's own funds, thanks to the toll system set up on Morocco's expressways in order to pass construction and maintenance costs on to users.

(4) The establishment in 1989 of the Road Fund (*Fonds Routier*), financed by three specific road-use taxes (registration tax, axle tax and domestic consumption tax levied on fuel sales). This had the effect of reducing the share of the national budget in total road maintenance expenditure from 100 percent to 60 percent. In addition, in 1995 the resources of the Road Fund were expanded by a supplemental levy on fuel sales to fund the construction of local access roads at the rate of 1,450 km a year.

(5) Operation and development of the state's airport facilities were entrusted to the National Airports Office (*Office National des Aéroports--ONDA*), set up for that purpose in 1989. The airport infrastructure has been greatly strengthened since then. For example, (i) the capacity of the Casablanca-Nouasseur airport was expanded during the 1990s from 3 million to 7 million passengers a year; (ii) a new airport was built at Agadir in 1991 with a capacity of 7 million passengers a year; (iii) four new medium-size port landing platforms were built, including three in southern Morocco, and (iv) six airports were rehabilitated and expanded, including those of Rabat-Salé, Marrakech-Ménara, Läayoune and Dakhla.

All these construction projects, among others, were financed 60 percent by ONDA thanks in particular to improved user services, reflected in a doubling of port dues (overflight, landing, switching, etc. charges) during the period 1980-94, which in turn facilitated the Government's withdrawal from financing of this sector.

(6) Participation by the beneficiary farmers, either directly or through a charge, in irrigation network financing, at the rate of 40 percent in investment and 100 percent in operating and maintenance expenditures, in the framework of the major agricultural waterworks development projects initiated by the Government. In addition, with a view to promoting the private sector's contribution to the national irrigation development effort, the Government encourages individual farmers or groups of farmers to equip their farms themselves, through a specific support mechanism which can cover 20-40 percent of the cost of private irrigation plant.

(7) In the context of reorganization of the national meteorological service, an autonomously managed service (*Service Geré de Manière Autonome--SEGMA*) was set up in 1991 with a view to making meteorology services more accessible and responsive to the economic and agricultural sectors. In parallel, a charge for use of the meteorology service was introduced which helped lighten the burden on the national budget.

(8) Concession of the management of auxiliary telecommunications services to the private sector.

(9) Independent electricity generation (see chapter II, section A, "Redefinition of the Role of Government").

With the object of developing this trend and involving the private sector more in the construction of basic infrastructure, the public authorities are continuing their study of the subject, as part of a large private-sector development project, in association with the World Bank.

II. INFRASTRUCTURE FINANCING IN THE POST-ADJUSTMENT PHASE

The structural adjustment process has yielded positive results in terms of: (i) restoring the basic equilibria, particularly getting the public deficit back down to a sustainable level; (ii) bringing inflation under control; (iii) ending external debt rescheduling; (iv) establishing convertibility of the dirham for current operations, and (v) implementing major structural reforms, notably in the areas of foreign trade, taxation, the financial system and rehabilitation of the situation of the public enterprises.

It is now accepted that consolidating these gains is a vital necessity, essential to durable macroeconomic stability and the return to strong and sustained economic growth.

Added to this necessity is the need to bring under control a number of constraints which still weigh on the Moroccan economy, notably the high level of debt service, which absorbs more than one third of the country's current foreign exchange receipts, the infrastructure and social services backlog and the unemployment problem.

In light of these considerations it is clear that the Government cannot continue to apply the conventional public financing methods in order to raise the whole of the financing needed to satisfy the real basic infrastructure needs generated by Morocco's economic expansion and population growth.

This being so, the strategy adopted by the authorities is based on: (i) redefinition of the roles of the government and private sectors, and (ii) search for alternative financing sources that can replace public infrastructure financing.

A. Redefinition of the Role of Government

Redefining the roles of government and the private sector is the cornerstone of the authorities' strategy. This approach is based on withdrawal by government from, in particular, industrial and commercial activities, which the private sector is in a position to perform better and more efficiently, in order to focus on strategic, social and public aspects, while playing a role of arbitral, supervisory and regulatory role in the other sectors.

This same approach also underlies the new formulas of partnership between the public and private sectors through recourse by the authorities to (to cite a recent example) **electric power generation under concession**. This partnership formula consists in granting concessions to private enterprises to build and operate independent electricity generation units to the private sector, with assignment of right of user and contracts for purchase of the power generated.

A first international call for bids was issued and the awardee selected in February 1955 for the operation of two units already built at Jorf Lasfar, with a commitment by the awardee to build another two 330-MW units. In addition, bids have been received in response to a call for bids issued for the execution under concession of a 50-MW wind-power generating park in northern Morocco and are currently being appraised. Other projects for construction under concession are currently being studied. They include a steam thermal power station at Mohammedia (300-600 MW) and a combined-cycle natural-gas power station at Kénitra (300-500 MW).

B. Search for Alternative Financing Sources

It is clear that if Morocco were to adhere to the conventional methods of public financing, project execution could not proceed at a rate incompatible with the exigencies of sustained and durable economic growth. This would lead to a slowdown in the rate of implementation of the infrastructure development programs and, in particular, a substantial reduction in maintenance expenditure, the impact of which will be severely felt over time. It is therefore necessary to seek alternative means of financing.

Three main alternative financing sources are currently being tested and will in future be used on a bigger scale.

1. The domestic financial market

Reform of the financial sector is aimed, among other objectives, at creating more modern and more suitable mechanisms for capturing domestic savings, as part of the process of diversification of infrastructure financing sources.

It is felt that available community savings would constitute one of the new sources of financing of infrastructure projects. The success of the latest stock exchange-based privatization operations testifies to the existence of savings available for long-term investment.

Similarly, infrastructure financing could be further developed through diversification of financial instruments.

2. Privatization

Privatization and deregulation form part of the structural reforms aimed at more efficient allocation of resources and more active involvement of the private sector in the infrastructure investment effort within the process of redefinition of the role of government.

This strategy is explained by the need to lighten the public expenditure burden by seeking new ways of financing the economy and the urgent need to pursue infrastructure development in order to satisfy the needs and expectations of the investors and users of the public services concerned. Some 30 public establishments have already been transferred to the private

sector since the privatization program began in 1983, and a large number of establishments are currently in process of appraisal, audit or transfer.

In parallel with privatization, the process has begun of abolishing the monopolies held by certain public-service establishments in favor of the private sector, with the object of increasing the involvement of the private sector in the financing, management and provision of services that were previously reserved exclusively to the public sector.

The processes of speeding-up the public enterprises privatization program rises and involvement of the private sector in the effort of equipping and managing public services can be expected to yield budget savings to the Government, allowing it to focus more on the development of basic infrastructures and the social sectors.

3. Recourse to external financing

While recourse to the international financial market continues to be necessary in any event, having regard to the limited supply of capital on the domestic market and the country's immense basic infrastructure needs, the fact remains that such recourse must be

compatible with the objective of bringing Morocco's external debt under control and improving its debt indicators. This does not mean that the many instruments offered by the international financial market do not deserve to be explored and, where appropriate, utilized in order to raise financing.

Foreign investment, which in itself constitutes a source of non-debt external financing, is another means of access to the international capital market which could channel investment by international companies to infrastructure projects.

4. Limited-recourse project financing

Limited recourse financing of projects is a mechanism which allows the investor to raise funds secured on the receipts and assets of the project to be carried out. The risks inherent in the projects financed in this way are concern solely project cash-flow and assets value.

This financing mechanism can trigger a process of change in the way infrastructures are financed in Morocco, where the private provision of infrastructure services is still relatively undeveloped and where alternative means of financing to replace public financing need to be found. Available international experience shows that infrastructure projects financed by this mechanism tend to concern mainly toll roads and independent electric power generation.

C. Need to Realize Budgetary Savings for Infrastructure Financing

Although infrastructure services are increasingly being financed out of private capital, the Government continues to be a major source of financing of community plant designed to reduce the social cost of adjustment and make up the lags that have occurred in basic infrastructure construction, notably rural electrification, road construction (particularly rural access roads), expansion of potable water supply and strengthening of the telecommunications network, which the private sector would not be in a position to carry out.

Despite the constraints of adjustment, the authorities have maintained an adequate level of infrastructure financing out of the national budget through strengthened public saving and deficit reduction. Adjustment has thus helped to generate a budget surplus available to cover part of the public-sector investment budget and, therefore, the basic infrastructure budget. It is therefore necessary need to consolidate the adjustment gains in order to expand the Government's capacity not only to meet its infrastructure obligations but also to maintain a stable macroeconomic framework, as an incentive to increased involvement of the domestic and foreign private sector in Morocco's economic growth process in general and the infrastructure development effort in particular.

According to a recent World Bank study addressed to strengthening of the private sector in Morocco, if the country were to post growth of 8-10 percent instead of 4-5 percent, it is highly likely that its infrastructures would become increasingly inadequate and its infrastructure services would steadily deteriorate. To enable Morocco to reduce the current

constraints and prevent their reappearance, therefore, public investment and, of course, domestic and foreign private investment in appropriate amounts will be essential in order to sustain the effort of bringing Morocco's infrastructures up to a level capable of facilitating the development of the private sector and of the national economy in general.

III. ROLE OF DONORS IN IMPROVING INFRASTRUCTURE FINANCING IN MOROCCO

In addition to the efforts accomplished by the Moroccan authorities to raise the necessary resources for basic infrastructure financing, the donors, both multilateral and bilateral, continue to have a very important role to play in improving the profile, diversifying the nature and increasing the volume of the financing operations expected from these sources.

A. Role of the Multilateral Donors

1. Role of the World Bank

IBRD is one of Morocco's major donors in the area of infrastructure financing. IBRD's portfolio, which includes a total of over US$1 billion in the infrastructure sector as of January 1995, covers practically every area of infrastructure activity (water supply, telecommunications, electrification, irrigation, transportation, etc.).

IBRD has supported and assisted Morocco's macroeconomic stabilization and structural reform efforts continuously for more than ten years, and is fully aware of what has been accomplished and what remains to be done in order to consolidate the adjustment gains by deepening the reforms and to ensure Morocco's sound and durable economic growth.

IBRD's role in infrastructure financing could be further strengthened and improved: the terms of its financing operations continue to be generally hard.

Improving the conditions of IBRD loans could be sought by, in particular, softening their financial terms to allow borrowers to improve the quality of life of the population and promote rural development.

For its part, IFC, as a major source of multilateral financing of projects carried out by the private sector in developing countries, can play a vital role in mobilizing additional financing for Morocco's basic infrastructure sectors that offer obvious attractions for the private sector. It can also support the process of privatization and abolition of monopolies by taking direct participations, and strengthen its role as a catalyst of direct foreign investment in our country.

2. Role of the other multilateral donors

Infrastructure financing in Morocco is supported also by contributions from other multilateral sources, including the African Development Bank, the Islamic Development Bank, and the Arab Fund for Economic and Social Development. Over the period 1989-94 these

multilateral donors financed 7 public basic infrastructure projects in Morocco with a total cost of some US$1.2 billion.

Strengthening the involvement of these financing institutions in the development of Morocco's infrastructure sector should. in my opinion, be sought by, in particular, adopting a more flexible lending policy which facilitates infrastructure financing and the development of new formulas of partnership with the private sector for the execution of infrastructures that offer proven profitability, notably in the telecommunications, electricity and road transportation sectors.

B. Role of the Bilateral Donors

Bilateral financial cooperation has always been a major instrument in the financing of the Moroccan economy, particularly in the area of basic infrastructures.

The chief economic partner countries or groups of countries to which Morocco could look to improve the existing support mechanisms so as to facilitate basic infrastructure financing in Morocco include the European Union, the United States, Japan and other friendly countries.

In the case of the European Union, in order to develop its contribution in terms of both volume and quality, beyond the conventional financial cooperation mechanisms, it will be necessary to devise new instruments through which to sustain the effort of restructuring and revitalization of the Moroccan economy, consolidate its gains and develop strategies of partnership with the Moroccan private sector for, *inter alia*, infrastructure construction.

Bilateral financial cooperation with the other countries in the infrastructure and social sectors could also be further strengthened and diversified by developing other partnership formulas and financial instruments. Debt conversion into investment projects in the above sectors to the benefit of private operators is a possibility that merits consideration in this respect.

INCREASING THE SUPPLY OF BANKABLE INFRASTRUCTURE PROJECTS IN DEVELOPING COUNTRIES

Paper prepared for the Development Committee
by the Institute of International Finance*

April 1995

INTRODUCTION

Over the course of the past year there have been large swings in market sentiment toward developing countries. These swings have had a greater impact on bond issues in international capital markets and the purchase of emerging market securities by portfolio investors than on bank lending and foreign direct investment. Reducing the volatility and enhancing the sustainability of private capital flows to developing countries is a widely shared objective. Fostering private financing for infrastructure projects can make an important contribution to this objective.

Despite the growth of private flows to emerging economies since the beginning of the 1990s, a relatively small amount has been devoted to infrastructure projects. By the World Bank's estimates, only seven percent of total infrastructure investment in developing countries is currently coming from private sources, including domestic lenders and investors. By contrast, 12 percent is coming from bilateral and multilateral aid agencies. Given the constraints on official financing, the proportion of financing from private sources will have to grow substantially in order to meet the projected demand for infrastructure investment in developing countries.

The private financial community welcomes this challenge. Commercial lenders and investors are continually adapting to new technologies and devising new instruments for intermediating efficiently between savers and investors. At the same time, they face numerous obstacles to financing many commercially viable infrastructure projects. This paper suggests a number of steps that could be taken by governments and multilateral development banks to catalyze more private financing for infrastructure projects. These steps would also help to leverage the limited resources provided through the aid budgets of the industrial countries.

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* The Institute of International Finance is a global association of financial institutions. Its 185 members include leading commercial banks around the world and a growing number of investment banks and fund managers.

THE PERSPECTIVE OF THE PRIVATE FINANCIAL COMMUNITY

The private financial community believes that the Development Committee's discussion of infrastructure financing should take into account the following points:

- **The supply of financing**. The strong growth of private financing to developing countries in the 1990s suggests that there is no global shortage of funds for good infrastructure projects. Developing countries that believe they are being priced out of international capital markets by high borrowing costs usually have infrastructure projects offering commercially attractive returns, but also riskier environments for private capital. Developing countries could enhance their ability to compete for the world's pool of savings by reducing these risks. The cost, in terms of lost output, of not completing these projects is substantial.

- **Sound economic policies and political stability**. Disciplined and steady macroeconomic management is critical to attracting financing from private sources for good infrastructure projects. Sound macroeconomic management in turn benefits from political stability. The private financial community can only encourage sound policies indirectly by responding positively or negatively to policy shifts. Consequently, commercial lenders and investors value the ability of the International Monetary Fund, the World Bank, and other multilateral and bilateral agencies to assist developing countries more directly in maintaining sound policies.

- **Progress in liberalization**. Developing countries have made substantial progress over the past decade in opening their economies to the outside and liberalizing internally. Nevertheless, there remain a number of countries where the process of liberalization has barely started, and there are many where further progress is necessary in order to have ready access to international capital markets and to meet global standards for the productive use of capital.

- **Privatizing infrastructure**. Privatization is part of the liberalization trend, and further privatization of infrastructure offers substantial benefits for most developing countries. Although publicly owned and operated infrastructure may be efficient when governments are exceptionally disciplined, all countries have opportunities to gain from privatizing infrastructure. At a minimum, private infrastructure companies can provide performance benchmarks for public sector entities.

- **Preconditions for more privatized infrastructure**. In the industrial countries, the trend has been toward less public funding of infrastructure. In addition to pervasive budget constraints, basic factors facilitating this trend are strong competition among project sponsors, diverse and liquid capital markets, and well-established legal systems. Developing countries have exceptional opportunities for taking advantage of the latest technologies and management techniques. To capitalize on these

opportunities, however, they will need more competitive business and more developed capital markets and legal systems.

- **Transparency and predictability**. The importance of regulatory transparency and judicial predictability in creating a favorable environment for infrastructure financing cannot be overemphasized. Commercial lenders and investors seek assurances that successive governments will respect contracts, and that local courts will be effective in enforcing them. Regrettably, there are no internationally accepted procedures for the arbitration of commercial disputes, as there are for investment disputes. Requirements to arbitrate under local laws are a particular deterrent to foreign investors and lenders. The legal costs involved in finding ways to address deficiencies in transparency and predictability can represent a substantial portion of project costs. In many developing countries, a related problem is that businesses are not accustomed to producing meaningful financial statements.

- **Commercial pricing**. Commercial pricing of infrastructure services is necessary to attract commercial financing. In the power sector alone, the World Bank has estimated that subsidies to consumers in developing countries amount to $90 billion annually. Popular resistance to eliminating such subsidies may ultimately be the reason why the amount of infrastructure investment actually undertaken during the next five to ten years will be below current projections. Early moves to phase out subsidies and to explain the rationale for full cost recovery will be critical steps for many countries.

- **Monopoly rights and risks**. Until they establish transparent and predictable business environments, developing country governments are likely to find it necessary to grant significant monopoly rights, or other special protections, to attract sponsors. This may seem contradictory to governments that are being pressed to break up existing monopolies and unbundle infrastructure services. It should be seen, however, as a particular requirement of infrastructure companies which, unlike industrial companies, sell into highly regulated markets. For some projects, especially in the power sector, a major risk faced by private sponsors may be the purchase of inputs or sale of outputs to a government monopoly. Opening up these monopolies to competition can make such projects substantially more attractive.

- **Performance guarantees**. Financial feasibility for many infrastructure projects depends critically on assurances that host-government authorities will faithfully honor commitments such as agreements to purchase power from a commercial generating plant. A common way to obtain these assurances is through host-country guarantees. In numerous countries, such guarantees are not "bankable," and commercial sponsors must seek enhancements from third parties such as multilateral agencies.

- **Low-income countries**. The intense interest in infrastructure financing in China and India suggests that no country is too poor to attract private financing for infrastructure projects. Even in countries with low per capita incomes, consumers are often willing and able to pay the full costs for reliable infrastructure services. Private lenders and investors can work creatively in low-income countries with host governments, aid agencies, and export credit agencies to make commercially viable projects bankable.

- **Regional variations**. The Asian region attracts substantial infrastructure financing because many countries in the region are experiencing rapid economic growth and appear to be politically stable. In Latin America, many countries are benefiting from more positive attitudes toward private enterprise and a tradition of greater regulatory and judicial transparency. Most of the countries of Eastern Europe and the Former Soviet Union do not have enough experience protecting private property rights to be viewed as comfortable environments for infrastructure financing. The Middle East and Africa are slow-growing regions with few governments committed to privatizing infrastructure services. Countries should understand clearly where they stand in the spectrum of risk as perceived by the private financial community. The closer they find themselves to the risky end of the spectrum, the more incentives they will have to offer to attract private financing, such as higher rates of return or longer concessions.

- **Variations among subsectors**. The attractiveness of infrastructure projects varies from subsector to subsector. Government commitments that are sufficient to attract private financing for telecommunications projects, for example, may not be sufficient to attract financing for sanitation projects. Host governments should accept these inherent differences and tailor the regulatory regime for each subsector accordingly.

- **Expected rates of return**. Governments sometimes feel obligated to limit the rates of return for private investors in infrastructure projects because they are providing project companies with access to a protected market. From a public sector perspective, a rate of return above 10 percent may suggest windfall profits for investors at the expense of consumers. Such an approach can become an insurmountable obstacle to financing good projects, however. The world of international finance is intensely competitive. Venture capital funds normally invest in projects that offer rates of return above 30 percent, even in high-income, slow-growing industrial countries. Commercial sponsors for infrastructure projects rarely consider investments in developing countries attractive unless they have rates of return above 15 percent. Project development costs are especially high for "pioneers" entering sectors where regulatory frameworks are just being developed. They need higher returns to offset these costs. Host countries that insist on lower rates of return are likely to find their projects moved to the end of the queue. A sure way to lower rates of return is to create track records of successful project financing over several years, thereby stimulating competition among potential sponsors for new projects.

- **Equity versus loan financing**. There is a common perception that plenty of equity financing is available for infrastructure projects while loan financing is in short supply. A more accurate view may be that there is a natural gap between suppliers of equity finance and suppliers of loan finance. Equity investors are seeking to keep their share of project costs low (10-15 percent) in order to achieve higher rates of return. Lenders are seeking to keep their share at a reasonable level (60-75 percent of project costs) because of the perceived risks. This creates normal funding gaps of 10-30 percent. These gaps can be closed with support from official institutions, such as enhancements from multilateral development banks and bilateral export credit agencies. They will tend to disappear over time as projects are successfully completed.

- **Multiple financing partners**. Many attractive infrastructure projects are large in scale, ranging from $100 million to $2 billion or more. Risk sharing among a group of financial partners is often critical to launching these projects. The recent interest among export credit agencies in participating in this process is a welcome development. The participation of two or more multilateral agencies in the same project can also be helpful both to lighten the financing burden and to protect against adverse actions by government authorities. The disadvantage of multiple partners is that they have different procedures and requirements, thereby slowing down preparations and raising costs.

- **Mobilizing domestic financing**. Domestic financing of infrastructure projects is inherently preferable because relatively few infrastructure projects generate significant hard-currency revenues. A major constraint on domestic financing is that high and volatile inflation rates preclude long-term financing or make it so expensive that projects become commercially unviable. In addition to bringing inflation under control, efforts by host governments to make domestic capital markets broader and more liquid will accelerate the pace of private financing for infrastructure projects.

- **The practices of multilateral agencies**. Partly as a result of inertia, multilateral agencies are financing some infrastructure projects that could be financed without them. Multilateral agencies should remain financiers of last resort. The status of multilateral agencies as preferred creditors or as equity partners can also have disadvantages when projects encounter difficulties. They may be less concerned about project failure because they have preferential access to foreign exchange, or they may fail to support actions normally taken by commercial lenders.

- **The catalytic impact of multilateral agencies**. To be significant catalysts of private financing, the multilateral development banks will have to be more flexible and creative. There are welcome signs of movement in this direction, such as the decision by the World Bank last year to "mainstream" guarantees. All of these agencies could speed up their procedures for selecting and evaluating projects. For some, this will require departing from a tradition of viewing their clients as their member

governments exclusively, and discovering how to deal with private sector entities as clients. Multilateral development banks could also exploit more fully their unique advantages in certain situations, such as the privatization of existing infrastructure facilities.

A PROGRAM OF ACTION

The private financial community has a positive attitude toward infrastructure financing in developing countries. Hundreds of commercially viable projects are taking shape that will provide substantial direct and indirect employment opportunities, raise productivity in other sectors, and contribute to global integration. In a number of countries, infrastructure bottlenecks have tilted the balance of economic activity away from investment and toward consumption. By relieving these bottlenecks, foreign financing for infrastructure can enhance the sustainability of growth.

The basic role of the private financial community is to channel global savings efficiently to meet the rising demand for infrastructure financing. This involves continuous adaptation to the changing economic environment, constant innovation to take advantage of new technologies, prudence in the choice of projects, and discrimination between emerging opportunities and potential risks. From time to time, markets overshoot sustainable positions, but with more effective self-monitoring and stronger collaboration with official institutions, the adverse impact of these episodes can be minimized. On balance, the private financial community believes that the most important steps to facilitate infrastructure financing must be taken primarily by the governments of developing countries, the governments of the industrial countries, and the multilateral agencies. Specifically, as the Development Committee formulates a program of action, it should consider including the steps outlined below.

Action by Developing Country Governments

- *Maintain attractive macroeconomic environments.* Countries that have inflation under control, high rates of domestic savings, and open trade and payment systems will have an advantage in obtaining financing from private sources for infrastructure projects.

- *Create transparent and predictable business environments.* The private financial community will provide financing for infrastructure projects more promptly and on more favorable terms in countries where the regulatory regime is transparent and stable, and where the judicial regime has demonstrated an ability to enforce contracts and resolve disputes quickly and fairly.

- *Design infrastructure frameworks.* More financing for infrastructure projects could be mobilized from the private financial community by adopting formal frameworks spelling out approval procedures for project sponsors and the commitments that governments are prepared to undertake. The World Bank and the regional development banks could assist in these efforts, and the private financial community is prepared to collaborate closely in designing frameworks that are attuned to the realities of the marketplace.

- *Develop domestic capital markets.* Domestic capital will eventually become the primary source for infrastructure financing in developing countries. Under the best of circumstances, however, it takes years to develop the business environments required to support diverse and liquid capital markets. Privatization of state enterprises and de-monopolization are often key steps in this process. Developing country governments should give a high priority to accelerating the development of their domestic capital markets.

Action by Industrial Country Governments

- *Contribute to the pool of global savings.* Low savings rates in the industrial countries as a whole are restraining economic growth and employment globally. The lower global interest rates associated with higher savings would be especially helpful in the financing of infrastructure projects in developing countries. These projects, in turn, may be particularly good vehicles for investing the savings of aging populations in the industrial countries.

- *Provide new priorities and better tools for multilateral agencies.* The multilateral agencies could be more effective in facilitating infrastructure financing if they were given clear mandates to work more closely with the private financial community, and if they were provided with more flexibility along the lines suggested in the next section. The industrial countries are able to set the agendas of the multilateral agencies through their majority voting power. They continue, however, to expect these agencies to address a multitude of objectives, and they appear reluctant to give these agencies the flexibility required to meet the challenges of operating in a world increasingly dominated by private flows of financing to developing countries.

- *Strengthen the role of export credit agencies.* Some export credit agencies have become more flexible recently in sharing the risks involved in financing infrastructure projects in developing countries. Other export agencies could usefully follow the lead of the more forward-looking agencies, and scope remains for additional steps by all in the direction of greater risk sharing.

Action by the Multilateral Agencies

- *Explore World Bank lending to the private sector.* The charter of the World Bank appears to prohibit lending to the private sector without a host-country counterguarantee. In a period when developing countries are increasingly interested in privately owned and operated infrastructure services, and when many projects have a mixed public-private character, it seems appropriate to find ways to tap the World Bank's ample resources to finance infrastructure projects in the private sector without a host-country guarantee.

- *Expand World Bank procurement of financial assets.* Because of its size and standing, the World Bank has the potential to promote demand for domestic securities in developing countries that have laid the foundations for local capital markets. The Bank recently departed from its customary practice of procuring goods and services to support a capital market project in Argentina. The Bank should move toward "mainstreaming" activities of this kind.

- *Refocus the International Finance Corporation (IFC).* The IFC has made many contributions over the past 28 years to promoting private sector development in developing countries and to drawing the attention of investors in the industrial countries to the growing opportunities in emerging economies. This record justifies an increased role for the IFC, but only when it can catalyze and not replace private financing. The IFC could be more catalytic within the limits of its existing resources by giving a higher priority to riskier countries, by scaling back its support for industrial projects in favor of infrastructure projects, and by relying less on loan syndications in favor of guarantees.

- *Relieve constraints on the Multilateral Investment Guarantee Agency (MIGA).* While MIGA has raised its country and project limits during the past year, the current limits are constraining the ability of equity investors to participate in infrastructure projects in developing countries. MIGA's limits are actually lower than those of some bilateral investment insurance agencies. A substantial increase in MIGA's capital should be considered to alleviate this constraint. MIGA could also be more supportive of infrastructure projects by broadening the definition of the political risks it will cover.

- *Reorient the International Development Association (IDA) toward the private sector.* IDA's potential for catalyzing flows of private finance for infrastructure projects in low-income developing countries does not appear to be fully recognized. For example, IDA's charter permits lending to private sector borrowers without a host-country guarantee, but this ability is not being used. In addition, making IDA resources available on less concessional terms for infrastructure projects in the private sector would allow IDA to recycle its scarce resources more rapidly. An innovative

way to use IDA resources to mitigate risks for a private pipeline project in Tanzania was recently approved. More initiatives of this kind should be undertaken.

- *Adjust the priorities of the regional development banks.* The EBRD stands out for its ability to work creatively with the private financial community in its countries of operation. Nevertheless, there appears to be scope for the EBRD to provide more support for infrastructure projects. The IDB and the ADB have both taken steps over the past year to be more active in lending to the private sector. They are now in a better position to catalyze flows of private financing through guarantees and through lender-of-record loan syndication programs.

- *Amend procurement rules.* Many sponsors are deterred from committing resources to developing projects in risky environments by the probability of losing the project through the International Competitive Bidding procedures of the multilateral development banks. Amending these procedures in situations where there is clear evidence of competition could permit export credit agencies to become involved at an earlier stage, and could substantially accelerate project implementation.

- *Improve collaboration among official agencies.* The multilateral development banks could greatly facilitate project financing with private partners by adopting similar documentation and procedures. Further benefits could be obtained through convergence with the practices of export credit agencies.

- *Create enhancement vehicles.* Individual multilateral development banks are actively exploring vehicles that would provide the basis for investment grade ratings or other protections allowing infrastructure sponsors in developing countries to gain access to institutional investors in the industrial countries. Other vehicles would "bridge" to financing from domestic capital markets or facilitate the transition to full cost-recovery for infrastructure services. These efforts deserve strong support as they have considerable potential for overcoming some of the most difficult obstacles to increased private financing for infrastructure projects.

DEVELOPMENT COMMITTEE

JOINT MINISTERIAL COMMITTEE
OF THE
BOARDS OF GOVERNORS OF THE BANK AND THE FUND
ON THE
TRANSFER OF REAL RESOURCES TO DEVELOPING COUNTRIES

1818 H Street, N.W., Washington, D.C. 20433

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April 27, 1995

COMMUNIQUE

1. The 50th meeting of the Development Committee was held in Washington, D.C. on April 27, 1995, under the chairmanship of Mr. Mohamed Kabbaj, Minister of Finance and Foreign Investment of Morocco. 1/ The Committee expressed its deep regret at the departure of Mr. Lewis T. Preston and recorded its great appreciation of his distinguished leadership as President of the World Bank. It offered its congratulations to his successor, Mr. James D. Wolfensohn.

Resource Flows to Developing and Transition Countries

2. The Committee welcomed the continued high level of total resource flows, and the increase since 1990 in various forms of private finance, especially foreign direct investment which does not add to debt-servicing burdens. At a time of rapid globalization and liberalization of financial markets, it noted the recent high volatility of financial flows, as exemplified by currency movements. But portfolio flows have declined, and Ministers recognized that markets are likely to be more selective in their provision of such capital. This emphasizes the need for recipient countries to follow sound macro-economic policies to gain or maintain access to private markets, and to mobilize significant domestic savings. They should avoid excessive reliance on short-term flows to finance longer-term development needs. The strong policy base and solid long-term prospects of many developing and transition countries suggest that they should be able to attract continued foreign direct investment.

1/ Mr. Michel Camdessus, Managing Director of the International Monetary Fund, Mr. Gautam S. Kaji, Acting President of the World Bank, Mr. N'Goran Niamien (Côte d'Ivoire), Chairman of the Group of 24 and Mr. Peter Mountfield, Executive Secretary took part in the meeting. Observers from a number of international and regional organizations, and Mr. Abdlatif Y. Al-Hamad, Chairman, and Mr. W.A. Wapenhans, Secretary of the Task Force on Multilateral Development Banks also attended.

3. The Committee expressed its concern about the prospect of a fall in total official development assistance. Given the pressing needs of the poorest countries, it urged continued strong support for the International Development Association (IDA) and for the Special Program of Assistance for Africa (SPA). It welcomed the recent agreement in the Paris Club to implement "Naples Terms" for the poorest and most-heavily-indebted countries, and called for them to be applied flexibly. The Committee noted that some of these countries have a heavy burden of debt owed to multilateral institutions. It invited the Executive Boards of the World Bank and the IMF to continue their review of this subject, so that Ministers can return to it at the next meeting.

Trade

4. The Committee welcomed the establishment on January 1 of the World Trade Organization (WTO) and urged close collaboration between the WTO and the Bretton Woods institutions. It called on the Bank and Fund to assist those countries which are not yet members of the WTO to join the organization and to become more fully integrated into the multilateral trading system. It noted the Bank's new estimates of the likely impact of the Uruguay Round upon the trade of developing countries. It welcomed evidence of the positive effect the Round will have on most developing countries, especially on those who are taking this opportunity to reform their own policies. It noted the Bank's view that the adverse impact upon food-importing countries and those which will lose preferential access to industrial markets is likely to be small. It asked the Bank and Fund to monitor the impact on individual countries and to be prepared to help as necessary. It agreed that further liberalization of the agricultural and service sectors would provide important additional gains.

Infrastructure

5. The Committee noted that developing countries currently invest over $200 billion a year in infrastructure, more than 90% of it in the public sector. Adequate, efficient and carefully designed infrastructure with full regard to the environment is crucial to sustainable development. More investment and improved performance in infrastructure will require a series of reforms in the structure and delivery of services. Governments have a continuing responsibility, whether as providers or regulators of infrastructure. In particular, efficiency requires prices which reflect all long-run economic costs, more business-like management, increased involvement of the private sector, and better-targeted subsidies. Such reforms should be designed to increase incentives to devote sufficient resources to maintenance, in order to make best use of existing assets and reduce the need for expensive replacements.

6. Improvement will also involve more use of private finance in various forms. The options chosen will vary for each country and service depending on conditions such as level of domestic savings and the depth of financial markets. Private participation can be encouraged through build-own-operate and build-own-operate-transfer concessions, leases, operating contracts, partial guarantees from the public sector, and privatization. The aim must be to pass the commercial risks to the private sector and to reduce the call on public funding and public guarantees.

7. The Committee agreed that the poor stand to gain directly and quickly from better infrastructure, which can also help to improve environmental conditions. Donor countries can help the poorest countries by providing financial and technical support, and investment guarantees for the development of infrastructure within a policy framework that encourages efficient operation, maintenance, and responsiveness to users. The multilateral institutions (including IDA) have a major responsibility for providing advice and financial support. They can also play a catalytic role in mobilizing funds from a wider range of private sector sources, using all the means available, including World Bank guarantees, IFC and MIGA.

Social Summit

8. The Committee generally welcomed the outcome of the recent Social Summit in Copenhagen, and agreed to discuss the implications for the developing and transition countries, and for donors and the Bank and Fund, at its next meeting in Washington DC on October 9, 1995.

Executive Secretary

9. The Committee expressed its deep appreciation to Peter Mountfield, the retiring Executive Secretary, for his dedicated service to the Committee over the past four years.

DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
on the
Transfer of Real Resources to Developing Countries)

FOR OFFICIAL USE ONLY

DC/95-1 (Rev.)

April 7, 1995

NOTICE OF MEETING

The 50th meeting of the Development Committee well be held on Thursday, April 27, 1995, commencing at 9.00 a.m. in the Meeting Hall of the International Monetary Fund, Washington, DC.

PROVISIONAL AGENDA

1. Financing of Infrastructure in Developing Countries 1/

2. Other Business

1/ Issues paper, prepared by the staff of the World Bank in consultation with the Fund staff, as requested in the October 1994 Communique. See also "Increasing the Supply of Bankable Infrastructure Projects in Developing Countries" by the Institute for International Finance and a paper about Moroccan experience. There will also be a report by the President of the World Bank and a statement by the Managing Director of the IMF on the World Economic Situation and Economic Trends in Developing Countries.

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MEMBERS OF THE DEVELOPMENT COMMITTEE

List of Countries Represented by them and their Executive Directors at the World Bank and the International Monetary Fund

(As of April 26, 1995)

Group No.	Members	Executive Directors	Countries
1.	Mohammad Abalkhail Minister of Finance and National Economy Saudi Arabia	Ibrahim A. Al-Assaf (Bank) Muhammad Al-Jasser (Fund)	Saudi Arabia
2.	Ibrahim Abdul Karim Minister of Finance and National Economy Bahrain	Faisal Abdulrazak Al-Khaled (Bank) A. Shakour Shaalan (Fund)	Bahrain, Egypt, Jordan, Kuwait, Lebanon, Socialist People's Libyan Arab Jamahiriya, Maldives, Oman, Qatar, Syrian Arab Republic, United Arab Emirates, Republic of Yemen
3.	Edmond Alphandery Minister of Economy France Alternate Member Christian Noyer Director of the Treasury Ministry of Economy France	Marc-Antoine Autheman (Bank and Fund)	France
4.	Anthony A. Ani Minister of Finance Nigeria	Harry M. Mapondo (Bank) Barnabas S. Dlamini (Fund)	Angola, Botswana, Burundi, Eritrea, Ethiopia, The Gambia, Guinea, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Seychelles, Sierra Leone, Sudan, Swaziland, Tanzania, Uganda, Zambia, Zimbabwe
5.	Anwar Ibrahim Minister of Finance Malaysia Alternate Member Clifford F. Herbert Secretary-General to the Treasury Ministry of Finance Malaysia	Suwan Pasugswad (Bank) J.E. Ismael (Fund)	Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Nepal, Singapore, Thailand, Tonga, Viet Nam
6.	Orlando Bareiro Aguilera Minister of Finance Paraguay	Julio Nogues (Bank) Carlos Saito (Fund)	Argentina, Bolivia, Chile, Paraguay, Peru, Uruguay

	Members	Executive Directors	Countries
7.	Franz Blankart Secretary of State, Director Federal Office for Foreign Economic Affairs Switzerland	Jean-Daniel Gerber (Bank) Daniel Kaeser (Fund)	Azerbaijan, Kyrgyz Republic, Poland, Switzerland, Republic of Tajikistan, Turkmenistan, Uzbekistan
8.	Anatoli Chubais First Deputy Chairman Russian Federation	Andrei Bugrov (Bank) Dmitri Tulin (Fund)	Russian Federation
9.	Kenneth Clarke Chancellor of the Exchequer United Kingdom	Huw Evans (Bank and Fund)	United Kingdom
10.	Roberto F. de Ocampo Secretary of Finance Philippines	Marcos C. de Paiva (Bank) Alexandre Kafka (Fund)	Brazil, Colombia, Dominican Republic, Ecuador, Haiti, Philippines, Suriname, Trinidad and Tobago
11.	Lamberto Dini Prime Minister and Minister of the Treasury Italy Alternate Member Antonio Fazio Governor Banca d'Italia Italy	Enzo R. Grilli (Bank) Giulio Lanciotti (Fund)	Albania, Greece, Italy, Malta, Portugal
12.	Mohamed Kabbaj (Chairman) Minister of Finance and Foreign Investment Morocco Alternate for the Chairman Mohamed Seqat Governor Bank Al-Maghrib Morocco	Abdul Karim Lodhi (Bank) Abbas Mirakhor (Fund)	Islamic State of Afghanistan, Algeria, Ghana, Islamic Republic of Iran, Morocco, Pakistan, Tunisia

Members	Executive Directors	Countries
13. Liu Zhongli Minister of Finance China Alternate Member Jin Renqing Vice Minister of Finance China	Zhang Shengman (Bank) Zhang Ming (Fund)	China
14. Paul Martin Minister of Finance Canada	Leonard Good (Bank) Ian D. Clark (Fund)	Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Guyana, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines
15. Philippe Maystadt Minister of Finance Belgium	Walter Rill (Bank) Willy Kiekens (Fund)	Austria, Belarus, Belgium, Czech Republic, Hungary, Kazakhstan, Luxembourg, Slovak Republic, Slovenia, Turkey
16. N'Goran Niamien Minister Delegate to the Prime Minister in charge of Economy, Finance, Commerce and Planning Cote d'Ivoire	Ali Bourhane (Bank) Yves-Marie T. Koissy (Fund)	Benin, Burkina Faso, Cameroon, Cape Verde, Central African Republic, Chad, Comoros, Republic of Congo, Cote d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea-Bissau, Republic of Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, Sao Tome and Principe, Senegal, Togo, Zaire
17. Robert E. Rubin Secretary of the Treasury United States	Jan Piercy (Bank) Karin Lissakers (Fund)	United States
18. Manmohan Singh Minister of Finance India	Bimal Jalan (Bank) K.P. Geethakrishnan (Fund)	Bangladesh, Bhutan, India, Sri Lanka

Members	Executive Directors	Countries
19. Pedro Solbes Minister of Economy and Finance Spain Alternate Member Alfredo Pastor Secretary of State for Economy Ministry of Economy and Finance Spain	Jorge Terrazas (Bank) Luis E. Berrizbeitia (Fund)	Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Spain, Venezuela
20. Carl-Dieter Spranger Federal Minister for Economic Cooperation and Development Germany	Fritz Fischer (Bank) Stefan Schoenberg (Fund)	Germany
21. Masayoshi Takemura Minister of Finance Japan	Yasuyuki Kawahara (Bank) Hachiro Mesaki (Fund)	Japan
22. Iiro Viinanen Minister of Finance Finland	Ruth Jacoby (Bank) Jarle Bergo (Fund)	Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, Sweden
23. Ralph Willis Treasurer Australia Alternate Member George Gear Assistant Treasurer Australia	John H. Cosgrove (Bank) Ewen L. Waterman (Fund)	Australia, Cambodia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, New Zealand, Papua New Guinea, Solomon Islands, Vanuatu, Western Samoa
24. Gerrit Zalm Minister of Finance Netherlands Alternate Member J.P. Pronk Minister for Development Cooperation Ministry of Foreign Affairs Netherlands	Eveline Herfkens (Bank) J. de Beaufort Wijnholds (Fund)	Armenia, Bulgaria, Croatia, Cyprus, Georgia, Israel, Former Yugoslav Republic of Macedonia, Moldova, Netherlands, Romania, Ukraine

* Alternate Members are those who attended the Meeting of the Committee for their Members.

APPENDIX C: OBSERVERS OF THE DEVELOPMENT COMMITTEE

African Development Bank	(AfDB)
Associate: Arab Bank for Economic Development in Africa	(BADEA)
Arab Fund for Economic and Social Development	(AFESD)
Arab Monetary Fund	(AMF)
Asian Development Bank	(AsDB)
Commission of the European Communities	(CEC)
Commonwealth Secretariat	(COMSEC)
European Investment Bank	(EIB)
European Bank for Reconstruction and Development	(ERBD)
The Cooperation Council for the Arab States of the Gulf (Gulf Cooperation Council)	(GCC)
Inter-American Development Bank	(IDB)
International Fund for Agricultural Development	(IFAD)
Islamic Development Bank	(IsDB)
Organization for Economic Co-operation and Development	(OECD)
Associate: Development Assistance Committee	(DAC)
OPEC Fund for International Development	(OPEC FUND)
United Nations	(UN)
Associates: United Nations Conference on Trade and Development	(UNCTAD)
United Nations Development Program	(UNDP)
World Trade Organization	(WTO)

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Development Committee
(Joint Ministerial Committee of the Boards of Governors
of the World Bank and the International Monetary Fund
on the Transfer of Real Resources to Developing Countries)

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