

Building on the Monterrey Consensus: The Untapped Potential of Development Finance Institutions to Catalyse Private Investment



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Financing for Development Initiative
in partnership with



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Preface

The World Economic Forum is pleased to issue this summary report of our Financing for Development Initiative, which has been undertaken in partnership with the United Nations Department of Economic and Social Affairs (UNDESA) and the Swiss Agency for Development and Cooperation (SDC).

The UN-sponsored International Conference on Financing for Development in Monterrey, Mexico, in 2002 concluded that greater cooperation between public and private actors will be required to overcome the inadequacies of development finance and achieve internationally agreed development goals. As a follow-up to the so-called Monterrey Consensus, the World Economic Forum organized a series of multistakeholder expert consultations to identify where opportunities and obstacles lie in two areas that appear particularly ripe for deeper public-private collaboration: 1) adapting multilateral development banks (MDBs) and bilateral aid agencies to the challenge of catalysing greater domestic and foreign private investment in developing countries; and 2) harnessing public-private partnerships as vehicles to extend the reach and effectiveness of development assistance.

The public-private partnership segment of this project released its report in September 2005 on the occasion of the United Nations 2005 World Summit in New York. This second report summarizes the recommendations developed in the private investment segment of the project, which included three two-day public-private roundtables in São Paulo, Hong Kong and New York, and innumerable bilateral consultations. In all, over 200 experts from financial institutions, other corporations, governments, international organizations, universities and non-governmental organizations from around the world contributed their views, submitting over 75 written proposals aimed at improving the effectiveness of official sector efforts to stimulate private investment in developing countries.

There continues to be important work for the development agencies in their traditional mode of operation – strong analytical and advisory work on key policy issues at global and country level, direct lending to public institutions for strengthening essential services such as education and health and providing other “global public goods”. In the poorest

and least creditworthy countries, direct official lending and grants to the public sector are likely to continue to be the primary vehicles for addressing development needs.

However, the thrust of this report is that in most developing countries there is enormous untapped potential for greater involvement of private markets, international and domestic, in meeting needs for development-oriented investments in infrastructure and other areas. There was a consensus among participants that development finance institutions such as the MDBs and bilateral aid agencies have the power to do much more to help unlock that potential through a range of actions, including more purposeful efforts to develop and promote user-friendly risk mitigation products, especially in the areas of regulatory and contractual risk mitigation, as well as a stronger focus on support for the development of domestic capital markets. Continued failure of these institutions to take proper advantage of this opportunity is likely to render them much less relevant in large areas of the developing world and to call into question their effectiveness as stewards of a large share of total official development assistance.

We would like to thank our partner, UNDESA, its Financing for Development Office and the SDC for their foresight and cooperation in working with the Forum to structure this project. In particular, Undersecretary General Jose Antonio Ocampo, Ambassador Oscar de Rojas, and their colleagues, Alex Trepelkov and Krishnan Sharma, have played important roles, as have Regis Avanthay, Head, SDC Global Issues and Sustainable Development Division and his colleague, Pascal Raess.

We would like to express our appreciation to Barbara Samuels, who directed this segment of the project and also serves as Project Director of the United Nations Financing for Development Steering Group of Business Interlocutors, as well as other members of the project team, including David de Ferranti, Senior Fellow of the United Nations Foundation, who provided important support in the drafting of the report; Stefanie Held, Senior Project Manager of the Initiative; Preeti Sinha, Global Leadership Fellow; and Mitch Strohming, Director of Research for the Global Clearinghouse. We also would like to acknowledge special input from

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Mahesh Kotecha, President of Structured Credit International and the Infrastructure Experts Group (www.infradev.org) for sharing their work and helping on a continuous basis over the last 18 months to refine the recommendations set forth here.

Finally, we would like to thank all of the expert participants in the roundtables and associated bilateral consultations. Above all, this report seeks to give voice to the experience of public and private sector practitioners. Their candour, technical knowledge, enthusiasm and willingness to contribute were the most essential elements in defining the project's findings and summary recommendations. Study participants were enormously generous and hardworking, contributing over 75 proposals as acknowledged in Appendix H. A number of participants also provided more extensive support, many throughout the full course of the project: Richard Frank; CEO of Darby Overseas Investment; Bob Sheppard, Co-Chair of the Infrastructure Experts Group and Managing Director, J.R. Sheppard & Company, LLC; Tom Cochran, former Director of Insured Portfolio Management and Global Public Finance, MBIA Insurance Corporation and Managing Director, CivilCredit Advisors LLC; Norman Anderson, President and CEO, CG/LA Infrastructure; Diana Smallridge, President, International Financial Consulting; Jon Haddon, Orrick Herrington & Sutcliffe; Thomas Felsberg, Managing Director, Felsberg and Associates, Brazil; John Wasielewski, Director, USAID Office of Development Credit; Bob Bestani, Director, Private Sector Department, Asian Development Bank; Dr. Sailendra Narain, Chairman, Centre for SME Growth and Development Finance; Valentino Gallo, Managing Director, Export and Agency Finance, Citigroup; Regina Nunes, Managing

Director, Standard & Poor's Brazil; Daniel Sonder, Director, Secretaria de Estado dos Negocios da Fazenda, Estado do Sao Paulo, Brazil; and James Winpenny, consultant & former Secretary, World Panel on Financing Water Infrastructure. Although this report reflects the project team's best efforts to interpret the thrust of expert views, not every project participant necessarily agrees with each of the findings and recommendations. Nor does the report represent an institutional position of the Forum or its members.

The Monterrey Consensus provides a solid foundation for thinking about how the international community could organize itself to mobilize the additional finance necessary for the achievement of common development objectives. We hope that this report contributes to a better understanding of the role that development finance institutions can play in this endeavour.



Richard Samans
Managing Director
World Economic Forum

April 2006

The Untapped Potential of Development Finance Institutions to Catalyse Private Investment

I. The Changed Context of Development Finance

Development finance institutions (DFIs) – i.e., the World Bank Group as well as regional development banks (RDBs) and bilateral donor agencies – are operating in a capital market environment much changed since these institutions became fully operational in the 1950s to 1970s. In particular, growth in the scale of private capital markets has been one of the most dramatic changes in the world economy over recent decades. In overall terms, the International Monetary Fund (IMF) reports that, by 2003, the value of global capital markets (defined to include stock market capitalization plus the value of total debt securities plus bank assets) had increased to US\$ 130 trillion, or 360% of global GDP.¹

Today there is much greater potential availability of private capital in many developing countries, particularly the 94 classified by the World Bank as middle income. Though still only a relatively small proportion of total private capital volumes, international flows to developing countries have shown dramatic changes over the past 30 years. Between 1970 and 1980, net private flows had increased almost tenfold, to US\$ 51 billion, or more than 50% above official flows. The early 1990s witnessed a fresh expansion of private flows to developing countries. From an annual US\$ 42 billion in 1990, net private flows to developing countries exceeded US\$ 178 billion in 1995 and reached a peak of over US\$ 275 billion in 1997, by which time they were close to eight times the size of official net flows. Macroeconomic problems were to trigger at least a temporary cooling off. With the emergence of macro-financial crises in such key emerging markets as Russia, East Asia, Brazil, Turkey and Argentina, the markets again went into reverse. Net private flows to developing countries, running at US\$ 263 billion in 1998, fell successively each year until bottoming out at US\$ 160 billion in 2002 and rising since then to an estimated \$301 billion. Notwithstanding year-to-year variations in the statistics, capital markets in developed countries are widely reported as being underinvested in developing countries. For example, in 2004 the US market had almost US\$ 13 trillion under management, with only 1.7% (\$222 billion) invested in foreign securities.²

Private capital markets are, of course, concentrated primarily in the more advanced OECD countries, with the EU accounting for 36% of the total and the US for 31%. The domestic capital markets of the emerging market countries are much smaller in aggregate terms, accounting in total for about US\$ 15 trillion in capital value, or 11.6% of the world total. Nonetheless, by comparison to the size of the national economies concerned, these domestic savings pools can be quite substantial, especially in the more advanced of the developing countries. In the Asian “emerging market” countries, in particular, the value of the domestic capital market is equivalent to 262% of GDP, and in Latin America to 135% of GDP.

Yet, enormous investment gaps persist in both middle and low income countries. According to recent World Bank analyses, the infrastructure investment needed to keep up with projected growth in the developing world is estimated as equivalent to an average of 5.5% of the developing countries’ annual GDP (with above-average needs in some of the lowest income countries). Currently, however, the public sector, which on average accounts for about three-quarters of all infrastructure investments, is spending only around 2 to 4% of GDP on infrastructure. Investment levels are generally higher in East Asia, but Latin American governments are estimated to be investing an average of only 1.6% of GDP, and those in Africa, where typical needs are especially high, just 2-3% on average. These infrastructure deficits have serious long-term implications: it is estimated that increasing Latin America’s infrastructure to the typical level in East Asia would contribute an additional 1.4-1.8% in annual GDP growth and reduce income inequality by 10 to 20%.³

Other sources supplement these estimates of aggregate needs with sector- or country-specific data. The Camdessus Report on water and sanitation in developing countries, issued in 2003, estimated developing countries’ investment needs in water and sanitation at US\$ 49 billion annually between 2001 and 2015. The International Energy Agency (IEA) has estimated these countries’ annual requirements in the electric power sector at as much as US\$ 120 billion. Meanwhile, a joint study by the Asian Development Bank (ADB), Japan Bank for

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International Cooperation (JBIC) and the World Bank, released in March 2005, estimated infrastructure investment needs in 21 developing countries in East Asia at US\$ 200 billion a year over the next five years, with China accounting for 80% of the total.⁴

The UN Millennium Project (UNMP) has estimated the Millennium Development Goals (MDGs) financing gap in low income countries to be US\$ 73 billion a year in 2006, rising to US\$ 135 billion annually by 2015; the UNMP estimated the gap in middle income countries at US\$ 10 billion a year. Other studies (by the Zedillo commission, the Development Committee of the Governors of the Bretton Woods institutions, and others) have produced varying estimates, but they tend to agree on the need for annual increases in financing of at least US\$ 50 billion.⁵

Despite these huge unmet investment needs, lending by multilateral development banks as a group, and the World Bank in particular, has fallen and is well below the potential permitted by their capital structures.

In the case of the World Bank, International Bank for Reconstruction and Development (IBRD) lending peaked in fiscal year 1999 (FY99) at US\$ 22.1 billion. This and FY98 (US\$ 21.1 billion) were, it should be noted, atypical years, with exceptionally high demand for emergency lending resulting from the East Asian and other economic crises. Looking at more “normal” years, IBRD had been committing about US\$ 14.5 billion a year in the mid-1990s before the onset of the crises. By contrast, the average of new commitments over the last five years (FY01-05) has been less than US\$ 11.6 billion, or some 20% down on lending in the mid-1990s.

Various explanations have been offered for the decline in aggregate multilateral lending, seen especially in the case of the IBRD (and the lack of significant growth on the part of the lending of the RDBs). However, the decline in overall multilateral resource mobilization must also be understood as a missed opportunity to help borrowing countries increase their investment in development-oriented assets. This is exemplified by the record on MDB lending for infrastructure over the same period.

Within overall MDB lending, lending for infrastructure fell faster than the total – especially in the case of the World Bank. Historically, the mainstay of the World Bank’s lending programme, at around 40% of total lending, infrastructure had declined to 21% of the total by 1999. In absolute terms, IBRD infrastructure lending fell from over US\$ 7 billion in 1993 to around US\$ 2 billion in 2002 increasing to US\$ 4.4 bn or 33% of the total in 2004. The trend among the regional banks, overall, was much less pronounced or systematic than at the World Bank. The total commitments to infrastructure of nine multilateral institutions (including the World Bank and the RDBs) declined from an annual average of US\$ 17.5 billion over 1995-1997 to an average US\$ 15.4 billion over 2000-2002.⁶ However, initiatives introduced two years ago under the World Bank Middle-Income Countries (MIC) action plan and the so-called Modernization and Simplification agenda, along with the Infrastructure Action Plan, are beginning to have a tangible impact on the volume of lending approvals to MICs. IBRD lending to MICs in FY05 has increased by 38 percent, primarily concentrated in South Asia, Europe and Central Asia. Lending approvals to India doubled, partially due to the post-tsunami reponse. It is expected that this trend will continue in the current FY.

As a result of lower MDB lending levels for several years and increases in capital, the amount of unused capital in these institutions has increased substantially relative to lending ceilings governed by their statutory capital gearing ratios and now approaches US\$ 181 billion.

In the World Bank alone there was up to US\$ 78 billion of unused capacity as of year-end 2004, with outstandings decreasing 11% over the last five years from US\$ 120 billion in 2000 to US\$ 110 billion in 2004. The capital of regional development banks is also underutilized, with aggregate unused capacity at year-end 2004 up to US\$ 103 billion.⁷ In other words, these institutions find themselves in the paradoxical position of deploying less and less of their resources at a time of when taxpayers in donor countries are being called upon to commit more and more of their national budgets to poverty alleviation.

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Reduced (albeit recovering) MDB lending activity and substantial unused capital raises questions about the ongoing role and priorities of MDBs in many countries where average incomes have risen to the point that governments no longer qualify for concessional finance but widespread poverty persists. It also raises uncomfortable questions about the effectiveness of this important component of worldwide official development assistance at a time when much greater attention is being paid to aid effectiveness.

The recent debate on effectiveness has focused on projects rather than the activities of development finance intermediaries like the MDBs. However, the unused capital committed to these intermediaries represents over 200% of global annual official development assistance (ODA). As such, questions about how to maximize the size of the payoff to economic development from the capital committed to them would appear to deserve a much more central place in this discussion than they have enjoyed to date.

II. General Findings and Recommendations

The needs of developing countries for support, both financial and technical, remain enormous – and far beyond the resources that the countries themselves and the official agencies (MDBs and bilaterals) can directly mobilize themselves. At the same time, compared with the world of closed national capital markets envisaged by the World Bank's founders, and to some degree experienced during the first post-War decades, the development, expansion and globalization of private capital markets since 1980 has created huge pools of internationally mobile private funds. These private flows hold considerable potential to help meet the less developed countries' requirements for increased investment and improved technology. But the full potential of the world's private capital markets to help finance development is not being captured.

A limited number of developing countries have succeeded in attracting substantial volumes of private flows, domestic and/or international, into development-oriented investments. However, the experience of the past 15 years shows that private capital mobilization for development-oriented investments has been:

- uneven (concentrated in a relatively small number of middle income countries);
- unreliable (sensitive to macroeconomic stresses and to difficulties with domestic regulatory policy environments); and
- inadequate (in quantitative terms, judged against the needs).

In the past decade, there has been considerable debate about the reform of aspects of the international financial architecture concerning low income and heavily indebted countries. But relatively little attention has been paid to middle income country issues and, more broadly, how the public capital deployed in multilateral and bilateral development finance institutions can best be used to catalyse much larger amounts of domestic and foreign private investment in countries where in principle such investment should be attractive because of prevailing and projected levels of economic activity and household income. Indeed, one prominent review of this question (a US Congressional Commission known after its chairman as the Meltzer Commission) argued in its majority report in 2000 for phasing out all World Bank lending to countries enjoying investment grade access to financial markets or per capita GDP of above US\$ 4,000 (and restricting lending to those with GDP of above US\$ 2,500).⁸

There remains a critical role for MDBs to make direct loans and grants, and provide policy advice. But given the potential availability of private capital in most developing countries as well as the sheer scale of investment needed to fulfil the MDG targets and infrastructure requirements in them, the overwhelming majority of the more than 200 expert participants in this project took the view that the weight of DFI activities should shift over time from direct lending to facilitating the mobilization of resources from the world's large private savings pools – international and domestic – for development-oriented investments through:

- wider use of risk mitigation instruments to alleviate part of the risk faced by investors; and
- stronger direct support for capacity building to strengthen the enabling environment for investment.

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These have become the priority development finance needs in all but the poorest least developing countries' communities. However, MDBs and bilateral aid agencies have not adapted sufficiently to these changed circumstances, as evidenced by declining MDB loan activity and growing capital headroom. In the language of the private sector, their value proposition has not kept pace with changes in client demand. **Project participants felt that the proper response would not be for the DFIs to exit this part of the developing world with the job undone (i.e., with the financing gap remaining). They should rather adapt their services, culture and capital allocation to the imperative of "crowding in" domestic and foreign private investment by placing much more emphasis on such risk mitigation instruments as partial guarantees as a transitional strategy and on capacity building in such areas as property rights, contract dispute adjudication, bankruptcy frameworks, accounting and auditing capabilities, corporate governance rules, banking supervision and securities market development as part of long-term strategy to render themselves obsolete only after the development of robust local currency capital market and bank lending institutions.**

In recent years, some DFIs have increased experimentation with risk mitigation services and begun to devote greater resources to building public and private institutional capacity in poor countries, but these steps have been modest relative to need and have not been assigned a priority by top management or shareholder governments. In the meantime, an international consensus has emerged, embodied by the Monterrey Consensus, that a deeper partnership between the public and private sectors is needed if we are to achieve common development objectives. These two areas (risk mitigation and capacity building) are particularly ripe for such deeper cooperation.

III. Specific Recommendations

The challenge for the management and shareholders of MDBs now is to develop, as a matter of priority and urgency, concrete strategies for overcoming the obstacles that stand in the way of a fundamental shift in their modus operandi, towards a model that sees the promotion of private investment in development as central to their mission. Doing so

will require looking objectively at existing policies, organizational models and incentive structures to identify the key constraints and develop specific recipes for change, while mobilizing shareholder buy-in for the changes required.

The implications of this are that change needs to come to the World Bank Group and also to the major regional banks – especially those in Asia and Latin America. The European Bank for Reconstruction and Development (EBRD), the youngest of the banks, has from its inception been more attuned to a private sector-led model, while the African Development Bank (AfDB) focuses on some of the least developed countries. There are also lessons for the larger bilaterals.

This report summarizes recommendations in five areas deemed by project participants to be most crucial. Some of these changes are likely to prove difficult initially. In this context, it may be more feasible for one of the institutions to take the lead and show the way than to try to negotiate change on a multi-agency basis. The World Bank has traditionally occupied a *primus inter pares* position among the MDBs, and would appear to be the logical choice to lead the way in the kind of transformation in view of its larger scale and global reach. However, some bilateral aid agencies and regional development banks have just as strong a claim to leadership on the basis of the important innovation they have already undertaken in this domain.

A) Reorient Culture, Capital and Skills

Nearly across the board, expert participants in the project recommended that the world's development finance institutions and their shareholder governments take more seriously the task of using their resources to stimulate private investment. For this to happen, they concluded that significant changes will be needed in how these agencies perceive their role and shape their management strategies, products and, most of all, internal cultures. The recent appointment of new presidents to four of the five major multilateral development banks and the high-profile push in 2005 by donor governments to increase aid volumes and efficiency present an unparalleled opportunity for change in this direction in 2006-2007.

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Institutions that traditionally have been lenders to sovereigns must transform themselves also into catalysts, mediators and facilitators at the sovereign, sub-sovereign and regional levels. They must see themselves fundamentally as providing bridges to private sector financing, and this should become their primary operational ethos in all but the lowest income countries. In this respect, they need to understand that the value they create in these markets derives principally from their superior capacity as official institutions to understand and indeed shape country investment environments and diversify risks across sectors and countries. Their explicit responsibility is to catalyse private sector resources to expand private sector activity, applying financial and technical expertise to specific sectors and deals in which the private sector has an interest in providing the large majority of the necessary financing but not necessarily all of it given the attendant risks.

“Lip service to private sector development is what happens today. Just saying it, having reports, or having a few official programs focused on private sector development is not sufficient. Private sector development cannot happen on a meaningful scale with results without a true partnership every step of the way, from diagnosing problems and solutions to implementation...”

Navigating the transition from direct lender of official funds to innovative enabler of private investment will require a minor revolution in the culture and processes of development institutions, which have historically focused on transactions with governmental entities, as success will increasingly need to be measured by the market, i.e., by the extent to which private investors, both domestic and international, perceive their services and transaction costs as competitive and attractive. Participants recommended the following:

- **DFI boards should signal the importance of change by shifting capital, staff resources and senior management attention to the parts of their institutions responsible for private investment risk mitigation and capacity building.** The growing capital headroom in the MDBs indicates that they do not face a current capital constraint; the problem is instead a misallocation of capital and lack of coordination among the private sector development activities of the various institutions. The ultimate responsibility to remedy these problems lies with the boards. Specifically:

- **In the World Bank Group, capital should be shifted to the complex of activities managed mainly by the International Finance Corporation (IFC).** A significant shift should occur immediately to signal to Bank management and staff the depth of commitment of shareholder governments to private sector development and to encourage a commensurate shift in staff resources and management attention. Further reallocations should follow in the years to come, as more developing countries graduate to the stage of preferring facilitation of private investment to official loans. Parallel steps should be taken in RDBs such that over time the weight of the MDB community’s financial activity and human capital comes to reflect the mission of catalysing domestic and external private investment through the selective assumption of risks in specific transactions and the sustained provision of capacity-building assistance to domestic legal, banking, securities, corporate governance and auditing institutions.
- **Shareholder governments should request a senior-level, cross-MDB Risk Mitigation Task Force to improve the strength and coordination of the private sector guarantee, insurance and related activities of these institutions.** Expert participants in the project cited examples of duplicative marketing efforts, even within the same institution. Work is reportedly underway to improve the coordination of the Multilateral Investment Guarantee Agency (MIGA), IFC and IBRD activities in this respect, and this effort should receive strong support. Private sector representatives should be included in this process.
- **The IFC’s for-profit culture and the role of its board should be re-examined and reformed.** As the principal arm of the World Bank Group responsible for stimulating private investment in poor countries, the IFC is the best equipped DFI for carrying out the agenda outlined in this report. But while it performs many of the functions stressed in this report quite well (if not at sufficient scale), there was a widespread impression among expert project participants that it has an insufficient appetite for risk given its mission as a development

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institution. This undue conservatism is manifested in often complicated and time-consuming deal approval procedures that decrease private investor interest in its products. It sometimes fosters the impression that the IFC is competing with rather than enabling, private banks and funds by assuming some of the more difficult risks these institutions will not accept and that an official multilateral institution is in a better position to manage because of its understanding of, and potential influence over, the regulatory or macroeconomic policy environment. The boards, at the World Bank and at MDBs more generally, are part of the problem in that they are widely seen as overstepping the traditional board role of setting frameworks and requiring accountability, occupying an undue proportion of senior management's time in deal-specific and other reviews.

- **Shareholder governments should consider inviting direct input from distinguished private sector experts perhaps in a small advisory committee** for the purpose of strengthening guidance on how to maximize the institutions' engagement with the private sector.
- **DFI management teams should also signal the importance of change to their organizations by personally articulating why it will be necessary to shift over time from an official lending to private sector enabling culture and make corresponding changes in personnel.** Senior leadership of development institutions need to champion this reorientation, refining internal processes and performance evaluation metrics with a view to stimulating innovation, outreach and prudent risk taking as well as promoting capacity-building activities that engage private sector resources and expertise.

“Development institutions need to change just as commercial banks did, moving from holding assets to being intermediaries with capital markets, decentralizing decision-making to experts within risk management guidelines, and enhancing market intelligence.”

- **The “lending culture”** of MDBs first attracted wider attention through the so-called Wapenhans report, prepared in 1992 by a former vice-president who had been commissioned to assess a trend, evident in the Bank's own data, for declining quality of

average project performance. Wapenhans crystallized a critique, which others had made less formally, in suggesting that the Bank's management information systems and incentives – reflecting patterns dating in some cases from the McNamara years (1968-81) – attached special importance to meeting quantitative lending targets to the Bank's different clients, and that other considerations, such as the quality of the projects involved, might receive less management attention or recognition via the internal career path. Although the Bank responded to the Wapenhans report with a variety of initiatives to increase attention to quality, with some positive impact according to the institution's autonomous evaluation department, many Bank insiders recognize the diagnosis of a lending culture as continuing to have some validity. Participants in the consultations invoked the lending culture as part of the possible explanation for the MDBs' failure to aggressively develop alternatives to direct lending – such as guarantees.

- **Management should reinforce the mandate for risk taking.** Traditional internal risk management processes (for example, internal treatment of guarantees and “zero loss” guidelines for private sector loans and investments) have the unintended effect of encouraging competition with the private sector, rather than facilitating the catalytic role of heralding new transactions with demonstration effects. Risk management processes need to be modified to enable targeted assumption of risks within acceptable risk guidelines, and differentiated treatment of risk mitigation products against country limits, budgets, capital and other internal processes. Clear senior management authorization and support for the legitimacy and value of targeted risk assumption is a prerequisite for successful large-scale private sector engagement.
- **New internal incentives and performance metrics should be established that align staff activity, training and promotion prospects with the mission of private sector engagement and prioritization of development impact over profitability.** Current performance indicators do not sufficiently take account of, or reward, the amount of private sector investment enabled

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through official sector programmes. Indeed, ODA statistics reported to the Development Assistance Committee (DAC) do not include guarantees as part of ODA targets.⁹ Examples of approaches that management teams should consider are Official Sector Leverage Indicators (measuring the amount of private sector capital mobilized by each donor's risk mitigation programmes, total cost and loss); Transaction Effectiveness Indicators (such as the number of transactions completed, transaction costs, time periods for approval, development impact and client evaluations); Business Engagement Performance Indicators (number and types of activities with business organizations and firms, anonymous evaluations, etc.); and Capacity-Building Indicators (such as extent and diversity of private sector involvement, types of information resources and toolkits, extent of in-country linkages, client evaluations, etc.). These new incentives and performance metrics need to drive compensation and promotion decisions, as well as the reformulation of organization structures, reporting requirements and outsourcing decisions.

B) Expand Risk Mitigation Activity

In setting out the IBRD's intended purposes, the Bank's 1944 Articles of Agreement in fact cited the promotion of private investment via guarantees and participations before referencing the option of direct lending (reserved for cases where private investment was not available on reasonable terms). In the event, guarantees did not feature high among the MDBs' instruments in their early decades. The World Bank's historians indicate one reason: the Bank's management was concerned, in the early years, to establish World Bank bonds as a respected product in financial markets and worried that guarantees issued by different borrowers with a World Bank guarantee might be priced by the markets at different spreads, thereby implicitly weakening the World Bank "brand". In subsequent years, the historians hypothesize that Bank management may have preferred to expand direct lending compared to guarantees out of a view that much of the Bank's contribution resided in the professionalism of the staff and the quality of the project supervision undertaken for direct loans, and a fear that this element might be weakened in the case of guarantees.¹⁰

Investors may be interested in protection against many different types of risk, and a variety of products have been developed by both official and private providers.¹¹ The main risks for which cover may be sought are:

- *Political risk.* Political risk instruments date from the 1960s, and are well-established and widely used. They cover war and civil disturbance, expropriation and confiscation, and currency convertibility and transferability. Some agencies have started to offer cover for terrorism (not normally covered by private insurers). Both private and public agencies offer PRIs, and the total cover now outstanding, about US\$ 80 billion, is divided roughly 50:50 between public and private issuers. The best-known multilateral product is that offered by MIGA, which has issued over US\$ 11 billion in policies. MIGA offers cover for both equity and loans. It does not require a sovereign guarantee. MIGA itself operates with a cap of US\$ 200 million per project, though higher amounts of cover can be arranged via syndication. Private issuers are prepared to offer larger amounts of cover than the official agencies. Their policies are typically shorter-term and more costly.
- *Regulatory and contractual risk.* Cover in this area typically includes breach of contract, changes in law, license requirements, approval and consents, obstruction in the process of arbitration, arbitral award following a covered default and non-payment of a termination amount. The product started to be offered from the early 1990s. As individual policies must be tailored to the specific characteristics of each project, this product involves high transactions costs. Most MDBs now offer products in this area, including the World Bank Partial Risk Guarantee (PRG) and MIGA's Breach of Contract Guarantee. However, take-up has been relatively limited to date. In addition to concerns over the high transactions costs and the fact that only loans and not equity are covered, host governments have been concerned that the guarantee would count against their MDB borrowing limits (though in 2005 the World Bank announced that it would switch from counting 100% of the value of guarantees against its internal country lending limits to counting just 25% of their value against those limits). Over 2001-2003, the IFIs covered just 14 projects, to a value of US\$ 976 million.

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– *Credit risk.* Partial Credit Guarantees (PCGs) are the most common form of cover for credit risk. They cover a percentage of the total amount borrowed and can protect against a wide range of events that can cause non-payment, including commercial risk. IFC’s PCG, introduced in 1999, is one of the best-known instruments of this kind. Despite the apparent attraction of this product for improving the creditworthiness of projects, market uptake has been modest. Over 2001-2003, only six IFC credit guarantees were issued for infrastructure, with a total value of US\$ 800 million. The private sector “monoline” insurance companies also offer integrated risk management

products, which include credit risk. *Foreign exchange risk.* Neither official nor private agencies offer explicit cover for foreign exchange risk. As such, investors seeking protection have to use alternative approaches, which include: (i) use of local currency finance; (ii) currency hedging; (iii) government exchange rate guarantees; (iv) indexing tariffs to foreign currency; and (v) devaluation liquidity backstop schemes.

A recent OECD study of development-oriented guarantees provided the summary below of the types of risk and the relevant products that have been offered by official agencies.¹²

Infrastructure Risks and Relevant Risk Mitigation Instruments (RMIs)		
Type of risk	Available RMI	Example
Political, foreign exchange availability	Political risk cover – either specific, part of comprehensive cover, or in a credit guarantee; preferred creditor status	MIGA political risk cover; participations (e.g., B loans)
Credit	PCGs	IFC PCGs; USAID DCA Partial Loan Guarantees
Devaluation	None as such. Local currency guarantees and devaluation liquidity schemes are relevant.	IFC local currency PCG; OPIC Foreign Exchange Liquidity Facility; Guarantco
Commercial	None specifically, but PCGs include this risk among others.	
Project profile	PCGs can lengthen loan tenors to match cash flows.	PCGs
Rate of return	Breach of contract cover can protect tariff covenants; devaluation liquidity schemes protect cash flow following devaluations.	MIGA Breach of Contract cover
Sub-sovereign	Certain RMIs can be offered without a sovereign counter-guarantee (SG); others need SG. Relevant RMI depends on type of risk to be covered.	The following do not need SG: IFC PCG; MIGA PRI; Private sector guarantees from IDB, ADB, AfDB, etc. The following do need SG: IBRD PRG; IBRD PCG; Public sector lending of IDB, ADB.
Contractual and regulatory	Breach of contract cover	World Bank Partial Risk Guarantee; MIGA Breach of Contract cover

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Despite the considerable innovation that has gone into developing the products highlighted in the summary – and the market acceptance of at least some of them, most obviously political risk instruments – their aggregate value has remained relatively modest compared with either official loans or overall private flows. During the two-and-a-half year period of 2001 to mid-2003, the OECD estimates that the major IFIs issued a total of 124 guarantees with a total face value of US\$ 5 billion, equivalent to an annual level of US\$ 2 billion. By comparison, according to the DAC, annual averages of other sources of finance for the period 2000-2002 were: Direct Investment, US\$ 121 billion; Bilateral Development Finance, US\$ 42 billion; Multilateral Development Finance, US\$ 23 billion; Bond Purchases, US\$ 16 billion; and NGO grants, US\$ 11 billion.¹³

The overwhelming majority of expert participants in the project recommended a major expansion of risk mitigation activity by DFIs notwithstanding important notes of caution raised by a few. These concerns related to the fact that financial crises and failed privatisations have soured enthusiasm for engaging the private sector, and the long history of “bailouts” have made policymakers wary of any type of guarantee arrangement that might serve to encourage reckless private sector risk-taking at taxpayer expense. Further, if a country defaults on a donor guaranteed obligation, a donor institution may be required by its operating rules to shut down its entire program for that country, meaning that any new lending and disbursements under approved loans would be prohibited. More generally, extending guarantee programs would mean increasing exposure to projects that are managed by the private sector rather than the governments with whom DFIs have working relationships. Most expert participants believed that these challenges should be addressed openly but that they do not represent an insurmountable problem.

Following are opportunities identified by project participants for expanding the risk mitigation activity of DFIs:

- **Partial first loss guarantees that raise credits to investment grade.** Developing countries often present unacceptable levels of risk and uncertainty that discourage interest from institutional investors such as pension funds, insurance companies and mutual funds (in

developed and developing countries alike) that are restricted to investing mainly in investment-grade assets. There is an important opportunity for the DFIs to provide a bridge between particularly middle income developing countries and this enormous untapped reservoir of capital, taking advantage of the DFIs superior capability to manage risks that are often a function of the government policy of the host country. In addition to expanding the application of such guarantees to specific transactions, project participants urged the creation of broader vehicles that pool partial guarantees and diversify their risks across a large number of transactions spanning industrial sectors and regions. Such partial first-loss guarantees when combined in a deal structure that also includes certain private investment tranches and guarantees have the potential to create capital market access to more risky countries, such as those rated high non-investment grade (BB- to BBB-) as well as others.¹⁴ Two models in particular deserve to be explored and developed by the DFI community as a strategic priority:

- **Multilateral credit insurance facility.** Developed countries have successfully used private sector financial guarantee insurers (monolines) to facilitate the access of sub-national government agencies and private sector infrastructure projects to international and domestic capital markets. Half of municipal debt in the US is insured by monolines, allowing states and local governments to access enormous amounts of low-cost, long-term borrowings from institutional investors.¹⁵ A specific proposal in this regard was discussed in depth over the course of the project’s deliberations.¹⁶
- **Multilateral securitization facility.** A key principal underlying market development is diversification, namely by combining different investments with different cash flow streams, risks and returns; with the combined returns of the assets being sufficient to service the liabilities, the risk of the whole can be less than the sum of its parts. These diversified structures have proven track records largely in developed markets but they also hold promise for enabling developing country borrowers’ access to local and international capital markets.¹⁷ In particular, there is an important initiative to create a new fixed income,

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securitized product called Global Development Bonds (GDBs) which are aimed at mobilizing capital in a systematic manner from international capital markets to finance sustainable development, in particular for critically needed infrastructure projects.¹⁸ This initiative also merits support from DFIs and their shareholders.

- **Products targeted to regulatory and currency risks.** Study after study has repeated the central finding: the principal reasons investors shy away from developing countries are regulatory and currency risks. Key instruments meriting broader application include Foreign Exchange Liquidity Facilities, Regulatory Risk Contingency Facilities, Partial Risk and Credit Guarantees, and Political Risk Insurance.¹⁹
- **Subsidization of infrastructure projects.** Many developing country infrastructure projects for basic services such as water and electricity are simply not commercially viable if they are to provide universal services. The failures with prior infrastructure projects have amply underlined the need to subsidize tariff payments to project sponsors to broaden access to lower income populations, as many potential and deserving recipients simply cannot afford to pay the rates needed to ensure project viability without subsidies. Several innovative structures (such as

“If poor people are to have access to critical services -- such as water, sanitation, and electricity on a large scale -- development institutions need to embrace new ideas and blend their separate grant and private sector functions, using subsidies in targeted ways.”

the World Bank’s Output-Based Aid) have demonstrated how infrastructure projects can be structured so that poor people can have the needed basic services, yet the official sector can still harness the needed private sector capital and expertise.²⁰

- **Inclusion in ODA targets.** The DAC should count guarantees within ODA targets, devoting effort to working through the technical aspects of this question, as well as develop guidelines for the measurement by DFIs of the additional amount of private sector capital the guarantees have mobilized. Even though guarantees do not represent actual official cash flows unless they are paid, their use does result in increased domestic

and international investment that has critical developmental impact. Failure to include guarantees in ODA targets has discouraged bilateral agencies from expanding their application.

C) Expand Support for Local Currency Financing

Beyond the scope for more aggressive MDB promotion of risk mitigation instruments, many participants in the consultations emphasized the importance of steps to promote the development of local capital markets. In principle, domestic savings, when available on a reasonable scale as in some of the middle income countries, can provide a more appropriate source of financing than international markets for long-term funding of infrastructure projects that will generate revenues largely in local currency terms – since the foreign exchange risk is avoided. The volume of such savings is substantial: according to the IMF estimates cited earlier, the value of capital markets in developing countries already exceeds US\$ 15 billion.

The development of domestic pools of long-term savings requires efforts at macroeconomic stabilization, and institutional and regulatory development in fields like pension programmes, the insurance sector, mutual funds and domestic bond development (sovereign, sub-sovereign, corporate). Many informed observers conclude that the MDBs have not devoted the sustained effort – either intellectual or operational – this area deserves. A recent report by the World Bank’s autonomous evaluation department finds that: “the Bank has had an *ad hoc* approach to the priority that capital market development should be given in financial sector reforms, and under what country conditions it is appropriate to support capital markets” and speaks of “the absence of guidelines or good practice on the relevance and priority of capital market development, and under which country conditions.”²¹

Others familiar with the MDBs’ programmes in the financial sector add that, within the World Bank Group, financial sector work, which has been cut back in overall terms in recent years, has been subject to a range of other demands: dealing with banking sector crises on an emergency basis, promoting microcredit and responding to shareholder demands for MDB engagement in the

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anti-money laundering field. The regional banks in turn have not built the core of technical expertise needed to substitute for a more substantive World Bank role. Without stronger impetus from the top, MDB work on domestic capital markets development remains severely underdeveloped. Among the principal recommendations of participants for remedying this problem are:

- **Tenor extension guarantees, partial guarantees, counter-guarantees and interest rate buy downs.** Local currency financing is often not tenable for local borrowers, due to high interest rates and short financing tenors. Project participants recommended aggressive development of official sector instruments that would serve to expand access to local currency capital, extend tenors and bring down interest rates.

“Developing countries are being strangled by the lack of affordable long-term capital.... Growth and job creation cannot be broad-based without widespread access....”

For example, USAID’s Credit Development Authority has pioneered a new programme that has successfully boosted the lending of local banks, with minimal cost and capital.²² The EBRD’s Municipal Finance Facility offers loans and interest subsidies for local government “municipal” entities. EU Phare grant support subsidizes the extension of maturities.²³ In addition, recommendations were made to explicitly use the development institutions such as MIGA to help build the capacity of local in-country development agencies, by offering counter-guarantees, or a South-South Export Credit Agency that would expand local capacity,²⁴ as local development institutions are limited in their ability to assume risks. Developed countries have created government agencies (for example, Export Credit Agencies) that aid their private sector companies by assuming political and other unacceptable risks, but many developing countries have not. Finally, the need to devise ways to bring down unacceptable interest rates was noted (through interest rate buy downs or interest rate liquidity facilities).

- **Swaps funds and local currency bonds.** For developing countries with ample reserves, local currency markets can be increased through the use of cross currency swaps and the issuance of local currency bonds that provide increased access to local currency needed for funding infrastructure projects, local companies and overall economic growth. The Asian Development Bank (ADB) recently introduced a cross-currency swap mechanism in which it swapped its hard currency with the local currency of a member country (Philippines) for 15 years, the proceeds lent to banks without a sovereign guarantee.²⁵ Also the regional development banks have stepped up their issuance of local currency bonds. Senior management needs to mandate the scaling-up of these local currency activities within prudent risk guidelines.
- **Pooled funding.** Given their critical role in developed countries, development agencies have pioneered the use of pooled funding (such as State Revolving Funds) successfully in several developing countries. The IFC and USAID have provided targeted assistance in Tamil Nadu, India, and Johannesburg, South Africa, using credit enhancements, partial guarantees and technical assistance that successfully leveraged official assistance with domestic private sector funds to have a larger development impact.²⁶ Development institutions need to collaborate in scaling up pooled funding mechanisms wherever appropriate.
- **Local and regional development financial institutions.** In collaboration with the private sector, efforts should be made to strengthen local sources of affordable development financing. Years ago, a common development approach was to employ government-owned and operated development banks to provide subsidized local currency financing, but negative experience included massive problems associated with politically directed lending as well as corruption. A new public-private sector approach is now

“We deny developing countries the instruments that are used routinely in developed countries. Credit enhancement is used throughout Europe and North America to enable needed infrastructure finance as well as increase exports and help small businesses access affordable funding.”

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recommended by some experts, focused on creating or restructuring existing development banks to include private sector capital and management in those countries and regions where commercial banks do not make needed finance available.²⁷ Furthermore, building on the success of developed countries, donors should develop their risk mitigation products in concert with the development and strengthening of in-country credit enhancement institutions.

D) Establish Investment Climate Capacity Building as a Central Priority

The long-term solution to insufficient finance for development is to improve business environments, especially regulatory and legal frameworks, as well as the overall skill set and governance of actors across both the private and public sectors. Critical skill sets include accounting, auditing, business planning, project development and management, credit analysis, dispute resolution, and strengthening legal systems and the rule of law. The needs have compounded, as many countries have decentralized infrastructure development to state and municipal levels at the same time that they have increased emphasis on small and medium size enterprise development.

While a large number of these types of capacity-building programmes have been launched at DFIs, study participants felt the current programmes are vastly insufficient and that current resources are often not effectively employed. In fact, only a fraction of aid is reported as being spent on truly local capacity building, with most spent on hardware and foreign consultants.²⁸

There was considerable discussion in the project about linking country eligibility for some of the risk mitigation tools recommended in section B (particularly, the facilities to provide a bridge to institutional investors seeking investment-grade assets) to a commitment to enter into a concerted programme of public and private institution building supported by the international community through DFIs. The goal would be to create a virtuous circle of higher demand by countries for the private investment facilitation services of DFIs; increased commitment by them to improve

their investment climates through capacity-building assistance; and a lower risk profile of the assets supported by these new DFI risk mitigation vehicles by virtue of the improvements in the enabling environment brought by such assistance. The key to the success of this scenario is a big increase in the donor community's commitment to conducting needs assessments, funding and improving the efficiency of such capacity building. The IFC has taken an important step in this direction in recent years by earmarking as much as a third of its annual net surplus to capacity-building assistance activities. However, this remains an isolated bright spot in an otherwise unimpressive picture.

Accordingly, recommendations were made in two categories: strengthening the enabling environment for private investment and supporting specific transactions.

• Enabling environment

- **Create a step change in funding.** If DFIs are to take seriously their role as a systemic bridge to wider availability of private investment capital in poor countries, then they will need to fundamentally alter the level of their commitment to the provision of capacity-building assistance for the construction of sound institutions relating to property rights, contract dispute adjudication, bankruptcy frameworks, accounting and auditing standards, corporate governance rules, banking supervision and securities markets. Resources devoted by the international community to this purpose are paltry in relation to the need and the potential pay-off to economic development. DFIs ought to be in the forefront of a major effort to rectify this problem.
- **Improve measurement of funding.** Part of the reason capacity building receives inadequate support is that there is very little measurement of it. What gets measured tends to get managed, and the donor community through the DAC could make a useful contribution by creating a process that regularly tracks the level and composition of resources devoted to this endeavour.

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– **Integrate private sector expertise on a more systematic basis.** The official sector can build a market of experts and country clients, serving as a bridge to match needs with supply, working hand in hand with the private sector. The training needs are great, but so is the supply of volunteers and consultants from within the developing countries as well as developed countries. New initiatives such as a “Global Corps of Capacity-Building Experts” and SWAT Teams could serve as organizing frameworks for delivering needed experts, supplemented with toolkits and e-learning.

– **Integration of programmes into country fabric.** There needs to be explicit processes for customizing technical assistance programmes around country priorities, involving a wide spectrum of experts and private sector participants and financial institutions that enable demand-driven programmes at both sovereign and sub-sovereign levels. Training programmes need to be developed with local institutions (such as development banks, business organizations, universities, think tanks and consulting firms) and be focused on the full range of relevant government officials (for example, ministry staff, regulators, judges, sub-sovereign officials, etc.) as well as private sector people (bankers, fund managers, consultants, etc.). Defined assistance programmes also need to improve the sub-national governance framework²⁹ providing targeted assistance to enable legal, regulatory, policy, institutional and overall project management improvements.

“Donors often undermine our capacity, by imposing their programs and consultants and not coordinating with each other. We need to have donor pooled funding, with options of programs and experts that meet our country-specific needs, and be free to select from that menu.”

– **Public benchmarking.** The US Export-Import Bank provides lower pricing for countries that have signed the Cape Town Treaty, thereby agreeing to comply with uniform legal frameworks which minimize risk in the financing

of high value mobile equipment.³⁰ Similarly, a number of benchmarking tools have been developed and could possibly be refined and tied to financial indices and investments, providing concrete benefits for countries that undertake concerted improvements in their business environments.³¹ Study participants recommended that development agencies work with fund managers, pension funds, social responsibility investment organizations, rating agencies and direct investors to refine the existing work and develop more specific instruments that can directly reward developing countries for improved investment climates (for example, indices, ratings, niche funds, etc.). Another critical way to develop powerful incentives is the development of more venues for countries to share experiences, best practices and new instruments with their peers.

- **Specific transactions**

– **Leadership in first-time transactions.** A critical role of the official sector is to act as a catalyst for first-time financial transactions, creating the conditions and confidence for subsequent transactions through demonstration effects. The effectiveness of this approach has been demonstrated by both multilateral and bilateral donors with strategically targeted transactions.³² More funding needs to be made available to cover the very large transaction costs associated with these first transactions, covering the large legal and administrative expenses.

– **“Learn by doing” transaction programmes.** Project participants underlined the imperative for donors to conduct wide-scale programmes that develop deals even when the country environment lacks the requisite regulatory and legal frameworks. Transactions provide critical vehicles for “learning by doing”, serving to effectively demonstrate to country government officials and stakeholders the imperative for change in the country environment (such as legal, regulatory and institutional frameworks) and enabling the identification of appropriate country-specific priorities. In essence,

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transactions can serve to “test” for priority changes and signal appropriate customized enhancements, creating the demand and dynamic for focused prioritized reforms. An additional mechanism that might be used (often used in existing donor programmes) is to tie access to donor project funding to the participation in capacity-building programmes.

- **Official private sector communication venues.** A critical means of enhancing official sector capacity, both at the country level (national and sub-sovereign) as well as development agencies is through the use of venues that facilitate collaboration with private sector experts and organizations. Interaction can help educate officials on the need for changes in government policies and improving the business environment, as well as the need to improve skill sets and official sector services in risk mitigation and project development. Study participants recommended the need to enhance donor support of public-private working venues aimed at improving sub-sovereign issues, infrastructure (such as water), risk mitigation, and improving the business environment and integrating them into core development activities.³³
- **Enhanced disclosure.** The catalytic effect of “transparency” has been widely recognized. Recent initiatives have shown the vast potential of enhanced disclosure and transparency in catalysing better financial governance and improving the overall business environment, creating pressures to adopt new processes and enhance in-country capacity building in accounting, auditing, project management and other critical business functions. Examples include donors openly publishing their disbursements to governments, countries publishing concession contracts and licenses for private infrastructure projects, and global campaigns to enhance the transparency of revenue arrangements between governments and firms.³⁴ Development institutions need to set firm disclosure requirements, further employing surveys as well as third party entities to measure performance.

- **Open client evaluations and independent auditors.** Incentives to accept capacity-building assistance can be increased through the use of independent auditors that monitor compliance. For example, the Nigerian government agreed to publish budgets and records of oil revenue collection, as well as applicable statutes and rules, and ask oil companies to also make full disclosure of their revenues and costs. Both disclosures are then examined by an independent auditor to assess any differences.³⁵ The general use of third party entities, coupled with open disclosure of evaluations, can be employed much more widely by development agencies as a catalytic mechanism to create pressure for change, setting the prerequisite dynamic for capacity building and improved business environments.

E) Strengthen Investment Project Pipelines through Project Development Support

A critical bottleneck impeding development finance is the shortage of identified good projects, especially those sized and structured optimally to meet needed performance standards. Official sector entities often depend on companies to identify infrastructure projects, but firms often lack the incentive to do so owing to the perception of unacceptable risk and uncertain profit. Furthermore, there is often an inconsistency between projects that meet public needs and those that satisfy profitability requirements. Demand for scaled-up project development funds and support processes has escalated as many developing countries have decentralized, shifting responsibility for many services to sub-national levels (states, municipalities).

Official sector institutions should assist in strengthening the abilities of the stakeholders in public-private partnership transactions to appropriately configure the technical, financial and risk allocation structures of the projects and to frame and implement corresponding procurement strategies. Lack of attention to the substance and process of robust public-private partnership arrangements often leads to projects bearing unduly high levels of inappropriately allocated risks. This, in turn, makes the projects non-bankable and susceptible to problems of contract renegotiation, regulatory failure/capture, corruption, etc.

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Government-backed risk cover instruments have limited usefulness if not backed by substantially enhanced project development capacities. Ill-prepared governments are likely to initially take on excessive levels of risk followed by a rapidly depleting ability to deliver when the guarantees are called. As evidenced by many failed infrastructure projects, the resulting severe problems and political backlash can become counterproductive, undermining the perceived and actual usefulness of private sector investment.

While some successful efforts in project development have been made (with new initiatives forthcoming),³⁶ both government officials and private sector companies cite the current lack of project development funds as a key bottleneck, cutting off at the very inception of an investment opportunity any promise of private sector investment. Existing funds for this purpose are reported as difficult to access and often tied to donor home-country suppliers, thus eliminating project sponsors and other suppliers from participation and failing to capitalize on local engineering and financial talent.

To remedy these problems, participants suggested that official sector institutions pool and scale up project development funds and also make them easier to access, utilizing appropriate experts from across the public and private sectors to identify quality projects and develop acceptable risk-mitigating financial structures. There was widespread agreement that such project development capacity needs to be built urgently, especially on a regional and national basis, in partnership with regional and local development institutions with a sector focus in areas such as water and energy. Three recommended action steps are:

- **Increase scope and sustainability of funding.** Project development funding needs to be increased dramatically in scope and committed on a long-term basis (over five years). Multi-donor funding is critical at different levels (sub-sovereign, national, regional and global) using technical assistance grants or revolving funds to finance the development costs of a pipeline of infrastructure projects. Project development funds are critical for

covering initial costs, but may be able to build in self-sustaining revenues from successful projects. In any case, donors need to insure long-term sustainability that successfully creates the capacity within the country to develop projects on an ongoing basis.

- **Simplify procurement and reduce transaction costs.** Procurement rules can prove counterproductive, hurting the ability of many qualified organizations and experts to provide project development services. In addition, recipients do not have easy access to information on available services. New streamlined processes need to be developed to both facilitate a larger supply of expert services to meet unmet demand, as well as the ability of countries to select the most qualified relevant experts. Project development funds need to be available for the most appropriate uses and not limited to using the services of the donor country.³⁷
- **Target funding at country and sub-sovereign levels.** Funds need to be operative at the country as well as sub-national levels, integrated to support the country's national development plans, including PPP and competitiveness programmes. Customization to the specific needs of the country (state, municipality) as well as the sector, project and client is critical for effectiveness. There is a special need to create new funding targeted at the individual sub-national level to help prepare individual projects for financial support, in the form of feasibility studies, demand assessments, etc. As noted in the section on capacity building, this funding needs to address overall capacity building with independent reviews to assure the quality and completeness of pre-existing feasibility and engineering studies; financial advisory services for project structuring; technical assistance for project implementation and oversight (including preparation of bidding documents, review of technical proposals, supervision of investments and commissioning); and obtaining full or shadow credit ratings.

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IV. Conclusion

This report has sought to summarize the thrust of recommendations emanating from an extended multistakeholder process of consultation. Such discussions made clear the large opportunity that lies before the international community to leverage ODA many times over by reorienting the work of development finance institutions in many of their client countries toward the facilitation of private investment at two levels: risk sharing and direct support for improvements in the investment enabling environment. Expert participants in the project expressed the hope that these recommendations will contribute to a clearer understanding within the international community of how to take full advantage of this opportunity.

Annex A:

Challenges to Implementation of Recommendations

The call for reorientation of DFI activities in all but the lowest income countries represents a vast challenge. Such a task requires redirecting DFI activities from organizations whose principal role is to make direct loans and grants to governments to those that create value by identifying market failures and building bridges between governments and the private sector. Many expert project participants expressed open skepticism that significant progress was possible. This section outlines the main obstacles to implementing the recommendations put forward.

Cultural Biases Against Risk Mitigation Tools.

Expert participants in the project pointed out that the culture within development finance institutions is often resistant to engagement with the private sector and the use of risk mitigation products. Since leadership of these institutions changes with the relatively short political cycles, it is the long-term professional staff who design and implement programmes. Without their buy-in, even the most astute and committed leadership is likely to fail in its mission. The staff in donor institutions who are responsible for development programmes must believe in the benefits of more fully engaging the private sector in development activities, including risk mitigation and capacity-building, if progress on this agenda is to be made. It was reported that World Bank officials (who reflect widespread DFI viewpoints) are reluctant to embrace change in this direction because they believe¹:

- They would not feel comfortable using the Bank's guarantee power to provide the private sector a safety net when the Bank has so little control over the use of the funds, the quality of a guaranteed project or the development impact of the project. Control would be in the hands of the private sector.
- The use of guarantees will lower standards for prudential commercial lending by banks. If banks know they have a guarantee, they will issue blank checks as they did in the 1980s, and be preoccupied with spreads and volumes rather than creditworthiness.
- Extensive use of guarantees will result in the World Bank being pressured to use its guarantee power in order to preserve the integrity of the world's financial system. That is what happened in the 1980s and some Bank staff argues that should be the responsibility of Central Banks, not the World Bank.
- If the World Bank were to pay a guarantee, and then seek redress against the country for such payment, and the country could not pay the Bank, then it is in

default to the Bank. The result would be that the Bank must immediately shut down all new lending to that country and all disbursements to that country on all loans not yet disbursed because of an imprudent private sector loan – even though the country itself may not have defaulted to the Bank.

- The use of guarantees would reduce the Bank to being a financial intermediary rather than an economic development agency, and would reduce the staff to being loan officers rather than development professionals. It would be a waste of an extremely valuable, objective, and non-political pool of talent.
- There is little confidence in the ability of the private sector to choose projects which have an economic development impact particularly of benefit to the poor since private sector projects are primarily geared to creating financial returns rather than high development impact.
- The private sector does not have the expertise, interest or power required for structural adjustment lending and for enforcing the overall fiscal, monetary, or trade conditionality that applies to the country as a whole. It is not what the private sector does. It is what the Bank does.
- If governments think guarantees are a good idea, let them do it bi-laterally, putting taxpayers' money at risk.
- There is no demand for private sector guarantees in areas relevant to development (education, health and fiscal policy) because there is no cash flow from those sectors. They are therefore uninteresting to the private sector.

The overwhelming majority of project participants disagreed with these perspectives, often quite strongly. However, it will be necessary to take them seriously if the cultural biases in the institutions are to be overcome. Among the responses that emerged in consultations were:

- 1) Overall Distrust of Private Sector – The counterargument is that despite many known problems with private sector investment and prior public-private partnerships in developing countries, there are no other options. The insufficiency of ODA means that efforts will have to be redoubled to create “win-win partnerships” and the understanding needed for quality finance that results in benefits for business and countries. Only by more open collaboration can both the private and public sectors learn their strengths and weaknesses, learn

Annex A:

Challenges to Implementation of Recommendations

how to build processes that avoid the pitfalls of known problems, and further develop each other's core strengths. Moreover, the recent convergence between business development and social responsibility activity within the business community creates a new opportunity for the official sector to engage the private sector. Businesses worldwide are recognizing that it is in their interest to confront public cynicism, political unrest, and terrorism with strategies aimed at contributing to growth and stability in developing countries. This new impetus in the private sector can be reinforced with efforts from within the DFI community, such as the World Bank Committee on Development Effectiveness (CODE), to identify the valuable lessons of past private sector involvement, especially in infrastructure, and how to avoid past mistakes.

2) [Guarantees will Lower Credit Standards and Reduce Private Sector Accountability](#) – The counterargument to this is that explicit, well-managed transparent risk mitigation programmes do not create moral hazard; in fact they can serve to reinforce each party's accountabilities and responsibilities. The roles of each party would be made explicit in open detailed documentation. For example, guarantees of regulatory risk would clearly outline the host government's responsibility, and in the event of a breach of contract, how the official sector would seek to use its unique bargaining power to remedy the problems. The private sector investor would still be responsible for commercial and production risk. In fact developed countries have a long and successful history of using government guarantees to mobilize finance for infrastructure, small and medium enterprise (SME) and mortgages. Even in the case of outright, 100%, irrevocable principal and interest credit guarantees such as those provided by private sector, triple-A rated, financial guarantee insurance companies ("monolines"), their long track record in developed countries has proven that the extra analysis and monitoring that accompanies them serve to improve the credit quality of the borrower and to reduce losses for the investor.

In fact, the mainstream core activity of development institutions making loans to developing countries where the loans are guaranteed by the developing country government is much criticized as a politically-driven process lacking in sound credit analysis and full disclosure of the risks. A disciplined, open, and explicit process of credit analysis and payback analysis

(incorporating the best practices in credit assessment and risk management) would create much-needed transparency and accountability. It would explicitly assess the borrower's ability and willingness to pay back the obligation and allow for open dialogues on exceptional political reasons for approving transactions. In this way, additional engagement of the private sector in transactions supported by the official sector could serve to improve the credit processes within development institutions and the transparency of impeded credit risks, not lower credit standards as feared.

3) [Official Sector will Lose Control](#) – The counterargument is two-fold: First, that official control is not necessary for development impact: economies worldwide benefit from private sector projects. Second, providing guarantees enables the official sector to vet the project thoroughly, provide advice on how to insure both profitability and development benefits, and influence key areas such as environmental safeguards, hiring practices, use of local firms, training, etc. In effect, guarantees targeted at specific risks can serve as a "partnership" bridge and framework for focused effective public-private sector collaboration within open transparent social parameters.

4) [Development Institutions would Subsume Bailout Function of Central Banks](#) - The counterargument to this is that systemic financial crises are inevitable and a necessary risk for all institutions that engage in international finance. The risks of undue losses are less than in prior debt crises, however, because of progress made in reducing the vulnerability of developing countries to crisis. Furthermore, any guaranteed debt obligation would be approved within specific, carefully structured and implemented private sector risk mitigation programmes implemented in accordance with internal, prudent risk management guidelines for each institution. These guidelines are aimed at protecting the capital base and, if applicable, the credit rating of the institution.

5) [Potential Impairment of Country's Entire Donor Programme](#) – The counterargument is that all donor projects, guaranteed or not, need to be thoroughly evaluated by the donor institution, and should therefore be structured correctly, with any default due to government negligence requiring the donor institution to respond appropriately with penalties. In

Annex A:

Challenges to Implementation of Recommendations

fact, a major concern of investors is that the management of donor institutions is often politicized, and lacks the discipline to exact meaningful penalties for governments that break their commitments. Even government officials in developing countries have stressed that donor institutions need to more consistently exercise such penalties, since they offer a means of reinforcing the ability of recipient governments to maintain their commitments. This can, in effect, protect developing country governments from their own internal vested interests, which can sabotage the larger good of the country by forcing erratic changes in government policies.

6) [Undermining of Development Institutions and their Core Capacities](#) – The counterargument is that development professionals will continue to be needed, not only for work with low-income countries where grants and IDA loans will continue to be the centrepiece of their activities, but also to support the process of targeting risk mitigation products at sectors and regions where there is particular significance for development. Indeed, many participants noted the need to more fully integrate development professionals from the main sovereign MDB operations with the private sector operations (for example from the IBRD with the IFC), to enable synergy and better coordination. Development professionals are needed to identify priority development projects; to ensure the viability of such projects and their development impact; to arrange successful consultation with local stakeholders and the involvement of the local business community; to monitor ongoing performance; and to anticipate and forestall project problems. Also, a large increase in capacity-building programmes is needed to strengthen legal, institutional and other frameworks that determine the robustness of the business investment climate – a natural role for the DFIs to play.

7) [Private Sector's Profit-Making Objective Is Inconsistent with Development](#) – The counterargument is that business objectives can be consistent with development objectives, and that this is proven by the many studies done by development institutions that show the direct contribution to economic growth and job creation. Where there are potential conflicts between business and development objectives, for example in infrastructure projects providing basic services, these can be avoided through careful early mapping of objectives,

project design, implementation and monitoring. A key lesson learned from failed infrastructure projects is the need to ensure affordable tariffs, especially for poor communities, which in some cases may only be possible with targeted donor subsidization (as emphasized in the section on risk-mitigation products).

In addition, enhancing the capacity of the host government to work directly with the business entity (both domestic and international) will enable more successful outcomes. As noted in later sections, an extremely important influence in improving the quality of developing country policies is the local business community, so the development of the private sector in developing countries can in effect complement the efforts of development institutions to improve both the quality and timeliness of policy-making. If needed, donor conditionality can be made part of large infrastructure guarantee and other donor guarantee programmes.

Study participants stressed the importance of openly acknowledging the above concerns and addressing them in open debate. The debilitating impact of such attitudes is evidenced in the current problems between private sector operations of the development banks and the main public sector operations, such as the IFC and MIGA with the World Bank, or the private sector operations of the Asian Development Bank and the Inter-American Development Bank with the main public sector operations. With the exception of the European Bank for Reconstruction and Development, virtually all officials acknowledge conflicts arising from different cultures and viewpoints, and the urgent need to find common ground for greater cooperation.

High Transaction Costs of Public Bureaucracies.

Development institutions have protected themselves with extensive and lengthy procurement and transaction processes (including competitive bidding for small projects and “one size fits all” payment terms) resulting in large transaction costs that deter all but the largest companies, or small, specialized businesses that survive on donor contracts. One development entity was reported as having five committees required to approve each single transaction, the reported reason simply being the need to provide meaningful activities for underemployed senior officials who do not want to retire. In addition, the legal costs are reported as extremely high, given the propensity of in-house legal staff to complicate each transaction combined with

Annex A:

Challenges to Implementation of Recommendations

inattention to streamlining documentation processes. In essence, it is reported that the vested interests of donor institutions are dominating operations without being accountable to market needs for efficiency and development results.

Risk Management Constraints. The central concern of the MDBs is rightly the preservation of their triple-A credit ratings, which enable them to access cheap capital from capital markets. The overwhelming problem for launching new risk migration programmes is the concern of board members and management that triple-A ratings may be threatened. However, many knowledgeable experts discount these fears, noting that the MDBs have increased capital while decreasing exposures, and also do not work closely enough with the rating agencies in exploring how they can more strategically leverage their capital. For example, private sector companies that provide financial guarantees and also have triple-A ratings work closely with the rating agencies to achieve higher leverage while preserving their triple-A ratings. They leverage their capital more than 100 times whereas most multilateral agencies are not leveraged at all (so that use a leverage of one to one – meaning a dollar of paid-in or callable capital plus unimpaired reserves for each dollar of loans or guarantees).

Another central problem area is the way risk management processes are designed and implemented in donor institutions. Some participants noted that often the private sector operations in MDBs have to manage to “zero loss” guidelines, meaning that the expectation for each transaction booked is that there will not be any losses that impact the balance sheet of the institution. In addition, official sector officials are often pressured to have high rates of return, reportedly as high as 23% on average. These policies and guidelines have the convoluted effect of pushing donors to compete against the private sector and each other for the least risky and most profitable deals, instead of implementing those transactions that the private sector cannot finance due to unacceptable risk or low profitability.

In addition, participants report that country limits and budget performance reports do not differentiate according to the reduced risk of risk mitigation products or the benefits of leveraging official sector by using guarantees to attract additional private sector capital. For example, in donor institutions a guarantee

may count the same as a direct loan against a country limit (and against capital), even though loss experience with guarantees may be significantly less than with a loan. As country limits are a scarce commodity and need to be allocated between competing projects, this accounting treatment creates a very strong internal bias to allocate the country limit to direct loans, as direct loans produce more revenues than guarantees. While guarantees produce less revenues, they may result in the country having access to more capital. This is a critical point, as developing countries benefit from private sector financing based on guarantees that leverage official sector capital, permitting the completion of large infrastructure projects that provide critical services such as electricity, roads, and water, with private sector capital.

The Politicization of Development Aid. The historical government-to-government functions of development institutions are further complicated by their inherently political nature. All multilateral development banks and bilateral aid agencies — including export credit agencies — are managed directly or indirectly by sovereign governments, specifically by senior level political appointees often lacking in a specific background in development finance and knowing little of the technical and organizational aspects critical to successful programme implementation.

Furthermore, the senior leadership of bilateral development institutions is often asked to show how their development funds contribute to the economic and political objectives of their own sovereign governments. In many cases, development institutions restrict use of funds to employing national citizens and home country firms and products (often referred to as “tied aid”). These restrictions and mandates are widely criticized as they are seen as undermining development effectiveness, with the perverse effect of hurting developing countries by imposing external processes and foreign consultants. The Development Assistance Committee (DAC) and World Bank have both underlined the importance of untying aid and reorienting development institutions to the needs of the targeted recipients without regard to home country suppliers and consultants.²

Annex B:

Illustrative Examples of Senior Management Initiatives

Navigating the transition from direct lender of official funds to innovative enabler of private investment requires major changes in the culture, processes and rules of development institutions. Their success will be increasingly measured by the market, which will ask: to what extent do we as developing country recipients and private investors perceive the services and transaction costs of development institutions to be competitive and attractive?

The existing capital and capacities of donor institutions cannot be used optimally unless the senior leadership of donor agencies takes effective actions to reform their internal organization and processes so as to foster meaningful involvement of the private sector. Study participants articulated six categories of actionable steps:

1) **Establish New Incentives and Performance**

Metrics: Align incentives with the mission of private sector engagement, prioritize development impact over profitability, and establish “private sector mobilization performance metrics.” These new incentives and performance metrics need to drive decisions on compensation and promotion, as well as the reformulation of organizational structures, reporting requirements, and outsourcing decisions.

The development of new, authorized means of openly engaging the private sector in project identification and development, the formulation of effective risk mitigation products, and capacity-building is critical.

2) **Authorize Risk Taking within Prudent Guidelines, Prioritizing Leveraged Use of Official Capital:**

Modify risk management processes to enable targeted assumption of risks within acceptable risk guidelines, and differentiated treatment of risk mitigation products against country limits, budgets, capital and other internal processes. Current internal risk management processes (for example, internal treatment of guarantees and “zero loss” guidelines for private sector loans and investments) have the unintended effect of encouraging competition with the private sector, rather than facilitating DFIs paying a catalytic role heralding new transactions with demonstration effects. **New cost-effective processes that clearly support the legitimacy and value of targeted risk assumption are prerequisites for successful large-scale private sector engagement.**

3) **Streamline Processes and Retool:** Openly identify the problems impeding effective official sector engagement of the private sector, particularly regarding processes driven by operating guidelines and charters.. Design remedies with commensurate training and capacity-building programmes to retool staff. **A joint MDB taskforce with significant private sector participation could prove effective in designing such remedies. Capacity-building programmes for donor staff, as well as new outreach programmes for private sector investors, are critical to the creation of the skills and demand for risk mitigation products that are needed to meet the criteria for investment grade instruments.**

“Education is a integral part of the answer. New investment grade asset classes need to be created by knowledgeable public-private sector expert teams and sold to investors.”

4) **Enhance Management Execution Capacity with Decentralized Responsive Decision-Making:**

Enhance the capacity of the full range of management that determine effectiveness in engaging the private sector – including Executive Directors and their advisors, senior management, and overall staff – to formulate and execute policies and processes in a timely and competitive manner. **One specific means would be to enhance the effectiveness of boards and senior management through the use of performance monitoring reports, and to decentralize transaction approvals for enhanced responsiveness. Another would be to add four independent, private sector non-voting board members to each MDB for five year non-renewable terms, with the explicit responsibility of providing candid input on how to maximize engagement with the private sector.**

5) **Redeploy Capital to Units that Leverage Official Sector Capital:**

Reallocate official sector capital and budgets to those donor entities that mobilize private sector capital and resources and can show results (i.e., private sector departments, other donor entities that coordinate with them, and outsourced firms). Private sector operations, often with few staff and insufficient resources and expertise, are able to leverage official sector capital with private sector

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contributions. **Official sector capital (and taxpayer dollars) would be much more effective if “leverage criteria” were used to allocate capital and determine budget allocations as well as outsourcing decisions (i.e., use private sector companies to manage funds and other operations).**

6) Implement New, Multidonor Coordination Initiatives on all Fronts:

Facilitate the implementation of performance-based programmes, the development of standard performance measures (including processes for untying aid), and the open review of success stories and failures, by setting up an effective “Donor Coordination Secretariat” employing third party experts working through the Development Assistance Committee and the World Bank. In addition, harmonization at the country and regional level needs to be accelerated through the urgent adoption of donor committees with private sector participation that pool funds in multidonor programmes. **For development institutions to be effective, they must implement meaningful coordination programmes that pool resources at global, regional, and country levels, eliminate redundancies, and reduce administrative costs for recipient countries and the private sector.**

Illustrative Implementation Steps

This section contains illustrative examples, based on input from the study participants, of specific implementation steps that could be adopted immediately by development institutions. Please note that these examples are meant to serve as illustrations and need further refinement with open, official-private sector input before actual implementation. The original proposals submitted by study participants can be accessed at the web sites indicated.

Clarification of Mission

As already noted, a huge divide exists between rhetoric and reality, between the critical need to engage the private sector in development, and the reality of limited private sector engagement. This divide exists even though such rhetoric is now mainstream, for example, having been proclaimed in the Monterrey Consensus and endorsed by all UN member countries. The often-cited reason for the divide is that many of those entrusted with implementing development policy, namely senior and middle management in the development institutions, simply do not believe in the merits of private sector engagement or lack capacity to implement it, or both.

The first step for bridging the rhetoric-reality divide needs to be a clearer explicit endorsement of private sector engagement at the top levels of the implementing organizations.

Political leaders worldwide need to be more effective in communicating the importance of engaging the private sector – by explicitly revising the mission statements of development institutions to stress that engaging the private sector is an urgent priority of each and every official working in them.

For example, the new leadership of the MDBs and the Executive Directors could issue such new mission “legitimizing” statements, with supporting documentation of rationales, success stories, and strategies for averting problems (such as prior failed privatizations). In addition, public statements could be issued by political groupings containing donor countries as well as recipient countries (for example, the G-7, G-22, G-77, DAC, etc.) in partnership with business organizations and coalitions (for example, the International Chamber of Commerce and its national chambers, The World Economic Forum, The World Council of Sustainable Development, The Group of 30, The International Institute of Finance, etc.).

These statements need to proclaim the urgent priority of engaging the private sector and show tangible commitment to this objective by announcing new specific action steps for immediate adoption, such as those indicated below. A central theme has to be that development institutions have entered a new era that



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requires enhanced aid effectiveness, and in which they are being challenged by the difficulty and importance of advancing development to avert despair, poverty and terrorism, in a time of overwhelming fiscal constraints.

The companion theme needs to be that the mission of private sector engagement cannot be effective without clear action steps. There should be acknowledgement that these themes have been echoed before, the difference now being that the development institutions will take explicit, hard decisions in changing internal processes, structures, capital allocations and staffing, to enable more effective partnership with the private sector, to allow open accountability for results and to avoid prior mistakes. Every taxpayer dollar must be more effectively used by enhancing internal efficiency and leverage of official sector capital through the harnessing of private sector expertise and capital.

Critical “truths” that need to be explicitly included in the mission to enable private sector engagement include:

- **First, the official sector’s success is dependent on its ability to optimize the relative contributions and core competencies of the private sector using its own strengths.** In short, the official sector cannot achieve its objectives without the private sector. The roles and strengths of the private and official sectors need to be explicitly defined, accepted and optimized. The private sector can bring core expertise and capital, and can assume commercial risks, but cannot take undue political and systemic risks that violate its fiduciary responsibilities to shareholders. If the official sector wants to engage the private sector, it must respect the need of the private sector to maximize profits without undue risk for its shareholders. The role of the official sector is to engage the expertise and capital of the private sector in areas critical for development, responsibly using the comparative strengths of official sector institutions in assessing, managing, and mitigating political, regulatory and systemic currency risks within prudent risk management guidelines.



- **Second, the official sector needs to use a wide range of means to openly and proactively engage the private sector in all aspects of the development process, from project identification to project development, from the specification of risk mitigation products, to designing and implementing capacity-building programmes aimed at improving business environments.** To accomplish this, open forums and venues for business engagement need to be created and used to redefine internal official sector processes and official sector programmes and services. Transaction costs and procurement rules need to be streamlined and improved to ease the ability of companies to work openly with the official sector. Currently private sector companies, whether large companies or SMEs, cannot afford to work with the official sector, except for those companies specializing in those areas. Concerns of undue lobbying should not prevent the launching of a serious campaign to enable wider private sector engagement, with the development of a wide range of legal open channels to facilitate open, cost-effective business engagement.

- **Third, the ultimate mission of development institutions is not to make profits, but rather to promote development, reduce poverty, improve living standards and create jobs.** Simple operating guidelines based only on profit making and loss avoidance in official sector institutions can have the perverse effect of encouraging official sector employees to compete against the private sector. New performance metrics and incentives need to be established to encourage public-private cooperation, not competition or crowding-out, as well as donor coordination to reduce redundancy and aid ineffectiveness.

These revised mission steps and action steps, with regular progress updates, could be communicated in various ways, such as on public web sites (e.g., donor institutions, the Development Assistance Committee, The World Bank, etc.), as well as in press releases and meetings (e.g., World Bank/IMF Meetings, UN Financing for Development 2007 Summit Meetings, etc.).

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Appraisal Criteria and Performance Reports

To be successful in implementing the new explicit mission of greater private sector engagement, **specific new incentives and accountabilities must be created within the development institutions that stress the priority of compliance, with aligned integration of these priorities into appraisal criteria and overall performance reports. Core indicators can be uniform for all development agencies and can be disclosed to the public (just as standard ratios are used for evaluating developing country performance), with supplemental qualitative progress reports.** A third party entity could coordinate this exercise working with the Development Assistance Committee and World Bank, providing open, timely performance updates of comparative data on an ongoing basis. Examples of performance measures (for further refinement) include:

OFFICIAL SECTOR LEVERAGE INDICATORS - These indicators (and other variations) can show the extent to which official sector capital is increasing the amount of capital available for development, in effect representing the efficiency with which taxpayer funds are being employed. For example:

- *Total amount of guarantees/total amount of finance provided (direct loans)*
- *Total amount of mobilized private sector capital (equity and debt)/amount of official sector capital used (actual outlay)*

These indicators are critical: despite the emphasis on leveraging official sector capital, approximately 3% of the finance provided today by development institutions is for guarantees that serve to mobilize private sector capital.³ This means that a huge opportunity to increase finance for developing countries is being missed. For example, USAID claims that its Development Credit Authority can mobilize up to 25 private sector dollars for each US taxpayer dollar, and that in five years of operation it has made almost a billion dollars of private sector credit available in 36 countries at a cost to USAID of only \$28 million.⁴

Moreover, the DAC does not count guarantees provided by bilateral agencies (e.g., JBIC, KfW, AFD, AID) as ODA for the purposes of calculating country contributions to aid targets on the basis that guarantees do not necessarily result in an inflow of capital from the bilateral agency to the recipient country. This exclusion from aid targets

acts as a disincentive, and constrains the use of guarantees by development agencies.

GUARANTEE EFFICIENCY MEASURES - To bridge the gap between rhetoric and reality, numeric indicators can document the efficiency and ongoing progress of official sector institutions in using official sector capital to mobilize additional private sector capital. For example:

- *Total amount of mobilized capital (equity and debt)/total amount of guarantee used (compared with direct loans)*
- *Total amount of mobilized capital (equity and debt)/total cost to taxpayer*
- *Total amount of losses from official sector guarantees/total amount of guarantees issues (compared with direct loans)*

Ratios such as these can document the efficiency of guarantees against that of direct loans. As noted earlier, this is critical as there is insufficient ODA to finance all the infrastructure and SME finance needed by developing countries. Measures such as these can document the performance of guarantees and better enable analysis of the effectiveness of guarantee programmes, ensuring appropriate capital allocations. Given the imperative of maintaining the high credit-worthiness of development institutions, the risk management processes that serve to evaluate the levels of prudent leverage could be developed with intensive input from private sector executives, risk management specialists, and rating agencies.

TRANSACTION EFFECTIVENESS MEASURES - The current volume of private sector transactions is far less than required for both infrastructure and SME finance. Numeric indicators and client evaluations can serve to quantify progress made and suggestions for improvement. For example:

- *Number of deals and total financing approved in the reporting period*
- *Indicators of development impact (for example, infrastructure services provided such as provision of water and electricity, jobs created, etc)*
- *Transaction costs and timeframes for approval (and measures being taken to reduce them)*
- *Client evaluations of official sector performance (conducted by a third party entity)*

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BUSINESS ENGAGEMENT PERFORMANCE

INDICATORS - The imperative for more open collaboration with the private sector can be underscored and driven with explicit directives that are measured and reported, as well as client evaluations. Examples include:

- *Engagement in Private-Public Working Groups and Results:* The overall role in creating and supporting groups on critical issues; the number of groups involved with or officials actively participating in Public-Private Working Groups; achievements (for example, improvements in internal processes, new products and services, etc)
- *Number and types of private sector experts consulted* (for major activities, such as developing projects and programmes requiring private sector partnership, etc.), and the results of consultation processes
- *Number and types of business firms hired to design and implement programmes*
- *Anonymous evaluations from private sector experts engaged in working groups and consultations*
- *Surveys and reports on how to enhance private sector engagement, with their findings openly disseminated*

CAPACITY BUILDING INDICATORS – The area of capacity-building is well-documented and includes many examples of persistent failure and open criticism, often related to the difficulties associated with politicized programmes implemented by donor country experts using donor country products (“tied aid”). Given the growing political support for focused capacity-building that uses the most cost-effective inputs (especially local SMEs), there is a huge opportunity to reorient and scale up progress in this area. Breakthroughs could be facilitated by means of transparent performance information on the types of capacity programmes, the extent of business and in-county engagement, and the results. Examples of what should be documented include:

- Capacity-building programmes tied to finance programmes and projects (noting the volume, types, and impact indicators)
- Extent of private sector involvement in official sector programmes (noting the number of contracts, experts, partnerships, etc.,) and its aims, e.g., improve the business environment, develop capacity in business skills (such as project development,

credit analysis, accounting, auditing, legal support processes and arbitration, property rights, etc.)

- Hiring practices and procurement processes for hiring private sector experts and companies. For example, the number of hiring processes that allow open selection of good and services (as opposed to tied aid)
- Number and types of information resources, tool kits, e-learning and other training in business skills, private sector outreach, etc that are made available to country recipients (noting the number of sources and impact indicators such as number of people served, trained, etc.)
- Amount and range of involvement from business and national entities, noting e.g., the types of experts involved, the number of locally employed experts, appropriate courses in universities and institutes, new degree programmes, number of graduates, etc.
- Anonymous evaluations from private sector experts and targeted recipients
- Surveys and performance analysis with findings openly disseminated

The above examples are only partial illustrations of business engagement performance incentives and measures that could be used within official sector development institutions to communicate priorities and to measure performance.



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Increase guarantee scoring to a ratio of 4:1* –

Given their excellent asset quality (including guarantees), MDBs that currently have gearing leverage ratios of one dollar of capital to one dollar of loans and guarantees should increase the leverage ratio for the purpose of guarantees to 4:1. **Under this proposal MDBs could provide four dollars in guarantees (compared with only one dollar of loan) for every dollar of capital.** This will provide incentives for MDBs to promote guarantees, which currently account for between one tenth and one hundredth of their individual activities. The benefits of the proposal are several-fold:

In time, **if guarantees became more established as a product, the role of MDBs as lenders would decline and their role as providers of risk mitigation products, to foster private lending and investment in developing countries, would rise.**

The private markets have become the largest source of external capital for emerging markets. This change is unlikely to be reversed, despite the Latin American debt crisis and the Asian financial crisis. **Increased use of MDB guarantees could increase the stability and size of erratic and concentrated private sector flows.**

Next steps include:

- Meeting between MDB treasurers and officials in charge of guarantee operations to discuss the concept
- Consultations with private sector experts in financial institutions and rating agencies on ways to enhance capital efficiency
- Persuading the stakeholders of MDBs, starting with key shareholder governments, that increases in leverage on guarantees should be pursued in place of capital increases
- A detailed study of the MDB Article provisions on gearing/leverage to determine whether higher leverage on guarantees requires charter amendments and drafting if needed such amendments to the appropriate Articles
- Discussions with the rating agencies to ensure that triple-A ratings would be preserved
- Start the process of making amendments in the Articles, if needed
- An open process of exploring this and other ways to more effectively leverage official sector capital is imperative if we are to maximize development impact and poverty reduction.

*SOURCE: Mahesh Kotecha,
www.globalclearinghouse.org/wefnewyork

Decentralize and Broaden Capacity* More effective operations of development institutions depend on the ability to act more as commercial, private sector entities skilled in project development and execution, either in-house or through third party entities and partnerships. **This will require appropriate staffing and relationships with third parties to enable appropriate assessment, monitoring and implementation.**

Decision-making needs also to devolve, to allow for greater responsiveness and scaled-up volume of transactions . The need for sub-sovereign finance has also increased this imperative, as it requires the full range of capabilities for building subsovereign portfolios of low risk, long-term infrastructure. Examples of critical capacities that are needed include:

- Local knowledge of and 24/7 presence in each country that qualifies for participation, including a good relationship with the sovereign government;
- Close linkages with reliable sources of project preparation assistance for every potential borrower;
- Close linkages with reliable sources of local bank loan and bond market development assistance;
- Deal design and closing skills akin to those of investment bankers or monoline insurers active in the international markets;
- Risk analysis and underwriting skills akin to those of the major rating agencies and monoline insurers active in the international markets;
- Well-established relationships with the international and affiliated or non-affiliated local rating agencies;
- Back book surveillance and proactive deal remediation capacity akin to those possessed by the best international commercial bank lenders or private sector financial guarantors; and
- Back offices capable of providing the administrative and systems support that characterizes high quality, private sector financial guarantors and lenders.

*SOURCE: Tom Cochran,
www.globalclearinghouse.org/wefbrazil



Annex B:

Illustrative Examples of Senior Management Initiatives

Support Workshops, Training Programmes, and Public-Private Sector Working Groups

As already noted, the staffing of development institutions needs special support in reorienting and retooling themselves to be effective in working with the private sector.

Specific orientation and training programmes need to be developed for wide scale participation, including the participation of the most senior leadership. As one study participant noted:

“The development institutions are full of people, senior and middle-management especially, who are allergic to the private sector. They do not see the value.” The viewpoints that constrain progress need to be brought to the surface and debated, allowing perceived problems and issues to be fully addressed in the crafting of implementation plans.

The design of the training programmes is critical. They must be directed by leading-edge private sector experts in the technical aspects of finance and projects as well in the contentious issues such as how to better engage the private sector in ways that advance development while avoiding negative social, political, and cultural consequences. Of particular importance, according to many participants, is the need to achieve better understanding and cooperation between the public departments of the development banks with the private sector operations.

Public-Private Sector Working Groups

are recommended as a critical tool by which development institutions can engage the private sector, especially given the widespread need to avert all risks of perceived and actual insider influence, lobbying, and corruption.

Many development institutions have “private sector advisors” and run business seminars. They invite business people to their offices to learn of their programmes. Such activities can help to help bridge the gaps. However, these efforts are not sufficient to galvanize the type and scale of private sector engagement ultimately needed to meet the end objective of harnessing billions more dollars worth of private sector capital, as well as its extensive expertise, and dynamically advancing development progress in poverty reduction and the attainment of the MDGs.

For this to happen, the official sector must create new venues for open collaboration on multiple fronts. **One important means is targeted working groups that bring together experts from across the public and private sectors with a focus on specified deliverables.** This allows for open exchange on issues and possible remedies, with explicit governance checkpoints that guard all parties from damaging charges. Currently it is extremely difficult to find funding for such working groups. Development institutions could support such groups, by providing funding for administration, and mandating the active open participation of the relevant experts.

For examples of public-private working groups, see www.infradev.org and www.globalclearinghouse.org/gin.

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Report Specifications

Much criticism of development activities centres on the use of scarce funds to write reports that are perceived as yielding little actual development value. Yet many reports provide intellectual bases for determining the use of a country's development funds and the formulation of national policies.

For these reasons, a pivotal action step would be to better align report specifications with the objective of private sector engagement. Selected reports could be required to have open review and comments from business organizations and experts from the recipient countries (thus encouraging upfront exchange on the issues and plans contained in the report).

For example, the *Poverty Reduction Strategy Papers (PRSPs)* and *Country Assistance Strategies (CASs)* of the World Bank could have added mandatory sections detailing:

- **Priority areas for improving the business environment and actions plans**
- **Priority infrastructure needs, priority projects and beneficial impacts, and possible ways to implement them**
- **Priority ways to improve the ability of SMEs to access needed capital, training, partners, and distribution networks for their goods and services.**

Development agencies would then be charged with helping developing country governments work with the private sector to implement these plans, by providing needed support in financing, networking, and venues as well as capacity-building.

Improving and Simplifying Transactions with Multilateral Development Banks*

Complying with the requirements of MDBs is increasingly difficult, mainly due to the increased complexity of environmental and social requirements. The MDB approval process can get stuck or delayed for internal reasons, which are often difficult to establish for private sector clients. Delays are highly detrimental to the successful closing of deals and result in high additional costs. Also, transaction costs are still very high, making smaller transactions difficult and excluding less sophisticated sponsors with potentially good projects. Dealing with MDBs has become costly and, over time, a “specialized business.” MDBs do not seem adept at learning from past experience when it comes to deal transactions. Often an entirely new analysis is stipulated for a project similar to one already financed/guaranteed.

Potential solutions to this situation include:

- Involving more areas/departments of MDBs as active stakeholders in the deal transaction process with a system of incentives (e.g., shared credit for successful deals) so that not only operational departments support the deals but also other departments (e.g., environmental and social) that have traditionally tended to impose internal resistance.
- Setting a clear internal code for dealing with external consultants and lawyers, for example, to minimise occurrences such as the following:
 - Certain categories of consultant, such as lawyers, take advantage of their established positions by seeking the “extra rent” type of remuneration, which undermines the developmental mandate of MDBs. The problem of escalating legal costs could be reversed by means of strict control of MDB staff regarding their external counsel activities and costs.
 - Limited compensation is available for staff with expertise in emerging markets and advanced capital markets, resulting in outdated or poor quality advice. More flexible compensation guidelines need to be set for hiring high-quality private sector experts. This is a precondition for reorienting development agencies and achieving success in mobilizing private sector resources.



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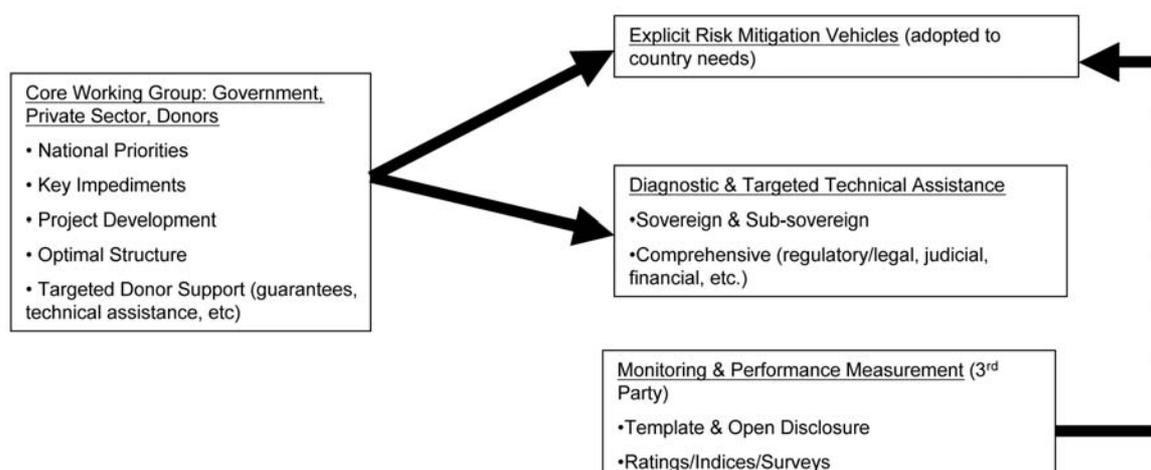
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- Expanding the practice of establishing sub-programmes to support a certain sector and/or type of project in a certain country. Streamlined approval processes could be facilitated for projects falling within the eligibility criteria.
- Disseminating among MDB staff the knowledge acquired from transactions so that when another similar deal is presented, staff do not repeat prior work and focus more efficiently on the due diligence and contractual framework and any new specific issues for that transaction.
- Establishing a periodic forum for clients that have successfully closed deals in which they are invited to candidly assess MDB staff performance and suggest ways to improve the MDB interface with the private sector.

*SOURCE: Giovanni Giovannelli,
www.globalclearinghouse.org/wefbrazil

In essence to effectively mobilize private sector resources, the paradigm for development needs to shift from being donor driven to being firmly developed at the grassroots with full participation of the private sector, as illustrated in the diagram below.

Country-Based Demand Driven Model: Public-Private Sector Partnership



Annex C:

Examples of Risk Mitigation Initiatives

The private sector employs over 90% of the workforce in developed countries. This suggests that the principal driver of rising per capita income in developing countries will be the development of the private sector in those countries. According to the World Bank, up to 90% of poverty reduction can be attributed to broadly-based growth.⁵ A study of 60,000 poor people in 60 countries identified employment as the best way to escape poverty.⁶

Today the private sector is the key supplier of capital (debt and equity) to governments and the private sector alike. In 1985 official sector flows to developing countries were three times as large as private sector flows, but in 2002, gross nonofficial flows were US\$ 380 billion versus official flows of less than US\$ 180 billion.⁷ Huge financing gaps exist in developing countries, and even under the best scenarios, official capital cannot fund these gaps. Increasing the supply of private capital is critical to growth. For example, according to the World Bank, doubling private credit levels as a share of GDP is associated with an increase in average long-term growth of almost two percentage points.⁸

Industrialized countries finance their infrastructure and economic growth largely with funds from the private sector, especially from capital markets. However, both international and domestic capital markets are largely inaccessible to most developing countries, due to concerns about high risk levels. These concerns of private sector investors have been exacerbated in recent years by the extremely high losses resulting from the Asian and Argentine crises. In addition, there have been unacceptably high levels of losses from infrastructure projects worldwide, with around 160 infrastructure projects with private sector participation cancelled between 1990 and 2004 (equating to \$US 79 billion or 9% of the total investment.. In certain sectors, for example water, transport and energy, the cancellation percentage has even been higher with cancellations at 37%, 13% and 11% respectively.⁹

As a result, the international companies that have brought infrastructure services to people worldwide have largely retreated from developing countries following losses amounting to billions of dollars. The boards of many companies providing infrastructure services (water, energy, transport, etc) have decided that the risks are unacceptable for their shareholders, and that they cannot take risks for which they are unable to manage, such as government regulatory risk

(i.e., governments break their contracts) and foreign exchange risk (i.e., governments devalue their currency, block, or change the currency in which payment is received).

The problems relating to wariness of escalating risk amplify the situation in which private sector investments are concentrated in or limited to those developing countries or sectors considered the most creditworthy and profitable. For example, infrastructure finance in 2004 grew by 12%; but the growth was concentrated in telecommunications, up 35%, while all other sectors fell by 20%. Energy projects were limited to Brazil, India, Malaysia, Mexico and Thailand. Transport projects were limited to Chile, China and India. Water projects were limited to Chile, China and Mexico. Furthermore, growth in project sponsors based in developing countries now means that they account for 39% of investment inflows in 1998-2003. But in fact, developing country sponsors were the most prominent in telecommunications, claiming 9 out of 10 projects implemented from 2001-4.¹⁰

Therefore, despite the potential, the reality is that developing countries are not benefiting to the full degree possible from harnessing private sector capital. Private sector capital, whether sourced from within or without the developing countries, is selectively focused on the projects and countries perceived as having acceptable risk.

Irrespective of ideology or degree of confidence in the efficacy of the private sector, development officials are all faced with a key imperative: to develop entrepreneurial ways of using the resources and capital of the official sector to more comprehensively engage the private sector in creating growth, jobs, and more broadly distributed benefits throughout the developing world.

Risk Mitigation Products as Aid Effectiveness Multipliers

Study participants stressed the need to change the role of development institutions: from acting as if they were still the largest source of capital to developing countries, to becoming catalysts that further increase private sector investment, the current dominant source of capital for developing countries.¹¹ The effectiveness of the multilateral and bilateral aid agencies can be multiplied immediately by increasing the offerings of

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targeted risk mitigation products. These can leverage existing official sector capacity by mobilizing private sector capital and expertise.

The huge amount of finance provided by capital markets, both domestic and international, is largely restricted to foreign direct investments and to debt issues rated investment grade (BBB or above) by the rating agencies. As detailed below in this section, a wide range of financial engineering techniques can serve as “aid effectiveness fulcrums” that significantly enhance the development impact of scarce official sector resources by “crowding-in” private capital from capital markets as well as from infrastructure project sponsors.

Risk mitigation products can unleash the underutilized power of the official and the private sectors, enabling the official sector to act as a market-maker catalyst and innovator. The opportunities and constraints centre on the pivotal role of the private sector, the multiplier role of official sector guarantees, and the limited ability of developing country governments to incur more public sector debt as noted below.

Current risk mitigation products offered by the private and official sectors demonstrate their potential power to leverage capital. Instead of simply making a loan or grant, the development institution can use a risk mitigation product to attract other private sector capital, increasing the total amount of capital available to the developing country recipient. Examples of “multiplier effects” include:

- **Full Guarantees** – The total amount of the debt is guaranteed by the development institution. In this way, private sector creditors can in effect substitute for official sector capital. The development institution provides no funds unless the borrower defaults on the guarantee. A reserve account would be established to cover an expected level of defaults.
- **Partial Guarantees** – Only a portion of the debt provided by the private sector is guaranteed, depending on the transaction and the perceived risk levels. For example, a portion of the interest payments or the principal might be guaranteed, or just later maturities if needed. This is cheaper for the borrower than having a 100% guarantee, and it allows the guarantor to reduce its allocated reserve to the project and conserve scarce capital for other transactions.

- **Co-Financing** – The development institution provides a portion of the funding, and the private sector provides the balance. The development institution can attract private sector capital that would not engage in the transaction without the official sector “umbrella,” and minimize the use of its capital.

The benefits of these types of risk mitigation techniques, along with others such as political risk insurance, are proven. USAID claims that its Development Credit Authority can mobilize up to 25 private sector dollars for each US taxpayer dollar, and that in five years of operation it has made almost a billion dollars of private sector credit available in 36 countries at a cost to USAID of only \$28 million.¹² The multiplier effect of guarantees is even greater in the lower risk environments of developed countries. For example, over 50% of US municipal finance is guaranteed by private sector insurers (monolines) with average leverage of 150:1 (meaning 150 dollars of municipal debt can be guaranteed by only one dollar of monoline capital). Such structures are now being used, with limited official sector support, to mobilize local savings in lower risk developing countries to finance infrastructure, although the effective monoline leverage against such emerging market risks is lower than in developed countries, reflecting the higher risks.¹³

Need for New Official Sector Products to Help Developing Countries Leverage Borrowing

Risk mitigation products can serve as “dual leverage instruments,” leveraging the limited sovereign borrowing capacity of developing country governments as well as the capital of official aid agencies. Developing country governments have high debt and liability burdens, limiting their ability to borrow and to guarantee funding needed for infrastructure and other projects. Furthermore, sovereign government issues of local currency, public sector debt often serve to crowd out private sector access to capital, adding to the imperative of reducing sovereign borrowing whenever possible. Risk mitigation products can be used to reduce the debt and contingent liability burden of projects assumed by the developing country government in two ways:

- Partially guaranteed loans made with counter-guarantees by the sovereign governments reduce the developing country’s liability from the total amount of the loan to only the portion guaranteed by the official aid agency; and

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- Loans made through the private sector departments of official aid agencies require no sovereign guarantee, and therefore are not limited by the sovereign's ability to borrow (even if the investments are in public infrastructure).

The use of guarantee products can therefore leverage the scarce borrowing capacity of sovereign governments and local financial institutions, enabling greater access to finance for infrastructure projects and more local currency financing to local companies.

Time to Scale Up

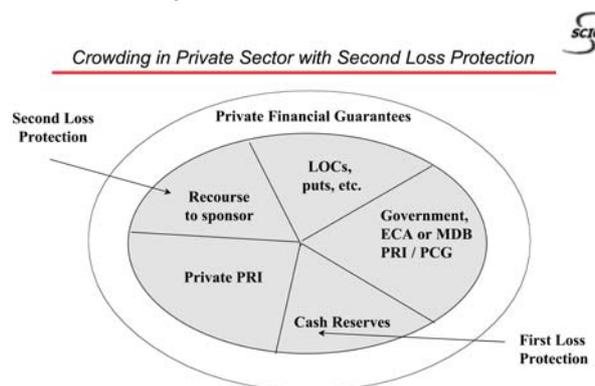
In fact, there have been extensive efforts by the donor agencies to develop risk mitigation products but actual results have been extremely limited. During the two-and-a-half year period of 2001 to mid-2003, the major international financial institutions issued a total of 124 guarantees with a total face value of US\$ 5 billion, equivalent to an annual level of US\$ 2 billion. This represents only 3% of the total amount of finance provided by MDGs and bilateral aid agencies, 1.5% of private sector debt finance, or 18% of NGO grants for that same time period. Similarly, an assessment of IFC's guarantees for the period 2002 - September 2004 indicates that only US\$ 210 million out of a total of US\$ 1.5 billion were in sub-Saharan Africa, and of that amount, virtually all is accounted for by just three projects in South Africa, Nigeria and a regional scheme.¹⁴

A number of new initiatives have recently been launched by the MDBs as well as bilateral donors, but again the scale is not sufficient to make the needed development impact.¹⁵ As noted in the prior section on the need for internal changes to processes and performance monitoring, there are numerous internal blockages that undermine the capacity of development institutions to successfully develop risk mitigation products and use them effectively to engage the private sector. The biases against risk mitigation are wide-ranging, and are embedded both in attitudes and processes.

For example, even in the face of increasing demand and support from the Board, one development executive explained that deals would be constrained by the "zero loss" guidelines – meaning that deals had to be done but absolutely any loss had to be avoided. Another development official in charge of working with the private sector confessed, "You have no idea how

impossible it is here to suggest something new. You simply cannot innovate. Anything new is frowned upon. Going outside (the box) is considered wrong...."

Zero loss underwriting is appropriate for a private sector, monoline guarantee company which is leveraged more than 100 times but "first loss" position is more appropriate for a multilateral that is leveraged one to one (see the egg diagram below). Private sector financial guarantors require a transaction to be "investment grade" before they provide their triple-A guarantees and then they take the second loss position (the egg white). Consequently they look for some other party to take the first loss position (the egg yolk), which can be covered with reserve funds or cash, with a letter of credit or first loss partial guarantee, or with over collateralization by a subordinated investor.



KEY: LOCs=Letters of Credit, PRI=Political Risk Insurance, ECA=Export Credit Agency, PRG=Partial Risk Guarantee, PCG=Partial Credit Guarantee

SOURCE: Structured Credit International Corp

If the MDB is concerned about the negative effect of potential losses from private sector activities on their ratings, they could set aside reserve funds for these activities from their excess capital. Bilateral agencies also need to innovate further, as they have done less risk mitigation transactions than Multilateral Development Banks. This is no small measure because the DAC does not count guarantees provided by bilateral agencies (for example, JBIC, KfW and AFD) as ODA for the purposes of scoring how much development assistance is being provided as a percentage of GDP. The rationale is that guarantees do not result in an inflow of capital from the bilateral agency to the recipient country unless the guarantee crystallizes and is paid. This is reported as a disincentive that constrains the use of guarantees by these bilateral agencies.

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Again, innovating in risk mitigation is endorsed and promoted in the Monterrey Consensus and by all country members of the UN, and seconded by MDB leadership, but undermined by prevailing processes and attitudes on an operational level.

Recommendations

Despite the extensive efforts of committed officials within the development institutions, participants acknowledged that progress in the risk mitigation area has been insufficient and that the opportunity for significantly enhanced effectiveness exists. Below is a synthesis of the overall recommendations and major actionable steps on enhancing risk mitigation capacity in development institutions. These are derived from the large number of recommendations provided by study participants. As noted, the key objective is to use technical financial structures that can better leverage official sector capital by harnessing more private sector capital, so that even without increasing ODA or the capital within development institutions, the public and private sector can immediately be significantly more productive in creating greater economic growth, infrastructure, and jobs needed to meet the MDGs.

OVERALL RECOMMENDATION: To successfully scale up the effectiveness of risk mitigation products, the official sector needs to lead the development of a partnership with the private sector to create risk mitigation products that better meet the needs of both the private sector and recipient countries.

- **First, official sector leadership needs to officially sanction risk mitigation as a core product of the development institution, legitimizing critical function of enhancing aid effectiveness.**
- **Second, senior leadership must insist upon and reward the development of partnerships and collaborative relationships with the private sector in improving and developing risk mitigation products.**
- **Third, all development institutions should report publicly how much private sector capital they have mobilized with their risk mitigation programmes.**
- **Fourth, in terms of bilateral ODA reporting, the DAC should count guarantees as ODA and consider appropriate technical methods for how**

to count them, as well as recognize the additional private sector capital that has been mobilized. Even though guarantees are not a flow unless they are paid, their use catalyzes local and international capital and has developmental impact. Not counting guarantees as ODA has discouraged bilateral agencies from offering guarantees.

Enhancing aid effectiveness cannot be successful without a more open and effective process of engaging the private sector in defining attractive risk mitigation products as well as customized risk mitigation transaction structures that meet the specific needs of countries and projects (with open, in-depth consultation with risk management experts and rating agencies to insure prudent risk management policies).

SUMMARY ACTION STEPS: Specific action steps in which the recommendations might be implemented are provided below. While efforts have been made in many of the areas, it is important now that the senior leadership of the official sector takes control on a results-basis, working proactively and urgently with the private sector to scale up these financial structures for greater leverage and success.

- 1) **Developed Country Models: Developing countries can benefit from the financial models used successfully by more developed countries. Donor institutions should launch a campaign promoting private-public partnerships aimed at aggressively engaging the private sector in adapting financial techniques that have been used successfully in developed countries to mobilize private sector capital.** Examples are provided below:

Public-Private Partnerships in Credit Insurance Guarantees – Developed countries have successfully used private sector financial guarantee insurers (monolines) to facilitate the access of sub-national government agencies and private sector infrastructure projects to international and domestic capital markets. Half of municipal debt in the US is insured by monolines, allowing states and local governments to access enormous amounts of low-cost, long-term borrowings from insurance companies, high net worth and other individuals

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attracted by tax free nature of municipal bonds and other institutional investors.¹⁶ Several proposals have been made and a precedent exists to enable developing country, sub-national governments and private sector borrowers to access international and local capital markets by creating a partnership between monolines and development agencies.

Public-Private Securitization Partnerships - A key principal underlying market development is diversification, in which different investments with different cash flow streams, risks and returns are combined, so that the combined returns of the assets are sufficient to service the liabilities, and the risk of the whole is less than the combined risks of its parts. These diversified structures have proven track records largely in developed markets but also for enabling developing country borrowers to access local and international capital markets.¹⁷ These activities could be scaled up with targeted support from donors, as explained in the following section.

Outsourced Mega Funds and Angel Networks - While official agencies have set up multidonor and single donor funds in developing countries, much more can be done to streamline scaled-up access to finance for projects and companies. For example, study participants proposed large regional funds that could scale up funding for both infrastructure and small and medium-sized companies. In addition, the urgent need to support enhanced access to equity finance, using angel networks and explicit venture capital funds, was stressed.¹⁸

- 2) ***Scaled-Up Risk Products Targeted on Regulatory and Currency Risks: Study after study has repeated the central finding that the principal reasons investors shy away from developing countries are regulatory and currency risks. Development agencies should mandate the urgent development and scaling up of new structures targeted on the critical impediments currently limiting private sector investment in developing countries – government regulatory and currency risks.***¹⁹

If the official sector is to be successful in reengaging the private sector on a meaningful scale following its

large-scale retreat from developing countries, meaningful, targeted official sector support to mitigate these unacceptable macro risks is required, according to study participants. This support should operate within strict guidelines that insure prudent risk management for the official sector (and preservation of triple-A ratings where applicable), and leave the operational and commercial risks for the private sector to assume. Key examples include ***Foreign Exchange Liquidity Facilities, Regulatory Risk Contingency Facilities, Partial Risk and Credit Guarantees and Political Risk Insurance***. These vehicles are illustrated in a later section.

- 3) ***Subsidization of Infrastructure Deals: Donors need to scale up access-broadening infrastructure programmes that provide targeted subsidies for poor clients who cannot pay for basic services such as water and electricity.***

Many developing country infrastructure projects are simply not commercially viable if they are to provide universal services. Previous failures with infrastructure projects have amply underlined the need to subsidize tariff payments to project sponsors in order to broaden access to lower income populations. Many potential and deserving recipients simply cannot afford to pay the rates needed to ensure project viability without subsidies. Several innovative structures (such as the World Bank's Output-Based Aid) have demonstrated how infrastructure projects can be structured to provide poor people with basic services, yet still enable the official sector to harness private sector capital and expertise.²⁰ ***Donors need to realign their institutions to enable the use of grant funding for subsidies to allow for broad-based access to infrastructure services.***

- 4) ***First Loss Guarantees: Donors need to unleash the catalytic power of the official sector by offering on a wide scale basis targeted first loss facilities***

Developing countries often present unacceptable levels of risk and uncertainty that deter investors, given their fiduciary responsibilities to clients and shareholders. In these cases, the official sector needs to be able to accept these risks, especially

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given its ability to reduce risks by virtue of its governmental stature. Such first loss guarantees when combined with private sector investments and guarantees can offer capital market access to more risky countries, such as those rated high non-investment grade (BB- to BBB-) as well as others. The IFC Municipal Fund has successfully used first loss provisions to herald new sub-sovereign transactions.²¹ ***Development institutions need to utilize first loss structures as a key mechanism to engage private sector capital.***

5) Global Development Bonds: To increase efficiency and donor coordination, donors need to consider creating a new asset class that uses the above risk mitigation principles.

A current initiative involving Wall Street and Washington will create a new, fixed income, securitized product called Global Development Bonds (GDBs). Its aim is to mobilize capital in a systematic manner on US and other international capital markets, especially from institutional investors, to finance sustainable development in the developing world, and in particular to provide more funding for critically needed infrastructure projects. Developing country investments can be made on a portfolio basis to diversify and reduce risks for fixed-income investors. GDBs would rely on established Collateralized Debt Obligation (CDO) techniques such as diversification, overcollateralization and tranching. However, GDBs would also augment these market techniques with automatic political risk insurance coverage from public sector agencies for authorized issuers, and in most cases with a currency devaluation facility, callable equity, and a monoline wrap for the senior tranche. The bonds would be backed by existing and new, emerging market infrastructure and corporate debt, and be rated, tradable securities. ***Development institutions need to proactively partner with the private sector in developing such new market instruments that enable access to capital markets in large volumes that advance development.***

“To be effective, donors need to decentralize and delegate approval authority to skilled professionals working within accepted risk management guidelines. New instruments are needed that simplify access and reduce transaction costs.”

These examples of ways to scale up effective risk mitigation programmes need to be undertaken as an open, dynamic and consultative process with targeted investors and recipient countries, in concert with the recommended action steps in the first section on imperative internal changes in development institutions.

ILLUSTRATIVE IMPLEMENTATION STEPS – Below are some illustrative ways in which risk mitigation structures can leverage official sector capital and deliver widespread developmental impact.

Adapt the Monoline Function to Developing Country Needs: A New Public-Private Partnership*

- A Public-Private Monoline Insurance Company, aimed at developing countries, could offer them greater coverage of financial guarantee credit insurance for infrastructure projects implemented on national, state, provincial and municipal levels than available in today's markets. To build on the success of this model to date, consider the monoline financial guarantee business, which started in the US and has become global. Financial guarantors can leverage their capital over 100 times. But they can do so because they take only investment grade risks, bridging the gap between investment grade and triple-A. This type of risk mitigation scheme, if fully developed, could potentially change the very face of developing country infrastructure finance. An example of the power of this structure is the current role of monolines in the US: more than 50% of all US municipal bonds are guaranteed by a monoline, and therefore rated triple-A. In this way, US municipalities can gain full access to US capital markets, with inexpensive, long term finance provided through investments made by pension funds, insurance companies and other institutional investors.

Monoline financial structures in developing countries would require participation from development institutions, as the current risks in those countries heavily restrict the ability of monoline companies to guarantee transactions there that are not rated as investment grade. However, development institutions can partner with monolines, or create new monolines with private sector participation, that use targeted support from the development institution to make such guarantees available to credit-worthy developing country projects.



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The exact structure and operating procedures for a developing country monoline would need to be developed. However, some suggestions related to sub-sovereigns are:

- The coverage could be made available for sub-national governmental entities willing to adhere to the underwriting criteria of the monoline on fiscal discipline
- The risks inherent in such coverage could be underwritten by market players to the extent available in current conditions, including insurance companies, guarantee funds, banks and development institutions
- Coverage against regulatory risks and municipal and state government defaults could be guaranteed by the central or federal government. The central or federal government could have access to federal or central tax revenues shared with states and municipalities to recover any payments made under such programmes.

The lessons learned from prior and ongoing monoline experiences (Asia Ltd, GuarantCo) could also be instructive.

The benefits offered by a monoline structure could be:

- i) access to low cost funding for infrastructure projects;
- ii) investment grade credit risk for investors, including institutional investors, which could be enhanced by tax benefits to make these investments even more attractive; iii) voluntary acceptance of fiscal discipline by states and municipalities; and iv) development of alternative channels for savings to be invested in a secure way in infrastructure projects, resulting in a growth in domestic savings placed in the formal financial sector. Such a structure could also, where needed, eliminate or mitigate devaluation risk, because the multilateral and international support could underwrite such risks. Finally, there is the high leverage factor that applies to resources invested in a monoline insurance company as already outlined elsewhere. While some advances have been made in this area, a full-blown commitment of development institutions to work with monoline companies to develop large-scale monoline programmes could enable developing countries to significantly increase their access to low-cost, long-term, capital market financing.

*Source: Thomas Felsberg,
www.globalclearinghouse.org/wefbrazil and Mahesh Kotecha,
www.globalclearinghouse.org/wefnewyork

The Example of ASIA Ltd.* An emerging market monoline called Asian Securitization & Infrastructure Assurance Ltd. (ASIA Ltd.) was established in 1995 to apply this business model to the emerging markets but it was downgraded in the aftermath of the 1997 Asian financial crisis. Recently wound up, the company was designed to guarantee infrastructure financings and asset-backed securities in Asia. It reached a volume of nearly a billion and a half dollars in contingent guarantee liabilities with claims paying resources of only \$250 million, achieving a leverage of over six times during its active life of two years before it was downgraded in early 1998 from single A to BB. The sovereign rating downgrades that followed the Asian crisis had a knock-on effect, whereby the share of the company's portfolio that was rated below investment grade rose to levels considered too high by the rating agencies to sustain its single-A rating. Had a risk mitigation facility existed from bilateral and multilateral development finance agencies to cushion the cram-down effect of sovereign ratings downgrades on ASIA Ltd's portfolio, the company would still be in business, providing guarantees for infrastructure financings and asset backed securities in Asia and perhaps farther afield. If an appropriate risk mitigation facility were devised today to cushion such a future blow from sovereign rating downgrades, it would be entirely possible to set up another such emerging markets financial guarantee insurance company with a public private partnership to provide effective risk mitigation in developing countries.

*Source: Mahesh Kotecha,
www.globalclearinghouse.org/wefnewyork

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Foreign Exchange Liquidity Facilities: Tools to Mitigate Currency Risk*

A critical impediment restricting developing countries in their access to finance is currency risk. Investors cannot protect themselves from massive changes in the foreign exchange rates, which is of great importance even in countries with local capital markets, given the shortage of needed affordable capital for long-term infrastructure and other projects.

A solution to this is the liquidity facility, which is structured only to cover foreign exchange risk (i.e., significant changes in the exchange rate that threaten project viability) leaving the private sector to assume operational and commercial risks.

This type of risk mitigation structure was called for in the Camdessus Report, and implemented once in the AES Tietê transaction in Brazil with the support of the US Government's Overseas Private Investment Corporation (OPIC). The US\$30 million foreign exchange (FX) liquidity facility provided by OPIC enabled AES Tietê to access the international capital markets for US\$300 million in 2001. The transaction refinanced short-term debt incurred by subsidiaries of AES in acquiring a ten-dam hydroelectric generation company that was privatized by the State of São Paulo in 1999. Although electric power rationing in Brazil resulted in the restructuring of the Tietê transaction in 2004 so as to eliminate the OPIC coverage, the coverage worked as intended during the continuing currency decline which followed the closing of the transaction.

Developing country infrastructure projects are particularly in need of this protection because they typically receive all of their revenues in local currency but may be financed with long-term debt denominated in US dollars. FX liquidity facilities are designed to be used with projects that receive revenues adjusted in accordance with local inflation. The resulting US dollar value of the project's cash available for debt service varies with changes in the host country's real FX rate, but historical evidence indicates that, for most countries, sharp declines in the real FX rate tend to be self-correcting within a reasonable period. An FX liquidity facility provides cash to cover debt service shortfalls when the real FX rate has declined dramatically, and the facility is repaid by the project on a subordinated basis from surplus cash when the real FX rate recovers. The structure of an FX liquidity facility is illustrated in the diagram below.

Benefits:

FX liquidity facilities offer benefits to host governments and their public, to those agencies that provide the liquidity facilities, to project sponsors and to lenders as it:

- Lengthens the tenors of US dollar-denominated debt to finance infrastructure projects
- Lowers the cost of financing (both of spreads and of risk mitigation structures)
- Enables infrastructure services to be provided to the public at lower tariffs because of the lower costs and longer tenors
- Protects the public from having to bear pass-through of FX-related costs
- Protects sponsors from having projects default as a result of adverse exchange rate movements
- Increases the attractiveness of developing country debt to lenders
- Leverages support provided by governmental / multilateral agencies (e.g., in the Tietê transaction, OPIC's US\$30 million FX liquidity facility attracted US\$300 million in private financing)

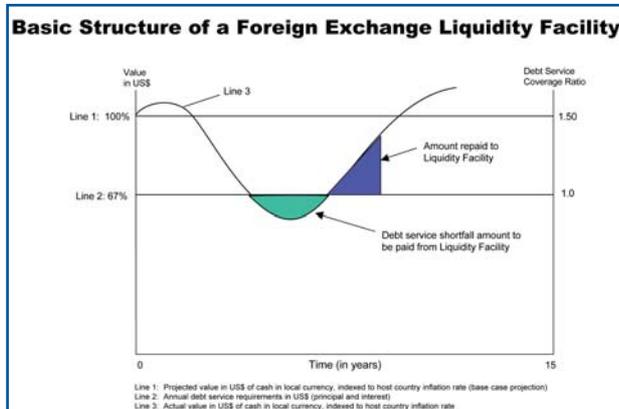
Recommended Next Steps for Implementation:

- **Governments can establish their own FX liquidity facility programmes** (playing the role OPIC played in Tietê). This would broaden the market by eliminating the need for explicit US ties and by increasing capacity.
- **Multilaterals can guarantee the obligations of FX liquidity facilities established by governments with below investment-grade foreign currency ratings.** This step is necessary if such programmes are to be accepted by lenders.
- **Mechanisms to mitigate regulatory risk must be developed.** (Please see the Regulatory Risk Contingency Facilities Proposal in the next box.) Three elements are necessary if a "targeted risk" approach is to be successful on a general basis in below investment-grade countries: (1) inconvertibility coverage must be available, (2) an FX liquidity facility must be used to mitigate currency mismatch risk and (3) regulatory risk must be mitigated so as to enable the transaction to achieve an investment-grade local currency rating.

*Source: Robert Sheppard,
www.globalclearinghouse.org/wefhongkong

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Source: J.R. Sheppard & Company, LLC

Regulatory Risk Contingency Facilities: Tools to Mitigate Government Performance Risk*

– The perception of unacceptable government regulatory risk curtails private investment in virtually all developing countries, for both local currency and foreign currency markets. The envisioned solution is a facility structured to only cover government regulatory risk (i.e., the government breaks its commitments to the investor), leaving the private sector to assume operational and commercial risks. This approach has recently been used successfully by the World Bank in transactions in Uganda and Romania.

What is proposed is a project-specific guarantee that could, in turn, be guaranteed by a multilateral agency or other appropriate entity. The host government would promise to abide by certain critical features of the regulatory regime that it established at the time new infrastructure investments were made by private investors (domestic or foreign). These critical features would include items such as the manner and timing of tariff adjustments and other features such as performance standards, which could fundamentally affect the amount of revenues earned by the project and, thus, its ability to meet its debt service obligations. The guarantee would not have to freeze all aspects of the regulatory regime: certain performance standards could be changed so long as enforcement was by means of fines that are limited in size or subordinated to payment of the project's debt service.

The amount payable under the guarantee by the government guaranteeing itself would be large enough to insure that the host government will take its

obligations seriously and to raise to investment-grade the local currency rating of a project covered by the guarantee. The guarantee would be contingent in that it could be called only if the government were to change the pre-established regulatory regime. The host government would, therefore, have no liability under the guarantee so long as it continued to enforce the regulatory regime that it had designed and implemented.

Benefits:

This structure will provide substantial benefits to host-country governments, project sponsors, and lenders:

- Host-country governments would benefit because the structure will promote needed investment at lower cost. (To be effective, contingent guarantees would have to be combined with inconvertibility coverage and foreign exchange liquidity facilities to achieve investment-grade foreign currency transaction ratings.)
- To the extent that multilateral agencies do not reduce the host country's lending limit dollar-for-dollar with the amount of the contingent guarantee, the host country will make more efficient use of its borrowing capacity. As noted in the prior section, given their lower risk profile and superior loss history, guarantees should count less than direct loans against capital and lending limits.
- The structure addresses one of the major concerns of project sponsors, who are currently reluctant to make new equity investments in countries that they perceive as posing significant regulatory risk.
- The structure also addresses lenders' major concerns, which include both regulatory risk and the lessening credibility of partial credit and co-financing schemes involving multilateral agencies.
- If used in conjunction with inconvertibility coverage and a foreign exchange liquidity facility, contingent guarantees could provide a structure in which a project's debt rating is significantly de-linked from the sovereign's rating. Emerging markets investors (who choose to take sovereign risk) provide little financing for infrastructure projects; but the "buy-and-hold" investors, who finance highly-structured infrastructure projects, do not want to take sovereign risk.
- Contingent guarantees represent the least onerous means of addressing regulatory risk: the host government promises to do what it should want to

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do anyway, and its guarantor takes little real exposure on a guarantee which is substantially less in both amount and risks covered than a direct debt guarantee capable of mobilizing a similar amount of private capital.

Recommended Next Steps for Implementation:

The most obvious step is that either (1) a multilateral must approach a potential host government and propose a programme utilizing contingent guarantees or (2) a government must approach a multilateral.

Assuming that agreement is reached on the concept of contingent guarantees, a major step that must be taken by the host government is the design and implementation of a programme to determine which projects will be eligible for guarantees. The most important aspect of any such programme is the means by which it ensures that projects covered by contingent guarantees will provide service to the public at a competitive cost. The key to political acceptance of a guarantee of regulatory stability is the idea that (without expropriating investors), service could not be provided cheaper under a different regime.

Most infrastructure sectors employ basic technology that tends to have a long, useful and economic life. For example, appropriate competitive bidding procedures can insure that electric power generation capacity is acquired at a price which, in hindsight, will not appear to have been above market and will not appear high in relation to current costs for obtaining similar capacity. Similarly, fuel pass-through provisions can be benchmarked to appropriate market standards. A properly-designed programme can insure that service is provided to the public at the lowest reasonable cost consistent with market pricing – and with avoidance of post-investment regulatory changes which effectively represent an expropriation of private investors.

The final step required is the selection of one (or, at most, a few) demonstration projects. Required returns for privately-financed electric power generation capacity in the US market fell during the 1980s because early projects were successful and, by demonstrating that the risks involved were not unduly high, drove down the risk premium applied to such projects. To reduce the risk premium for infrastructure

projects in a given developing country, there must be a track record of success, where “success” is defined as:

- Successful operation of the project and provision of services to the public at competitive cost
- Generation of returns to project sponsors that are broadly consistent with their original expectations, and
- Demonstrated ability of transactions to avoid being downgraded to below investment grade as a result of downgrade of the sovereign (i.e., a significant de-linkage between the transaction’s rating and the sovereign’s rating).

*Source: Bob Sheppard,
www.globalclearinghouse.org/wefhongkong

Expand Partial Guarantees and Political Risk Insurance

– Partial guarantees (credit and risk) and political risk insurance are longstanding products of official sector agencies. Study participants advocated scaling up these products, making adjustments as needed in consultation with the private sector to enhance effectiveness.

Specific issues and recommendations for **Partial Guarantees** include extending coverage for refinancings and restructurings; reducing transaction costs and complexity; partnering more with private sector; and expanding the programme initiated by the USAID Development Guarantee Authority.

In the area of **Political Risk**, MIGA’s effectiveness needs to be enhanced by eliminating the requirement for insurance coverage of an equity interest before debt can be guaranteed.



Annex C:

Examples of Risk Mitigation Initiatives

Sub-sovereign Applications: Provide FX Risk Mitigation for Sub-national Infrastructure Project Sponsors in Countries Where Local Credit Markets Cannot Yet Deliver Efficient Financing* -

Local credit markets in many countries are not yet capable of providing the size and tenor of local currency funding needed to efficiently finance economically viable projects that are sponsored by sub-national governments. In such instances, medium to long term capital must be imported in some form, but sub-national sponsors and their constituents should not be burdened with the FX risk of that capital importation.

Multilaterals and bilateral institutions should help shield sub-national borrowers from FX risk by supporting, where appropriate:

- Assumption of FX risk by the host sovereign nation (e.g., provision of FX collars provided by the Chilean government to concessionaires requesting them);
- Provision of local currency financing to sub-national governments (as has already been undertaken in some instances such as the IFC Municipal Fund); and
- Redoubling of efforts to create and apply FX risk mitigation strategies (such as the FX liquidity structure used in financing the Brazilian Tietê power project).

*Source: Tom Cochran,

www.globalclearinghouse.org/wefnewyork

Global Development Bonds: an Example of New Financial Structures Aimed at Rapidly Scaling Up Access to Capital Markets*

Global Development Bonds (GDBs) are intended to form a new fixed income product that addresses the need to massively scale up private sector capital for development. The techniques are not new, but assembling the specific features and players is, as is the goal: to attract institutional investors into financing sustainable development, largely infrastructure projects, in the developing world.

GDBs address the need to mobilize private sector capital for development by utilizing the technology of securitization. This has been developed over a period of 30 years and adapted more recently for infrastructure and other project and corporate debt in the form of collateralized debt obligations (CDOs). Thus GDBs will employ market credit enhancement techniques such as diversification, overcollateralization, and tranching. The highest tranche will be AA or triple-A; the lowest, providing the highest return, will be, or will be the equivalent of, equity, and, if in the form of a first loss pool, could be a type of “callable” equity. In early issues, and perhaps beyond, as has been the case with municipal bonds, GDBs will employ credit guarantees from the monoline insurers. They will utilize limited, public sector enhancements as needed, such as political risk insurance, devaluation facilities, first-loss pools, and partial risk guarantees, as well as host-government guarantees and participation.

While truly a public-private partnership, GDBs do not start with the MDBs or bilateral agencies and, for the most part, will not depend on new programmes or products from them. They will require, however, a fundamental “cultural” change in that the development agencies will have to eliminate case-by-case project approval or review. Instead, for GDBs, a public agency (OPIC would be a logical possibility in the US) will authorize a “qualifying GDB issuer” to issue bonds to finance “qualifying uses” in “qualifying countries.” The authorization process, permissible uses and eligible countries will be spelled out in regulation and the agency then will monitor implementation much as the US Securities and Exchange Commission monitors corporate bond issuances.

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Examples of Risk Mitigation Initiatives

We anticipate that GDBs initially will involve US issuers (which will be special purpose vehicles), investment managers, underwriters, rating agencies and monolines, will use USG agency support, and will be sold to US institutional investors on US capital markets. The concept can be used, however, in any country that has a capital market, using its own securities laws. We expect the ramped-up portfolio at closing of the initial issuance will be approximately 50% existing debt acquired from projects, banks, and other investors: in effect a refinancing pool. The remaining proceeds will provide additionality through investments in eligible sustainable development projects. The initial issuance will be developed in the financial community. GDBs will be rated and tradable. With the rating process and criteria established and market acceptance gained, the goal is regular issuances from multiple issuers in many markets.

*Source: John Mullen,
www.globalclearinghouse.org/wefnewyork

Annex D:

Examples of Local Currency Financing Initiatives

A central problem faced by developing countries is how to access the affordable, long term funding needed to finance economic development, especially local-currency capital for financing required for infrastructure projects such as water and energy and the growth of domestic companies. As a result of the nonavailability or high cost of local finance, developing countries have relied heavily on external finance denominated in foreign currencies, accessing lower cost longer-term finance for their governments as well as companies.

However, the history of development finance is blighted with the tragic consequences of such reliance on foreign debt. Financial crises have amply demonstrated time and again the huge economic, social and political costs incurred by developing country governments and companies when they borrow large sums of capital denominated in foreign currencies.²² The Asian and Argentine crises have recently documented the potential for catastrophic effects on local banking systems, companies, and individuals. In – these cases, countries lost years of growth and millions of people lost their livelihoods and savings, becoming destitute overnight. In recognition of these risks, developing countries with International Monetary Fund (IMF) support have developed comprehensive debt programmes that manage asset-liability currency mismatches, with extensive monitoring of foreign-currency debt.

As noted already, one of the main virtues of local currency financing is that it protects borrowers against the devaluation risk associated with borrowing in foreign currencies. This is particularly important for infrastructure projects, which often have revenues denominated in local currency and cannot easily cover the cost of foreign-currency debt payments if the local currency experiences a severe devaluation. Private investors usually will not consider infrastructure projects unless they have some form of protection against devaluation risk.

Reported Problems: Domestic Crowding Out and Lack of Confidence. While the efficacy of borrowing in local currency is well understood by all parties, this understanding is academic in the face of the harsh reality that pushes borrowers to foreign currency loans or renders them no access to any credit at all. The key problem is that local currency financing may simply not be available at affordable interest rates or for long enough time periods to generate revenues for payback.

Furthermore, developing country governments often “crowd out” the private sector, by soaking up the available funding for financing large government deficits. National governments or central banks tend to dominate the market, borrowing at the lowest interest rates. Private sector banks in developing countries often confine their lending business to holding government bonds and only making very select loans, usually for short tenors, to prime borrowers. It is typical for even prime borrowers to face annual interest rates above 20%, and limited financing time periods of not more than a couple of years.

This problem of large fiscal deficits crowding out the private sector is often accompanied by a paralyzing lack of confidence in the country, its institutions, and its future. This is perhaps best evidenced by the long history of capital flight, with developing country citizens and companies exporting capital to developed countries. The success stories associated with expatriate capital, coming from citizens who have moved to other countries worldwide and send capital back to their home countries, actively funding new businesses in many developing countries, is a welcome countertrend that is receiving much attention. However, while the potential for building on these positive trends is well documented, further actions are needed to yield the optimal positive outcomes.

Multiplying the Challenge: The Advent of Sub-Sovereign Infrastructure Finance. Given the recent trend of decentralization, in which sub-sovereign governments accept increasing responsibility for delivering services to citizens, the MDGs cannot be reached unless the challenges of sub-sovereign finance are met. States, provinces and municipalities are increasingly responsible for identifying, developing, managing and maintaining infrastructure projects that provide basic services to developing country citizens.

As a result, the already daunting challenges of infrastructure finance in developing countries has become magnified, as state, province and municipal governments are unlikely to have access to foreign exchange or capital markets and often lack the level of resources available to central governments of developing countries. Further, states, provinces and municipalities are likely to be dependent on the central government for a large amount of revenue. The private sector is particularly concerned about the large risks and uncertainties associated with projects on a sub-sovereign level. Sub-sovereign entities, consisting of

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municipalities, states and provinces, usually lack track records; credit ratings; regulatory, legal and financial frameworks; as well as information on intergovernmental relationships and revenues that would be used for paying back obligations.

Impediments to Sub-national Borrowing for Infrastructure.²³ In many key respects, sub-national infrastructure finance can be thought of as a special form of project finance, with a sub-national general purpose or special purpose governmental, quasi-governmental or non-profit sponsor as the master developer and operator of a public utility or other basic public good. Credit market impediments to locally-denominated sub-national infrastructure finance tend to be similar to those faced by for-profit project sponsors in developing countries, including:

- 1) small numbers of potential lenders or investors in securities (often the same institutions);
- 2) rudimentary credit evaluation skills employed in-house by the few lenders or investors who do control capital, coupled with underdeveloped credit rating agencies;
- 3) lack of rational credit spreads and the resulting absence of market incentives which reward good — and punish poor — financial management;
- 4) single risk exposure limits on lenders and investors posing particular problems for medium and large scale borrowers and issuers;
- 5) underdeveloped or unfamiliar new securities laws, bank regulatory systems and related legal frameworks; and
- 6) general reluctance by lenders and investors to provide the medium to long tenors needed by project sponsors to match the expected economic lives of most public infrastructure assets.

Sub-national public and non-profit borrowers often face acute and specialized versions of these general, local, credit market development barriers. In many countries, the whole concept of sub-national project sponsorship and hard-credit borrowing is so new and the spectrum of possible sub-national borrowers is so wide that the development of buy-side credit evaluation skills and rating systems for sub-national borrowers often lags behind the development of these skills and systems for corporate finance, asset backed structured finance and sovereign finance.

In addition, many developing countries with a prior history of sub-national borrowing are versed in “soft credit” – in other words, the credit that has been

extended has been soft in one or more respects; for example, concessional interest rates, relaxed amortization terms, with little or no risk premiums being charged, and explicit or implicit forgiveness of defaults. This “soft credit” has usually been provided by an official source such as a department of the sovereign government, a government-sponsored (and often subsidized) development bank, a multilateral or bilateral development finance institution, or as directed investment by heavily regulated banks which considered this form of lending as having a sovereign guarantee (explicit or implicit). Overcoming a decades-long soft credit culture for sub-national borrowers is at least as challenging as building a hard credit culture *de novo*.

By contrast, many of the legal and financial impediments to sound sub-national borrowing tend to be quite different from those faced by for-profit project sponsors, especially as corporate-style bankruptcy and liquidation treatment is likely to be inappropriate. Chief among these quite particular impediments often are:

- 1) the lack of clear, consistent central government policies governing sub-national borrowing;
- 2) underdeveloped local taxing powers and systems necessary to collect these “own source revenues” (e.g., property taxation without adequate cadastre systems, ability to charge for water without adequate authority to enforce collection, etc.);
- 3) intergovernmental transfer systems which lack transparency, fairness and annual predictability;
- 4) poorly defined and often poorly enforced accounting standards ; and
- 5) inadequate legal means to pledge revenue streams to lenders or investors, and uncertainty regarding the priority of lender or investor rights after a financial default has occurred.

Overcoming these legal and financial barriers to the development of prudent sub-national borrowing requires years and sometimes decades of committed, well-informed effort by reform-minded decision-makers in key positions at the central and sub-national levels of government. Equally important, it will require the substantially increased support of the multilaterals, bilaterals, and the development assistance community.

Even when the locally denominated credit market, legal and administrative barriers have been largely overcome, sub-national borrowing for infrastructure should retain other additional important and distinctive risk features, including:

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- 1) *Sub-national contract performance risk* - if there is a contractual relationship between a general purpose regional or local governing body (e.g., state, province or municipality) and the actual sub-national borrower (e.g., a public, ring-fenced water and sanitation enterprise, a public or non-profit health services provider, etc.);
 - 2) *Sub-national regulatory risk* - if there is a sub-national governing body which has to agree to a public utility rate or special tax adjustment required by provisions of the financing documents (e.g., to maintain a required minimum debt service coverage ratio);
 - 3) *Sub-national fraud risk* – if corrupt behaviour results in a substantial loss or interferes with the sub-national government’s ability to continue providing an agreed-upon subsidy flow or an agreed credit enhancement to a special purpose, ring-fenced entity; and
 - 4) *Sub-national political risk* - if a sub-national entity decides to divert a previously dedicated fee or special tax revenue and impairs a ring-fenced enterprise’s ability to maintain a specified, minimum debt service coverage ratio.
- **Reduced Cost to Donors.** The cost of providing credit is reduced, as donors do not have to provide the entire credit themselves. The cost is reduced to the portion of debt financed, or if a guarantee, to the cost of holding reserves (or in the case of loss, to the amount guaranteed). For example, USAID’s Credit Development Authority Programme sets aside reserves equal to the present value of total expected defaults under the programme, permitting it to leverage its cost and achieve higher development impact with limited resources.
 - **Development of Local Capital Markets.** As noted in the earlier section, there is a profound lack of confidence in most developing countries that impairs the investment environment and serves to reduce the availability of affordable finance. Risk mitigation products can serve as catalytic confidence levers that stimulate the development of local markets. The official development community can herald a new beginning by championing projects. For example, private sector banks that would not consider lending to a certain sector might be encouraged through an official sector partial guarantee. Pension funds might consider investing in infrastructure bonds for projects that have been supported by a Multilateral Development Bank.

Credit Enhancement as a Tool for Local Market Development. The imperative and potential for change in local capital markets is widely recognized, but the challenge is finding ways to break through the many barriers noted above to enable access to local sources of finance. In fact, as noted in the prior section on improving access to markets, risk mitigation products can serve as powerful catalytic tools, and therefore provide added impetus for local market development in developing countries. Key benefits unique to risk mitigation and credit enhancement include: ²⁴

- **Increased Access to Finance.** Risk mitigation products can serve to mobilize and leverage resources, harnessing private sector capital that would not have been available without the credit enhancement. For example, with partial credit guarantees banks that have not been willing to lend to certain borrowers may be willing to extend credit to those borrowers, often at less interest cost and for longer time periods.
- **Increased Efficiency and Transparency.** The need for more efficiency in the use of donor resources is widely accepted, along with the need to increase the transparency of how donor resources are employed and the resulting benefits. Risk mitigation products can serve to force efficiency, discipline and transparency on all parties: risks need to be explicitly documented and risk mitigation products tailored to meet the specified risks. The targeted private sector creditor needs to be consulted about the nature of perceived unacceptable risks, and the government and donor need to be efficient in addressing those risks. Openly identifying and discussing how to mitigate risks such as changes in regulations or fraud serve to bring sensitive issues into the open, enabling the straightforward design of solutions.
- **New Impetus for Government Fiscal Transparency and Good Governance.** A critical way to enhance confidence is to create incentives for improved governance of governmental institutions. Availability of finance can create

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profound incentives for fiscal discipline, accountability and transparency in disclosure and practices. Risk mitigation products that involve the private sector will require open, regular reporting and adherence to new measures of fiscal discipline. Again, this can reinforce accountability and results.

It is important to note, however, that the use of risk mitigation products can serve the above objectives only if they are designed and implemented with full transparency and high quality resources. As suggested in the next section, the special demands of sub-sovereign finance will require scaling up across the development community with the development of in-country capacity to meet this challenge efficiently and effectively.

Development of In-Country Credit Enhancement Entities. Having risk mitigation products targeted on local market development is not sufficient; indigenous capacities for credit enhancement also need to be created in developing countries if risk mitigation products are to be successful in developing local markets that serve to advance economic development.

The imperative for in-country capacity is evidenced by the pervasive number of in-country credit enhancement entities in industrial countries. Throughout Europe, Canada and Europe, specialized intermediaries help finance states, provinces and municipalities. For example, the US, as the world's largest market for municipal finance, has over 50% of all debt issuances insured commercially by monolines, with another large portion of its debt financed through credit pooling (State Revolving Funds). In Sweden, Finland and the Netherlands, state-sponsored local government co-operatives borrow in the markets and on-lend to sub-sovereign entities. In France, Belgium, Spain and other Western European countries, specialized banking companies (once state-owned) provide for local government financing. Bond banks are used in Canadian provinces.

Study participants also stressed the need for other credit enhancement institutions within developing countries themselves, especially with regard to export finance and SME finance. All OECD countries have Export Credit Agencies (ECAs) to which taxpayer money is provided to promote exports. However, many developing countries do not have ECAs, but would benefit from such a national institution, or possibly one large South-South ECA.²⁵

Similarly, developed countries have institutions that help finance SMEs. For example, the US has the Small Business Administration. Developing countries also need to have such support mechanisms, perhaps in the form of restructured Development Financial Institution (DFIs).²⁶

“We deny developing countries the instruments that are used routinely in developed countries. Credit enhancement is used throughout Europe and North America to enable needed infrastructure finance as well as to increase exports and to help small businesses access affordable funding.”

To develop viable local capital markets, developing countries will need to develop these types of intermediaries as well. The message is important: **risk mitigation products provided by the donor community need to be used as a means to strengthen or create local institutions that can serve such risk mitigation and credit enhancement roles within developing countries themselves.**

Local Currency Financial Techniques: Progress to Date. The donor community has focused extensively on developing local currency markets. The most widespread local-currency financing technique used by development institutions is the guarantee of local-currency financing provided to a borrower with a guarantee from the development institution. By taking the credit risk of borrower default, the development institutions have been able to mobilize local-currency financing that local financial institutions would not otherwise have been willing to provide.

Local Currency Guarantees. As noted earlier, a local-currency guarantee has the beneficial effect of mobilizing local-currency savings for local development projects. It also can be used to encourage the development of local capital markets by developing a wider range of instruments in which local institutions can invest. The local-currency guarantee has been particularly effective in fields such as infrastructure, where local financial institutions sometimes feel they do not have the credit analysis experience to provide funding without a guarantee, or where local regulatory constraints prevent them from accepting credit risk of the kind associated with infrastructure. It is important to

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note that *local currency guarantees also improve the risk profile of the development institution giving the guarantee*, in that a local currency guarantee can be less risky than a loan denominated in dollars or other hard currency, because the technique insulates the borrower from financial stress associated with currency devaluations, and therefore makes it less likely that currency devaluation will cause the borrower to default. A majority of the local-currency guarantee transactions have been in countries such as Mexico, Colombia and Chile that have experienced reform of their pension systems and now have institutional investors with an appetite for long-term, local-currency denominated assets. In countries without a market for long-term, local-currency debt instruments, it has proven more difficult to use the local-currency guarantee instrument.

In a number of cases, however, MDBs have provided a “put” option to local commercial bank lenders, as a way of encouraging the banks to provide longer-term financing than would otherwise have been available to local borrowers. This is a promising technique for extending the maturity of loans to match the requirements of infrastructure projects, which often require longer-term lending to be commercially feasible. The efforts of MDBs to provide this kind of “tenor-extension guarantee” should be encouraged.

Other techniques have also been used to provide local currency financing. For example, an MDB can sometimes borrow local currency on the strength of its own balance sheet and then use the proceeds to make loans denominated in local currency. Another technique, which has been used by the Asian Development Bank in the Philippines, is to enter into a “swap” in which the MDB uses the proceeds to make long-term loans denominated in local currency, using local banks as intermediaries.²⁷

Innovative new programmes have been implemented that violate prior mainstream donor practices. For example, some donors, such as the EBRD and The Municipal Fund (a joint initiative of the World Bank and the International Finance Corporation) sometimes waive the requirement for the central government of the host country to provide a sovereign counter-guarantee. This is a major departure from prior practices that have relied heavily on the sovereign counter-guarantees for credit comfort.²⁸

In addition, some donor programmes have created the “patient capital” model needed for longer term results, combining grants to cover large first-time transaction costs (such as lawyers fees) as well as subsidies needed to supplement tariffs or extend maturities.²⁹ This is a critical innovation, as it combines grants with loans and guarantees, often requiring new structures and relationships between donor entities.

Below is a synthesis of the overall recommendations and major actionable steps provided by study participants that are considered likely to have the desired outcome of enhancing the internal capacity of donor institutions to increase access to local currency finance.

OVERALL RECOMMENDATION: *To enhance the ability to increase access to local currency finance, development institutions need to work more extensively with the private sector in developing new financial methods, creating catalytic first-time transactions, and developing local institutions within developing countries for both credit enhancement and SME finance.* Study participants underlined the imperative for greater senior leadership of development institutions in the area of developing local current finance, building on the experiences to date, including both the scaling up of risk mitigation products for immediate large scale replication, and new vehicles that facilitate the development of in-country indigenous capacity. It is important to note that the internal organizational changes recommended in the first section of this report are needed to facilitate the required innovation and collaboration with the private sector. In addition, the other risk mitigation tools (noted in the prior section) that deal with risks such as regulatory and performance risk are critical additional tools.

Participants also suggested that several of the instruments mentioned in the prior section on risk mitigation would be extremely useful in developing local currency markets, and urged large-scale replication:

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- **Monolines** - as in developed countries, can be used to tap savings in local capital markets
- **Partial Risk Guarantees** – as illustrated by USAID’s Credit Development Authority, guarantees can be used to encourage local banks to provide access to credit and also extend longer term credits to new credits
- **Diversified Funds** – using the official sector as a catalyst, jump-start access to both equity and debt funds (including venture capital)
- **First Loss** – building on the success of the IFC Municipal Fund, extend official sector ability to create demonstration effects and build market confidence.

In addition, the importance of developing needed information, analyses and ratings were stressed. All these measures will require senior leadership across development agencies to create new technical avenues of targeted open collaboration between experts in the official sector and those in the private sector.

ILLUSTRATIVE IMPLEMENTATION STEPS – Below are examples of existing techniques that could be scaled up to enhance access to local currency financing.

Tenor Extensions: Development Institutions Targeting Their Guarantee Power to Enable Extension of Local Currency Finance*

In some cases development institutions have targeted their guarantee power on the need to lengthen maturities. For example, the IFC and Proparco, the French development finance institution, granted an option to local Cameroon banks that required them to refinance 100% of the outstanding debt in the sixth and seventh years after disbursement. This allowed the banks to treat the seven year loans as having a five year maturity for regulatory purposes, which reduced the risk of the loans, and therefore the amount of capital they were required to set aside for the loans. This enabled the local banks to approve the loan and provide a greater amount of financing.

*Source: Jon Haddon, “A Partial Solution,” *Project Finance Magazine*, April, 2004.

Local Currency Swaps: Public Private Partnerships Between Development Institutions, National Governments and Commercial Banks*

The Asian Development Bank has begun a local currency swap programme aimed at providing increased local currency capital for development projects to its member countries. The first transaction was in the Philippines, with \$US 200 million provided to the Philippine government in return for the equivalent in local currency. The ADB will use the local currency for on-lending to Philippine commercial banks at fixed rates. The banks in turn have additional liquidity for lending operations, enabling them to make long-term loans with no currency or maturity mismatches. The commercial banks are responsible for commercial risk, and the ADB for the risk of the country and the resident banks.

*Source: Robert Bestani and Ajay Sagar, “The Local Currency Financing Revolution,” *Asia Pacific Report*, Asian Development Bank, May 8, 2004, pp. 12-15. Also see Bob Bestani, “The Road Less Travelled: A Private Sector Framework for the Multilateral Development Banks,” www.adb.org

ISSUE LOCAL CURRENCY BONDS: Increasing the Supply of Local Currency Financing*

The MDBs have recently begun to issue local currency bonds that enable them to source needed local currency for local currency denominated activities. For example, the Inter-American Development Bank (IDB) has issued a 10-year local-currency bond for Ps1 billion (US \$93 million) in the Mexican market, offering a rate of 8.67%. In Mexico 65% of the issue was taken up by Afores (pension funds) and the rest by foreign investors. The issue was oversubscribed by Ps1.3 billion and was led by HSBC. The IDB issued a three-year peso-denominated bond in Mexico last year for Ps3 billion paying 6.59% per annum. Following this issue, the Bank launched local-currency bonds in Colombia, Brazil, Chile and Peru, helping to develop an international market in Latin American paper.

The critical issue is insuring high development impact from the proceeds. Funds raised in the local market must not “crowd out” domestic insurers, but rather serve to provide them with longer term affordable sources of finance.

*Source: *Latin Finance*, October 4, 2005.

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STRENGTHEN AND DEVELOP IN-COUNTRY FINANCIAL ENTITIES: Need for in-country linkages with donors and the private sector

For decades, Development Financial Institutions (DFIs) have played a significant role in the economic and industrial development of both developed and developing economies. However, of late faced with the high cost of resources and stiff competition from commercial banks, most of the DFIs are converting themselves into 'Universal Banks' and shaking off their main function of providing long-term financing for development. This trend has received the backing of governments / central banks in many countries without them realising the adverse effects and implications of the transformation of DFIs to Universal Banks. Many such countries have started registering a slow or downward trend of growth for want of financing.

For enhancing long term investments, a new form of local DFIs is essential in developing countries. DFIs have a significant and critical role in promoting investment climates and rendering financial assistance to various development programmes, including infrastructural, and thereby maintaining sustained economic growth of a country. To achieve this objective a strong network of local DFIs today seems essential for financing.

To meet this challenge, the proposal is either to (i) Restructure existing Development Financial networks in developing countries so as to have more Local / Regional flavour without government intervention or (ii) Set up local DFIs as the new face of Public Private Partnerships (PPPs) or Joint-Venture Companies (JVCs), without government ownership.

The cardinal principles for both the forms are (a) less or no reliance on government support and donors' grants / concessional funding for loan portfolio and (b) self-reliance, based mainly on using local resources and domestic capital markets, moving to international capital markets in due course.

*Source: Dr. Sailendra Narain,
www.globalclearinghouse.org/wefhongkong

Partial Local Currency Guarantees without Sovereign Guarantees: The IFC/World Bank Municipal Fund*

Established in May 2003, the Municipal Fund is a joint initiative of the World Bank and the International Finance Corporation (IFC). It gives creditworthy local and state entities the opportunity to invest in infrastructure projects without taking sovereign guarantees. This is a novel approach to development infrastructure, as traditionally the World Bank has invested in municipalities through government guarantees as required by its charter. The International Finance Corporation instead has invested in a wide range of sub-sovereign infrastructure projects but always through private sector sponsorship. By bringing together the World Bank public policy experience and IFC credit culture and market expertise, the Municipal Fund intends to fill a gap in a potentially large market where the opportunities for impact are immense.

The Municipal Fund supports investments made by states, municipalities and municipally controlled entities in sectors such as water, wastewater, electricity, district heating, solid waste and urban transport. We also support public-private projects such as leases, management contracts, and concessions, either through financial support or through private concessions / special purpose vehicles controlled by sub-sovereign institutions.

For example, the Municipal Fund provided a peso-denominated partial credit guarantee of up to US \$3 million to support the issue of up to US \$8.8 million in bonds in the Mexican capital market. The Tlalnepantla operation represents IFC's first direct municipal finance deal and the first municipal bond offering in Mexico without recourse to a federal guarantee or assignment of federal transfers.

The proceeds are being used to finance the design and construction of a wastewater treatment plant – the first in Tlalnepantla – that will recycle residential and industrial wastewater for industrial reuse. The use of recycled water will free up potable water to meet the growing demand, reduce the flow of untreated sewage into a drainage canal of the Rio San Javier, and relieve some of the pressure on groundwater aquifers in the Mexico City area. The project will also implement a leak reduction programme for the existing water supply network.

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For Declan Duff, director of the IFC/World Bank Group Municipal Fund, these awards represent “an exciting and encouraging recognition.” Mr. Duff added, “The Tlalnepantla project is pioneering in several ways. IFC, along with our partners, Protego and Dexia, introduced a promising new model of finance in Latin America, whereby municipalities can secure financing entirely through their own fiscal revenues.”

*SOURCE: <http://www.ifc.org/municipalfund>

Annex E:

Examples of Capacity-Building Initiatives

Despite many efforts over the years in this critical area, developing countries often consider donor capacity-building programmes to be ineffective and even counterproductive owing to how such programmes are conceived and administered. Common criticisms include:

- As donors are sometimes restricted to using their own home country goods and services, recipient countries are unable to select the most appropriate local providers of such services, so these providers are unable to gain experience and grow;
- Donors often do not coordinate, leading to redundancy with overlapping projects and excessive reporting requirements; and
- Developing countries cannot direct the focus of capacity-building as project selection is often driven by the donor's political agenda and priorities.

As a result, some developing country government officials feel that capacity-programmes inadvertently undermine their countries, instead of helping them. In fact, some research indicates that aid flows may damage policy environments by creating moral hazards, by siphoning skilled workers from governments and by encouraging political infighting, fraud, and theft.¹

In addition, developing country governments are inherently constrained by resources, so direct donor collaboration with developing countries in exclusion of the private sector can limit the potential for identifying opportunities and strategies, and implementing successful transactions. Private sector experts underlined the need to work with donors in helping the government to identify development priorities and the full range of potential technology and implementation options.

“The private sector can provide ideas on options – technology, process, tools - that help governments to be more successful, but today donors deal mainly through governments. The process is dysfunctional and bureaucratic without being informed on the best ways to achieve development objectives.”

Escalating Demand for Capacity-Building Programmes.

Meanwhile, daunting needs have multiplied on two fronts, as many countries proceed to decentralize the responsibility of infrastructure development to state, provincial and municipal levels and to place increased emphasis on small and medium-sized enterprise development. Indeed there is

widespread recognition of the urgent need for developing countries to find ways to develop local capacity.

The decentralization process in many countries has resulted in the transfer of service responsibilities from central governments to sub-sovereign entities. These sub-sovereigns face large investment needs as they strive to improve the quality and coverage of the infrastructure and basic services that are essential to support economic growth and reduce poverty. However, the regulatory environment in which they operate is still evolving, and their own institutional capacity is uneven.²

The Need to Change Delivery Mechanisms: Creating In-Country Capacity. The lessons learned in capacity-building programmes over the many years of extensive efforts point to one single critical success factor: **The ability of developing countries to master their own development will be undermined if there is not an explicit strategy to build in-country sustainable capacity.** To achieve this, study participants stressed that basic changes need to be made in how capacity-building programmes are designed and implemented.

If programmes are to be effectively scaled up to meet the daunting demand, four strategic wholesale changes in design and implementation are required:

- **COUNTRY INTEGRATION:** Study participants emphasized the imperative of linking capacity-building systemically to in-country institutions and organizations.³ As noted, the standard capacity-building programmes often rely heavily on imported experts from the donor institution (sometimes due to tied aid), and all too often fail to make sufficient skill transfer in the country or to develop in-country, long-term capacity to provide training and self-sustain the skill set. Capacity-building programmes need to identify long-term, systemic strategies for indigenous sustainability, based on long-term funding and partnerships with local institutions and organizations (regional, national, and sub-sovereign).
- **USE OF THE PRIVATE SECTOR:** The design and implementation of capacity-building for private sector development must involve business at the systemic level, whether private sector companies, business organizations or private sector experts. Donor staff usually have limited private sector experience, and lack the skill sets to design, implement, and support capacity-building programmes focused on the private sector. Further, channelling aid directly to private sector organizations can serve to strengthen needed growth as well as avert problems with government effectiveness and governance.

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- **GLOBAL AND REGIONAL TOOLKITS:** To enhance effectiveness and enable large-scaling up, donors need to jointly develop more effective and relevant tool kits to include principles, best practices, and e-learning programmes that support these locally-based capacity programmes. The tool kits should offer “menus” of possible approaches, enabling customized approaches that fit the specific needs of the recipients. The scope of existing tool kits needs to be widened to cover sector issues (such as water, energy, transport, etc.), the improvement of the country’s business environment (legal and regulatory frameworks, property rights, etc.) and skill sets (accounting, business planning, credit analysis, etc.).⁴
- **USE OF THE INTERNET:** Technology offers new opportunities for whole-scale effective and efficient delivery of information that enhances capacity-building. For example, targeted recipients should be able to freely access information on free tool kits and e-learning programmes offered by development agencies and other organizations, as well as contact information for both official and private sector experts and services. Some initiatives exist in this area but need to be strengthened with financial support.⁵
- Independent reviews to assure the quality and completeness of pre- existing feasibility and engineering studies;
- Financial advisory services for project structuring;
- Technical assistance for project implementation and oversight (including preparation of bidding documents, review of technical proposals, supervision of investments and commissioning);
- Support in obtaining full or shadow credit ratings;
- Financial improvement plans, including measures to improve the administration of local taxes and utility service charges; the efficiency of municipal expenditures; and the quality of financial controls, budgeting, accounting and reporting.
- Training of key municipal officials in financial management and project management; and
- Communication, public information and stakeholder consultation.

As noted in the risk mitigation section, donor funds need to be used to subsidize a portion of capital expenditures for development projects that are important but not financeable on commercial terms.

In addition, donor funding is rarely available for developing the skill sets needed to develop a country’s capacity for distribution, marketing, or sales or information dissemination.⁷ If the country’s business environment is to be improved, capacity-building funds need to cover the development of the skill sets for distribution and logistics critical to developing the private sector in the country. The success of companies, especially small and medium sized ones, is inherently dependent on the ability of the country’s overall distribution and logistic systems to provide critical support. For example, supplies or output may need to be delivered using public roads, airports, or ports; reliable companies may be needed for computer services, to ship items or help with overseas marketing; information is needed from credit rating agencies, credit bureaus and transaction centres. The scope of capacity-building needs to be enlarged to help create the country’s information, distribution, and logistic infrastructure and a supporting business environment.

Expanding the Focus: Business Skill Sets, Business Organizations, Property Rights, Distribution and Logistic Supports. Insufficient funds are focused on the huge need for developing core business skills (development of business plans, credit analysis, accounting, auditing, etc.), and the training of government officials to work effectively with the private sector. Funding needs to inspire new working relationships between the government (national, state, and sub-sovereign) with the private sector, enabling the strengthening of the capacity of government officials to work effectively with the private sector, and the capacity of the private sector (business organizations and companies) to develop their businesses. Critical areas such as property rights, core to enabling widespread access to credit, need to be supported with both the development of basic principles as well as in-country support programmes (for example, property registry centres).⁶

As noted above, there is an urgent need for technical assistance funds on a large scale to provide support at the sub-sovereign level in several areas. In developing countries where decentralization is at early stages, there is need for support to central governments in designing efficient and responsible sequencing of fiscal decentralization and appropriate intergovernmental fiscal frameworks. More broadly, capacity-building support is also needed for areas such as:

OVERALL RECOMMENDATION: *To enhance capacity-building in developing countries, the leadership of official sector institutions needs to refocus and scale up capacity-building programmes in partnership with the private sector to ensure greater mobilization of private sector expertise in improving business-enabling environments.* Study participants underlined the imperative for greater senior leadership of development institutions in changing the way capacity-building

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programmes are conceived and implemented, building on the experiences to date, including both the scaling up of successful capacity-building programmes for immediate, large-scale replication, and new vehicles that facilitate the development of in-country indigenous capacity. It is important to note that the internal organizational changes recommended in the prior section of this report are needed to facilitate the innovation and collaboration with the private sector required for this recommendation.

Specific action steps to enhance capacity-building include:

- 1) **Funding:** *Increase scope and sustainability of funding* – Capacity-building funds need to be committed on a long-term basis (over 5 years) to insure sustainability and the creation of indigenous capacity within the country.
- 2) **Procurement:** *Simplify access and reduce transaction costs with a pre-qualified directory of experts and organizations* – Existing procurement rules are not cost-effective, and impair the ability of many qualified organizations and experts to provide capacity-building services. In addition, recipients of donor services do not have access to information on available expertise, so the ability to select the most appropriate experts is limited. New, streamlined processes need to be developed to facilitate a larger supply of expert services and the ability of countries to select the most qualified experts.
- 3) **Untie Aid:** *Allow countries to use the most appropriate services and qualified experts* - Capacity-building funds need to be available for the most appropriate uses and not limited to using the services of the donor country.
- 4) **Delivery Mechanisms:** *Create new mechanisms to harness needed expertise from private sector* – The official sector should build a market of experts and country clients, enabling needs to be matched with suppliers, and working hand-in-hand with the private sector. The training needs are great, but so is the supply of volunteers and consultants from within the developing countries as well as developed countries. New initiatives such as a “Global Corps of Capacity-Building Experts” and SWAT teams could serve as organizing frameworks for delivering needed experts, supplemented with tool kits and e-learning. *(Please see illustrative examples.)*

- 5) **Country Integration with Sub-sovereign Focus:** *Designate country technical assistance delivery centres and improve the sub-sovereign governance framework* - There needs to be effective multi donor coordination in assembling an adequate supply of targeted technical assistance against defined priority country needs with decentralized centres of support in local institutions (such as local development banks, business organizations, consultancies, etc.). Training programmes need to be developed with local institutions (such as development banks, business organizations, universities, think-tanks and consulting firms) and be focused on the full range of relevant government officials (for example, ministry staff, regulators, judges, sub-sovereign officials, etc.) as well as private sector people (bankers, fund managers, consultants, etc.). Defined Assistance Programmes also need to improve the sub-national governance framework⁸ providing targeted assistance to enable legal, regulatory, policy, institutional and overall project management improvements.

LINKING CAPACITY-BUILDING WITH RISK MITIGATION & PRIVATE SECTOR ACTIVITIES

Capacity-building, however, is not limited to the training programmes mentioned in the prior section, but also includes other capacity-building activities that serve as catalysts, incentives and influences that create turning points, demonstration effects, large dissemination and development impact. In fact, this is perhaps the most critical capacity-building role of the official sector: to launch new catalytic initiatives that directly target the morass of dysfunctionality in developing countries where both public and private sectors are ineffective and at a stalemate, using targeted, official sector resources judiciously to catalyze new constructive relationships that mobilize private sector resources.

RECOMMENDATION: *The senior leadership of donor institutions need to make concerted efforts to supplement ongoing capacity-building programmes with catalytic initiatives that create demonstration effects and rewards for change, as well as enhance capacity.* These programmes need to be designed and implemented with the private sector. As with the prior recommendations, this will require a new way of working with the private sector, as outlined in the first set of recommendations.

Study participants highlighted the critical role of six specific types of catalytic mechanism, and the need for development agencies to scale up these activities in partnership with the private sector:

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- 1) **Leadership in First-Time Transactions:** *Be a market leader in heralding the first transactions in a country - A critical role of the official sector is to act as a catalyst for first-time financial transactions, creating the conditions and confidence for subsequent transactions by demonstration effects. The effectiveness of this approach has been demonstrated by both multilateral and bilateral donors with strategically-targeted transactions.⁹*
More funding needs to be made available to cover the very large transaction costs associated with these first transactions, covering the large legal and administrative expenses.
- 2) **“Learn-By-Doing” Transaction Programmes:** *Establish explicit transaction programmes that create impetus for capacity building - Study participants underlined the imperative for donors to conduct wide-scale programmes that develop deals even when the country environment lacks the requisite regulatory and legal frameworks.* Transactions provide critical vehicles for “learning-by-doing,” serving to effectively demonstrate to country government officials and stakeholders the imperative for change in the country environment (such as the legal, regulatory and institutional framework), and to enable the identification of appropriate country-specific priorities. In essence, transactions can serve to “test” for priority changes and signal appropriate customized enhancements, creating the demand and dynamic for focused prioritized reforms. An additional mechanism that might be used (often used in existing donor programmes) is to tie access to donor project funding to participation in capacity-building programmes.
- 3) **Official-Private Sector Communication Venues:** *Integrate private sector working groups into core development work - A critical means of enhancing official sector capacity, both at the country level (national and sub-sovereign) as well as of development agencies, is through the use of venues that facilitate collaboration with private sector experts and organizations. Interaction can help educate official officials on the need for changes in government policies and for improving the business environment, as well as the need to improve skill sets and official sector services in risk mitigation and project development. Study participants recommended the enhancement of donor support of public-private working venues aimed at improving sub-sovereign issues, infrastructure (such as water) risk mitigation and the business environment, and their integration into core development activities.¹⁰*
- 4) **Enhanced Disclosure:** *Require and participate in open disclosure of information on programmes, objectives, disbursements and results - The catalytic effect of “transparency” has been widely recognized. Recent initiatives have shown the vast potential of enhanced disclosure and transparency in catalyzing financial governance and improving the overall business environment, creating pressures to adopt new processes and enhance in-country capacity-building in accounting, auditing, project management and other critical business functions. Examples include donors openly publishing their disbursements to governments, countries publishing concession contracts and licenses for private infrastructure projects, and global campaigns to enhance the transparency of revenue arrangements between governments and firms.¹¹*
Development institutions need to set firm disclosure requirements, further employing surveys as well as third party entities to measure performance.
- 5) **Open Client Evaluations and Independent Auditors:** *Employ third-party entities to obtain the candid evaluations of clients and targeted beneficiaries, including governments and investors, and require independent audits of projects - Pressure can be increased through the use of independent auditors that monitor compliance. For example, the Nigerian government agreed to publish budgets and records of oil revenue collection, as well as applicable statutes and rules, and ask oil companies to also make full disclosure of their revenues and costs. Both disclosures are then examined by an independent auditor to access any differences.¹²*
The general use of third-party entities, coupled with open disclosure of evaluations, can be employed much more widely by development agencies as a mechanism to create pressure for change, setting the prerequisite dynamic for capacity-building and improved business environments.
- 6) **Information Benchmarking, Peer Sharing Venues, and Incentives:** *Develop targeted use of information, such as public benchmarking of enabling environment conditions, and the development of related financial indices, to create local pressures, incentives, and rewards - For example, the US Export-Import Bank provides lower pricing for countries that have signed the Cape town Treaty, thereby agreeing to comply with uniform legal frameworks which minimize risk in the financing of high value mobile equipment.¹³* Similarly, a number of benchmarking tools have been developed, and could possibly be refined and tied to financial indices and investments, providing

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concrete monetary rewards for improvements in the country's business environment.¹⁴ Study participants recommended that development agencies work with fund managers, pension funds, social responsibility investment organizations, rating agencies, and direct investors to refine the existing work and develop more specific instruments that can directly reward developing countries for improved business environments (for example, indices, ratings, niche funds, etc.). Another critical way to develop powerful incentives is the development of more venues for peer countries to share experiences, best practices and new instruments, as illustrated in the examples below.

Development institutions need to scale up their funding and more explicitly support activities involving the private sector that use information, networks and peer review.

"Replication is key.... Seeing peer countries progressing is invaluable, and creates a competitive dynamic.... Countries do not want to be left behind."

By expanding their programmes to employ the above instruments and processes, development agencies can be as innovative in approaching capacity-building as in risk mitigation. Key to the process is developing new catalyst programmes and instruments that cover both standard training as well as new incentive dynamic inputs, both with a much enhanced degree of private sector partnership. In short, if development agencies invest more in targeted catalytic instruments and processes, they will be more effective in improving the conditions for private sector engagement and private sector-led growth.

ILLUSTRATIVE IMPLEMENTATION STEPS: Below are illustrative examples of how to implement the above recommendations.

Increase Efficiency & Access to Experts with Simplified Partnership Processes

Currently many private sector experts are precluded from participating in capacity-building programmes by onerous bureaucratic requirements.

Senior leadership can change this by mandating the streamlining of requirements. Suggested ways include:

- Empower recipient countries to select the providers of services (untied aid)
- Use pre-qualified lists with extensive information on expertise and prior performance
- Require such lists to include a wide range of qualified private sector experts
- Require harmonization of overlapping donor programmes & duplicative reporting requirements
- Establish and implement performance evaluation systems (and include this in an open database for recipient countries)
- Provide long term funding (5 years)

The Development Assistance Committee or the World Bank could develop streamlined guidelines in consultation with bilateral donors and the Multilateral Development Banks.

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Private Sector Governance Training: Can a Global Corps of Financial Experts Help?*

The creation and rapid education of international standard financial regulators and institutional infrastructure are critical if emerging market financial sectors are to develop quickly and appropriately to support faster domestic economic growth. Current bilateral and multilateral assistance for the development of financial infrastructure in emerging markets is largely geared to direct long-term lending and, secondarily, to equity investment, with few resources invested in the education of key financial counterparties in developing countries to prevailing international market practices. Particularly in Asia, the initiatives for corporate governance training have been largely centered on listed companies and the stock markets, not the broader financial community including commercial and central banks.

Short-term technical assistance and targeted training by private sector experts can help fill the gaps in education and standards in this critical area. Active, senior level practitioners from developed financial markets in the US, Europe and, even to some degree in Asia itself, are more than willing to offer *pro-bono* time to assist this global education process through individual consultations and targeted workshops or training forums. This includes very senior level individuals from financial regulators, commercial and investment banks and associated disciplines such as legal and accounting firms.

The Financial Services Volunteer Corps (FSVC) has a fifteen-year track record in successfully designing and administering such exchanges and institution building programmes, and is restricted in scope only by the limits of official aid money for such activities. It has a very successful history of such targeted assistance and training to financial sector intermediaries around the world. Since inception it has completed over 1,500 programmes.

In reforming or creating financial institutions, emerging market financial regulators and sector leaders have the opportunity to eliminate conflicting laws and regulations and become early adopters of international best practices by being given rapid and practical exposure to developed market practices. The traditional response times and required bidding practices of multilateral agencies to provide such technical financial assistance are too slow in many cases to be of timely assistance.

Having access to an established pool of leading experts in a wide range of disciplines offers reforming officials and their constituents the opportunity for both rapid and practical education as well as benchmarking their approaches against varying global standards in key areas. Access to such unbiased and practical advice, not tied to any lending or investment programmes, has been shown to foster an

atmosphere of cooperation and dialogue that can be followed up with more traditional assistance. In addition, the nascent institutional ties that are created by such informal and non-commercial exchanges can be vital for giving the new institutions access to private sector touchstones over time, beyond official channels of cooperation, which benefit both the official and private sectors by introducing a more realistic and early concept of market disciplines.

The major obstacle remains that there are few available grants or alternative private sector funding sources for targeted assistance to financial sector infrastructure, apart from the internally-directed resources of the financial groups within the multilateral institutions. Official aid programmes are increasingly focused on humanitarian goals without appreciating the need to reinforce institution building in this sector to develop market-oriented economies that can sustain job creation and economic growth. While FSVC currently has almost US \$10 million per annum of funding, almost all of this is allocated to specific country baskets by its donors, and often also restricted to use with specific counterparties, thus hindering the implementation of broadly-focused programmes such as governance work that can and should cut across both official institutions and private sector players.

Voluntary agencies or not-for profit institutions such as FSVC fall outside the traditional scope of contractors qualified to bid for paid consulting work within most multi-laterals. Hence, any cooperation we have been able to build to date between our private sector practitioners and the multilateral agencies has been based on individual relationships and special circumstances, such as arose from Indonesia's needs in the 1998-2000 post-crisis period, during which special funding was available for one-off projects. **To grow and sustain efforts to involve the private sector in such technical assistance, the cooperation between the private sector corps of experts and the official sector should be institutionalized. This requires the provision of new, multi-year grants of core funding organized around practice areas or themes such as corporate governance with and no geographical restrictions.**

Indeed the counterparties themselves are increasingly requesting technical assistance not just from developed market experts, but from other emerging markets like themselves that have already gone through the institution-building process. Sustaining the appropriate overseas outposts for both client servicing and volunteer recruitment requires long term funding sources.

*SOURCE: Betsey Wood,
www.globalclearinghouse.org/wefhongkong

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Link Access to Sub-national Local Currency Financing to Enhancement Programmes for Local Credit Market Development*

Access to local currency finance for sub-national entities could be linked to programmes aimed at enhancing local credit markets. For example, where legal frameworks, stable intergovernmental fiscal relationships, and other “building blocks” of a sound sub-national credit system fail to meet minimum standards, development institutions would require concurrent commensurate technical programmes before approving any local currency financings or guarantees to the sub-national sector without a sovereign counter guarantee.

This would serve as an incentive to the host sovereign government to improve the building blocks for more widespread private sector investment. Prior to a country’s having met some agreed minimum standards, initial local currency transactions could be closed with a sovereign counter-guarantee, which could be terminated as soon as the minimum standards were met.

Conditionality in the context of sub-national borrowings guaranteed by donors would address such basic sub-national credit/debt market building blocks as:

- Appropriate legal and financial structures that enable sub-sovereign entities (such as provinces, municipalities, regional or local special purpose entities, etc.) to be reliable borrowers (e.g. taxing power and the legal latitude to use it to secure debt, means of pledging intergovernmental flows from higher levels to lenders or bondholders, etc.);
- Appropriate legal and regulatory frameworks for bank lending and/or capital market fixed income transactions for sub-national borrowers, (including reliable means of registering and enforcing security interests in cash flows, real and personal property, transparent financial reporting, etc.);
- Securities laws providing for full and continuing disclosure of financial performance information by sub-national borrowers;
- Law enforcement and court systems prepared to enforce laws governing bank and capital market debt markets, etc., fairly and swiftly;
- Reliable dispute-resolution mechanisms capable of researching and resolving issues of interpretation and implementation (e.g., concession agreements, construction contracts, etc.) more quickly than and as fairly as the official court system;

- Relatively high scores on governance measures (e.g., Transparency International);
- Pools of high quality professional legal and accounting talent;
- Evidence of private savings accumulation (e.g., through insurance policies, pension funds, certificates of deposit, etc.); and
- Rational credit quality spreads in capital market and/or bank lending markets.

*SOURCE: Tom Cochran,
www.globalclearinghouse.org/wefnewyork

New Donor Cooperation to Catalyze New Access to Credit & Training: JBIC/USAID Philippine Initiative*

Donors need to innovate collaboratively to enhance their own capacity to deliver, along with that of the recipient country. The JBIC/USAID initiative consists of two facilities in a first pilot country, The Philippines, that will be extended to other countries:

- **Municipal Water Loan Financing Initiative (MWLFI):** Utilizing the current facilities of JBIC and USAID in the Philippines, this structures a co-financing scheme that will mobilize private funds to Local Government Units (LGUs) and Water Districts (WDs) for their water/sanitation projects.
- **Philippines Water Revolving Fund (PWRF):** A new, special fund for water and sanitation projects is being set up by mixing public and private funds.

Municipal Water Loan Financing Initiative (MWLFI)

Most of the water and sanitation projects require funds for the long term (more than 7 years). However, in the Philippines, most of the private financial institutions are not able to provide long-term loans. Moreover, water and sanitation projects of LGUs and WDs are regarded as high risk investments; there have been few investments from the private sectors. The MWLFI will change the situation. By using ODA funds, which makes it possible to finance long-term projects, and by co-financing with the private fund, a long-term loan of up to 15 years will be available for water and sanitation projects of LGUs and WDs. Moreover, using the guarantee facility will lessen the risk of the investment.

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Philippines Water Revolving Fund (PWRF):

The PWRF is a special fund that will finance water and sanitation projects by using both public and private funds. As a catalyst to mobilize the private fund to the projects, a Japanese Yen Loan from JBIC and the guarantee facility of USAID are expected to play a major role. In the Memorandum of Understanding (MOU), the Development Bank of the Philippines (DBP) will also take part as a local representative of the Philippines, by supporting research into the establishment of a sustainable PWRF scheme. PWRF will be modelled after the US State Revolving Fund, but incorporating Japanese expertise and experience in water and sanitation projects in the Philippines accumulated over more than 30 years through JBIC's ODA projects.

Additionally, the issues and lessons learned through the implementation of the MWLFI project will be incorporated into the establishment of the PWRF in the future. The PWRF will be the first model case of a special fund for water and sanitation projects in Asia and is expected to be similarly applicable to other developing countries.

*SOURCE: JBIC, www.globalclearinghouse.org/wefnewyork

A Sustainable Forum to Facilitate Dynamic Exchange Between Experts on Improving Risk Mitigation Tools (www.infradev.org)*

The Experts Group on Public/Private Risk Sharing ("the Experts Group") grew out of a suggestion made by Dan Bond (First Vice President, Ambac Assurance Corporation, and currently co-chair of the Experts Group) at the UN's Financing for Development conference in Monterrey, Mexico in March 2002. The Group's membership of 180 members is drawn from all types of institutions that are involved in the process of financing infrastructure projects: developing country borrowers; developing country governments; project sponsors; official multilateral and bilateral financial organizations; investment banks and specialized financial advisory firms; law firms active in development finance; international and local credit rating agencies; private providers of political risk insurance; monoline insurance companies, and institutional investors.

The Experts Group was created in response to the decline in developing-country infrastructure finance that began in the late-1990s. During the three years of the Group's existence, few new projects have been developed, as project sponsors have instead continued to deal with overcapacity in their home-country markets, reduced corporate credit ratings,

and low share prices. In the current environment, developing-country governments and multilaterals have a choice of waiting for private investors to devise new reasons to invest in developing-country infrastructure projects or to take the initiative in addressing investors' concerns so as to induce project sponsors to renew their international investment programmes.

The Experts Group can play a valuable role in helping developing-country government officials design new structures to encourage private investors to increase their efforts in infrastructure finance. An expanded interchange between developing-country governmental officials and other members of the Experts Group can produce the following benefits:

- Assistance in designing programmes to mitigate the risks which have prevented private investors from making new investments in recent years
- Assistance in designing new structures to facilitate financing for new infrastructure investments
- Provision of a direct source of information for government officials about similar problems faced by other governments and their responses to these issues
- Cost-effective access to a variety of viewpoints and expertise from diverse institutions; members of the Experts Group contribute their services without compensation
- Increased awareness on the part of potential private investors of new initiatives undertaken by developing-country governments

Recommended Next Steps for Implementation:

- Seek assistance from multilateral agencies in identifying appropriate developing-country officials for invitation to join the Experts Group
- Identify appropriate persons working for project sponsors for invitation to join the Experts Group (many firms have made significant personnel changes during the last two years)
- Identify and approach potential sources of funding to assist the Experts Group in maintaining its current activities and in broadening its membership

*SOURCE: Robert Sheppard, www.globalclearinghouse.org/wefbrazil

Annex F:

Examples of Project Development Initiatives

A critical bottleneck impeding development is the shortage of projects identified as eligible for finance, especially those with optimal size and structure for meeting performance standards. Official sector entities usually depend on companies to identify projects, but firms often lack the incentive to do so owing to the perception of unacceptable risk and uncertain profit. Furthermore there is often an inconsistency between projects that meet public needs and those that satisfy profitability requirements. Demand for scaled-up project development funds and support processes has escalated as many developing countries have decentralized, shifting responsibility for many services to sub-national levels (states, municipalities).

Project Development as Risk Mitigation.¹⁵ Official sector institutions need to help strengthen the abilities of the stakeholders in Public Private Partnership (PPP) transactions to appropriately configure the technical, financial, and risk allocation structures of the projects and to frame and implement corresponding procurement strategies. Lack of attention to the substance and process of robust PPP arrangements often leads to projects bearing unduly high levels of inappropriately allocated risk. This, in turn, makes the projects non-bankable and susceptible to problems of contract renegotiation, regulatory failure/capture, corruption, etc.

On the other hand, properly researched and structured projects identify and mitigate the risks to an optimal degree, and allocate them in a balanced manner with recourse to dispute resolution mechanisms consistent with the laws and regulatory environment of the country. This, in turn, substantially reduces the dependence on and the cost of government-backed risk- and guarantee-bearing instruments. The emphasis thus needs to be on building safer planes rather than improved parachutes.

“We need safer planes rather than improved parachutes.”

Government-backed risk cover instruments have limited usefulness if not backed by substantially enhanced project development capacities. Ill-prepared governments are likely to initially take on excessive levels of risk but then often exhibit a rapidly depleting ability to deliver when the guarantees are called. As evidenced by many failed infrastructure projects, the resulting severe problems and political backlash can become counterproductive, undermining the perceived and actual usefulness of private sector investment.

While some successful efforts in project development have been made (with new initiatives forthcoming)¹⁶, both government officials and private sector companies cite the current lack of project development funds as a key bottleneck, cutting off at the very inception of an investment opportunity any promise of private sector investment. Existing funds for this purpose are reported as difficult to access and often tied to donor home-country suppliers, thus eliminating project sponsors and other suppliers from participation and failing to capitalize on local engineering and financial talent.

Recommendations: To remedy these problems, participants suggested that official sector institutions pool and scale up project development funds and also make them easier to access, utilizing appropriate experts from across the public and private sectors to identify quality projects and develop acceptable risk-mitigating financial structures. There was widespread agreement that such project development capacity needs to be built urgently, especially on a regional and national basis, in partnership with regional and local development institutions with a sector focus in areas such as water and energy. Specific action steps include:

- 1) **Funding:** *Increase scope and sustainability of funding* – Project development funding needs to be increased dramatically in scope and committed on a long-term basis (over 5 years). Multi-donor funding is critical at different levels (sub-sovereign, national, regional and global), using technical assistance grants or revolving funds to finance the development costs of a pipeline of infrastructure projects. Project development funds are critical for covering initial costs, but may be able to build in self-sustaining revenues from successful projects. In any case, **donors need to insure long-term sustainability that successfully creates the capacity within the country to develop projects on an ongoing basis.**
- 2) **Procurement:** *Simplify access and reduce transaction costs* - Procurement rules are not cost-effective, impairing the ability of many qualified organizations and experts to provide project development services. In addition, recipients do not have easy access to information on available services. **New streamlined processes need to be developed to facilitate both a larger supply of expert services to meet demand, and the ability of countries to select the most qualified relevant experts.**

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- 3) **Untied Aid:** Allow recipient countries to select the most appropriate services and products - **Project development funds need to be available for the most appropriate uses and not limited to the services of the donor country.**¹⁷
- 4) **Targeted Funding at Country and SubSovereign Levels:** Launch project development funds in targeted manner to insure effectiveness - **Funds need to be operative at the country as well as sub-national levels, and integrated to support the country's national development plans, including PPP and competitiveness programmes.** Customization to the specific needs of the country (state, municipality) as well as the sector, project, and client is critical for effectiveness. There is a special need to create new funding targeted at the individual, sub-national level to help prepare individual projects for financial support, in the form of feasibility studies, demand assessments, etc. As noted in the section on capacity-building, this funding needs to address overall capacity-building with independent reviews to assure the quality and completeness of pre-existing feasibility and engineering studies; financial advisory services for project structuring; technical assistance for project implementation and oversight (including preparation of bidding documents, review of technical proposals, supervision of investments and commissioning); and obtaining full or shadow credit ratings.
- 5) **Designate a Joint "Effectiveness Secretariat":** Mandate a central location for coordination and collection of needed information - **Project development funds should be managed by a joint secretariat that facilitates ongoing effective collaboration in sharing information, toolkits, and learning from each other's successes and failures. Coordinating mechanisms could include the World Bank, regional development banks, individual bilateral donors, or the Development Assistance Committee (DAC).**

"Project development funds are lacking ...there is no focus on needs or results. Real intelligence on performance is lacking."

- 6) **Include Focus on Building Country's Distribution and Logistic System:** Donor funding often focuses only on the immediate project, neglecting the intrinsic need of the country to develop a strong internal capacity for distribution and sales. The success of each individual project

and company is dependent on the ability of the country's overall distribution and logistic system to provide critical support. For example, supplies or output may need to be delivered using public roads, airports, or ports; reliable companies may be needed to ship items or help with overseas marketing. **Development institutions need to do needs assessments based on private sector input, and devise ways to work with the private sector in improving in-country distribution and sales capacities.**

Indigenous Project Development Capacity: Define new explicit strategies to build in-country project development capacity - Key ideas include the creation of **"Steering Committees" of experts from the public and private sectors at federal and state levels to oversee the project development process and the development of appropriate policy, legislative and regulatory frameworks.**¹⁸ In addition, there is the need to develop partnerships for project development with experienced private sector and research entities that can collaborate with federal and state governments in identifying projects and then manage the procurement process for operators, service providers and contractors. Another requirement is for strengthening (or creating if needed) regional and local development financial institutions in collaboration with the private sector that can assist in this process (see the proposal in Annex D on examples of local currency finance initiatives.)

External Project Development Teams: Develop capacity to immediately scale-up needed expert inputs to enhance project development capacity - **Roving SWAT Teams of experts** (with extensive private sector experience) can respond quickly to private sector opportunities, help government officials determine how to approach the private sector and structure bankable deals, jump-start the project identification process and help interested parties quickly access available funding. **A Pre-Qualified Expert Directory** could enable easy identification of the most appropriate experts to develop projects, supplemented by toolkits and e-learning programmes. Official aid agencies could develop tool kits for worldwide access in collaboration with private sector experts skilled in project development, financing, risk mitigation tools, and accessing capital markets. Given the daunting demand for training, **massive e-learning toolkits could be supplemented with in-person training.** The expert training capabilities of development agencies, for example, the World Bank Institute, could be used to coordinate and deliver such services.

ILLUSTRATIVE IMPLEMENTATION STEPS: Below are illustrative examples of possible action steps.

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Examples of Project Development Initiatives

Risk Management through Project Development: The Example of Andhra Pradesh*

In the context of attracting private investments to infrastructure, there is a need to enhance the “Project Development” capacities in governments and the private sector. Official institutions need to provide financial and technical assistance to strengthen Project Development capacities for creating infrastructure projects in PPP formats in developing countries. However, this needs to be done not merely through Technical Assistance loans/grants to be in turn used for a series of procurements of consultants but, instead, through establishing long-term institutional arrangements with a sustained commitment to delivering bankable projects.

At a more specific level, in order to promote private investments in infrastructure projects implemented in PPPs, official institutions could provide:

- **Risk Capital:** e.g. through a TA Grant or sponsorship of a Revolving Fund (say US\$ 25 million for a country like India) to finance project development (including environmental and social management) costs of a pipeline of infrastructure projects. The Project Development investments can be expected to be recovered from the successful projects.
- **Technical Capacity:** by entering into one or more long term partnerships with entities, preferably domestic, that have the technical capacity to undertake, in collaboration with official institutions, rigorous project development on behalf of state or federal governments, as well as manage a procurement process for operators/service providers/contractors
- **Oversight:** by working with select state/federal governments through a “steering committee” type of arrangement to oversee this project development process as well as the evolution of appropriate policy, legislative, and regulatory frameworks

The Private Sector Development Department of the ADB is currently experimenting with a similar structure on a pilot scale in the State of Andhra Pradesh in India in collaboration with IL&FS Infrastructure Development Corporation. Such an arrangement is expected to be efficient, to create a focus on results rather than reports, and to enable lessons of one project to be taken to the next. This effort could also be combined with structured training and capacity-building programmes for decision makers at official, and more importantly, at political levels.

*SOURCE: Pradeep Singh,
www.globalclearinghouse.org/wefhongkong

The Infrastructure Gap in Latin America: A Performance-Based, Market-Oriented Solution*

The aim is to address the infrastructure gap in Latin America through the creation of three, institutionalized funding structures, which between them will administer a set of funds that will allow the requirements of Latin America to be met, at the same time creating sustainable, attractive opportunities for international investors.

This is an integrated policy initiative, addressing three key aspects of project creation: the identification, design and preparation of good projects; the equity funding requirement; and the near total absence of long-term debt financing. The **feasibility study fund** would target the financing of 100 bankable feasibility studies per year – financing local firms to identify and bring to market real, bankable, projects. The **equity fund** would create a mechanism to match the US\$ 20+ billion available for infrastructure investment from Latin pension funds with an equal amount of money from developed world institutional investors. The **debt fund**, set at US\$ 10 billion, would be backed by the US Treasury, or some agency of similar stature, and would issue Latin American Infrastructure bonds to investors – effectively making debt available at much better tenor and terms than is currently the case.

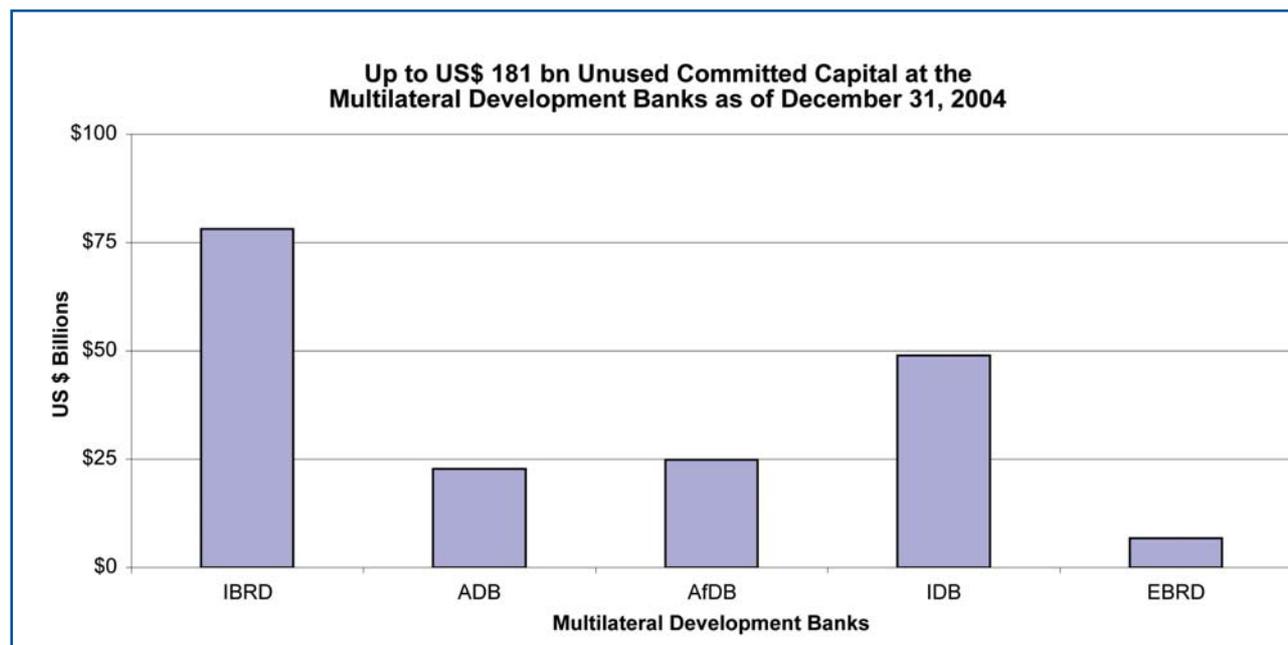
The scheme would also require the creation of a monitoring/ratings agency to: (a) rate the operational and financial aspects of proposed projects; (b) assess the operational and financial performance of projects throughout project lifecycles; and (c) publish project information, on a quarterly basis – measuring performance against both projections and international benchmarks, thus informing investors, operators, policy-makers and the public.

*SOURCE: Norman Anderson,
www.globalclearinghouse.org/wefbrazil

Annex G:

Underutilized Capital at the Multilateral Development Banks

Chart A



	IBRD	ADB	AfDB	IDB	EBRD	Total
CAPITAL (US\$bn)						
Paid-In Capital	11.4	3.7	3.2	4.3	7.0	32.1
Other Capital	24.1	9.5	2.3	14.2	2.4	57.9
Total Callable Capital	178.2	50.4	30.1	96.6	19.8	375.0
TOTAL CAPITAL (a)	213.7	63.6	35.6	115.1	29.2	465.0
LOANS, GUARANTEES AND EQUITY INVESTMENTS (US\$bn)	**					
Disbursed Loans	109.6	24.3	8.1	49.8	10.5	212.1
Undisbursed Loans	24.8	15.6	2.4	16.1	7.0	70.4
Guarantees	1.2	0.7	-	0.3	0.7	3.3
Equity Investments	-	0.3	0.3	-	4.3	7.4
TOTAL OF LOANS, GUARANTEES AND EQUITY INVESTMENTS (b)	**					
	135.6	40.8	10.7	66.3	22.5	293.1
Underutilized Capital (a-b) (US\$bn)	78.1	22.8	24.9	48.9	6.7	181.4

** Equity investments are made by these institutions except for IBRD and IDB.

IBRD: International Bank for Reconstruction and Development

ADB: Asian Development Bank

AfDB: African Development Bank

IDB: Inter-American Development Bank

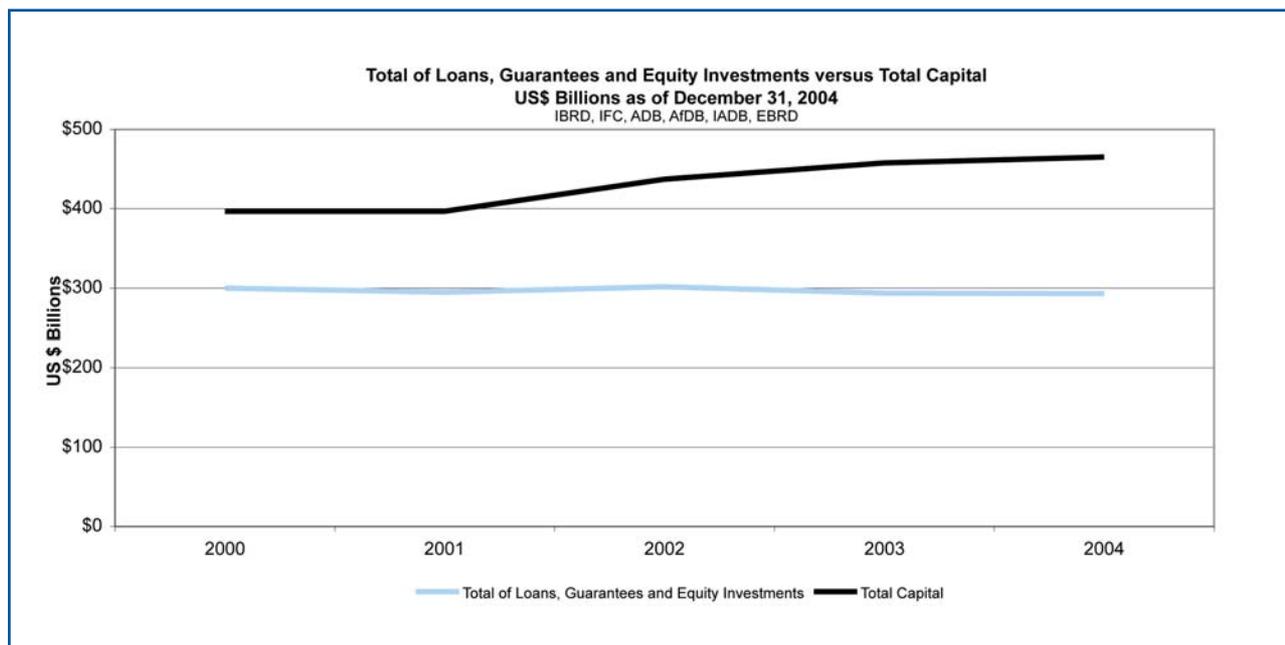
EBRD: European Bank for Reconstruction and Development

Underutilized Capital is defined as (paid-in capital, other capital and total callable capital) – (disbursed loans, undisbursed loans, guarantees and equity investments).

Annex G:

Increasing Capital and Declining Exposures at the Multilateral Development Banks (End 2000–2004)

Chart B



	2000	2001	2002	2003	2004	Percent Change 2000-2004
IBRD						
Capital	206'467	207'599	210'342	216'007	213'698	3.5%
Loans, Guarantees and Equity Investments**	160'721	151'451	152'882	144'588	135'599	-15.6%
IFC						
Capital	5'733	6'095	6'304	6'789	7'782	35.7%
Loans, Guarantees and Equity Investments**	13'622	13'614	14'319	15'771	17'243	26.6%
ADB						
Capital	52921	51434	56'264	61'193	63'619	20.2%
Loans, Guarantees and Equity Investments**	39'604	39'870	40'311	35'812	40'811	3.0%
AfDB						
Capital	4'501	4'580	32'347	34'643	36'122	702.5%
Loans, Guarantees and Equity Investments**	11'257	10'629	10'926	11'295	10'750	-4.5%
IDB						
Capital	109'054	109'873	110'881	113'723	115'122	5.6%
Loans, Guarantees and Equity Investments**	63'042	65'794	66'863	66'616	66'266	5.1%
EBRD						
Capital	18'597	18'050	21'443	26'177	29'210	57.1%
Loans, Guarantees and Equity Investments**	11'772	13'282	16'193	19'736	22'468	90.9%
TOTAL						
Capital	397'273	397'631	437'581	458'532	465'552	17.2%
Loans, Guarantees and Equity Investments**	300'018	294'640	301'494	293'818	293'137	-2.3%

IBRD: International Bank for Reconstruction and Development

IFC: International Finance Corporation

ADB: Asian Development Bank

AfDB: African Development Bank

IDB: Inter-American Development Bank

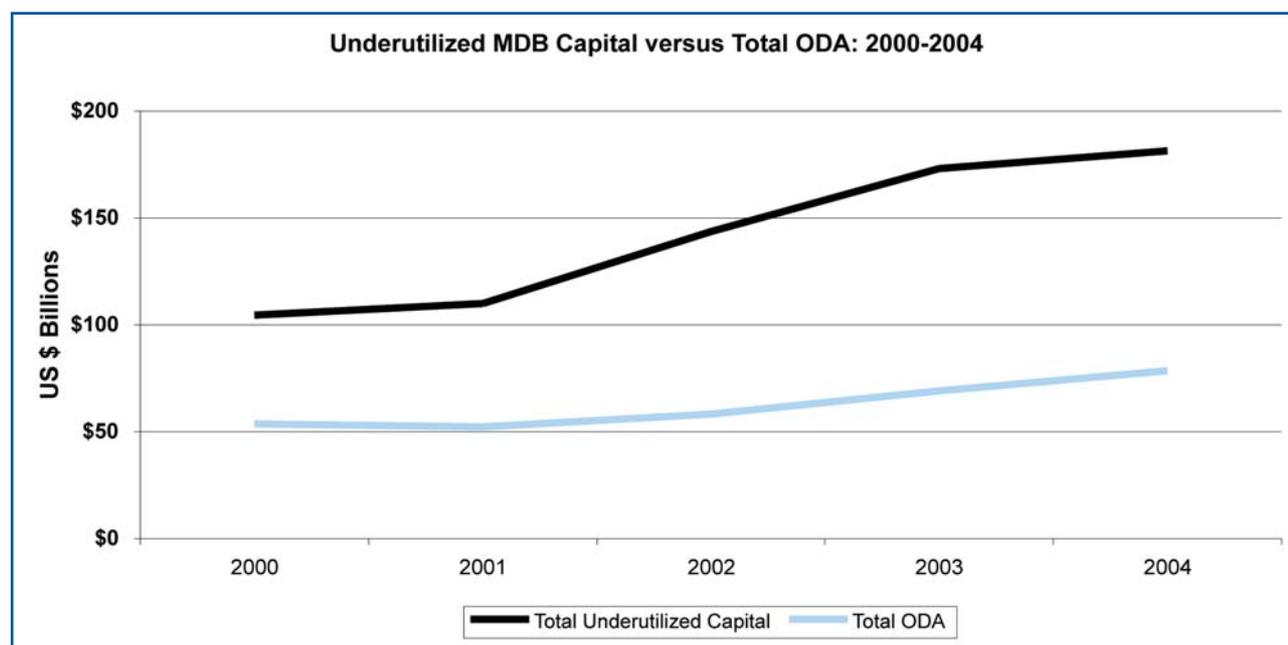
EBRD: European Bank for Reconstruction and Development

Capital includes paid-in capital, other capital and total callable capital.

Annex G:

Underutilized Multilateral Development Banks (MDB) Capital versus Total ODA, 2000-2004

Chart C



(US\$bn)	2000	2001	2002	2003	2004	Percent Change 2000-2004
IBRD	45.7	56.1	57.5	71.4	78.1	70.7%
ADB	13.3	11.6	16.0	25.4	22.8	71.3%
AfDB	(7.4)	(6.6)	20.9	22.8	24.9	na
IDB	46.0	44.1	44.0	47.1	48.9	6.2%
EBRD	6.8	4.8	5.2	6.4	6.7	-1.2%
TOTAL Underutilized Capital	104.5	110.0	143.6	173.1	181.4	73.5%
TOTAL ODA	53.7	52.4	58.3	69.1	78.6	46.4%

IBRD: International Bank for Reconstruction and Development

ADB: Asian Development Bank

AfDB: African Development Bank

IDB: Inter-American Development Bank

EBRD: European Bank for Reconstruction and Development

Underutilized Capital is defined as (paid-in capital, other capital and total callable capital) - (disbursed loans, undisbursed loans, guarantees and equity investments)

Source: Structured Credit International based on Annual Reports and S&P Ratings Report and OECD's Development Assistance Committee (DAC)

Annex H:

Roundtable Participants

World Economic Forum Financing for Development (FfD) Workshop
São Paulo, Brazil, 26–27 October 2004

Name	Title	Organization	Country officeaddress
Geir Bileedt	Senior Vice President, Marketing and Sales	ABB Ltda	Brazil
Paul Mudde	Senior Vice President/Head of Stakeholder Engagement & Business Development	ABN AMRO	The Netherlands
Martin Fernando Cohen	Head Structured Finance	Andrade Gutierrez	Brazil
Adriano Spina	Lawyer	Banco Citibank Brasil S.A.	Brazil
Jose Roberto Salvini	Lawyer	Banco Citibank Brasil S.A.	Brazil
Roberto Dumas Damas	Project Finance Manager	Banco Itaú	Brazil
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Michael Isimbabi	Principal	Capital Researchers	United States
Norman Anderson	President and Chief Executive Officer	CG/LA Infrastructure LLC	United States
Anand Hemnani	Vice President	CG/LA Infrastructure	United States
Valentino Gallo	Managing Director, Export and Agency Finance	Citigroup	United States
Richard Frank	Chief Executive Officer	Darby Overseas Investment	United States
Aline Dieguez B. M. Silva	Economic Advisor	Economic and Fiscal Studies Department	Brazi
Urban Frei	Environmental Scientist ETH/Project Manager	ECOS	Switzerland
Claudio Escobar	Regional Director for Brazil & Southern Cone	EDC – Export Development Canada	Brazil
Fernanda Campos	Vice President of Finance and Control	EDP Brazil	Brazil
Thomas Felsberg	Managing Partner	Felsberg and Associates	Brazil
Marco Aurélio de Barcelos Silva	Legal Advisor and Special Assistant to Secretary of International Affairs	Government of Minas Gerais, Brazil	Brazil

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Gabriel Goldschmidt	Principal Investment Officer, Latin America and Caribbean Regional Office	IFC	Brazil
Anthony J. Pellegrini	President	International Association of Development Funds	United States
Diana Smallridge	President	International Financial Consulting	Canada
Wallim Vasconcellos	Partner	Iposeira Gestao de Ativos	Brazil
Robert Sheppard	Managing Director	J.R. Sheppard & Company, LLC	United States
Alan Riddell	Director	KPMG	Brazil
Thomas H. Cochran	Director of Insured Portfolio Management and Global Public Finance	MBIA Insurance Corporation	United States
Daniel Sigelmann	Advisor	Ministry of Finance	Brazil
Marcos Pinto	Consultant on PPP	Ministry of Planning/IADB	Brazil
Vinicio Fonseca	Director	Odebrecht	Brazil
Laudelino Soares	Risk Manager	Odebrecht	Brazil
Odo Habeck	Managing Partner	OGH Advisors	United States
Jonathan Haddon	Attorney at Law	Orrick Herrington & Sutcliffe LLP	United States
Nancy Rivera	Director, Structured Finance	Overseas Private Investment Corporation	United States
José Carlos Meirelles	Partner	Pinheiro Neto Advogados	United Brazil
Carlos Sequeira	Chairman	PRO Nicaragua Investment Promotion Agency	Nicaragua
Daniel Sonder	Director	Secretaria de Estado dos Negocios da Fazenda Companhia Paulista de Parcerias	Brazil
Andrea Calabi	Secretario	Secretaria De Estado DXE Economia e Planejamento	Brazil

Regina Nunes	Managing Director	Standard & Poor's, Brazil	Brazil
Mahesh Kotecha	President	Structured Credit International	United States
Giovanni Giovannelli	Chief Financial Officer	TNS & Novatrans	Brazil
Luis Eduardo Díaz	Executive Director	TVC Marília	Brazil
Krishnan Sharma	Focal Point for Business Engagement	UN DESA	United States
Ciara O'Sullivan	Programme Officer	UNDP	Brazil
Leida Mercado	Environmental Economics Advisor	UNDP	Costa Rica
Antonio Assefh	Representative & Head of Regional Office	UNIDO	Uruguay
Valério Veloso	Head of Investment and Technology Promotion	UNIDO	Brazil
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Odo Habeck	Managing Partner	OGH Advisors	United States
Jonathan Haddon	Attorney at Law	Orrick Herrington & Sutcliffe LLP	United States
Richard Samans	Managing Director	World Economic Forum	Switzerland
Barbara Samuels	Senior Advisor	World Economic Forum, Financing for Development Initiative and Business Steering Committee	United States

Annex H:

World Economic Forum FfD Workshop

Hong Kong, 15-16 March 2005

Name	Title	Organization	Country officeaddress
Brian Little	Regional Director of Structured Capital Markets Asia	ABN AMRO Bank	Singapore
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Ajay Sagar	Principal Structured Finance Specialist, Private Sector Department	Asian Development Bank	Philippines
Daniel Wagner	Senior Cofinancing Specialist (Guarantees)	Asian Development Bank	Philippines
Henry Pitney	Private Sector Legal Counsel	Formerly with the Asian Development Bank	United States
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Sailendra Narain	Chairman	Centre for SME Growth & Development Finance	India
John Bray	Director	Control Risks	Japan
Stephen Temple	Principal	Darby Asia Investors Limited	Hong Kong, SAR
Elizabeth M. Wood	Senior Managing Director	Financial Services Volunteer Corps	United States
Subhrendu Chatterji	Managing Director, Management Unit	FIRST Initiative	United Kingdom
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Mitch Strohminger	Director of Research	Global Clearinghouse	United States

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Roundtable Participants

World Economic Forum FfD Workshop

New York, USA, 22–23 June 2005

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Suellen Lazarus	Representative in Washington DC	ABN AMRO Bank	United States
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Daniel Bond	President	Ambac Assurance Corporation	United States
Michael Eckhart	President	American Council On Renewable Energy (ACORE)	United States
Alan Patricof	Co-Founder	APAX Partners	United States
Chaiyuth Sudthitanakorn	Executive Director, Thailand, Malaysia, Myanmar, Nepal, Singapore	Asian Development Bank	Philippines
Jasper Wong	Director, Head of Transaction Management	West LB AG, Hong Kong Branch	Hong Kong, SAR
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Valentino Gallo	Managing Director, Export and Agency Finance	Citigroup	United States
Thomas Cochran	Managing Director	Civil Credit Advisors	United States
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Julio Dreizen	President	Constellation S.A.	Argentina

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Elizabeth Wood	Senior Managing Director	Financial Services Volunteer Corps	United States
Mitch Strohming	Director of Research	Global Clearinghouse	United States
John Mullen	Executive Vice President & COO	GlobalNet Venture Partners, LLC	United States
Pradeep Singh	Chief Executive	Infrastructure Leasing and Financial Services	United States
Carlos Guimaraes	Private Sector Coordinator, Office of the President	Inter-American Development Bank	United States
Hector Morales	U.S. Executive Director	Inter-American Development Bank	United States
José Carlos Castaneda	Executive Director, Belize, Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua	Inter-American Development Bank	United States
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Sumeet Thakur	Investment Officer	International Finance Corporation	United States
Diana Smallridge	President	International Financial Consulting Ltd	Canada
Kathy Shandling	Executive Director	International Private Water Association (IPWA)	United States
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Tetsuya Harada	Chief Representative, Manila Representative Office	Japan Bank for International Cooperation	Japan
Julie Martin	Vice President, Political Risk & Trade Credit	Marsh McLennan	United States

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Ann Low	Advisor	Permanent Mission of the United States to the United Nations	United States
Peter Raymond	Managing Director	PricewaterhouseCoopers	Indonesia
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Frank Fernandez	Senior Vice President and Director of Research	Securities Industry Association (SIA)	United States
Rafael Herz	Vice President for Business Development	Sithe Energies	United States
Laura Feinland Katz	Managing Director	Standard and Poor's	United States
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Katherine Renfrew	Managing Director, Emerging Markets	TIAA-CREF	United States
Ed Roche	Lead Analyst State Revolving Funds	United States Agency for International Development	United States
John Wasielewski	Director	United States Agency for International Development	United States
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Inge Kaul	Economist, Focal Point for Dialogue with Business Sector, Department of Economic and Social Affairs	United Nations Development Programme	United States
Stephany Griffith Jones	Consultant	United Nations, Department of Economic and Social Affairs	United Kingdom
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Yung Chul Park	Professor, Department of Economics	University of Korea	Republic of Korea
Eugene Rotberg	Former Vice President and Treasurer	World Bank	United States
Richard Samans	Managing Director	World Economic Forum	Switzerland
Barbara Samuels	Senior Advisor, Financing for Development Initiative	World Economic Forum	United States
Gulhan Suadiye	Research Assistant	World Economic Forum	Turkey

Annex H:

Proposals for World Economic Forum FfD Workshop in Brazil, 26–27 October 2004

Leveraging official sector capital and enhancing financial governance—practitioners' solutions

To access proposals and for a full list of documents presented kindly visit
<http://www.globalclearinghouse.org/wefbrazil/>

- **Constraints & Impediments Affecting Financial Markets and Private Sector Investment:** Bob Sheppard (Infrastructure Experts Group) & Dr Barbara Samuels (World Economic Forum and Business Steering Committee, UN Financing for Development)
- **Unbundling of Official Support:** Diana Smallridge (International Financial Consulting Ltd)
- **Defining an Innovative Menu of Options & Advisory Support for Customizing to Specific Country Needs:** Gabriel Goldschmidt (International Finance Corporation)
- **Advancing the Brazilian PPP Programme:** Daniel Sonder (Secretaria de Estado da Fazenda de São Paulo) & Jose Carlos Meirelles (Pinheiro Neto Advogados)
- **Leveraging Official Sector Financial Instruments to Increase Local Funding of Sub-sovereign Infrastructure:** Tony Pellegrini (International Association of Development Funds)
- **Tenor Extension Guarantees:** Jonathan Haddon (Orrick Herrington & Sutcliffe)
- **Multi-lateral Sponsored Regional Swap Facility:** Odo Habeck (OGH Advisors)
- **Local Debt Markets and Official Agencies – Enhancing Growth Opportunities:** Valentino Gallo (Citigroup)
- **Legal Tool Kit for Government Mitigation of Regulatory Risk:** Jonathan Haddon (Orrick Herrington & Sutcliffe)
- **Contingent Guarantees to Mitigate Regulatory Risk:** Bob Sheppard (Infrastructure Experts Group)
- **New Local Insurance Vehicles Such as Monolines:** Thomas Felsberg (Felsberg and Associates)
- **Latin America Infrastructure Initiative: Setting Up Feasibility, Equity & \$10 Billion Debt Funds:** Norman Anderson (CG/LA Infrastructure LLC)
- **Need for an Emerging Market Export Credit Agency:** Diana Smallridge (International Financial Consulting) & Paul Mudde (ABN AMRO)
- **Multilaterals Provide Brazilian Export Credit Agencies with a Political Risk Breach of Contract Guarantee:** Vinicio Fonseca (Odebrecht)
- **Reengineering the Bretton Woods Institutions:** Richard Frank (Darby Overseas Investments)
- **Needed Changes in Country Governmental Processes:** Tom Cochran (MBIA)
- **Promoting Equitable Private Sector Participation in Development, The Case of Water & Sanitation:** Urban Frei (ECOS)
- **Mechanisms & Incentives to Develop Local Capital Markets:** Wallim Vasconcellos (Iposeira Gestão de Ativos)
- **Enhancing Government Capacity with Customized Market Research to Define Individual Risk-Mitigating Country Frameworks:** Jonathan Haddon (Orrick Herrington & Sutcliffe)
- **Brainstorming on New Proposals & How to Enhance Leverage of Official Sector Resources:** Mahesh Kotecha (Structured Credit International)
- **Needed Changes in Official Sector Processes: Credit, Analysis, and Deal Structure:** Tom Cochran (MBIA)
- **How to Improve and Simplify Deal Transactions with the Multilateral Development Banks from the Perspective of the Private Sector:** Giovanni Giovannelli (TNS and Novatrans (Terna Group))
- **Using Performance Measurements to Track Progress & Incentivize Organizational Change:** Diana Smallridge (International Financial Consulting) & Linda Kemeny (RWE Thames Water)
- **Facilitating Deals in the Infrastructure (Water & Wastewater) Sector – Some Discussion Threads:** Linda Kemeny (RWE Thames Water)
- **Setting up a Sustainable Forum to Facilitate Dynamic Exchange between Experts on Improving Risk Mitigation Tools:** Bob Sheppard (Infrastructure Expert Group)
- **Proposal to Improve Bankable Property Rights:** Bill Armstrong (Property Rights Powerpoint)
- **Taking an Interdisciplinary Approach, The IDB's Business Climate Initiative:** Angela Paris (IADB)
- **Trade Finance Facilitation Programme:** Angela Paris (IADB)
- **Enhancing the Impact of Financial Guarantees:** James Winpenny (World Panel on Financing Water Infrastructure)

Annex H:

Proposals for World Economic Forum Financing for Development Workshop in Hong Kong, 15–16 March 2005

Catalyzing private sector capital and enhancing financial governance – practitioners’ solutions

To access proposals and for a full list of documents presented, kindly visit
<http://www.globalclearinghouse.org/wefhongkong/>

- **Key Project Finance Lessons & Needed Interventions:** Mahesh Kotecha (Structured Credit International)
- **Continued Vulnerabilities & Required Actions Steps:** Brian Little (ABN-AMRO Bank)
- **The Role of Multilateral Development Banks:** Daniel Wagner (Asian Development Bank)
- **Current Risks in the Global Economic System, and The Role of Risk Management Tools:** Daniel Wagner (Asian Development Bank)
- **Launching Sub Sovereign Finance & Technical Assistance:** Henry Pitney (formerly Asian Development Bank)
- **Private Sector Governance Training Initiatives – Can a Global Corps of Financial Experts Help?:** Betsey Wood (Financial Services Volunteer Corps)
- **Presentation: Private Sector Governance Training: Can a Global Corps of Financial Experts Help?:** Betsey Wood (Financial Services Volunteer Corps)
- **Creating Country-Based Frameworks:** Silvina Vatnick (Financial Sector Learning Programme, World Bank)
- **Developing Applied Learning Supports:** Marie-Ann Birken (Orrick, Herrington & Sutcliffe LLP)
- **Strengthening Financial Governance:** The Critical Need for Country Owned Financial Sector Strategies: Subhrendu Chatterji (FIRST Initiative, World Bank)
- **Enhancing Critical Linkages to the Private Sector:** Silvina Vatnick (Financial Sector Learning Programme, World Bank)
- **Using Market Mechanisms:** Wayne Silby (Calvert Funds); Jolanta Wysocka (Russell Investment Group); and Melissa Brown (AsrIA – The Association for Sustainable & Responsible Investment in Asia)
- **Targeted Risk Mitigation Using Contingency Facilities:** Bob Sheppard (Co-Chair, Infrastructure Experts Group)
- **The Untapped Power of the Official Sector:** Bob Bestani (Asian Development Bank)
- **JBIC Policies & Activities:** Atsushi Kaneko (JBIC)
- **Linking Financial Governance to Political Risk Insurance:** John Bray (Control Risks)
- **Bankable Property Rights -- The Third Rail of Financial Sector Reform:** Bill Armstrong (Inter American Development Bank)
- **Chain of Property Rights:** Bill Armstrong (Inter American Development Bank)
- **Developing Sub-sovereign and Local Banking Capacity:** Bernard Poignant (Veolia Environment)
- **Significance of Local Development Financial Institutions in Developing Countries:** Dr Sailendra Narain (Centre for SME Growth & Development Finance)
- **Presentation: Significance of Local Development Financial Institutions in Developing Countries- Relevance, Role & Suggested Framework:** Dr Sailendra Narain (Centre for SME Growth & Development Finance)
- **Mainstreaming Effective Partial Guarantee Programmes and Donor Coordination:** John Wasielewski (USAID)
- **Risk Management through Project Development:** Pradeep Singh (Infrastructure Leasing & Financial Services)
- **Presentation: Risk Mitigation through Project Development:** Pradeep Singh (Infrastructure Leasing & Financial Services)
- **Local Currency Swaps and other Instruments:** Ajay Sagar (Asian Development Bank)
- **Presentation: Local Currency Financing Initiative:** Ajay Sagar (Asian Development Bank)
- **Corporate Governance Issues in Infrastructure Finance:** Bob Sheppard (Infrastructure Experts Group)
- **Enhancing Official Sector Leverage and the Possible Role of Monolines:** Mahesh Kotecka (Structured Credit International)
- **Effective Partnering with Performance Incentives and Frameworks:** Diana Smallridge (International Financial Consulting)
- **Advancing the New Paradigm:** Bob Bestani (Asian Development Bank)

Annex H

Documents presented

- ADB Papers on Corporate Governance, <http://adb.org/PrivateSector/Finance/publications.asp>
- Alandur Sewerage Project: A Success Story of Public–Private Partnership Arrangements (Dr Mathur)
- An Alternative Way to Measure Corruption (Global Access, Marianne Camerer)
- India: <http://www.publicintegrity.org/ga/country.aspx?cc=in>
- Indonesia: <http://www.publicintegrity.org/ga/country.aspx?cc=id>
- Calvert Fund & Foundation
- "Corporate Responsibility Matters," http://www.calvert.com/news_newsArticle.asp?article=2696&image=HEADERBAR_CRM.JPG&format=print
- Corporate Responsibility Toolkit, www.calvert.com/advisorsalestools_6192.html?format=print&format=print
- Know What You Own (R) Service, www.calvert.com/sri_kwyo.asp
- A listing of Social Research Analysts, www.calvert.com/sri_4857.html
- Request a Free Community Investing Kit, www.calvert.com/foundation/email.htm
- Corporate Governance Develops in Emerging Markets (McKinsey)
- Corporate Governance (Bob Bestani)
- Corporate Governance Standard & Poor's Reports
- Bank Mandiri
- Infosys
- Sinochem
- Facilitating Deals in the Infrastructure (Water & Wastewater) Sector – Some Discussion Threads (Linda Kemeny, Financing Strategy Director, RWE Thames Water plc)
- Financing Major Projects: The Case of Paiton (Brian Little, ABN AMRO)
- India Urban Institute
- Urban Reform Incentive Fund (www.indiaurbaninfo.com/niua/newsletter.htm)
- Investing in Stability (UNE)
- OECD White Paper on Asia Corporate Governance, www.oecd.org/dataoecd/4/12/2956774.pdf
- Mekong Project Development Facility (MPDF) – This facility is managed by the IFC and funded by ADB and IFC, and a number of donor countries. MPDF provides support to SMEs in Vietnam, Lao PDR, and Cambodia. For more information see www.mpdf.org.
- Premium for Good Governance (McKinsey)

Annex H:

Proposals for World Economic Forum Financing for Development Workshop in New York, 22–23 June 2005

Catalyzing private sector capital and enhancing financial governance: Practitioners' solutions

To access proposals and for a full list of documents presented kindly visit
<http://www.globalclearinghouse.org/wefnewyork/>

- **Diversified Portfolios of Local Currency Assets:** Randall Dodd (Financial Policy Forum)
 - **Global Development Bonds:** Mike Eckardt (American Council on Renewable Energy) and John Mullen (GlobalNet Venture Partners, LLC)
 - **Critical Official Sector Enhancements in Derivatives, Infrastructure, and Equity Financings:** Valentino Gallo (Citigroup)
 - **Proposal for a New Asian Investment Fund:** Professor Yung Chul Park (Center for International Trade and Finance, Seoul National University)
 - **Needed Steps to Advance Infrastructure Finance:** Pietro Masci (InterAmerican Development Bank)
 - **Overview of Current Guarantee Activity:** Jim Winpenney (independent economic consultant & author of the Camdessus Report)
 - **New Directions in Use of Guarantees & the USAID-JBIC Philippine Water Programme:** John Wasielewski (USAID) & Osamu Murata (JBIC)
 - **Ways to Expand Official Sector Support:** Peter Raymond (PwC) & Philippe Valahu (MIGA) – invited
 - **IFI Risk Mitigation Instruments:** Peter Raymond
 - **New Ways to Support SubSovereign Financing:** Tony Pellegrini (International Association of Development Funds), Tom Cochran (CivilCredit Advisors) & Pradeep Singh (Infrastructure Leasing & Financial Services – India)
 - **The Imperative & Challenges:** Tony Pellegrini (International Association of Development Funds)
 - **Subnational Borrowing Policy Action Proposals:** Tom Cochran (CivilCredit Advisors)
 - **Ways to Expand Official Sector Support:** Bruno Mejean (Nord LB)
 - **Needed Steps to Advance Small & Medium Sized Companies:** Alan Patricof (APAX Partners)
- A Venture Capital Proposal:** Eugene Rotberg (World Bank)
- **Promote Use of Guarantees through Changed Internal Policies and Development of Monolines:** Mahesh Kotecha (Structured Credit International Corp)
 - **Considerations for Expanding Use of Financial Guarantee and Related Products:** Tom Cochran (CivilCredit Advisors)
 - **Proactive Steps that Official Sector Entities Can Take:** Tracy Webb (OPIC)
 - **Links to Project Development Fund & Needed Local Supports:** Norman Anderson (CG/LA Infrastructure) & Pradeep Singh (Infrastructure Leasing & Financial Services – India)
 - **Can a Global Corps of Financial Experts Help?** Betsey Wood (Financial Services Volunteer Corp)
 - **Use of Information and Benchmarking Tools:** Laura Feinland Katz (Standard & Poor's) & Marianne Camerer (Global Integrity)

Documents presented

- Guarantee Report done for OECD
- JBIC Presentation
- Study for USAID-JBIC Water Sector Collaboration in the Philippines
- The Philippine Water Revolving Fund: Assessment of Feasibility
- Press Releases on Proposed Water and Sanitation Financing Initiatives
- Local Government Unit (LGU) Experience Under JBIC-Financed Projects
- Business World Article, October 14, 2004: Ruby Anne M. Rubio
- USAID Year 2004 in Review
- Risk Management through Project Development
- Risk Mitigation: A Ratings Perspective: Laura Feinland Katz
- The Consequences of Corruption: Hennie Van Vuuren
- Public Integrity Index Presentation: Marianne Camerer

Endnotes

- ¹ *Global Financial Stability Report*. April, 2005. Washington DC: IMF.
- ² Sheppard, J. Robert Jr based on (a) foreign security holdings calculated from Federal Reserve data and Merrill Lynch report on world bond markets; (b) total asset data from Watson Wyatt, Insurance Information Institute and Investment Company Institute.
- ³ For infrastructure cost estimates, see, e.g., *Global Development Finance 2004* and *Infrastructure and the World Bank – a Progress Report 2005*, both issued by the World Bank, Washington DC.
- ⁴ ADB, JBIC and World Bank. *Connecting East Asia: a New Framework for Infrastructure*. 2005. Manila, Tokyo and Washington DC.
- ⁵ For MDB cost estimates, see 2004 and 2005 editions of *Global Monitoring Report*, published by the World Bank, Washington DC.
- ⁶ World Bank. *Global Development Finance 2004*. Washington DC. The nine institutions were ADB, AfDB, EBRD, EIB, IBRD/IDA, IDB, IFC, IsDB and MIGA.
- ⁷ The unused capacity of Multilateral Development Banks is calculated from official sources based on the statutory guidelines in the charters that stipulate possible exposures up to the total of callable capital. Exposures include disbursed and undisbursed loans, guarantees and equity investments. Please note that utilization of capacity is inherently dependent on access to capital markets and demand. Sources: Annual Reports and Standard & Poor's.
- ⁸ Others, including a commission led by Paul Volcker and Angel Gurría, challenged the Meltzer recommendations on grounds of continuing need for MDB assistance in these countries.
- ⁹ For the official ODA statistics, see the information collected by the Development Assistance Committee: http://www.oecd.org/document/3/0,2340,en_2649_33721_34700611_1_1_1_1,00.html
http://www.oecd.org/document/9/0,2340,en_2649_33721_1893129_1_1_1_1,00.html.
- ¹⁰ Kapur, Devesh, John P. Lewis and Richard Webb. *The World Bank: Its First Half Century*. Washington DC: Brookings, 1997.
- ¹¹ This section on guarantees depends very heavily on (and quotes freely from) Winpenny, James. *Guaranteeing Development?* 2005. Paris: OECD.
- ¹² Ibid.
- ¹³ Op. cit.
- ¹⁴ The IFC Municipal Fund has successfully used first loss provisions to herald new sub-sovereign transactions. See IFC Municipal Fund: <http://www.ifc.org/municipalfund>.
- ¹⁵ See AFGI: <http://www.afgi.org/finannualrept97.htm>.
- ¹⁶ See the proposals set forth by Thomas Felsberg (Managing Partner, Felsberg & Associates) and Mahesh Kotecha, (President, Structured Credit International) at www.globalclearinghouse.org/wefbrazil and www.globalclearinghouse.org/wefnewyork. Also please note there are recent efforts to develop monoline facilities by bilateral donors (e.g., Guarantco).
- ¹⁷ Key examples of securitization structures are Collateralized Bond Obligations (CBOs), Collateralized Debt Obligations (CDOs) and Collateralized Loan Obligations (CLOs).
- ¹⁸ Global Development Bonds (GDBs) would rely on established techniques such as diversification, over-collateralization, and tranching. GDBs also would augment these market techniques with automatic political risk insurance coverage from public sector agencies for authorized issuers and, in most cases, with a currency devaluation facility, callable equity and a monoline wrap for the senior tranche. The bonds would be backed by existing and new, emerging market infrastructure and corporate debt, and be rated, tradable securities.
- ¹⁹ See, for example, the World Panel on Financing Water Infrastructure (Camdessus Report) 2003, and "Targeted Risk Mitigation Using Contingent Facilities," Bob Sheppard, Co-Chair of the Infrastructure Experts Group, www.globalclearinghouse.org/wefhongkong.
- ²⁰ See Goldschmidt, Gabriel, Principal Investment Officer, Latin America & Caribbean Department, International Finance Corporation. "Defining an Innovative Menu of Options & Advisory Support for Customizing to Specific Country Needs." www.globalclearinghouse.org/wefbrazil. For information on Output-Based Aid, see <http://rru.worldbank.org/Discussions/Topics/Topic4.aspx>
- ²¹ Operations Evaluation Department, World Bank. *OED Review of Bank Assistance for Financial Sector Reform*. 2005. Washington DC: World Bank.
- ²² In five years, USAID's Credit Development Authority has made 114 guarantees totalling US\$ 335 million, enabling the extension of US\$ 856 million of private sector credit in 36 countries. These US government-backed guarantees are designed to promote new or expanded lending from the private sector for activities that have a positive development activity. See USAID Guarantees, Year in Review 2004, http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/year_in_review_2004_4_05.pdf. For example, see Haddon, Jonathan. "Tenor Extension Guarantees." Orrick Herrington & Sutcliffe, www.globalclearinghouse.org/wefbrazil.
- ²³ The EBRD Municipal Finance Facility is explained at <http://www.ebrd.com/country/sector/fi/euebrd/munic/index.htm>. For an example of the EU Phare programme, see <http://www.ebrd.com/new/pressrel/1996/68oct10.htm>.
- ²⁴ See Fonseca, Vinicio. "Multilaterals Provide Brazilian Export Credit Agencies with a Political Risk Breach of Contract Guarantee." Odebrecht, www.globalclearinghouse.org/wefbrazil.
- ²⁵ See Sagar, Ajay. "Local Currency Swaps and other Instruments." Asian Development Bank, www.globalclearinghouse.org/wefhongkong, and Habeck, Odo. "Multilateral Sponsored Regional Swap Facility," OGH Advisors, www.globalclearinghouse.org/wefbrazil.
- ²⁶ For example, see Pellegrini, Tony. "Leveraging Official Sector Financial Instruments to Increase Local Funding of Subsovereign Infrastructure." International Association of Development Funds, www.globalclearinghouse.org/wefbrazil.

Endnotes

- ²⁷ The equity holding of local development banks should be so structured as to ensure professional management, broad-based boards with independent directors, and appointment of the CEOs by the boards. Shareholders could include: public financial institutions; public funds; mutual funds; local banks; international financial institutions (like IFC, World Bank, regional development banks, etc.); domestic and/or international private funds; domestic and/or venture capital funds; funds operating under bilateral and multilateral arrangements; and local public at large by market borrowing programmes. See Narain, Sailendra. "Significance of Local Development Financial Institutions in Developing Countries." Centre for SME Growth & Development Finance, www.globalclearinghouse.org/wefhongkong.
- ²⁸ One development expert estimates that only US\$ 6 billion of the total US\$ 18 billion reportedly spent on capacity-building programmes is spent on in-country goods and services. For the official statistics, see the information collected by the Development Assistance Committee: http://www.oecd.org/document/3/0,2340,en_2649_33721_34700611_1_1_1_1,00.html
http://www.oecd.org/document/9/0,2340,en_2649_33721_1893129_1_1_1_1,00.html.
- ²⁹ For proposals on key issues and processes, see Cochran, Tom. "Subnational Borrowing Policy Action Proposals," CivilCredit Advisors, www.globalclearinghouse.org/wefnewyork; and Wood, Betsey, "Private Sector Governance Training Initiatives - Can a Global Corps of Financial Experts Help?" Financial Services Volunteer Corp, www.globalclearinghouse.org/wefhongkong.
- ³⁰ The Cape Town Convention on International Interests in Mobile Equipment and the Aircraft Equipment Protocol were concluded on 16 November 2001 at a Diplomatic Conference jointly sponsored by the International Institute for the Unification of Private Law (UNIDROIT) and the International Civil Aviation Organization (ICAO) in Cape Town, South Africa.
- ³¹ A growing amount of openly disclosed business survey and governance-related reports are now available as information sources for both policymakers and investors. Examples include Investment Climate Surveys (covering more than 26,000 firms in 53 developing countries, econ.worldbank.org/wdr/wdr2005); the Doing Business Project (which benchmarks regulatory regimes in 130 countries, rruworldbank.org/ics); and Global Integrity Reports (which covers overall governance), <http://www.publicintegrity.org/ga/scores.aspx?cc=ar&act=scores>). Also see Kraay, D. Kaufmann, and M. Mastruzzi. 2005. "Governance Matters IV: Indicators for 1996-2004." World Bank Institute (draft).
- ³² For example, IFC Municipal Fund has reported successful demonstration transactions (e.g., South Africa, Mexico). Many donors such as USAID's Credit Authority routinely combine capacity building programmes with guarantee and lending programmes.
- ³³ Examples of working groups that need more donor support to increase effectiveness are: the International Association of Development Funds (<http://www.developmentfunds.org/>) International Private Water Association (<http://www.ipwa.org/>), Infrastructure Experts Group (www.infradev.org) and Government-Investor Networks (www.globalclearinghouse.org/gin).
- ³⁴ Examples include the Extractive Industries Transparency Initiative, encouraging governments and firms to reconcile payments by firms to governments and account for any missing amounts and The Publish What You Pay Campaign, proposing legislation that requires oil and mining companies to disclose payments to the government as a condition for stock exchange listings.
- ³⁵ See *World Bank Development Report 2005*, p. 52.
- ³⁶ Examples include The Balkans Infrastructure Development Facility (www.bidfacility.com); USAID/INDIA FIRE Program (www.usaid.gov/press/releases/2000/fs20000085.htm); and PPIAF (www.ppiaf.org/).
- ³⁷ The problems associated with tied aid are explained in Klein, Michael and Tim Hartford. *The Market for Aid*. 2005. Washington, DC: IFC.

Footnotes: Annex A-D

- ¹ This section relies on contributions made by Eugene Rotberg, former Treasurer of the World Bank (www.globalclearinghouse.org/wefnewyork).
- ² For example, see the DAC Paris Resolution and Michael Klein et al, *The Market for Aid*, IFC, Washington.D.C.
- ³ See Winnpenny, James. 2005. "Guaranteeing Development: The Impact of Financial Guarantees," The OECD Development Centre, <http://www.oecd.org/dataoecd/3/12/35547016.pdf>
- ⁴ In five years, USAID's Credit Development Authority has made 114 guarantees totalling \$335 million, enabling the extension of \$856 million of private sector credit in 36 countries. These US Government-backed guarantees are designed to promote new or expanded lending from the private sector for activities that have a positive development activity. See USAID Guarantees, *Year in Review 2004*, http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/year_in_review_2004_4_05.pdf
- ⁵ Kraay, Aart, 2003. "What Can Cross-Country Regressions Tell Us About the Determinants of Pro-Poor Growth?" World Bank. Washington, D.C. Processed.
- ⁶ Narayan, Deepa et al., 2000. "Voices of the Poor: Crying Out for Change." Washington, D.C.: World Bank.
- ⁷ See Klein, Michael and Tim Harford, *The Market for Aid*, 2005. International Finance Corporation. p.44.
- ⁸ World Bank Investment Report 2005, "A Better Investment Climate for Everyone," 2004. and Caprio, Gerald and Patrick Honohan, 2003. "Can the Unsophisticated Market Provide Discipline?" Paper presented at the Market Discipline: The Evidence Across Countries and Industries Conference, Chicago II, October 30.
- ⁹ See Ada Karina Izaguirre, "Private Infrastructure," Public Policy for the Private Sector, *Public Policy Journal, World Bank*. <http://rru.worldbank.org/PublicPolicyJournal>
- ¹⁰ Ibid.
- ¹¹ See in particular papers submitted by Bob Bestani (www.globalclearinghouse.org/hongkong) and Mahesh Kotecha (www.globalclearinghouse.org/wefnewyork).
- ¹² In five years, USAID's Credit Development Authority has made 114 guarantees totalling \$335 million, enabling the extension of \$856 million of private sector credit in 36 countries. These US Government-backed guarantees are designed to promote new or expanded lending from the private sector for activities that have a positive development activity. See USAID Guarantees, *Year in Review 2004*, http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/year_in_review_2004_4_05.pdf
- ¹³ For example, toll roads in Chile were financed in part with local pension funds using official sector support and monoline support.
- ¹⁴ Annual averages of other larger sources of finance for the time period 2000–2002 were: Direct Investment US\$ 121 billion; Bilateral Development Finance US\$ 42 billion; Multilateral Development Finance US\$ 23 billion; Bond Purchases US\$ 16 billion; and NGO grants US\$ 11 billion. Figures from the Development Assistance Committee (DAC). See Winnpenny, James. 2005. "Guaranteeing Development: The Impact of Financial Guarantees," The OECD Development Centre. <http://www.oecd.org/dataoecd/3/12/35547016.pdf>
- ¹⁵ For example, the World Bank has launched a new infrastructure programme, with new innovative structures such as Output-Based Aid (OBA). Also bilateral initiatives include GuarantCo, among others.
- ¹⁶ See AFGI <http://www.afgi.org/fin-annualrept97.htm>
- ¹⁷ Key examples of securitization structures are Collateralized Bond Obligations (CBOs), Collateralized Debt Obligations (CDOs), and Collateralized Loan Obligations (CLOs).
- ¹⁸ For example, see "Latin America Infrastructure Initiative: Setting Up Feasibility, Equity & \$10 Billion Debt Funds:" Norman Anderson, CEO, CG/LA Infrastructure LLC, www.globalclearinghouse.org/wefbrazil
- ¹⁹ See for example, the World Panel on Financing Water Infrastructure (Camdessus Report). 2003.
- ²⁰ See "Defining an Innovative Menu of Options & Advisory Support for Customizing to Specific Country Needs," Gabriel Goldschmidt, Principal Investment Officer, Latin America & Caribbean Department, International Finance Corporation, www.globalclearinghouse.org/wefbrazil. For information on Output-Based Aid, see <http://rru.worldbank.org/Discussions/Topics/Topic4.aspx>
- ²¹ See IFC Municipal Fund: <http://www.ifc.org/municipalfund>
- ²² Developing countries with large amount of foreign currency indebtedness are exposed to international disruptions, and possible impact on their domestic banking systems and exchange rates. For example, the rapid rise of US interest rates is considered a major risk for developing countries with large dollar-denominated debt. Such increases precipitated the Latin American debt crisis in the 1980s and the Mexican 1994 peso crisis. Currency and tenor mismatches created major weaknesses in the Asian banking systems. The Argentine dollar-linked exchange rate exposed the country to unsustainable changes in their global competitiveness.
- ²³ This section draws heavily on material provided by Tom Cochran, www.globalclearinghouse.org/wefnewyork
- ²⁴ For more examples and case studies illustrating the vital role of credit enhancements in local market development of developing countries, see Robert Kehew et al, "Local Financing for Sub-Sovereign Infrastructure in Developing Countries," The World Bank, Discussion Paper 1, February 2005.
- ²⁵ See Paul Mudde, "A Saviour for Emerging Markets," *Global Trade Review*, January-February 2003, pp. 45-47.
- ²⁶ See Dr. Sailendra Narian, "The Significance of Local Development Institution in Developing Countries," www.globalclearinghouse.org/wefhongkong.
- ²⁷ See Ajay Sagar, www.globalclearinghouse.org/wefhongkong
- ²⁸ See for example the IFC Municipal Fund: <http://www.ifc.org/municipalfund>
- ²⁹ See for example the IFC Pamir transaction: www.globalclearinghouse.org/wefbrazil

Footnotes: Annex E-H

- ¹ See Michael Klein and Tim Harford, *The Market for Aid*, IFC, Washington, D.C., pp. 59 – 62.
- ² Study participants emphasized the subsovereign issue and made extensive proposals. For example, see “Subnational Borrowing Policy Action Proposals,” Tom Cochran, CivilCredit Advisors, www.globalclearinghouse.org/wefnewyork.
- ³ The challenge of integrating capacity-building programmes into the local country institutions and ongoing processes is one that has plagued development specialists for decades.
- ⁴ A number of tool kits are available, but proposals recommend enhancing their scope and impact. For example, see proposal on water tool kits, “Promoting Equitable Private Sector Participation in Development, The Case of Water & Sanitation,” and “Policy Principles and Implementation Guidelines for Private Sector Participation in Sustainable Water Supply and Sanitation Services,” Urban Frei, ECOS, www.globalclearinghouse.org/wefbrazil.
- ⁵ See for example, an open global portal developed for policy makers and investors in support of Financing for Development to facilitate the mobilization of private sector investment: www.globalclearinghouse.org/gicp
- ⁶ See proposal, “Proposal to Improve Bankable Property Rights,” Bill Armstrong, InterAmerican Development Bank, www.globalclearinghouse.org/wefbrazil.
- ⁷ One example of donor funding in this area is the support of rating agencies and governments obtaining ratings.
- ⁸ For proposals on key issues and processes, see “Subnational Borrowing Policy Action Proposals,” Tom Cochran, CivilCredit Advisors, www.globalclearinghouse.org/wefnewyork
- ⁹ For example, IFC Municipal Fund has reported successful demonstration transactions (e.g., South Africa, Mexico). Many donors such as USAID’s Credit Authority routinely combine capacity-building programmes with guarantee and lending programmes.
- ¹⁰ Examples of working groups that need more donor support to increase effectiveness are: The International Association of Development Funds (<http://www.developmentfunds.org/>) International Private Water Association (<http://www.ipwa.org/>), Infrastructure Experts Group (www.infradev.org), and Government-Investor Networks (www.globalclearinghouse.org/gin).
- ¹¹ Examples include the Extractive Industries Transparency Initiative, encouraging governments and firms to reconcile payments by firms to governments and account for any missing amounts, and The Publish What You Pay Campaign, proposing legislation that requires oil and mining companies to disclosure payments to the governmental as a condition for stock exchange listings.
- ¹² See *World Bank Development Report 2005*, p. 52.
- ¹³ The Cape Town Convention on International Interests in Mobile Equipment and the Aircraft Equipment Protocol were concluded on November 16, 2001, at a Diplomatic Conference jointly sponsored by the International Institute for the Unification of Private Law (UNIDROIT) and the International Civil Aviation Organization (ICAO) at Cape Town, South Africa.
- ¹⁴ A growing amount of openly disclosed business survey and governance-related reports are now available as information sources for both policy-makers and investors. Examples include Investment Climate Surveys (covering more than 26,000 firms in 53 developing countries, econ.worldbank.org/wdr/wdr2005), the Doing Business Project (which benchmarks regulatory regimes in 130 countries, ruworldbank.org/ics); and Global Integrity Reports (which covers overall governance), <http://www.publicintegrity.org/ga/scores.aspx?cc=ar&act=scores>). Also see Kraay, D. Kaufmann, and M. Mastruzzi. 2005. “Governance Matters IV: Indicators for 1996-2004,” World Bank Institute (draft).
- ¹⁵ This section draws heavily on input from Norman Anderson (www.globalclearinghouse.org/wefnewyork) and Pradeep Singh (www.globalclearinghouse.org/wefhongkong).
- ¹⁶ Examples include The Balkans Infrastructure Development Facility (www.bidfacility.com); USAID/INDIA FIRE Programme (www.usaid.gov/press/releases/2000/fs20000085.htm); and PPIAF (www.ppiaf.org/).
- ¹⁷ The problems associated with tied aid are explained in Klein, Michael and Tim Hartford, *The Market for Aid*, 2005. IFC, Washington, D.C.
- ¹⁸ See “Risk Management through Project Development,” Pradeep Singh, Infrastructure Leasing & Financial Services – India, www.globalclearinghouse.org/wefnewyork

Abbreviations

ADB: Asian Development Bank
AfDB: African Development Bank
DAC: Development Assistance Committee
DFI: Development Finance Institution
ECA: Export Credit Agency
EBRD: European Bank for Reconstruction and Development
FX: Foreign Exchange
GDBs: Global Development Bonds
IBRD: International Bank for Reconstruction and Development
IDB: Inter-American Development Bank
IFC: International Finance Corporation
MDB: Multilateral Development Bank
MDGs: Millenium Development Goals
ODA: Official Development Assistance
PPP: Public-Private Partnership
SMEs: Small and Medium-sized Enterprises



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