6

# International Financial Institutions: Crisis Response and Support for the Private Sector

The international financial institutions (IFIs) have a crucial role to play in supporting an effective response to the global crisis and the development emergency that now confronts many developing countries.[1] As a result, the focus of the IFIs has shifted to counteracting and mitigating the global private credit crunch and recession. This contrasts with 2007, when the impact of the IFIs stemmed largely from their ability to leverage private capital, which reached record levels of about $1 trillion in net terms in that year.

In 2008 credit conditions for developing countries deteriorated sharply as private flows dried up. Cross-border syndicated bank loans fell from $410 billion to $167 billion. Bond issuances fell from $170 billion to $72 billion. Equity investments fell from $269 billion to $174 billion. In 2009 net private capital flows to developing countries could fall still further, to less than one-fifth of the 2007 peak level, as private credits continue to contract.[2] Indeed, net private flows could even turn negative in 2009 if difficulties in rolling over maturing debt intensify.

The immediate priority for the IFIs is to respond to the crisis and deal with an unprecedented rise in demand for financing. The World Bank estimates that developing countries face a financing gap of $270 billion–$700 billion in 2009 depending on the severity of the economic and financial crisis and the strength and timing of policy responses.[3] Should a more pessimistic outcome occur, the financing gap could increase to as much as $1 trillion. Some middle-income countries had relied heavily on private finance to fund large current account deficits in 2008. They have been the first to feel the impact of the global crisis. They need funding to smooth a reduction in deficits, as well as to roll over existing debts and manage reduced liquidity in their banking systems.

In 2009 another round of impacts is expected to hit all developing countries. Reflecting the global recession, this round will come through reductions in export volumes and prices, remittances, tourism, foreign investment, and reduced public revenues and hence expenditures.

The immediate priority for the IFIs is to limit the fall in economic growth in developing countries, to maintain public infrastructure assets, and to assist poor households. The negative effect on human capital of growth collapses seems to be greater than the positive effect from growth accelerations.[4] Thus the ability of the IFIs to offset recent shocks is critical to sustaining recent gains toward achieving the Millennium Development Goals (MDGs).

Before the crisis hit, one-third of all developing countries had current account deficits surpassing 10 percent of gross domestic product (GDP). These countries will face growing problems in financing such deficits and will need to restrict demand. Private capital for trade, infrastructure, microfinance, and health care has been sharply cut. All told, the reduction in net private capital could amount to about 5 percentage points of developing-country GDP in 2009.

The private sector in developing countries finds itself in a particular squeeze. The flight to quality means that financing is more expensive or simply unattainable for many firms. The International Finance Corporation (IFC) estimates that its clients have postponed or cancelled about $100 billion worth of projects because of lack of finance.

The boom, and now bust, of private financial flows to developing countries highlight the complexity of tapping the development potential of the private sector. On the one hand, in a normal year, private capital far exceeds official aid and is viewed as indispensable to achieve the MDGs, especially for big-ticket items like infrastructure and social services. On the other hand, private capital has been volatile and is allocated on commercial terms rather than according to where the development impact is greatest.

The resources of the multilateral development banks (MDBs) flow largely to the public sector, so these institutions must be careful that any crisis response not undermine the long-term strategy of support for the private sector and that the response builds long-term productivity improvements into the projects they finance. The MDBs need to find what the African Development Bank (AfDB) refers to as the growing "sweet spot" between traditional public and private domains.

Although differentiated according to country circumstance, the core IFI strategy must have four components:

- Stabilize the macroeconomy and, where appropriate, encourage stimulus
- Protect development assets, by avoiding stop-go expenditures on new projects and maintaining existing infrastructure assets spending
- Protect poor households and help maintain social and political stability
- Maintain the long-term focus on market development and strengthening of the private sector.

The IFIs have responded with agility to country needs to stabilize the balance of payments so far. The International Monetary Fund (IMF) has provided $49 billion since mid-2008 and the MDBs (the World Bank Group and the four major regional development banks) had record gross disbursements of $55 billion in 2008. Much of this increase took the form of budget support to maintain public expenditure, including improvements in social safety nets to mitigate the effects of the crisis on the poorest. But IFI capacity to continue to expand operations in response to the crisis is declining. Some MDBs may require significant capital increases because crisis lending has reduced available headroom. In this context, the Group of Twenty (G-20) leaders at the recent summit in London took timely action in agreeing to support sizable increases in resources available to the IMF and the MDBs.

Low-income countries, while less affected by the crisis so far, have not had access to additional resources to the same extent. Disbursements of concessional funds from MDBs were relatively flat in fiscal 2008 at about $12.5 billion. The IMF provided about $260 million in additional Poverty Reduction and Growth Facility funds in 2008. While disbursements may pick up thanks to generous replenishments of the International Development Association (IDA), the African Development Fund, and the Asian Development Fund, existing resources may not be sufficient to meet low-income country needs. Accordingly, agreements reached at the G-20 summit in London also sought to boost resources available to support low-income countries.

Along with greater resources, the MDBs have made progress in the effectiveness of their interventions, including in terms of the indicators relevant for the Paris Declaration on aid effectiveness. In some areas, however, such as the use of country systems, use of project implementation units, and predictability of aid, the MDBs still fall short. The Development Assistance Committee suggests that efforts will have to be geared up considerably to meet the Paris Declaration targets set for 2010.

The role of the IFIs of course extends beyond financing. Knowledge is a core IFI comparative advantage. A crucial role for the IFIs in the context of the current global crisis is to inform policy making by analyzing the international spillovers of national policy actions and bringing out the interconnected nature of the challenges, and to highlight the need to ensure that national responses are consistent with the global good. Amid rising pressures for policies to turn inward, the IFIs' role in warning against the risks of trade protectionism and financial mercantilism is indispensable. Drawing policy lessons from the current crisis, especially but not only in financial regulation, will be another key area. The IMF has a particularly important role in enhanced surveillance of risk in the globalized financial markets.

The crisis has highlighted the need for a reform of the Bretton Woods institutions and indeed all the IFIs to fill the gaps in development finance—especially in risk management instruments and facilities for low-income countries—that have been revealed and to better integrate private sector development with public sector lending and reform. The central issues are the mandates, instrumentalities, and governance of the institutions to allow them to play a more effective role. A vigorous crisis response in 2009 can set the stage for a new multilateralism, one that embraces finance, trade, development, and climate change.

## Strategic Overview: Crisis Response and Medium-Term Strategies to Support the Private Sector

The crisis has only reinforced the IFI focus on private sector activity as the critical driver of development. When the private sector is strong and vigorous, development progress is made, but when the private sector falters, the key strategy is how to protect development against reversals. Fiscal stimulus packages in response to the crisis will catalyze sustainable economic growth only if they result in a reawakening of private and business sector activities. The private sector, in turn, will rebound only if it is supported by an adequate financial sector and by an appropriate enabling environment. Hence, structural reform of the business environment is an important complement to macroeconomic and fiscal policies in dealing with the crisis. The most effective strategies will be those that link the crisis response with long-term productivity enhancements and with a vision of how to nurture the private sector over the long term.

At the heart of the IFI approach toward private sector development is the realization that growth is central to poverty reduction and that private sector development in a properly regulated environment is the main engine of growth. As the Asian Development Bank (ADB) has put it: "Thriving businesses create jobs. Jobs provide incomes. Steady incomes reduce poverty and provide opportunities for new generations."

The approach to private sector development has evolved as countries move beyond first-round macroeconomic and trade integration reforms to second-round microeconomic and institutional reforms such as administrative, legal, and regulatory functions. The latter require private sector input to determine priorities and impact, and presuppose in-depth knowledge of the sector. Thus, public policy increasingly relies on a healthy dialogue with and understanding of the private sector. The IFIs have understood this and adapted their strategies accordingly, raising the share of financial and human resources dedicated to private sector development and changing approaches to build partnerships and broaden engagement.

Nevertheless, the IFIs have not always found it easy to develop effective operational approaches. In a 2005 evaluation of development effectiveness, the Independent Evaluation Group of the World Bank noted that private sector development projects had one of the lowest success rates of any sector.[5]

Partly, these findings reflect the tensions involved in providing public support to private companies. First and foremost, as some MDB funding is on terms that are generally more favorable to companies than purely commercial finance, questions have been raised about the distortionary effects of implicit public subsidies. The benefits from lending to the private sector are clear. New theories of the importance of "self-discovery"[6] and the potential for market failure in introducing new products and processes into an economy provide the underpinnings for public funds to support demonstration projects. But there can also be costs. Direct credit lines may distort broader credit markets and create unsustainable financial intermediaries.[7]

The MDBs have also been concerned about whether their funding to the private sector is additional to private funding, or simply a cheaper option that could undermine market discipline. Additionality of funding has been fostered by aggressively expanding into underserved market segments such as micro, small, and medium enterprise funding; big-ticket infrastructure; social sectors; and, increasingly, underserved areas. For example, the European Bank for Reconstruction and Development (EBRD) was initially the only market-oriented lender in transition economies, so its activities were additional almost by definition. The IFC has put an increased focus on poor countries and Africa in its strategy, explicitly aiming at having 50 percent of its new projects in these countries by 2011. Such strategies promote additionality but also call for flexibility. As markets mature and demonstration effects take hold, the rationale for public intervention diminishes.[8]

More fundamentally, the MDBs have moved to sharpen the identification of the public policy rationale for supporting private firms. In this, they have shifted from support for specific firms to support for market development, with a focus on creating the right enabling environment for business, setting standards for environmental and social assessments for firms, reducing capital flight and corruption, and widening the scope of markets.

Accordingly, a broader, more comprehensive approach toward private sector development has been adopted. Broadly speaking, IFI efforts to catalyze the private sector can be classified under two headings:

- Extending the reach of markets, through risk mitigation, improvement in the enabling environment, and direct support for demonstration projects; and
- Improving basic infrastructure and social service delivery through introducing private sector management and incentives, including innovative finance, to induce faster speed of implementation and expansion of access of the poorest segments of society.

The strategic challenge today is to respond to the financial crisis while remaining committed to the long-term goals of private sector development. Table 6.1 shows some of the main elements of IFI support for the private sector. It should be noted that many IFI operations bundle finance, knowledge, and partnerships. Moreover, some elements might be more significant as instruments for mobilizing other elements (for example, partnerships for finance and advisory services) than as a means of support in themselves. Many new mechanisms have been introduced in 2008, particularly to stabilize markets, in risk management and finance, but knowledge and partnership activities

**TABLE 6.1 Selected elements of IFI support to the private sector**

| | Extending the reach of markets | | | Improving basic service delivery | |
|---|---|---|---|---|---|
| Area of engagement | Risk management | Enabling environment | Direct project support | Infrastructure | Social services |
| Finance | Countercyclical lending/ balance of payments support<br>Flexible Credit Line[a]<br>DPOs/deferred drawdown<br>Disaster insurance<br>Microfinance Liquidity Facility[a]<br>Trade Finance Facilitation Program<br>Global Trade Finance Program<br>Global Food Response Program[a]<br>IDA Fast-Track Initiative[a] | Financial market development<br>Public sector reform | Equity<br>Loans<br>Guarantees<br>Micro-, small, and medium enterprise funds | Public-private partnerships<br>Sustainable Infrastructure Action Plan<br>Energy for the Poor Initiative | Innovative financing<br>Health for Africa<br>Vulnerability Financing Facility[a]<br>Advance Market Commitment for Vaccines[a] |
| Knowledge | Macroeconomic policy<br>Debt Sustainability Framework<br>International Tax Dialogue<br>Saving mobilization<br>Extractive Industries Transparency Initiative++ | Doing Business<br>Financial Sector Assessment Program<br>Standards and codes<br>Regulatory reform<br>Foreign investment promotion | Technical assistance<br>Small and medium enterprise toolkit | Risk management frameworks | Social performance indicators[a] |
| Partnerships | Climate change<br>Stolen Asset Recovery[a]<br>Ethics in business<br>Global Emerging Markets Local Currency Bond Program | Corporate social responsibility<br>Equator principles<br>Corporate governance | Carbon markets<br>Aid for trade<br>Consultative Group to Assist the Poor<br>Sovereign Fund Facility[a] | Public-Private Infrastructure Advisory Facility<br>Global Gas Flaring Reduction | Global Partnership for Output-Based Aid<br>Global Fund to Fight AIDS, Tuberculosis, and Malaria<br>Global Alliance for Vaccines and Immunizations |

a. Mechanism introduced in 2008 or 2009.

have also evolved. At the same time, the institutions have intensified activities under existing mechanisms.

As the crisis unfolds, the IFIs have responded in flexible ways, but some weaknesses in each area of engagement—finance, knowledge, and partnerships—have also been revealed.

## Finance

On financing, several key strategic issues emerged during 2008:

- Are IFI resources adequate to meet the needs caused by a major global slowdown?
- Does the crisis alter long-term projections of demand for MDB activities?

- Are modalities of support sufficiently flexible?
- Is MDB capital leveraged and deployed to minimize risk?
- Are low-income countries adequately protected?
- Do MDB activities adequately protect vulnerable groups within countries?

The IFIs have had the financial capability to respond to the crisis but are now approaching resource limits. While the IMF's liquidity position remained satisfactory at the end of 2008, G-20 leaders at the recent summit in London agreed to support a large expansion in the IMF's precrisis lending capacity to enable the institution to face the expected unprecedented rise in demand for financing. As an immediate measure, bilateral financing from members will be increased to $250 billion. In the near term, the immediate financing from members will be incorporated into an expanded and more flexible New Arrangements to Borrow and will be increased by up to $500 billion. The G-20 leaders also supported consideration of market borrowing by the IMF to be used if necessary in conjunction with other sources of financing to raise resources to the level needed to meet demands. The IMF's concessional lending capacity for low-income countries and access limits will be doubled. The leaders committed to using additional resources from agreed-on IMF gold sales, together with surplus income, to provide $6 billion additional concessional and flexible finance for the poorest countries over the next two to three years. In addition to these steps, G-20 leaders agreed to support a general allocation of special drawing rights (SDRs) equivalent to $250 billion to increase global liquidity, $100 billion of which will go directly to emerging market and developing countries.

Among the MDBs, the ADB is already short of resources, and without a general capital increase it cannot conduct regular multiyear programming discussions with major clients. The EBRD is also reviewing its capital resources. The AfDB is already finding that it may need to bring forward its plans for a capital increase in 2012. The International Bank for Reconstruction and Development (IBRD) estimates it could use its $100 billion in available resources over the next three years. At the London summit in April 2009, the G-20 leaders agreed to support a 200 percent general capital increase at the ADB and to review the need for capital increases of the AfDB, EBRD, and the IDB. The G-20 statement supported additional lending by the MDBs, including to low-income countries, of $100 billion over the next three years.

From a strategic perspective, MDB capital increases should be based on longer-term business needs rather than a crisis response. To illustrate, IBRD lending after the East Asia crisis fell to one-half of its crisis-lending levels, so crisis-lending levels should not be the basis for capital need. At the same time, the crisis may be changing the nature of demand from middle-income clients, who may now see the MDBs as more reliable development finance partners than private capital markets and look to them for a larger part of their financing needs. Demand for risk-based instruments, such as deferred drawdown options and guarantees, has been especially strong and may well continue after the current crisis is over.

The issue of capital increases is therefore tied to the issue of adequately flexible and speedy modalities of MDB engagement. A striking feature of 2008 was that even in the face of dramatic shocks, some IFI facilities were underused. A number of precautionary instruments, such as the World Bank's deferred drawdown option, and various trade financing arrangements, which have had slow uptake in times of ample private liquidity, are now seen as useful additions for MDBs. Clients are increasingly requesting such credit lines. The crisis has highlighted the need for speed and transparency in access to resources. But the standard MDB lending model is built around negotiated agreements and safeguard procedures that take considerable time, although in emergencies the response can be rapid.

The strategic issue is how to ensure that MDB facilities complement the leading role of the IMF in countercyclical lending and are provided only in the context of viable macroeconomic programs. The broader trend toward ex ante certification of policies rather than ex post conditionalities may make this task easier. In countries with good policies, MDB finance could be directly targeted at fiscal expenditures that need to be supported during a crisis to avoid long-lasting development setbacks.

The MDB role in crises is to protect public assets and the most vulnerable households so that welfare and economic losses are minimized. For example, one estimate suggests that $45 billion in road asset value in developing countries was lost between 1970 and 1989 for lack of $10 billion in maintenance spending.[9] The MDBs do not have the resources, however, to offset private capital swings in most countries. From this perspective the MDB role is to provide resources to fund budget priorities, not to provide countercyclical balance of payments financing per se.

One of the benefits of the shift of MDB financing toward nonconcessional, nonsovereign lending, documented in the 2008 *Global Monitoring Report*, was the increase in leverage that could be brought about by partnering with the private sector. With the crisis, leverage options have narrowed. For that reason, the IFC has shifted its focus by launching a broad and targeted set of initiatives to help shore up the private sector through support for trade financing, recapitalization of banks, and financing for small and medium enterprises. There are better prospects for guarantees and other innovative financing instruments to generate leverage by mitigating risk. While there has been an expansion of such instruments, the crisis has highlighted the ample scope for scaling up in a more systematic way if balance sheets permit.

Low-income countries have far fewer options than middle-income countries to access new funds during crisis periods. They are constrained by fixed limits on grants and concessional credits. There is therefore an asymmetry in treatment between low- and middle-income countries and a much greater risk that low-income countries will be forced to adjust through domestic demand contraction, risking recent development gains. Poor households in low-income countries will then be left with no relief. For that reason, the World Bank established a Global Food Crisis Response Program based on additional trust funds in May 2008 and is now proposing a flexible Vulnerability Fund as a way of responding to the current crisis.[10]

Several technical solutions have been advanced to deal with the limited availability of incremental resources for poor countries: front-loading of new commitments, contingent debt service clauses in concessional credits, emergency procedures to accelerate disbursements on existing projects, relaxation of budget support ceilings, and access to nonconcessional financing (with or without buy-down arrangements to lower future debt service costs) subject to limits under the Debt Sustainability Framework.

The crisis has revealed areas where a cutback of private capital can be particularly damaging to development: trade, infrastructure, banks (including those dealing with micro-, small, and medium enterprise finance), energy, and household safety nets. Options to ensure that these areas can be managed through future cycles should be a strategic priority for MDBs. In this way, the crisis may drive considerations of selectivity and comparative advantage of MDBs.

## Knowledge

In recent years, all IFIs have emphasized their knowledge and learning contributions to development and their desire to shift toward more knowledge-based institutions. Knowledge services, such as country analytical work, technical assistance, and global data and research, provide countries with analytic, diagnostic, and capacity-building support. Shared knowledge on the development vision, policies, and expenditure frameworks to link programs with budget resources has become indispensable in the current volatile environment.

In fact, provision of knowledge is one of the core comparative advantages of multilateral agencies.[11] The IFI reorientation toward knowledge services focuses on building country absorptive capacities, strengthening country strategies, underpinning aid effectiveness, and disseminating and sharing global practices and experiences in implementing development. Four areas stand out:

- Understanding of the global economic system and development of risk mitigation
- Country-level implementation of global standards and codes
- Country-level development of robust markets
- Social and environmental assessments

Many countries are struggling to understand the nature of the current financial crisis and the channels through which they could be affected. For example, middle-income countries in the Middle East and North Africa region have asked for help in understanding the factors behind the large swings in oil prices and the implications of the financial crisis.

Growing economic nationalism and financial mercantilism in the face of the crisis are pressuring the open, global economy. The IFIs have a valuable role to play in documenting cooperative, collective solutions and the pitfalls of beggar-thy-neighbor policies. The implementation of new forms of state aid to industry, regulatory forbearance for banks, temporary trade and capital account restrictions (even those permitted under the World Trade Organization), incentives for foreign investments, and exchange rate policies are all areas where the IFIs can monitor developments on a global basis and provide advice and information to countries and regional peer review groups.

The IMF, in particular, has a critical role to play in enhanced surveillance of macroeconomic and financial risks. The IMF will closely collaborate with a new Financial Stability Board (including G-20 countries, members of the Financial Stability Forum, Spain, and the European Commission) to monitor progress in implementing the G-20 Action Plan for strengthening financial supervision and regulation. Both institutions will also prepare joint semiannual Early Warning Exercises (EWEs), which integrate macrofinancial and regulatory perspectives and identify macrofinancial risks; the first of these joint exercises was completed in March 2009 in collaboration with the Financial Stability Forum. At the same time, financial sector advice given under the joint IMF–World Bank Financial Sector Assessment Program (FSAP) will be better integrated into country surveillance activities and policy dialogue. To further bolster its macroeconomic analysis, the IMF has also expanded its semiannual vulnerability analyses to advanced economies. Many emerging economies have been surprised at the dimensions of their exposure to a global recession. For low-income countries, the joint IMF–World Bank Debt Sustainability Framework provides a key tool for assessing fiscal risk.

The crisis has underlined the benefits of financing development in ways that do not create debt. Self-reliance echoes calls from many developing-country policy makers but is undermined by tax evasion and illicit capital flows.[12] These were a major topic of discussion at the Doha Conference on Financing for Development, and the international tax dialogue and anticorruption efforts are examples of how IFI knowledge activities can have impact on broad development policies.

Increasingly IFIs are viewed as useful vehicles for monitoring the application of global standards and codes and other forms of international benchmarking. Financial Sector Assessment Programs (FSAP), associated Reports on Observance of Standards and Codes, and business and foreign investment promotion rules and regulations have been valuable tools for this dialogue. With new regulatory approaches to the financial sector certain to emerge out of the global crisis discussions, the IFIs will be well placed to monitor individual country compliance and to assist developing countries with implementation.

Strengthening country systems, especially on financial management and public expenditure, are important pillars of the IFI agenda of leveraging knowledge with financial resources to maximize development impact.

Sound markets with well-developed regulatory systems are the best form of insurance against risk. IFI knowledge can help countries implement institutional reforms to build more robust markets.[13] All the MDBs have technical assistance programs that help entrepreneurs understand the responsibilities and risks they bear as business people. This work has helped advance an understanding of how social and environmental standards can help businesses contribute to sustainable development in a cooperative fashion without losing competitiveness.

## Partnerships

Before the crisis, the scale of private capital was already driving MDBs to seek new partnerships to advance development. As the crisis unfolds, the strategic need to engage coherently with partners in shaping strategies and carrying out specific programs becomes more critical. Strategic partnerships are evolving around:

- Resources for development to fill financing gaps
- Division of labor according to comparative advantage among agencies
- Innovative and scaled-up approaches
- Global public goods

The MDBs engage in partnerships to achieve common development objectives, under agreed-upon shared and joint responsibilities. Partnerships are meant to augment the MDBs' own development initiatives, but they also facilitate harmonization of efforts between donors, recipient countries, and various other stakeholders at global, regional, and country levels. The MDBs are slowly moving toward expanding partnerships in this broad sense. There are now many instances of partnerships among and between multilaterals, bilaterals, and private agencies: as of fiscal 2008, the World Bank alone had more than 1,000 trust funds with donor commitments totaling $26.3 billion. But private resource mobilization remains limited. World Bank Group trust fund contributions from foundations and corporations totaled only $1 billion between 2002 and 2008, and the development gains from trying to expand these resources significantly appear small. Hence, resource mobilization is no longer seen as the main driver of private partnerships.[14]

More scope exists to build partnerships in response to specific challenges. Earlier successes with public-private partnerships include the Consultative Group on International Agricultural Research and the Onchocerciasis (River Blindness) Control program. Along the same lines, the Global Alliance for Vaccines and Immunizations, the Global Fund to Fight AIDS, Tuberculosis, and Malaria, and new commitments to agricultural research in Africa offer much promise and exemplify the MDB approach of reaching out to world-class corporations. Another example is the IFC's Global Emerging Markets Local Currency Bond program. But these approaches work only when there is a full understanding of the comparative advantage of various partners, in terms of either sectoral expertise or the nature and terms of the financing they provide.

Partnerships are especially important in the delivery of global public goods. In those cases, the voice of developing countries in shaping international goals is important. A recent example is the UN Office on Drugs and Crime/World Bank Stolen Asset Recovery (StAR) program, where bank secrecy rules in developed countries were adapted to enable developing countries to reclaim stolen assets which, by some counts, could exceed $1 trillion.[15] StAR (along with the Extractive Industries Transparency Initiative) helps promote transparency and better governance across the developing world (box 6.1).

## IFI Operational Results and New Initiatives

The IFI crisis response has prioritized stabilizing markets. The medium-term support for private sector strategies falls under two categories—extending the reach of markets, and improving basic service delivery. This section summarizes IFI activities in 2008 and recent new initiatives along these dimensions.

### Extending the Reach of Markets

#### Stabilizing markets, countercyclical financing, and risk management

In 2008 the IFIs played an important role in countercyclical financing (table 6.2) and in financing emerging development needs. The IMF has taken the lead with its strong encouragement of additional fiscal stimulus in countries with healthy balance of payments and public debt profiles. Since mid-2008, it also has provided financial support, amounting to about $49 billion, to nine emerging countries to permit orderly adjustment to payments crises.[16] Requests for such support are expected to rise sharply in 2009. The IMF moved quickly to establish a new Flexible Credit Line (FCL) to provide large and up-front financing to emerging economies with very strong fundamentals and policies. The facility can be used on a precautionary basis or for actual balance-of-payment needs. Because access to the FCL is restricted to those countries that meet strict qualification criteria, drawings under it are not tied to policy goals agreed with the country. Countries not qualifying for the FCL can count on new High Access Precautionary Stand-By Arrangements (SBAs) as a regular lending window. Like the FCL, precautionary SBAs can be frontloaded and take account of the strength of a country's policies and the external environment. Decisions have been taken on a doubling of access levels for emerging markets and low-income countries, and conditionality has been reformed to make it more focused and tailored to country circumstances. Furthermore, the IMF has made substantial progress with a comprehensive review of the

**BOX 6.1 Stolen Asset Recovery Initiative**

Corruption and asset theft are development problems of the first magnitude. The direct economic impact is huge. An even greater impact probably results from the insidious effects of degrading public institutions, tainting and destabilizing financial systems, and undermining the rule of law.

The StAR Initiative, launched by the World Bank and the United Nations Office on Drugs and Crime in October 2007, works with financial centers and developing countries to reduce the barriers to asset recovery and facilitate developing countries' efforts to secure the return of stolen assets. Programs have been started in six countries, and discussions with many more are under way. The StAR initiative is about justice and the prospect of taking legal action after years of impunity for corrupt officials, even when the prospects for the return of stolen assets are low. StAR is exploring how financial centers can strengthen regulations and improve compliance and enforcement of authorities to trace the beneficiary ownership of bank accounts and to enhance supervision of accounts of politically exposed persons. At the same time, StAR provides legal assistance and training to developing countries to strengthen their capacity to manage asset recovery programs as part of broader anti-corruption efforts.

In a first success, Haiti appears to be on its way to recovering $6 million after the Swiss Federal Office of Justice ruled that account holders had failed to prove that the funds were legally acquired. The order may be appealed.

lending framework and external debt policies for low-income countries.

The Fund also modified its Exogenous Shocks Facility to speed up access, given the limited uptake of demand for resources from this facility in early 2008 when commodity prices started to soar. As a result, $261 million has been committed under this facility as of the end of 2008. There were twelve cases of augmentation under Poverty Reduction and Growth Facility arrangements in 2008, increasing financial commitments under these arrangements by about $214 million.

The MDBs also expanded their activities, in the first instance to help countries manage food and fuel price increases. The World Bank and the ADB both announced major initiatives to help countries manage higher food prices. The World Bank's Global Food

**TABLE 6.2 Examples of IFI crisis response programs in 2008**

| Agency | Program | Amount | Key features |
|---|---|---|---|
| IMF | Flexible Credit Line | No formal access limits | Eligibility based on strong macroeconomic fundamentals |
| IMF | Modified Exogenous Shocks Facility | Up to 75 percent of quota | Rapid access component with streamlined conditionality |
| IMF | High-Access Precautionary Stand-By Arrangements (SBAs) | Access above normal limits for SBAs | Emergency financing procedures<br>Only core macroeconomic conditions |
| IMF | Poverty Reduction and Growth Facility Augmentation | Flexible within annual and cumulative ceilings | Balance of payments support |
| IBRD | Development Policy Operations | $100 billion over 3 years | Budget and payments support |
| IBRD | Global Food Crisis Response Program | $200 million +<br>$1 billion (other donors) | Trust funds from net income for social protection and food production |
| IBRD | Energy for the Poor | Trust fund | Increase energy access |
| IDA | Fast-track Facility | $2 billion | Support critical public spending.<br>Front-loading of IDA 15 |
| IFC | Global Trade Finance Program | $3 billion | Guarantees of trade credits |
| IFC/Japan | Bank recapitalization fund | $3 billion | Equity and subordinated debt for banks |
| IFC | Infrastructure Financing Facility | $500 million | Equity and loans for private and PPP infrastructure |
| ADB | Trade Finance Facilitation Program | $150 million | Support for trade transactions |
| ADB | Budget support | $717 million | Budgetary support for food security/safety nets |
| IDB | Liquidity Program for Growth Sustainability | $6 billion | Balance of payments support to member governments |
| EBRD | Crisis response | €7.0 billion | Expected 2009 financing of €7 billion (€1.6 billion over 2008), mainly for crisis response, including expanded Trade Facilitation Program |
| AfDB | Trade Finance Initiative | $1 billion | Lines of credit to financial institutions |
| AfDB | Emergency Liquidity Facility | $1.5 billion | Short-term emergency finance support |

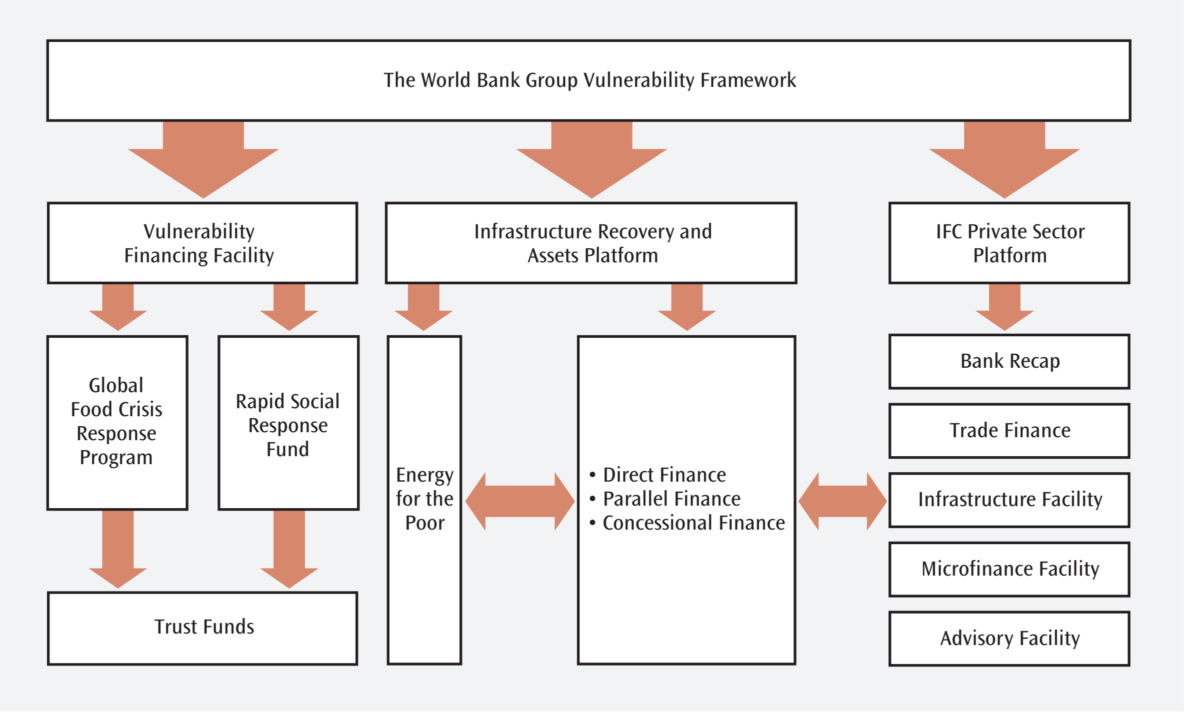
*Source:* IMF and MDBs.
*Note:* The indicated amounts do not include mobilization from partners.

Crisis Response Program has already committed $856 million for 29 countries, including $325 million for African countries. IDA has also provided $4.1 billion in new commitments of concessional financing in the second half of 2008. While helpful, that still leaves low-income countries vulnerable to global shocks. Nonconcessional lending by the IBRD has risen sharply and could reach $35 billion in fiscal 2009, triple the level of the previous year.

The World Bank has rapidly implemented a Vulnerability Financing Facility to provide an umbrella structure under which specific initiatives can be formed to pool grant resources from donors with World Bank funds in a rapid-response program to expand and strengthen social safety nets and protect

## BOX 6.2 World Bank Group's Vulnerability Framework

The World Bank Group's Vulnerability Framework is an umbrella mechanism that includes a comprehensive range of ongoing and new programs to support growth and poverty reduction in countries impacted by the global economic crisis. A key component is a Vulnerability Financing Facility (VFF) with a focus on mitigating the impact on the poor and vulnerable through strengthening safety nets and basic social services. It comprises the Global Food Crisis Response Program (GFRP) and the Rapid Social Response Fund. A second key component is the Infrastructure Recovery and Assets Platform (INFRA) that aims to support infrastructure spending critical for growth, including energy for the poor programs. A third key component aims to strengthen support to the private sector through IFC programs. The Vulnerability Framework draws on the full range of the World Bank Group's financial, technical, advisory, and coordinating resources. The framework has an open, flexible architecture that would facilitate ready adaptation to evolving needs. Support for programs in the Vulnerability Framework would be one option for donors wishing to contribute additional resources to help developing countries respond to the global economic crisis. At the London summit in April 2009, G-20 leaders committed to supporting the Vulnerability Framework through voluntary bilateral contributions.



other critical public programs (box 6.2).[17] The facility is part of a broader Vulnerability Framework to assist vulnerable countries to deal with the impact of the global economic crisis. A supporting initiative is the IDA Financial Crisis Response Fast-Track Facility, set up in late 2008, which aims to fast-track up to $2 billion of financial assistance, with the potential to increase this amount in the future, depending on the need.

The MDBs have also responded to cutbacks in private trade credits. Private trade finance was hurt as counterparty risk rose and spreads on trade finance soared even for creditworthy borrowers. The ADB, EBRD, and IFC have moved to strengthen trade financing facilities and the Inter-American Development Bank (IDB) and the AfDB have new trade finance facilities under preparation (box 6.3).

Other areas that have been sharply affected are infrastructure, banks, and micro-, small, and medium enterprises. The MDBs have focused programs to respond to the needs in these sectors. The IFC established a new infrastructure crisis facility to ensure that viable privately funded infrastructure projects in emerging markets will have access to finance to weather the global crisis, and it partnered with the Japan Bank for International Cooperation to help recapitalize banks in smaller emerging markets through equity and subordinated debt (box 6.4).

### Volume and Allocation of MDB Lending

Overall, MDB gross disbursements in 2008 reached a record volume of $55.1 billion, up from 48.7 billion in 2007 (figure 6.1). Of this, $42.5 billion was in nonconcessional resources, up from $36.7 billion in 2007. Gross concessional flows rose by only 3.5 percent to $12.5 billion, compared with the 17.2 percent increase in nonconcessional lending to sovereign borrowers. Total MDB lending is expected to rise sharply in the next three years, in response to the global economic crisis, to an annual average of as much as $100 billion.

***Nonconcessional lending to sovereigns.*** Nonconcessional lending to sovereigns totaled about $27.8 billion in 2008, up from $23.7 billion in 2007, with increases spread across all regions. But nonconcessional

## BOX 6.3 MDBs and trade finance

The World Bank Group has ramped up its support to the private sector by doubling the IFC's Global Trade Finance Program from $1.5 billion to $3.0 billion. Trade guarantees issued under the program will have an average duration of six months, thereby supporting up to $18 billion of trade finance over the next three years. The program offers banks guarantees covering the payment risk in trade transactions. Since the program's inception in September 2005, $3.2 billion in trade guarantees have been issued to support 2,600 transactions. Of the total transactions, 48 percent were for banks in Africa, 70 percent involved small and medium enterprises, 50 percent supported trade with the world's poorest countries, and 35 percent facilitated trade between emerging markets.

The EBRD's trade facilitation program guarantees political and commercial risk of 100 issuing banks and factoring companies. As of the end of 2008, the program had facilitated more than 7,600 trade deals worth more than €4.5 billion.

The ADB trade finance facilitation program started operations in 2004 and consists of three products: a Credit Guarantee; a Revolving Credit Facility; and a Risk Participation Agreement under which ADB shares risk with international banks to support trade in challenging and frontier markets. The program has supported over 1,000 international trade transactions for a total value of about $500 million and has grown exponentially over the past 12 months.

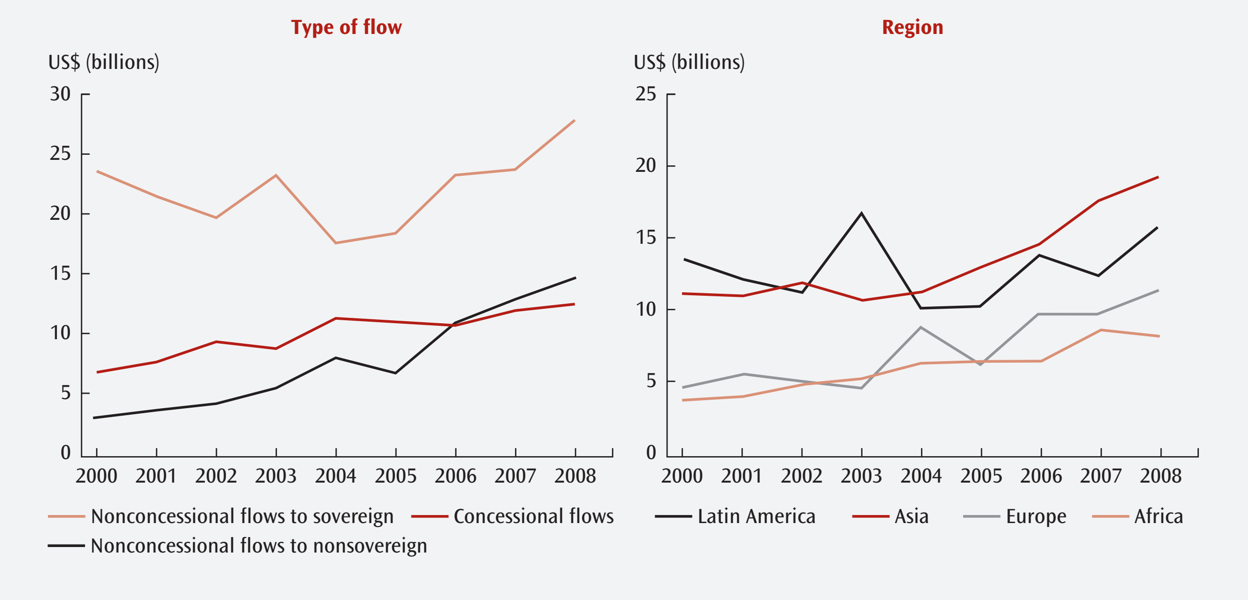
The IDB has recently approved a two-year mandate for the Structured and Corporate Finance department to support trade finance largely through credit guarantees. The AfDB is in the process of preparing a $1 billion trade finance initiative.

## BOX 6.4 IFC response to the crisis

The IFC has ramped up four facilities with about $30 billion in new financing over the next three years, combining its own funds with those from partners. The facilities include:

- **Bank Recapitalization Fund ($3 billion).** This is a global equity and subordinated debt fund managed by the IFC that aims to recapitalize distressed banks. It will also provide advisory services. Japan will be a key founding partner and provide $2 billion to the fund.
- **Infrastructure Crisis Facility ($10 billion).** This facility will help ensure that viable privately funded infrastructure projects in emerging markets can weather the financial crisis. The facility will comprise a loan financing trust, an equity facility, and an advisory facility. The loan and equity components are expected to provide rollover financing and to substitute temporarily for commercial financing for new projects. Funding for existing projects would have a three- to six-year maturity. The IFC expects to invest a minimum of $300 million and mobilize between $1.5 billion and $10 billion from other sources.
- **Microfinance Liquidity Facility ($500 million).** The IFC expects to invest $150 million of its own money with contributions from Germany's KfW development bank and other donors for a total investment of $500 million, to provide refinancing to more than 100 strong microfinance institutions in 40 countries, which reach 60 million poor borrowers. The facility will be managed by three of the industry's leading fund managers.
- **Expanded Global Trade Finance Program ($18 billion over 3 years).** (See box 6.3 on trade finance.)
- **Global Trade Liquidity Pool (up to $50 billion over 3 years).** The IFC is working with a number of partners—global and regional banks—to create a global trade liquidity pool that will fund trade transactions for up to 270 days and will be self-liquidating once conditions for trade finance improve. The initiative involves $1 billion of IFC's own resources. G-20 countries have agreed to provide $3 billion to $4 billion in voluntary, bilateral contributions.

**FIGURE 6.1 MDB gross disbursements, 2000–08**




*Source:* Staff of the big five multilateral development banks.

lending has sharply accelerated recently. The IBRD lending pipeline has doubled since the start of fiscal 2009. Commitments in the first half of fiscal 2009 reached $12.4 billion, compared with $3.3 billion in the first half of fiscal 2008. Lending of $100 billion is envisaged for fiscal years 2009–11, almost triple the annual rate before the crisis. An acceleration in lending is also taking place at other MDBs. For example, the ADB has proposed $4 billion–$5 billion in additional commitments in 2009.

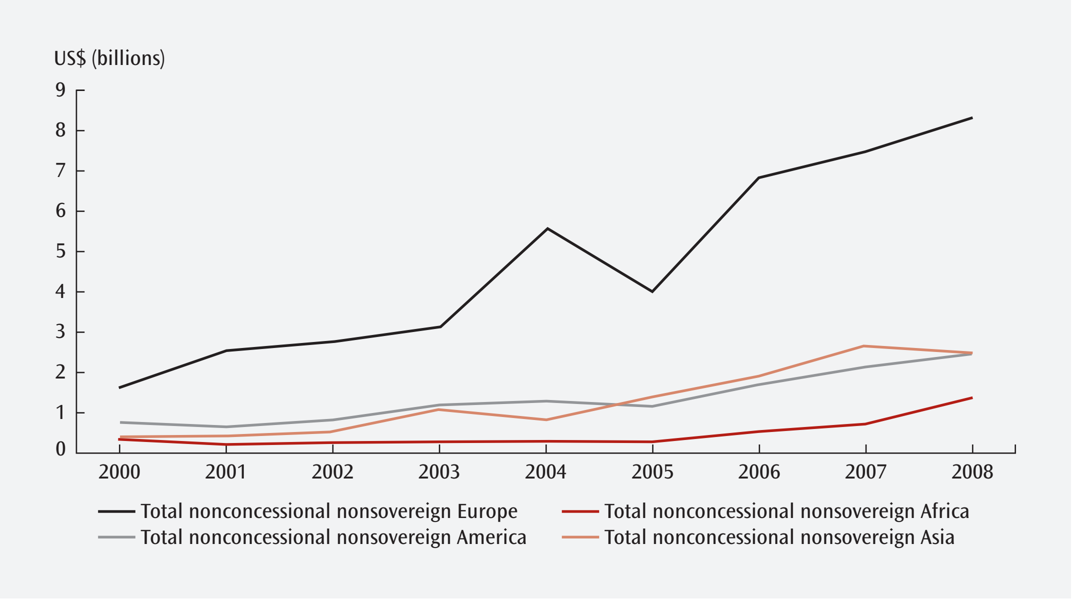
*Concessional lending.* Despite the crisis and record levels of donor pledges for recent replenishment of MDB concessional windows, gross concessional flows from MDBs were relatively flat in 2008 at about $12.5 billion. A sharp upward trend is expected as disbursements from new commitments start to rise. Credits and grants from the Asian Development Fund grew by 33 percent, and by 10 percent from the African Development Fund. Flows from IDA, however, declined.

IDA is in a strong position to increase support—thanks to the nearly $42 billion in commitment authority agreed for IDA 15 replenishment for the next three years—with scope for front-loading. It has up to $20.3 billion of resources available in fiscal 2009; while it committed only $4.1 billion in the first half of the fiscal year, commitments are expected to accelerate in the second half. IDA has a significant undisbursed portfolio against past commitments, amounting to $33 billion at the end of fiscal 2008.

*Direct support to firms.* MDB nonconcessional loans and guarantees to nonsovereign entities, mainly to the private sector, increased by about $2 billion in 2008 to $15 billion (figure 6.2). MDB nonsovereign flows (lending and equity investments) have grown by almost fourfold since 2000. The EBRD plans a 33 percent increase in commitments for 2009, to €7 billion. With the slump in private capital flows, demand for support from the private sector arms of the MDBs in likely to be strong in the period ahead.

The top two sectors for MDB private sector operations are infrastructure and financial institutions. Between them, these two

**FIGURE 6.2 MDB gross disbursements to nonsovereign borrowers, by region, 2000–08**




*Source:* Staff of the big five multilateral development banks.

sectors account for over 60 percent of total commitments.

Sixty percent of MDB nonconcessional, nonsovereign flows were directed to Europe, but there is an encouraging increase even in Africa. Geographically, the IFC has recently placed the poorest countries at the top of its agenda, and this led to commitments of $3.5 billion in IDA countries in fiscal 2008, of which $1.4 billion was in Africa across 25 countries. This is matched by AfDB's private sector operations, which grew to $1.5 billion in 2008.

In the current context, there are also good opportunities to provide nonsovereign public entities at the subnational level with long-term finance. The World Bank Group has integrated its approach to subnational financing by offering financial and guarantee products using the IFC balance sheet,[18] but this mechanism has not yet seen significant growth, and volumes are still modest, with a total exposure of $350 million. A number of countries have asked for support for nonsovereign lending to subnationals, extending beyond finance to include enhanced capital market access, especially in cases where administrative responsibilities for basic infrastructure services have been devolved to local governments. The EBRD has a longstanding and successful municipal finance business, with total commitments of €2.8 billion to date.

*Guarantees.* Beyond countercyclical financing, the MDBs have moved forward with other programs to reduce risk in emerging markets. The role of the Multilateral Investment Guarantee Agency (MIGA), for instance, has expanded in countries such as Ukraine and the Russian Federation, where private insurance has become more expensive (box 6.5). The IFC is also stepping up its guarantee operations, including increased collaboration with MIGA.

*Coordination of MDB crisis support.* The MDBs have stepped up coordination of their support to countries impacted by the global crisis. An important example of such coordination is a €24.5 billion program of support to the banking sector and bank lending to businesses hurt by the crisis in Central, Eastern, and Southern Europe jointly announced by the World Bank Group, the EBRD, and the European Investment Bank (EIB) in February 2009. The coordinated program of support will include contributions of €6 billion from the EBRD, €11 billion from the EIB, and €7.5 billion from the World Bank Group (IBRD €3.5 billion, IFC €2 billion, and MIGA €2 billion).

## The Enabling Environment for Private Sector Development

MDB support for private sector development has shifted from a focus on privatization and restructuring of state-owned enterprises to one of improving the enabling environment for the private sector. The new focus is on supporting regulatory reforms, encouraging competitive and business-friendly environments, and redefining the public sector role as a catalyst and facilitator for the private sector rather than a competitor.

The IFIs use a full range of instruments to pursue a better enabling environment for private sector development. Lending for the financial sector and for public sector reform helps provide conditions in which the private sector can operate effectively. Analytical work, such as country diagnostics, metrics and global benchmarking, and specific advisory services, such as the World Bank Group's Foreign Investment Advisory Service and the Public-Private Infrastructure Advisory Facility, help countries pursue reforms to create a more efficient private sector. Partnerships, such as the introduction of global standards and codes, help ensure that the playing field is level across countries, as well as within countries.

### Financial sector

Although banks in developing countries in general have not suffered severe direct losses

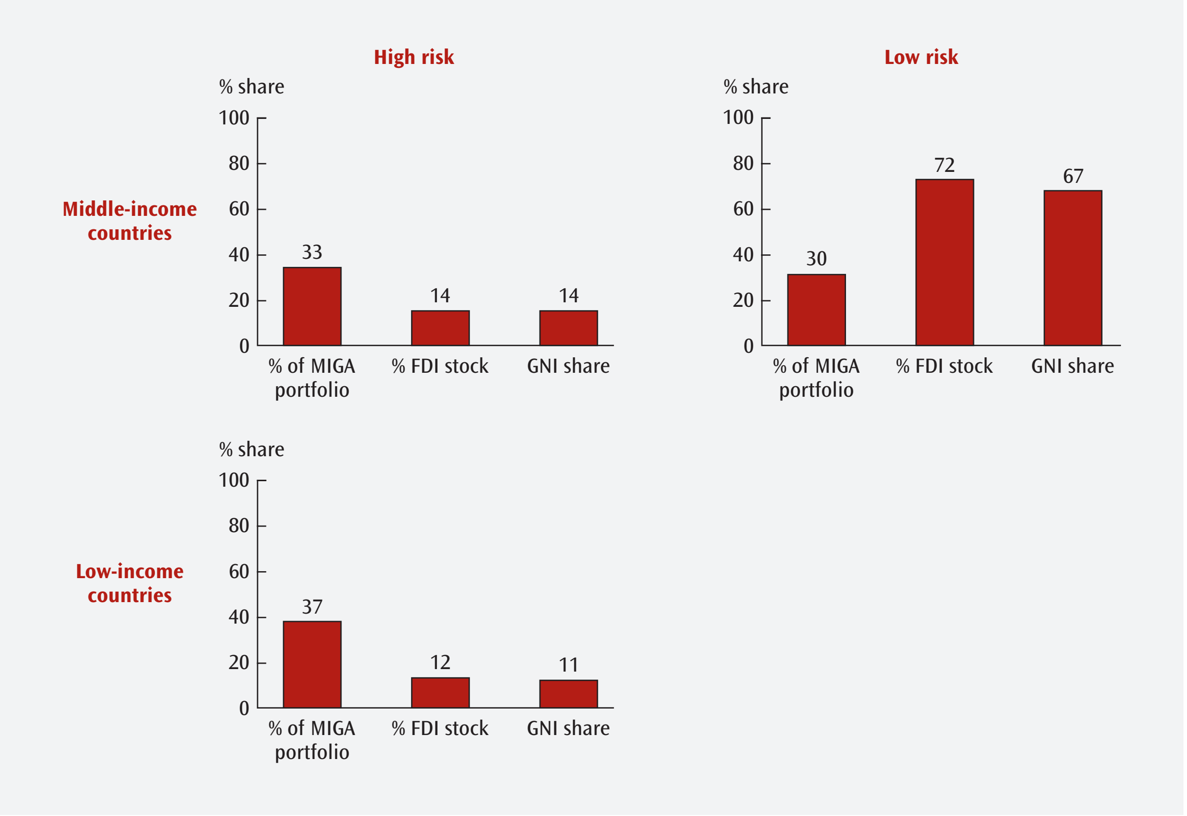
## BOX 6.5 MIGA's contributions to supporting investment in developing countries

The Multilateral Investment Guarantee Agency (MIGA) is a specialized agency within the World Bank Group that offers political risk insurance to foreign long-term investors in developing countries. Guarantees issued by MIGA cover against the risks of inconvertibility of local currency into foreign exchange and its transfer out of developing countries, expropriation (including so-called "creeping expropriation" related to a series of governmental actions that eventually lead to the abandonment of an investment), breach of contract by the sovereign or its agents, and destruction of assets or interruption of business activities arising from politically motivated violence or civil unrest. By assuming these risks, MIGA aims at encouraging productive foreign investments into developing countries.

MIGA can manage these political risks better than private insurance providers can, but its administrative costs are higher. For this reason, MIGA is best positioned in the riskiest developing countries, where private insurers charge very high premiums.

The figures below show that MIGA is "overweight" with respect to foreign direct investment (FDI) stocks in high-risk countries—in the sense that its exposure in risky countries is far higher than these countries' share of total FDI to developing countries or their share of total developing country gross national income (GNI). By contrast, MIGA is "underweight" in low-risk, middle-income countries, which receive 72 percent of all FDI of developing countries but account for only 30 percent of MIGA's exposure.

**Share of FDI stocks, GNI, and MIGA exposure in developing countries by income and risk, 2007**



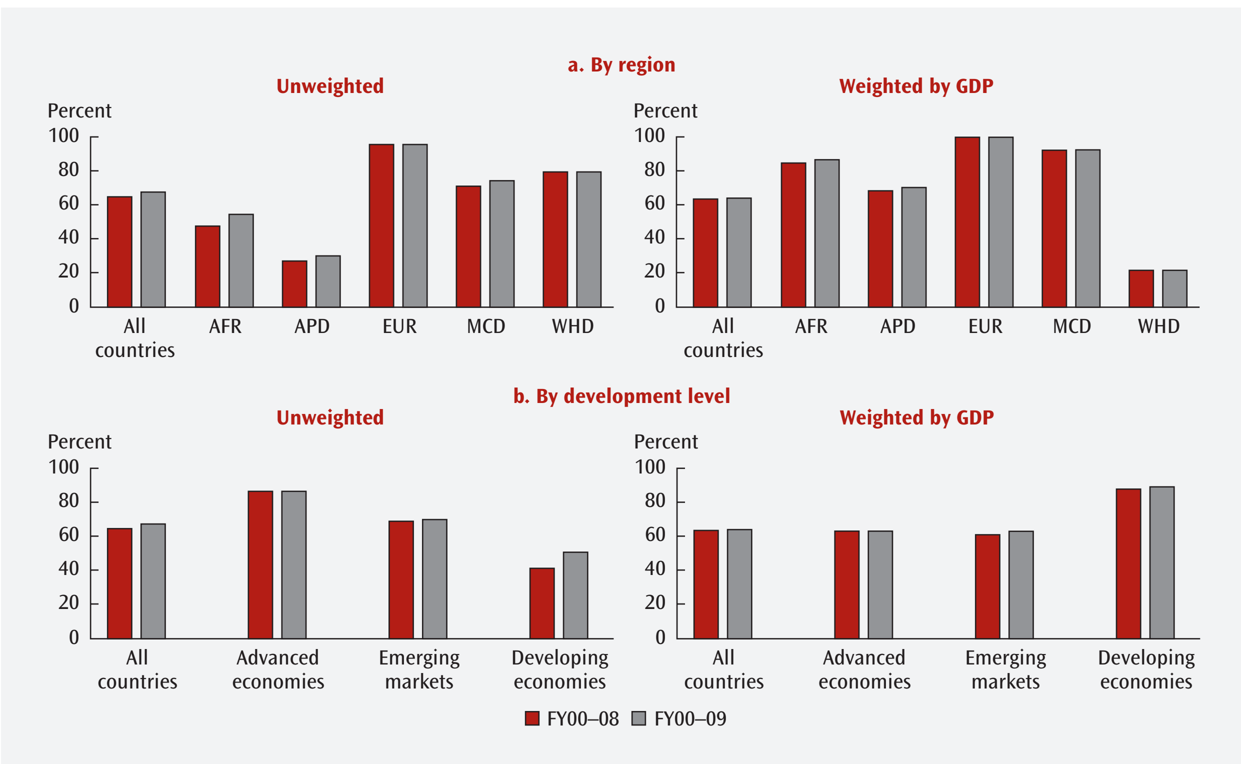

*Source:* MIGA.
*Note:* Low risk is defined as an Institutional Investor score greater than 50. Income per capita cutoff is $1,785.

from the current global financial crisis, they are increasingly suffering from the indirect fallout from reduced credit availability, higher counterparty risks, and slower real growth domestically. In addition to the shocks from the crisis, the difficulties faced by developing-country banks reflect shortcomings and vulnerabilities in developing countries' financial systems identified in assessments under the joint IMF–World Bank Financial Sector Assessment Program (FSAP).

Financial sector assessments have now been made for over 40 percent of developing countries—over 87 percent if weighted by GDP (figure 6.3). These assessments will now become a truly global program thanks to the recent G-20 agreement to apply the FSAP to all countries, including the major industrial countries. Since August 2007, the assessments have paid particular attention to crisis management, cross-border supervisory cooperation, exposure to subprime mortgages, and tighter funding conditions, in addition to the traditional focus of macrofinancial stability, regulatory and supervisory issues, and financial market infrastructure. Recently concluded assessments have found weak risk management, insufficient tools to assess borrower creditworthiness or collateral, inadequate contingency planning, and weak payment infrastructure, all underscoring the need to accelerate financial sector reforms.

All the regional development banks have a strong focus on the financial sector. For example, over 40 percent of the operations of the EBRD have supported the financial sector, especially micro- and small enterprises (box 6.6). Similarly, the IFC has supported micro-, small, and medium enterprises throughout the years—in fiscal 2008, the IFC's clients provided 8 million loans

**FIGURE 6.3 Financial Sector Assessment Program country coverage**




*Source:* IMF–World Bank database.
*Note:* AFR = Africa; APD = Asia and Pacific; EUR = Europe; MCD = Middle East and Central Asia; WHD = Western Hemisphere.

**BOX 6.6 EBRD's micro- and small enterprise lending program**

EBRD support to private business development through its micro- and small enterprise (MSE) lending program provides individual entrepreneurs and firms with access to otherwise scarce finance. The EBRD implements MSE lending through local commercial banks and nonbank microfinance institutions. The programs are currently being expanded to help rural areas and small farming enterprises. Loans are accompanied by technical assistance to strengthen partner institutions and to establish efficient credit procedures for lending to small businesses. A new focus on risk management and corporate governance is being introduced in response to the global crisis.

Currently, there are MSE lending programs with commercial banks in 13 countries. Nonbank microfinance institutions have proven to be efficient intermediaries. The EBRD has to date partnered with 29 microfinance institutions providing loans, equity, and technical assistance for institutional strengthening, risk management, asset and liability management, and upgrades of management information systems and operational procedures.

for almost $100 billion to such enterprises. The AfDB is preparing a facility to provide short-term emergency finance to financial institutions.

### Business Climate

The MDBs have collaborated on a number of Investment Climate Assessments and Enterprise Surveys. In the past six years, over 70,000 enterprises across 104 countries have been surveyed, providing valuable information on how regulations affect firms' economic performance. Middle-income countries, faced with an increasingly competitive environment, have been among the most active partners in these diagnostics.

All the regional development banks have active programs to support the broad enabling environment. Examples are the ADB's Making Markets Work Better for the Poor program, designed to understand the links between growth, poverty, and market dynamics; the EBRD's Turn-Around Management and Business Advisory Services programs that are focused on medium and smaller enterprises; and the AfDB's engagement on continent-wide programs such as the Infrastructure Consortium for Africa, the Africa Water Facility, and the African Fertilizer Financing Mechanism.

*Doing Business* is the World Bank Group's flagship to benchmark business environment reforms. Low-income countries have become the major source of demand for business advisory services. Africa was identified as the second most reforming region in *Doing Business 2009*, with 28 countries implementing 58 reforms. Botswana, Burkina Faso, Ghana, Kenya, and Senegal have been cited as top reformers. Another example of the growing impact of analytical work is seen in the marked improvement in the implementation rate of recommendations made by the World Bank Group's Foreign Investment Advisory Service: from 47 percent in 2001 to 70 percent in 2006.[19]

### Social, Environmental, and Ethical Standards

The IFC has an active role in setting social and environmental standards and promoting good corporate governance. Its Equator principles are a benchmark for the financial industry to manage social and environmental issues in project financing and have been adopted by 66 of the largest global banks. The agency supports the management of social, environmental. and labor dimensions of its companies' business practices. Along with other development finance institutions, the IFC signed on to a Corporate Governance Approach Statement in 2007 to promote good corporate governance practices.[20] This approach supports the rights and equitable treatment of shareholders, disclosure and transparency, and the role of boards of directors. The Extractive Industries Transparency Initiative gives additional prominence to transparency for natural resource development.

Despite progress, the approach that MDBs should adopt to support private sector development activities still generates controversy. For example, the ADB has been holding consultations with multi-stakeholders since 2005 on updating its safeguards. The bank has proposed articulating policy principles and then separating these from procedural requirements; balancing a front-loaded procedural approach with one that is also focused on results during implementation; and introducing flexibility that is tailored to different clients with varying capacities as well as to different financing products and modalities. The bank's intent is to enhance effectiveness and strengthen the relevance of safeguards to changing client needs. These proposals have met with resistance from some NGOs, demonstrating the complex nature of MDB efforts to support private sector development. The challenge to MDBs is to keep processes simple but at the same time ensure that the highest safeguard standards are met.

## Improving Basic Service Delivery

### Infrastructure

Between 2003 and 2007, investment commitments to infrastructure projects with private participation in developing countries grew by almost 1.5 times—amounting to $158 billion in 2007,10 percent higher in real terms than the previous peak in 1997. Recent private activity also showed more diverse investors and projects. Companies from developing countries mobilized half of funding for infrastructure projects with private participation in 2005–06, in contrast to the 1990s, when large international companies from the developed world played a dominant role.

In the current economic crisis, additional infrastructure spending can provide a short-term stimulus and address long-term development needs. So far infrastructure spending accounts for about two-thirds of the stimulus programs in emerging economies. Stimulus spending should prioritize maintenance and can benefit poor households by providing short-term employment and income generation through labor-intensive public works programs. Successful examples in Argentina (Trabajar), Indonesia (Urban Poverty Project), and the Republic of Korea show the potential.

The funding gap for new infrastructure projects has risen by about $20 billion per year as prospects for private sector financing recede as a result of the financial crisis. In response, the World Bank is launching a new infrastructure initiative—Infrastructure Recovery and Assets (INFRA) Platform—which could provide an incremental $2 billion to $4 billion per year over the next three years. Embedded in the bank's Sustainable Infrastructure Action Plan (SIAP), the new platform would be an umbrella for mobilizing additional finance for energy, transport, water, and information and communications technology infrastructure in developing countries over and above the targets envisaged in SIAP (box 6.7).

The current crisis occurs just as infrastructure had been afforded a higher priority by MDBs. One area of focus is the reengagement of IDA with hydropower in Bujugali (Uganda), Resumo Falls (Rwanda), and Inga (Democratic Republic of Congo). Clean coal is being supported in Botswana. Other MDBs share this focus. The ADB is financing the first Ultra Mega Power Project in India, at Mundra, with participation by the Korean Ex-Im Bank and the IFC. The EBRD has launched a sustainable energy initiative with a focus on industrial energy efficiency, firm-level energy audits, and technical cooperation. This program has been extended to a multidonor, multi-IFI initiative coordinated in the World Bank. The IFC supported a 50 megawatt wind park in Mongolia.

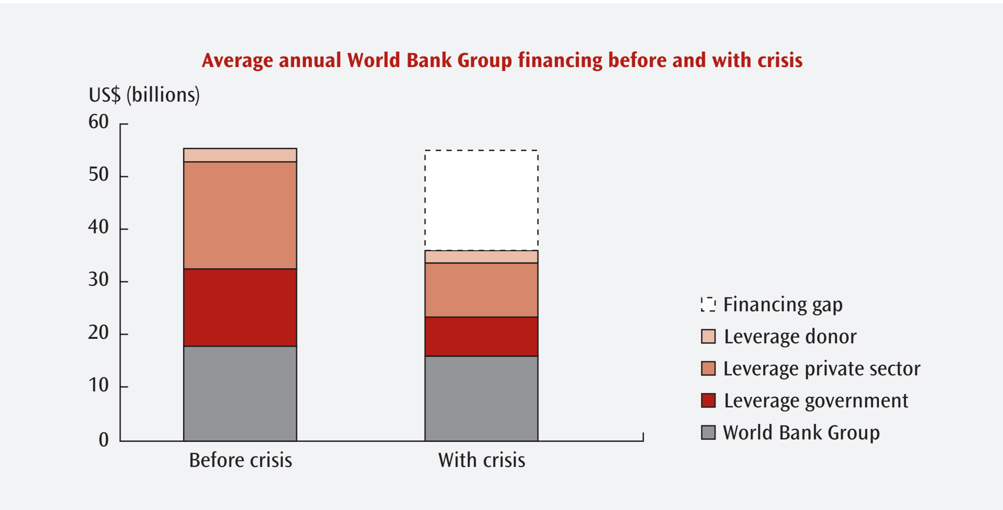
The AfDB, along with others, is responding to the shrinking share of infrastructure

## BOX 6.7 World Bank's Sustainable Infrastructure Action Plan and the Infrastructure Recovery and Assets Platform

The Sustainable Infrastructure Action Plan (SIAP) was approved in July 2008 to leverage private and public funding of $109 billion to $149 billion over fiscal 2008–11 based on World Bank Group financing of $59 billion–$72 billion. This would represent a major increase compared with lending of $28 billion in fiscal 2000–03 (leveraged to $45 billion). However, estimates in December 2008 were already showing that investment commitments in private infrastructure projects were 40 percent below levels just a year earlier, putting the SIAP at risk.

To mitigate this risk, the World Bank Group is establishing a framework initiative for infrastructure recovery and assets during the crisis. This framework will serve as an umbrella for the World Bank's crisis response in infrastructure. The objectives of the three-year program are to stabilize existing infrastructure assets by restructuring current portfolios; ensure delivery of priority projects by accelerating disbursements and identifying additional financing, and by seizing opportunities for "green infrastructure" through access to carbon finance leveraging facilities; support public private partnerships in infrastructure through advisory and restructuring support, use of guarantees, and innovative instruments (in coordination with the IFCs' Infrastructure Crisis facility); and support new infrastructure project development and implementation by providing financing and advice to governments launching growth and job enhancement programs.

**World Bank Group average annual infrastructure financing and leverage: crisis impact**




*Source:* World Bank.

in total development assistance to Africa, which dropped from 23 percent in the mid-1980s to 13 percent by 2006. The AfDB hosts the Infrastructure Consortium for Africa, the Africa Water facility, and the NEPAD Infrastructure Project Preparation Facility.

Water and sanitation are two other focus areas for infrastructure. The number of countries that are off track to meet the MDG in sanitation is second only to the number off track in reducing mortality indicators. To meet the needs in these areas, the MDBs have experimented with new forms of innovative financing, including public-private partnerships, working more closely with subnational finance, output-based aid or performance-based grant initiatives, and political risk guarantees. Output-based aid is oriented toward a results focus by providing subsidies for externalities or redistribution only after prespecified results have been achieved. But these new instruments have yet to be adequately scaled up.

The World Bank's target under the Africa Action Plan is to connect 2.5 million more people to clean water by 2015. With more than 300 million Africans lacking access to clean water (and 500 million lacking sanitation), progress at this rate will leave large unmet needs except in the very long run.

#### Social Sectors

Education and health are two other sectors where much needs to be done to achieve the MDGs (see chapter 3). In both cases, scaling-up approaches envisage leveraging the private sector for service delivery. Private providers in these areas are not a new phenomenon, but organized, scaled-up, or franchised private delivery of social service is still at an early stage in most developing countries. That provides an opportunity that the IFC and the AfDB have incorporated into their strategies. Social sector operations involving the private sector are still modest, with 2 percent of lending in 2008 for the EBRD and the IFC and with less than 1 percent for the other MDBs. In general, empirical evidence and best practices from around the world support more active private provision of services under appropriate regulatory systems, and there is scope for greater MDB engagement in this area.

The AfDB has proposed an increased focus on higher education and technology and vocational training. The IFC is focused more on health and has recently partnered with IDA and the Bill and Melinda Gates Foundation to develop a significant Africa health initiative. The IFC is supporting the first private hospital in Bosnia and the first student loan program in Jordan.

## Evaluation and Assessments

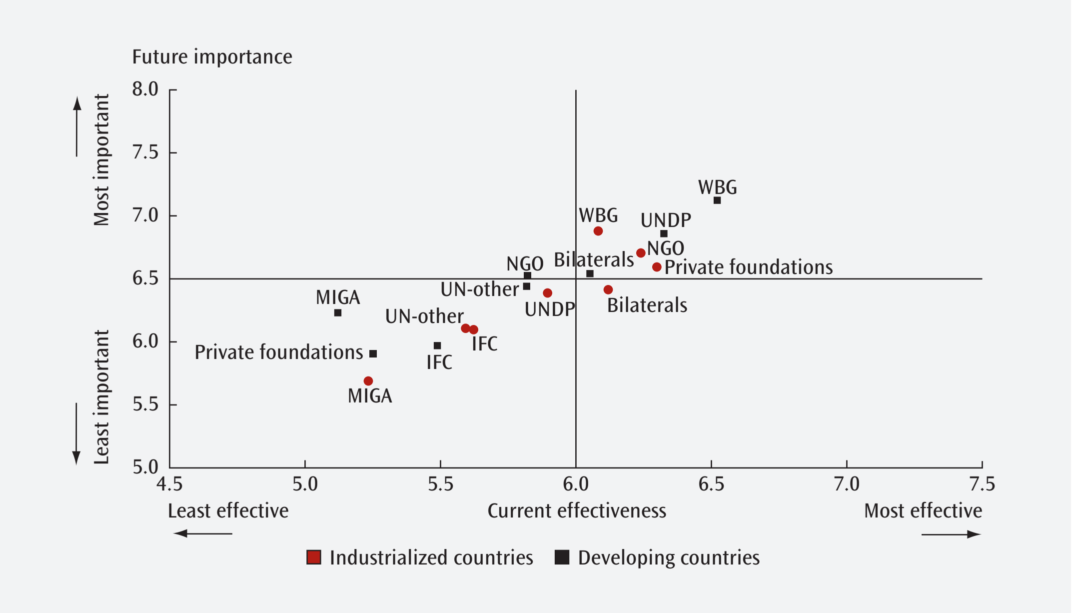
Evaluation of MDB responses to previous crisis episodes suggests seven points to consider:

- Quality is as important as scale of crisis-response support
- The implications for poverty and social safety nets should be given priority
- Opportunities for greener development activities should be developed
- Collaboration within and across groups is necessary but not always easy
- Safeguards continue to be vital to ensure that funds reach intended beneficiaries
- A focus on results is even more important when resources are scarce
- Preparedness and early warning make interventions more effective.[21]

The current financial crisis may affect support for the private sector as the main driver of development. Although all the MDBs are making strong efforts to reorient their strategies toward support for the private sector, they may face some difficulties among recipient countries about whether this is the best way of advancing development. To illustrate, in a recent Gallup World Poll, the private sector arms of the World Bank Group, the IFC, and MIGA, suffered from much lower perceptions of development effectiveness (figure 6.4) than the rest of the World Bank Group. This could be because the single greatest priority cited by respondents is poverty reduction rather than growth or strengthening the economy. The MDBs need to do a better job of linking these priorities.

Perceptions may improve as more efforts are devoted to a focus on development effectiveness in private sector projects. The IFC introduced a development outcome tracking system in 2005 to measure its development results. This shows that in fiscal 2008 the percentage of projects with high development outcomes increased from 63 to 71 percent (81 to 87 percent when weighted

**FIGURE 6.4 Effectiveness and future importance of donor institutions**




*Source:* Gallup World Poll 2008.

by dollar value of projects). In general, evaluations show there is no trade-off between investment profitability and development results. Significantly, both improve when the overall investment climate is improving.[22]

All the MDBs have independent evaluations of their private sector support operations. The EBRD's Evaluation Department recommended a range of actions in 2008, covering financial sector operations policy, business advisory services, private equity funds, and technical cooperation programs. The AfDB established a new function in the chief economist's office in 2008 to review development outcomes for new private sector operations. Additionality and complementarity are also reviewed. A recent review of the ADB's private equity funds found "unsatisfactory" returns and weak monitoring of environmental and other safeguards. The Independent Evaluation Group of the World Bank found that the private sector portfolio was among the weakest in terms of development results.[23]

These examples illustrate the practical difficulties in implementing a strategy focused on private sector development. One common finding in evaluation is the presence of overlaps and limited coordination between different parts of an institution in providing an integrated and consistent program of support for the private sector.

As a direct consequence, the World Bank Group has consolidated its investment climate reform work and investment promotion work under a single entity—the Investment Climate Department. A new IDA-IFC secretariat was established in fiscal 2008 to improve coordination of private sector operations in low-income countries and to promote more joint IDA-IFC operations. In the decade ending in 2008, the World Bank Group approved just 17 projects in IDA countries that leveraged both public (IDA and other donors) and private (IFC and other private partners) resources. In the past couple of years, the pipeline of such projects has grown to 35, most of them in Africa. Global practice groups in oil, gas, chemicals and mining, information and communications technology, and global capital markets bring together different parts of the World

Bank Group in these areas. The IDB and ADB also face issues in ensuring consistency within each institution in how private sector support is conducted; recent assessments have pointed to fragmentation and overlapping areas of responsibility across bank groups.[24]

Coordination and harmonization across and within agencies are key issues for multilateral aid effectiveness, and all the multilaterals have signed on to the Paris Declaration on Aid Effectiveness.[25] That declaration set out specific indicators to be achieved by 2010. Seven of the twelve indicators are relevant for multilateral agencies. Progress on these indicators has been monitored in two surveys: a benchmark survey conducted in 2006, and a follow-up survey conducted in 2008.

Table 6.3 shows the 2008 survey results based on responses from 54 aid recipient countries. Because each multilateral agency operates in a different number of countries, the number of respondents for each agency is different. Nevertheless, the data are indicative of the strengths and weaknesses of the multilaterals.

The MDBs do reasonably well on aligning aid to national priorities and including aid in government budgets but still fall well short of the 2010 target. They have also made good progress on coordinating their technical cooperation to strengthen country capacity. As with all donors, use of country financial management and procurement systems still lags behind. The World Bank is a leader among multilaterals, and indeed all donors, on this score; others have followed with more caution. Multilaterals have been trying to reduce the number of independent project implementation units and now score better than bilaterals on this indicator, but

**TABLE 6.3 Paris Declaration survey results, 2008**

| | Align aid flows[a] | Coordinate technical cooperation[b] | Use country PFM system[c] | Use country procurement system[d] | Avoid parallel PIUs[e] | Predictable aid[f] | Program-based approaches[g] | Joint field missions[h] | Joint analytical work[i] |
|---|---|---|---|---|---|---|---|---|---|
| ADB | 80 | 61 | 61 | 36 | 40 | 79 | 59 | 18 | 25 |
| AfDB | 57 | 28 | 44 | 42 | 121 | 45 | 38 | 17 | 44 |
| IDB | 55 | 60 | 52 | 26 | 108 | 54 | 52 | 35 | 44 |
| WB | 66 | 85 | 62 | 52 | 101 | 65 | 54 | 31 | 59 |
| All multilaterals | 48 | 63 | 48 | 40 | 1,193 | 45 | 48 | 35 | 60 |
| All bilaterals | 43 | 57 | 47 | 50 | 1,267 | 41 | 40 | 24 | 49 |
| All donors | 46 | 59 | 48 | 44 | 2,460 | 43 | 44 | 31 | 55 |
| 2010 targets | 85 | 50 | 80 | 80 | 611 | 71 | 66 | 40 | 66 |

*Source:* DAC 2008.
*Note:* The category "All multilaterals" includes vertical funds, UN agencies, and other multilaterals.
a. Percent of aid on budget.
b. Percent of coordinated technical assistance.
c. Percent of aid using country's public financial management system.
d. Percent of aid using country's procurement system.
e. Number of project implementation units (PIUs).
f. Percent of aid delivered on schedule.
g. Percent of aid using program-based approaches.
h. Percent of joint missions.
i. Percent of joint country analytic work.

all donors continue to rely heavily on such mechanisms, with likely costs in terms of weakening other areas of recipient country government. The MDBs have high scores on aid predictability, but progress since 2006 has been mixed on this indicator. The MDBs lead all donors in terms of program-based approaches to their flows. They tend to lag behind other donors in coordinating field missions and undertaking joint analytical work. Their stronger in-house capabilities permit them to do independent work. But this may perpetuate the problems of overlap and waste and of excessive claims on government officials' time.

Overall, multilateral agencies, and the MDBs in particular, are closer than bilateral donors to reaching the Paris Declaration performance targets, but considerable progress is still required if they are to meet the 2010 commitments. The target for coordinated technical cooperation has already been met by three of the MDBs, and the ADB has met the target for aid predictability. In all other cases, the MDBs still have work to do. The DAC suggests that the multilaterals will have to gear up their efforts considerably to achieve the 2010 targets.

To sharpen the MDBs' focus on results, a common performance assessment system (or COMPAS) was designed in 2005 as a self-assessment framework to track MDB capacities to manage for development results. COMPAS reviews show progress: the MDBs have been improving the quality of project design and supervision, strengthening results frameworks, better managing risk in project portfolios, and increasing staff training in managing for results. The 2008 COMPAS reports that for most MDBs more than 80 percent of projects have baseline data, monitoring indicators, and clearly defined outcomes. Moreover, between 57 and 84 percent of MDB-funded projects receive satisfactory or better ratings in reaching their intended development objectives. In addition, MDBs have made improvements in assessing and strengthening partner countries' capacities in managing for results.[26]

## Notes

1. The IFIs covered in this chapter include the International Monetary Fund (IMF), the World Bank Group, and the four big regional development banks (AfDB ADB, EBRD, and IDB).
2. IIF 2009.
3. World Bank 2009b. See also Birdsall 2009.
4. Arbache and Page 2007.
5. IEG 2005. The evaluation covered IBRD and IDA operations.
6. Hausmann and Rodrik 2003.
7. IEG 2006. IEG found that in over 90 percent of projects, there was at least one form of additionality in IFC projects. Providing funding on commercial terms is an important discipline for MDBs and goes a long way toward ensuring that they are indeed additional.
8. The Independent Evaluation Group found that IFC additionality was less than satisfactory in one-fifth of cases; see IEG 2008.
9. World Bank 2009c.
10. Robert Zoellick, "Time to Herald the Age of Responsibility," *Financial Times,* January 25, 2009.
11. DAC 2008.
12. Tandon 2008.
13. The IFC has rapidly expanded its advisory services programs (including the Foreign Investment Advisory Service and the Global Partnership on Output-Based Aid) since 2002 to become a second leg of its core business alongside investments.
14. World Bank 2009a.
15. Kar and Cartwright-Smith 2008.
16. Belarus ($2.5 billion), El Salvador ($800 million), Georgia ($700 million), Hungary ($15.7 billion), Iceland ($2.1 billion), Latvia ($2.4 billion), Pakistan ($7.6 billion), Serbia ($500 million), and Ukraine ($16.4 billion).
17. World Bank 2008a.
18. A three-year pilot World Bank–IFC subnational development facility provides loans to municipal and regional governments, public utilities, and financial institutions without sovereign guarantees.
19. Recommendations adopted within one year of completion of advisory project.
20. The statement endorses the OECD Principles of Corporate Governance.
21. IEG 2008b.
22. IEG 2008a
23. Like other parts of the development agenda, promoting private sector development can be a

high-risk activity, and significant failure rates are to be expected. While success rates may be somewhat lower than for other sectors, evaluation evidence also shows that, when successful, improvement in the enabling environment for private sector development can be very large, with high benefit-to-cost ratios.

24. See the Office of Evaluation and Oversight, IDB, "Synthesis of OVE Evaluations of Bank Action for Support of Private Sector Development"; and ADB, "Private Sector Development: A Revised Strategic Framework," February 2006.

25. The Paris Declaration is relevant for official aid. Hence the EBRD, which lends largely to the private sector, is not separately identified here.

26. To be published in April, the 2008 COMPAS report, as well as previous years' reports, can be found at www.mfdr.org/COMPAS/.