WORLD BANK OPERATIONS EVALUATION DEPARTMENT

OED REACH

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Improving Investment Climates: An Evaluation of World Bank Group Assistance

Based on the joint OED/OEG/OEU evaluation, "Improving Investment Climates: An Evaluation of World Bank Group Assistance."

The quality of the investment climate (IC) varies significantly across countries, regions, and industries. The World Bank Group (WBG) needs to customize interventions to country needs, using local knowledge and expertise to build an understanding of country-specific constraints and opportunities.

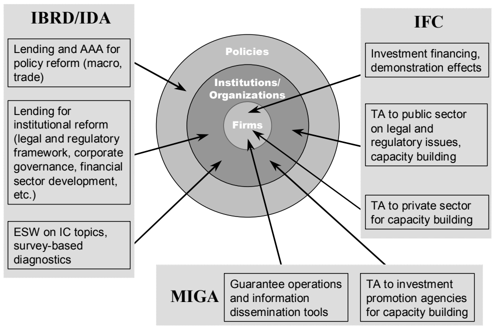
- Institutions – the "rules of the game" – are key to the quality of the investment climate. World Bank Group strategies for improving the IC have suffered from a lack of knowledge about what types of institutional arrangements will work in different environments.
- The feasibility of reform depends on the political economy of the reform process, and the sustainability of reform hinges on broad stakeholder support. The WBG needs to assess the capacity and incentives facing public sector organizations to implement reforms.
- The broad nature of the IC as a topic and the need to work with both the public and private sectors creates organizational challenges for the WBG. Better use of the comparative advantages of the Bank, the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA) would help the WBG deliver on its IC agenda more effectively.

The quality of a country's investment climate is determined by the risks and transaction costs of investing in and operating a business. These, in turn, are determined by the legal and regulatory framework, barriers to entry and exit, and conditions in markets for labor, finance, information, infrastructure services, and other productive inputs. This study evaluates the performance of the WBG over the past 10 years in promoting better investment climates in client countries. The evaluation was conducted in parallel with the preparation of the *2005 World Development Report* on the same topic.

The investment climate is now one of the two pillars of the WBG's corporate strategy for reducing poverty; and the Bank, IFC, and MIGA bring to bear a variety of instruments that influence the IC (see figure). The Bank addresses the policy and institutional environment through lending and nonlending services, the latter including an expanding set of survey-based diagnostics. IFC influences the IC through its technical assistance and advisory services (TAAS) and through its investment operations – directly by increasing the quantity and quality of infrastructure, financial, and social sector services, and indirectly through the demonstration effects of investment projects. MIGA influences the IC through political risk guarantees, capacity building of investment promotion intermediaries (IPIs), and information dissemination tools.

World Bank. A large share of the Bank's lending is related to investment climate reform. Broadly defined IC projects accounted for over 45 percent of all Bank projects during fiscal years 1993-03; more narrowly defined "core" IC projects accounted for 14 percent. Although it has varied, the IC share of total Bank lending shows no observable trend over the past 10 years. "Core" IC projects performed better than the Bankwide average, although IC project performance has not improved as rapidly as that of the rest of the Bank portfolio.

World Bank Group Investment Climate Activities



Note: AAA = analytical and advisory activities; ESW = economic and sector work; TA = technical assistance.

The five country case studies conducted by OED showed that:

- Often, IC reform has been politically enabled by crisis or by opportunity.
- Loan conditionality sometimes helped to strengthen the hand of reformers.
- Local champions often initiated reforms, but broad support was needed to sustain them.
- The implementation of reforms got bogged down at lower levels of bureaucracy if incentives were not changed.
- Modest, piecemeal efforts have been less successful than a comprehensive set of reforms.

IFC. IFC investments in high-impact strategic sectors (infrastructure, financial, and social sectors) contribute most significantly and directly to improving investment climates. For investment projects approved during 1993-97, 73 percent had satisfactory or better impact on the IC, as measured by private sector development (PSD) impact ratings. IFC has been increasing its IC TAAS aimed at identifying and removing constraints and bottlenecks to private investment. During fiscal 1993-02, IFC conducted 655 IC TAAS operations for a total cost of $167 million. OEG's evaluation of TAAS operations in five field-visit countries found that the quality of execution was very good and implementation of recommendations was mostly satisfactory, yet changes on the ground take a long time and depend on other factors.

MIGA. MIGA guarantees can mitigate aspects of IC related to political risk and may affect IC indirectly through demonstration effects. MIGA's strategy for selecting technical assistance (TA) clients has changed frequently. In-depth TA programs have been driven by the results of initial diagnostics (needs assessments) and the availability of external funding. MIGA TA has been effective in improving the quality of IPIs. However, the impact of TA on the IC and actual foreign direct investment flows – MIGA's mandate – has been difficult to measure. MIGA has been more effective when clients are committed governments with stable organizational frameworks for IPIs.

Organizational issues. The 2002 Private Sector Development Strategy defines the broad division of labor among the Bank, IFC, and MIGA in implementing the IC agenda. In practice, the division of labor is less clear. Both the Bank and IFC are involved in providing policy advice to governments, and both MIGA and the Foreign Investment Advisory Service provide assistance to IPIs. Coordination between the Bank and IFC has been uneven, but since 2002, the joint Bank-IFC PSD Vice-Presidency has attempted to enhance coordination and realize synergies across the WBG.

Recommendations. To increase the effectiveness of WBG assistance to improve investment climates, the evaluation concludes that:

- The WBG should clarify the roles of the Bank, IFC, and MIGA on investment climate activities, making corporate strategy and practice consistent. At the country level, coordination and consistency across the WBG on investment climate diagnosis, priorities, results focus, strategy, and assistance need to be improved.
- The Bank should do a better job of setting priorities and packaging investment climate reforms in lending operations, paying more attention to institutions and the political economy of reform.
- IFC should raise the profile of IC work and develop operating guidelines for TAAS with a focus on quality control, results achievement, and proactive management of potential conflicts. IFC should identify and track IC impacts.
- MIGA should improve the focus and effectiveness of technical assistance by implementing a clear strategy for client selection, exercising greater selectivity, and aligning its work program more closely with WBG priorities and lending for capacity building.

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