Improving Investment Climates: An Evaluation of World Bank Group Assistance

Overview Report

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Operations Evaluation Department, IBRD/IDA
Operations Evaluation Group, IFC
Operations Evaluation Unit, MIGA

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Abbreviations and Acronyms

AAA	Analytical and Advisory Activities
CAS	Country Assistance Strategy
COI	Conflict of Interest
DFI	Development Finance Institution
ESW	Economic and Sector Work
EU	European Union
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
HFO/WSJ	Heritage Foundation/Wall Street Journal Index of Economic Freedom
IBRD	International Bank for Reconstruction and Development
IC	Investment Climate
ICA	Investment Climate Assessment
IDA	International Development Association
IFC	International Finance Corporation
IPI	Investment Promotion Intermediary
MDB	Multilateral development bank
MIGA	Multilateral Investment Guarantee Agency
OED	Operations Evaluation Department
OEG	Operations Evaluation Group
OEU	Operations Evaluation Unit
OPCS	Operations Policy and Country Services
PCR	Project Completion Report
PDF	Project Development Facility
PEP	Private Enterprise Partnership
PREM	Poverty Reduction and Economic Management
PSAS	Private Sector Advisory Services
PSD	Private Sector Development
SME	Small- and Medium-scale Enterprise
TA	Technical Assistance
TAAS	Technical Assistance and Advisory Services
TATF	Technical Assistance Trust Fund
WBG	World Bank Group
XPSR	Expanded Project Supervision Report

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Preface

The Investment Climate Study is a joint evaluation of the Operations Evaluation Department (covering the activities of IBRD/IDA), the Operations Evaluation Group (covering IFC), and the Operations Evaluation Unit (covering MIGA).[1] The purpose of the evaluation is to assess the effectiveness of the World Bank Group (WBG) in helping its member countries improve their investment climates, within the context of the WBG's overall mission of poverty reduction and sustainable development. Its findings and recommendations provide guidance for the WBG's future strategy and activities in this area. The evaluation was conducted in parallel with the preparation of the *2005 World Development Report* on the investment climate.

The methodology of this evaluation is outlined in the *Approach Paper*.[2] The evaluation spans the past ten years and covers IBRD/IDA lending and non-lending services designed to improve the investment climate; IFC investment operations and investment climate-related technical assistance and advisory services; and MIGA guarantees and technical assistance (FY1998-2003). The findings are based on a literature review, portfolio reviews, field missions to evaluate selected projects and prepare country case studies, and surveys of foreign investors, other stakeholders, and WBG staff. This Overview report highlights the main conclusions and recommendations of the joint evaluation, drawing on the separate accompanying reports of OED, OEG, and OEU.

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

- Roger Leeds, Professor at the School of Advanced International Studies of the Johns Hopkins University, and Director of the School's Center for International Business and Public Policy.
- Beatriz Boza, former head of the regulatory body for competition policy in Peru (INDECOPI) as well as its investment promotion agency (PromPeru), and founding director of *Ciudadanos al Dia*, a non-profit organization that promotes transparency and good governance.
- Herbert Oberhaensli, Chief Economist and Head of Economic and International Relations, Nestle Corporation.
- John McMillan, Professor of Economics at the Stanford University Graduate School of Business, and Senior Fellow at the Stanford Institute of Policy Research.

1. The activities of the International Center for Settlement of Investment Disputes (ICSID) were not covered in this evaluation.

2. "An Evaluation of World Bank Group Investment Climate Activities: Approach Paper" (November 26, 2002).

Summary

The quality of a country's investment climate is determined by the risks and transaction costs of investing in and operating a business, which in turn are determined by the legal and regulatory framework, barriers to entry and exit, and conditions in markets for labor, finance, information, infrastructure services, and other productive inputs. The WBG supports improvements in investment climates by working with both the public and private sectors. Through its lending and non-lending services, the Bank (IBRD/IDA) supports the broad policy environment (macroeconomic stability and openness) as well as microeconomic policies and institutions. IFC influences the investment climate through its Technical Assistance and Advisory Services (TAAS) to both the public and private sectors, and through its investment operations — directly by increasing the quantity and quality of infrastructure and financial and social sector services, and indirectly through the demonstration effects of investment projects in all sectors. MIGA influences the investment climate through political risk guarantees, technical assistance to investment promotion intermediaries for capacity building, information dissemination tools, and mediation services.

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

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

The joint OED/OEG/OEU evaluation finds four main challenges for the WBG as the organization attempts to achieve better outcomes of its investment climate activities:

Focus on reforms at the institutional level more than at the policy level. Institutions – the "rules of the game" – are key to the quality of the investment climate. Yet more is known – and more has been accomplished to date – in macroeconomic, financial sector, and trade reform than in institutional areas. The institutional agenda is on the frontier of the WBG's knowledge of the development process. While the basic principles of good institutions are well recognized (such as market access and competition, protection of property rights, and contract enforcement), the institutional arrangements for carrying out reform seem to be

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

Customize interventions to country needs. The quality of the investment climate varies significantly across countries, and even within countries, across regions and industries. This diversity results from different macroeconomic circumstances, the progress made in earlier reform efforts, and the diversity among firms themselves. Thus there is no single set of priorities within the broad set of characteristics that determine the investment climate – the priority issues are country-specific. When establishing strategies for improving the investment climate, the WBG needs to understand country-specific constraints and opportunities as well as country-specific institutional designs. It is critical for the WBG to build this understanding using local knowledge and expertise.

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

Organizational challenges within the WBG. The broad nature of the investment climate as a topic and the need to work with both the public and private sectors creates internal organizational challenges for the WBG. Better use of the comparative advantages of the Bank, IFC, and MIGA would help the WBG deliver on its investment climate agenda more effectively. Corporate strategies need to be consistent with each other, and strategies and practice should be harmonized. At the country level, investment climate strategies need to be integrated across the World Bank Group as well as within the Bank across sector units. In the IFC, the rapidly expanding TAAS activity needs to be provided on a strategic basis rather than an *ad hoc* basis. Similarly, MIGA's delivery of technical assistance needs to follow a clear and coherent strategy for client selection to ensure high effectiveness and development impact. And all three parts of the organization need to do a better job of monitoring the impact of their activities on measurable improvements in the investment climate.

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

- The WBG should clarify the roles of the Bank, IFC, and MIGA on investment climate activities, bringing corporate strategy and practice into consistency. At the country level, coordination and consistency across the WBG on investment climate diagnosis, priorities, results focus, strategy, and assistance needs 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 investment climate work and develop operating guidelines for technical assistance and advisory work related to the investment climate.
- MIGA should improve the focus and effectiveness of technical assistance by implementing a clear strategy for client selection, exercising greater selectivity, and align its work program closer with WBG priorities and lending.

1. Introduction

1.1 A country's "investment climate" is its environment for private sector activity. The quality of the investment climate is determined by the risks and transaction costs of investing in and operating a business, which in turn are determined by the legal and regulatory framework, barriers to entry and exit, and conditions in markets for labor, finance, information, infrastructure services, and other productive inputs. Governments influence the quality of their country's investment climate through policies, institutions, and their relationships with the private sector. The quality of the investment climate is linked to poverty reduction by the impact of better investment climates on private sector activity, and thus on economic growth and employment.

1.2 The Investment Climate Study is a joint evaluation of the Operations Evaluation Department (covering the activities of IBRD/IDA), the Operations Evaluation Group (covering IFC), and the Operations Evaluation Unit (covering MIGA). The individual evaluations of OED, OEG, and OEU are contained in separate accompanying reports. Their combined findings and recommendations are summarized in this Overview report.

Evaluation Scope and Design

1.3 The evaluation spans the ten-year period from fiscal years 1993 through 2002-03 and covers IBRD/IDA lending and non-lending services designed to improve the investment climate (IC); IFC investment operations and IC-related TAAS; and MIGA guarantees and technical assistance (FY1998-2003).[3] The evaluation addresses the following questions:

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

3. The evaluation scope and design is set out in the study's Approach Paper dated November 26, 2002. The IBRD/IDA portfolio analysis covers fiscal years 1993 through 2003; the remaining components of the IBRD/IDA evaluation, which were prepared earlier, cover fiscal years 1993 through 2002. The IFC evaluation covers fiscal years 1993 through 2003 for investment operations and fiscal years 1993 through 2002 for non-investment activities. It should be noted that the World Bank Group is currently attempting to improve the focus and effectiveness of its investment climate activities as part of the re-emphasis on the growth agenda. Where relevant, these recent activities are noted but are not evaluated.

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

The Investment Climate, Investment, and Growth

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

1.5 OED's *2003 Annual Review of Development Effectiveness* shows that policies and institutions matter a great deal in determining the growth of per capita income and improved social indicators. In turn, empirical research shows that growth is the key driver for poverty reduction, suggesting that policies and institutions that promote broad-based growth are central to the pro-poor growth agenda.[4] The literature review conducted for this study attempted to dig deeper into the relative importance of policies and institutions.[5] Recent studies have found that institutions generally prevail over geography and policies in explaining cross-country differences in income. Macroeconomic and structural reforms are necessary conditions for growth, but modern institutions are needed to sustain growth.

1.6 Certain good-practice principles are applicable to all institutional arrangements, such as transparency, accountability, competition, the rule of law, and the protection of property rights. However, the institutional arrangements needed to implement these principles are somewhat country-specific. An institutional arrangement that is successful in one country doesn't necessarily transfer well to another country without modifications, and unorthodox arrangements sometimes work.

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

1.8 The importance of the investment climate for enterprise performance is also evident in IFC investment operations. Based on the measure of IC used regularly by IFC and OEG,

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4. See, for example, Aart Kraay, "When is Growth Pro-Poor? Cross-Country Evidence." IMF Working Paper. Washington, D.C., March 2004.

5. Following the institutional economics literature, "institutions" are understood to mean "the rules of the game" that affect investment decisions by influencing transaction costs and risk.

IFC achieved higher development and investment success rates when the investment climate improved from high-risk to middle-risk between project approval and evaluation. When the IC deteriorated, success rates dropped below average.[6] IFC also achieved better investment outcomes in countries with good investment climates, either at the time of approval or evaluation. That is, both IC quality and its direction of change are associated with IFC investment outcomes, suggesting a robust positive relationship between the IC and investment success. Moreover, certain aspects of IC were highly correlated with investment success: trade openness, a dynamic banking and finance sector, effective government regulation, and the absence of black markets. These results are consistent with other recent OEG evaluations.[7]

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

2. World Bank Group Strategy, Activities, and Outcomes

The Investment Climate in the World Bank Group

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

2.2 Although CASs in all regions show a trend toward second-generation reforms, the relative emphasis given to different institutional themes varies by region. In East Asia, for example, priority was given to corporate restructuring, corporate governance, and financial

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

7. *Annual Review of IFC's Evaluation Findings* 2002 and 2003; *IFC's Assistance to Transition Economies* (forthcoming EvalBrief), and *IFC Country Impact Reviews* for China, Brazil, and Russia.

sector issues following the economic crisis of the late 1990s. In LAC, regulatory and judicial reform and enterprise competitiveness were given greater emphasis than in other regions. In ECA, property rights, judicial reform, bankruptcy law, and access to finance were top priorities. The differences across regions reflected the diversity of constraints faced by firms, varying progress in broader policy areas (privatization, financial sector reform), and dissimilar macroeconomic contexts.

2.3 The importance given by IFC to improving investment climates has grown over the past decade – particularly from 2000 to 2004 — in parallel with its frontier strategy and focus on high-impact strategic sectors.[8] Its 2004 *Strategic Directions Paper* points out that while IFC has been focusing on frontier countries and markets,

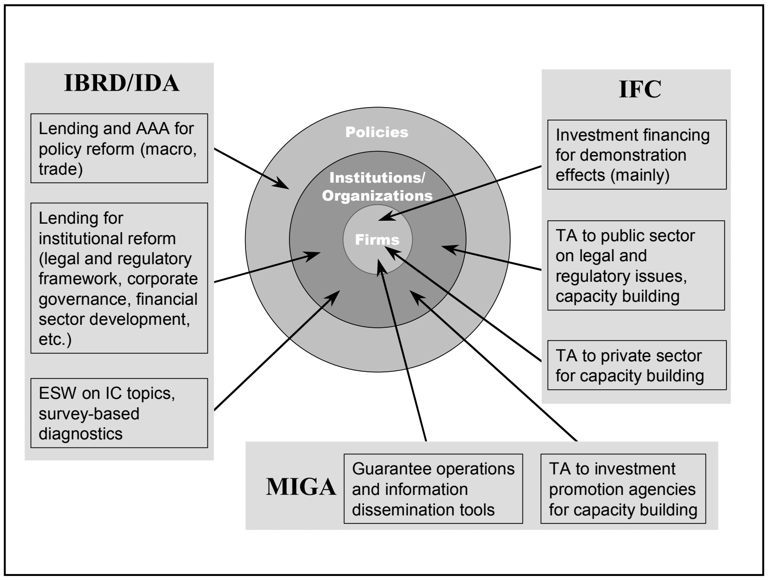
> *"it is becoming increasingly clear that to meet the challenges in these markets, IFC will have to…scale up its provision of technical assistance and advisory services and…take a more proactive approach to project development. IFC's technical assistance and advisory services will continue to focus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

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

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

8. *IFC Strategic Directions* 2000-2004.

Figure 2.1: World Bank Group Investment Climate Activities



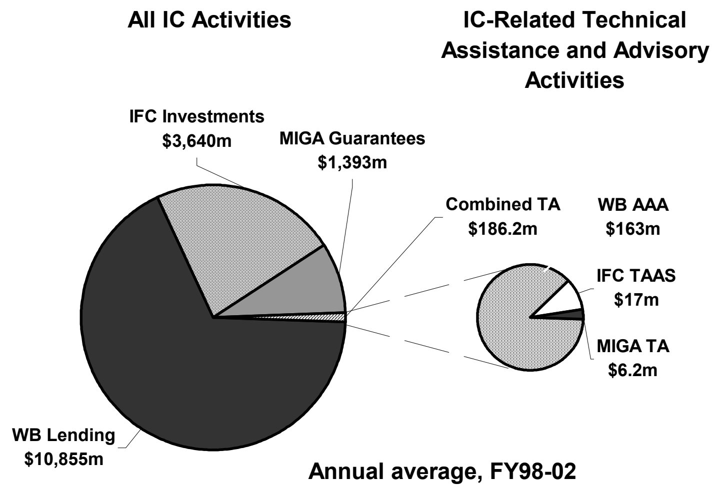
2.6 Figure 2.2 gives a rough idea of the Bank, IFC, and MIGA shares of WBG investment climate activities. The Bank's lending for investment climate objectives, broadly defined, accounted for an average of 68 percent of WBG investment climate activities over fiscal 1998-2002;[9] IFC investments (in all sectors) accounted for another 23 percent, and MIGA guarantees for 9 percent. A small share – an estimated $186 million per year, or 1 percent of the total – was devoted to all types of technical assistance, advisory services, and economic and sector work from the three organizations.[10] A breakdown of this combined technical assistance again shows the Bank accounting for the largest share (88 percent) followed by the IFC (9 percent)[11] and MIGA (3 percent). The sections below describe these activities in more detail and evaluate their effectiveness in improving investment climates.

9. Projects containing Core or Non-Core investment climate themes as primary or secondary objectives (see definitions below).

10. World Bank AAA was estimated as 1.5 percent of the value of investment climate lending.

11. IFC's IC-related technical assistance includes both IFC- and donor-funded TA. See OEG report para. 67 for details.

Figure 2.2: Annual Volume of WBG Investment Climate Activities



World Bank

2.7 **Non-lending services.** Analysis of investment climate topics is frequently part of economic reports and sector reports. During FY1993-2003, more than 300 reports were directed toward one or more core investment climate themes. The Bank also has developed diagnostic tools to assess the quality of a country's investment climate and the constraints facing private enterprises. In addition to these formal vehicles of non-lending assistance, advice is also provided informally to governments and the private sector through discussions, sharing of information, and in-country seminars.

2.8 The Bank's economic and sector work has helped motivate investment climate reform in many countries. Nevertheless, there are areas where more work needs to be done to provide guidance to clients as well as to Bank staff in designing reforms. Not enough is known about good practice in institutional design, or about the dynamic process of changing institutions. It would be useful to have a typology of country situations and institutional designs that would provide guidance on which types of arrangements work where — in other words, an understanding of what types of institutional arrangements can be "exported" from one country to another — how the change process happens, and how it can be supported and sustained. The Bank's economic and sector work (ESW) and research has not yet provided enough of this knowledge.

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

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

2.11 More recently, the PSD Vice-Presidency's "Doing Business" project has begun gathering data on the costs of doing business in a large number of countries (145 in the 2005 Doing Business publication). Information is gathered from surveys of experts rather than firms; to allow comparisons across countries, most indicators are structured around a hypothetical firm. The Doing Business project has received high marks from external audiences as well as WBG staff for providing, for the first time, objective indicators of the costs of regulation and administrative procedures. At the same time, some of the limitations of the methodology must be recognized. Since countries differ in optimal firm size and structure, estimating the time required to set up a straw firm provides comparability but may provide an incomplete picture for countries with heavier reliance on the informal sector.[12]

2.12 **Lending operations.** The Bank's investment climate lending operations were identified for this evaluation using a set of "Core" and "Non-Core" investment climate themes to describe the objectives of each project.[13] According to these definitions, a large share of the Bank's lending is related to investment climate reform. Projects that have Core or Non-Core IC themes as primary or secondary objectives of the project (labeled "All-IC" in Figure 2.3) accounted for 45 percent of all Bank projects and 52 percent of project value over fiscal 1993-2003. Core IC projects (those that have one or more of the five Core IC themes as a primary objective of the project) accounted for 14 percent of all Bank projects. However,

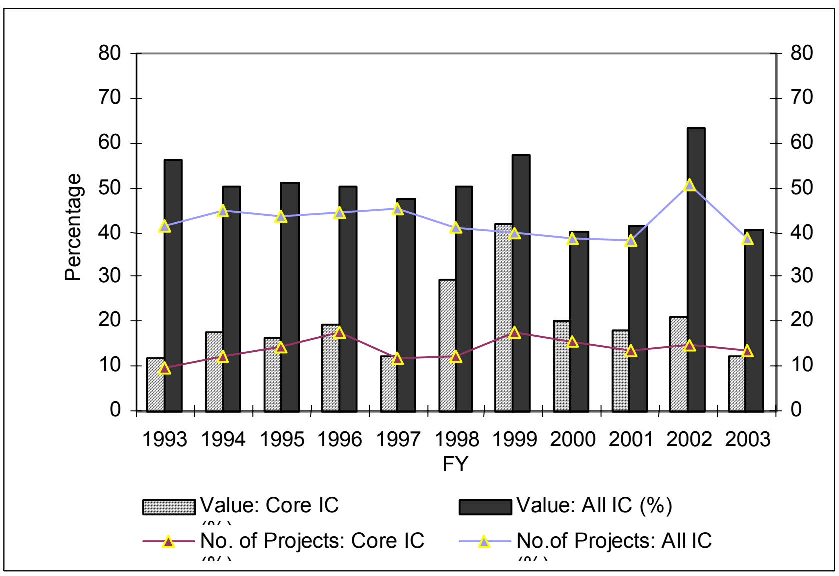
12. Management notes that Doing Business is a "time and motion" study which measures the obstacles faced by an entrepreneur performing standardized tasks; for example starting a business, getting credit and enforcing contracts. Some of these tasks are measured for a hypothetical firm. The methodology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

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

many projects have both IC and non-IC objectives — IC components are often only a part of larger projects (e.g., regulatory reforms in macroeconomic adjustment loans). This means that the size of IC lending is smaller than overall project volumes suggest.

2.13 Figure 2.3 underscores the fact that investment climate lending always has been a large part of what the Bank does. At the same time, the WBG's increased strategic focus on the investment climate, contained in corporate and sector strategies as well as CASs, has not been accompanied by an increase in the share of lending devoted to this objective. Although both core IC and all IC lending have varied (notably during the East Asian crisis of 1997-1998), neither share of lending in support of investment climate objectives shows an observable trend over the past ten years. Nor has the composition of IC lending shown much change. Of the five Core IC themes, regulation and competition policy has been and remains by far the dominant theme. Other areas — judicial reform, property rights, and corporate governance — received less emphasis, both in the early and later years of the fiscal 1993-2003 period. Across Non-Core IC themes, "infrastructure for private sector development" and "other financial and private sector development" accounted for two-thirds of the projects over fiscal 1993-2003. The importance of the latter theme declined over the period, and "infrastructure for PSD" is now the dominant theme in Non-Core IC lending.

Figure 2.3: The Investment Climate Share of World Bank Lending



2.14 **Performance**. Over the entire fiscal 1993-2003 period, the performance of IC projects and IC project components was mixed. Completed Core IC projects performed better than the Bank average: outcome ratings for 81 percent of Core IC projects were moderately satisfactory or better, compared to 77 percent for all Bank projects. Outcomes were worse in low-income countries than in middle-income countries (79 percent moderately satisfactory or better in low-income countries, compared to 83 percent in middle-income countries). Outcomes of investment climate operations are positively correlated with indicators of macroeconomic and financial sector performance — although there is no evidence to indicate causality from operations to economic performance.

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

2.16 Outcome ratings for Core IC projects improved slightly over the decade: 81 percent of Core IC projects were moderately satisfactory or better during fiscal 1994-1998, rising to 82 percent during fiscal 1999-2003. However, the performance of the overall Bank portfolio improved significantly over the same period, from 78 percent in fiscal 1994-1998 to 83 percent in fiscal 1999-2003. Thus, the performance of IC lending has deteriorated relative to average Bank lending. An analysis of OED's ICR Reviews suggests that more recent IC projects were more heavily focused on longer-term institutional reforms that were more vulnerable to the political economy of reform, to implementation and enforcement shortcomings, and to gaps in the capacity of public sector agencies. A greater share of the earlier projects involved reforms for which good practice was better understood (e.g., privatization transactions and financial sector reforms).

2.17 The country case studies prepared by OED provide lessons on what worked and what didn't; the factors that led to success and failure; and lessons that can be generalized to the Bank's investment climate activities.[14]

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

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

- **Local champions often initiated reforms, but broad support was needed to sustain them.** It was important to have the backing of key politicians to spur reform. However, while much attention was paid to the role of senior political leaders, other

14. The country case study methodology is outlined in Annex 1 of the OED report.

stakeholders — professional civil servants, business groups, and the general public — were critical to sustaining reforms.

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

- **Modest, piecemeal efforts have been less successful than a comprehensive set of reforms.** Reform programs that were meaningful, coordinated, and sustained were more likely to be successful. Evidence from the country case studies shows that, in some countries, the reforms undertaken were insufficient to reduce administrative and regulatory constraints to investment. The Bank's support was too modest, too piecemeal, and too inconsistent to get the job done.

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

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

IFC

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

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

2.22 To evaluate the impact of investment operations on the investment climate, OEG used the PSD Impact rating, one of four indicators included in the Expanded Project Supervision Report (XPSR) framework in determining an investment project's development outcome. For projects approved during 1993-1997, 73 percent had satisfactory or better PSD Impact ratings.

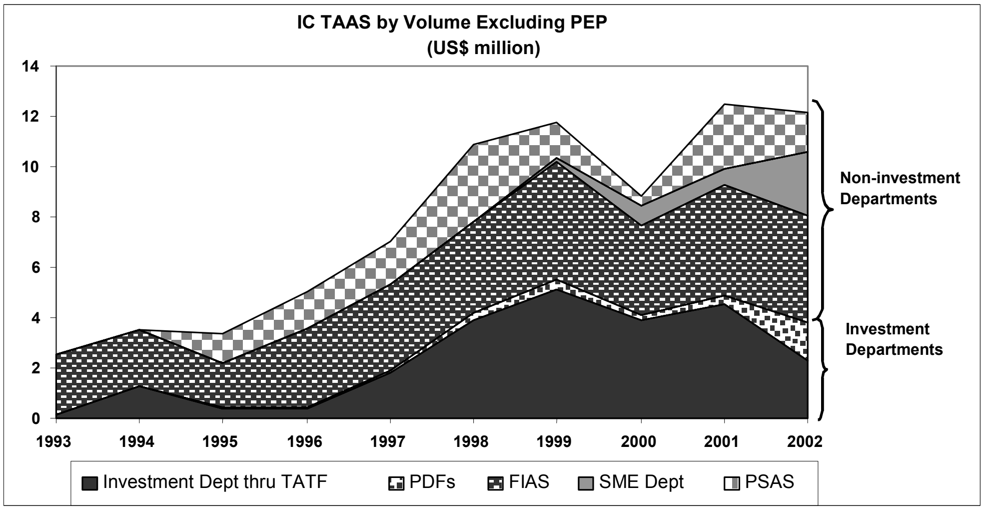
2.23 The PSD Impact indicator has several potential components for any given project. The "demonstration effect" is often high for projects that serve as a role model or lead to related investments. Pioneering or "first of its kind" projects, by definition, have strong demonstration effects. Another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

2.24 **Non-investment operations.** IFC's investment climate-related TAAS focused on identifying and removing specific constraints to investment (usually by sector) and other bottlenecks (institutional, administrative) that impede investment.[15] The main clients for IC TAAS were governments; some activities were directed at private sector clients, for example, to build their capacity to engage in policy dialogue with the government.

2.25 IFC conducted 655 IC TAAS operations for a total cost of $167 million during FY1993-2002 (38 percent of all IFC TAAS activities in volume terms). The Private Enterprise Partnership (PEP), IFC's donor-supported technical assistance program in the former Soviet Union, accounted for about half of IC TAAS in volume terms. The amount of IC TAAS grew significantly in both volume, number of projects, and in diversity of instruments and activities over the past decade. Excluding PEP, the growth of IC TAAS since 1996 was dominated by increased IFC investment department activity financed mainly by the Technical Assistance Trust Fund, and by growth in Foreign Investment Advisory Service activity (Figure 2.4). From fiscal 2000 onwards, modest increases were attributable to the joint Bank/IFC Small- and Medium-scale Enterprise (SME) Department and to IFC Project Development Facility activities.

15. In this evaluation, OEG focused on IFC's TAAS that contained an explicit component to advise the government on the legal and regulatory framework, or to build the capacity of a regulator or government agency. TAAS that advised on how to conduct transactions (e.g., sales or privatization transactions) were excluded.

Figure 2.4: IFC Investment Climate Related Technical Assistance and Advisory Services



2.26 Most of the growth in IFC's IC TAAS was for advice on specific sector legislation and capacity building. More recent IC TAAS projects have incorporated capacity-building components, either as part of a policy advisory project or alone (for example, via the SME Department's policy advocacy and corporate governance assistance). Recent growth in general investment climate advice has been due to an increase in FIAS administrative barriers studies as well as SME mapping exercises. Consistent with IFC's frontier strategy, most of IFC's IC TAAS operations were in countries with poor investment climates.

2.27 In general, OEG finds that IC TAAS work has not been strategically planned, and that done by Investment Departments has often been driven by their desire to make sector-specific IC improvements in order to develop a pipeline of projects that they can potentially finance. The growth of TAAS has been in response to specific needs and opportunities, but unlike investment operations, has not fallen under corporate-level priority setting, performance measurement, or related incentives. In transition and frontier countries, where the private sector was small and IFC's prospects for financing projects were limited, IFC tended to do more IC TAAS to create opportunities for private participation in general, with less emphasis on paving the way for specific future IFC projects. Non-investment departments (the joint Bank/IFC Foreign Investment Advisory Service, Private Sector Advisory Services, the Project Development Facilities, and the SME Department) have developed projects and programs that are relatively independent from one another, from the IFC investment departments, and from the Bank's country departments. There has rarely been a country-level program manager with accountability to plan, prioritize, coordinate, and oversee implementation of IFC's IC work during the review period. Project-level monitoring and evaluation of IC TAAS operations is relatively recent or being introduced, and similarly has not been well coordinated at the corporate level across the different providers of TAAS.

2.28 It is difficult to attribute follow-up investments to IC TAAS in part because there has been little monitoring on which to base evaluation. More generally, establishing causality links from quality of TAAS delivery to outcomes in terms of the implementation of recommendations to impacts on the ground is problematic without good monitoring data.

Changes in policies, laws, and practices – or their failure to materialize — often result from numerous actions or inactions by various stakeholders and other internal and external forces.

2.29 OEG evaluated IFC's non-investment IC TAAS activities in five field visit countries. The evaluation covered (i) the quality of the TAAS ("input"), (ii) the implementation of recommendations ("outcome"), and (iii) changes on the ground associated with the implementation of recommendations ("impact"). Interviews were conducted with interviewed and/or surveyed people familiar with specific assignments such as clients, task managers, investment officers, partners, consultants, business associations, and other donors.

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

2.31 Ratings for the implementation of recommendations (outcomes) and for the final impacts of assistance were lower than those for the quality of assistance. Forty-six percent of respondents indicated that IFC's advice was implemented to a large extent, 29 percent said they were implemented in part, and 19 percent indicated that almost none of the major recommendations had been implemented. Barriers to implementation included poor dissemination, weak institutional capacity of government counterparts, opposition from influential interest groups, and political infighting. Implementation was more likely when the TAAS was teamed with follow-up programs—including lending conditionality by the Bank or other donors—supported by private sector associations, public/private working groups, and/or an influential local champion. The most important themes that emerged from discussions with stakeholders on projects evaluated by OEG include the following:

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

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

2.33 In the past year IFC management has begun to implement two important initiatives: (i) to develop a more strategic approach to developing and delivering TA; and (ii) within a results-based management framework, to set up a monitoring and evaluation system for IFC's rapidly growing TAAS business line. Senior management has endorsed these initiatives and implementation is expected to take place in FY05.

MIGA

2.34 MIGA's mandate is to facilitate FDI flows to developing countries through guarantee and technical assistance activities, but does not explicitly encompass investment climate issues.

2.35 **Political risk guarantees.** MIGA offers insurance against certain political risks, a subset of IC issues. While its guarantees do not directly address IC issues (as MIGA does not normally work with governments in its guarantee operations), MIGA projects can affect the IC through demonstration effects and linkages to the local economy.

2.36 MIGA has made some progress toward meeting the objectives of its most recent strategy (2000),[16] focusing its guarantees on IDA-eligible countries (particularly in Africa), on complex infrastructure projects, on South-South investments, and on SMEs. Between FY90 and FY04, MIGA has supported more than 400 projects in 85 countries for a total exposure of $12.8 billion. These projects were associated with investment flows of $51 billion. Over the past few years, MIGA has become increasingly active in countries with poor investment climates.

2.37 **Technical assistance.** MIGA offers capacity building to Investment Promotion Intermediaries (IPIs). Working with government agencies, MIGA assists IPIs' strategy development (such as needs assessments, strategic plans, and marketing plans) and provides promotion support tools (investor information systems, IT system tools, contact relationship management, promotional materials), and staff training.

2.38 MIGA's strategy to select TA clients and focus its activities has changed frequently. In 2002, MIGA identified several criteria for prioritizing TA among countries and organizations: (i) low-income countries, (ii) countries with a reasonably attractive investment environment, (iii) strong government commitment to the goal of attracting FDI, including the demonstration of such commitment by providing adequate funding, and (iv) the ability to absorb support. Based on these criteria, MIGA developed a tiered assistance approach, with a different menu of services targeted to each country category, but it was never formally

[16] *MIGA Review 2000.*

adopted as the basis for client selection. In 2003, MIGA introduced additional criteria relating to investor interest to provide an active market for MIGA guarantees, and complementarity with WBG strategies for PSD. Despite these stated priorities, MIGA has never limited itself to working within the framework of the tiered approach. Client selection has been demand-driven for diagnostic needs assessments. In-depth technical assistance activities were driven by the results of needs assessments and availability of external funds.

2.39 During FY98-03, MIGA provided TA interventions to 63 countries. Of these 63 countries, 41 received one or two TA interventions (mostly needs assessments), and 22 received more in-depth TA. The average IC levels for countries receiving in-depth TA were similar to those of recipients of MIGA guarantees; the average IC levels for countries receiving diagnostic TA was worse than for guarantees recipients.

2.40 In 2002 and 2003, after new selectivity criteria were identified, MIGA was active in 41 countries. Of the 41 with any MIGA TA activity, 36 had reasonably attractive investment environments and 26 were low income (of which 21 also had reasonable investment environments). In 2002-03 MIGA delivered in-depth TA activities to 19 of the 41 countries, and of these, 16 met both the low income and reasonable IC level criteria. MIGA's more recent in-depth TA activities are therefore meeting these two major criteria well.

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

2.42 **Impacts.** Findings from a small sample of evaluated MIGA **guarantee projects** showed mixed results with regard to their impacts on private sector development (which includes demonstration effects). In some cases, MIGA had clearly played a positive role in supporting early investments in a sector or country, and some of its projects have had follow-on investments, and thus, a positive demonstration effect. A majority of evaluated projects had low PSD impacts because of low financial returns, due to economic or sector crises or regulatory problems. In addition, MIGA projects are mostly small in comparison to their host economies, and therefore have limited PSD impacts.[17]

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

2.44 There is limited empirical research on the link between investment promotion and actual investment flows. Although a recent FIAS study concluded that there is a positive

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[17] See MIGA/R2004-0055: *2004 Review of Development Effectiveness in MIGA.*

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

2.45 Evidence from the two case studies suggests that MIGA's TA has been more effective when it was engaged with committed governments and where there was a stable organizational framework for the investment promotion function within the government — for example, IPIs with direct support from, and reporting to, the President or Prime Minister, where increases in FDI flows were government priorities, and where the IPI was adequately funded.

From Strategy to Outcomes: Illustrations from Country Case Studies

2.46 Annex A shows how WBG strategies and activities translated into outcomes in three countries that were the subject of case studies by both OED and OEG: Peru, Mozambique, and Romania. The findings include the following.

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

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

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

3. Coordination in the World Bank Group

3.1 The 2002 PSD Strategy defines the broad division of labor among the WB, IFC, and MIGA in implementing the investment climate agenda:

> *"IBRD/IDA focus on investment climate and related institution building, improvements of governance, legal and regulatory systems, financial sector policies and public financing. IFC pursues demonstration projects that promote the credibility of government policies, provides additional financial services in local markets, and provides political risk protection to co-financiers. Its strategy is to deploy its instruments such that they support relevant institution building particularly in the financial sector and for small and medium enterprises. MIGA provides focused political risk guarantees, institution-building and investment promotion assistance."*[18]

In practice, the division of labor on investment climate work among the Bank, IFC, and MIGA is less clear-cut. Both the Bank and IFC are involved in providing policy advice to governments, and both FIAS and MIGA provide assistance to investment promotion intermediaries.

Advice on Policies and Institutions

3.2 There is a lack of consistency between the 2002 PSD Strategy and IFC's own strategic documents with respect to the division of labor between the Bank and IFC on providing policy advice to governments. IFC's original Articles of Agreement state that one of the purposes of the Corporation is to "seek to stimulate, and to help create conditions conducive to, the flow of private capital…into productive investments." IFC first proposed "strengthening its investment and advisory work in support of investment climate improvements in member countries" in 2001, and again in 2002-04. According to the 2001 IFC *Strategic Directions Paper*, "IFC is to promote and support TA and advisory activities to improve the investment climate, including appropriate institutional and policy reforms."

3.3 OED and OEG investigated two issues related to the division of labor between the Bank and IFC on policy advice: the degree of coordination between the Bank and IFC and possible duplication of effort; and concerns about conflicts of interest associated with WBG policy advice related to potential IFC investments.

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18. *World Bank Group Private Sector Development Strategy* (2002), p. 65.

3.4 Coordination between the Bank and IFC has been uneven. Although current practice is to prepare joint Bank/IFC CASs, discussions with staff indicate that there is a perception within IFC that its participation has little impact on the Bank's lending and non-lending services. An exception is the analytical work done by FIAS, which has often been taken up in Bank lending operations. At the project level, cooperation between the Bank and IFC is often dependent upon personal relations as well as on the attention given by Bank and IFC management to encouraging collaboration in country teams. With respect to duplication of effort, client and staff feedback suggested that, since so much needs to be done on so many investment climate topics, duplication of effort is not a real problem. Moreover, the Bank tends to focus on broader, economy-wide and sector-wide policy advice (e.g., regulation or competition policy), whereas the IFC focuses more on industry-specific advice (e.g., advising on corporate bond markets), much of which is directed to the financial sector.

3.5 Since 2002, the joint Bank-IFC Private Sector Development Vice-Presidency has attempted to enhance coordination and realize synergies across the WBG. For example, twelve WBG-wide country investment climate review meetings have been organized, and a WBG-wide training program on investment climate reform is being developed. MIGA now participates in the PSD Sector Board, and both PSD and FIAS are members of MIGA's Benchmarking Steering Committee. The Vice President responsible for PSD in the Bank is also Chief Economist of IFC. As noted earlier, these recent activities have not been evaluated in this report.

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

Assistance to Investment Promotion Intermediaries

3.7 Both MIGA and FIAS provide technical assistance to promote foreign direct investment. FIAS's mandate is to provide technical assistance to improve the overall investment climate and assistance in developing the legal and institutional framework for the establishment of IPIs. MIGA generally works with established IPIs on their organizational development and investment promotion efforts. This division of labor is generally followed, with some overlap due to the similarity of MIGA and FIAS objectives. The extent of overlapping activities — both in terms of the number of projects and in terms of project costs — is not significant and has been declining. However, the similarity of the two mandates is likely to create confusion among WBG clients about who is providing which services.

3.8 MIGA and FIAS have attempted to establish their respective functional roles and responsibilities in providing technical assistance to support investment promotion, and have agreed to "hand off" clients to one another. As a result of efforts to improve coordination between FIAS and MIGA, nearly half of the number of FIAS projects in overlapping areas involve joint missions with MIGA staff and/or some form of MIGA involvement. Although no major conflicts were found in the countries studied by OEG and OEU, coordination and cooperation between FIAS and MIGA should be codified, including protocols for the hand-off of clients.[19]

Integrating Microeconomic and Macroeconomic Agendas

3.9 Responsibility for the Bank's investment climate operations is spread across the institution. Investment climate lending operations in the Regions are primarily managed by the Finance and Private Sector Development, Poverty Reduction and Economic Management (PREM), and Infrastructure sector units. The wide-ranging "ownership" of the Bank's IC portfolio is apparent in the assignment of projects to individual networks and sector boards. In fact, more IC projects are assigned to non-PSD networks than to PSD. During FY1999-2003, 31 percent of the Core IC portfolio was assigned to the PREM network, 23 percent to Infrastructure, and 19 percent to the Financial Sector network, compared to only 17 percent to the PSD network.

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

4. Recommendations

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

19. Management notes that co-ordination and cooperation between FIAS and MIGA is codified. At the specific request of the President of the World Bank Group, a brochure was prepared entitled "The World Bank Group Guide to FDI Advisory and Information Services" which sets out the roles of the various units. A Memorandum of Understanding (MOU) setting out the detailed interface between FIAS and MIGA is currently being finalized. OEU welcomes the preparation of this MOU

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

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

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

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

   a. Do more analytical work on institutional arrangements and the political economy of reform, involving local organizations in this work. *(OED report recommendation 1a)*

   b. Be less timid in dealing with vested interests and in building a balanced constituency for reform. Make better use of the Bank's convening power to bring the government together with other stakeholders, and be more proactive in disseminating information and pushing for transparency. *(OED report recommendation 1b, c, d)*

   c. Make better use of survey-based diagnostics, focusing them on specific country needs. Use surveys only as an input to making policy recommendations in order to balance business perspectives with broader economic and social concerns. *(OED report recommendation 2a, b, c)*

   d. Consider packaging a critical mass of microeconomic reforms into investment climate adjustment loans, rather than piggy-backing small investment climate components onto macroeconomic adjustment operations. *(OED report recommendation 3a, b, c)*

3. **IFC:** Raise the profile of IC work and develop operating guidelines for technical assistance and advisory work related to the investment climate.

   a. For its TAAS work, make IC a central theme and strategic priority. The regional investment departments should define the IC agenda and product mix relevant to each country's IC needs. Each country TA program should have a strategic plan and clear accountability for TA coordination, execution, monitoring, and evaluation. *(OEG report recommendation 1)*

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

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

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

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

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

c. Formalize MIGA's relationship with client countries through formal contracts that clearly state the objectives, scope of work, costs, and indicators of success, and include arrangements for sharing costs. *(OEU report recommendation 4)*

Annex A: WBG IC Activities in Peru, Mozambique, and Romania

<table>
<tr><th>STRATEGY</th><th>ACTIONS</th><th>OUTCOMES</th></tr>
<tr><th colspan="3">PERU</th></tr>
<tr>
<td>World Bank
Selective approach to PSD issues, considering the roles of partner institutions (CAS 1994).
Greater attention to PSD as source of future growth but not yet area of primary concentration. Improve property rights through land titling and registration; strengthen regulatory environment, continue privatization, decentralization, build capacity at the municipal level (CAS 1997).
Generate employment and increase competitiveness by addressing barriers to private sector growth and increasing exports. Increase focus on governance and institutions, property rights, and judicial reform (CAS 2002).
IFC
Poverty reduction through private sector-led growth (CAS 1994).
Stronger role for PSD, especially financial sector development (CAS 1997).
Developing financial infrastructure, private participation in infrastructure, post-privatization programs (CAS 2001).
Reactivate private sector growth; enhance competitiveness; foster financial sector development; support reform program (CAS 2002).</td>
<td>World Bank
Private Sector Assessment (1994)
ESW on secured transactions (1997)
Investment Climate Assessment (2003)
Judicial Reform Project (1997)
Financial Sector Adjustment Loan (1999)
Urban Property Rights Project (1998)
IFC/World Bank
Study on private participation in infrastructure
FIAS report on promoting foreign investment
IFC
39 investments in infrastructure (water, telecom, power); mining; agribusiness; the financial sector; and social sector (private university)
TA for financial market reforms, including the regulatory framework for the mutual funds industry, and development of the primary and secondary mortgage market.</td>
<td>World Bank
Reforms of early 1990s — with significant Bank involvement — improved IC and private investment.
Subsequently, increasing unpredictability of judiciary and tax instability, and political situation in general, dampened private investment after 1997.
Overall, WB's involvement in institutional development efforts relatively less successful, due to long gestation needed and political issues.
IFC
Four out of 5 investment operations had high Development Outcome ratings and resulted in high PSD Impact.
Implementation of IFC's TA recommendations helped mutual funds grow from $100-200 million to $1.6 billion with 62,000 individual investors.
Recommendations on mortgage finance largely not implemented, due in part to a change in government. IFC invested in a commercial bank to provide housing credit and support the development of the primary market.</td>
</tr>
</table>

<table>
<tr><th>STRATEGY</th><th>ACTIONS</th><th>OUTCOMES</th></tr>
<tr><td colspan="3">MOZAMBIQUE</td></tr>
<tr>
<td>World Bank
• Comprehensive strategy for rehabilitation and reform of the postwar economy. Creating a more favorable investment climate was identified as a priority area (CAS 1991).
• Accelerate privatization and create a microeconomic environment for growth and diversification of private sector activity. Improve the business environment through removal of bureaucratic red tape and restrictions embodied in the regulatory system; institutional development (CAS 1995).
• Intensified efforts to improve the investment climate through continued macroeconomic reform, added efforts to enhance the microeconomic business environment, private sector capacity-building programs, and infrastructure development in high-potential sectors (CAS 1997).
IFC
• Continue to help reduce the impediments to PSD.
• Provide financial and advisory services for financial development.
• Promote innovation, competitiveness and employment.
• Intensify efforts for legal and regulatory reform including revision of the commercial code (CAS 1995, CAS 1997, and CAS 2000).</td>
<td>World Bank
• "Mozambique: Impediments to Industrial Recovery" (1994)
• RPED manufacturing survey (1997)
• Investment Climate Assessments (1997, 2002)
• Sponsorship of private sector conferences
• Economic Recovery Credits (1992, 1994, 1997)
• Financial Sector Capacity Building Project (1994)
• Economic Management Reform Credit (1998)
• Enterprise Development Project (2000)
World Bank/IFC
• FIAS administrative barriers to investment studies (1996, 2001)
IFC
• 29 investment projects including in MOZAL (aluminum smelter), the financial sector (e.g. a foreign bank and an investment banking affiliate), and agribusiness.
• Several studies on policy, regulatory, and administrative constraints to PSD.
• Advisory services through FIAS, APDF, and AMSCO, and PSAS. Lead advisory in the privatization of Mozambique's oil and gas distribution company (Petromac)
• Investment department provided advisory assistance on regulatory framework for the insurance industry</td>
<td>World Bank
• Significant progress was made in financial sector reform and privatization. But the reforms of the early 1990s failed to pay enough attention to weak corporate governance and technical capability in state-owned banks and enterprises (OED Country Assistance Review 1998).
• The government's preoccupation with peace process and elections, as well as differences in perceptions between government and WB regarding implementation capacity and effect of reform retarded many areas of policy reform.
• Investment and growth have increased, but primarily due to foreign "mega" investments; labor-intensive growth has not yet materialized.
World Bank/IFC
• Inter-ministerial working group set up to reduce red tape. Many of the FIAS recommendations are under implementation.
IFC
• Out of 4 investment operations evaluated, 3 had low development outcome (DO) but high PSD Impact, 1 had low DO and low PSD Impact.
• In the banking sector, service levels and competition were improved.
• MOZAL created local supply linkages.
• In the insurance sector, nearly all TA recommendations were incorporated into the law passed in September 2003.
• Petromac privatization is still underway.</td>
</tr>
</table>

STRATEGY	ACTIONS	OUTCOMES
MOZAMBIQUE (continued)		
MIGA • Support projects with high development impact and investment intermediaries charged with attracting FDI • Continue support of Investment Promotion Center (CPI) and WB-funded technical program	**MIGA** • MIGA issued 25 guarantees for 10 projects, for a total exposure of US$411 million (gross) during FY98-04, especially in agribusiness, infrastructure, and oil and gas • Pilot country for the MIGA-Swiss Partnership: long term, multi-component TA program initiated in FY02, providing advice to CPI to advance free zone work program	**MIGA** • Outcomes of individual MIGA guarantees and TA have not been evaluated. However, MIGA appears to have offered relevant products in its support for a post conflict IDA country, making Mozambique MIGA's 4th largest host country (in terms of outstanding guarantee exposure).
ROMANIA		
World Bank • Improve business environment by lowering barriers to entry for firms and joint ventures *(CAS 1995).* • Promote PSD through macroeconomic stabilization, privatization, price liberalization, and restoration of financial discipline. Establish a well-functioning legal code and rationalize bureaucratic involvement in business. Establish a sound and competitive financial sector through bank competition and regulation. Improve infrastructure to reduce the unreliability and high cost of infrastructure services *(CAS 1997).* • Strengthen institutions for a market economy *(CAS 2001).* **IFC** • Strengthen business environment by lowering barriers to entry for firms and joint ventures and developing an adequate	**World Bank** • "Legal framework for PSD" (2002) • "Financial Markets, Credit Constraints, and Investment in Romania" (1999) • Financial and Enterprise Sector Adjustment Loan (1996) • General Cadastre and Land Registration Project (1997) • Private Sector Adjustment Loans I and II (1999, 2001) • Public Institution Building Loans I and II (1999, 2001) • Rural Finance Loan (2001) **World Bank/IFC** • FIAS helped draft investment promotion law, conducted an administrative barriers study (1999), and proposed investment incentives policy. **IFC** • Investment operations in telecom, financial sector, manufacturing, and agribusiness, and SMEs. • TA for housing regulations, capital market legislation, mortgage finance, private participation in health care,	**World Bank** • Projects had significant impact on the investment climate. However, political frictions and reduced transparency still remain impediments to increasing investment: (i) the legal system remains complicated, with weak institutional capacity; (ii) frequent changes in legislation create uncertainty for business; (iii) the legal status of fixed property is still unsatisfactory, especially in rural areas. • Customs reform has facilitated trade. • Secured transactions reform has led to increased access to finance. **World Bank/IFC** • FIAS's administrative barriers study led to an Action Plan. Fiscal reform is underway, new tax code implementation is expected by 2004, land registration has improved, and lead time for business permits is lower. **IFC** • Out of 6 investment projects evaluated, 3 had high DO and 4 had high PSD Impact. • Health care sector opened to

STRATEGY	ACTIONS	OUTCOMES
ROMANIA (continued)		
incentive framework for PSD *(CAS 1997 and CAS 2001).* • Increase private sector role in agriculture, energy, transport, water supply, local government and telecommunications *(CAS 1997).* • Strengthen financial and capital markets and privatize state-owned banks *(CAS 2001).* **MIGA** • Support Government's efforts to attract FDI by offering TA for development of investment promotion capabilities *(CAS 2001)* • Issue guarantees in banking (notably for SME and rural finance) and infrastructure; support to privatization program *(CAS 2001)*	and the national pension system. • Joint study with EBRD and other IFIs to identify investment impediments. • Advised on the privatization of Bucharest Water Supply, the State Ownership Fund (ball bearings), and tractor manufacturer (Tractorul). **MIGA** • Limited TA for investment promotion capacity building, focusing on diagnostics • Guarantee projects overwhelmingly in the financial sector (and in services)	private sector participation and efficiency gains achieved. • Following privatization of Bucharest Water Supply, access and service improved and new investments in the sector followed. • Implementation of pension reform recommendations was limited and private participation remains low. **MIGA** • MIGA TA had some positive outcomes in enhancing – to some degree – capabilities of the investment promotion intermediary (ARIS), but the IPI lacks credibility, links with other government entities, and has a weak governance structure