

PRIVATE SECTOR DEVELOPMENT STRATEGY
Promoting the Private Sector for Growth and Poverty Reduction

September 1999

ABBREVIATIONS

BOO	build-own-operate
BOT	build-operate-transfer
CAP	country assistance plan
COS	country operational strategy
DFI	development finance institution
DMC	developing member country
EBRD	European Bank for Reconstruction and Development
FIRR	financial internal rate of return
IDB	Inter-American Development Bank
IFC	International Finance Corporation
MDB	multilateral development bank
PRG	partial risk guarantee
PSD	private sector development
PSG	private sector group
PSO	private sector operations
SMEs	small- and medium-sized enterprises
TA	technical assistance

NOTE

Unless otherwise specified, in this report, "\$" refers to US dollars.

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I. NEED FOR A COMPREHENSIVE STRATEGY

1. The Bank needs to articulate a comprehensive strategy for private sector development (PSD) for at least four reasons. First, a major shift is taking place in the role of the private sector in the developing member countries (DMCs). As DMC governments are faced with a growing shortage of resources (accentuated by the Asian crisis), they are increasingly turning to the private sector to lead economic development. For assistance in creating the enabling environment for the private sector to assume this role, DMC governments are looking to institutions such as the Bank. Second, there is also a major shift taking place in the Bank's strategic framework with the adoption of poverty reduction as its overarching objective. Consequently, the Bank needs to reorient its PSD assistance strategically to focus on "pro-poor growth"¹. Third, learning from the Asian crisis, DMCs have realized the risks to the financial and corporate sectors arising from globalization and the need, therefore, to strengthen them with assistance from institutions such as the Bank. Finally, because the environment for development assistance in the region is competitive, pluralistic, and rapidly evolving, the Bank needs to draw on its strengths and experience to improve how it assists its DMCs in PSD.

2. PSD is not new to the Bank (Appendix 1): the Bank's first loan was a credit line for small- and medium-sized enterprises (SMEs) in the private sector in Thailand. Such assistance through the Bank's public sector window has expanded over the years to cover over 23 DMCs and a total of \$4.4 billion. This has been an important element of Bank assistance for PSD. However, other public sector assistance of the Bank has also contributed significantly to PSD. Policy dialogue, technical assistance (TA), and project and program loans have promoted policy, legal, institutional, and regulatory environments that support PSD by, among other things, removing market distortions, strengthening domestic financial markets, and promoting good governance. Such assistance covers a range of sectors: finance and capital markets, agriculture, industry, trade, and infrastructure. In 1983, the Bank added private sector operations (PSO) to provide loans and equity investments to private enterprises without government guarantee. While PSO have expanded and diversified over the years, they still remain small in aggregate.²

3. A lesson learned under credit lines, both in relation to the financial intermediaries and the assisted private enterprises, is that the right policy, legal, and regulatory environment, and good governance are vital for their effective functioning. While the Bank did assist DMCs in addressing the enabling environment, the Asian crisis has reaffirmed that further concerted efforts are required by DMCs and, in turn, the Bank. A second lesson was that the Bank's public and private sector windows should have worked more closely together to increase benefits to the DMCs, and optimize development impacts. Public sector assistance should have paid more systematic attention to private sector interests and concerns. The Bank will draw on this experience in reviewing its approach to PSD.

II. THE CONTEXT

4. The Bank's PSD assistance will need to be tailor-made to the differing levels of economic and private sector development of its DMCs (Appendix 2). In various settings,

¹ Under the Bank's Poverty Reduction Strategy, "pro-poor growth" is characterized as: (i) labor-absorbing growth that increases worker productivity and wages, and availability of basic services; (ii) accelerated growth that also invests in human capital; and (iii) growth that is sustainable through conservation of the natural environment and resources.

² PSO approvals to date total \$1.5 billion, or less than 2 percent of total Bank approvals. Also, the total annual PSO approvals amount to 3-4 percent of total annual approvals, which is well below the figure for the Inter-American Development Bank (6 percent), the World Bank Group (10 percent), and the European Bank for Reconstruction and Development (60 percent).

enhancing the private sector's contribution to development and poverty reduction may mean, for example, (i) a primary focus on facilitating the emergence of domestic entrepreneurs through support related to microenterprises and SMEs in the People's Republic of China; (ii) providing support to rural nonfarm enterprises or agri-business in Bangladesh; (iii) formulating and implementing technically demanding and highly complex projects to support privatization and financial sector reform in Thailand; or (iv) assisting in the effective and developmentally sound integration of relatively advanced domestic industries with complex regional and global production networks, particularly in the transition economies of Cambodia, Lao People's Democratic Republic and Viet Nam, that form part of the Greater Mekong Subregion. Special consideration will need to be given to the small size of the Pacific DMCs and the great distances between them.

5. The Bank also needs to consider its limitations and strengths. Since its financial and human resources are limited, the Bank's assistance must be selective and strategically focused. The Bank has distinctive strengths: it is located in and has close understanding of the region, and its public and private sector windows are under the same organization. To be most effective in its development assistance in promoting the private sector, the Bank needs to take into account what other development agencies are doing in the region and coordinate with them for maximum development impact (Appendix 3). Finally, the Bank's comparative advantages must be employed in the context of individual country PSD strategies.

III. THE STRATEGY

A. Strategic Thrusts

6. The objective of the Bank's Private Sector Development Strategy (the strategy) is to expand the contribution of the private sector to accelerated and sustainable pro-poor growth. To meet this objective, the strategy will consist of two strategic thrusts:

- (I) Expand the role of the private sector by:
 - continuing to shift the role of government in the market from owner and producer to facilitator and regulator;
 - promoting private sector participation in physical and social infrastructure, including provision of basic services that will benefit the poor;
 - creating the enabling environment and incentives to make markets work better; and
 - catalyzing private sector projects that deliver developmental impacts and have demonstrational effects.
- (II) Establish policies and create institutions that will enable private sector-led growth to be less vulnerable to shocks (such as the Asian crisis) and make social benefits more robust.

1. Expanding the Participation of the Private Sector for Accelerated Pro-Poor Growth

7. The private sector needs to become the engine of growth given the limited capacity and mixed track record of the public sector. Growth benefits the poor most if it creates demand for their labor, hence, the private sector needs to generate jobs and incomes for the poor. This is even more compelling in Asia where the largest number of the world's poor live. Although Asia

remains the fastest growing region in the world, it needs to grow even faster if it is to break out of its poverty. Governments need to get the markets to work better and adopt development approaches that, for example, minimize distortions such as policies discriminating against exports and labor-intensive agriculture and industry.

8. The basic question is how the public and private sectors can best complement each other in the overall development effort. The task of reducing a government's presence in the market as owner of the means of production and producer of end products, and shifting it to become facilitator and regulator of these activities is well under way. Government entities are often buttressed by monopolies and should loosen their grip on economic terrain that could be better served by competitive markets. Moreover, shifting the government's role would free public resources for higher priority activities (e.g., diverting resources from loss-making state entities to essential education and health services and social safety nets). In many poorer DMCs, growth and (ultimately) poverty reduction depend on such shifts.

9. Liberalizing markets and carving out a definitive role for the private sector can be achieved through a variety of means such as contracting out, concessions, management contracts, leasing of state assets, corporatization and, of course, privatization. In each case, the objective is to increase efficiency and stimulate economic growth, with attendant impact on poverty reduction. In practice, successful alignment of the public and private sectors will depend on a combination of sound regulatory environments, competitive conditions, effective incentives in privatized enterprises, market prices for public assets and concessions, and consistency with social objectives.

10. A necessary condition for all PSD initiatives in any DMC is a sound and stable macroeconomic environment. DMC governments must provide a sound policy environment to support and nurture the development process. Such policies, and their reliable implementation, constitute the critical starting point for the private sector to contribute to economic growth and the reduction of poverty. In particular, this includes prudent monetary and fiscal policies (including tax code and exchange rate regimes) and more open trade and investment policies. At the macroeconomic level, the Bank will continue to deepen its assistance to DMC governments to enable markets to work better and help the private sector to flourish.

11. To attract private sector participation in infrastructure, primarily public utilities, as well as basic services such as education, health, water, and sanitation, the Bank will work with governments through its public sector window to (i) create the enabling environment; (ii) assist in preparation of projects for subsequent participation by the private sector; and (iii) promote public-private partnerships to maximize synergies between social and developmental goals and commercial interests. The Bank will aim to catalyze private sector investment in subsectors that have strong developmental impacts by supporting pilot projects that are demonstrational. The conviction is that the long-term interests of all stakeholders in the development process are best served if economic growth is efficient and inclusive.

2. Enabling Sustainability of Private Sector-led Growth and its Benefits

12. Globalization presents opportunities and risks. Opportunities include (i) increased trade and flow of labor; (ii) lowering of transaction and information costs; and (iii) the creation of internationally uniform – and therefore predictable – environmental, social, and labor standards. The risks are best perceived in the context of the Asian crisis. Before the crisis, the private sector in the region took advantage of globalization to absorb large amounts of capital and increase exports of goods and services. The crisis highlighted the vulnerability of the domestic corporate and banking sectors and the risks inherent in the currency and maturity mismatches.

Economies contracted resulting in loss of jobs, incomes, and lack of access to affordable basic services for people. The lessons are clear. Economies need to be better prepared and more robust to withstand shocks. Governments need to play a proactive role in establishing the requisite policy, regulatory, and institutional frameworks for the domestic private sector to survive a crisis and take advantage of the opportunities presented by globalization in order for growth to be sustainable. Governments also need to introduce social protection programs that will minimize the destructive impacts on basic services and setbacks to development gains – primarily poverty reduction – induced by shocks to the economy. The Bank will assist in strengthening social protection programs, including safety nets, and labor laws that protect workers. Long-term sustainability also means that the Bank must continue to emphasize environmental protection.

B. Operational Focus

13. Consistent with the strategic thrusts, and keeping in mind the Bank’s comparative advantages, four areas of operational focus will underpin Bank PSD assistance:

- (i) effective governance in the public and private sectors;
- (ii) effective financial intermediation;
- (iii) expanded public-private partnerships; and
- (iv) regional and subregional cooperation.

14. Taken together, these areas of focus – which characterize the key issues of an enabling environment for PSD in the Asian context – provide an operational framework for mutually reinforcing public and private sector Bank assistance. Their direct linkages in support of the three “pillars” of the Bank’s Poverty Reduction Strategy are summarized in Appendix 4.

1. Effective Governance in the Public and Private Sectors

15. **Public Sector Governance.** Effective principles of public governance are a vital ingredient for PSD. Good public governance contributes to sustainable development through the efficient deployment of public funds and constitutes an essential enabling condition for the private sector to contribute to that development. In this context, the economies of the region will need to restructure to raise productivity (of both capital and labor) over the longer term, as the basis for sustainable growth in employment and incomes. Although productivity performance and restructuring take place primarily at the level of individual enterprises and industries (or sectors), government has an important role to play in facilitating this process, and the Bank is in a good position to assist. This includes adoption of (i) an effective competition policy; (ii) a sound legal framework, including transparent commercial laws and an effective bankruptcy regime; (iii) a general “code” of good governance to combat corruption; (iv) sound and transparent sectoral regulations; (v) environmental, labor, and technical safety standards; (vi) well-defined property rights; (vii) an efficient and equitable tax system; (viii) international accounting standards; (ix) an efficient market pricing system; and (x) efficient and equitable public institutions and services, at all levels, that create a predictable and stable operating environment for business.

16. **Commercialization and Privatization.** A key dimension of effective public governance—especially in the context of economic restructuring – relates to commercialization and privatization of state-owned enterprises. The Bank will help to plan, prepare, finance, and implement such initiatives. The goal is to ensure that the performance of privatized enterprises is efficient and consistent with social objectives. A fundamental issue is ensuring economic efficiency in the utilization of privatized assets, based on external competitive conditions and

internal incentive structures (Appendix 5). The Bank will help explore how the privatization process can be implemented through participation of the community involved. In its PSO, the Bank will explore the scope for direct financial assistance to the projects resulting from privatization programs supported by the Bank and/or other multilateral development banks. Labor issues and retrenchment present significant social costs, to address which, the Bank will help to set up social safety nets.

17. **Corporate Governance.** The Asian crisis exposed major weaknesses in the structure of the corporate sector. A significant challenge over the medium term is to improve corporate performance. For this, corporate restructuring (including mergers and acquisitions), strengthening of governance, and corporate debt restructuring, will be required. The Bank will selectively support such efforts through its various operational modalities.

2. Effective Financial Intermediation

18. The growing need in the DMCs for effective resource mobilization and for allocating resources efficiently to productive investments has been demonstrated dramatically by the Asian crisis. Without sound, efficient, and broad-based financial markets, domestic savings – which are substantial in many of the DMCs – will not be mobilized and domestic private entrepreneurs cannot obtain efficient finance, particularly for long-term investment. The Bank's comparative advantage in this important area stems from its continuous involvement with the financial sectors of its DMCs in both its public and private sector operations.

19. **Financial Institutions and Markets.** A focus of the strategy will be on strengthening the structure and operations of existing financial institutions including commercial banks, government-linked banks, nonbank financial institutions, bond markets, and equity markets. An equally important area requiring attention will be the supervisory and regulatory framework for these institutions and markets. The Bank will play an even more active role in assisting governments with financial sector reform and the accompanying institutional capacity building, including human resources and technology, in the DMCs. Emphasis will shift from intermediation to capacity building in its direct financial assistance for institutions such as banks, insurance companies, leasing companies, securities firms, rating firms, and pension fund management companies. In addition, the Bank's goal will be to support institutions that can serve as role models in the process of rehabilitating the financial system.

20. **Long-Term Financing and Capital Markets.** One of the fundamental lessons learned from the Asian crisis relates to currency mismatch, and the mismatch between long-term investments and short-term financing instruments. To address this, the Bank will continue to help promote long-term financing and support the creation of diversified domestic capital markets including markets for equities, bonds, and long-term notes. Approaches will include pension reform and stimulation of housing finance and insurance. To help catalyze the process, the Bank will consider undertaking local currency borrowing and lending (aimed primarily at SMEs and utilities that have revenues in local currency).

21. **Investment Funds.** The Bank will make more effective use of the accumulated experience of its sizable portfolio of investment funds (29 investment vehicles since 1983) to identify pressing constraints to PSD, tap the knowledge of its fund managers, and become more actively involved in influencing future funds' investment objectives in terms of country and sector focus. Building on past experience, new types of funds will be explored of particular relevance to the region's needs and conditions, e.g., debt and equity funds, micro-equity and SME funds, environment funds, and corporate restructuring and recovery funds.

22. **Small- and Medium-sized Enterprises.** Within the corporate sector, the focus is on supporting SMEs, which are a major generator of employment and income. Assistance to SMEs under credit lines has not been totally satisfactory, and lessons learned will need to be incorporated in the use of financial intermediaries in future assistance programs for SMEs. Direct assistance for SMEs, either as equity or debt financing, may also be required, for example, in the Pacific DMCs. SMEs require capital, but they are also in need of assistance in developing: viable business plans; accounting, financial and marketing skills; management capacity; and environmentally clean production practices. Hence, the Bank will also consider TA and business advisory assistance to SMEs.

23. **Entrepreneurship and “Start Ups”.** Creation of new firms – a difficult process in many DMCs – can help absorb released workers. It can also provide new sources of employment and incomes as the region’s economies restructure. The Bank will support this by helping to develop the necessary environment, entrepreneurial education, and business incubators. In this context, the Bank will actively support microfinance targeted to women and the rural and urban poor (para. 28).

3. Public-Private Partnerships

24. The focus is on establishing effective consultative mechanisms that will promote and sustain public-private partnerships in the DMCs, to balance social and developmental goals and commercial interests. The Bank will embark on a much more proactive set of initiatives aimed at promoting and brokering such partnerships, particularly in infrastructure development, and advising governments on ways to develop substantive partnerships with the private sector. The Bank will also tap into the extensive pool of private sector resources available regionally and globally, and develop networks and relationships with key PSD stakeholders. A high-level advisory and consultative body in the nature of a corporate advisory council could be established to provide information and feedback on PSD and act as a forum for exchanging PSD ideas. For example, this will facilitate the exchange of information and ideas on solutions to constraints in the business environment, opportunities for changing public-private roles in specific sectors and countries, and new areas for the private sector to enter with a “comfort level” provided by the Bank.

25. **Physical Infrastructure Development:** The public sector in the DMCs will continue to have a major role in the provision of infrastructure. However, expanding private sector participation in the financing, installation, commissioning, and operation of infrastructure facilities can improve efficiency, deliver much-needed services cost-effectively, and release resources from public budgets at all levels. The Bank will continue to assist its DMCs in the processes of involving the private sector in areas such as energy, water, transport, and telecommunications facilities. In this context, the Bank will also actively encourage and assist DMCs to develop their use of information technology. Through its public sector operations, the Bank will help establish an effective regulatory framework for infrastructure, strengthen public institutions responsible for provision and regulation of infrastructure services, and train and develop skills of public officials responsible for infrastructure development. These approaches will be designed to help rationalize each sector and identify an effective role for the private sector in the provision of infrastructure. Additionally, it will ensure that the process of transferring infrastructure responsibilities to the private sector is transparent and competitive, and produces greater efficiencies and better service to consumers.

26. The Bank has had some success in using public sector based TA operations to generate infrastructure projects involving public-private partnerships, and it will continue to use TA to this end. Three projects have been awarded to private sector operators based on Bank-supported

international competitive bidding³ (Appendix 6). The Bank will also invest in targeted infrastructure funds with the goal of expanding infrastructure services.

27. **Social Infrastructure Development.** The Bank will assist DMCs to identify the means by which the private sector can help deliver more effective social services. Where appropriate, the Bank will support the private sector's role to help improve, foster, and directly finance the delivery of essential goods and services such as education, health, and nutrition. The Bank will assist DMCs to explore such opportunities for private sector involvement in the social sectors as a means to achieve more effective coverage of essential services by the public sector, whether through direct contribution or through contracting out the private provision of publicly funded social goods and services. The Bank must recognize that the private sector will decline to finance or participate in providing some social services, unless creative financing modalities are developed between the public and private sectors, with the Bank's intermediation and assistance.

28. **Agriculture and Rural Sector Development.** In the Bank's DMCs, the agriculture sector contains the single greatest concentration of private sector production. The overwhelming majority of Asia's poor obtain their livelihood from agricultural production. Thus, Bank assistance in promoting public-private partnerships in the agriculture sector can have a tremendous impact on poverty reduction. To stimulate small rural nonfarm enterprises that can help raise incomes and the welfare of the poor, particularly poor women, the Bank can support additional micro-credit funds. The Bank will continue to assist its DMCs to allow markets to determine input and output prices; in developing public-private partnerships in the supply of agricultural inputs, particularly in fertilizer distribution and agro-processing industries; in transferring the management of on-field irrigation systems to farmer groups; and in developing rural infrastructure (e.g., farm-to-market roads). The Bank can also help to strengthen public capacity in the delivery of rural credit, extension, and research, and in the management of irrigation and natural resources.

4. Regional and Subregional Cooperation

29. Regional and subregional cooperation has emerged as an increasingly important strategy for development in Asia. Whereas in North America and Europe economic integration has involved formal regional cooperation arrangements (i.e., the North American Free Trade Agreement and the European Community), in Asia—especially East and Southeast Asia—economic integration has been driven by the strategic decisions of firms, with governments playing an active, if largely informal, facilitating role. Therefore the private sector has been both a prime mover and a prime beneficiary of regional cooperation in a widening network of investment, production, and trade flows that is likely to endure beyond the Asian crisis.

30. Subregional cooperation, a key area of involvement for the Bank, involves encouraging specific, limited linkages of complementary activities across borders to create a region or subregion of economic growth. Economic cooperation can make a subregion, as a whole, relatively more attractive to private investors by extending access to factors of production, production processes, products, and markets beyond national boundaries: it provides wider business opportunities that accelerate development. Since subregional cooperation programs

³ R22-99: Inv. 7152/1669-PRC: *Chengdu Generale des Eaux – Marubeni Waterworks Company Ltd.*, 21 January 1999.
 R84-95: TA 2338-BAN: *Private Sector Implementation of the Megnaghat Power Rural Electrification Project*, 9 May 1995.
 R320-96: TA 2730-PRC: *BOT Changsa Power Project*, 31 December 1996.

often involve “lagging parts” of participating countries, they could potentially provide a vehicle for direct contribution to poverty reduction.

31. In this context, the Bank will concentrate on facilitating investment in subregional infrastructure projects that provide essential means for trade and investment linkages. For investors, such projects represent new types of business opportunities – and new types of risks: their transborder nature requires appropriate mechanisms to support project preparation and financing. The Bank will thus assist in the preparation, financing, and risk management of subregional projects that involve private sector participation⁴.

32. Complementing this, the Bank will continue to play a significant role by helping to address nonphysical barriers to the movement of goods, services, and people. Examples include initiatives related to trade facilitation, investment facilitation, and cross-border training and standards certification and accreditation. This focus will allow the realization of economic benefits from investment in subregional infrastructure, and more broadly, will facilitate subregional economic linkages, integration, and development. In addition, the Bank will facilitate dissemination and exchange of subregional cooperation experience at the policy, program, and project levels.

33. An initiative the Bank is pioneering – partly in response to the challenges of the Asian crisis – involves the development of subregional economic corridors, e.g., Thai-Lao PDR-Viet Nam East-West Economic Corridor in the Greater Mekong Subregion. The corridor integrates physical infrastructure facilities, support for streamlined policies and procedures to minimize nonphysical barriers, and production and trading centers along a geographic corridor, in order to provide accelerated employment and income generation. Such corridors can provide a tangible focus and framework for subregional investment.

34. These four areas of operational focus will be reviewed when the strategy, as a whole, is reviewed after three years of implementation experience.

IV. CHANGE IN THE BANK

A. Organizational Culture, Processes, and Skills

35. For the strategy to be successful, the Bank must make a commitment to change its business philosophy and mindset, processes and procedures, and mix of staff skills. Such internal change and strengthening are at the heart of the strategy because of the new ways in which the Bank must do business.

36. As part of its overarching objective, the Bank must “think poverty reduction” in all its operations. As a means to promoting pro-poor growth that will ultimately achieve the objective of poverty reduction, the Bank will need to institute a systematic review process that will analyze the appropriate role and scope for private sector participation in Bank projects. The feasibility of recognizing in performance reviews the contribution by public sector staff to PSD and by PSO staff to development impacts will be examined.⁵ The Bank will also need to enhance and institutionalize partnerships between public and private sector staff.

⁴ An example of such a subregional project is R189-94: Loan No.1329-LAO: *Theun-Hinboun Hydropower Project*, 14 October 1994.

⁵ To provide incentives for close collaboration, public and private sector staff who cross-refer and/or work together on projects may each need to receive recognition. Such “double accounting” of recognition in staff

1. Changes in Bank Processes and Procedures

37. Country-specific PSD strategies should be made an integral part of the COS to ensure that PSD is explicitly targeted in the Bank's programs. PSO should support the goals of the COS, e.g., greater competition and employment. This integration is possible because the Bank's public and private operations are strategically included under the same charter, management, and institution (unlike the World Bank Group). In this context, PSO may be relevant even in sectors that are not prioritized for public sector operations.⁶ The country assistance plan (CAP) should, at the earliest stages, proactively consider private sector alternatives to prospective public sector projects or parts of these projects.⁷

38. Accordingly, PSD staff (para. 41) as well as private sector specialists will need to work as part of the country teams that are responsible for country-level planning and programming. Additionally, the private sector specialists will need to be included in project teams on a case-by-case basis where their skills are required in processing infrastructure and other projects involving public-private partnerships and public sector projects that have potential for private sector participation. In programming missions, the private sector specialists will provide experience-based inputs to policy dialogue on PSD issues.

39. Developmental impacts and contribution ultimately to poverty reduction by Bank-assisted PSO should be tracked. The impact of the Bank's public sector operations on PSD could also be scored, for example, where public sector loans help to create a policy and/or physical environment conducive to private investment or that generate investment opportunities for the private sector. Two rudimentary "scorecards" are shown in Appendix 7.

40. Approval processes for PSO will need to be more responsive to client needs, and focus on risk assessment and mitigation. A credit committee from among Bank private sector specialists should be set up to exercise responsibility and control over credit risk issues prior to Management and Board approval. Also, Resident Missions will play a greater role in identifying, monitoring, and administering PSO.

2. Staff Skills

41. The strategy will require staff specialized in PSD activity (as distinguished from private sector specialists for PSO). Such skills will constitute the core of an intellectual capacity in the Bank for addressing issues of private sector participation in development (as has been done for social development and environment issues). Such staff could, for instance, identify areas for public-private partnerships, lead dialogue with governments on PSD, review Bank projects for private sector potential, and review government policies vis-à-vis the private sector. The Bank should consider undertaking a private sector assessment of each DMC. Skills relating to regulation and the legal aspects of PSD, especially in utilities, will also be required. Finally, active participation in the programming and project processing activities in the public sector area will require additional time commitment from PSO staff.

performance evaluation has been used in other multilateral development banks and bilateral organizations to support the required teamwork.

⁶ For example, telecommunications may no longer be justified for public sector funding in certain DMCs, but the Bank may have a role to play in catalyzing private investment in telecommunications projects in lesser developed DMCs. This is clearly evidenced by the Grameen Phone Project in Bangladesh, which addresses dimensions of poverty reduction and gender and development, while stimulating domestic entrepreneurship (Box A1.3 in Appendix 1).

⁷ At the Inter-American Development Bank, staff must systematically justify why the private sector is not taking up some of the burden in a public sector project.

B. Operating Principles

42. To implement these fundamental changes required by the strategy, two important operating principles are proposed to guide the delivery of PSD assistance and concentrate the Bank's efforts on where it can contribute best.

43. **“Think PSD” in Public Sector Operations.** This involves governments and the Bank, and entails a disciplined, sequenced examination of private sector alternatives at key stages of a Bank project: (i) at concept clearance, asking whether the private sector can undertake the project without government assistance or, if not, whether a public-private partnership is feasible or whether parts of the project can be undertaken by the private sector; or (ii) after project completion when construction and implementation risks no longer exist, asking whether the private sector can step in by taking over management and/or ownership, partially or wholly, or by refinancing government debt. The new mindset also entails deliberate efforts in public sector operations to achieve improvement in the enabling environment for the private sector and in PSO to provide experience-based inputs to these efforts.

44. **“Think Development Impact” in PSO.** At concept and preparation stages of any PSO, due consideration should be given to maximizing the development impact through employment opportunities, income, cleaner environment, and access to public services; effective competition; and better corporate governance in bankable projects. Demonstrational and catalytic impacts will be important in PSO, and this will be pursued by seeking viable private sector alternatives in projects that can be replicated if successful. This may entail extending the reach of PSO to smaller DMCs.

C. Instruments

45. The Bank will use all the assistance modalities at its disposal for PSD, including public sector project and program lending, TA, PSO, cofinancing, and guarantee schemes. Certain extensions of the limits for existing PSO instruments will be essential. These are indicated below and will be examined in greater detail in the R-paper after taking into account the additional risks, if any, for the Bank.

46. **Equity Investments and Loans.** The Bank has tended to use mainly senior loans and equity investments for its PSO. The Bank will continue to use these instruments as well as others at its disposal (e.g., equity-linked and subordinated loans) based on the needs of its client companies. The Bank will be more proactive in managing its private sector portfolio. This means anticipating problem investments through close monitoring and preemptive actions, and balancing risk exposures through equity divestments, loan sell downs, and debt securitizations. Timely exits from investments, particularly after developmental impacts have been achieved, will also enable the Bank to free up resources for recycling. Currently, the prudential limit on a single project exposure is \$50 million (or 25 percent of total project cost).⁸ With the increase in investment size over the years, particularly of infrastructure projects, it may be appropriate to increase this limit.

47. **Partial Risk Guarantee.** The Bank is yet to provide a partial risk guarantee (PRG). Borrowers have preferred to obtain a direct private sector loan from the Bank rather than avail of a PRG (without government counterguarantee), given that both instruments are subject to a combined limit of \$50 million, which is the same as the limit for a stand-alone direct loan. A

⁸ \$50 million is approximately 0.5 percent of the Bank's paid-in capital and reserves. The limit of the International Finance Corporation (IFC) is 3.0 percent of its paid-in capital and reserves, and the limit of the European Bank for Reconstruction and Development (EBRD) is 5.0 percent.

separate and higher limit is needed for the PRG (without government counterguarantee) to enable the Bank to meet the needs of clients, and to play a more significant role in mitigating sovereign risks associated with infrastructure projects.⁹

48. **Local Currency Financing.** The Bank will aim to develop the local market for long-term debt by issuing or guaranteeing local currency bonds/debt instruments to lengthen maturities and provide interest rate benchmarks. Through this, the Bank could provide long-term local currency financing to reduce currency mismatches (para. 20) on the balance sheet of corporate entities, such as utilities that earn local rather than foreign currency revenues. This could help borrowers avoid foreign exchange risk and enable the Bank to more effectively participate in corporate debt restructuring exercises and support secondary mortgage facilities.

49. **TA Funds for Project Development.** For the Bank to extend the reach of its PSO to smaller countries and newer sectors, it has to enhance its capability to develop projects. TA resources are proposed for developing private sector projects, particularly development of SMEs and microenterprises.

V. IMPLEMENTING THE STRATEGY: ACTION PLAN FOR THE YEAR 2000

A. Increasing Awareness of the Strategy

50. To increase awareness of the strategy,
- (i) staff instructions will be issued to draw attention to the strategic thrusts and the four areas of operational focus of PSD;
 - (ii) Bankwide seminars will be conducted to increase staff awareness of the strategy;
 - (iii) strategic thrusts, operational focus, and operating principles will be codified and disseminated to staff through the Operations Manual/Staff Instructions; and
 - (iv) external Bank seminars will be organized to promote dialogue among key representatives of the private sector on specific new opportunities for private sector contribution to development and poverty reduction in Asia.

B. Integrating Public and Private Sector Operations

51. To integrate operations,
- (i) country-specific PSD strategies will be made a part of the COSs and CAPs;
 - (ii) PSD specialists will take a lead role in preparing and implementing a PSD strategy for each DMC;
 - (iii) during public sector project processing, staff will be expected to consider the prospects of private sector participation from concept stage;
 - (iv) a core of staff will be brought on board to work exclusively on PSD, with interface functions between public and private sector operations of the Bank; and
 - (v) a high-level consultative corporate advisory council will be established to provide information and feedback on PSD and act as a forum for exchanging PSD ideas.

⁹ At the Inter-American Development Bank (IDB), the single project limit for the PRG (without sovereign counterguarantee) has recently been set at \$150 million or 50 percent, whichever is less. This is double the IDB's limit for a direct loan of \$75 million or 25 percent of project cost, whichever is less.

C. The R-Paper for the Strategy

52. The following items are proposed for review in the R-paper,
- (i) PSO approval processes, to make them more responsive to client needs;
 - (ii) raising the prudential limit for a single PSO from the current figure of \$50 million;
 - (iii) establishing a separate and higher prudential limit for a PRG without government counterguarantee;
 - (iv) creation of a staff credit committee, to be responsible for credit risk issues;
 - (v) local currency financing, to define the scope and modus operandi of local currency resource mobilization and financing by the Bank; and
 - (vi) introducing TA, including regional TA, in PSO.

D. Review for PSD

53. The strategy will be reviewed after three years of implementation experience.

APPENDIXES

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TAKING STOCK OF BANK ASSISTANCE FOR PRIVATE SECTOR DEVELOPMENT

A. Assistance through Bank Public Sector Operations

1. Credit Lines

1. Traditionally, the Bank's assistance for private sector development has been through its public sector operations. Through Article 14(i) of the Bank's Charter,¹ the Bank has been extending credit lines to selected state-owned and private financial intermediaries of its developing member countries (DMCs) through the government or with government guarantees specifically to support investments in productive private small- and medium-sized enterprises (SMEs). The credit lines were a quick and cost-effective mode of Bank assistance to these private enterprises, which otherwise may not have had any access to foreign exchange needed for investment. The Bank has approved 110 credit lines totaling about \$4.4 billion for use by 65 intermediaries in 23 DMCs. These have benefited over 22,000 SMEs.

2. Experience with these operations was varied. Several Bank-assisted development finance institutions (DFIs) have developed into profitable, mature, strong, and diversified institutions that play important roles in their countries' economic progress. These include, for instance: China Development Corporation (Taipei, China); ICICI Ltd.; Korea Development Bank; Korea Long-Term Credit Bank; Development Bank of Singapore and Industrial Finance Corporation of Thailand. In contrast, several other DFIs, particularly state-owned ones, have encountered major problems that have resulted from the following causes: excessive state control and regulation of their lending policies and operations; directed lending to specified enterprises or target groups; major changes in official trade and investment policies affecting client performance; substantial depreciation of the local currencies resulting in large exchange losses that destabilize clients and, in turn, the intermediaries' own stability; inadequate capitalization that cannot withstand substantial portfolio losses; inefficiencies arising from lack of competitive motivation and institutional weaknesses; and lack of effective prudential oversight and failure to develop alternative sources of longer term funding. Several DFIs became virtually bankrupt. To keep ailing DFIs afloat, some governments have continued to sustain them with subsidized funding, straining limited budgetary resources. The credit line operations clearly show that the Bank's focus on the intermediaries alone would not ensure success of the operations. Success depends to a large extent on the policy, legal, and regulatory environment in which the intermediaries function. Even strong and mature institutions may fail if the environment is not conducive to their performance. The focus in these operations is, therefore, increasingly on the prevailing financial sector environment and wider institutional policies as much as on the soundness and suitability of the intermediaries chosen to channel Bank funds.

3. Historically, the focus in these operations was largely on state-owned DFIs. Since the 1990s, a number of private financial intermediaries (including commercial banks and leasing companies) have been used to channel Bank funds under umbrella credit lines. This has led to expeditious and competitive use of Bank funds. Credit line operations have also helped (i) the Bank contribute to institutional enhancement, capacity building, and human resource development in the financial sector; and (ii) reinforce the Bank's policy dialogue with DMC authorities on financial sector reforms and capital market development issues.

¹ Asian Development Bank. 1995. *Agreement Establishing the Asian Development Bank*. Article 4, para. 1.

2. Enabling Environment

4. A range of Bank assistance has focused on improving the policy, legal, institutional, and regulatory environment of the private sector in DMCs. It has been provided through Bank-financed TA and policy dialogue with DMC authorities, and (since 1987) through program lending to encourage and assist DMCs in formulating and implementing reforms that promote private sector development by removing market distortions, strengthening domestic financial markets, and promoting good governance standards. Through such program loans the Bank has supported legal, policy, and other reforms in finance (in India, Indonesia, Lao People's Democratic Republic [Lao PDR], Thailand, Sri Lanka, and Viet Nam); agriculture (in Bangladesh, Lao PDR, Nepal, Pakistan, Papua New Guinea, Philippines, Sri Lanka, and Western Samoa); industry (in Bangladesh, Mongolia, Nepal, and Pakistan); hydrocarbon (in India); trade (in Indonesia); and road transport (in the Philippines).

3. Physical Infrastructure

5. In the 1990s, the Bank began to address the weaknesses of public sector agencies. These weaknesses appeared to be rooted in the structural characteristics of public ownership, a persisting obstacle to improving sector management in the 1980s. Growing recognition was being given to the possibility of introducing competition into the management of sectors that had appeared to constitute natural monopolies, and this competition could lower costs despite the economies of scale that appeared to support monopoly structures. Privatization of state-owned enterprises (SOEs) in the physical infrastructure sectors became a principal objective of the Bank. In DMCs with underdeveloped markets or constraints derived from their political economies, corporatization of public enterprises became an alternative means of improving the efficiency of sector management.

6. Bank efforts in supporting the Philippines to install new power generating capacity through the private sector have been hugely successful, ending the brownouts that had been the main obstacle to the Philippines' efforts to improve its investment environment. The thrusts of Bank efforts in privatization have been substantially on the commercialization of publicly-owned utilities, with notable success in Indonesia, the People's Republic of China (PRC), the Philippines, Sri Lanka, and Thailand, and with ongoing efforts with good potential for success in India, Lao PDR and Viet Nam. An important lesson learned is that powerful vested interests frequently seek to subvert privatization to their own ends; transparency and competitive bidding are key elements of sound privatization, but are not easily secured.

7. The Bank has also supported efforts of several DMCs to pursue an integrated approach to transport development, with a focus on the road subsector. The Bank has assisted DMCs in the privatization of the road subsector management through road construction and maintenance and through tollways, which are commercially viable only on a few road sections in several DMCs. The Bank has made successful progress on road construction and maintenance in nearly all the DMCs in which it has been active in the sector. The Bank has further improved sector management by transferring it from government line ministries to autonomous road authorities. The Bank continues to seek ways to improve the funding of road construction and maintenance – a key issue – as revenues generated through vehicle and fuel taxes are significant, but tend to accrue to the budget rather than to the sector.

4. Financial Sector

8. In parallel, recognition was also being given to the fact that if energy and physical infrastructure are properly priced, they can be self-financing in their capacity to generate capital and to service debt, and do not need to be financed by government. This strengthened the need to develop strong markets to support the financing requirements of private sector-led growth. With this aim, the Bank shifted its financial sector operations from a narrow focus on the resource needs of DFIs, to a broader effort of developing financial and capital markets in DMCs. In support of this second objective of developing DMC financial markets, the Bank undertook the following range of activities: recourse to market pricing for the cost of funds, and introducing competition among lenders to reduce these costs; decontrol of lending to allow funds to move to activities offering the highest returns; introduction of market-based funding of public sector borrowings; widening the range of instruments mediating between savers and borrowers; strengthening public supervision of deregulated markets; and improving DMC access to global markets. Primarily through program lending, the Bank has made good, but partial, progress in this area in India, Pakistan, the Philippines and Sri Lanka.

5. Trade and Investment

9. Cognizant of the stage of development of its DMCs, and the fact that most DMCs had weak markets overshadowed by public interference offering poor incentives to private investors, a third objective of the Bank became the creation of an enabling environment for private investment. The Bank provided support in the areas of stable macroeconomic management; investment, trade, and price decontrol; functioning financial and capital markets and flexible labor markets; good infrastructure; and a legal system protecting and enforcing contractual and property rights. Solid, but partial, progress has been made in the area of enabling frameworks by most Bank DMCs. With program lending playing a key role, investment deregulation has been the area of greatest success, as DMCs have opened up closed sectors to private and foreign investment. Bank support played a role in India, Lao PDR, Nepal, Pakistan, the Philippines and Viet Nam, where prices were partially decontrolled. Although the Bank did not explicitly undertake labor reforms, its efforts to reform public enterprises and deregulate investment supported, indirectly, the introduction of flexibility in labor markets. The Bank has also provided assistance in legal system reform.

6. Agriculture Sector

10. An important part of the Bank's agenda in the 1990s also became the commercialization of agricultural production, as most Bank DMCs were subject to heavy public intervention in the sector during the 1970s-1980s. These interventions consisted of support prices and input subsidies for producers, and price controls on items consumed by the poor. In most DMCs, the balance of subsidies provided adequate production incentives, which combined with technological innovation, led to Asia's green revolution. Poverty reduction provided the rationale to redistribute through subsidies. But, what resulted were distorted incentives, misallocated resources, escalating fiscal deficits, and the dead weight of the public bureaucracies. The Bank has attempted to undo this by providing assistance in the dismantling of complex state interventions to allow markets to determine input and output prices; opening the market for agricultural produce and input supply to the private sector; and developing rural infrastructure with a substantial focus on farm-to-market roads, rather than input supply. The Bank also promoted wider participation by beneficiaries, non-government organizations (NGOs), and the private sector in the design and implementation of Bank projects.

11. A complementary objective in commercializing the agriculture sector was to reduce or reform the role of public agencies. The Bank provided support in eliminating the public sector's role in the marketing of inputs and outputs in favor of the private sector, and assisted in transferring the management of on-field irrigation systems to farmer groups. Given the weak markets inhibiting the private supply of rural credit, extension, and research, the Bank strengthened public capacity in the delivery of these support services and in the management of irrigation and natural resources.

12. The most notable impacts in the commercialization of the agriculture sector were made in the transition economies in Indochina and the Central Asian Republics (CARs), and in Bangladesh. Through program lending, which has influenced policy changes, the Bank helped to induce impressive increases in output and productivity in Bangladesh since 1992. Bank program and project loans that have supplemented IMF-supported interest rate, exchange rate and pricing reforms, have helped Lao PDR and Viet Nam to install sector policies that have reversed years of stagnating agricultural output and increased rural incomes. Program loans have also begun to facilitate the CARs in their transition from collective to private farming, and privatization of plantations has made good progress in Sri Lanka.

13. The Bank's record in improving the delivery of support services has been mixed. Its support for agricultural research in international agencies and in DMCs has generated high returns in terms of developing new technologies and applying them on the ground. However, its record on improving rural credit has been poor, with the exception of micro-credit, which is a relatively newer initiative that has shown good initial results and holds promising potential, particularly in its role towards the development of women. This is due, in large part, to the weak performance of agencies the Bank supports in the management of irrigation, forestry and fisheries rooted in the structural characteristics of public management and negligible budget support.

7. Social Infrastructure Sector

14. The Bank has been partly successful in improving the management capacity of public agencies entrusted with the delivery of health and education. Where feasible, management has been entrusted to beneficiaries and NGOs, or contracted out to the private sector, (e.g., maintenance of vehicles, construction, or accounting and billing). However, as the actual delivery of health and education services remains in the public sector, the Bank has provided significant amounts of capacity building, principally through training, for addressing weaknesses in delivery. The Bank is increasingly providing support to DMCs through program and project loans to assist them in shifting budget funds from sectors that are self-financing, such as physical infrastructure, to those that are not, primarily health and education.

15. In urban development, the Bank has shifted from discrete financing of urban water supply systems to a more integrated approach encompassing the financing and management of urban development. This has included: delineating boundaries between urban and provincial or national authorities so as to separate responsibilities and establish accountabilities; financing frameworks that facilitate revenue collection, revenue sharing, and cost recovery, and allow the development of borrowing capacity and self-financing municipal budgets; contracting out of municipal services and privatization where possible (e.g., Bank-supported privatization of Manila and Colombo water supply); and capacity building of municipal bodies. These issues have recently become part of Bank policy agenda in the mid-1990s.

8. Post-crisis Assistance

16. Following the Asian financial crisis the Bank has taken significant measures to help its crisis-affected DMCs. In 1998, in order to help Indonesia strengthen its financial sector and assure a sustainable flow of resources to the private sector, the Bank approved a \$1.5 billion loan to support reforms of governance in the financial sector to assist in the restructuring of the sector, and to restore its ability to effectively mobilize and efficiently allocate resources for investment. With physical infrastructure bottlenecks constraining growth, the Bank has been assisting DMC governments to encourage private sector participation in the provision of physical infrastructure services. The Bank approved a \$300 million loan to the government of the Philippines for a power sector restructuring and privatization program, designed to transfer ownership of power generation to the private sector.

17. The Bank has also been utilizing technical assistance (TA) to assist DMC governments to identify the scope for private sector participation in infrastructure development, and to formulate appropriate policy and regulatory frameworks to facilitate private investment. In 1998, the Bank approved a TA for the study of private sector participation in gas transmission in Bangladesh, and port development in the Maldives. The Bank also funded a study, completed in 1998, in the road subsector in the PRC that concluded that although construction risk is best left to the public sector, once traffic volume increases to a sufficient level, leasing or securitization is a feasible option for mobilizing private capital for the transport sector.

9. Catalyst for Information

18. The Bank has played a pivotal role as an intermediary and catalyst of information flows. The Bank sponsored a regional workshop in Manila in December 1998 that brought together government officials, bankers, and private sector developers to discuss best practices for promoting private investment in power, ports, airports, expressways, and water supply development.

10. Regional and Subregional Cooperation

19. The Bank has played a significant role in the emergence of several initiatives aimed at regional cooperation. It nurtured and sustained the effort, launched in 1992, of six countries in the Greater Mekong Subregion to develop norms of cooperation that have now reached the level of preparation of specific subregional projects in transport and energy, with the participation of the private sector. Two other subregional groupings (Indonesia-Malaysia-Thailand and Brunei-Indonesia-Malaysia-Philippines) have requested Bank assistance in the preparation of subregional growth centers. More recently, the South Asia Growth Quadrangle (Bangladesh, Bhutan, India, and Nepal) has asked for Bank assistance, and the Bank has already undertaken a similar initiative in the CARs.

11. Good Governance

20. Although the Bank formally adopted good governance as a development objective only in 1995, sector level governance interventions have formed part of its operations since its inception. These have focused mainly on the governance dimensions of private sector development and public sector reform, but good governance comprises key elements that cut across sectors and require a macro framework approach: public administration, public finance management, subnational governance, and development of sound judicial and audit frameworks. In the past two years, the Bank has initiated work in all these areas in several

DMCs, and will continue to do so, with the additional element of improving information technology.

12. Lessons Learned

21. First, a lesson learned under credit lines, both in relation to the financial intermediaries and the assisted private enterprises, is that the right policy, legal, and regulatory environment, and good governance are vital for their effective functioning. While the Bank did assist DMCs in addressing the enabling environment, the Asian crisis has proven that further concerted efforts are required by DMCs and, in turn the Bank. Hence, this underlies the Bank's rationale in reducing its DFI lending in the 1990s, as most DFIs were inextricably linked to public interference in resource allocation. Bank support for employment-generating investment has shifted to creating an enabling environment for market-based financing, rather than directly providing investment funds, in order to promote more inclusive and sustainable growth towards the ultimate goal of poverty reduction.

22. The rise in economic growth rates in Asia, up to the financial crisis, was the most important event of the 1990s. The market-driven and private sector-oriented framework that enabled this transformation was mostly put in place by the DMCs themselves. However, many DMCs turned to the Bank for assistance, notably in South Asia, the transition economies and the Philippines, and in these cases the Bank can claim credit for its successful efforts in this area. The Bank's efforts in the Pacific DMCs were less fruitful, as structural constraints remain difficult to overcome in these small states. Bank assistance has shifted to improved aid coordination, rather than additional aid, in the Pacific DMCs, with a focus on supporting policy frameworks and private investment.

23. The Bank has followed several tracks in its approach to poverty reduction. The first was to consider how to relate growth-oriented projects. Growth is the single most important contributor to poverty reduction; increasing employment and access for the poor to productive resources are recognized tools to this end. However, a second lesson learned is that growth in the DMCs must be labor-intensive. One of the most crucial comparative advantages of the Bank's DMCs lie in their inexpensive labor force, and policies that have facilitated labor-intensive production, rather than capital-intensive, have been the key to generating real employment, typically in industrial and service SMEs and through foreign direct investment (FDI). The Bank is keeping these lessons in mind and bringing them to bear in establishing links between its growth, led by the private sector, and poverty reduction objectives.

24. Finally, a third lesson learned is that the Bank's public and private sector windows should have worked more closely together to increase benefits to the DMCs, and optimize development impacts. Public sector assistance should have paid more systematic attention to private sector interests and concerns. The Bank will draw on this experience in reviewing its approach to private sector development.

B. Assistance through Bank Private Sector Operations

25. The Charter of the Bank contemplates the role of the Bank's private sector operations (PSO) in the region's development. It specifies that one of the Bank's functions is to promote investment of private capital in the region for development purposes [Article 2(i)]. The Charter also empowers the Bank to provide loans without government guarantees, make equity investments, as well as facilitate financing to private institutions or enterprises operating in its DMCs [Article 11 and 15(2)]. Initially, however, the Bank adopted an indirect approach to financing the private sector by providing public sector loans to DFIs for on-lending to SMEs.

26. Not until 1983 did the Bank make its first equity investment; its first loan without any government guarantee was provided in 1986. Since then, the Bank through PSO has facilitated \$15 billion of investment commitment for development, reflecting steady albeit somewhat unfocused growth until March 1995, when the Board approved the Bank's current operational strategy for PSO.² This strategy requires a country focus in project selection and accords high priority to two sectors: (i) infrastructure, and (ii) financial sector and capital markets, including funds. In exceptional cases, industrial, agricultural, and other projects may be considered for PSO if consistent with the Bank's operational strategy in the host DMC.

27. The responsibility to implement the current PSO strategy was assigned to the Private Sector Group (PSG), a large single division created to consolidate PSO during the Bank's reorganization in January 1995.³ Two years of full organizational integration of public and private sector operations had failed to yield the expected volumes of private sector projects. PSG took over PSO from the public sector projects departments and from the former Private Sector Department, then responsible for a part of PSO and public sector operations related to DFIs, financial sector, capital markets, and industry. At present, PSG is responsible for processing and administering private sector projects, and has a critical mass of project finance and risk management expertise in the Bank.

1. Experience with the Existing Strategy for PSO

28. During the past four years, PSG was able to generate investment projects that met country-specific development needs in its priority sectors in accordance with the 1995 strategy for PSO. In these projects, it has been shown that the Bank has been catalytic (leveraging the Bank's financial resources by attracting other investors and lenders) and additional (not substituting for commercial sources of finance). PSG's approved projects in the financial sector and capital markets, in particular, not only dovetailed with the relevant country strategies and programs but also complemented the public sector operations in the concerned countries. For instance, in the PRC, the Bank took an equity position in one of the six newly established commercial banks with a nationwide presence, to complement a government-guaranteed loan from the Bank. The investment in the PRC bank was the first foreign investment in a local state-owned commercial bank. It supports the Bank's strategic plan to transform itself into a shareholding bank grounded on "best practice" principles. Another important intervention of the Bank in the Indian financial sector is its equity investment in an infrastructure finance company which helped attract other international investors and gave the Bank the opportunity to leverage its limited resources for financing private sector infrastructure projects in India. An unguaranteed loan to the development bank in Sri Lanka was combined with a syndicated loan that gave the bank funding access to international banks and provided resources for onlending to SMEs in Sri Lanka. The syndicated loan is covered by a partial credit guarantee provided by the Bank against a counterguarantee from the Government of Sri Lanka.

29. PSG's approved BOO/BOT projects reflect the priority accorded under the 1995 strategy to helping address infrastructure bottlenecks in the DMCs. The catalytic effect of the Bank's direct participation in these projects was essential to attract participation from other foreign lenders and investors. Included among these infrastructure projects are a gas-fired power plant in Pakistan, a hydropower project in Nepal, a coal-fired power plant in PRC, a cellular telephone project in Bangladesh, a water supply project in the PRC, and a port project in Sri Lanka. These

² R56-95, *Strategy for the Bank's Assistance for Private Sector Development*, 9 March 1995.

³ R188-94, *Revision 1: Reorganization of the Bank*, 17 November 1994.

projects have given PSG hands-on experience across a broad range of subsectors in infrastructure.

30. PSG has tended to concentrate Bank financing assistance on greenfield projects. Follow-on financing to support expansions has been avoided in the belief that the Bank can play a more definite catalytic role in start-up situations. However, the damage created by the Asian financial crisis on the corporate sector requires the Bank to provide refinancing and/or restructuring support to bring distressed assets back to productive use.

2. Development Impact of Bank-Assisted Private Sector Projects

31. The Bank's direct assistance to private sector projects has always been justified, among others, on the basis of the projects' expected development impacts. A staff study was recently conducted to examine the actual development impact achieved with a sample of these projects. The study was based on a detailed review of Project Completion Review reports (PCR) and Project Performance Appraisal Reports (PPAR) on 21 projects in seven DMCs, representing 24 percent of the investment and 32 percent of the outstanding exposures in the PSG portfolio as of 31 December 1998. The sample consisted of 11 non-financial sector projects (6 infrastructure and 5 manufacturing) and 10 financial sector companies.

32. Certain criteria for assessing the developmental impacts of PSO have been compiled from many sources, including other multilateral development banks (MDBs), and used to assess the development impact of private sector projects assisted by the Bank. The criteria, which are not necessarily exhaustive since other criteria can be added depending on private sector projects being assessed, include

(i) general development impact

- (a) promotion of private sector,
- (b) demonstration impact, and
- (c) catalytic impact;

(ii) non-financial sector

- (a) direct effects:
 - i. new and incremental employment directly generated,
 - ii. foreign exchange earned or saved,
 - iii. investment in human capital,
 - iv. additional funds mobilized, and
 - v. contribution to economic growth;
- (b) indirect effects:
 - (i) upstream and downstream linkages,
 - (ii) technology transfer, and
 - (iii) poverty alleviation and social development;

(iii) financial sector

- (a) broadening of financial options,
- (b) availability of foreign currency funds,
- (c) increased resource mobilization, and
- (d) capital market development.

33. Based on the review of the project documents against the measurement criteria developed, all projects were found to have generated positive contributions to development, in varying degrees. The study also identified other indirect development impacts of the Bank-assisted private sector projects. For example, the textile mill projects encouraged the development of many downstream businesses such as carpet making, handmade bag manufacturing and garment factories. Additional employment and attendant benefits of higher income levels and improved living standards have been positive. Similarly, the infrastructure projects helped increased aggregate output as the industrial sector was no longer hampered by inadequacies of power supplies, port and transportation facilities, and telecommunication services. A power project in the Philippines and a fertilizer project in Pakistan had clear social benefits to the community where the plants were located.

34. The catalytic role of the Bank's private sector operations was demonstrated most significantly in the sampled infrastructure projects. For instance, power interruptions were a common feature in the Philippines due to the inadequate power supplies, resulting in significant loss to the economy. Investments in new power facilities were clearly needed, but the government lacked funds. The Bank's participation played a crucial role in mobilizing funds for the project, and boosted investor confidence. The same confidence boosting impact was also true in the case of Philippine Long Distance Telephone Company (PLDT) in the telecommunications sector, when the conditions at that time prevented PLDT from accessing traditionally available financing. The Bank's participation was instrumental in providing long-term financing that led to the expansion of telecommunication services in the Philippines.

35. In the financial sector, the Bank's active intervention was also deemed critical to the establishment of National Development Leasing Co. (NDLC), the first leasing company in Pakistan. Bank involvement was judged a major milestone since it happened at a time when new modalities of financing capital goods, consistent with the requirements of an Islamic financial system, were being sought in Pakistan. Its subsequent involvement in several leasing companies enabled a continuing policy dialogue that eventually led to the approval of nonbanking finance companies to issue various types of financial instruments for the mobilization of funds. Many leasing companies have since been formed and the leasing industry firmly established in the country.

36. Another recent study by staff examined closely the Bank's investments in funds. The study was intended to assess the development impact of these funds and to identify key lessons learned. Based on a review of 29 funds since 1983 totaling \$3.4 billion in investor commitments, of which the Bank's share is \$245 million, the study found that the funds portfolio achieved an acceptable level of profitability, yielding an estimated financial internal rate of return (FIRR) of 6 percent per annum. The development impacts of these funds included: (i) positive development of individual subprojects; (ii) mobilization of long-term risk capital to sectors in need of such capital; (iii) increase in liquidity of capital markets; and (iv) development of the fund management industry. The positive developmental impact of specific subprojects and the direction of long-term capital to specific sectors are best illustrated by the private equity funds and venture capital funds supported by the Bank. These funds typically support a limited number of specific projects and companies. Some of the focused funds played a key role in the implementation of major infrastructure projects, and supported private sector companies which have since become leaders or flagship companies in key economic sectors of the Bank's DMCs.

37. The Bank has also supported funds that invest mainly in listed stocks. Such funds play a pivotal role in capital market development as they provide expertise in pricing and analysis that

retail investors may lack, especially in emerging stock markets. Such funds enhance liquidity and help the markets perform more efficiently. Mutual funds facilitate the mobilization of scarce domestic capital in the DMCs. All the funds supported by the Bank contribute to the growth of the fund management industry, through the establishment of investment management companies and training of fund managers. This is an important transfer of know-how to DMCs, the effect of which outlasts individual funds supported by the Bank. The Bank, through PSO, has also supported a variety of consulting studies on investment funds, in coordination with its investment program, aimed at developing local capital markets.

38. The findings of the foregoing studies clearly substantiate the widely held view that private sector projects assisted by the Bank have significant development impact. Three cases illustrating in detail such development impact are presented in Boxes A1.1, A1.2, and A1.3.

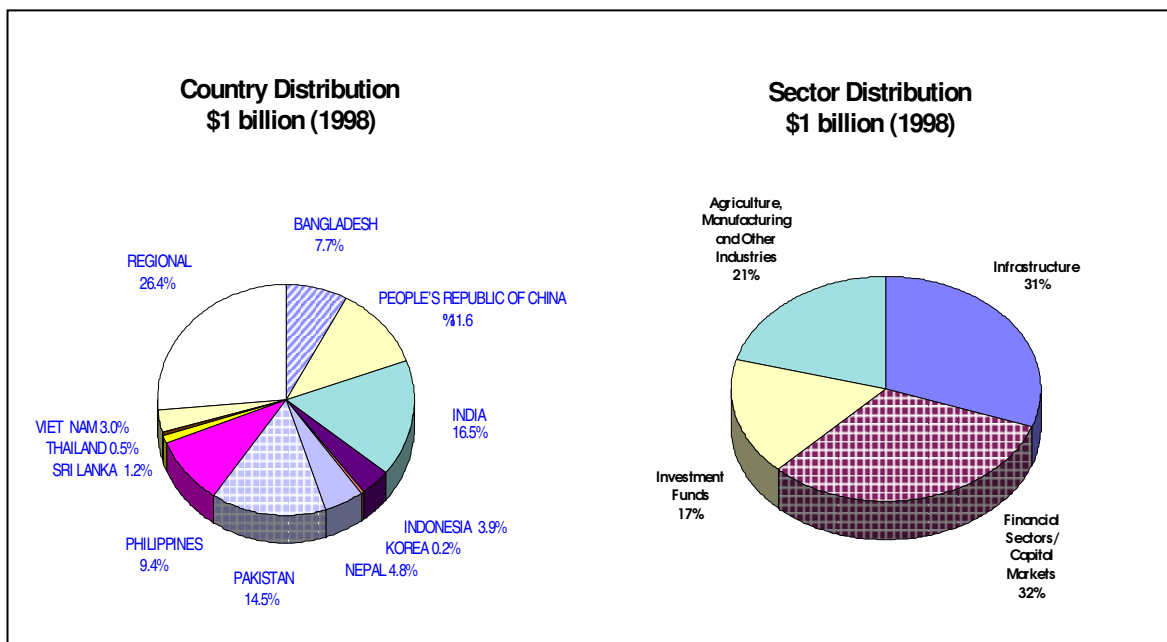
3. Operational and Financial Performance

a. Project Approvals

39. Since the start of PSO in 1983, the Bank has so far approved 130 private sector projects involving \$1.7 billion of Bank funding and \$13 billion of funding commitments from other sources. This represents an average funding leverage of close to eight times on the Bank's own funds.

40. Private sector projects have been undertaken in 13 DMCs. In addition to country-specific investments, there have been 14 regional projects, mostly funds. Due to the need to be cost effective in project processing and administration, there has lately been a tendency to focus on larger projects. The average cost of private sector projects assisted by the Bank has increased from \$81 million during 1983-1994 to about \$250 million in the more recent years. This has led to a concentration of PSO in larger DMCs where larger projects are more readily undertaken. Thus, fully 60 percent of the private sector portfolio at present is accounted for by five relatively large countries: viz., PRC, India, Indonesia, Pakistan, and Philippines (Figure 1).

Figure A1: Country and Sector Distribution of PSO Portfolio



Source: The Bank's Quarterly Report on Private Sector Operations for the Quarter Ended 31 December 1998.

41. Extending the reach to countries such as CARs, Pacific DMCs and other smaller DMCs (such as Bhutan and Lao PDR) continues to be a challenge but can be brought about through additional resources or in partnership with other international financial institutions that are active in these countries, with a view to undertaking joint due diligence and other activities. Extending country reach has to be pragmatic, i.e., guided by specific opportunities in particular countries and should be facilitated through PSG's closer alignment with the formulation of the Bank's country operational strategies.

42. PSO's sector focus on infrastructure and financial markets (Figure 1), while consistent with the strategy implemented since 1995, falls short of meeting the medium-term needs of the DMCs. In transition economies, there is a need to support SMEs as they are capable of absorbing surplus labor from SOEs and help facilitate the restructuring of the state sector. Post-crisis, SMEs can absorb labor from the harder hit large companies. Microenterprises also offer a potential for poverty reduction, the Bank's overarching objective. Social sectors, specifically education and health, need private sector financing as the public sector is not capable of fully meeting the demands in the education and health sector, and should concentrate on the "nonbankable" parts of the health and education system. These are sectors that will need the attention of PSO in the future.

43. The Bank's commitment to PSO in terms of annual approval targets is relatively low compared to that of the other MDBs primarily because other MDBs have made a conscious decision in their strategy to increase their direct support for the private sector (Table A1.1).

Table A1.1: Comparison of MDBs' Private Sector Operations

MDB	% Annual Approvals for the Private Sector as % of Total Lending
The Bank	3
IDB	6
WB Group (with IFC)	10
EBRD	60

Source: Interviews with and/or 1998 financial statements of the MDB concerned.

EBRD – European Bank for Reconstruction and Development

IDB – Inter-American Development Bank

IFC – International Finance Corporation

WB – World Bank

44. The Bank has achieved a high 40 percent disbursement ratio⁴ average during the last five years in PSO, compared to only 17 percent in public sector operations. This is partly because equity investments generally disburse faster than other Bank activities and partly because private sector projects are more efficiently and quickly implemented than public sector projects.

⁴ Disbursement ratio is defined as the ratio of disbursement over the undisbursed net loan/equity balance less cancellations.

b. Portfolio Composition and Quality

45. Currently the private sector portfolio consists of 99 projects totaling \$1.070 billion (as of 30 June 1999) in outstanding investments and undisbursed commitments. The total outstanding

portfolio is \$670 million, comprising \$434 million of loans (65 percent) and \$236 million in equity investments (35 percent). The Bank's outstanding portfolio is heavily weighted toward equity, whereas the equity investments of the International Finance Corporation (IFC) amount to only 23 percent of its portfolio. This was a result of a conscious decision by the Bank's Management to increase equity investments in anticipation of significant capital gains based on experience prior to the Asian financial crisis. Given that equity investments are mostly in the local currency of the host DMCs, they were inherently vulnerable to exchange rate fluctuations. The depreciation of the local currencies as a result of the crisis adversely affected the value of the Bank's equity portfolio as that of other investors in the region. For example, IFC's profitability dropped by 43 percent in 1998, despite a lower equity exposure and having a globally diversified portfolio. IFC's loss in 1998 was mainly due to the Asian crisis.

46. Under the Bank's risk rating system for private sector projects, 16.7 percent of the outstanding portfolio is rated as unlikely (under the "doubtful" or "loss" categories). This is fully covered by loss provisions amounting to 20.8 percent of the outstanding portfolio.

47. Most of the problem projects in the private sector portfolio are old investments made prior to the 1995 strategy. These investments are mostly in manufacturing and agro-processing which are now low priority for PSO. The Bank learned valuable lessons from these projects. Loan delinquencies and implementation difficulties tend to be associated with relatively weak sponsorship and poor corporate governance practices. Success is better assured if a project has (i) sponsors who have the financial and operational capability to implement the project; (ii) a competent management team with corporate governance structures that ensure accountability; (iii) the size that can benefit from economies of scale; and (iv) financial sustainability independent of tariff protection and subsidies. These factors are now critically examined in the evaluation of all new projects.

c. Profitability

48. It is difficult to accurately measure profitability of the Bank's portfolio of private sector investments because assumptions need to be made about key variables. For example, fund costs cannot be accurately determined as funding has been allocated from the pool of Bank's ordinary capital resources. To estimate PSG's operations profitably, an imputed interest cost is calculated, based on an assumed debt-to-equity ratio on the liability side. Based on such assumptions, a notional income statement of PSO is prepared periodically. The one for 1998 is given in Table A1.2.

Table A1.2: Notional Income Statement of PSO, 1998 (\$ million)

	1998
Income: From Loans	30.5
From Equity Investments	<u>21.7</u>
Total Income	52.2
Expenses: Direct Expenses	4.2
Imputed Interest	4.5
Other Expenses	<u>2.2</u>
Total Expenses	<u>10.9</u>
Net Income before Provision	41.3
Provision for Possible Losses	<u>38.4</u>
Pro-Forma Net Income	2.9

Source: The Bank's Management Financial Report on Private Sector Operations, 31 December 1998.

Note: The effect of AFIC's losses was excluded from the above calculation.

49. PSO has to generate profits, consistent with the expectation of the Bank in order to (i) sustain operations without cross-subsidy from the other activities of the Bank; and (ii) to demonstrate the financial viability of investments in the private sector to commercial lenders and investors.

4. Lessons Learned from PSO

50. Several lessons were learned from the Bank's past experience with PSO in the financial, infrastructure, and manufacturing sectors. These lessons are now being taken into account in the selection, preparation and appraisal of prospective private sector projects for Bank assistance.

1. Financial Sector Projects, including Funds

- (i) Successful operation of investee banks and financial institutions depends on the existence of a conducive policy environment.
- (ii) A sound corporate governance structure could help maintain, or at least monitor, the integrity of management of investee institutions.
- (iii) Guidelines to ensure against sectoral concentration of subprojects in financial sector projects must be established to ensure diversification.
- (iv) Selection of experienced fund managers is key to ensuring fund performance.
- (v) Fund supervision should be built into the fund management's structure at inception.
- (vi) Pre-operating expenses should be controlled to prevent adverse financial performance prior to the start of fund operations.
- (vii) Flexibility should be considered in the timing of investments and managing pre-set guidelines to enable managers to balance targeted returns on capital with completion risk.
- (viii) Disclosure procedures should be established for related-party transactions to ensure transparency.
- (ix) Periodic valuation of fund investments should be performed independently.

- (x) Bank staff should be active in monitoring investee funds.
- (xi) Fund managers should be tapped to develop projects that promote private sector development and as leverage in the Bank's policy dialogue with DMCs.

2. Infrastructure and Other Non-Financial Projects

- (i) Success is better ensured if a project has sponsors who have the operational and financial capability to implement the project.
- (ii) Accountability can be ensured through competent management teams and corporate governance structures.
- (iii) Larger size projects may benefit from economies of scale, making it less vulnerable to economic and financial difficulties.
- (iv) An appropriate project design is essential to the eventual success of the project.
- (v) The project appraisal process ought to be strengthened and needs to include a thorough review of market assumptions, including the project's resiliency to adapt to changing market conditions.
- (vi) There is a need by project companies to develop an appropriate hedging mechanism to mitigate against adverse consequences of foreign exchange rate volatility.
- (vii) Transparency makes projects cost-efficient and less vulnerable to criticism.
- (viii) A well established regulatory framework to mitigate political and commercial risks is essential to the project's viability and sustainability.
- (ix) The Bank must ensure that returns on private power generation projects are reasonable, that power is produced at the least possible cost, and that it is delivered to the consumers at affordable rates.

Box A1.1: Pacven Investment Limited (PIL)

The Bank through PSO has played a pivotal role in the development of the venture capital industry in Asia. Cognizant of the shortage of risk capital available to innovative small and medium-sized enterprises in many DMCs, the Bank started developing venture capital funds as a key component of its overall operations in investment funds. It commissioned a regional study on venture capital financing in 1985 and sponsored a symposium in Bangkok in 1988 to disseminate the study's findings and promote venture capital activities. Pacven Investment Limited was an outcome of such promotional efforts.

PIL was a regional venture capital fund incorporated in Singapore. The objective in establishing PIL was to catalyze a regional approach to institutional venture capital. PIL's primary focus was on the Association of South East Asian Nations (ASEAN) which was in urgent need of risk capital, for promoting new entrepreneurs in the export sector. PIL helped foster the growth of innovative small and medium-sized enterprises and provided valuable venture capital management expertise to ASEAN countries.

PIL fulfilled its main objective of mobilizing risk capital. It succeeded in raising S\$59 million compared with the original target of S\$40 million. It invested in 36 companies in Asia and the Pacific and achieved good portfolio quality. As of 31 December 1998, 14 companies in National Association of Securities Dealers Automated Quotations (NASDAQ) yielded exceptional returns on PIL's investment. The fund's success catalyzed the establishment of many other funds under PIL's fund manager, as well as other venture capital companies in the ASEAN region. The Bank invested \$2.2 million in PIL and received a total return of \$6.2 million, or a financial internal rate of return of 26 percent over eight years.

From that small beginning, PIL's fund manager, Walden Management Singapore (WMS), has become a premier venture capital company in Asia and the Pacific. WMS currently manages \$1,000 million in venture capital funds globally, with about half invested in Asia and the Pacific. WMS has established country-specific venture capital management companies and venture funds in 10 countries in Asia, and the Bank through PSO played a pivotal role in making the success possible.

Box A1.2: The Credit Rating Information Services of India Ltd. (CRISIL), India

The Bank through PSO has been involved in the development of capital markets in its DMCs for the last 20 years. Capital markets are needed to facilitate efficient mobilization of resources – both domestic and international. For the debt segment of capital markets to function well, credit rating agencies (CRAs) are needed to provide investors with objective information on which to base their investment decisions. CRAs promote transparency in the capital markets.

The Bank through PSO has thus far invested in the equity capital of three CRAs: (i) CRISIL, with \$0.4 million investment made in 1989; (ii) Rating Agency of Malaysia, with \$0.2 million invested in January 1991; and (iii) Thai Rating and Information Services, with \$0.2 million invested in November 1993. In each case, the Bank helped establish the first CRA in the country. From the combined direct equity investment of \$0.8 million in the three CRAs, the Bank has so far gained a net return of \$3.9 million, yielding an estimated rate of return of 34 percent per year.

The case of CRISIL is most noteworthy. CRISIL was instrumental in the development of the bond market in India. When CRISIL was successfully listed in 1993, its shares further broadened and enhanced liquidity of the local stock market. The success of CRISIL spawned three more rating agencies in India. In 1997, the Bank divested from CRISIL, selling its shares to Standard and Poors, which needed the equity stake to strengthen its strategic alliance with CRISIL.

Box A1.3: GrameenPhone, Bangladesh

The GrameenPhone project is a joint venture between a well-established Norwegian telephone operator and a telecommunications company controlled by Grameen Bank of Bangladesh. It involves the construction and operation of a nationwide cellular telephone network using GSM technical standard. The back bone of the proposed system is the state of the art 1,800 kilometer fibre-optic transmission system that is leased from the Bangladesh Railways. The network covers almost the entire country and provides the most cost effective solution to building up a nation-wide network covering cities as well as rural areas. The key innovative aspect of the project is the inclusion of village pay telephones. Based on the proven and successful experience of Grameen Bank, women in rural villages are given the chance to lease a cellular phone, financed by a loan from Grameen Bank, and to sell telephone services to other people living in the village. This allows many villages to have access to telephone services for the first time, providing a sound business opportunity for female entrepreneurs.

The development impact of the GrameenPhone project has been well documented. Researchers from the University of Bonn did an analysis of the development impact of village pay phones (VPPs). They found that out of the 300 operational VPPs, each served 1,500-2,000 people, giving about half a million people access to telephone services for the first time. A sample of 50 phone owners spread over 50 villages surrounding Dhaka metropolitan city indicated that 15 percent of the users are poor, accounting for 25 percent of phone calls made through VPPs. Thirty-five percent of the total phone calls sampled were for family and personal purposes, and 10 percent were directed for the purpose of seeking solutions related to health. The proportion is higher for poor people, where most of their calls are directed to obtaining market information and emergency health services. A significant impact cited by the study relates to the use of VPPs to increase transparency and consequently real income, via productivity increase and fair pricing of commodities supplied by villagers. Women were also more empowered due to phone ownership. The study concludes that “telephones in rural areas trickle tremendous socioeconomic benefits to the villagers, and more so to the poor ones”.

Another research study, funded by the Swedish development agency, SIDA, is underway. Based on the initial research findings, GrameenPhone is considered one of the most innovative telecommunications projects, combining a focus on poverty alleviation with a commercially viable and self-funding operation.

The total cost of the project was \$167 million. The Bank’s support approved in 1998, consisted of a \$16.7 million loan and a \$1.6 million equity commitment, and was an important component of a financing package from a group of four multilateral and bilateral funding agencies.

PRIVATE SECTOR AND DEVELOPMENT: THE ASIAN CONTEXT

1. Strengthening the private sector is necessary, but not sufficient, for long-term equitable and sustainable development. For example, while the extensive international private capital and domestic private investment flows have played an increasingly key role in supporting the development process, on closer examination, these have generally been concentrated in a few middle-income developing countries in Asia (Boxes A2.1 and A2.2). Similarly, within countries, these flows have concentrated in particular geographical areas (e.g., large urban centers) and sectors (e.g., selected export-oriented industries), thereby not equitably benefiting the entire population at large.

Box A2.1: Dramatic – but Unbalanced – Expansion of Private Capital Flows

The composition of net long-term resource flows to developing economies has changed fundamentally, with the dramatic expansion of private capital flows.¹ Concessional finance, which had declined for a decade in 1998 was one third below the 1990 level in real terms, with the decline expected to continue. At the same time, private capital flows to developing countries have expanded rapidly since the early 1990s, from 43.5 percent of net long-term resource flows in 1990 to 89.5 percent in 1996. At the height of the financial crisis in 1998, private capital flows to developing countries remained at 82.3 percent of net long-term resource flows, or more than four times the level of official flows.

Private capital flows include foreign direct investment (FDI), often accompanied by transfers of technology, know-how, and management skills; and investment from international capital markets, including portfolio equity flows and private debt flows from commercial banks, bonds, and other sources of credit. The potential volatility of capital from international capital markets was demonstrated by the severe drop in flows to developing countries, from \$136 billion in 1997 to \$72 billion in 1998, much of it in East Asia. FDI maintained a strong trend, dropping slightly from \$163 billion in 1997 to \$155 billion in 1998. In fact, among the Asian crisis countries only Indonesia experienced a drastic decline in FDI during 1996-1998, while FDI rose to both the Republic of Korea and Thailand. Private capital flows are likely to continue to play an increasingly key role in financing development, with FDI as the dominant form of external finance.

While private capital is playing an increasingly central role in net long-term resource flows to developing countries, its contribution to development, and in particular to poverty reduction in Asia as a whole, has been limited and uneven. For example, East Asia (led by the People's Republic of China [PRC]) has been the primary recipient of FDI inflows to developing countries, averaging over \$60 billion per year during 1996-1998—a significant share of this originating within the region (e.g., from Japan, Korea, and Taipei, China), raising potential issues about the scale of future inflows if recovery lags. This contrasts markedly with South Asia, which during the same period received well under \$10 billion per year. The concentration of FDI flows becomes even more pronounced at the country level, with more than 70 percent of FDI flows to all developing countries going to the top 10 – all middle-income – recipients; including in 1998 in Asia the PRC, Malaysia, and Thailand. Within countries, these flows have tended to concentrate in particular geographic areas (e.g., large urban centers), and are often associated with selected sectors (e.g., export-oriented industries). Therefore a key challenge for multilateral development banks such as the Bank is to facilitate the flow of an increasing share of private sector capital flows to lagging economies and regions.

¹ World Economic Outlook, International Monetary Fund, May 1999; World Investment Report, 1998, UNCTAD.

2. These shortcomings must be placed in the context of the historically unprecedented developmental achievements of the East Asian economies over the past 25-30 years. The spectacular performance of these economies over an extended period was characterized by sustained high growth rates until the onset of the Asian financial crisis in 1997. This growth was accompanied by a dramatic decline in the incidence of absolute poverty, with significant increases in per capita incomes and dramatic improvements in critical social indicators, including life expectancy, health, and education. The outstanding socioeconomic progress of the East Asian economies was driven by private investment, both domestic and foreign, supported by effective macroeconomic policies of governments. At the same time, rapid growth was accompanied by environmental degradation, resource depletion, and an increasingly unequal distribution of income and wealth. However, on balance, it is a remarkable record of sustained development.

3. The Asian crisis dramatically exposed key weaknesses in the structure and performance of the private sector, and in the role of government with respect to the private sector. In general terms, the crisis showed the failure of government to carry out some of its key roles, including financial sector regulation and supervision. At the same time, the crisis was the consequence of poor decisions of individual private sector enterprises (financial and corporate, domestic and foreign). For example, some questionable domestic business practices that contributed to the crisis included (i) preference for debt over equity in order not to dilute family ownership; (ii) lending based on personal relationships rather than business plans, cash flow analysis, or risk assessment; (iii) investment for growth with little attention to markets and profitability; and (iv) a general disregard of accounting standards, financial disclosures, corporate governance, and shareholder value. Similarly, with respect to foreign investors, evidence indicates that key pertinent information, such as (listed) corporate financial and performance indicators, was largely available, but was not fully utilized or appropriately incorporated into the risk assessment of the markets. The crisis revealed that rapid and sustained growth put overwhelming pressures on corporate management and performance; on the role of government; and on existing institutions such as the region's financial systems. These weaknesses must now be addressed effectively to lay the foundations for a resumption of the region's long-term growth.

4. Beyond East Asia, the challenge is to learn the lessons from the crisis, while creating conditions to accelerate the role of the private sector in development, in ways consistent with and responsive to local conditions. In the case of South Asia and the Pacific, although governments have undertaken important policy reforms to facilitate the private sector's role in development, this role has lagged substantially, as reflected in the relatively more limited private capital inflows. The transition economies, in turn, are at various stages of implementing measures to build the institutional frameworks for market economies to facilitate the role of the private sector in development, with varying levels of success.

5. A key fundamental lesson of the Asian crisis is that the economies of the region will need to be restructured – in ways appropriate to the various country settings – to achieve efficient and inclusive growth and therefore poverty reduction on a sustained basis. In this, government has a key role to play in complementing the private sector – the role of regulator and facilitator and ensuring that markets work for sustainable and equitable development. The role of the private sector and its contribution to development is then best understood and supported within this wider context.

Box A2.2: Role of Private Investment in Development

Private investment is playing a key role in its relative contribution to gross domestic product (GDP) throughout Asia, although there are differences in this role among countries in the region. In 1997 gross domestic investment in East Asia, including Southeast Asia, stood at 33.5 percent of GDP, of which 24.2 percent originated in the private sector, and only 9.3 percent from the public sector. In South Asia, gross domestic investment stood at 18.7 percent of GDP, composed of 11.9 percent from the private sector and 6.7 percent from the public sector. This reflects the central role of private investment in financing growth in the region in the 1990s, as well as the investment-driven nature of East Asia's rapid growth. The key exception is the People's Republic of China (PRC), where the share of public investment in 1997 was 17.5 percent of GDP and 15.8 percent for private investment. However, even in the PRC, this reflects a significant increase in the relative role of private investment from 1990 when private investment stood at 8.3 percent of GDP as compared with 16.1 percent for public investment. While the quantity of private investment is impressive, the question of the quality of this investment has been drawn into sharp focus by the Asian financial crisis. Hence a key challenge to multilateral development banks such as the Bank is to help improve the quality of private investment for sustainable development.

The level and composition of gross domestic fixed investment is an important sign of a burgeoning private-sector driven, market economy. The key role of the private sector in driving growth in the region is again illustrated here. For example, in 1996 private investment's share of gross domestic fixed investment in Southeast Asia stood at 81.1 percent in the Philippines, 77.6 percent in Thailand, and 60.5 percent in Indonesia; and in South Asia at 66.1 percent in India, 67.8 percent in Nepal, and 62.5 percent in Bangladesh. In the transitional economies where private investment played virtually no role in the 1980s, gross domestic fixed investment in 1996 reached 68.6 percent in Cambodia, 76.3 percent in Viet Nam, 87.5 percent in the Kyrgyz Republic, and 98.8 percent in Kazakhstan. Pakistan also exhibited a significant increase in the role of private investment from 36.1 percent of gross domestic fixed investment in 1980 to 52.5 percent in 1996. Again, the PRC provides the exception, with the share of private investment in 1996 at 47 percent, a moderate increase from 43.3 percent in 1980.

Source: Pfeffermann, G., G. Kisunko and M. Sumlinski, *Trends in Private Investment in Developing Countries, Statistics for 1970-97*, International Finance Corporation, Discussion Paper 37, May 1999.

PRIVATE SECTOR ACTIVITIES OF OTHER MULTILATERAL AGENCIES

I. The World Bank Group

The World Bank (WB)

1. Support by the World Bank Group – The World Bank (WB), International Finance Corporation (IFC) and Multilateral Guarantee Agency (MIGA) – for private sector development as a means to promote growth and efficiency and thereby to reduce poverty has undergone substantial evolution. Early project lending focused on creating the infrastructural base to complement industrial and agricultural development. Adjustment lending in the 1980s expanded the focus by working to establish a macroeconomic framework for private sector development of stability and appropriate relative prices. Since 1989, a strategy has been incorporated that focuses on improving the business environment, restructuring the public sector and supporting privatization, and reforming and developing the financial sector in developing countries. Together, the components of this strategy are helping to nurture a healthy private sector, a prerequisite for attracting private capital flows.
2. Efforts to improve the business environment focus on necessary policy, regulatory, and legal reforms. These activities have an increasingly sharper focus through a program of private-sector assessments, initiated in fiscal 1992 and carried out in conjunction with IFC.
3. Promotion of public sector restructuring has tended to focus on trimming over-extended public sectors and supporting privatization of state-owned enterprises (SOEs) and the private sector delivery of public services. However, the focus has shifted to complement privatization with efforts at upgrading areas of public administration that have the potential to affect profoundly the growth and efficiency of the private sector: tax and customs administration, trade and investment promotion, enterprise-support services, court administration, and infrastructure planning and provision. The WB is also involved with issues of the importance of transparency, of dealing with the potential direct social costs of privatization, and of establishing a post-privatization environment that stimulates competition, promotes equity, and inhibits avoidable concentrations of ownership and economic power.
4. The WB is also providing support for the private provision of infrastructure, focusing on: i) the privatization of public utilities; ii) development of regulatory frameworks to provide appropriate mechanisms for pricing privately delivered infrastructure services, encouraging competition, and where appropriate, removing barriers to entry; and iii) provision of WB financing or partial guarantees to attract additional private capital for infrastructure projects.
5. In the financial sector, WB is focusing on creating the appropriate legal, regulatory, and supervisory structures to realize the full benefits of financial sector reform. WB is placing greater emphasis on the need for policy reform in conjunction with macroeconomic reform, and improvements in the financial infrastructure and strengthening of specific financial institutions.
6. WB is also improving its capacity to support governments in the design and implementation of private sector development reforms by understanding the dynamics of the environment affecting private sector development and devising ways to eliminate or work around obstacles to implementation; forging links among various local institutions critical to private sector development to build capacity so that local institutions can deepen and sustain progress initiated through the WB; and learn from successful country experiences, tailored to specific country needs, in other countries.

7. In recent years, WB's efforts in support of private sector development have accelerated rapidly. Typically, about two thirds of all WB operations include components that explicitly support private sector development. The WB has a Vice President under which a critical mass of highly competent professionals has been assembled to provide technical support for financial and private sector development, and the industry and energy sectors. The WB has also initiated major efforts towards promoting small- and medium-sized enterprises (SMEs) and the entrepreneurial role of women, encouraging the private sector in the poorest of developing countries and supporting the necessary underpinnings of public sector reform.

8. Recently, the WB has started reaching out to, and conducting dialogue with, multinational corporations (MNCs) in an effort to promote private enterprise in developing countries. The WB has noted that in many countries where it operates, the industrial sector consists mainly of export-oriented enterprises, such as textiles and electronics, over which the host countries have little influence on market and production decisions. It is the multinationals who are in control. Without this dialogue with MNCs, multilateral development banks run the risk of providing incorrect advice if they do not understand the decision making processes of multinationals.

9. The WB and the IFC have recently made efforts to create synergies between themselves. They are undergoing an organizational change at the corporate level and a merger of offices is being orchestrated in the field. Co-location of offices has already been accomplished in a number of countries to better coordinate IFC and WB efforts at private sector development. There has been a recent merger of the positions of the WB country director with the IFC resident representative. In a recent move to increase its presence and operations in the Asian region, a joint WB-IFC regional office is currently being established in Singapore.

B. The International Finance Corporation (IFC)

10. The IFC was established in 1956 as a member of the World Bank Group, but as a legally and financially independent multilateral agency to foster economic growth by promoting private sector investment in its developing member countries (DMCs). The IFC combines aspects of a multilateral development bank with that of a private merchant bank. In its project financing, IFC provides loans without government guarantees and makes equity investments, and seeks to mobilize additional project funding from other investors and lenders through loan syndications, parallel financing, and guarantees. IFC prices its financing and other services in line with the market, and seeks profitable returns. In addition, IFC sponsors and funds selected financial intermediaries.

11. IFC offers a range of advisory services and technical assistance (TA) in such areas as capital market development, corporate restructuring, risk management, and project preparation and evaluation, and advises member governments on creating an environment that encourages the growth of private enterprise and foreign investment. IFC maintains an Emerging Markets Data Base and functions as an advisor to several projects that it finances and frequently joins large MNCs and leading DMC business groups in its operations.

12. IFC's general policy guidelines are quite similar to, and in some respects, identical with those of the Bank for direct private sector financing. IFC views development, not profits, as its primary goal. But, it sees the aim of profitability as consistent with the development objective and not in conflict with it. IFC seeks to strike a proper balance between its profitability and

risk-taking in its investment activities. It makes a major contribution to development when its involvement makes a critical difference to investors intending to proceed with large investments that have an important effect on a country's economy. IFC tries to ensure that its participation makes a special contribution that supplements or complements the role of market operators.

13. IFC has been quite active in private sector financing in Asia, aided by its representative offices in Bangkok, Beijing, Islamabad, Jakarta, Manila, New Delhi and now by the newly opened joint IFC-WB office in Singapore. IFC's assistance to projects in Asia covers a wide range of industrial and infrastructural sectors. It has financed projects in the oil refining, petrochemical, cement, textile, automobile, electronics, and agro-processing industries, as well as in the energy, transport, telecommunications, tourism, and health sectors. Some of these projects have been jointly financed by the Bank. IFC has also supported several financial intermediaries in commercial banking, leasing and housing finance. As part of its Foreign Investment Advisory Services program, IFC has provided advice on investment policy and procedural aspects to several Asian countries, including Bangladesh, the People's Republic of China (PRC), India, Lao People's Democratic Republic (Lao PDR), Malaysia, Mongolia, Nepal, Philippines, Sri Lanka, Thailand, and Viet Nam. In addition, IFC has been providing advice on corporate financial restructuring and on privatization. To help entrepreneurs in the region's smaller economies establish new businesses or expand and diversify existing ones, IFC has established a South Pacific Project Facility based in Australia.

14. In the past, IFC has focused mainly on sectors rather than on countries. This is however beginning to change as the planning exercise is now being driven by country considerations. However, when a project is cleared for processing, the concerned sector department takes the lead and drives the process. IFC's strategy currently focuses on three areas: (i) key sectors which have originally been in the public sector but are now moving to the private sector, i.e., infrastructure, oil and gas, transport, utilities and education; (ii) financial sector, with emphasis on domestic financial market development; and (iii) SMEs. In its work to support SMEs, the IFC has established a business advisory unit that provides capacity building and advice on producing viable business plans as well as accounting, financial, and credit analysis, and risk assessment skills to help SMEs and start-ups in their operations.

15. In the past, IFC used to prepare country assistance strategies (CAS) separately from the WB. This has changed and currently, the IFC works closely with the WB in preparing joint country strategies, particularly with regard to activities in capital market development, foreign direct investment promotion, and SME development. This has been institutionalized in the sense that the Board is aware of the process. For countries classified as high priority due to IFC's large investment program or where significant opportunities have been identified, IFC prepares a detailed private sector strategy as an annex to the CAS to supplement what is included in the text. There are 20 such countries. For lower priority countries, the private sector strategy will only be included in the text. For countries that are classified as hostile to the private sector, IFC does not participate in the CAS. IFC signs off on the CAS and the Board presentation is done jointly.

16. To facilitate a division of labor and to prevent a conflict of interest on the advisory side, the IFC will normally provide advisory services on issues such as foreign direct investment or regulatory frameworks, whereas the WB advises on policy issues. IFC discloses its investments in projects so host governments are fully aware of the dual role the IFC plays. In the case of jeopardy, if the IFC is a lender and/or investor, it acts as representative of other investors and lenders, whereas the WB would advise on policy issues. This is where the "chinese wall" must be put up between the two entities to prevent a serious conflict of interest.

17. With respect to the guarantee instrument, the WB's guarantee program has not been used extensively, but IFC has issued \$100 million of guarantees. To mitigate risks, IFC shares guarantees with the local banks, and the local banks price the loan depending on the percentage IFC is guaranteeing.

C. Multilateral Investment Guarantee Agency (MIGA)

18. MIGA was established in 1988 to reduce poverty through FDI to and among DMCs, by offering political risk investment insurance coverage to private investors and providing promotional and advisory services to assist its DMCs in their efforts to attract and retain FDI. MIGA has estimated that 55 out of 1,400 projects are submitted to their Board, and of the 1,400 projects received worldwide on an annual basis, 400 are from Asia. Twenty percent of MIGA's portfolio comes from Asia. Projects have been guaranteed in Bangladesh, PRC, and Pakistan. A constraint faced by MIGA in doing more work in Asia is the fact that some of their host countries are not members of MIGA, e.g., Thailand and Cambodia.

19. MIGA recently raised its capital to \$2 billion, its project limits to \$200 million (project size of up to \$1 billion) and country limits to \$620 million. In 1998, it provided 73 guarantees worth \$1.3 billion, mainly to power projects, charging 50 to 150 basis points. MIGA has issued 60 guarantees related to infrastructure projects. Investors' confidence in the past have made them reluctant to obtain political risk insurance for war or insurgency. The trend, however, has reversed. Most of the policies underwritten by MIGA provide coverage to investors in the event of war in the host countries.

20. MIGA would like to collaborate with the Bank in the following areas: (i) by providing guarantees to projects where the Bank is an investor; (ii) by co-insuring with the Bank in Bank projects; and (iii) by relying on the Bank's due diligence on projects that MIGA insures, since similar standards (e.g., environmental and labor) set by the Bank are also required by MIGA.

II. Inter-American Development Bank (IDB)

21. The IDB has traditionally followed policies similar to those of the WB for private sector development. In recent years, private sector development has begun to occupy a more prominent position in its activities. IDB has set up the Inter-American Investment Corporation (IIC) to support SMEs in Latin America and the Caribbean with loans, guarantees, and equity investments. IDB also administers the Multilateral Investment Fund (MIF), which was established in January 1993 to finance programs of policy change, training, and improved access to credit to help member countries strengthen their private sectors. MIF consists of a Technical Cooperation Facility that helps identify and implement policy changes to promote the private sector, a Human Resources Facility that helps retrain displaced workers and strengthen worker productivity, and a Small Enterprise Development Facility that helps broaden economic participation by the poor, women, and minorities.

22. Over a period of several years, IDB has made a conscious bankwide effort to promote institutional change in mindset and work processes. This has resulted in much closer collaboration between its public and private sector departments in successfully developing private sector projects in its DMCs. IDB has established a management review process whereby justification must be made systematically as to why the private sector is not participating in a public sector project. This review process has proven to be an incentive for the public sector departments to coordinate with the private sector departments to identify projects that have the potential of being undertaken and/or funded by the private sector.

23. To further facilitate the coordination of activities channeled toward private sector development, the President of IDB created a private sector coordination committee. The committee is comprised of the Vice President and individuals from MIF, IIC, the Private Sector Department, and the Legal department. The key to the success of its efforts relies on agreements in internal processes.

24. To further promote the development of the private sector, during its eighth replenishment in 1994, IDB raised its private lending limit from 5 percent of annual lending commitment to 10 percent. Project limits were also increased to \$75 million or 25 percent of total project cost, except for smaller countries where a limit of up to 40 percent of project cost applies.

D. Inter-American Investment Corporation (IIC)

25. Sponsored by IDB, IIC is a multilateral investment corporation that promotes the economic development of its regional member countries by stimulating the establishment, expansion, and modernization of private SMEs in the Latin American and Caribbean region. IIC began operations in 1989 with subscribed capital of \$200 million, which was recently increased to \$700 million. IIC provides long term loans and guarantees to, and makes equity investments in, private enterprises that have difficulty raising finance from other sources on reasonable terms, and it provides lines of credit to financial intermediaries. By Charter, IIC can only provide corporate lending or project financing; it is prohibited from accepting sovereign guarantees. IIC mobilizes additional capital for assisted projects through syndication and underwriting operations, by identifying joint venture partners and facilitating transfer of technology. IIC also provides fee-based advisory services to private firms and advisory services to member governments on their investment policies, and assists them in privatization of SOEs, particularly those of medium scale.

26. IIC supports projects which in addition to providing potentially profitable investment opportunities have a developmental impact on the host countries. Particular attention is paid to mitigating adverse environmental impacts. IIC is currently developing a new product – an agency line of credit – that will enable them to lend directly to a project sponsor with a financial institution counterpart. The risk will be borne by IIC and the financial institution to the extent of their respective exposures.

III. The European Bank for Reconstruction and Development (EBRD)

27. The EBRD was established in 1991 with a unique mandate to foster the transition towards open market economies and to promote private and entrepreneurial initiative in the Central and Eastern European countries committed to, and applying, the principles of multiparty democracy, pluralism, and market economics, thereby assisting their economies to integrate into the international economy. EBRD seeks to help the countries where it operates to establish the framework of a market economy, implement restructuring and privatization, create modern infrastructure, strengthen financial institutions and legal systems, and develop the local private sector. EBRD has 55 members, and like the Bank enjoys a strong triple-A credit rating that reflects its strong capital level and membership, and conservative fiscal policies.

28. The EBRD has merged its merchant banking with its development banking. Not less than 60 percent of its funding is to be directed to private enterprises and/or SOEs that are implementing programs to achieve private ownership and control. Not more than 40 percent of

EBRD's funding is to go into public infrastructure and other projects. In reality, 85 percent of EBRD's operations directly or indirectly benefit the private sector, but 50 percent of these deals involve government risk. In all its projects, the EBRD must follow three principles: i) transition impact; ii) sound banking and investment; and iii) additionality.

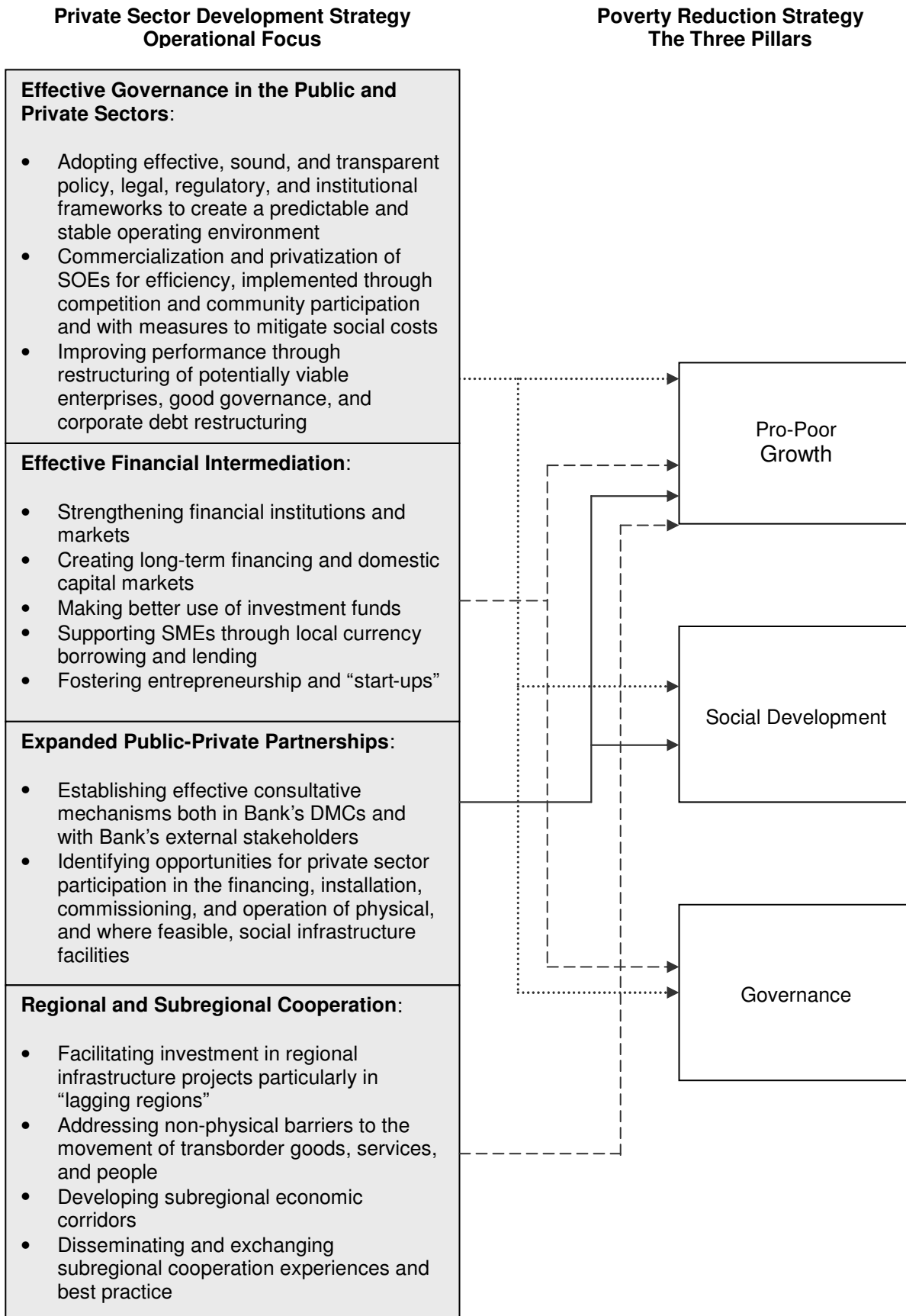
29. The EBRD's Banking unit is organized into six business groups, three of which are country groups and the other three sector groups. The country groups include: Russia and the Central Asian Republics (CARs); Central Europe; and South and Southeast Europe and the Caucasus. The sector groups include: financial institutions; infrastructure; and industry and commerce. The sector groups normally take the lead and currently, are lending 80 percent of the business, but there is an effort to push more business to the country groups. The country groups take care of sectors not covered by the sector groups, but overall, a "country team" approach is used. EBRD does not do "programming" work with governments as the Bank does, and they also do not do advisory work.

30. Currently, their strategy is focusing on the following: i) supporting banks and other financial institutions that have an institutional commitment to SMEs; ii) a full range of financing structures in infrastructure operations including private, sovereign, sub-sovereign, and public-private partnerships; iii) supporting the restructuring of potentially viable large enterprises, by carefully selecting a few projects that have a strong demonstration effect; iv) continuing its equity investments; and v) promoting a sound investment climate and strengthening institutions that are important for the functioning of markets, by working closely with its Foreign Investment Advisory Councils.

31. The EBRD also has a Risk Management unit that is located outside of their Banking unit. The Risk Management department is responsible for reviewing every transaction. All private sector projects must be signed off by the Risk Management department. There is an Operations Committee that helps to coordinate among the country and sector groups. In its project work, both the concerned country and sector groups get full credit regardless of which group originates or leads the deal. This provides an incentive for the country teams on one hand, and sector teams on the other, to work together. The Operations Committee is co-chaired by the Vice President and Deputy Vice President of the Banking unit, and is comprised of the Head of Finance, the Chief Economist (who ensures the "transition" impact), the General Counsel, and the Head of Risk Management.

32. The EBRD is doing work with municipalities, given the trend toward decentralization of governments. They treat the municipality as a non-sovereign entity, i.e., a private sector entity, since a municipality does have its own sources of funding and does not depend solely on government transfers. An important criteria adhered to by the EBRD is that all of its projects must be self-sustaining, and over time, the revenues of the project must be able to service the debt.

HOW THE BANK’S PRIVATE SECTOR DEVELOPMENT STRATEGY SUPPORTS ITS POVERTY REDUCTION STRATEGY



INSTITUTIONAL CONSIDERATIONS IN PRIVATIZATION

1. Privatization, especially in economies with significant state enterprise presence, may increase economic efficiency and contribute to economic growth, and therefore employment and income generation. It can also reinforce a more rational and competitive economic structure in key sectors.

2. The basic argument for privatization rests on the logic that privatization will result in “private property rights” that, coupled with competitive markets, will provide the natural incentives for efficient utilization and redeployment of assets. In practice, privatization often proceeds on the assumption that assignment of (private) property rights is sufficient, even in the absence of competitive markets, to ensure efficient use and/or redeployment of assets. More generally, a number of factors are likely to condition the relative success of privatization, and these need to be considered broadly at the level of privatization strategy, and in the privatization of specific state enterprises.

3. A fundamental issue in privatization is to ensure economic efficiency in the use of privatized assets. Two key factors that condition the efficiency gains from privatization relate to external competitive conditions and internal incentive structure.

- (i) **Competitive Conditions.** Strong evidence indicates that competition may be more important than ownership to increasing efficiency through privatization: efficiency gains will be limited at best, if privatized enterprises operate in a monopoly environment. Therefore privatization has to take into consideration the existing level of competition, and competition policy in particular sectors. Furthermore, in developing economies characterized by weak or incomplete institutional framework for markets, including capital markets, private ownership may not lead automatically to increased efficiency or to a secondary reallocation of assets to efficient producers. The result may be continuing inefficiencies in the use of privatized assets. That is, the government may not be able to ensure that the buyer is the most efficient producer, potentially weakening the efficiency of the economy over both the short and longer term if privatized assets are used even more inefficiently in terms of their contribution to economic development.
- (ii) **Internal Incentive Structure.** In large public, private, and mixed enterprises there is substantial delegation of responsibilities by owners to managers who have considerable autonomy in pursuing their own interests. Although ownership is clearly defined, ownership-based control is weak, at best, when shareholders are dispersed. Therefore the transfer of ownership rights, does not necessarily lead to controlling owners motivated and capable of restructuring enterprises towards long-term economic success. When managers and owners are separate, a fundamental issue relates to the incentive system within the enterprise: how to make managers behave efficiently. However, this may also be addressed to a large extent while the firm remains in the public sector.

4. A second issue in privatization relates to ensuring consistency with other social objectives and conditions. For example, privatization often entails restructuring and retrenchment: job losses. In an economy with extensive slack resources (e.g., high unemployment) this can have very high economic and social costs, even if compared with underutilization of assets (i.e., underemployment). Therefore providing a social safety net, appropriate retraining and reemployment programs, and efficient labor markets are essential complements to privatization.

5. In sum, privatization can provide potentially important gains, especially in economies with a heavy state enterprise presence. However, a reassigning of ownership rights does not necessarily guarantee good economic performance, which occurs in a wider institutional setting that conditions actual benefits and costs. Governments therefore have to weigh a number of diverse factors in designing an effective privatization program, and in the privatization of specific enterprises.

CREATING OPPORTUNITIES FOR PUBLIC-PRIVATE PARTNERSHIPS

1. The Bank is in an advantageous position to help prepare build-operate-transfer (BOT) projects for competitive bidding to private developers and to assist the government and the private sector to assure the successful implementation of such projects. With its public and private sector operations playing complementary roles, the Bank can take an integrated approach to a development challenge. For example, in the early 1990s, the Bank's review of its operational strategy in Bangladesh identified the growth corridor between Dhaka and Chittagong as critical to industrial development, as well as export promotion. The major impediment to growth in the area was also identified as the absence of a reliable power supply at a reasonable cost. To overcome this impediment, the Bank provided technical assistance (TA) to Bangladesh to (i) develop a master plan for the energy sector in the country; (ii) shape the principles of the country's tariff policy; (iii) reorganize, unbundle, and restructure into corporations the utilities involved within an independent regulatory regime; (iv) determine the roles of the public and private sector – transmission line for the public and power plant for the private sector; (v) determine the site and size of the required power plant; (vi) complete the design and preliminary engineering work; and (vii) prepare the bidding documents for selection of the private developer, assist in bid evaluation, and draft contract documents. The gas-fired BOT power project that had been developed under the TA was successfully bid in 1998 and with the award having been made to the lowest bidder, the Bank has started processing a loan without a government guarantee for the private sector company that will undertake the project. As a complementary project, the Bank will provide a public sector loan to the government for funding the transmission line that will evacuate power from the BOT generating plant.

2. Another example of the Bank's success in assisting developing member countries to prepare BOT projects is the water supply project in Chengdu, the capital of Sichuan Province in the People's Republic of China (PRC). Following a Bank-sponsored seminar that brought together senior government officials, bankers and private sector water operators in Beijing, the Bank provided the PRC with TA to prepare a pilot BOT water supply project to be awarded on the basis of transparent international competitive bidding. Another TA grant from the Bank helped the government do a water pricing study that served as a basis for the new guidelines for water tariffs issued in late 1998. The bidding process was completed in 1998 and the BOT project was awarded to a consortium of French and Japanese companies. The project was approved for direct financing under the Bank's private sector operations in early 1999.¹

3. Another BOT project in the PRC, a power plant in Changsa, Hunan Province, was also bid out successfully in 1998 with TA from the Bank and is now being processed as a private sector project by the Bank.

¹ Investment 7152/1669-PRC: *Chengdu Generale des Eaux - Marubeni Waterworks Company Limited*, for \$26.5 million, approved on 11 February 1999.

Scorecard Concepts

Private Sector Operations: A Scorecard for Greater Development Impact

1. A scorecard can "score" all prospective private sector projects against a set of development impacts desired in the DMCs. These development objectives will be defined in terms of the Bank' s strategic development objectives and private sector development objectives. Bank-assisted private sector projects should have development impacts as defined by these objectives. Below is an conceptual illustration of the "scorecard" concept, using Bank' s private sector projects as examples; further refinement and elaboration will be needed to implement such an approach.

2. The scorecard will enable the Bank to strengthen the development focus of its private sector operations because it will have defined ex ante what the objectives of these operations are.

Table A6.1: Development Impact Scorecard (An Illustration)											
Country	Project	Development Impact Areas									
		Poverty Reduction through growth	Environment Protection	Subregional Cooperation	Infrastructure Improvement	Capital Market Development	Better Banking	More Competitive Sector	Opening to FDI	Good Governance	Forex Saving/Earning Initiative
BANGLADESH	Grameen Phone										
BANGLADESH	La Farge Surma Cement										
PEOPLE'S REPUBLIC OF CHINA	Everbright Bank										
PHILIPPINES	Maynilad Water Services										
THAILAND	Eastern Power										

Public Sector Operations: A Scorecard for Greater Private Sector Development Effect

3. A scorecard can also be developed to track the contributions of the Bank' s public sector projects to private sector development, where public sector loans help to create a policy and/or physical environment conducive to private investment or that generate investment opportunities for the private sector. An illustration of such a scorecard is given below.

Table A6.2: Scorecard for Private Sector Development Effects of Public Sector Projects (An Illustration)							
Country	Project	Private Sector Development Effects					
		Create enabling environment	Build regulatory capacity	Promote effective governance	Facilitate financing	Develop capital markets	Provide support infrastructure
INDIA	Private Sector Infrastructure Facility						
INDONESIA	Financial Governance Reforms						
PHILIPPINES	Power Sector Restructuring						

