

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



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Preface

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

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

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

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

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

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

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

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

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

Finally, we would like to thank all of the expert participants in the roundtables and associated bilateral consultations. Above all, this report seeks to give voice to the experience of public and private sector practitioners. Their candour, technical knowledge, enthusiasm and willingness to contribute were the most essential elements in defining the project's preliminary findings and summary recommendations. A separate acknowledgement of participants who took the added time to prepare proposals, reflect on drafts of the report and provide other special input into the process will be contained in the final full volume. Although this summary reflects the project team's best efforts to interpret the thrust of expert views, not every project participant necessarily agrees with each of the findings and recommendations. Nor does the report represent an institutional position of the Forum or its members.

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



Richard Samans
Managing Director
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January 2006

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I. The Changed Context of Development Finance

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

Today there is much greater potential availability of private capital in many developing countries, particularly the 94 classified by the World Bank as middle income. Though still only a

relatively small proportion of total private capital volumes, international flows to developing countries have shown dramatic changes over the past 30 years. Between 1970 and 1980, net private flows had increased almost tenfold, to US\$ 51 billion, or more than 50% above official flows. The early 1990s witnessed a fresh expansion of private flows to developing countries. From an annual US\$ 42 billion in 1990, net private flows to developing countries exceeded US\$ 178 billion in 1995 and reached a peak of over US\$ 275 billion in 1997, by which time they were close to eight times the size of official net flows. Macroeconomic problems were to trigger at least a temporary cooling off. With the emergence of macro-financial crises in such key emerging markets as Russia, East Asia, Brazil, Turkey and Argentina, the markets again went into reverse. Net private flows to developing countries, running at US\$ 263 billion in 1998, fell successively each year until bottoming out at US\$ 160 billion in 2002 and rising since then to an estimated \$301 billion.

Notwithstanding year-to-year variations in the statistics, capital markets in developed countries are widely reported as being underinvested in developing countries. For example, in 2004 the US market had almost US\$ 13 trillion under management, with only 1.7% (\$222 billion) invested in foreign-securities.²

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

Yet, enormous investment gaps persist in both middle and low income countries. According to

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

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

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

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

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

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

Within overall MDB lending, lending for infrastructure fell faster than the total – especially in the case of the World Bank. Historically, the mainstay of the World Bank’s lending programme, at around 40% of total lending, infrastructure had declined to 21% of the total by 1999. In absolute terms, IBRD infrastructure lending fell from over US\$ 7 billion in 1993 to around US\$ 2 billion in 2002. The trend among the regional banks, overall, was much less pronounced or systematic than at the World Bank. The total commitments to infrastructure of nine multilateral institutions (including the World Bank and the RDBs) declined from an annual average of US\$ 17.5 billion over 1995-1997 to an average US\$ 15.4 billion over 2000-2002.⁶

As a result of falling demand for traditional MDB loans, the amount of unused capital in these institutions has increased substantially relative to lending ceilings governed by their statutory capital gearing ratios and now approaches US\$ 159 billion. In the World Bank alone there was up to US\$ 78 billion of unused capacity as of year-end 2004, with outstandings decreasing 11% over the last five years from US\$ 120 billion in 2000 to US\$ 110 billion in 2004. The capital of regional development banks is also underutilized, with aggregate unused capacity at year-end 2004 up to US\$ 81 billion.⁷ In other words, these institutions find themselves in the paradoxical position of deploying less and less of their resources at a time of when taxpayers in donor countries are being called upon to commit more and more of their national budgets to poverty alleviation.

Declining MDB lending activity and rising unused capital raises questions about the ongoing role and priorities of MDBs in many countries where average incomes have risen to the point that governments no longer qualify for concessional finance but widespread poverty persists. It also raises uncomfortable questions about the effectiveness of this important component of worldwide official development assistance at a time when much greater attention is being paid to aid effectiveness. The recent debate on effectiveness has focused on projects rather than the activities of development finance intermediaries like the MDBs. However, the unused capital committed to these intermediaries

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represents over 200% of global annual official development assistance (ODA). As such, questions about how to maximize the size of the payoff to economic development from the capital committed to them would appear to deserve a much more central place in this discussion than they have enjoyed to date.

II. General Findings and Recommendations

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

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

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

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

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

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

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

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

III. Specific Recommendations

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

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

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

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

A) Reorient Culture, Capital and Skills

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

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Institutions that traditionally have been lenders to sovereigns must transform themselves also into catalysts, mediators and facilitators at the sovereign, sub-sovereign and regional levels. They must see themselves fundamentally as providing bridges to private sector financing, and this should become their primary operational ethos in all but the lowest income countries.

In this respect, they need to understand that the value they create in these markets derives principally from their superior capacity as official institutions to understand and indeed shape country investment environments and diversify risks across sectors and countries. Their explicit responsibility is to catalyse private sector resources to expand private sector activity, applying financial and technical expertise to specific sectors and deals in which the private sector has an interest in providing the large majority of the necessary financing but not necessarily all of it given the attendant risks. Navigating the transition from direct lender of official funds to innovative enabler of private investment will require a minor revolution in the culture and processes of development institutions, which have historically focused on transactions with governmental entities, as success will increasingly need to be measured by the market, i.e., by the extent to which private investors, both domestic and international, perceive their services and transaction costs as competitive and attractive. Participants recommended the following:

- **DFI boards should signal the importance of change by shifting capital, staff resources and senior management attention to the parts of their institutions responsible for private investment risk mitigation and capacity building.** The growing capital headroom in the MDBs indicates that they do not face a current capital constraint; the problem is instead a misallocation of capital and lack of coordination among the private sector development activities of the various institutions. The ultimate responsibility to remedy these problems lies with the boards. Specifically:
 - **In the World Bank Group, capital should be shifted to the complex of activities managed mainly by the International Finance Corporation (IFC).** A significant shift should occur immediately to signal to Bank management and staff the depth of commitment of shareholder governments to

private sector development and to encourage a commensurate shift in staff resources and management attention. Further reallocations should follow in the years to come, as more developing countries graduate to the stage of preferring facilitation of private investment to official loans. Parallel steps should be taken in RDBs such that over time the weight of the MDB community's financial activity and human capital comes to reflect the mission of catalysing domestic and external private investment through the selective assumption of risks in specific transactions and the sustained provision of capacity-building assistance to domestic legal, banking, securities, corporate governance and auditing institutions.

- **Shareholder governments should request a senior-level, cross-MDB Risk Mitigation Task Force to improve the strength and coordination of the private sector guarantee, insurance and related activities of these institutions.** Expert participants in the project cited examples of duplicative marketing efforts, even within the same institution. Work is reportedly underway to improve the coordination of the Multilateral Investment Guarantee Agency (MIGA), IFC and IBRD activities in this respect, and this effort should receive strong support. Private sector representatives should be included in this process.
- **The IFC's for-profit culture and the role of its board should be re-examined and reformed.** As the principal arm of the World Bank Group responsible for stimulating private investment in poor countries, the IFC is the best equipped DFI for carrying out the agenda outlined in this report. But while it performs many of the functions stressed in this report quite well (if not at sufficient scale), there was a widespread impression among expert project participants that it has an insufficient appetite for risk given its mission as a development institution. This undue conservatism is manifested in often complicated and time-consuming deal approval procedures that decrease private investor interest in its products. It sometimes fosters the impression that the IFC is competing with, rather than enabling, private banks and funds by assuming some of the more difficult risks these

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institutions will not accept and that an official multilateral institution is in a better position to manage because of its understanding of, and potential influence over, the regulatory or macroeconomic policy environment. The boards, at the World Bank and at MDBs more generally, are part of the problem in that they are widely seen as overstepping the traditional board role of setting frameworks and requiring accountability, occupying an undue proportion of senior management's time in deal-specific and other reviews.

- **Shareholder governments should consider inviting direct input from distinguished private sector experts perhaps in a small advisory committee** for the purpose of strengthening guidance on how to maximize the institutions' engagement with the private sector.
- **DFI management teams should also signal the importance of change to their organizations by personally articulating why it will be necessary to shift over time from an official lending to private sector enabling culture and make corresponding changes in personnel.** Senior leadership of development institutions need to champion this reorientation, refining internal processes and performance evaluation metrics with a view to stimulating innovation, outreach and prudent risk taking as well as promoting capacity-building activities that engage private sector resources and expertise.
- **The “lending culture”** of MDBs first attracted wider attention through the so-called Wapenhans report, prepared in 1992 by a former vice-president who had been commissioned to assess a trend, evident in the Bank's own data, for declining quality of average project performance. Wapenhans crystallized a critique, which others had made less formally, in suggesting that the Bank's management information systems and incentives – reflecting patterns dating in some cases from the McNamara years (1968-81) – attached special importance to meeting quantitative lending targets to the Bank's different clients, and that other considerations, such as the quality of the projects involved, might receive less management attention or recognition via the internal career path. Although the Bank responded to the Wapenhans report with a variety of initiatives to increase attention to quality, with some positive impact according to the institution's autonomous evaluation department, many Bank insiders recognize the diagnosis of a lending culture as continuing to have some validity. Participants in the consultations invoked the lending culture as part of the possible explanation for the MDBs' failure to aggressively develop alternatives to direct lending – such as guarantees.
- **Management should reinforce the mandate for risk taking.** Traditional internal risk management processes (for example, internal treatment of guarantees and “zero loss” guidelines for private sector loans and investments) have the unintended effect of encouraging competition with the private sector, rather than facilitating the catalytic role of heralding new transactions with demonstration effects. Risk management processes need to be modified to enable targeted assumption of risks within acceptable risk guidelines, and differentiated treatment of risk mitigation products against country limits, budgets, capital and other internal processes. Clear senior management authorization and support for the legitimacy and value of targeted risk assumption is a prerequisite for successful large-scale private sector engagement.
- **New internal incentives and performance metrics should be established that align staff activity, training and promotion prospects with the mission of private sector engagement and prioritization of development impact over profitability.** Current performance indicators do not sufficiently take account of, or reward, the amount of private sector investment enabled through official sector programmes. Indeed, ODA statistics reported to the Development Assistance Committee (DAC) do not include guarantees as part of ODA targets.⁹ Examples of approaches that management teams should consider are Official Sector Leverage Indicators (measuring the amount of private sector capital mobilized by each donor's risk mitigation programmes, total cost and loss); Transaction

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Effectiveness Indicators (such as the number of transactions completed, transaction costs, time periods for approval, development impact and client evaluations); Business Engagement Performance Indicators (number and types of activities with business organizations and firms, anonymous evaluations, etc.); and Capacity-Building Indicators (such as extent and diversity of private sector involvement, types of information resources and toolkits, extent of in-country linkages, client evaluations, etc.). These new incentives and performance metrics need to drive compensation and promotion decisions, as well as the reformulation of organization structures, reporting requirements and outsourcing decisions.

B) Expand Risk Mitigation Activity

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

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

- *Political risk.* Political risk instruments date from the 1960s, and are well-established and widely used. They cover war and civil disturbance,

expropriation and confiscation, and currency convertibility and transferability. Some agencies have started to offer cover for terrorism (not normally covered by private insurers). Both private and public agencies offer PRIs, and the total cover now outstanding, about US\$ 80 billion, is divided roughly 50:50 between public and private issuers. The best-known multilateral product is that offered by MIGA, which has issued over US\$ 11 billion in policies. MIGA offers cover for both equity and loans. It does not require a sovereign guarantee. MIGA itself operates with a cap of US\$ 200 million per project, though higher amounts of cover can be arranged via syndication. Private issuers are prepared to offer larger amounts of cover than the official agencies. Their policies are typically shorter-term and premia higher.

- *Regulatory and contractual risk.* Cover in this area typically includes breach of contract, changes in law, license requirements, approval and consents, obstruction in the process of arbitration, arbitral award following a covered default and non-payment of a termination amount. The product started to be offered from the early 1990s. As individual policies must be tailored to the specific characteristics of each project, this product involves high transactions costs. Most MDBs now offer products in this area, including the World Bank Partial Risk Guarantee (PRG) and MIGA's Breach of Contract Guarantee. However, take-up has been relatively limited to date. In addition to concerns over the high transactions costs and the fact that only loans and not equity are covered, host governments have been concerned that the guarantee would count against their MDB borrowing limits (though in 2005 the World Bank announced that it would switch from counting 100% of the value of guarantees against its internal country lending limits to counting just 25% of their value against those limits). Over 2001-2003, the IFIs covered just 14 projects, to a value of US\$ 976 million.
- *Credit risk.* Partial Credit Guarantees (PCGs) are the most common form of cover for credit risk. They cover a percentage of the total amount borrowed and can protect against a wide range of events that can cause non-payment, including commercial risk. IFC's PCG, introduced in 1999, is one of the best-known

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instruments of this kind. Despite the apparent attraction of this product for improving the creditworthiness of projects, market uptake has been modest. Over 2001-2003, only six IFC credit guarantees were issued for infrastructure, with a total value of US\$ 800 million. The private sector “monoline” insurance companies also offer integrated risk management products, which include credit risk. *Foreign exchange risk.* Neither official nor private agencies offer explicit cover for foreign exchange risk. As such, investors seeking

protection have to use alternative approaches, which include: (i) use of local currency finance; (ii) currency hedging; (iii) government exchange rate guarantees; (iv) indexing tariffs to foreign currency; and (v) devaluation liquidity backstop schemes.

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

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

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

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

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

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

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

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

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

- **Products targeted to regulatory and currency risks.** Study after study has repeated the central finding: the principal reasons investors shy away from developing countries are regulatory and currency risks. Key instruments meriting broader application include Foreign Exchange Liquidity Facilities, Regulatory Risk Contingency Facilities, Partial Risk and Credit Guarantees, and Political Risk Insurance.¹⁹
- **Subsidization of infrastructure projects.** Many developing country infrastructure projects for basic services such as water and electricity are simply not commercially viable if they are to provide universal services. The failures with prior infrastructure projects have amply underlined the need to subsidize tariff payments to project sponsors to broaden access to lower income populations, as many potential and deserving recipients simply cannot afford to pay the rates needed to ensure project viability without subsidies. Several innovative structures (such as the World Bank's Output-Based Aid) have demonstrated how infrastructure projects can be structured so that poor people can have the needed basic services, yet the official sector can still harness the needed private sector capital and expertise.²⁰
- **Inclusion in ODA targets.** The DAC should count guarantees within ODA targets, devoting effort to working through the technical aspects of this question, as well as develop guidelines for the measurement by DFIs of the additional amount of private sector capital the guarantees have mobilized. Even though guarantees do not represent actual official cash flows unless they are paid, their use does result in increased domestic and international investment that has critical developmental impact. Failure to include guarantees in ODA targets has discouraged bilateral agencies from expanding their application.

C) Expand Support for Local Currency Financing

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

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

Others familiar with the MDBs' programmes in the financial sector add that, within the World Bank Group, financial sector work, which has been cut back in overall terms in recent years, has been subject to a range of other demands: dealing with banking sector crises on an emergency basis, promoting microcredit and responding to shareholder demands for MDB engagement in the anti-money laundering field. The regional banks in turn have not built the core of technical expertise needed to substitute for a more substantive World Bank role. Without stronger impetus from the top, MDB work on domestic capital markets

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development remains severely underdeveloped. Among the principal recommendations of participants for remedying this problem are:

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

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

- **Swaps funds and local currency bonds.** For developing countries with ample reserves, local currency markets can be increased through the use of cross currency swaps and the issuance of local currency bonds that provide increased access to local currency needed for funding infrastructure projects, local companies and overall economic growth. The Asian Development

Bank (ADB) recently introduced a cross-currency swap mechanism in which it swapped its hard currency with a member country (Philippines) for 15 years, the proceeds lent to banks without a sovereign guarantee.²⁵ Also the regional development banks have stepped up their issuance of local currency bonds. Senior management needs to mandate the scaling-up of these local currency activities within prudent risk guidelines.

- **Pooled funding.** Given their critical role in developed countries, development agencies have pioneered the use of pooled funding (such as State Revolving Funds) successfully in several developing countries. The IFC and USAID have provided targeted assistance in Tamil Nadu, India, and Johannesburg, South Africa, using credit enhancements, partial guarantees and technical assistance that successfully leveraged official assistance with domestic private sector funds to have a larger development impact.²⁶ Development institutions need to collaborate in scaling up pooled funding mechanisms wherever appropriate.
- **Local and regional development financial institutions.** In collaboration with the private sector, efforts should be made to strengthen local sources of affordable development financing. Years ago, a common development approach was to employ government-owned and operated development banks to provide subsidized local currency financing, but negative experience included massive problems associated with politically directed lending as well as corruption. A new public-private sector approach is now recommended by some experts, focused on creating or restructuring existing development banks to include private sector capital and management in those countries and regions where commercial banks do not make needed finance available.²⁷ Furthermore, building on the success of developed countries, donors should develop their risk mitigation products in concert with the development and strengthening of in-country credit enhancement institutions.

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D) Establish Investment Climate Capacity Building as a Central Priority

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

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

There was considerable discussion in the project about linking country eligibility for some of the risk mitigation tools recommended in section B (particularly, the facilities to provide a bridge to institutional investors seeking investment-grade assets) to a commitment to enter into a concerted programme of public and private institution building supported by the international community through DFIs. The goal would be to create a virtuous circle of higher demand by countries for the private investment facilitation services of DFIs; increased commitment by them to improve their investment climates through capacity-building assistance; and a lower risk profile of the assets supported by these new DFI risk mitigation vehicles by virtue of the improvements in the enabling environment brought by such assistance. The key to the success of this scenario is a big increase in the donor community's commitment to conducting needs assessments, funding and improving the efficiency of such capacity building. The IFC has taken an important step in this direction in recent years by earmarking as much as a third of its annual

net surplus to capacity-building assistance activities. However, this remains an isolated bright spot in an otherwise unimpressive picture.

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

• Enabling environment

- **Create a step change in funding.** If DFIs are to take seriously their role as a systemic bridge to wider availability of private investment capital in poor countries, then they will need to fundamentally alter the level of their commitment to the provision of capacity-building assistance for the construction of sound institutions relating to property rights, contract dispute adjudication, bankruptcy frameworks, accounting and auditing standards, corporate governance rules, banking supervision and securities markets. Resources devoted by the international community to this purpose are paltry in relation to the need and the potential pay-off to economic development. DFIs ought to be in the forefront of a major effort to rectify this problem.
- **Improve measurement of funding.** Part of the reason capacity building receives inadequate support is that there is very little measurement of it. What gets measured tends to get managed, and the donor community through the DAC could make a useful contribution by creating a process that regularly tracks the level and composition of resources devoted to this endeavour.
- **Integrate private sector expertise on a more systematic basis.** The official sector can build a market of experts and country clients, serving as a bridge to match needs with supply, working hand in hand with the private sector. The training needs are great, but so are the supply of volunteers and consultants from within the developing countries as well as developed countries. New initiatives such as a "Global Corps of Capacity-Building Experts" and SWAT Teams could serve as organizing frameworks for delivering needed experts, supplemented with toolkits and e-learning.

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- **Integration of programmes into country fabric.** There needs to be explicit processes for customizing technical assistance programmes around country priorities, involving a wide spectrum of experts and private sector participants and financial institutions that enable demand-driven programmes at both sovereign and sub-sovereign levels. Training programmes need to be developed with local institutions (such as development banks, business organizations, universities, think tanks and consulting firms) and be focused on the full range of relevant government officials (for example, ministry staffs, regulators, judges, sub-sovereign officials, etc.) as well as private sector people (bankers, fund managers, consultants, etc.). Defined assistance programmes also need to improve the sub-national governance framework²⁹ providing targeted assistance to enable legal, regulatory, policy, institutional and overall project management improvements.
- **Public benchmarking.** The US Export-Import Bank provides lower pricing for countries that have signed the Cape Town Treaty, thereby agreeing to comply with uniform legal frameworks which minimize risk in the financing of high value mobile equipment.³⁰ Similarly, a number of benchmarking tools have been developed and could possibly be refined and tied to financial indices and investments, providing concrete benefits for countries that undertake concerted improvements in their business environments.³¹ Study participants recommended that development agencies work with fund managers, pension funds, social responsibility investment organizations, rating agencies and direct investors to refine the existing work and develop more specific instruments that can directly reward developing countries for improved investment climates (for example, indices, ratings, niche funds, etc.). Another critical way to develop powerful incentives is the development of more venues for countries to share experiences, best practices and new instruments with their peers.
- **Specific transactions**
 - **Leadership in first-time transactions.** A critical role of the official sector is to act as a catalyst for first-time financial transactions, creating the conditions and confidence for subsequent transactions through demonstration effects. The effectiveness of this approach has been demonstrated by both multilateral and bilateral donors with strategically targeted transactions.³² More funding needs to be made available to cover the very large transaction costs with these first transactions, covering the large legal and administrative expenses.
 - **“Learn by doing” transaction programmes.** Project participants underlined the imperative for donors to conduct wide-scale programmes that develop deals even when the country environment lacks the requisite regulatory and legal frameworks. Transactions provide critical vehicles for “learning by doing”, serving to effectively demonstrate to country government officials and stakeholders the imperative for change in the country environment (such as legal, regulatory and institutional frameworks) and enabling the identification of appropriate country-specific priorities. In essence, transactions can serve to “test” for priority changes and signal appropriate customized enhancements, creating the demand and dynamic for focused prioritized reforms. An additional mechanism that might be used (often used in existing donor programmes) is to tie access to donor project funding to the participation in capacity-building programmes.
 - **Official private sector communication venues.** A critical means of enhancing official sector capacity, both at the country level (national and sub-sovereign) as well as development agencies is through the use of venues that facilitate collaboration with private sector experts and organizations. Interaction can help educate officials on the need for changes in government policies and improving the business environment, as well as the need

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to improve skill sets and official sector services in risk mitigation and project development. Study participants recommended the need to enhance donor support of public-private working venues aimed at improving sub-sovereign issues, infrastructure (such as water), risk mitigation, and improving the business environment and integrating them into core development activities.³³

- **Enhanced disclosure.** The catalytic effect of “transparency” has been widely recognized. Recent initiatives have shown the vast potential of enhanced disclosure and transparency in catalysing better financial governance and improving the overall business environment, creating pressures to adopt new processes and enhance in-country capacity building in accounting, auditing, project management and other critical business functions. Examples include donors openly publishing their disbursements to governments, countries publishing concession contracts and licenses for private infrastructure projects, and global campaigns to enhance the transparency of revenue arrangements between governments and firms.³⁴ Development institutions need to set firm disclosure requirements, further employing surveys as well as third party entities to measure performance.
- **Open client evaluations and independent auditors.** Incentives to accept capacity-building assistance can be increased through the use of independent auditors that monitor compliance. For example, the Nigerian government agreed to publish budgets and records of oil revenue collection, as well as applicable statutes and rules, and ask oil companies to also make full disclosure of their revenues and costs. Both disclosures are then examined by an independent auditor to access any differences.³⁵ The general use of third party entities, coupled with open disclosure of evaluations, can be employed much more widely by development agencies as a catalytic mechanism to create pressure for change, setting the prerequisite dynamic for capacity building and improved business environments.

E) Strengthen Investment Project Pipelines through Project Development Support

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

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

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

While some successful efforts in project development have been made (with new initiatives forthcoming),³⁶ both government officials and private sector companies cite the current lack of project development funds as a key bottleneck, cutting off at the very inception of an investment opportunity

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any promise of private sector investment. Existing funds for this purpose are reported as difficult to access and often tied to donor home-country suppliers, thus eliminating project sponsors and other suppliers from participation and failing to capitalize on local engineering and financial talent.

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

- **Increase scope and sustainability of funding.** Project development funding needs to be increased dramatically in scope and committed on a long-term basis (over five years). Multi-donor funding is critical at different levels (sub-sovereign, national, regional and global) using technical assistance grants or revolving funds to finance the development costs of a pipeline of infrastructure projects. Project development funds are critical for covering initial costs, but may be able to build in self-sustaining revenues from successful projects. In any case, donors need to insure long-term sustainability that successfully creates the capacity within the country to develop projects on an ongoing basis.
- **Simplify procurement and reduce transaction costs.** Procurement rules can prove counter-productive, hurting the ability of many qualified organizations and experts to provide project development services. In addition, recipients do not have easy access to information on available services. New streamlined processes need to be developed to both facilitate a larger supply of expert services to meet unmet demand, as well as the ability of countries to select the most qualified relevant experts. Project development funds need to be available for the most appropriate uses and not limited to using the services of the donor country.³⁷
- **Target funding at country and sub-sovereign levels.** Funds need to be operative at the country as well as sub-national levels, integrated to support the country's national development plans, including PPP and competitiveness programmes. Customization to the specific needs of the country (state, municipality) as well as the sector, project and client is critical for effectiveness. There is a special need to create new funding targeted at the individual sub-national level to help prepare individual projects for financial support, in the form of feasibility studies, demand assessments, etc. As noted in the section on capacity building, this funding needs to address overall capacity building with independent reviews to assure the quality and completeness of pre-existing feasibility and engineering studies; financial advisory services for project structuring; technical assistance for project implementation and oversight (including preparation of bidding documents, review of technical proposals, supervision of investments and commissioning); and obtaining full or shadow credit ratings.

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IV. Conclusion

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

Endnotes

¹ *Global Financial Stability Report*. April, 2005. Washington DC: IMF.

² Sheppard, J. Robert Jr based on (a) foreign security holdings calculated from Federal Reserve data and Merrill Lynch report on world bond markets; (b) total asset data from Watson Wyatt, Insurance Information Institute and Investment Company Institute.

³ For infrastructure cost estimates, see, e.g., *Global Development Finance 2004* and *Infrastructure and the World Bank – a Progress Report 2005*, both issued by the World Bank, Washington DC.

⁴ ADB, JBIC and World Bank. *Connecting East Asia: a New Framework for Infrastructure*. 2005. Manila, Tokyo and Washington DC.

⁵ For MDB cost estimates, see 2004 and 2005 editions of *Global Monitoring Report*, published by the World Bank, Washington DC.

⁶ World Bank. *Global Development Finance 2004*. Washington DC. The nine institutions were ADB, AfDB, EBRD, EIB, IBRD/IDA, IDB, IFC, IsDB and MIGA.

⁷ The unused capacity of Multilateral Development Banks is calculated from official sources based on the statutory guidelines in the charters that stipulate possible exposures up to the total of callable capital. Exposures include disbursed and undisbursed loans, guarantees and equity investments. Please note that utilization of capacity is inherently dependent on access to capital markets and demand. Sources: Annual Reports and Standard & Poor's.

⁸ Others, including a commission led by Paul Volcker and Angel Gurría, challenged the Meltzer recommendations on grounds of continuing need for MDB assistance in these countries.

⁹ For the official ODA statistics, see the information collected by the Development Assistance Committee: http://www.oecd.org/document/3/0,2340,en_2649_33721_34700611_1_1_1_1,00.html
http://www.oecd.org/document/9/0,2340,en_2649_33721_1893129_1_1_1_1,00.html.

¹⁰ Kapur, Devesh, John P. Lewis and Richard Webb. *The World Bank: Its First Half Century*. Washington DC: Brookings, 1997.

¹¹ This section on guarantees depends very heavily on (and quotes freely from) Winpenny, James. *Guaranteeing Development?* 2005. Paris: OECD.

¹² Ibid.

¹³ Op. cit.

¹⁴ The IFC Municipal Fund has successfully used first loss provisions to herald new sub-sovereign transactions. See IFC Municipal Fund: <http://www.ifc.org/municipalfund>.

¹⁵ See AFGI: <http://www.afgi.org/finannualrept97.htm>.

¹⁶ See the proposals set forth by Thomas Felsberg (Managing Partner, Felsberg & Associates) and Mahesh Kotecha, (President, Structured Credit International) at www.globalclearinghouse.org/wefbrazil and www.globalclearinghouse.org/wefnewyork. Also please note there are recent efforts to develop monoline facilities by bilateral donors (e.g., Guarantco).

¹⁷ Key examples of securitization structures are Collateralized Bond Obligations (CBOs), Collateralized Debt Obligations (CDOs) and Collateralized Loan Obligations (CLOs).

¹⁸ Global Development Bonds (GDBs) would rely on established techniques such as diversification, over-collateralization, and tranching. GDBs also would augment these market techniques with automatic political risk insurance coverage from public sector agencies for authorized issuers and, in most cases, with a currency devaluation facility, callable equity and a monoline wrap for the senior tranche. The bonds would be backed by existing and new, emerging market infrastructure and corporate debt, and be rated, tradable securities.

¹⁹ See, for example, the World Panel on Financing Water Infrastructure (Camdessus Report) 2003, and "Targeted Risk Mitigation Using Contingent Facilities," Bob Sheppard, Co-Chair of the Infrastructure Experts Group, www.globalclearinghouse.org/wefhongkong.

²⁰ See Goldschmidt, Gabriel, Principal Investment Officer, Latin America & Caribbean Department, International Finance Corporation. "Defining an Innovative Menu of Options & Advisory Support for Customizing to Specific Country Needs." www.globalclearinghouse.org/wefbrazil. For information on Output-Based Aid, see <http://rru.worldbank.org/Discussions/Topics/Topic4.aspx>

²¹ Operations Evaluation Department, World Bank. *OED Review of Bank Assistance for Financial Sector Reform*. 2005. Washington DC: World Bank.

²² In five years, USAID's Credit Development Authority has made 114 guarantees totalling US\$ 335 million, enabling the extension of US\$ 856 million of private sector credit in 36 countries. These US government-backed guarantees are designed to promote new or expanded lending from the private sector for activities that have a positive development activity. See USAID Guarantees, Year in Review 2004, http://www.usaid.gov/our_work/economic_growth_and_trade/development_credit/year_in_review_2004_4_05.pdf. For example, see Haddon, Jonathan. "Tenor Extension Guarantees." Orrick Herrington & Sutcliffe, www.globalclearinghouse.org/wefbrazil.

Endnotes

²³ The EBRD Municipal Finance Facility is explained at <http://www.ebrd.com/country/sector/fi/euebrd/munic/index.htm>. For an example of the EU Phare programme, see

<http://www.ebrd.com/new/pressrel/1996/68oct10.htm>.

²⁴ See Fonseca, Vinicio. "Multilaterals Provide Brazilian Export Credit Agencies with a Political Risk Breach of Contract Guarantee." Odebrecht, www.globalclearinghouse.org/wefbrazil.

²⁵ See Sagar, Ajay. "Local Currency Swaps and other Instruments." Asian Development Bank, www.globalclearinghouse.org/wefhongkong, and Habeck, Odo. "Multilateral Sponsored Regional Swap Facility," OGH Advisors, www.globalclearinghouse.org/wefbrazil.

²⁶ For example, see Pellegrini, Tony. "Leveraging Official Sector Financial Instruments to Increase Local Funding of Subsovereign Infrastructure." International Association of Development Funds, www.globalclearinghouse.org/wefbrazil.

²⁷ The equity holding of local development banks should be so structured as to ensure professional management, broad-based boards with independent directors, and appointment of the CEOs by the boards. Shareholders could include: public financial institutions; public funds; mutual funds; local banks; international financial institutions (like IFC, World Bank, regional development banks, etc.); domestic and/or international private funds; domestic and/or venture capital funds; funds operating under bilateral and multilateral arrangements; and local public at large by market borrowing programmes. See Narain, Sailendra. "Significance of Local Development Financial Institutions in Developing Countries." Centre for SME Growth & Development Finance, www.globalclearinghouse.org/wefhongkong.

²⁸ One development expert estimates that only US\$ 6 billion of the total US\$ 18 billion reportedly spent on capacity-building programmes is spent on in-country goods and services. For the official statistics, see the information collected by the Development Assistance Committee:

http://www.oecd.org/document/3/0,2340,en_2649_33721_34700611_1_1_1_1,00.html

http://www.oecd.org/document/9/0,2340,en_2649_33721_1893129_1_1_1_1,00.html.

²⁹ For proposals on key issues and processes, see Cochran, Tom. "Subnational Borrowing Policy Action Proposals," CivilCredit Advisors, www.globalclearinghouse.org/wefnewyork; and Wood, Betsey, "Private Sector Governance Training Initiatives - Can a Global Corps of Financial Experts Help?" Financial Services Volunteer Corp, www.globalclearinghouse.org/wefhongkong.

³⁰ The Cape Town Convention on International Interests in Mobile Equipment and the Aircraft Equipment Protocol were concluded on 16 November 2001 at a Diplomatic Conference jointly sponsored by the International Institute for the Unification of Private Law (UNIDROIT) and the International Civil Aviation Organization (ICAO) in Cape Town, South Africa.

³¹ A growing amount of openly disclosed business survey and governance-related reports are now available as information sources for both policymakers and investors. Examples include Investment Climate Surveys (covering more than 26,000 firms in 53 developing countries, econ.worldbank.org/wdr/wdr2005); the Doing Business Project (which benchmarks regulatory regimes in 130 countries, www.worldbank.org/ics); and Global Integrity Reports (which covers overall governance), <http://www.publicintegrity.org/ga/scores.aspx?cc=ar&ct=scores>). Also see Kraay, D. Kaufmann, and M. Mastruzzi. 2005. "Governance Matters IV: Indicators for 1996-2004." World Bank Institute (draft).

³² For example, IFC Municipal Fund has reported successful demonstration transactions (e.g., South Africa, Mexico). Many donors such as USAID's Credit Authority routinely combine capacity building programmes with guarantee and lending programmes.

³³ Examples of working groups that need more donor support to increase effectiveness are: the International Association of Development Funds (<http://www.developmentfunds.org/>) International Private Water Association (<http://www.ipwa.org/>), Infrastructure Experts Group (www.infradev.org) and Government-Investor Networks (www.globalclearinghouse.org/gin).

³⁴ Examples include the Extractive Industries Transparency Initiative, encouraging governments and firms to reconcile payments by firms to governments and account for any missing amounts and The Publish What You Pay Campaign, proposing legislation that requires oil and mining companies to disclose payments to the government as a condition for stock exchange listings.

³⁵ See *World Bank Development Report 2005*, p. 52.

³⁶ Examples include The Balkans Infrastructure Development Facility (www.bidfacility.com); USAID/INDIA FIRE Program (www.usaid.gov/press/releases/2000/fs20000085.htm); and PPIAF (www.ppiaf.org/).

³⁷ The problems associated with tied aid are explained in Klein, Michael and Tim Hartford. *The Market for Aid*. 2005. Washington, DC: IFC.



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