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# **PRIVATE SECTOR DEVELOPMENT STRATEGY**

## **REPORT ON EXTERNAL DIALOGUE**

**November 15, 2001**

In preparation of the PSD Strategy for the World Bank Group the Executive Directors of the World Bank Group authorized an issues paper for public discussion which focus on proposed new approaches. The paper "Private Sector Development Strategy: Issues and Options " was released on June 1. A dialogue was held with a range of parties including governments, the private for-profit sector, NGOs and trade unions during June, July and August 2001. A report summarizing the discussions was prepared.

Both the "issues and options" paper and the report on the dialogue are contained in this document, which accompanies the proposed PSD Strategy for the World Bank Group.

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**Private Sector Development Strategy**  
**— Issues and Options—**

**A DISCUSSION DOCUMENT**

**June 1, 2001**

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# PRIVATE SECTOR DEVELOPMENT STRATEGY

## — Issues and Options —

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# PRIVATE SECTOR DEVELOPMENT STRATEGY

## — Issues and Options —

### I. INTRODUCTION

This discussion paper is meant to elicit feedback on a select set of issues and options that may form part of the future Private Sector Development (PSD) strategy of the World Bank Group (WBG). The paper is the outcome of a discussion process within the WBG dating back to mid-2000 culminating in a discussion with the Executive Directors of the World Bank Group on May 23, 2001. The options presented in the paper do not constitute recommendations either of Management or the Executive Directors of the World Bank Group. However, the topics are seen as meriting serious attention and debate.

The paper is focused on six major themes:

- The creation of an investment climate that promotes growth and provides opportunity for the poor;
- The role of the private sector in enhancing access to social services for the poor;
- The role of private solutions in providing access to infrastructure services in environments with weak governance;
- Ways to deploy WBG instruments so as to shift performance risk from taxpayers in developing countries to private providers and to target subsidies better to the poor;
- Ways to impose disciplines on the provision of finance and advice to private parties by the World Bank Group so as to allow explicit targeting of subsidies on activities where such subsidies are required to support the poor or to deal with externalities such as environmental ones; and
- Transparent ways of measuring subsidies embedded in World Bank Group products and evaluating their impact.

A full-fledged draft PSD strategy is planned to be presented to the Executive Directors of the World Bank Group by December of 2001. That eventual strategy would broadly be structured around the following questions:

- How can the private sector best complement the public sector in achieving the overarching goal of poverty reduction?
- What is the role of development institutions in furthering and developing an appropriate role for the private sector?
- What is the comparative advantage of the World Bank Group in this respect?

- How can the different parts of the World Bank Group best complement each other in their PSD activities so as to contribute effectively to poverty reduction?
- How can the objectives of the World Bank Group's PSD work best be defined and measured?

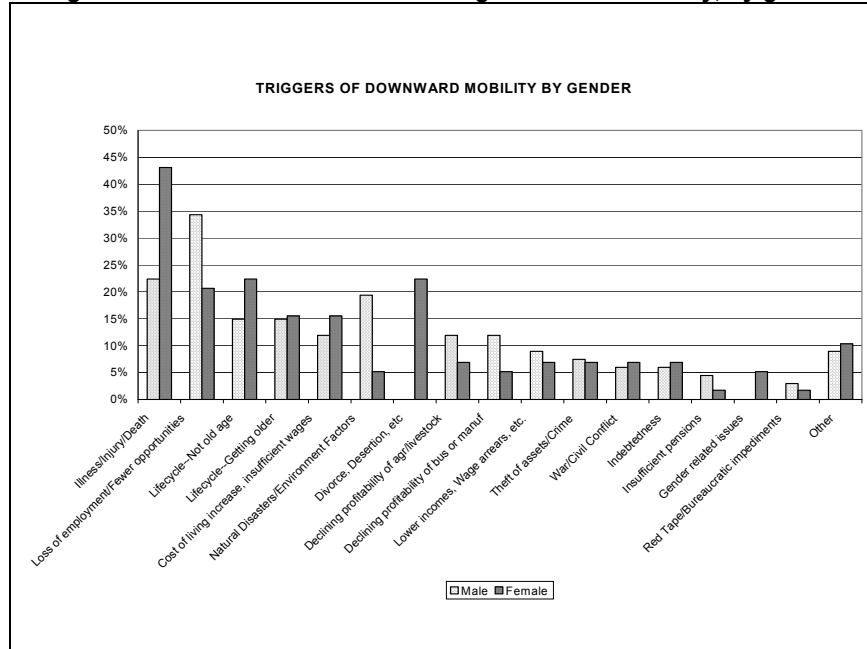
Answers to these questions are intimately linked, because any PSD strategy is not about a traditional sector like transport or education, but about a way of doing things. The ways of doing things that the Bank recommends to clients can also apply to itself. For example, if certain activities are better carried out by the private sector in a country, that might also apply to activities of the WBG itself, which should then leave such activities to private parties. Hence a PSD strategy has potentially broad implications for overall WBG strategy.

The six themes, on which this paper focuses, form only part of the issues to be addressed in a PSD strategy. They are intended to represent a set of particularly thought-provoking options that may yield new innovative ways of placing private initiative at the service of the poverty reduction effort.

## **II. PSD STRATEGY AND POVERTY REDUCTION**

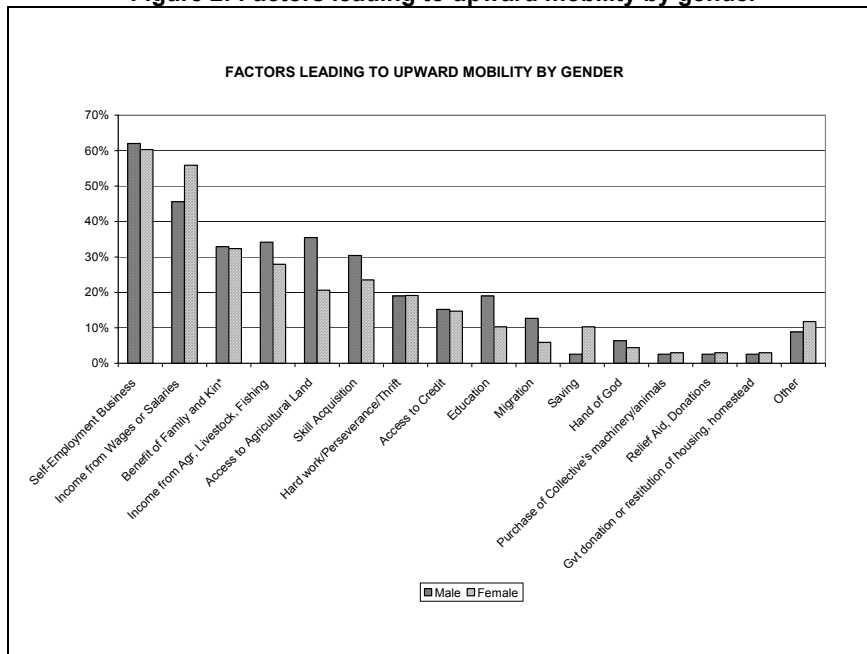
**A. Opportunity for the poor.** De facto, the private sector is one of the central features in the life of poor people across the world. Almost all of the poor pursue some form of private activity to earn their living. They may work as farmers, as small entrepreneurs or as laborers for others. Roughly two-thirds of the poor work in rural areas on farms or on non-farm activities. The Bank's study "Voices of the Poor" documents that next to illness and injury, the scope for entrepreneurial activity and the availability of jobs is the most important factor determining the fate of poor people – for better or for worse (Figures 1 and 2). Overall, opportunities for jobs and entrepreneurial activity in the private sector are critical for the poor. Hence the pervasive importance of small and medium enterprises, of small informal activity and of micro-finance services (Audretsch, 2000; Aw, Forthcoming; Hallberg, 2000; Morduch, 1999; Nugent and Yhee, Forthcoming; OECD, 1997; Snodgrass and Biggs, 1996). In many cases improved security of property rights for the urban and rural poor are means to improve their access to credit (de Soto, 2000; Dollar and Kraay, 2000). Access to credit enhances opportunity and security for the poor.

**Figure 1: Shocks and stresses causing downward mobility, by gender**



Source: Narayan et. al. (2000b).

**Figure 2: Factors leading to upward mobility by gender**



Source: Narayan et. al. (2000b).

**B. Basic services for the poor.** The poor also receive most basic services from private providers or through their own effort. Women in particular often suffer from poor service offerings and have to spend considerable time to obtain water and fuel for their family. Energy, water and communication services are typically privately provided in the

poor areas of the world, where national public sector networks typically do not reach. Basic health and education are also in large part provided by private parties to poor citizens (Table 1). Even where public services can in principle reach the poor have often voted with their feet and chosen private offerings due to better quality and service orientation (Narayan et. al., 2000a).

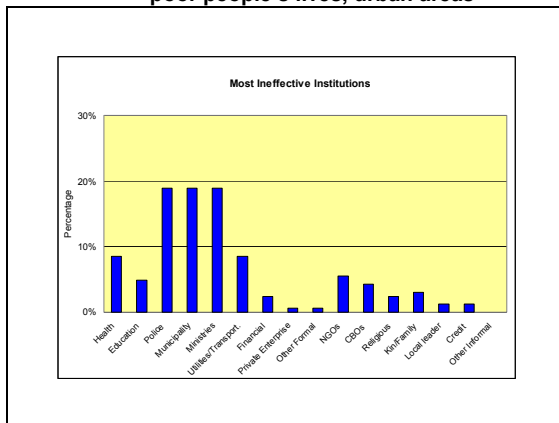
**TABLE 1: PERCENT OF TOTAL HEALTH EXPENDITURES THAT ARE PRIVATE**

	SHARE OF PRIVATE HEALTH EXPENDITURES	NUMBER OF COUNTRIES
All countries	53.6	115
Low income	63.1	32
Low-middle income	42.8	36
High-middle income	54	15
High income, non-OECD	62	10
High income, OECD	32.6	22
East Asia and Pacific	53.2	14
Latin American and Caribbean	58.1	32
Middle East and North Africa	47.4	11
South Asia	74.8	5
Sub-Saharan Africa	59.6	19
Rest of the world	29.3	34

Source: Filmer et. al. (1997).

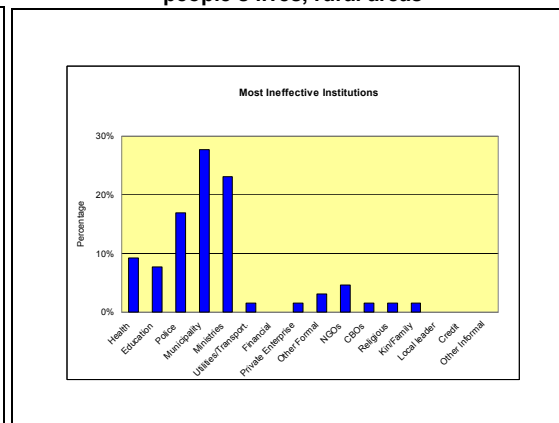
The people interviewed in “Voices of the Poor” consider private sector institutions to be much less ineffective than many other institutions. They like community-based organizations and family support better, but they have little doubt that the private sector is among the least ineffective institutions (Figures 3 and 4).

**Figure 3: Most ineffective institutions in poor people’s lives, urban areas**



Source: Narayan et. al. (2000b).

**Figure 4: Most ineffective institutions in people’s lives, rural areas**



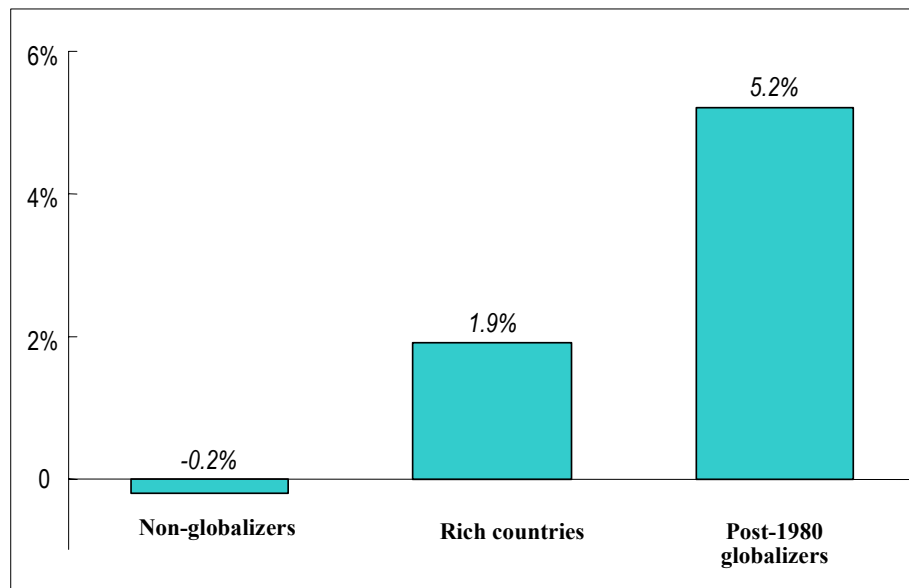
Source: Narayan et. al. (2000b).

**C. The engine of growth and poverty reduction.** The role of the private sector is not only relevant, because poor people happen to be employed in it or because they are de facto served by it. More importantly entrepreneurship and markets are critical tools to raise productivity and thus allow the poor not just to have a job or business, but a

progressively better paying one. Furthermore, the hope of better basic service delivery for poor people in many cases lies in shifting performance risk to private parties, while focusing the public sector's effort on improving the regulatory framework and building institutional capacity (West and Martin, 2001).

During the second half of the 20<sup>th</sup> century, for the first time in history, it has become possible for poor people everywhere to escape from poverty within a human life span. Prior to the industrial revolution, income and living conditions in the world had remained little changed for thousands of years. Today, a wide variety of countries have been able to double average per capita income in about 10 years (e.g. Botswana, Chile, China, Ireland, Japan, Korea, Thailand) – by adopting and adapting technical and organizational advances already invented elsewhere (Figure 5).

**Figure 5: Convergence and divergence in the 1990s**  
GDP per capita growth rates



Source: Dollar (2001).

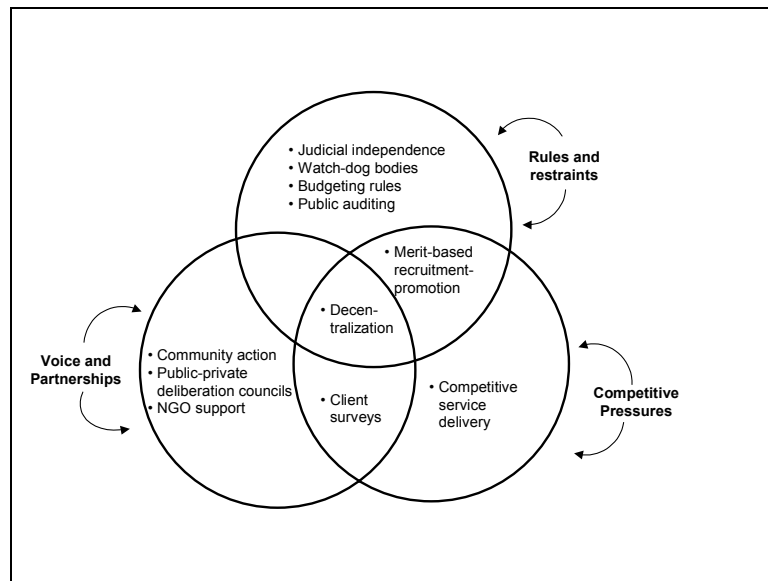
This growth in productivity is the very reason why we can even think about international development targets like halving poverty by 2015. By the same token we can today be upset about the lack of progress in poverty reduction in many countries, particularly Africa – precisely because growth and, therefore, rapid poverty reduction is now possible, but not automatic and growth does not always translate into effective poverty reduction – across countries or within them (Collier and Gunning, 1997; Stiglitz, 1998).

Enabling the poor to benefit from productivity advances and better service options is at the core of the development challenge. Effective poverty reduction requires a balance between the state and the private sector such that the private sector's initiative and efficiency is exploited in the interest of citizens and with respect for the environment. More broadly development requires functioning communities and a level of co-operation

and trust in society (“social capital”) (Collier, 1998; Fukuyama, 2000; Guisaco et. al., 2000; Knack, 1999; Ostrom, 1997). At the same time competition is required that provides choice for citizens and that creates new opportunity for entrepreneurs and workers as well as incentives to improve productivity.

Getting the balance between competition and co-operation right is hard. We may characterize the critical task of institution-building as resting on three pillars (Figure 6) - voice and partnership, rules and restraints and competitive disciplines. The PSD strategy is particularly concerned with the introduction of competitive disciplines that help channel private initiative in socially useful directions. From this perspective PSD is a way of helping focus the state and other institutions on critical public functions and rendering them more effective.

**Figure 6: Mechanisms to enhance state capability – three drivers of public sector reform**



Source: World Bank (2000a).

The core of the contribution that the PSD agenda can make to development is the creation of a sound investment climate. A good investment climate promotes markets that provide opportunity for entrepreneurs and create jobs supported by adequate institutions (World Bank, Forthcoming). For example, in a number of cases a key role for the government is to open up entry for entrepreneurs and to provide citizens with choice. Such policy approaches and concomitant reduction in “red tape” also tend to reduce opportunities for corruption (Brunetti et. al., 1998; de Soto, 1989; Pfefferman and Kisundo, 1999; World Bank, 2000b)

Openness to “best practice”, entrepreneurs and markets embedded in decent governance systems are a key reason, why we can have hope for poverty reduction. The effective and rapid adoption of best practice requires openness to new ideas and technology. Competition provides incentives to adopt them (Geroski, 1990; Nickell, 1996; Scherer,

1992; World Bank, Forthcoming). Competition means free entry for new entrepreneurs. This creates opportunities for all sorts of firms, be they small, medium or large. New entrants try new ways of doing things and are crucial to the process of diffusing best practice. Competition also means choice for customers. This empowers consumers and makes firms responsive to them. Overall open and competitive markets, supported by facilitating public policies, have proven to be the best mechanism both to stimulate innovation and to spread best practice within countries and across borders. Growth, driven by such markets, is a powerful pre-requisite for poverty reduction.

For example, openness to technology imports and product market competition, particularly in demanding export markets but also among domestic firms, underpinned much of the growth of East Asian economies (Stiglitz, 1998). At the same time the experience of the Asian crisis has driven home the importance of governance mechanisms, particularly for financial markets (Caprio and Honohan, 2001). The most comprehensive survey (over 50 studies) of the experience with trade liberalization suggests that the costs of trade liberalization are small compared to the benefits (Matusz and Tarr, 1999). Liberalization and deregulation has tended to favor labor-intensive and rural occupations. This has produced a boost to growth and led to only relatively short episodes of increase in unemployment for a relatively small part of the affected population. This is not to downplay the hardship that may be imposed on losers in the process. However, without the introduction of market forces it has proved hard to raise living standards (Edwards, 1997; Frankel and Romer, 1999; Sachs and Warner, 1995; Srinivasan and Bhagwati, 1999; Winters, 1999; see Rodriguez and Rodrik, 2000 for a critique of the above).

In a similar vein, the experience with privatization, which is as controversial or more so than that of trade liberalization shows success - when done right. Studies of several thousand of privatization cases in countries across the globe suggest that privatization into a competitive or well-regulated market environment is typically better than state-ownership. Even when the environment was not prepared perfectly, privatization has fared relatively well compared to realistic alternatives (Barnett, 2000; Bernal and Leslie, 1999; Boubakri and Cosset, 1998; Boubakri and Cosset, 1999; Djankov and Murrell, 2000; D'Souza and Megginson, 1999; Earle and Estrin, 1998; Ehrlich et. al., 1994; Frydman et. al., 1999; Galal et. al., 1994; Harvylyshyn and McGettigan, 1999; Jones et. al., 1999; La Porta and Lopez-de-Silanes, 1997; Megginson et. al., 1994; Megginson and Netter, 2001; Newbery and Pollitt, 1997; Petrazzini and Clark, 1996; Pohl et. al., 1997; Shirley and Walsh, 2000).

The effective shift to private markets is normally critically dependent on opening up entry for new firms that are not controlled by incumbents – not just on privatization of existing assets. New entrants create new jobs and provide essential competition that disciplines state-owned firms as well as privatized ones provided they operate under hard budget constraints. This has proven particularly important in transition economies (Pinto et. al., 1993; see Frydman et. al., 1998 for limitations of budget constraints). Sometimes privatization has distributed wealth to well-connected parties. To prevent such effects privatization design needs to take into account the corporate governance environment and

ways to target benefits to citizens more broadly. Full privatization is not always the best approach. Where private participation is considered for natural monopolies, concession-type arrangements may play a useful role (Klein, 1998).

Connecting the poor to markets by giving them choice, by providing entrepreneurial opportunity, by building roads and communication systems – all such measures support the most powerful mechanism for escaping poverty, namely the ability to adopt and adapt improved practices. People also need some minimum of health and education to respond to new opportunities and increase income. As is well-known improved education, particularly of girls, is probably the most powerful tool to help correct inequality in income distribution.

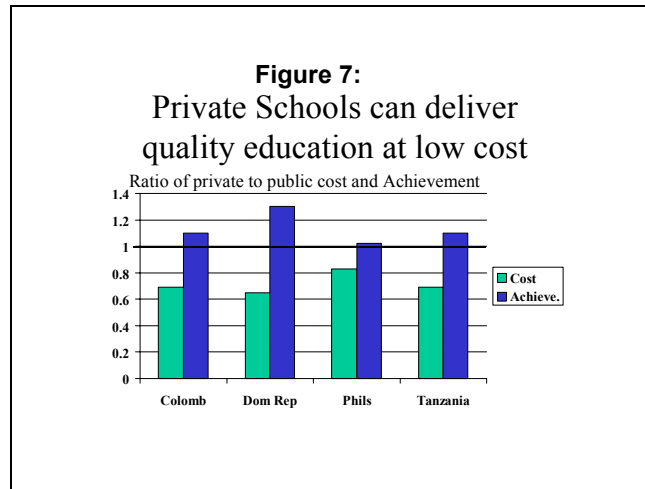
The interplay between better governance systems and the development of entrepreneurs and markets is crucial. This does not mean that countries need to wait for governance systems to be perfect before creating markets. Competition is part of the system of checks and balances that helps create good governance. The weaker the governance climate in a country, the stronger in many cases the argument for free entry and choice for citizens. In designing policy and project interventions government failure has to be weighed, case-by-case, against market failure.

**D. Basic service delivery and the role of markets.** The amount of potential resources available from donors is now relatively large compared to known poverty dimensions and the grant element in aid is now about 75 to 80 per cent of total transfers (World Bank, 2001). For example, in Africa's low-income countries the average aid level amounted to about 9 per cent of GDP during the 1990s. At the same time the poorest 20 per cent of people had incomes equivalent to just 4 per cent of GDP (World Bank, 2000c).

The world has become so rich that poverty elimination is within practical reach (UNDP, 2000). The critical elements are adequate resources and delivery systems with improved incentives such that intended beneficiaries are reached. A number of traditional delivery systems have failed to provide effective service, particularly to poor citizens and subsidies have often not been well targeted and reached richer parts of the population (Castro-Leal et. al., 1999).

The last decade has seen a number of experiments to tap the potential of private initiative to improve basic service delivery. Both in infrastructure and in the social services effective models have been tested (for infrastructure, see Bacon, 1994; Baker and Tremelot, 2000; Bartone et. al., 1991; Brook and Tynan, 1999; Brook, 2000; Collignon and Vezia, 2000; Ehrhardt, 2000; Estache et. al., 2000; Izaguirre and Rao, 2000; Klein and Roger, 1994; Komives and Brook, 1998; Komives et. al., 2000; Lawson and Meyenn, 2000; Mariño et. al., 1998; Maas, 2001; Roger, 1999; Saghir et. al., 1998; Wellenius, 2000; for social services, see Hoxby, 2000; James, 1990; James, 1991; Jimenez and Sawada, 1998; OECD, 1994; Filmer et. al., 1997; Shobhana, 2000; West, 1997). Despite abuses of privatization processes and despite remaining problems a number of private ventures have led to improved service delivery than alternative public providers for

example in water concessions in Abidjan, Buenos Aires and Santiago (Clarke et. al., 2000; Noll et. al., 2000) or in some education systems (Figure 7). Also, a number of developing countries have demonstrated that it is possible to improve electricity systems by way of operating wholesale market competition, most notably Chile and Argentina (Chisari et. al., 1999; Jadresic, 2000; Lalor and Garcia, 1996; Wellenius, 1997).



Source: Jimenez et. al. (1991).

More and more private and market-based schemes have not only shifted performance risk to competent private parties. In addition, in several cases public resources have been focused more directly on targeted subsidy schemes to reach the poor, for example in water and telecommunications (Bosch, 2000; Foster et. al., 2000; Gomez-Lobo et. al., 2000; Yepes, 1999).

### III. THE ROLE OF THE WORLD BANK GROUP IN PROMOTING PRIVATE SECTOR DEVELOPMENT

**A. Interventions of the WBG in support of PSD.** Much of what the WBG does can help promote private sector development. At the broadest level the creation of a sound investment climate is the critical pre-requisite for private sector development. A sound investment climate requires macro-economic stability, good governance (e.g. rule of law, absence of corruption, functioning financial sector, a regulatory framework that safeguards social and environmental concerns), sound infrastructure and educated, healthy individuals. Various parts of the World Bank Group contribute to this. In this sense private sector development is being promoted across the Group. The contribution from the PSD operations of IBRD/IDA and from IFC and MIGA to the creation of a good investment climate lies in three broad areas:

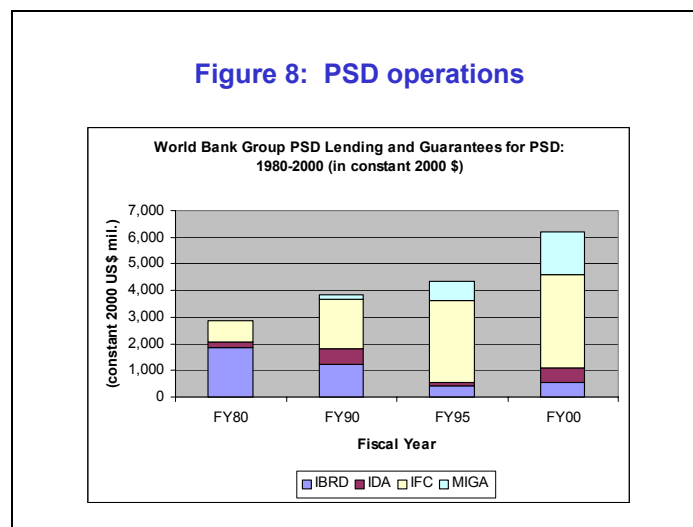
- Policy work and policy-based lending to promote open, competitive private markets (sound property rights systems, company tax systems, removal of entry and exit barriers, deregulation of pricing, etc.).

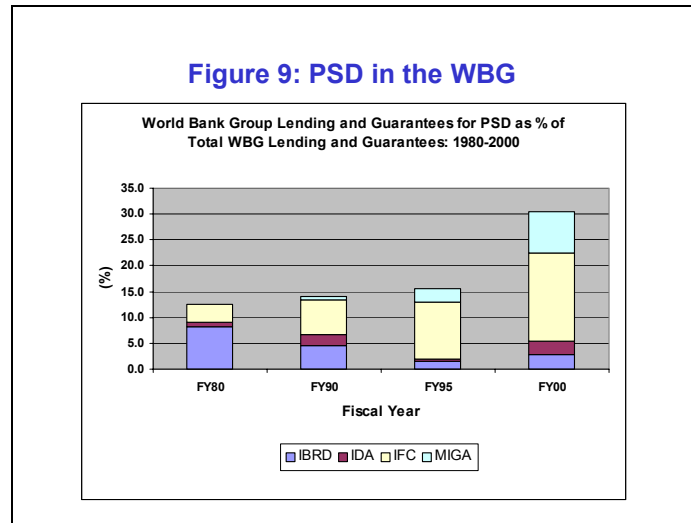
- Demonstration projects, direct financial or advisory assistance to SMEs and micro-enterprises (creation of support institutions for SMEs, micro-finance schemes, entrepreneur training schemes etc.).
- Support of privatization, concession and contracting-out options for the delivery of goods and services (choice of market structure, market design, regulatory regime, privatization process design and management, financial support).

Measured by lending and guarantee volume the WBG as a whole has increased PSD operations by about 60 per cent during the 1990s in real terms. In relative terms the share of PSD operations has increased from about 14 percent in 1990 to about 30 per cent in 2000 (Figures 8 and 9). This rapid increase in relative terms is due to the combination of the real increase in PSD operations combined with an overall absolute decline in IBRD operations.

The increase in PSD operations is mainly due to an increase in operations of IFC and MIGA. The Bank (IBRD/IDA) itself still lends in the order of US\$1 billion to private firms via on-lending operations. However, the Bank has withdrawn from lending to public enterprises in many sectors where competition and private participation works. IFC and MIGA have taken over here.

Taxpayers in client countries are responsible for paying back Bank loans even if projects or recipient enterprises do not perform. This is not the case for IFC and MIGA operations, both of whom assume the risk of project or enterprise performance. The shift in operations from the Bank to IFC and MIGA thus implies that performance risks have been shifted from taxpayers in developing countries to private investors. This not only promises to support growth but will also help reduce the exposure of taxpayers in poor countries to public sector debt and thus help reduce the dependency of poor countries on government debt.





**B. Core issues for discussion.** Looking forward more and more sector strategies of the WBG have embraced the potential of PSD approaches as have, as a matter of course, IFC and MIGA. Competition and transparency are recognized as the tools that allow governments to become more effective and citizens to be better served by adopting PSD approaches. The recent public institution and governance strategy paper is written in a fashion complementary to the proposed PSD strategy, highlighting the scope for competitive disciplines to improve government performance (World Bank, 2000a).

While many sector strategies have embraced private sector development and while implementation is moving in the same direction a number of key areas remain, where some re-orientation of strategies might make sense. In some cases such re-orientation would affect the broad thrust of strategy, in others it would be more about disciplined implementation. The following three main themes may warrant further thought and re-orientation:

*i. The investment climate*

The WBG has undertaken much work in support of an improved investment climate in client countries. This ranges from work on the governance environment and institution-building including strengthening the rule of law via support for efficient financial sector development to the provision of infrastructure and social services that allow people to respond to economic opportunity. One particular feature of a good investment climate is the space it creates for entrepreneurs and markets to develop and exploit new opportunities for growth and job creation across the economy (Dollar, 2001; World Bank, Forthcoming). This is, of course, of particular importance for the development of small and medium enterprises. Furthermore, the Bank Group is pursuing the development of policies and practices that render private activity compatible with social and environmental sustainability. This includes efforts to foster corporate responsibility. The general direction for work on the investment climate is widely agreed. At the same time many detailed issues remain to be addressed and the WBG is grappling with these. The

PSD strategy will aim at providing goals and mechanisms to enhance the quality of work, two of which are highlighted here.

First it may be desirable to conduct more systematic work across countries and over time to improve the design and implementation of policy reform for a better investment climate. In addition, most direct financial or non-financial assistance to private firms appears ineffective when the basic policy and institutional framework is deficient – just like for aid effectiveness overall. To operationalize this basic approach there would also be a need for better systematic assessment of the quality of the investment climate across countries and over time. This would be needed to underpin better policy-based lending. In addition, decisions on World Bank Group interventions in support of firms could also be made on the basis of such assessments to prevent ineffective firm-level support. IFC's experience and interventions, which also help promote a good investment climate would need to be further integrated with the Bank's work.

Second, most PSD work has focused on supporting growth and thus hoped to support poverty reduction indirectly. More work may be required to assess the scope for more direct, effective pro-poor interventions. This would include (but not be limited to):

- Effective support to the development of small scale entrepreneurs;
- Ways to scale up micro-finance schemes;
- Improvements in property rights assignment and distribution;
- More aggressive incorporation of service obligations for the poor in private infrastructure schemes;
- More focus on complementing deregulation with the provision of basic infrastructure e.g. rural roads; and
- Targeted subsidy design.

None of this is entirely new, but it may require more focused attention.

#### **Questions for discussion:**

- **Is there agreement that the work on investment climate is critical and that the issues revolve around implementation issues?**
- **Are the highlighted implementation issues the critical ones and how should they be addressed?**
- **What role should the World Bank Group play vis a vis other actors including other multilateral or bilateral aid agencies or private actors?**

*ii. Improving access to basic infrastructure services in weak governance environments*

**Free entry into monopoly segments in infrastructure.** It is sometimes argued that public provision is preferred when governments have weak implementation capability for contracting-out or regulation. It is not clear that this follows, because weakness in exercising necessary regulatory functions is not necessarily improved by public provision. The alternative is to allow free entry even into natural monopoly segments of businesses, e.g. the wires of electricity systems or water pipelines. When that is allowed (Yemen and Cambodia - electricity, Somalia-telecom, Paraguay-water) consumers have more choice and service than when it is legally prohibited (as is the case in many low income countries). Allowing such small-scale entry of infrastructure service providers opens up options both for non-profit and for-profit providers and tends to rely on local rather than foreign providers (Baker and Tremolet, 2000; Brook and Tynan, 1999; Brook, 2000; Collignon and Veza, 2000; Ehrhardt, 2000; Estache et. al., 2000; Komives et. al., 2000). Financing is also easier to arrange for such options than for large-scale private projects. Domestic taxpayers are typically not exposed to credit risk that typically arises from explicit or implicit guarantees under large-scale projects.

Critics of such approaches fear “anarchy” among small-scale providers, inefficient system development and pockets of private monopoly power. The counter-argument is that problematic service that people choose to buy is still better than no service at all. After all the poor pay typically a lot more for service than the better-off. Light-handed regulation of service standards can help mitigate some of the problems associated with free entry into infrastructure. In the longer-term the transition to more efficient integrated infrastructure systems needs to be supported through gradual creation of an adequate regulatory environment (Smith, 1997a; Smith, 1997b; Smith, 2000).

**Questions for discussion:**

- **Should entry into natural monopoly areas of infrastructure systems be allowed, for whom and under what conditions?**
- **How should issues of quality and price regulation be tackled in weak governance environments? Can they be better handled when the public sector also provides the service or can regulation be better improved by delegating the responsibility for provision to non-governmental providers?**

*iii. Improving access for the poor to social services*

**PSD and the social sectors.** Another controversial issue is the role that market-type mechanisms can sensibly play in health and education. On the one hand, it is feared that markets and private participation could hurt the poor, because fees might go up or because service might be directed at the rich or because essential social goals might be neglected by private providers. On the other hand, the experience with public provision

in many low-income countries is disappointing and the poor have often chosen private providers, where they have the choice (Filmer et. al., 1997; Narayan, 2000a)

Potential solutions lie in allowing private (for-profit and not-for-profit) providers to enter the market where that is currently not the case to give the poor greater choice. If it is felt that such providers are not serving the poor adequately or that user fees would push the poor to stay away from essential services such as primary education, then subsidy schemes could be put in place to enhance the purchasing power of the poor (Cave, 2001; Greene, 2000; Kim et. al., 1998; King et. al., 1997; Patrinos and Ariasingam, 1997; Sawhill and Smith, 1998; Shokraii Rees, 2000; Vawda, 1997; see Carnoy, 1997 for a critique of education vouchers). Community participation could help set service standards (Benchemsi, 2000; Gugerty and Kremer, 2000; Jimenez and Sawada, 1998). Light-handed regulation of service standards (including mandatory disclosure requirements) combined with accreditation, certification and monitoring systems would often be required to help present the poor with better choices. More broadly, the delegation of service provision to non-governmental providers does not imply that government responsibility to ensure service provision is diminished.

#### **Questions for discussion:**

- **Should the WBG consider the options for private sector provision and customer choice in the social sectors?**
- **What role could communities have in setting service standards, monitoring service or providing service? How should the regulatory framework be developed for social service provision in weak governance environments?**

#### **IV. THE COMPARATIVE ADVANTAGE OF THE WORLD BANK GROUP VIS-À-VIS THE PRIVATE SECTOR**

**A. PSD in the Country Assistance Process.** The overall approach to PSD is part and parcel of the Comprehensive Development Framework (CDF) and complements other sector strategies. Based on consultative processes country assistance strategies need to be derived. As in the case of many other development issues there is no simple cook-book model for applying PSD approaches to particular types of countries. Case by case discretion is required to design the appropriate PSD component of a country strategy (Figure 10).

**Figure 10: PSD in the Country Assistance Process**

- |   |   |
|---|---|
| • Framework and approach                                | • CDF, sector strategies, PSD strategy                                      |
| • Country-specific application                          | • PRSP, CAS   |
| • Market-type disciplines on the exercise of discretion | • Rate-of-return target<br>• Output-based contract<br>• Unbundled subsidies |

To help provide focus and selectivity the particular question for a PSD strategy is what the respective roles of the WBG and the private sector should be and hence how they should relate to each other. Because PSD is essentially about a way of doing things, it has to be left to other sector strategies to provide guidance and focus on the content of the WBG's work, for example whether to work on certain sectors or certain topics.

**B. New ways of complementing the private sector.** There are two fundamental points. First, the private sector may often be better at assuming performance and market risks than public agencies. Shifting those responsibilities and risks to the private sector may thus be desirable. As part of this shift in risk allocation the exposure of domestic taxpayers in poor countries to the burden of public debt can be reduced.

Second, when shifting risks it is often desirable to unbundle some of the products of the WBG. For example, by unbundling the policy risk function from the traditional Bank loan freestanding policy risk guarantees have been created in the Bank and MIGA that shift commercial risk to private parties. There may now be further options available to shift performance risk to private parties so as to improve the investment climate and service for the poor. Unbundling the subsidy component embedded in some WBG financial products would allow targeting it better at its intended purposes or beneficiaries.

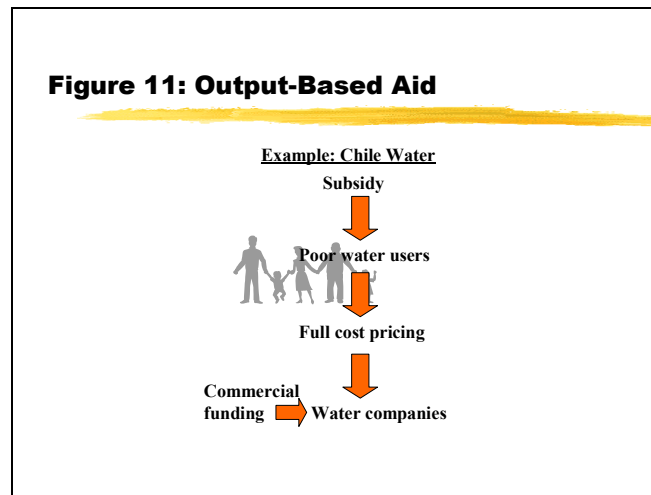
Three major themes are proposed for discussion:

*i. Output-based aid*

Traditional aid in some sectors and in some low-income countries has at times been associated with disappointing performance by the state-owned providers that were funded (Burnside and Dollar, 1997; Collier and Dollar, 2000; Easterly, 1998; Easterly and Levine, 2000; Pritchett, 1996; World Bank, 1998). In addition, subsidies embedded in aid funds may not have reached the poor but benefited the better-off. There are thus two

main issues: How to improve service to the poor and how to ensure that any subsidy judged necessary actually benefits the poor.

The key to better service delivery is to shift performance risk more effectively to service providers and away from taxpayers. This can be achieved wherever it is possible to disburse aid when service is delivered and not when inputs are constructed. Such schemes are, in principle, feasible in most parts of infrastructure and some areas of health and education (Figure 11; Brook et. al., 2000; Vinson, 1999). Service standards should be responsive to beneficiaries by empowering them to choose. This includes community participation to set goals for collective goods and services. Providers (for-profit and/or not-for-profit) can then compete for the right to provide service on the best possible terms. Funding can be obtained in the market when the provider is competent and cash flow is expected to be adequate, which is facilitated when aid is disbursed upon achievement of contractual service obligations. IFC could help develop the financial markets for this. Policy risk guarantees by MIGA or the Bank can help deal with the special risks in difficult environments.<sup>1</sup> In many complicated policy environments small scale solutions that are within the managerial and financial reach of domestic providers may provide appropriate solutions. (Note that output-based funding could be achieved with grants or with loans. In the case of loans ultimately the local taxpayer pays, with grants foreign taxpayers pay – both in the case of concessional loans such as IDA).



Normal competitive markets are output-based schemes. Consumers pay when the product or service is finished, not when the firm builds a factory. Typically improved

<sup>1</sup> The Bank has provided policy advice on output-based schemes during the 1990s. The private infrastructure schemes supported by the Bank have typically contained output-based remuneration for private providers, although the Bank has not itself disbursed funds as a function of output. The closest scheme to a true output-based project was the Guinea water concession in 1987, where the Bank de facto funded a water price subsidy that declined over a ten-year period. Currently an output-based financing scheme is under consideration for small-scale water supply in Paraguay.

service delivery systems by themselves will help the poor most, because access to service rather than subsidies are crucial for them. For example, poor water users typically pay 10 to 40 times as much as those connected to pipelines.

Where it is judged that some form of subsidy is needed to help the poor this can be combined with market-type mechanisms. Output-based aid allows in particular to shift performance risk to private parties while retaining the option of subsidizing user fees partially or completely, for example in education. Where consumers do not have choice one can use targeted subsidy schemes to deserving customers or one can auction the right for service provision to the bidders of the lowest subsidy. Output-based subsidies can also help reach sub-sovereign projects efficiently without complications of counter-guarantees.

It may be argued that such output-based schemes and targeted subsidy schemes are hard to implement in countries with weak governance systems. They are, indeed, harder to implement there than in other places. However, it is not obvious why, therefore, potentially less effective alternative approaches should be favored. The question is: if feasible output-based schemes with competent sponsors, policy-risk guarantees and adequate expected cash flow (possibly supported by aid) do not work, then what chances are there that traditional approaches will actually help the poor?

There may also be worries about adequate capacity building when resorting to private provision of service. Staff typically learn most when working for the most competent provider. Staff trained in such companies are also most likely to set up local SMEs as sub-contractors or competitors. Capacity-building to government would remain important and focused on the core functions of government, namely the contracting process and the regulatory or monitoring functions that remain in public hands.

In a number of cases private schemes may be most effectively managed by domestic firms, for example output-based small-scale infrastructure schemes that are currently under consideration in Cambodia (water and electricity) and in Paraguay (water). However, in other cases foreign companies may be more efficient. This may worry some governments. However, under private provision employees of the provider are mostly local staff, even when the provider is owned by a foreign company. Otherwise the foreign company would not be competitive. Typically the move towards private provision also stimulates the emergence of domestic private providers where they do not yet exist.

None of this is to say that output-based schemes are miracle solutions. They can help shift performance risk and allow more explicit targeting of subsidies. However, the ability to measure relevant output in an unbiased fashion is critical. Capacity in government to contract out and to regulate is required, in particular to prevent private providers from shifting risk back to domestic taxpayers. Governments would typically also be involved in allocating the funds to be disbursed against output. Arranging financing may also be hard in the case of large projects. However, many small-scale solutions are typically within reach of local investors.

**Questions for discussion:**

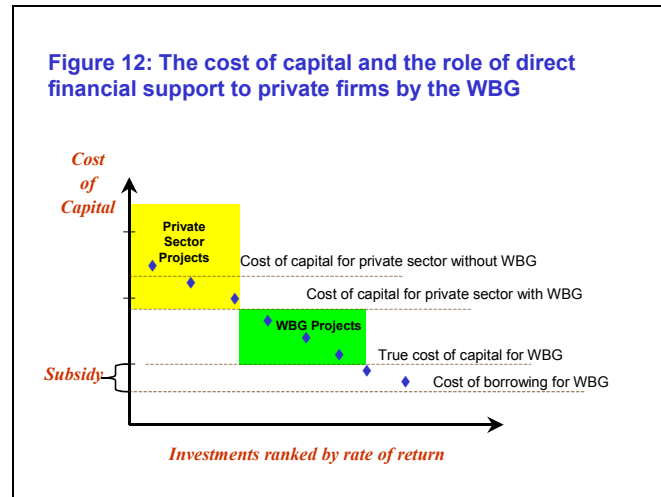
- **Under which conditions should output-based aid schemes be tried out?**
- **Should they be grant or loan-based or both?**
- **Which sectors or projects would seem to qualify (e.g. certain infrastructure or social sectors)?**
- **What type of providers would typically be eligible to compete (e.g. for-profit, not-for-profit)?**
- **What role should governments, communities and private providers play in output-based aid schemes?**

*ii. Commercial disciplines for commercial services*

In those areas, where limited supply response, i.e. failure by the private sector to pursue all good deals is the rationale for activity by the WBG one needs to determine whether the World Bank Group truly tackles market failures or whether it misallocates the subsidy embedded in its products.

A number of arguments are typically made for the role of the WBG. WBG presence may help reduce political risks and may provide valuable demonstration effects. The special relationship with governments and the long experience in developing economies may allow the WBG (IFC, MIGA, Bank on-lending operations) to identify and invest in good projects that the private sector is not willing to pursue. Its commercial acumen and financial capability may also allow it to improve on fragmented and inefficient domestic financial markets.

Developmental interventions by the WBG should benefit other private parties by improving investment opportunities. Such benefits are not captured by the WBG itself. Nevertheless all these justifications assume that the WBG would pick up “good deals left on the table” by the private sector in the following sense. Due to its special standing the Bank Group arguably has a lower risk-adjusted cost of capital than private firms. It can thus undertake some projects that are not attractive to private firms. There will be such projects until the investment climate has improved to such a degree that there are no more projects left for the World Bank that the private sector would not want to fund itself (Figure 12).



But there is no argument that substandard deals supporting private parties be financed that require subsidies in the sense that the affected parts of the WBG should be content with average returns of less than its own risk-adjusted cost of capital. There is also ample evidence that subsidized credit does not lead to efficient investment.

Under the existing system WBG management already copes with the issue as follows. Discretionary decisions by the Bank, IFC or MIGA establish

- whether financial assistance to private firms has sound development impact by supporting projects in developing client countries that promote growth (adequate economic rate of return) and are environmentally and socially sound.
- whether an activity is deemed to complement private activity rather than substituting for it. This includes application of the pricing guidelines for IFC or Bank on-lending operations that require market-based pricing for financing private firms (e.g. OP 8.30).

The key remaining strategic issue is whether an institution that helps fund good deals that are left on the table by the private sector should also be required to earn a target rate of return, that is set so as not to provide incentives to waste subsidies and not to hand out “corporate welfare”.

Unbundling the subsidy contained in some of the WBG products (Bank on-lending operations, IFC and MIGA) would allow “profits” so earned to be used explicitly to subsidize those activities that are deemed to require subsidies under disciplines discussed below.

**Questions for discussion:**

- **Is the imposition of return targets to meet the full cost of capital for development agencies that invest in private projects compatible with development goals?**
- **Should such targets be imposed and, if so, how?**

**iii. Targeted subsidy allocation**

Unbundling subsidies would leave the total amount of resources at the disposal of the WBG constant. What was possible before can still be achieved, for example by re-bundling subsidies with loans. However, the unbundling process can provide more transparency and allow deployment of instruments in new ways, for example under output-based aid schemes that shift performance risk and target subsidies.

The issue remains what disciplines to place on the allocation of unbundled subsidies (including those for output-based projects). In principle the incentive system would be as today. The allocation of the subsidies would need to reflect the strategic thrust of the WBG overall. As is the case now, country considerations and thus the Country Assistance Strategy would drive the allocation.

Transparency and measurement are key for discipline on such allocation processes. Hence, unbundling and clear measurement of the size of subsidies could be helpful. This may build on the practice of some member countries that prepare special subsidy reports. There are a few policies of the Bank Group that require the calculation of subsidy dependence of projects or the subsidy equivalents embedded in them, for example for agricultural credit. However, broader application and more systematic and transparent implementation might be useful. Such systematic evaluation of the level of subsidies and improved measurement of the outcome of activities funded by them are in any case desirable. The eventual PSD strategy would contain proposals for concrete measurement approaches.

**Questions for discussion:**

- **Should subsidies be unbundled or is there a danger of losing synergies?**
- **What kind of measurement approaches would be desirable?**

**C. Shifting performance risk to the private sector and targeting subsidies - selected implications for work in low and middle income countries and for highly indebted countries**

*i. Balancing work in low and middle income countries*

Middle-income countries are still in need of assistance, particularly at the sub-sovereign level (firms, municipalities). At the same time the shareholder and donor community would like to focus assistance on low income or frontier countries.

Unbundling of subsidies makes it easier to focus subsidies on low-income countries. At the same time, this may allow, for example IFC and MIGA to expand activity in Middle Income Countries without diluting the terms of assistance to low-income countries.

*ii. PSD strategy and highly indebted countries*

If one shifts performance risk to the private sector this could potentially help improve interventions to low income countries and reduce the risk that taxpayers in those countries would be faced with future repayment obligations. Of course, debt relief itself shifts risk away from these taxpayers, but after the fact, not as part of original project design.

For example, assume that all infrastructure projects in IDA countries are done under output-based contractual disciplines. In this case IDA funds would be disbursed upon achievement of service goals rather than for construction. Assuming that this new way of doing things were not to affect lending volumes, this could annually shift performance risk for about US\$ 1.5 billion away from domestic taxpayers. Similarly, the subsidy element in on-lending operations under IDA could be unbundled and used for targeted poverty reduction. The commercial component of on-lending operations could be assumed by IFC. In this case, again, performance risk would be shifted from domestic taxpayers to private investors and foreign taxpayers (via IFC). On-lending operations under IDA currently amount to about US\$ 0.2 to 0.3 billion per annum. Altogether the shift in performance risk from domestic taxpayers to private investors and foreign taxpayers could amount to about a third of IDA resources, assuming no change in the volume of operations. While highly indebted countries are only part of IDA countries this could still contribute to reducing the likelihood of future rounds of debt relief.

Of course, the shift of performance risk to the private sector may affect the total sums involved. Direct lending to the private sector under on-lending operations might be affected because IFC might take a different view on whether on-lending was justified from the Bank. Output-based schemes may reveal policy problems more clearly than traditional loans to public sector projects and lead to a reduction in volume in some cases. However, where successful, output-based schemes may stimulate greater activity overall and stimulate willingness of donors to provide funds. None of these schemes would reduce the need for IDA funds, but risks would be re-allocated to those parties better able to manage and bear them (Figure 13).

**Figure 13: PSD Strategy and Potential Impact on IDA Operations**

- |   |   |
|---|---|
| <ul style="list-style-type: none"> <li>• <b>Actions</b> <ul style="list-style-type: none"> <li>– On-lending operations carried out by IFC</li> <li>– Infrastructure and some social sector operations become output-based</li> </ul> </li> <br/> <li>• <b>Results</b> <ul style="list-style-type: none"> <li>– Exposure reduction of poor taxpayers/performance risk to private sector</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>• <b>Shift in existing activities</b> <ul style="list-style-type: none"> <li>– About US\$ 0.2–0.3 billion per year</li> <li>– About US\$ 1.5 billion per year</li> </ul> </li> <br/> <li>-----</li> <li>– About 30-40 per cent of total IDA lending</li> </ul> |
|---|---|

#### **D. Next steps**

Following dialogue and debate on the basic approaches set out in this discussion paper, a consultation report will be prepared for management of the World Bank Group that would summarize the feedback obtained. Taking into account the thrust of the debate more detailed reviews of the implementation challenges would be carried out. In particular organizational and operational implications would be considered in greater detail. As mentioned in the beginning all this would feed into the PSD strategy to be presented to the Executive Directors of the World Bank Group for decision by December 2001.

## ANNEX I: ISSUES IN THE UNBUNDLING OF WBG PRODUCTS

Traditionally, the WBG has provided products in bundled form. Most importantly the traditional Bank loan bundles funding, guarantee (to investors), subsidy (e.g. IDA) and advice (as part of project preparation and supervision). With the rise of private alternatives, more and more products have been unbundled. This is simply a reflection of the same forces that unfold when market-type mechanisms are introduced in client countries. The introduction of market forces drives, in particular, towards an unbundling of subsidies to allow for fair competition on the one hand, while preserving means to help the poor and remedy market failures on the other hand.

The analytical and/or operational unbundling of products has the potential to establish more clearly the comparative advantage of the WBG. First, unbundling allows the activities of the WBG to be focused on matters that it can tackle relatively better than others, e.g. political risk guarantees vs. funding. Second, unbundling may be necessary to deal with potential conflicts of interests, hence, for example, the independence of ICSID. Unbundling also creates greater transparency and thus potentially enables better judgments as to the effectiveness of an intervention.

Unbundling of a product can be implemented such that it still allows integrated, simultaneous or parallel provision of the component parts to a client, if there are synergies between the components or if one wants to safeguard the average terms on which a country receives financial and non-financial support. For example, the average resource flow to countries and the average terms of such flows need not be affected by unbundling. What would be affected is the discipline on the achievement of the ostensible goals of the support provided.

The table below shows that already today the World Bank Group has some level of unbundled provision of products for each function it seeks to fulfill and there are competitors/partners in all areas. This means in particular that there is no area of absolute advantage for the WBG.

FUNCTION	EXAMPLE OF UNBUNDLED PROVISION IN WBG	COMPETITORS/PARTNERS
Guarantees	Credit and political risk guarantees by IBRD/IDA, MIGA and IFC	Private insurance companies, other MFIs, ECAs
Subsidies	Fiscal subsidies under OP 8.30; grants under social funds, GEF, DGF, trust funds	Public and private donors, including foundations
Advice	Fee-based (FIAS, IFC advisory services, IBRD reimbursable T.A.)	Investment banks, consultants, academics, think tanks
Capacity building	Free and fee-based programs e.g. by WBI	Training institutes, universities...
Global standard-setting	Dams, mining, forests,	UN organization, OECD,

<b>FUNCTION</b>	<b>EXAMPLE OF UNBUNDLED PROVISION IN WBG</b>	<b>COMPETITORS/PARTNERS</b>
	environment, re-settlement, insolvency...	Council on Economic Priorities, Basle Committee, IOSCO...
Certification	ROSC, procurement assessments...	Rating agencies, ISO...
Arbitration	ICSID	New York Convention...

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## Consultation Report

Extensive discussions were held during June-August 2001 with a wide range of stakeholders inside and outside the World Bank Group (WBG). The discussions were based on the paper “PSD Strategy: Issues and Options” cleared by the Executive Directors for external dissemination in May. Stakeholders included representatives from government, private sector, civil society, trade unions and multilateral institutions.

There were three sets of dialogues: a) inside the WBG: with ten sector boards,<sup>1</sup> several units in the Bank, regional chief economists, IFC managers and MIGA staff; b) externally with government, private sector and civil society stakeholders (in 17 cities in both developed and developing countries); c) meetings with regional development banks: AfDB, ADB, EBRD and IDB (*complete list of meetings in attachment 1*). In addition, an on-line discussion was carried out with civil society organizations moderated by the New Economics Foundation (*summary of on-line discussion in attachment 2*). The paper was also posted on the web site of the Rapid Response Unit of the Private Sector Advisory Services Group with invitation for comments. This consultation report attempts to provide a balanced picture of what came out of these discussions. It tries to faithfully summarize important points of view, in the process reflecting both areas of broad agreement as well as diversity of views.

There was wide-spread interest in the issues and options identified for discussion. Some of those familiar with previous strategies thought that this represented a far-reaching approach. There was consensus that the proposed strategy will be a sensible way for the WBG to engage in assisting the private sector to develop. Some donor agency officials said that WBG’s PSD strategy will be important for their own rethinking of aid in promoting PSD.

Six main issues were presented for discussion: a) need for systematic work on the investment climate; b) greater role for the private sector in the provision of social services; c) adjusting regulatory approaches to allow small-scale entry in the provision of infrastructure; d) move towards output-based aid schemes; e) imposing rate of return disciplines on WBG finance to private sector; and f) unbundling and targeting of subsidies inherent in WBG products. There was strong support for the idea of systematic work on the investment climate and of moving towards output-based aid. There was also support for the proposals regarding free small-scale entry, imposition of rate of return disciplines and unbundling of subsidies, but commentators had a wide range of questions on these topics. There was some scepticism about the scope for private provision of social services. However, many commentators acknowledged that the poor do rely considerably on private provision and wanted this reality to be addressed. Several commentators brought up an additional theme which they felt was relatively neglected in the paper, i.e., the need to address the social and environmental sustainability of PSD efforts.

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<sup>1</sup> All relevant sector boards were approached for consultations. Some of the boards with which meetings could not be arranged due to conflicting schedules sent in written comments.

As can be seen from the description below, three basic currents of thought emerged in the discussions on the individual themes: a) the need for balanced treatment of the roles of the public and private sectors, b) questions on the adequacy of the analysis underlying the proposals, and c) need for more detailed discussion of the challenges in implementing the proposals. Discussants wanted these issues to be addressed in the strategy paper or in supporting documents. Discussants thought that the Issues and Options paper, while a bit longer than optimum, did raise the right questions and created the basis for a fruitful dialogue.

## Investment Climate

*“The regulatory framework is the biggest stranglehold on us” – developing country private sector representative*

*“If private sector development is a window for multi-national companies to step in, I am not for it.” – developing country government official*

There was overwhelming support for the idea of doing systematic work on the investment climate. The meetings with the developing country private sector brought out clearly the dual problems they face: excessive regulation and taxation-related burdens, coupled with poor provision of services. Excessive regulation, inconsistency of policies, and harassment and arbitrary decision-making by public sector agencies is common. Inadequate and unpredictable provision of services, whether infrastructural services or business-related services such as ISO certification, was also mentioned as a major problem.

On investment climate analysis, internal commentators agreed that past work, such as private sector assessments, had suffered from a lack of a standard framework. They recognized that, while it is not easy to assess the environment in which firms operate, the challenge should be taken up given the demand from clients. The usefulness of carrying out such analysis at the local and municipal government levels, in addition to the country level, was highlighted both by internal as well as external commentators.<sup>2</sup> It was agreed that comparisons of investment climate across countries, regions or cities are useful in making policy-makers sit up and take notice.

Some commentators felt that a number of important issues related to the investment climate were not adequately discussed by the paper. These include financial sector issues, need for good governance, some key investment climate issues in Eastern Europe such as manipulation of policy-making, and predatory practices by the state, and the need

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<sup>2</sup> The Urban Development Department of the Bank pointed to their local economic development initiative which tries to do similar analyses. In Indonesia, examples were given of studies of investment climate at the local level that has prompted local governments to look afresh at the investment climate in their jurisdictions.

for safety nets and retraining. There was also a feeling, expressed in particular by many donors, that the role of the public sector in setting the investment climate was under emphasized. Participants sought reassurance that the WBG would continue to take capacity building seriously. Representatives from donor agencies argued that the strategy should address the different comparative advantages of donors and other development partners in effecting change in the investment climate.

#### *Market access and unequal competition*

The issues of market access and unequal competition came up repeatedly. An oft-repeated fear, expressed most strongly by the private sector in Africa, is that the domestic private sector is often too weak to benefit from competition and liberalization. There was a fear of state monopolies being replaced by multi-national monopolies.

There were also concerns about unfair competition from subsidized imports in the event of trade liberalization. Some commentators argued that developing country firms face many odds to begin with and their problems are compounded when there is subsidized imports on top of it. Some developing country policy makers, for example, argued that governments have to protect and subsidize private enterprises when other countries make the playing field uneven by sending subsidized exports. They suggested that, since many governments lack the capacity to do selective interventions, they often end up resorting to inefficient across-the-board subsidization.

There were also concerns about inadequate access to developed country markets. Several commentators felt that the importance of market access in affecting the success of PSD efforts was not duly emphasized in the paper. For example, some developed country policy makers wanted the PSD strategy to stress the need for OECD countries to open their markets to developing country imports.

#### *Foreign investment*

Comments on foreign investment focused on the pros and cons of foreign investment and on the problems in attracting such investment. Some private sector commentators and policy makers in developing countries, especially in Africa, were concerned that large foreign companies may occupy much of the space created by liberalization and privatization and that this would inhibit domestic business growth. Some civil society commentators had similar sentiments. They felt that although many jobs are created through foreign investments, the profits end up elsewhere; hence, the WBG should not be promoting foreign business development in poor countries. However, others in civil society had different views and felt that any good and well-intentioned investment, especially when it takes into account social and environmental concerns, is the basis of a good economy irrespective of where it comes from.

Developed country private sector representatives articulated concerns of foreign investors. a) reluctance of foreign firms to go alone in high-risk environments without matching funds from developed country governments or local country governments; b)

difficulties faced by medium-sized enterprises in raising money from capital markets because their deal sizes are small; c) difficulties arising from the fact that revenues are in local currency; d) distrust within developing countries between government and private sector; e) high transaction costs compared to deal size; and f) risks of losing intellectual capital. Participants asked how the WBG can help resolve these problems. They asked, for example, why the Bank does not deal with unsolicited proposals and suggested that this delays development. Some donors were interested in how foreign investment can be attracted to difficult countries without too many guarantees.

### *The role of the private sector in promoting growth and poverty reduction*

*“We have a problem with this document. What is it aiming at – developing the private sector or poverty reduction? The private sector does not have a social role—they are supposed to make money” – developing country private sector representative*

Some commentators felt that the paper had under-emphasized the role of the private sector in promoting growth while highlighting its role in the delivery of services. They wanted this imbalance to be corrected.

The links between private sector growth and poverty reduction was the subject of considerable discussion and some confusion, resulting perhaps from a misunderstanding of the role of the private sector in poverty reduction.

One line of thought is that the private sector has little, if no role, in poverty reduction. According to this view, the private sector’s role is to maximize profits and this is what it should be judged by, not its contribution to poverty reduction. Several private sector representatives equated poverty reduction with redistributing part of the entrepreneur’s incomes to poorer members of society and felt that it would be unfair to ask them to do this, particularly given the difficult circumstances they typically work in. Another line of thought, expressed mainly by some civil society organizations, is that PSD may generate inequality and may worsen, not alleviate, poverty.

Both lines of thought imply that the strategy document should articulate better the links between PSD and poverty reduction. It needs to state explicitly that the goal of the for-profit private sector is to maximize profit but that public policy is to be framed in a manner that its profit-maximizing behavior also contributes to poverty reduction.

### *Small and medium enterprises*

The subject of SMEs came up repeatedly in the discussions. Commentators described the problems faced by SMEs and suggested actions to deal with these. The problems mentioned include: a) restrictions of various kinds on SME operations, b) heavy taxation, often by local governments; c) discrimination by financial institutions against SMEs; d) poor capacity of SMEs to adjust to difficult conditions, especially when the country as a whole is going through adjustment shocks.

Civil society commentators argued for more support to SMEs through a variety of means, such as facilitation, small-business support and the provision of appropriate capital. Japanese government officials stated that the Japanese government is interested in continuing financial support to SMEs in order to supplement private funds, enhance policy-based learning, and enhance management capacity of SMEs. In this context, they noted that governments need to build capacity to assist SME growth.

Several private sector representatives argued that subsidies to SMEs create distortions. According to them, the right approach is to identify, and remove, policy and systemic barriers to SME growth. Measures recommended by them include setting up credit bureaus in banks in order to facilitate access to credit, reforming tax regimes at both country and government level, and removing various restrictions on SME operation. Some highlighted the role of local governments in promoting SMEs and said that these entities need to be convinced that it makes economic sense to support SMEs.<sup>3</sup> They felt that the WBG can help by disseminating cross-country evidence on how SMEs can be developed, including examples of how local governments can expand their tax revenues through a vibrant SME sector.

### Private provision of social services

*“Provision of social services should be a responsibility of government, not a priority for PSD” – donor agency staff*

*“Private provision of social services is a reality. The question is how to react to this” – developed country private sector representative*

*“We don’t mind paying for something if we get the services” – developing country NGO representative*

There were mixed views on private provision of social services. Some commentators, specially among donors and developed country NGOs, were uncomfortable with the idea. However, there was greater receptivity in the developing world, and among developed country private sector representatives.

Several donor representatives echoed the sentiments expressed in the first comment above. Canadian government representatives stated that there is a high level of discomfort in Canada over user fees in health and education sectors. A donor agency staff felt that the solution may be decentralization rather than private provision. In this view, public facilities can work when there is community oversight, with NGOs possibly coming in as managers of the facilities. Another donor agency staff suggested that lack of resources may be the main impediment to efficient public sector provision and, hence,

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<sup>3</sup> In Indonesia, cross-city comparisons of investment climate have reportedly opened up the eyes of some local governments who are now taking steps, such as reforming their tax base, to promote SMEs.

it may be better to go for debt relief first and, only if that proves ineffective, go for private provision.

Some NGOs argued that health and education user fees are major deterrents to universal service provision and that subsidy systems seldom function as intended. They feared that private provision of social services may thus go against universal access to these services. This will be particularly unacceptable in the case of primary education and basic health services which can be considered basic human rights.<sup>4</sup> They also had doubts about the willingness of the private sector to provide services such as health care which, because of risk and asymmetrical information, may be particularly difficult to provide in a market environment. They were thus concerned that private sector actors may not use public subsidies fairly to provide services, sometimes expensive ones, to poor people.

Some donor agency staff were surprised at the high proportion of private expenditures on social services. Some wondered if these data were not out-dated. One regional development bank staff speculated that the statistics on health are largely driven by the urban sectors or by the fact that private health care is more expensive.

There was considerably greater support for private provision in the developing country meetings. Many agreed that the poor often go to the private sector, defined broadly to include NGOs and traditional providers, to get education and health services. In the private sector meeting in Japan, commentators said that private provision in the social sectors is a reality, the question is how to react to this reality. The meeting with the private sector in Cote d'Ivoire heard the story of a private businessman who has built up a rather effective private school program in his village with potential for replication elsewhere. Education is subsidized here but not fully; users do pay a substantial part of the cost. The possibility of the private sector taking over public facilities was also mentioned. For example, one suggestion in Indonesia was for young doctors to take over deteriorating public health facilities.

#### *Challenges in private provision of social services*

It was suggested that unfair competition from public sector providers often create problems for private providers. One commentator cited the case of Indonesia where several hundred schools set up by an NGO have reportedly closed down partly because subsidized public schools were charging lower fees, and partly because deteriorating economic conditions prompted parents to take children out of schools. Conflicts of interest was also mentioned as another barrier in Indonesia. For example, doctors in public hospitals, who are also involved in private practice, have the authority to award licenses to private doctors but are sometimes reluctant to do so because they fear increased competition.

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<sup>4</sup> The NGOs also asked if DEC or any other part of the Bank has conducted cross-national studies on the social impact of privatizing social services and if there are well-understood lessons about what works/what doesn't under different country conditions.

Inadequate quality was also mentioned as another problem. In this context, commentators raised questions as to whether private provision is the way to go in tertiary education, especially in the absence of regulation. One answer to this was suggested in the private sector meeting in Pakistan, i.e. governments should focus on one or two strategic tasks, such as certification.

Some commentators felt that paper has not adequately discussed the issues of regulation and monitoring. They argued that governments often do not have a good ability to regulate in the social sectors. Some also felt that the paper has ignored problems with community organizations, such as local capture and caste systems, and hence its confidence in the ability of communities to set standards, monitor and regulate may be misplaced.

#### *Output-based aid and targeting of subsidies*

*“All this (output-based schemes) should have been done long ago” – donor agency staff*

*“Why haven’t output-based aid schemes been tried out earlier?” environmental NGO*

There was considerable enthusiasm about output-based aid schemes among all categories of stake-holders but particularly among donors. At the same time, several commentators identified a wide array of problems in implementing such schemes.

#### *Support for output-based schemes*

The discussions brought out examples of output-based schemes being practiced around the world. German development assistance, for example, is moving towards more incentive based partnerships with the private sector across all sectors. OBA schemes have been adopted and results so far have been impressive. Although mindful of the complex administrative requirements of OBA schemes, the German Government has set OBA targets for their regional and sectoral managers. Several discussants said that more OBA-type schemes are needed and believed that OBA can be effective, even in social sectors, provided there was good governance and adequate project finance.

#### *Problems in targeting subsidies and implementing output-based aid schemes*

The main problems mentioned fell in the following categories:

- *Targeting the poor:* Identifying the poor, ensuring that the poor are not left out and minimizing leakages to the non-poor and private providers is difficult. Means-testing is an option but is administratively expensive. Some developing country government officials pointed out that it may be difficult for elected local government officials to allocate subsidies to some classes of voters and not others.

- NGOs asked what lessons can be learned from existing research about how to target effectively in different sectors and country conditions.
- Some participants from civil society organizations felt that targeted subsidies may foster corruption in local communities and perpetuate top-down approaches to development. Trade unions and some NGOs felt that targeting subsidies undermines social cohesion.
  - *Measuring output*: It may be difficult in some cases to measure output, particularly to ensure that the preferences of users are taken into account and divergent preferences are reconciled. NGOs asked if social indicators will be developed for PSD projects to capture these dimensions and whether communities and users will have a role in creating appropriate indicators.
  - *Government capacity to contract and monitor*: In many countries, specially those with weak governance, governments will have limited capacity to write contracts and monitor compliance. Will output-based aid work in such environments? What kind of accountability mechanisms are envisioned to monitor performance of service providers? This concern was expressed by all classes of commentators. In this context, civil society commentators suggested that civil society organizations, such as community cooperatives, may be more effective than the state in monitoring the provision of targeted subsidies.
  - *Dealing with failure to provide services*: This was a particular concern of NGOs, but also shared by a few others. What can be done if the providers do not provide the services as stipulated in the contract? What actions can the poor take in such situations, especially in a weak governance and judiciary environment? What can be done to ensure continuity of basic services (e.g. changing terms of contract, going for alternative providers, including the public sector)?
  - *Ensuring competition*: How can one ensure adequate competition among providers or, when monopoly conditions exist, how can price levels be controlled? Are there pricing lessons in social sectors that suggest how to maintain both profits and cost control for consumers?
  - *Obtaining project finance*: Obtaining project finance could be difficult, especially where financial markets are underdeveloped. For this reason, it will be harder to do OBA for green-field projects than for existing ones. NGOs were concerned that, under OBA schemes, domestic businesses and contractors may find it difficult to compete with international businesses and contractors who have greater up-front access to investment resources. Others, notably the private sector and some donors, were worried that uncertainty about long-run subsidy flows may inhibit financiers.
  - *Cost-effectiveness*: Since the size of many OBA projects is likely to be small, this may increase transaction costs and lower cost-effectiveness of projects.

Some commentators suggested that subsidies can be managed only if they are on a small-scale and limited to a small geographic area. Some argued for general social safety nets but not subsidies for specific services, such as electricity or telephones. The latter raised issues of how to choose between activities to subsidize (i.e., end up with a “father knows best” scenario). Others argued for taking into account the social environment in which the targeted people live when developing indicators to identify the poor; the same indicator, or the same value for an indicator, may not be applicable in all environments.

Commentators also had several clarificatory questions. They asked what a typical WB project might look like if OBA is implemented, whether the amount of subsidy under the OBA and non-OBA approaches are the same; whether OBA is project or program based, whether there would be a difference in approach in non-IDA countries compared to IDA countries, and whether OBA schemes will be based largely on loans or grants. Some commentators wanted to know if the WBG would cover payment risk as part of performance risk. If OBA schemes were done on a large scale, what would be the implications for Northern taxpayers? Who bears the social and environmental risks under this scheme? Would these schemes mobilize financing for subsidies through (often regressive) taxation rather than progressive utility rates?

Some donor representatives were not enthusiastic about the idea of a special OBA fund – the preference was for the Bank to fund OBA projects from its own resources. There was some concern about fragmentation with all the existing trust funds. There was recognition that most governments favored starting OBA schemes on a pilot basis. At the same time, it was pointed out that OBA projects are management intensive and hence may need to be done on a bigger scale in order to generate enough incentive for governments to put in the effort.

### **PPI, free small-scale entry, regulation of natural monopolies, shifting risks to private sector**

#### *Views on free-entry and small-scale entry into natural monopoly segments of infrastructure*

Several commentators welcomed the idea of free entry by small-scale operators but many had reservations about the scale at which this could be implemented. Several implementation challenges were mentioned

- unrestricted small-scale entry may give rise to quality problems (internal commentator); small systems lack scale economies thus leading to higher prices than integrated systems;
- small scale infrastructure may undermine the longer term development of large infrastructure systems; the short-term gains may not be worth the long-term problems; it will be difficult to consolidate these small units later;

- some (trade unions) thought that the private sector may not move in to provide services if entry is opened up; others were worried about the risk of over-investment, leading to over-capacity; and
- consumers may not be willing to pay much to a private provider if there is an expectation that governance may improve and state-owned utilities may start delivering services in future at a lower price; hence, such schemes may work in isolation but not in conjunction with a state-owned utility.

### *Need to emphasize governance*

While acknowledging the merits of free, small-scale entry into natural monopoly segments of infrastructure in environments of weak governance, several commentators, particularly inside the Bank Group, mentioned the need to emphasize at least a minimum level of governance and identify actions to improve governance over time. They felt that minimum governance capabilities needed to implement these schemes in countries with weak governance should be spelt out.

The need to be realistic in setting standards for small-scale infrastructure provision was also stressed. Some commentators argued that too restrictive standards (e.g. with respect to size of land parcels, width of streets, infrastructure services provided upfront) push the poor in urban areas into slums and illegal subdivisions. This makes it difficult to provide infrastructural services in a cost-effective way and is often the cause of environmental degradation.

Commentators also asked some clarificatory questions. For example: a) what will WBG's policy will be towards informal providers; will they be regulated? b) is there any experience where, rather than privatizing to a large entity, a city was divided into several small areas, where distribution and bill collection is privatized to small enterprises, while a large enterprise does water treatment?

### *Large scale private provision of infrastructure: competition and regulation*

An internal commentator felt that the paper has not discussed some important transition issues, i.e. the first two or three steps required to move from heavily distorted and corrupt business environments to conditions that support real competition. These conditions are yet to be achieved in most developing countries and much of the Bank's PSD work so far has focused on merely laying the grounds for such competition. Two transition issues that should be covered extensively for a PSD strategy are:

- how to formulate privatization strategies under declining interest by foreign investors in developing countries; and
- how to develop credible regulatory environments that strike the appropriate balance between consumer protection and attracting private investment.

Although many PSD projects are battling with these problems there is very little attention to this in the paper. In the case studies cited in the paper about options, there is little indication that the approaches have been, or can be, applied across a wide range of poor countries.

NGOs were not sure about the prospects of competition and asked if competitive markets can be expected to arise organically in countries with weak governance and, if not, how does the Bank propose to ensure that markets are free and competitive without adequate governmental oversight. They were also concerned about the political implications of privatization without adequate regulatory supervision and asked whether privatizing government services really help create good governance or is it more likely that those firms that provide the services become so entrenched and politically powerful that it is impossible to properly regulate them later? If the latter is true, they wondered whether countries should wait till a good regulatory framework is in place before privatizing?

Other points made were:

- The assertion that "Funding can be obtained in the market when the provider is competent and cashflow is expected to be adequate" (page 16) sounds an unreal prospect in the poor countries (internal commentator);
- There should be more emphasis on avoiding privatization transactions that lead to private monopolies and a shrinking of choice (trade unions);
- Perhaps the biggest bang for the buck for the WBG lies in certification of PPI regulatory processes (private sector representative);
- Subsidies may be required to induce private providers to come into infrastructure (private sector representative);
- Governments should take a holistic view and worry about foreign exchange obligations (government official);
- Many infrastructure projects are plagued by over-regulation with different bodies of government putting restrictions. Increased competition is what is needed (private sector representative);
- How can you be confident of getting a fair return or willing to be locked up in a rate battle because of concerns about the poor's ability to pay? (private sector representative);
- Government capacity for regulating private providers and implementing both small-scale and large-scale private provision solutions should be enhanced through specialized technical assistance (donor agency); and

- In transition economies, the public utilities may be reaching a large section of the population, unlike in Africa. So privatization there may have different connotations. (Bank staff).

### *Shifting risks to the private sector*

There was wide support for the notion of shifting risk to the private sector. However, some commentators, noted with reference to the California power crisis that this can also be risky. Therefore, one needs to be careful about deciding how much risk to shift to the private sector.

One view, expressed by civil society commentators in the on-line discussion, was that the main task should be to lower risks overall, not merely talk about shifting risks from one party to another. However, it was agreed that where risks exist, it was better that this be assumed by the private sector rather than the public sector.

### **Environmental and social issues**

*“No one disputes that these (labor standards, other social standards) are laudable goals in the long run, but in the short run these can be problematic for our private sector” --- developing country policy-maker.*

*“According to the PSD strategy as presented, there will be plenty of losers and winners. How do you propose to deal with the losers?” – donor agency staff*

*“Socially and environmentally responsible investment is top priority for us” – Environment sector board*

Some concerns were expressed by government and private sector about the difficulties of adhering to strict social and environmental standards (as exemplified by the first comment above). At the same time, there were demands from several commentators, specially among donors and NGOs, for placing greater emphasis on environmental and social responsibility issues. Trade unions, for example, asked for more emphasis on corporate responsibility and labor standard setting, including freedom of association, collective bargaining and other worker rights. Civil society organizations, through the on-line discussion, suggested that the Corporate Social Responsibility Framework, which includes adoption and monitoring of codes may be an appropriate model for WBG lending, providing a more bottom-up than top-down approach to monitoring and enforcement.

### ***Environment issues***

Internal commentators from the environment family stated that, since environmental assets provide the basis for most private sector activity in most of the WBG's client countries, safeguarding them is not just a matter of public good but also of good

business.<sup>5</sup> They suggested that the strategy address the issue of how to apportion the responsibility of meeting the costs of environment-related "externalities" between the public and private sectors. The Environment Sector Board also argued that the paper should have a lot more in terms of developing pro-active strategies, measures and instruments to stimulate environmentally positive investment. An internal commentator wanted to see the strategy address the issue of using the Bank's enormous financial power, vis-à-vis all the goods and services whose procurement it finances each year, to help create demand for "green" products and production processes.

Similar sentiments were expressed by environmental NGOs who argued for a move from a mere "do-no-harm" approach to a more pro-active stance by the WBG in promoting environmentally-friendly activities, industries and processes in the private sector. They argued that the WBG should exploit the fact it has both policy-making capacity as well as investment financing capacity to promote environmentally friendly activities. In their opinion, it should do more to help borrowers identify barriers to creation of markets for ecosystem services and energy markets for supportive of private investment in renewables. Environmental NGOs felt that WBG efforts to promote renewables have remained marginal efforts, and have not affected the mainstream of Bank lending and policy advice in the power sector, which has a strong emphasis on privatization.

They also argued for:

- building in environmental concerns when rules are being changed and new institutions (such as regulatory agencies) are being established in individual countries with support from WBG projects; these may be difficult to do later;
- greater interaction between the WBG's work on the environment and on PSD; building bridges between the environment and PSD strategies; greater coordination between the work of the Bank and the IFC in this area;
- greater collaboration among donors to set uniform standards to guide their PSD-related work on the environment;
- developing indicators for monitoring progress with monitoring the environment-related aspects of the PSD strategy and setting the right targets for these; and
- building environmental management capacity among SMEs or develop innovative/adapted forms of environmental regulation for SMEs.

Internal commentators also emphasized the need for good regulation. They argued that it is important to have very clear rules of the game with respect to environmental liabilities when privatizing sensitive sectors such as energy. There felt a need to explicitly address

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<sup>5</sup> In this context, they suggested the inclusion, in the strategy paper, of some positive examples of cases where incorporating good social/environmental practices into private sector activities also means good business results.

the adequacy of the existing regulatory framework when privatizing, especially since there is some perception of backsliding on environmental standards in many countries as they privatize. At the same time, they felt that it is necessary to correct the unrealistic provisions of the regulatory framework in many countries.

### **Other environment-related issues/questions**

Other specific questions asked on this subject included the following: How can the WBG check if the company in which it has invested is following its guidelines on environmental impact? Who would be in charge of enforcing the relevant regulations - government, private sector associations, employer's associations? What role does WBG have in helping to set these up?

### ***Gender Issues***

Internal commentators from the gender sector family strongly argued for the strategy to be gender-sensitive. They provided examples of the kind of issues and questions which need to be addressed in this regard: a) the different needs of women when discussing infrastructure; b) how women are affected differently by privatization; c) how property rights for women could be different from that for men; and d) the differential access of women to finance. They argued that the analysis should look at things from the lens of women and the interventions proposed should be gender-sensitive. These positions were reiterated in other meetings, for example by representatives of women entrepreneurs in developing countries.

### **The role of the state, private sector and community organizations**

Several commentators wanted the paper to better clarify the relative roles of the public and private (for-profit and non-profit) sectors in promoting growth and delivering services to the poor. A developing country civil society representative remarked that there is an overall lack of clarity in developing countries, including in civil society, about the role of these three groups. There is confusion, for example, about the financing vs. service-provision roles of government. Similar sentiments were expressed by some internal commentators.

#### ***The role of the state***

There was a range of views on this subject. Some commentators, mostly from trade unions and civil society, were uncomfortable with the notion of state failure. They felt that the paper assumed the absolute demise of the state and saw private provision as an end in itself. Trade unions felt that the WBG's first concern should be to analyze why the public sector is not working well and then try to help countries improve the functioning of their public sectors. They felt that many privatizations and deregulations has had serious problems but that these were glossed over in the paper. The on-line discussion

with civil society organizations revealed similar sentiments but there was also recognition of state failure. Some civil society commentators suggested that one way to deal with this is to remove barriers to competition. Private sector participants were vocal about what they saw as serious failures of the state in delivering basic services and ensuring a climate conducive to investment.

Several commentators felt that the paper has under-emphasized the fact that an effective public sector is needed to promote PSD. Some internal commentators wanted more arguments in favor of a critical role of the state in areas such as social and environmental safeguards.

#### *The role of non-profit and community organizations*

Several commentators, both inside and outside the Bank, highlighted the potential of not-for-profit and community organizations to effectively deliver services to the poor. They welcomed the broader definition of the private sector to include the non-profit sector but wanted this to be made more explicit. They argued that these groups are better at involving the poor in decision-making and effective in setting standards and monitoring performance. Civil society organizations who participated in the on-line discussion suggested that the WBG take these organizations more seriously and shift a larger portion of their lending to them. At the same time, they pointed out that civil society is not homogeneous with some organizations better at monitoring and some at service delivery. The WBG should recognize these differences in dealing with such organizations.

Some concerns were also expressed about community organizations. Some commentators argued that problems of local capture and caste systems may prevent community organizations from being effective at setting standards and monitoring objectively. Others suggested that social funds may have been able to bypass the traditional government mechanisms but may have created barriers to effective public sector management. Some civil society commentators feared that redefining civil society too much as a service provider may dilute its role as a counter-balance to the state.

#### *Partnerships between government, for-profit and non-profit organizations*

The scope for public-private partnerships at various levels of government was also mentioned. Civil society representatives argued strongly for three-way partnerships between state, private sector and community organizations and wanted these partnerships to evolve in a democratic free-entry way, rather than in a top-down, engineered fashion. Internal commentators felt that the paper had not adequately emphasized the potential for partnership between the private and public sectors; such partnerships have been used effectively in the many areas of the WBG's work, such as on the environment.

It was suggested that the appropriate division of labor may vary across sectors. For example, civil society commentators argued that all three sets of actors can cooperate in areas such as education, human rights and social protection while, in other areas, such as

in the utility sector, one set of actors may be better at delivery while others may be better at standard setting and monitoring.

### *Capacity of private sector, state and community organizations to carry out their roles*

All categories of commentators emphasized the need for capacity building of the various actors and saw a big role for the WBG in this. There were concerns about the capacity of the private sector, especially the small players, in the poor countries to provide the kind of services expected of them in the paper. In the online discussion, concerns were raised about civil society's capacity. It was pointed out that NGOs often lack sufficient management skills and their reporting and accounting systems are weak. It was argued that they can manage loans from the WBG only if management systems are in place. Civil society commentators thus wanted the WBG to focus more on training and capacity building of NGOs and civil society organizations.

## **The working of the World Bank Group**

### *Unbundling*

Several donor representatives thought that unbundling of WBG products is an interesting and worthwhile concept and should be considered. However, they also argued that the WBG's comparative advantage lies in the bundling of various products and unbundling may reduce its competitiveness. Some developed country government officials asked what the consequences would be for products and the WBG's portfolio. They also suggested introducing a code of conduct for donors on use of grants, subsidies, including disclosure of subsidy element of loans, guidelines for unbundling of grant element. NGOs asked if the WBG has thought through the question of which unbundling modality would be most appropriate for different sectors, different levels of poverty and different institutional capabilities.

### *Rate of return disciplines*

A number of questions were asked about rate-of-return disciplines: a) how would you determine the risk-adjusted ROR? (developed country government official); b) how has WBG staff reacted to these proposals? (developed country government official); and c) what does this mean for the development activities of the IFC (IFC manager)?

### *The comparative advantage of the WBG*

There was some discussion of the comparative advantage of the World Bank Group and what it can bring to the table. European policy makers suggested that the strategy paper should include some definition of the comparative advantage of the WBG vis-à-vis the strategy and how the WBG might lead and co-ordinate to get consistency across all donors and in PRSPs. They also felt it necessary to stress that multilateral institutions with PSD strategies should coordinate their work better.

With regard to the role of the IFC, it was asked that, if informational asymmetries is the reason for market-type failures, shouldn't IFC's role be simply to provide more information? By doing more than this, is IFC not crowding out private investment? In a related vein, some developed country government officials asked about disciplines on the WBG to prevent it from competing with the private sector and the appropriate division of labor between IFC and IDA. Questions were also asked, both externally and internally, about the comparative advantage of the WB vis-à-vis IMF, given that the latter is also following development-oriented conditionalities? It was suggested by a donor agency staff that it would be better for the IMF to focus on BOP issues and WB on development. Internal commentators in the Bank were concerned whether the WBG's work on the financial sector will survive vis-à-vis the IMF? In this connection, they wanted better articulation of the links between the financial and real sectors in the strategy paper.

Private sector representatives suggested that having the WBG, or such multilateral development institutions, is like an insurance policy for the private sector. They also agreed that, by picking up some risks that the private sector is unlikely to, the WBG can over time help reduce the risks and thus induce the private sector to come in without WB involvement. For them, the critical question was whether WBG involvement reduces the risks or gives the government a leeway, so that they do not make the fundamental reforms. They argued that, if the latter is more likely, loans should not be made without demanding reforms.

#### *Division of labor and coordination within WBG*

The division of labor and collaboration within the World Bank Group also came up for discussion. Some developed country policy makers were concerned about the incentives of some parts of the WBG to implement the strategy. Several commentators noted that the successful implementation of the strategy will require close cooperation between the various parts of the WBG and wanted that the final paper to include an account of efforts that will be made to get the various private sector development-related parts of the Bank Group to coordinate in implementing the strategy. Some commentators wondered how there can be better coordination with other facilities, such as the Public-Private Infrastructure Advisory Facility (PPIAF), and how IFC can be made to move from a narrow "closing the deal" mentality to a broader commitment to development.

Within the Bank, there was demand for better coordination between the work on PSD and on that on finance. Internal commentators also argued about the need for PSD-work to be better coordinated with work on institutional issues in the PREM network. There were also suggestions for the PSD sector board to be reorganized on the lines of the poverty board with representation from all networks.

## **Implementation of the strategy**

### *Relevance of PSD strategy to other strategies*

There were concerns and questions about the relevance of the PSD strategy to other sectoral strategies of the Bank as well as to country assistance strategies. Who would coordinate with other strategies to ensure that the result was coherent? How will the strategy relate to Bank OPs in process? How will the strategy account for regional differences? Will there be regional sub-strategies? Will there be regional adaptations?

Commentators asked how the PSD strategy was going to be reflected in the country assistance strategies. A participant from the private sector asked if the strategy will be consistent with the CDF. NGOs also wanted to know how the strategy will relate to the country ownership of development choices through PRSP and other national planning processes. Will adoption of the strategy mean that Bank Group operations may contain elements not consistent with needs and preferences expressed by stakeholders within a country?

### *Private sector consultations*

Commentators, especially from the private sector, suggested that the WBG make greater efforts to get feedback from the private sector before embarking on individual projects, just as they are doing on the PSD strategy. Some commentators expressed concerns that the bulk of the private sector has very little say in the development programs in developing countries. They argued that when private voices are heard they tend to be those of powerful lobbies that do not represent a broader cross-section of private enterprises, and even less of local entrepreneurs, and hence their intervention often acts as an obstacle to diversification of the economy. They felt that the WBG should thus work to help set up and support more representative associations of the private sector in the countries that it works in. A related suggestion was that there be a directive from Bank management to resident representatives to meet periodically with various private sector chambers. There were complaints about poor access of the private sector to information produced by the WBG, such as the country economic memorandums as well as project-specific information. It was commented that the private sector has been pushing at the Annual Meetings for more disclosure but progress is still inadequate.

### *Other implementation issues*

Several commentators complained that the Issues and Options paper moved too easily from first principles to solutions, bypassing the complexities of implementation. They felt the paper was too narrow in focus, did not pay sufficient attention to implementation details and did not provide adequate evidence to support its arguments. Some commentators wanted more examples so that the arguments come across in a more compelling way. To a large extent, the reactions came because commentators did not have access to the background papers and/or did not realize that this was not the strategy

paper per se. Some commentators felt that it is necessary to provide an assessment of what has been achieved on the ground by previous strategies.

Questions were asked about the scope of implementation of the strategy. Will the strategy be implemented through pilot projects or will large chunk of the WBG portfolio be overnight subjected to the principles to be put forward in the strategy? If pilot projects are done, it would be useful if the WBG puts out a paper that talks at some length on what the pilot projects might look like.

*Attachment 1***List of meetings**Government

1. June 19 Oslo: Ministry of Foreign Affairs, NORAD
2. June 22 London: DFID
3. July 10 Brussels: European government representatives (from Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Luxembourg, Netherlands, Spain and the United Kingdom)
4. July 16 Tokyo: Ministry of Economy, Trade and Industry
5. July 16 Tokyo: Japan International Cooperation Agency
6. July 16 Tokyo: Ministry of Finance
7. July 17 Tokyo: Japan Bank for International Cooperation
8. July 17 Tokyo: Ministry of Foreign Affairs
9. July 17 New Delhi: India government officials
10. July 19 Sydney: Austrade
11. July 19 Islamabad: Pakistan government officials
12. July 20 Canberra: AusAid
13. July 20 Canberra: Treasury
14. July 23 Wellington: Ministry of Foreign Affairs and Trade
15. July 23 Wellington: Treasury
16. July 23 Jakarta: Indonesia government officials
17. July 28 Cairo: Egypt government officials
18. July 30 Abidjan: Cote d'Ivoire government officials
19. August 8 Ottawa: Ministry of Finance

*Private sector*

1. July 10 Brussels: Union of Industrial and Employers' Confederation of Europe (UNICE)
2. July 13 Washington DC: US Chamber of Commerce
3. July 16 Tokyo: Keidanren
4. July 16 Mumbai: Indian private sector and NGOs
5. July 18 Lahore: Pakistani private sector and NGOs
6. July 23 Jakarta: Indonesian private sector and NGOs
7. July 28 Cairo: Egyptian private sector and NGOs
8. July 30 Abidjan: Cote d'Ivorian private sector and NGOs
9. August 8 Ottawa: Canadian private sector
10. August 14 Washington DC: Corporate Council on Africa

NGOs and trade unions

(NGOs also participated in some of the meetings with the private sector in developing countries)

- |              |  |
|--------------|--|
| 1. June 20   | Berlin: Green Environment, NGOs  |
| 2. July 9    | Brussels: International Confederation of Free Trade Unions, European Trade Union Confederation, World Confederation of Labor, Trade Union Advisory Committee to the OECD |
| 3. July 17   | Tokyo: NGOs, diplomats and private sector  |
| 4. August 22 | Washington DC: Globalization Challenge Initiative, Friends of the Earth, AFL-CIO, RESULTS Education Foundation, Bank Information Center, Initiative for Policy Dialogue  |
| 5. August 23 | Washington DC: World Resources Institute   |

**Multilateral agencies**

- |              |   |
|--------------|---|
| 1. July 10   | Brussels: European Commission   |
| 2. July 11   | Brussels: European Development Finance Institutions, Centre for the Development of Enterprise, OECD, DEG, SIMEST, EIB, FMO, EBRD, CDC |
| 3. July 26   | Manila: Asian Development Bank  |
| 4. July 31   | Abidjan: African Development Bank   |
| 5. August 17 | Washington DC: Inter-American Development Bank  |

**World Bank Group**

**Sector Boards**

- |              |                    |
|--------------|--------------------|
| 1. May 29    | Social Protection  |
| 2. May 29    | Gender             |
| 3. June 5    | Transport          |
| 4. June 6    | Rural Development  |
| 5. June 27   | Economic Policy    |
| 6. June 28   | Finance            |
| 7. July 5    | Social Development |
| 8. August 8  | Environment        |
| 9. August 15 | Water              |

**Others**

1. May 29 IFC directors
2. June 1 Regional chief economists
3. June 4 Private Sector Development sector board
4. June 6 DEC
5. June 7 IFC/MIGA (selected staff)
6. June 24 PSI Directors
7. July 2 IFC field managers
8. September 5 PSI Council

*Attachment 2***KEY MESSAGES FROM ON-LINE DIALOGUE WITH CIVIL SOCIETY**

*(from report prepared by the New Economics Foundation)*

***1. Support for alternative organizations***

The WBG should look more closely at smaller types of private organizations to deliver services to the poor. In particular, co-operatives and small and medium-sized enterprises (SMEs) offer a significant opportunity to build up a locally based and locally owned private sector.

***2. Targeted subsidies can be highly problematic***

Profits should not be made from commercial loans and subsidies would be better applied to capacity building projects for NGOs and/or support for SMEs.

***3. Debt Reduction***

Any PSD strategy should not be developed in the absence of considering the issue of debt reduction. Debt reduction plays a significant role in freeing up investment opportunities to deliver services to the poor. Nonetheless, it was argued that debt reduction on its own was not sufficient and that education or other complementary programs must be considered.

***4. Partnership approaches***

Each sector – private, public, not-for-profit has a complementary role to play and the WBG should develop more tri-sector partnerships, rather than favoring the delivery of services via one sector over another.

***5. Definitions/Terminology***

The use of the term "private sector" is not sufficient to cover all non-state actors. Furthermore, the WBG requires a more sophisticated approach to dealing with civil society as there were different types of organizations that fall within this heading and each fulfils a highly varied and different role in society.

***6. Governance***

There is wide support for investment in governance systems and enabling legislative environments both to support a healthy private sector and to support co-operative or non-profit organizations. At the same time, any focus in this area should not lead to increased bureaucracy or regulatory burdens on either sector.

### ***7. Focus on under-developed, less-profitable regions***

The WBG should focus more on supporting under-developed areas, where profits are likely to be limited, such as in low-income rural areas.

### ***8. One-size does not fit all.***

There was a marked difference in responses from different regions of the world. The particular characteristics of the local economy must be taken into consideration, and strategies should be locally defined and developed.

### ***9. Accountability***

Capacity building for civil society and alternative performance indicators should be developed – the same measures should not be used for all organizations.

The accountability of the private sector must also take into consideration whereby social and ethical criteria and corporate social responsibility (CSR) approaches should be adopted.

### ***10. Future dialogue***

Different strategies should be considered in delivering an e-dialogue and the limitations of an e-dialogue should be considered. All participants ultimately contributed in English, although questions were delivered in several languages. E-dialogues should be hosted from different countries in their native language and designed through more democratic structures.

E-dialogues can only begin to raise the issues and shape the focus of the debate. Local workshops on the subject would also complement the process.