



IDA14

Strengthening the Private Sector in IDA Countries

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Acronyms

ADB	Asian Development Bank
APDF	Africa Project Development Facility
BAPA	Bangladesh Agro-Processor's Association
BDS	Business Development Services
BEI	Bangladesh Enterprise Institute
CAS	Country Assistance Strategy
DB	Doing Business
EBRD	The European Bank for Reconstruction and Development
FIAS	Foreign Investment Advisory Service
FSAP	Financial Sector Assessment Program
FSD	Financial Sector Development
FUNDES	Foundation for Sustainable Development of SMEs International
IC	Investment Climate
ICA	Investment Climate Assessment
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
IPP	Independent Power Project
JDR	Joint Donor Review
MDG	Millennium Development Goals
MIGA	Multilateral Investment Guarantee Agency
MSME	Micro, Small and Medium Enterprise
NGO	Non-Governmental Organization
OBA	Output-Based Aid
OECD	Organization for Economic Cooperation and Development
PDF	Project Development Facility
PEP	Private Enterprise Partnership
PPI	Private Participation in Infrastructure
PPP	Public-Private Partnership
PREM	Poverty Reduction and Economic Management
PRSC	Poverty Reduction Support Credit
PRSP	Poverty Reduction Strategy Paper
PSD	Private Sector Development
QAG	Quality Assurance Group
ROSC	Report on the Observance of Standards and Codes
SEDF	South Asian Enterprise Development Facility
SME	Small and Medium Enterprise
WBG	World Bank Group
WDR	World Development Report

Strengthening the Private Sector in IDA Countries

I. INTRODUCTION

1. ***Private sector development (PSD) has featured prominently in previous IDA Replenishment discussions.*** During the IDA13 discussions,¹ Deputies supported the thrust of the World Bank Group's PSD strategy.² They urged IDA to move forward with the implementation of a strong program of activities focused on improving the investment climate, building entrepreneurial capacity, improving market access for small producers, and strengthening appropriate regulatory and supervisory capacity in client countries. The Deputies noted that Output-Based Aid (OBA) approaches held promise to improve the delivery of basic infrastructure and social services in IDA countries. Furthermore, they encouraged IDA to exploit synergies with other members of the World Bank Group (WBG), especially with IFC, to adopt innovative approaches to support the private sector.

2. ***At the IDA14 meeting in Paris in February 2004, Deputies requested that PSD be one of the "special themes" that would be given in-depth treatment during the IDA14 Replenishment process.***³ This paper responds to that request. It summarizes the WBG PSD strategy, provides an update on the implementation of the strategy in IDA countries, and suggests ways of moving the PSD agenda forward. In particular, it addresses issues related to IDA's support for better investment climate and regulatory environment, increased attention to Small and Medium Enterprise (SME) development, development of public-private partnerships especially with respect to provision of infrastructure, and enrichment of relationships between IDA, IFC and MIGA.⁴

3. ***This paper is structured as follows.*** Sections II.A and II.B summarize the 2002 PSD strategy and the main shifts in focus in the PSD agenda respectively. Section III provides an update on the implementation of the PSD strategy in IDA countries by the WBG during FY02-04. Within this, Section III.A describes the diagnostic instruments used by the Bank to assess the investment climate in client countries. It also describes how this diagnostic work is informing better government-business dialogue and how it forms the basis for results-based monitoring in IDA countries. Section III.B describes how the PSD agenda is pursued at the country strategy level as well as in lending operations. It summarizes progress in implementation on key proposals of the PSD strategy and also outlines areas of collaboration with the IFC, most notably on private provision of infrastructure and SME development. Section III.C describes the Bank's efforts towards collaborating, building partnerships and sharing

¹ See *Additions to IDA Resources: Thirteenth Replenishment Supporting Poverty Reduction Strategies*, July 2002, page 16.

² Articulated in the document, *Private Sector Development Strategy: Directions for the World Bank Group*, April 2002. This was followed by an *Implementation Progress Report* June 2003. To put the PSD strategy into action, the six World Bank regions completed their individual regional PSD Strategy Implementation Plans in FY04, following a standard template endorsed by the PSD Sector Board. The PSD strategy is complemented by other operational strategies, notably those related to the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and Small and Medium Enterprises (SMEs).

³ See IDA14, *Replenishment Priorities: Proposed Special Themes*, February 2004.

⁴ For a description of IFC and MIGA activities in IDA countries, see *Annexes 1 and 2* respectively.

knowledge with other development partners and client countries. Section IV suggests ways of moving the PSD agenda forward.

II. PRIVATE SECTOR DEVELOPMENT STRATEGY

II.A Main Components

4. ***The WBG's PSD strategy, formulated in 2002, is based on the central precept that a vibrant and competitive private sector is key to growth and poverty reduction.*** The private sector plays a critical role in IDA countries where resource scarcity makes investment mobilization, efficient resource allocation, and technological progress paramount. Private activity helps reduce poverty in two ways. *First*, private markets are the engine of productivity growth,⁵ which provides a central avenue for higher incomes, economic growth and employment generation. *Second*, private initiative can complement government efforts to empower the poor by providing basic infrastructure and social (health and education) services.

5. ***The PSD strategy has two broad objectives: opportunity and empowerment.*** It aims to create opportunity for poor people by extending the reach of markets through investment climate reform⁶ and support of SMEs based on market-based delivery systems. It aims for empowerment, in part, by improving poor people's access to basic infrastructure and social services through private participation. To achieve these objectives, IDA countries must implement a set of reforms focused on alleviating the microeconomic constraints to private sector investment, competition, and growth. Work on investment climate reforms is seen as crucial both for their promotion of business development and as a precondition to the success of other types of PSD interventions by the WBG group.⁷ Therefore, the PSD strategy calls for a special emphasis on improving the investment climate in support of poverty reduction in IDA countries.⁸ This includes strengthening competition policy, improving property rights and their enforcement, and promoting regulatory reform. It emphasizes the need to assess the key factors driving growth and hence poverty reduction and, combined with consultation processes, inform policy-based and other lending.

⁵ Hall and Jones (1999) find that nearly 70 percent of the difference between high output and low output economies can be accounted for by productivity differences, rather than factor accumulation. Dollar and Kraay (2001) show that as economies grow, the poor benefit roughly proportionally.

⁶ Investment climate refers to factors influencing firms' opportunities and incentives for efficient operation. Kaufmann and Kraay (2002) showed that country investment climate factors are strongly associated with per capita income growth.

⁷ A wealth of studies point to the importance of favorable policies to the success of WBG operations. See, for example, C. Burnside and D. Dollar, (1997). *Aid, Policies, and Growth*, World Bank Policy Research Working Paper, no. 1777, P. Collier and D. Dollar, (2000). *Can the World Cut Poverty in Half? How Policy Reform and Effective Aid Can Meet International Development Goals* World Bank Policy Research Working Paper No: 2403. In addition, a recent review of IFC projects found that improving the investment climate markedly improves project outcomes. IFC, (2004). *An Evaluation of IFC's Investment Climate Activities (2004)*.

⁸ The paths out of poverty offered to poor people by PSD include opportunities for employment and entrepreneurship, enhanced delivery of services, and better prices and product availability. The companion IDA14 paper on *Growth in IDA Countries* notes the positive correlation between economic growth and such investment climate factors as openness to trade, good governance, stability, and conditions supporting PSD, including low transaction costs.

II.B Strategic Shifts in Focus

6. ***The PSD strategy calls for a shift in focus from privatization and restructuring of state-owned enterprises to improving the investment climate.*** While the privatization agenda remains substantial, there has been recognition that private enterprises work best in a sound business environment open to competition. The first stage of this shift was devoted to designing and implementing rigorous and standardized diagnostic tools to identify priority investment climate constraints as a basis for dialogue with governments, strategy development and operations financed by IDA and IFC.⁹ With these diagnostic tools now developed, the emphasis is shifting towards developing best practice guidelines on solution designs and implementation processes. This will enable translation of the findings from diagnostic tools into lending operations and improved policy reform processes.¹⁰

7. ***Within the SME agenda, too, the investment climate has come to the forefront.*** SMEs, the heart of the private sector in IDA countries, often merit special attention, in large part because they suffer disproportionately from policy and institutional impediments in the investment climate. SMEs are the most constrained by poor economic policy, excessive regulation, weak property rights and legal systems, and weak financial services, and therefore benefit the most from effective reforms in these areas.¹¹ Thus the SME activities of the Bank and the IFC are increasingly focusing on this reform agenda, as well as efforts to build institutions and adopt integrated approaches to direct SME support.

8. ***Within the privatization agenda, there has been an evolution from an exclusive focus on productive sectors to the inclusion of infrastructure and, subsequently, social sectors (health and education), with a growing emphasis on OBA approach.***¹² In infrastructure as well as in social services, while the continuing importance of public participation is well acknowledged, the WBG is working with clients to provide a broad menu of public and private options, including public-private partnerships. There is growing collaboration between IDA and IFC in this regard (Section III.B).

III. IMPLEMENTING THE PSD STRATEGY IN IDA COUNTRIES DURING FY02-04

9. ***IDA is making progress using four approaches: first, good diagnosis of the investment climate which leads to effective reforms; second, policy dialogue and advice aimed at triggering reform; third, lending and grants to support the private sector response; and fourth, monitoring***

⁹ To an extent, this has been achieved. From FY99-00, it was estimated that over 60 percent of IDA's PSD lending commitments addressed issues related to investment climate. This is expected to edge up to over 70 percent during FY03-05.

¹⁰ As part of this effort, the PSD Anchor and the Foreign Investment Advisory Service (FIAS) have launched a program to identify the transferable elements of successful cases of legal, regulatory and institutional reform in areas such as business inspections and land registration.

¹¹ World Development Report, (2005). *A Better Investment Climate for Everyone.*

¹² The WBG's evolving business model for infrastructure and social service delivery calls for a pragmatic approach to balance public versus private provision of infrastructure, the need for cost recovery with affordability, and the payment of targeted subsidies with fiscal sustainability.

and evaluation of the implementation and impact of reforms. With the extensive diagnostic work on the investment climate and other PSD related diagnostic and advisory work well underway, lending should continue as an important means of supporting PSD in IDA countries. In the implementation of the PSD strategy, a number of trends can be observed in the refocusing of PSD work.

III.A Diagnostic Work, Government-Business Dialogue, and Results-Based Monitoring

Diagnostic Instruments for Assessment

10. *The measurement agenda has brought with it advances in several tools for assessing conditions for PSD.* Ongoing efforts focused at the IDA country level include the Doing Business Project, the Investment Climate Assessments, and the Country Corporate Governance Assessments, as well as a concerted effort to integrate non-WBG diagnostics.

11. *The Doing Business (DB) project produces rich data about specific regulations, which are comparable across countries and updated annually.* The project applies a new survey tool that compiles objective indicators of business regulations covering 145 countries, including 62 IDA countries.¹³ These indicators can bring long-hidden problems into sharp relief.¹⁴ Early experience suggests how a detailed, factual assessment can offer very specific ideas for reform (Box 1). It also contributes to a more systematic understanding of the regulatory burden and reform patterns in IDA countries, where businesses suffer both from heavy costs and slow reform progress. Research based on these indicators leads to a more systematic understanding of how barriers to entry, exit and operation can contribute to unemployment, informal business practices and stagnation. A remaining challenge lies in scaling up the utilization of a growing number of available DB indicators, both by topic and country, to achieve reforms.

Box 1: Starting a Business in Ethiopia - Publish and Perish

Many legal constraints to PSD persist due to neglect, not intention. In Ethiopia, the WBG's "Doing Business in 2004" report revealed that a requirement to publish an enterprise's articles of association in local papers added inordinately to costs while serving little public value. Confronted with the evidence, the Ethiopian government scrapped the regulation. The total cost of registration declined in one year from 422 percent of per capita national income to 78 percent, while 12 days were pared from total registration time.

12. *Investment Climate Assessments (ICAs), which are broader and more detailed assessments of a single country's investment climate, combine surveys of hundreds of firms with publicly available indicators and special studies.*¹⁵ Underpinning all assessments is a

¹³ In 12 IDA countries, *Doing Business in 2004* helped spur governments to cut either the time or cost of starting a business or both.

¹⁴ For instance, in Angola, it costs more than eight times per capita income to set up a business. The law, which makes it so expensive, is 103 years old. So the problem here is more a lack of attention than a lack of resources or willpower.

¹⁵ ICAs got a significant boost through the IDA13 Replenishment process, which stipulated that ICAs should be initiated in a majority of IDA countries by the end of the IDA13 period.

common survey instrument that is administered to a representative sample of private sector firms. The standard approach allows global comparisons, but also permits flexible adaptation to individual country priorities through additional modules. The result is a detailed report in the public domain, aimed at promoting dialogue, policy reform and, therefore, growth and poverty alleviation. Well over half of the assessments launched have been in IDA countries.

13. ***The ICA program has greatly accelerated in FY04***, with 20 surveys launched in FY04, making a total of 54 surveys launched by end-FY04. Around 15 surveys are planned for launch in FY05. Almost all assessments undertaken so far have been followed by dissemination events and private-public dialogue. So far, ICAs have shaped 15 new lending operations in 13 IDA countries such as: Cambodia (Box 2), Honduras, India, Mozambique, Nicaragua, Nigeria (Box 3) and Uganda. A remaining challenge is to monitor progress in the countries in economical ways that engage key stakeholders.

Box 2: Cambodia - Trading for Success?

Much of Cambodia's recent growth relied on rapid expansion of exports. Supported by diverse analyses including a value chain study, an enterprise survey, and a detailed trade logistics study, the Cambodia ICA highlighted the need for reform of trade facilitation and made specific recommendations for streamlining trade regulation and improving service. Discussion of preliminary findings with government led to a Prime Ministerial Decree creating an Inter-Ministerial Working Group for Improving the Investment Climate and Trade Facilitation, composed of top officials, which adopted four broad initiatives encompassing 20 specific reforms from the key recommendations of the ICA. A planned PSD project will assist the government in implementation. The Working Group plans to tackle the broader investment climate agenda set out in the ICA once the trade agenda has been addressed.

14. ***Among the lessons being learned from ICAs is the clear link between investment climate constraints and enterprise performance.*** For example, recent cross-country studies show the role of corruption, regulatory compliance costs, and power outages in constraining labor productivity (and hence wages) in a cross-section of IDA countries. Other cross-country work has reinforced the central importance of competition in stimulating productivity. Globally, firms have emphasized macroeconomic instability, regulatory policy uncertainty, taxes, regulatory burden, corruption and infrastructure as their top priorities. Perhaps the most powerful lesson of the early ICAs is the persuasive power of specific evidence from local enterprises and industries revealed in comparative perspective. The rigorous approach of ICAs motivates government and business leaders to discuss the content and nature of priority reforms identified, rather than debate the evidence itself.

Box 3: Nigeria - From ICA to Action

The Nigerian ICA laid the empirical basis for focused consultations between business and government through a competitiveness forum (now called the Better Business Initiative), organized by a local think-tank. Based on broad local private sector participation, it identified and forwarded a policy reform agenda to senior federal government officials. Based on this agenda, follow-up surveys and innovative pilot projects sponsored by the WB-IFC SME Department, the design of a Micro, Small and Medium Enterprise (MSME) Credit was identified. The MSME project represents a collaboration of the World Bank and the IFC, which would finance \$32 million and \$5 million respectively.

15. ***As ICAs better capture the priorities of the formal urban economy, special attention has been devoted to extending this approach to the rural non-farm economy and urban-informal sectors.*** Rural non-farm enterprise surveys, developed with the Bank's Agriculture and Rural Development network, pay particular attention to issues such as rural-urban linkages and (agriculturally-driven) seasonality factors affecting demand and labor supply. For example, in the South Asia region, IDA countries have seen: (i) an investment climate analysis for rural entrepreneurs in Bangladesh, contained in the 2004 report *Promoting the Rural Non-Farm Sector in Bangladesh*; (ii) a pilot rural ICA in Sri Lanka, launched in 2003 and now nearing completion; and (iii) pilot investment climate surveys, in preparation of the 2005 WDR, of informal enterprises conducted in major cities in 10 IDA countries and rural nonfarm surveys in seven countries.

16. ***Rural results tend to highlight the difficulties non-farm enterprises have in accessing financing, infrastructural services, and markets.*** Both rural and urban informal firms show strong seasonal trends in demand and reveal weak linkages of small, informal firms to larger-scale formal enterprises. Information on the full range of enterprises, from small and informal to large and multinational, is contributing to a deeper understanding of informality as a rational reaction to the limited benefits and excessive costs of formal economic participation imposed by hostile investment climates. These results have also revealed informality to be more a continuum than a sharp demarcation, with even large firms showing some types of informal behavior given a sufficiently difficult or costly burden of formality.

17. ***An important challenge in sustaining the ICA approach is the cost and difficulty of carrying out repeated large-scale surveys.*** If the initial information generated by ICAs is to be used to monitor reforms, there must be longitudinal data. This requires repeating surveys at regular intervals on comparable samples over time. Several past evaluation initiatives, such as "private sector assessments," lost momentum after a few years. The challenge for the ICA approach will be to maintain momentum so that investment reform priorities can be identified and pursued on a continuing rather than a one-time basis. One part of the challenge is to "mainstream" the approach in the regional work of the WBG. Another is to institutionalize capacity to generate and utilize ICAs within client countries.

18. ***Country Corporate Governance Assessments¹⁶ have been completed in five IDA countries*** (most recently in India, Indonesia and Moldova). These assessments analyze how well national securities and corporate laws comply with the OECD principles for corporate governance. They serve as a basis for policy discussions and lending decisions, and provide the

¹⁶ The Bank conducts country corporate governance assessments under the *Reports of the Observance of Standards and Codes* (ROSC) initiative at the invitation of country authorities. This is a joint exercise with the IMF, in which the two institutions are undertaking a large number of summary assessments of the observance of selected standards relevant to private and financial sector development and stability. These assessments are being collected as "modules." Under this modular approach, the IMF takes the lead in preparing modules in the area of data dissemination and fiscal transparency. Modules for the financial sector (monetary and financial policy transparency, banking supervision, securities market regulation, payment systems, and deposit insurance) are mostly derived as by-products from a parallel Bank-Fund Financial Sector Assessment Program (FSAP). The World Bank has been asked to take the lead in three areas covered by ROSCs: (i) corporate governance; (ii) accounting and auditing; and (iii) insolvency regimes and creditor rights.

foundation for future capacity building and technical assistance initiatives. ROSCs appear to be best attuned to a few lower-income countries with reasonably developed equity markets.

Business-Government Dialogue

19. *Business-government dialogue has been an important element of successful investment climate reforms.* The remaining challenge is to capture the lessons of successful consultations and apply them more systematically to PSD reforms. The dissemination of DB, ICA, and FIAS reports regularly includes business-government dialogue that often leads to successful reform outcomes. Examples include:

- The Nigeria ICA findings helped launch the Competitiveness Forum Working Group, which has spurred a private sector-led process of further research and policy dialogue with government on key investment climate issues (Box 3).
- Investors Councils composed of leading government and business officials have begun operating in Ghana, Senegal, Tanzania and Uganda. The IFC and its Mekong Project Development Facility has also organized consultative business forums between top government leaders and business representatives to discuss and monitor reforms. Specialized working groups carry forward the agenda between meetings in priority areas (like trade and taxes).
- The Global Corporate Governance Forum, jointly founded by the OECD and the Bank, now funded by donors, holds regional private-public roundtables that discuss policies and identify areas for improvement.

Results-Based Monitoring

20. *The PSD strategy emphasizes results measurement.* This is in line with the increased results orientation of the WBG and global monitoring of the progress in achieving the Millennium Development Goals (MDGs). PSD-related dimensions figured prominently in the IDA13 Replenishment discussions and progress against PSD input and output indicators are being measured over the IDA13 period.¹⁷ During 2003-04, the average cost of starting a business in the 39 IDA countries being monitored fell by 8 percent and the time required to start a business fell by 11 percent, on a population-weighted basis. Along the dimension of business start up, *Doing Business 2005* finds that the two fastest reforming groups of countries in the world were the EU (where the EU directorate had established specific benchmarks) and IDA countries (where benchmarking allowed a concerted campaign to reduce entry delays and costs).

¹⁷ The IDA13 targets for private sector development were, on the input side, to complete seven Investment Climate Assessments each fiscal year, and to launch surveys in the majority of IDA countries by the spring of 2005. On the outcome side, the target was to reduce both the average time and the average cost (relative to per capita income) of formal entry by 7 percent - as measured by the DB project - by spring 2004. Meeting these targets required improvements in the business environment of IDA countries.

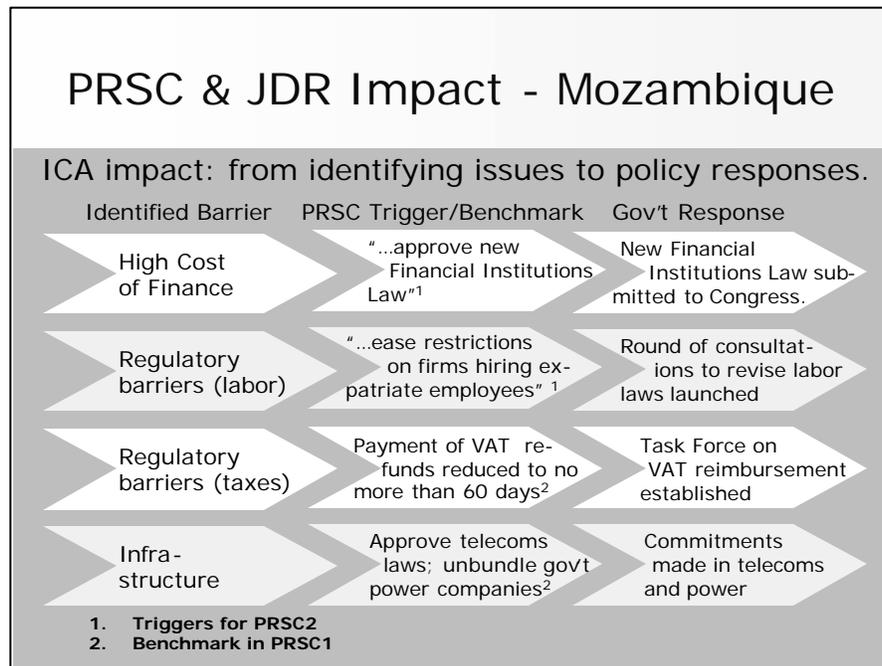
III.B From Measurement to Action: PSD in Country Strategy, Operations and Lending

PSD in Country Strategy

21. *Findings from the growing body of diagnostics are now being incorporated in Country Assistance Strategies (CASs) and Poverty Reduction Strategy Papers (PRSPs).* For example, ICA findings have been incorporated in CASs in 11 countries, where the timing allowed. In addition, PRSPs and follow-on operations are picking up investment climate reform priorities and PSD themes. Examples include:

- Cambodia, where ICA recommendations such as streamlining trade facilitation and business regulations and strengthening governance of Private Participation in Infrastructure (PPI) became part of the CAS,
- Eritrea, where ICA findings on the need for progress on demobilization became central to the CAS agenda, and
- Mozambique, where key ICA findings and recommendations on constraints such as financing, regulatory barriers in labor and taxation, and infrastructure became essential components of the PRSC and the joint donor review (JDR, Figure 1).

Figure 1: ICA Implementation in Mozambique



22. *As more diagnostic work is completed this trend of greater integration of PSD issues in CASs is expected to continue.* The growing contributions of the IFC and MIGA to CASs further strengthen their PSD orientation (see below). However, a continuing challenge lies in having

PSD concerns, and especially investment climate reform priorities, systematically incorporated as part of the growth and poverty alleviation agenda into CASs and country-led PRSPs (even where there is no recent ICA). A similar challenge confronts the agenda of enhancing the role of the private sector in the delivery of infrastructure and social services.

Financing for PSD Operations

23. *As a crosscutting initiative, the PSD work spans many parts of the WBG.* It is found in programmatic lending (e.g. PRSC, SAC), investment projects or their components in various sectors (transport, economic reform, financial sector etc.) and in technical assistance projects. The estimated amount of IDA lending that addresses PSD objectives has been increasing (Figure 2).¹⁸ As of September 2004, IDA's total active portfolio attributable to PSD themes consists of 342 projects, estimated to be about \$7 billion. During FY03-04, just under half of all projects with PSD objectives took place in IDA countries – 134 out of a total of 222 projects. In FY04, 72 projects addressed PSD objectives (Table 1). Over two-thirds of the PSD portfolio commitments fall under the investment climate umbrella.¹⁹ Examples of how diagnostic work feeds into operations include:

- In Mozambique, the Poverty Reduction Support Credit (PRSC) under preparation will support investment climate reform, including the establishment of a unique identification number for all enterprises for use in transactions ranging from registration of the business and land to paying taxes.
- In Honduras, an investment loan will pick up the agenda of reform established by the ICA.
- In Cambodia, a PSD loan will advance the agenda of streamlining trade facilitation and the establishment of a single window for importers and exporters to deal with bureaucracy at the border.
- In Uganda, the ICA findings fed directly into a \$27 million operation supporting six components, ranging from trade facilitation to financial services.

¹⁸ Given the crosscutting nature of PSD work as mentioned above, it is difficult to determine the exact amount of IDA lending for PSD. Thus the IDA lending figures for PSD cited in this paper are amounts of IDA credits that address PSD thematic objectives, as estimated by Bank staff. They do not, for example, include support for public utilities.

¹⁹ Within this, regulation and competition policy are central because they form an important part of most adjustment operations. Infrastructure is also important mainly because of the relatively high level of transportation-related components in PSD operations.

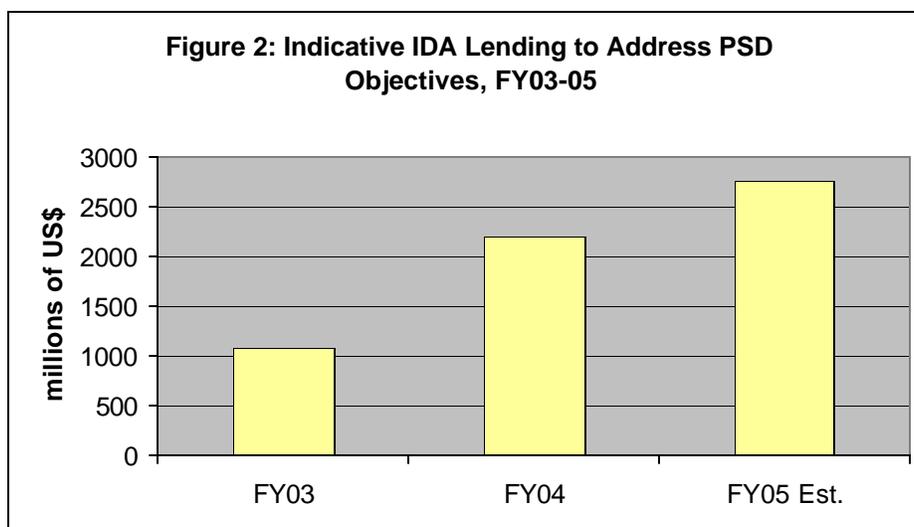


Table 1: FY04 Lending to Projects Addressing PSD themes by Region
(US\$ millions)

PSD Themes	AFR	EAP	ECA	LAC	MNA	SAR
Corporate governance	6	0	0	0	0	4
Personal & property rights	7	38	10	11	0	0
Regulation & competition policy	269	30	27	17	0	62
Judicial & dispute resolution	8	1	0	0	0	0
Legal institutions for a market economy	14	0	6	10	0	3
Investment Climate						
Other FSD / PSD	69	5	0	28	6	43
Infrastructure services for PSD	295	93	41	0	0	157
Tax policy and administration	34	0	2	0	0	34
Trade facilitation/market access	149	0	0	7	0	10
Export development & competitiveness	72	13	0	7	0	43
Other PSD						
SOE/bank restructuring and privatization	134	25	13	5	0	148
Standard & financial reporting	22	0	5	3	0	28
Rural non-farm income generation	22	3	4	0	0	16
SME support	15	38	4	6	8	69
Technology diffusion	4	0	0	0	0	0
Total PSD	1120	246	112	94	14	617
Countries with projects with PSD components	29	6	12	9	2	14

Source: World Bank

24. *As a direct financier to the private sector, IFC is a key channel of WBG PSD activity in IDA countries, providing over \$4 billion in direct finance in FY04* (Annex 1). The IFC is placing more emphasis in its work on strengthening the investment climate, developing domestic financial markets and encouraging small and medium business formation in order to fund the expansion of private enterprises and generate jobs. In IDA countries, the formation and growth of sustainable businesses continues to be a particular challenge. There remains a great need for

long-term capital, improvements in the investment climate, stronger community and small business linkages with large organizations, and more private enterprise formation. Among the measures IFC has taken to strengthen impact are: (i) a greater concentration of commitments in high impact sectors and low-income countries; (ii) eight new project development facilities created since 2000 to build capacity and develop SMEs; (iii) a broader range of financial services; and (iv) increased use of partnerships such as those with IDA described below. By region, there is a heavy emphasis on South Asia and Africa (Table 2).

Table 2: IFC in IDA Countries

(US\$ millions)

Region	1999	2000	2001	2002	2003	2004
Central and Eastern Europe	36.4	70.2	64.8	86.4	101.8	124.8
East Asia and Pacific	713.7	639.9	661.9	630.6	622.3	588.4
Latin America and Caribbean	139.4	151.2	145.2	126.9	143.2	132.3
Middle East and North Africa	563.6	482.2	488.2	493.1	480.8	373.1
South Asia	816.4	863.7	1034.9	1082.9	1346.2	1489.9
Southern Europe and Central Asia	347.4	371.3	351.0	413.8	418.6	437.6
Sub-Saharan Africa	835.2	909.8	1055.4	1029.8	950.2	1043.8

Source: IFC

25. *Consistent with the overall PSD strategy for SMEs, a major change over the last few years has been a re-orientation of SME support* from providing direct assistance to individual firms (for business development plans, capacity building or finance) to supporting institutions that service such businesses, including training firms, business associations, local consultants, and financial institutions. IFC provides a broad range of technical assistance support to benefit SMEs, which is in large part delivered through its Project Development Facilities (PDFs) and the Private Enterprise Partnership (PEP). There are now 12 Facilities managed by IFC that support small business development.²⁰ In addition, in the fall of 2003, PDFs were placed directly under the responsibility of the IFC regional directors to strengthen the facilities' integration with regional strategy, products and services. The IFC-WB SME Department continues to provide expertise and dissemination of best practices.

26. *An important focus of PDF work is improving the difficult business environment for SMEs in IDA countries, often following up on or extending IDA IC diagnostic work.* In Bangladesh, this involved substantial partnership on follow-up to reduce business entry costs and taxes on SME agribusinesses, and to monitor reform progress (Box 4). In Cambodia, there was active partnership throughout ICA implementation and in follow-up activities, including a sharp focus on reducing business entry costs. In La Paz, Bolivia, the LAC facility teamed with FUNDES to achieve a dramatic streamlining of business licensing and registration procedures.

²⁰ Includes those in Latin America, North Africa, the Middle East, Sub-Saharan Africa, Indonesia, Bangladesh, Southeast Asia, China, South Pacific, the former Soviet Union, and the Balkans.

Box 4: Bangladesh - Partnership on the SME Agenda

To carry out the Bangladesh ICA, the World Bank partnered with the Bangladesh Enterprise Institute (BEI) and the South Asian Enterprise Development Facility (SEDF), one of IFC's regional facilities serving SMEs. The ICA reform agenda identified an urgent need for infrastructure reform (especially in electricity), addressing pervasive corruption and over-regulation, and improving access to finance, each of which disproportionately burdened SMEs. With its WB and BEI partners, SEDF monitored the follow-up to the ICA agenda with a semi-annual panel survey of SMEs. It partnered with an industry association, BAPA, to study and work for the reduction of the tax burden on agro-processors. At the request of the Ministry of Commerce, it identified measures to streamline business registration and is providing technical assistance to implement them and to automate the registry of joint stock companies.

27. ***IDA and IFC also undertook a Micro, Small, and Medium Enterprise (MSME) initiative in Africa.*** In the past, IDA and IFC have undertaken separately a large number of MSME programs and projects in Sub-Saharan Africa, with mixed results. To improve this performance, during the IDA13 Replenishment, Deputies asked IDA “to exploit synergies with other members of the WBG, in particular IFC, to encourage innovation in support of PSD, and devote significant resources during IDA13 to such innovative programs.” Heeding this call, IDA and IFC are collaborating on a new series of integrated IFC/IDA MSME operations in Africa that promise to enhance the range of opportunities for SMEs.

28. ***The program supports MSMEs through three main pillars:*** (i) access to financial services; (ii) access to business development services, including strengthening inter-firm linkages (both domestic and foreign) and access to information; and (iii) improvements in the business environment for MSMEs. The components of individual country projects depend on country-specific circumstances. The program objectives are to: (i) increase the number of fully financially sustainable micro-finance institutions; (ii) increase the size and profitability of MSME portfolios among selected financial institutions; (iii) establish several funds to provide risk capital investments to MSMEs; (iv) develop sustainable private BDS markets through upgrading selected BDS providers and/or through demand-driven subsidies to MSMEs; and (v) reduce the cost to MSMEs of regulatory compliance, with initial emphasis on the cost and time to register a business (one of the IDA13 targets).

29. ***The first of these joint operations was approved in December 2003 by the IDA Board for Nigeria.*** IDA funds will be used to support capacity building and technical assistance to firms and to financial institutions oriented to MSMEs, as well as initiatives to improve the business environment for small enterprises. IFC will target investments in SME financing institutions and microfinance and use the experience gained via the Africa Project Development Facility (APDF) and other IFC initiatives to expand successful capacity building programs with IDA funding. Similar programs are being developed for six other African countries.²¹ Depending on the number and scope of country projects, total indicative program costs amount

²¹ The implementation of this initiative has proven more cumbersome than originally expected, as the management of both institutions worked to put in place procedures and processes to address potential conflicts of interest by IFC as a lender to SME organizations which may also receive IDA funding under the joint program. Specific measures are being worked out with the IFC-Bank Conflict of Interest Office, which should enhance the chance of success of this initiative and the opportunities for its replication.

to approximately \$175 million over a four-year implementation period. The program is expected to leverage additional funds by facilitating the mobilization of substantive additional capital into banks and other financial agencies it supports. The program will draw extensively on joint teams from IDA, IFC, APDF staff and local consultants.

30. *Experience reveals that sustainable financial services can help poor people to increase incomes, build assets and reduce vulnerability to shocks through microenterprise activity.*

IDA is pursuing a number of activities to improve access to financial services for poor people in a sustainable manner. First, the Bank's policy and operational work focuses on supporting sound policies and institutions for financial intermediation. This entails work on credit information and payment systems, as well as the regulatory, legal and institutional factors that determine the conditions and availability of financial services for poor people.²² In addition, IDA will further elaborate methods and indicators to measure the degree to which poor people have access to the financial system, and the effects these access conditions have upon their well-being. The objective of this work is to help ensure that CASs and PRSPs reflect conditions and needs with respect to the access that low-income people and businesses have to financial services.

31. *Finally, there are a number of microfinance operations underway in IDA countries.* In addition to two stand-alone microfinance operations in FY04 amounting to \$39 million, nine other FY04 projects totaling around \$430 million have microfinance components.²³ Stand-alone projects include the Madagascar Microfinance Project, which is phase 1 of a 15-year Adaptable Program Lending (Box 5) and the Bangladesh Second Poverty Alleviation Microfinance Project. In addition, the Broad-Based Access to Financial Services Project in Nicaragua was recently approved and focuses primarily on technical assistance for scaling up a range of microfinance providers. IDA assistance has played an important role in providing countries the means to build and support microfinance providers through capacity-building initiatives.

Box 5: Macro-Access to Microcredit in Madagascar

This project seeks to ensure the long-run viability of savings and loan association (SLA) networks to be established in four provinces of Madagascar, in order to provide access to financial services to lower-income people. Technical assistance is provided as part of an integrated approach that includes supporting the establishment of an appropriate legal, regulatory and supervisory framework for microfinance, the expansion of microfinance skills through a training program and the development of sustainable local institutions. The project does not provide funds for on lending, but rather focuses on savings mobilization and promoting member-owned organizations. SLA is expected to reach about 187,000 low-income families and about 935,500 in the 15-year adjustable program loan (APL).

32. *One major innovation proposed in the WBG PSD strategy is scaling up the use of OBA as a mechanism to improve infrastructure delivery to low-income communities.* Much of the Private Participation in Infrastructure (PPI) agenda is encompassed in the project work of the

²² Given the volume of international remittance flows and their substantial benefit to the poor, the Bank will also continue to focus on the development of competitive and accessible channels for sending and receiving international remittance payments.

²³ IFC also takes part in microfinance activities – through investments (totaling \$245 million in 2004) and technical assistance. IFC encourages market-priced microfinance projects rather than subsidized lending.

World Bank and IFC. PPI is also a key component of the World Bank's Infrastructure Action Plan.²⁴ The OBA approach is a powerful tool to harness public-private partnerships to reach the poorest segments of the population in the poorest countries, while increasing accountability for results. In this approach, service delivery is contracted to a third party – usually private companies but also NGOs – under arrangements that link payments to the results actually delivered. Payment is not provided until the teachers are teaching, the public phones work, or the water is flowing (Box 6). The aim is to make sure that subsidies are targeted closely at the poor, and to make sure that service provision is efficient. Currently, over 30 such Bank projects, most of which are in IDA countries, are under preparation or implementation and are aimed at expanding services to low income consumers or to protect the poor from increases in prices required to reach financial viability (Annex 3). OBA approaches have proved successful in water, sanitation, power, transport, telecommunications, and health, and in countries where it generally has been difficult to attract private interest.²⁵ Demonstrable benefits thus far have included reduced subsidy payments, improved operating performance, and better targeting of government and donor funding towards the poor. Examples include:

- A small-scale rural water project in Cambodia financed through a \$16.9 million IDA credit has subsidies targeted to 40 percent of the connections with intended beneficiaries amounting to over 13,000 households. Similar schemes are being considered for the sanitation sector in Cambodia, which currently has a weak record on provision of sanitation services for its rural poor.
- A health project in Rajasthan, India, is financed through a \$89 million IDA credit and has intended beneficiaries of 3.4 million people for in- and out-patient care.
- In Bangladesh, OBA approaches are being piloted for the delivery of electricity and water through small-scale networks to poor households in targeted communities, and for delivery of social services in health and education for specific beneficiary groups (e.g., children at risk) within targeted communities. IDA assisted the government in the identification and preparation of pilot operations for electricity and water, and in the development of standard approaches and pilot projects for the social sectors.
- Replicating successful pilot contracts in Chad and in Latin America, a \$67 million IDA credit is being used to introduce Performance-Based Management and Maintenance of Roads contracts in Tanzania, Madagascar, Cape Verde, and elsewhere in Chad. Approximately two million people, many of them very poor and living in rural areas, should benefit from these improved road conditions through lower transport costs, better access to markets and services, and reduction in time and effort needed to perform routine tasks, thereby increasing standards of living.

²⁴ World Bank, (2003). *Infrastructure Action Plan*.

²⁵ The Bank is also managing a trust fund, the Global Partnership for Output-Based Aid (GPOBA), which is helping in the design and evaluation of OBA schemes and disseminating knowledge on OBA.

Box 6: Output-Based Aid in Mumbai – Flush With Success?

Within the larger Bombay Sewage Disposal Project, the pilot Slum Sanitation sub-project targets the provision of one million slum dwellers with sanitation services. Rather than a traditional input-based approach, the sub-project focuses on sanitation service as a package of construction, hygiene education, capacity building, operation and maintenance plan, and utilities to assure that facilities are used and maintained. It establishes contracts with micro-scale service providers to construct and operate sanitation blocks, with provisions rewarding the actual provision of sanitation services, making effective service a profitable small business endeavor.

33. *A sample of 14 IDA Bank projects in different sectors (from the universe of over 30 Bank OBA projects currently under implementation) estimated that they improve service delivery of infrastructure services to a total of 18.6 million people.* The total value of IDA credit in the sample is US\$387.8 million, plus a grant amount of approximately US\$73 million (Bank and GEF sources). If successful, scaling up of OBA operations in the Bank could lead to a significant increase in the allocation of IDA resources to the provision of infrastructure services to the poor. The Bank is also managing a trust fund, the Global Partnership for Output-Based Aid (GPOBA), which is helping in the design and evaluation of OBA schemes and disseminating knowledge on OBA. In FY05, the WBG will undertake a review of OBA to draw lessons learned from these pilot experiences. This will allow learning from experience and a scaling up of the successful practices identified at the pilot stage.

34. *To expand the number of viable infrastructure projects developed in Africa and other poor regions, IFC and IDA have entered a set of unique partnerships.* Africa has received relatively little expansion of private investment in public services, with its associated benefits. To help overcome the many challenges governments and private investors face in this area, on a pilot basis, IFC and IDA have teamed-up with the governments of several African and other countries to help them create the conditions under which private investment in the power sector can take place. IDA-IFC infrastructure programs are now in operation or near operation in Ghana, Senegal, Cameroon, Kyrgyzstan, and Tajikistan. Ghana, Senegal and Tajikistan (Box 7) provide three notable examples where a joint IFC-IDA team has been working closely with the government and private industry to address the issues facing the power industry.

Box 7: IDA-IFC Collaboration in Senegal, Ghana and Tajikistan - A Powerful Alliance

In **Senegal**, IFC organized trust funds and commissioned a study to assess the investment requirements of the electricity sector. Based on the results of this study and preliminary market soundings, IFC and IDA advised the government to invite the private sector to develop an Independent Power Project (IPP). IFC contacted a number of potential international bidders for the IPP, while IDA arranged trust funds for advisors to help the government with the bidding process, and supported the government in assessing and monitoring private sector participation in the sector. Two international companies have submitted bids for the project and the winning bidder was selected at end-March 2004. It is expected that a combination of IFC, IDA and MIGA will provide financing support.

In **Ghana**, IDA is coordinating with other donors on an economic analysis of the sector, while IFC has provided the government a powerful sector model that captures the cash flow impact of all the various parts of the sector. IFC hopes to finance the conversion of a crude oil fired IPP (Takoradi II) into a combined-cycle operation, thereby increasing electricity supply without additional fuel consumption. This could reduce tariffs in Ghana. The joint IDA-IFC team is helping the government to implement a private management contract for the state-owned electricity distribution company and IDA will make financing available for much needed capital investments in the distribution network. This is expected to reduce losses, raise collections and improve efficiency, helping the sector to become self-sustaining.

The IFC's innovative Pamir project in **Tajikistan** will generate and supply electricity under a 25-year concession, taking control of the assets of the state utility and expanding generation capacity through rehabilitation of existing plant, transmission and distribution assets. In addition, the project will provide tariff subsidy mechanisms to ensure basic provision of electricity to the poorest. In order to subsidize tariffs to the poor, IDA is supporting the project along with a grant from the government of Switzerland.

35. *Efforts by the WBG to understand how best to tap private initiative in delivery of social services (health and education) and improve affordable access are relatively new.* The PSD strategy recognizes that, alongside the public sector, the private sector (including nonprofit organizations) has played a central role in providing health and education services in a number of developing countries for many years.²⁶ There have been several assessments of the private education or health sectors in IDA countries, and a few projects that have included the private sector. But the use of the private sector in health and education projects is still rare and there is no systematic program in either analysis or engaging the private sector in implementation.

Advisory and Non-Lending Technical Assistance Through FIAS and MIGA

36. *The Foreign Investment Advisory Service (FIAS), a joint program of the IFC and World Bank, completed 42 projects in IDA countries related to investment climate policy reforms and capacity building in 2004* (Table 3). These diverse projects include reviews of investment laws and policy frameworks, diagnostic studies of administrative barriers to investment, specialized work on competition policy, and analysis of corporate social

²⁶ "More than half of all basic health services are provided by private parties in low-income countries and, in Sub-Saharan Africa, about a third of primary education is provided privately." World Bank, (2002). *Private Sector Development Strategy*, page iii.

responsibility.²⁷ On average about two-thirds of FIAS policy recommendations in IDA countries were fully or partially implemented within a three-year period after the recommendation was made. FIAS collaborates with IDA in a number of countries, providing its advisory work as inputs to ICAs, CASs and PRSPs and through direct collaborations.²⁸ FIAS analytic work is routinely incorporated in ICAs and often IDA and FIAS have collaborated on joint surveys. Further collaboration is expected to focus on solution design and implementation, including identification of global best practices in reform and technical assistance to reforming governments.

Table 3: FIAS Advisory Projects in IDA Countries Completed In 2004

Region	AFR	EAP	SAR	ECA	LAC
Number	13	9	4	10	6

37. *MIGA's technical assistance and information services work helps IDA countries attract and retain foreign direct investment* (Annex 2). This is done through advice and tailored assistance to investment promotion intermediaries as well as a suite of online services about investment opportunities, business operating conditions, and business partners. In FY04, the agency undertook 35 new technical assistance activities in IDA-eligible countries, focusing especially on Africa. MIGA's assistance also takes the form of capacity building and investment dispute mediation services. And, of course, MIGA continues to provide guarantees: in FY04, 20 guarantee projects (57 percent of new projects) were undertaken in IDA-eligible countries (Table 4).

Table 4: MIGA in IDA Countries

	Number of projects in IDA countries	Total number of projects	Percent in IDA countries	IDA (US\$ million)
FY02	14	33	42.4	480.6
FY03	19	37	51.4	431.7
FY04	20	35	57.1	413.6

III.C Collaboration, Partnerships and Sharing Knowledge for Results

Strengthening Collaboration

38. *New and improved mechanisms are helping ensure greater coordination between the relevant partners of the WBG in investment climate work and MSME support* (Box 8). Several of the collaborative activities are described above in the sections on the IFC and MIGA.

²⁷ A new tracking system found that on average about two-thirds of FIAS policy recommendations in IDA countries were fully or partially implemented within a three-year period after the recommendation was made.

²⁸ For example, in Nigeria, FIAS collaborated with IDA and the IFC on a project component designed to streamline company registration.

Because PSD is a cross-cutting theme, collaboration and coordination within the WBG to implement the PSD strategy in IDA countries requires unusually broad collaboration involving many groups within the WBG in the implementation of the PSD agenda, including: (i) IFC, MIGA and the Bank regional vice-presidencies; (ii) multiple disciplines and networks, including those for rural development, human development, financial sector development, legal, PREM and infrastructure; and (iii) several specialized facilities, including FIAs, and the SME PDFs.

39. *Although the WBG is taking advantage of several effective channels for collaboration and coordination, challenges remain.* One challenge is to better tap the resource of over 200 PDF and PSD Network staff, many working in the various in-country IFC PDFs, who over the past year have increasingly focused on matters of the investment climate and policy reform. In FY05, a joint training program, largely in field offices, will foster this collaboration and coordination. At the same time, work will continue to build up knowledge resources and sharing of experience and best practice in IC reform.

Box 8: Examples of Effective Channels for WBG Collaboration

A new joint **World Bank/IFC PSD Vice Presidency**, formed in FY03-04, which oversees the implementation of the Bank's PSD strategy and focuses efforts on coordinating PSD work across the WBG. The Vice Presidency convenes meetings among headquarters and regional staff to coordinate PSD work. For example, in Country Review meetings, co-chaired by the PSD Vice President, the Bank Country Director, and the IFC Regional Director, senior Bank Group staff, including MIGA and PDF staff, discuss PSD strategy in a country and effective ways of improving coordination in implementing this strategy across the WBG.

The **PSD Sector Board**, which is composed of members from IFC, MIGA and the PSD Anchor and regions of the Bank. It serves as an increasingly important vehicle to share information and lessons learned as well as to improve the coordination of efforts.

Joint CAS preparation by Bank and IFC staff for about 15 out of 40 CASs each fiscal year, with active input by MIGA as well.

A new **program of knowledge development and training** for WBG staff and its clients aimed to build capacity to better design and implement Investment Climate operations. The program covers three critical steps for assisting clients: PSD diagnostics, solution design and implementation process. The training - mostly in the field - provides operational staff with tools based on best practice, including proven and innovative policy reform management strategies. An annual PSD forum, a flagship-learning event for WBG staff worldwide working on PSD issues.

IFC and IDA collaboration on **advancing credit reporting** in member countries, sharing expertise and research globally and by broad project level collaboration. WB staff focus on policy and legal issues, while IFC emphasizes development of best practice credit bureaus.

PDF-led implementation of several collaborative programs with the IBRD/IDA, the World Bank Institute (WBI) and MIGA.

Partnerships with Other Stakeholders

40. ***The PSD Network is partnering with other stakeholders on many fronts that include:*** (i) collaboration with EBRD and the ADB on implementation and financing of investment climate surveys; (ii) co-financing FIAs work and PDFs (IFC contributes roughly 20 percent of facilities' operating costs, and multiple donors contribute the remainder); (iii) the Norwegian Trust Fund window for activities related to private sector and infrastructure, which provides grant resources for WBG activities aimed at mainstreaming investment climate, governance and infrastructure for the poor across the Bank and IFC; and (iv) partnerships with the private sector through Investor Councils and in analytic and policy work on corporate social responsibility.

Sharing Knowledge

41. ***Through the PSD Anchor and WBI, the WBG jointly implemented a learning program that piloted efforts to improve capacity*** to transform diagnostic studies into operations and policy dialogue on investment climate reforms. Also in FY04, the PSD Anchor launched a new systematic program of knowledge development and training for Bank staff and clients that covers the three critical steps for the World Bank to assist clients in improving the investment climate: diagnostics, solution design and reform implementation processes. The remaining challenge is to scale up training to reach all regional staff and an increasing body of local stakeholders engaged in the reform process in IDA countries.

42. ***The PSD Rapid Response unit upgraded and expanded a new version of its knowledge management Website***, which was noted in the recent QAG review of Sector Boards as a best practice model. The website allows bank staff, policy makers and reformers to hold policy discussions as well as the leading research, databases, and privatization tool kits. The site is on target to reach one million visits a year globally.

43. ***Several regional PSD groups have put knowledge management at the forefront as well.*** For example, the South Asia region collaborated with the PSD Anchor and WBI on a regional workshop on the investment climate, inviting leaders from government and business from six countries, all of which had ICAs recently completed or well underway. The workshop not only brought together comparative information on investment climate performance in the region and international best practice information, but also provided an excellent chance for reformers in the region to meet, exchange ideas and create networks with each other.

IV: SCALING UP: PROGRESS AND CHALLENGES FOR THE PSD AGENDA

Investment Climate: Enhancing Productivity for Poverty Alleviation

44. ***Extending the reach of markets through investment climate reform provides the economic opportunities necessary for lifting people out of poverty.*** When the Deputies reviewed the PSD agenda in the IDA13 Replenishment process, they stressed the importance of moving from an emphasis on privatization to greater focus on the investment climate. This has largely occurred, both in analytic and operational work of the WBG. Within IC agenda, the Bank has moved to the frontier of developing and applying better measurement, essential to

better focusing efforts to strengthen the investment climate in particular countries and localities. Looking forward to IDA14:

- Given the central importance of the investment climate to the growth agenda, it must come to the forefront in WBG strategy, with consistent attention to priority investment climate issues in every CAS and PRSP. Consistent input from IFC and MIGA through joint CASs can reinforce the PSD orientation of IDA strategy.
- While the DB project coverage is already extensive and ICAs will be launched in a majority of IDA countries by the end of IDA13 (in accordance with the IDA13 Agreement), IDA still needs to push ahead towards the goal of increasing coverage for IDA countries. In those IDA countries where baseline information has already been established, the focus will shift to monitoring key indicators over time in efficient and replicable ways in partnership with stakeholders. As countries address individual constraints, new ones will come to the fore and good diagnostics can help to pinpoint the second generation of reforms. Recognizing the short lifespan of many other assessment initiatives, a key challenge will be to sustain effort over time, ensuring that broad benchmarking is followed up with progress monitoring and re-evaluating of reform priorities accordingly.
- On the design of investment climate reforms, there is substantial learning and pilot experience. This kind of learning, largely from case studies of experience, needs to be conducted with methodological rigor, both to assure the appropriateness of solutions proposed to clients and to persuade key stakeholders of their validity. To date, efforts to collect and synthesize the lessons of experience and best practice are still preliminary and must be strengthened during the IDA14 period. Successful reform experiences in developing countries can be documented and many of their features adapted and replicated. Successful pilot initiatives, such as those in business registration reform, output-based private provision of social services and SME support, can be scaled up as their features become clearly defined and widely available to operational staff.
- There is also major progress in transforming diagnostics into country operations and programs in the implementation agenda. Operations and TA are increasingly focusing on the PSD agenda. The transformation of ICA, DB and other diagnostic findings into operations, and the growth in volume of IDA PSD activity also signals advancement, while raising potential financing challenges for the future.

Thinking Small: Support for SMEs

45. *The SME sector serves as a critical link between the growth and poverty agenda.* At the same time, SMEs suffer disproportionately from policy and institutional impediments in the investment climate, and have significantly less access to financial and business development services than do larger enterprises. As recommended in the PSD strategy, IDA has shifted from direct support to SMEs to an emphasis on strengthening the business environment and building capacity in financial systems and business development services. IDA is also working to dramatically leverage capacity by working through intermediary institutions that have

substantially lower transaction costs in supplying finance and services to individual enterprises. It is recognized that some direct support will continue for its demonstration effect. Looking forward to IDA14:

- A three pronged SME development strategy will be scaled up: (i) emphasizing the broader elements of investment climate reform strategy that disproportionately affect SMEs; (ii) leveraging SME financial and business development service capacity-building efforts; and (iii) creating successful business models which provide demonstration effects for SMEs at large.
- In this area as well, the measurement agenda to monitor and evaluate SME support programs is seen as a critical part of the next phase of PSD strategy implementation. There also needs to be stronger emphasis on knowledge management among the growing number of IFC's PDFs, so that information flows among them and the center, assuring that all staff working on PSD share a common understanding of appropriate methods and best practices and can share their lessons of experience.
- It is recognized that the scope and reach of the WBG's SME work, including that of the PDFs, is not comprehensive and can be further extended in IDA countries. This will require support and systematic collaboration among all parts of the WBG, building on the models of IFC-IDA collaboration in Africa and on the increasingly close collaboration of PDFs with IDA on the investment climate agenda. As part of this effort, a review of IFC-IDA collaboration in Africa will be conducted in FY06 and reported at the mid-term review.
- On microenterprise finance, there is a continuing challenge to spread awareness that the PSD agenda concerning property rights and enabling conditions for the financial system are fundamental to poor people's access to credit. Second, there remains the challenge of scaling up the current approach to microfinance, with its generally favorable returns, emphasizing enabling conditions and the use and capacity of intermediaries.

Mobilizing the Private Sector for Infrastructure and Social Services - OBA

46. *OBA is proving itself to be a valuable means delivering services to poor people.* Public investment in infrastructure has been curtailed in many countries over the last few years, in part due to fiscal constraints. This coupled with significantly reduced private sector participation in infrastructure since the 1990s has limited many countries' overall growth potential. Discussions of the PSD strategy emphasized that there is no one right answer to how public services should be delivered. Rather, the WBG emphasizes finding the appropriate pragmatic solution on a case-by-case basis. Although governments will continue to play a central role, the potential for private delivery in some cases can importantly enhance capacity, efficiency and effectiveness in reaching the poor. Where private delivery is appropriate, IFC-IDA collaboration is especially valuable in IDA countries, where policy, institutional or regulatory reform as well as catalytic financing may be required to bring private provision on line. On OBA, already evidence is mounting of the potential of well-structured contracts to improve service delivery to the poor. Looking forward to IDA14:

- A review of OBA pilot projects will be conducted in FY05 to lay the groundwork for scaling up pilot efforts and mainstreaming this approach. This report will be made available at the mid-term review.

Collaboration and Partnerships: Pulling Together Better

47. *Collaborative approaches are leveraging the resources, tools and skills of the different parts of the WBG to promote the PSD agenda in IDA countries.* This paper has documented the important areas of collaboration and synergy between IDA, FIAS, IFC, and MIGA in diagnostics, strategy and operations. At the same time, there is no question that the different operating procedures and project time frames of these organizations have required mutual adjustments, with some challenges remaining. As envisioned in the PSD strategy, IFC-IDA collaboration is expanding dramatically in IDA countries, especially in infrastructure and SME support. Already, some initially contentious issues arising from pilot efforts, like addressing potential conflict of interest and establishing common procurement procedures, have been successfully resolved. Looking forward to IDA14:

- There should be growing collaboration on joint CASs, on identifying and implementing investment climate operations and reforms, on private delivery of infrastructure and social services and on SME support. The aim needs to be a seamless product provided to clients along the entire spectrum of public and private sector development finance. To achieve greater impact, the WBG will work to further make collaboration systematic across all parts of the WBG, including the multi-donor project development facilities (PDFs). As part of this effort, the WBG will also build on and expand operational collaboration exemplified by the MSME program described above. Moreover, the PSD Knowledge Management (KM) program will extend to all WBG PSD staff to assure uniform understandings and enhanced capability to diagnose, apply international best practice, and implement successful reform initiatives in often challenging local environments.

ANNEX 1: ROLE OF IFC IN IDA COUNTRIES

By sector, three key areas of IFC investment in IDA countries are the financial sector (including insurance markets), infrastructure, and extractive industries (Table A1.1). But the full portfolio is broadly diversified across a range of manufacturing and service sectors, with a marked increase in investment in such sectors as agriculture and forestry, plastics and rubber, information technology, health and education. Section III.B provides details on IFC's role in IDA countries.

Table A1.1: IFC Projects in IDA Countries by Sector

(Millions of US dollars)

Sector	2003	2004
A – Agriculture and Forestry	59.8	123.2
B – Oil, Gas and Mining	415.7	372.0
C – Utilities	510.1	481.3
D – Construction and Real Estate	52.9	52.9
E – Transportation and Warehousing	147.6	130.7
F – Food & Beverages	179.3	177.2
G – Chemicals	104.8	132.0
H – Nonmetallic Mineral Product Manufacturing	308.3	229.7
I – Primary Metals	273.1	234.0
J – Pulp & Paper	56.6	75.8
K – Textiles, Apparel & Leather	175.1	199.5
L – Plastics & Rubber	66.8	65.3
M – Industrial & Consumer Products	187.4	162.4
N – Information	205.5	418.4
O – Finance & Insurance	1071.6	1048.2
P – Collective Investment Vehicles	83.0	73.9
Q – Wholesale and Retail Trade	11.4	13.9
R – Professional, Scientific & Technical Services	12.5	9.9
S – Health Care	30.6	47.5
T – Education Services	15.5	19.3
U – Accommodation & Tourism Services	95.8	123.6
Total	4063.2	4189.8

Source: IFC

ANNEX 2: ROLE OF MIGA IN IDA COUNTRIES

Since the “2000 Review of MIGA’s Results and Activities” identified investments in IDA-eligible countries as a priority area for the agency, the levels of MIGA support to projects in the poorest countries have steadily increased through the full spectrum of services - investment guarantees, technical assistance, and legal advisory services. In FY04, 20 guarantee projects (57 percent of new projects) were undertaken in IDA-eligible countries (Table 4). Of these, six guarantees for investments were in conflict-affected countries and eight projects benefited small and medium-sized enterprises. With the launch of MIGA’s Small Investment Program (SIP) - which includes a standardized guarantee product and underwriting approach aimed specifically at SME’s - MIGA expects to increase support to such projects.

Under MIGA’s new management team, on board since May 2004, the agency is undertaking a realignment of its business model with the explicit purpose of enhancing MIGA’s focus on development impact. MIGA will pay particular attention to facilitating investment in low-income/high-risk countries and on the infrastructure sector. Conflict-affected countries have also been identified as a top priority going forward, in view of the important role that political risk insurance can play in these environments to jump-start private investment. MIGA’s portfolio already reflects a tendency to support projects in riskier markets with low-income/high-risk countries accounting for 43 percent of MIGA’s portfolio exposure, even though such countries only account for a small percentage of worldwide Foreign Direct Investment (FDI).

MIGA also provides technical assistance with the aim of enabling developing countries to attract investment. This assistance takes the form of capacity building, web-based information services, and investment dispute mediation services. In FY04, the agency undertook 35 new technical assistance activities in IDA-eligible countries, especially in Africa, which is a primary area of focus of MIGA technical assistance. In its technical assistance interventions, MIGA places a premium on working with countries that both present development challenges and are committed to market-oriented reforms. MIGA investment advisory services have proven to be particularly effective in catalyzing both policy reform and new investment in such Central American countries as Nicaragua and Honduras, where MIGA has long-term technical assistance efforts in place. Likewise, the online services and supporting technology guidance provide a much-needed promotional vehicle for IDA countries worldwide, as well as, access to economic and competitive information that they would not otherwise have.

MIGA’s increasing efforts to integrate its activities with the Country Assistance Strategies (CASs) of the World Bank Group will further enhance the agency’s development impact. During fiscal 2004, MIGA collaborated closely with the WBG country teams to develop innovative approaches to facilitate FDI including in IDA countries such as Kenya, Mozambique and Tanzania.

Box A2.1: Joint IDA-MIGA Guarantee Products

In FY04, the joint MIGA and IDA Boards approved a MIGA-IDA-AfDB guarantee facility (in an aggregate amount of \$227 million) in support of small and medium infrastructure projects in the countries of the West Africa Economic and Monetary Union as part of the WAEMU Capital Markets Development Project. Banque Ouest Africaine de Développement (BOAD) acts as an intermediary for the new facility that will benefit investors in Benin, Burkino Faso, Cote d'Ivoire, Mali, Niger, Guinea-Bissau, Senegal, and Togo. The Agence Française de Développement is a co-guarantor in the project and has provided funding for the secondment of a MIGA staff member to BOAD to assist the institution with the implementation of this program and the development of BOAD capacity to undertake private sector operations.

As part of its effort to increase support to conflict-affected countries, MIGA also established a guarantee facility for Afghanistan, with funding provided by IDA and the Asian Development Bank. The availability of political risk insurance through the Afghanistan Investment Guarantee Facility (AIGF) is expected to significantly encourage foreign investment in the country. The facility is being financed by an initial IDA credit of \$5 million being supplemented by a \$5 million soft loan from the Asia Development Bank (ADB) and \$10 million in insurance capacity from MIGA. This will be co-insured by the ADB in the equivalent amount of \$10 million. Together with support to be raised by MIGA from private and other public insurers, the total size of the facility is expected to be \$60 million, a significant amount for Afghanistan.

AIGF will not only insure "traditional" FDI projects, but will extend coverage to loans and credits provided to local businesses by newly established foreign banks in Afghanistan. Additionally, AIGF will provide coverage to foreign loans to be used to finance local equity investment or the importation of critical capital goods for Afghanistan reconstruction.

MIGA is also collaborating with the World Bank to provide technical assistance to the Afghan Investment Support Agency and advising on the legal and policy environment for industrial estate development, a critical element of the country's infrastructure development plan.

Annex 3: OBA Operations in IDA Countries

AFRICA REGION (AFR)					
Country	Sector	Bank Project Name	Project Description	OBA Component	Project Status
CAPE VERDE	Transport	Road Sector Support Project (P087004)	Project's objectives are to improve access roads linking villages and rural areas to main roads and improving island networks.	Performance maintenance and rehabilitation component, building on Chad experience.	Bank Pipeline: Approval 01/2005 GPOBA funding 03/2004 for feasibility.
CHAD	Transport	National Transport Program Support Project (P035672)	Main objective of \$67 million credit is to improve year-round access to markets and services through a more efficient transport system and better transport services. These development objectives are also those of the National Transport Program, which is financed only in part by the project (roughly 25 percent), and in part by other donors and the government. Possible follow -on project being developed.	An OBA-type \$11.5 million contract started in July 2001 covering the management, maintenance and rehabilitation during four years of 440 km of the main eastwest highway. True risk to private sector of OBA payments is limited, but pilots seen as good starting point for further risk balance in future regional projects. The pilot project is generally considered to be successful. The Bank funds 80 percent of the total contract amount of this pilot contract. Possible follow -on project being developed.	Bank Active: Effectiveness 03/2001 GPOBA funding 03/2004 for possible additional roads.
DRC	Health	Emergency Multisector Rehabilitation and Reconstruction Project (P057296)	The project consists of a US\$44 million grant covering health sector and US\$410 million credit covering other areas. Specific project objectives are: (a) rebuilding agricultural production, (b) rehabilitate and reconstruct critical infrastructure, (c) restore essential social services, and (d) strengthen capacity of government regarding development programs.	Eight contracts are signed in April 2003 with NGO to support 67 Health Zones (8 million people). Contracts include performance-based payments that would award those performing particularly well in delivering health services to the poor.	Bank Active: Effectiveness 11/2002. GPOBA Pipeline GPOBA for funding to support designing, implementing and supervising such a system.

AFRICA REGION (AFR)					
Country	Sector	Bank Project Name	Project Description	OBA Component	Project Status
MADAGASCAR	Transport	Transport Infrastructure Investment Project (P082806)	The major development objectives of the \$150 million project are to rehabilitate the country's major transport infrastructure and facilitate trade. The APL is divided into three phases, with the first focusing on essential reforms and highest priority investments.	Performance maintenance and rehabilitation component, building on Chad experience.	Bank Pipeline: Approval 07/2005 GPOBA funding 03/2004 for feasibility.
MALAWI	Multisector	Rural Infrastructure Services (P057761)	The project is aimed at expanding access to and improving the quality of infrastructure services (telecommunications, electricity and water) in selected districts in Malawi.	OBA components are still being designed, but it is expected that they will be based around connection expansion subsidies, particularly for telecommunications and electricity.	Bank Pipeline: Approval 07/2005 GPOBA Pipeline.
MOZAMBIQUE	Electricity	Energy Reform and Access Project (P069183)	Objectives of IDA Credit \$40 million are to increase access to modern electricity services in urban and peri-urban areas. The objectives are to be accomplished through a combination of reforms for improved industry performance and investments in electricity supply infrastructure.	Connection subsidies for small-scale providers; the first phase of this APL, includes about five rural concessions, for the first of which, in Northern Inhambane. The project aims to provide connections to 5,000 households within five years; up to 15,000 additional connections are to be financed under the other concessions. Concession for Northern Inhambane awarded, to start operations by May 2004.	Bank Active: Effectiveness 03/2004 GPOBA funding 06/2003 for design of subsidy fund flows.
MOZAMBIQUE	Telecom	Mozambique Communication Sector Reform Project (P073479)	The objective of the \$14.9 million credit is to improve access to and quality of efficient and affordable communications services by creating an enabling environment for competition and private participation in sectors deemed critical to facilitate national and regional market integration, i.e., telecommunications, postal and air transport infrastructure and services.	The OBA component is estimated at \$3 million. The approach to be used is the negative concession for provision of payphone and possibly Internet services in rural areas, under selected pilots.	Bank Active: Effectiveness 06/2002 Design of bidding documents under preparation. Tender expected in 2005.

AFRICA REGION (AFR)					
Country	Sector	Bank Project Name	Project Description	OBA Component	Project Status
NIGERIA	Telecom	Privatization Support Project (P070293)	\$114.29 million credit attempts to support transparent and effective implementation of the Federal Government of Nigeria's privatization program through expanded private investment and improved efficiency in the productive sectors, and in infrastructure. Also aims to create an enabling environment for PSP and competition in infrastructure services, notably in telecommunications and electric power.	Negative concessions for rural areas have been agreed by government as part of a rural telecommunication access strategy; consulting assignment for the design of pilot projects under way; WB funding (up to US\$4 million) is provided for pilot projects; Design of pilot projects finalized, identification of additional funding sources under way.	Bank Active: Effectiveness 11/2001.
RWANDA	Health	Poverty Reduction Support Credit 1 (P085192)	The \$80 million PRSC I, II and III will support the government of Rwanda's policies for reducing poverty as outlined in the PRSP published in 2002. The key objective of the PRSP is to reduce poverty by supporting policies that lead to rural development and investment in infrastructure, enhanced human development, and support to transparent governance and public sector management.	PRSC will be supporting the expansion of pilot performance-based contracting schemes. The specifics have not yet been agreed upon.	Bank Pipeline: 01/2005 GPOBA Pipeline.
SENEGAL	Electricity	Electricity Project (P073477)	The proposed \$100 million IDA APL program will support the delivery of quality electricity services in SENELEC areas and will promote private sector participation in the country's electricity sector.	Details being developed. OBA rural connection scheme, possibly under a minimum subsidy concession approach for up to 18 concession areas.	Bank Pipeline: Approval 07/2004.

AFRICA REGION (AFR)					
Country	Sector	Bank Project Name	Project Description	OBA Component	Project Status
TANZANIA	Transport	Transport Sector Project APL (P055120)	Objectives are to remove constraints to transport services on road network and to strengthen the management and implementation capacity of TANROADS.	Performance maintenance and rehabilitation component, building on Chad experience.	Bank Pipeline: Approval 07/2005 GPOBA funding 03/2004 for feasibility.
UGANDA	Telecom	Energy for Rural Transformation Project (P069996)	\$49.15 million credit and 12.12 million GEF grant. Phase 1 will put in place a functioning conducive environment and commercially oriented, sustainable service delivery of rural/renewable energy and Information & Communication Technologies (ICTs). GEF objective is build in-country capacity for renewable energy.	Telecom component of \$5.5 million is aimed at implementing OBA schemes, as the telecom sector reform agenda was successfully implemented under a previous project. OBA scheme involves negative concessions for rural areas, including public telephone services, Internet Points of Presence and telecenters in each of 154 rural sub counties. Estimated subsidy requirement US\$6 million, WB funding estimated of US\$5 million. Drafting of tender documents to be finalized by early 2004. Pre-qualification announced in March 2004.	Bank Active: Effectiveness 07/2002.
UGANDA	Electricity	UG Fourth Power Project (P002984)	Project is being restructured to accommodate IDA financing to support declining subsidy associated with privatization of UEDC, a power distribution company.	Declining subsidy scheme to reduce tariff increases that would be required to bring tariffs up to cost covering levels. Private operators have been selected and negotiations have largely been completed: awaiting approval from boards of private operators.	Bank Active: Effectiveness 04/2002.

EAST ASIA & PACIFIC REGION (EAP)					
Country	Sector	Bank Project Name	Project Description	OBA Component	Project Status
CAMBODIA	Water	Provincial and Peri-Urban Water and Sanitation Project (P073311)	The \$16.9 million credit and \$3.1 million grant aims to assist the country in moving forward to fulfill the MDGs in water supply and sanitation by 2015. The project design aims at building partnerships with the private sector and user groups in financing, operating, and maintaining constructed facilities, after designing specific instruments that ensure inclusion of low-income communities residing in the service areas.	Connection subsidies to small-scale providers under least subsidy concessions to establish small networks in 4-5 selected communities, subsidies being provided for about 40 percent of envisaged connections; OBA contracts already awarded to local operators in four provincial towns.	Bank Active: Effectiveness 11/2003 GPOBA funding 06/2003 for reviewing options for scaling up project.
EUROPE & CENTRAL ASIA REGION (ECA)					
Country	Sector	Bank Project Name	Project Description	OBA Component	Project Status
GEORGIA	Telecom	Georgia Telecommunications Reform Project (P087143)	A small lending operation is being prepared which will include a \$3 million OBA component.	Project being developed based on the South Caucasus PPIAF grant. The OBA component will expand on the experiences gained through the pilot to most of the remaining provinces of Georgia.	Bank Pipeline: 01/2005.
TAJIKISTAN	Electricity	Pamir Private Power Project (P075256)	The objective of the \$10 million IDA credit and \$8 million IFC loan is to improve reliability, and enhance the quality of electricity supply in the Gorno Badakshan Autonomous Oblast region, through private sector involvement, in a financially, environmentally, and socially sustainable manner. The project components shall include: 1) completion of the existing Pamir hydro plant; 2) rehabilitation of several power plants; 3) rehabilitation of transmission lines; and 4) technical assistance, and consulting services, to be financed by Pamir Energy and the IFC.	OBA subsidy to cover difference between lifeline tariff for domestic consumers and the costs of supply, totaling \$9-10 million annually.	Bank Active: Effectiveness 03/2003.

LATIN AMERICA & CARRIBEAN REGION (LAC)					
Country	Sector	Bank Project Name	Project Description	OBA Component	Project Status
BOLIVIA	Electricity, Telecom	Decentralized Infrastructure for Rural Transformation (P073367)	The objectives of the \$20 million IDA credit are to expand and improve rural infrastructure access, specifically for solar home systems and mobile telecom services, with specific connection targets being developed.	The OBA components would focus on subsidies linked to the provision of approximately 20,000 new solar home systems in remote areas, which will be divided into lots to be offered to the private sector through competitive bidding. Similar projects on a smaller scale will take place in the telecom sector.	Bank Active: Effectiveness 12/2003 GPOBA funding 06/2003 for design of tendering process for solar home lot allocation.
NICARAGUA	Electricity	Offgrid Rural Electrification (PERZA) (P073246)	The \$12 million IDA credit and \$4 million GEF grant aim to support the sustainable provision of electricity services and associated social and economic benefits in selected rural sites. This would be accomplished by: (i) supporting the government in the design and implementation of its national rural electrification strategy; (ii) implementing innovative public/private off-grid electricity delivery mechanisms in several pilot sites for later replication on a national scale; and (iii) demonstrating in the pilot areas the potential of targeted rural microfinance and business development services (BDS) to significantly enhance the development impact of rural electrification.	OBA solar home system connection scheme, and isolated systems for about 18,000 new connections in area outside of existing concessionaire's area (Union Fenosa). The national electrification fund (FODIEN) must be re-developed and made sustainable to manage OBA funds. Payments made for a combination of connections, continued maintenance, and training.	Bank Active: Effectiveness 11/2003 GPOBA funding 11/2003 for assisting with the development of electrification fund.
NICARAGUA	Telecom	Nicaragua - Telecommunication Reform (P055853)	\$15 million project, aimed at supporting the reform of the telecommunications sector, including new legal and regulatory framework, capacity building to the regulator, privatization of the incumbent, and an OBA component. The design, and operations of a rural telecommunications development fund will be supported, to provide incentives for private investments, thus improving the sector's services in those areas.	The OBA component is estimated at \$1 million. The approach to be used is the negative concession for provision of payphone and possibly Internet services in rural areas, under one selected pilot project. Based on this experience a \$10 million follow -up operation is being proposed to scale-up the experience gained through the pilot throughout Nicaragua. Regulatory instruments and tender documents ready. Exact location of the pilot under discussion. Tender to be launched in mid 2004.	Bank Active: Effectiveness 04/2000.

SOUTH ASIA REGION (SAR)					
Country	Sector	Bank Project Name	Project Description	OBA Component	Project Status
BANGLADESH	Water, social services	Social Investment Program Project (P053578)	IDA credit to support the provision of basic services to selected districts in Bangladesh and to promote innovative approaches to meeting infrastructure needs through the local private (for-profit and not-for-profit) private sector.	OBA schemes for small scale water supply and social services; social assistance component of the project will develop an OBA scheme in two districts, where NGOs will be responsible for providing maternal and child health care and increasing immunization coverage. Partial-OBA small-scale water schemes being developed to feasibility stage.	Bank Active Effectiveness 04/2003.
INDIA	Health	Rajasthan Health Systems Development Project (P050655)	\$89 Loan with main objectives being to (a) increase access to health care services by the poor and (b) improve the quality of health care services through institutional development.	OBA scheme targeted with an existing network of NGOs working on family planning, reproductive health and communicable disease control and treatment.	Bank Approval 03/2004. OBA components being developed.
INDIA	Electricity	Rural Electricity Access Project (P083789)	\$50 million loan to demonstrate scalable sustainable institutional models for increasing access to electricity services in rural areas and to contribute to growth of rural incomes and improved delivery of social services through supply of electricity services to targeted rural areas.	Subsidy mechanisms still being designed but OBA approaches for piloting private sector provision are being considered.	Bank Pipeline: Approval 09/2005.
NEPAL	Telecom	Telecommunications Sector Reform Project (P050671)	The objectives of the \$22.56 million IDA credit is to support telecommunications sector reforms to increase access by developing a competitive and liberalized market structure and enable the private provision of telecommunication infrastructure and services in rural areas.	Negative concession for rural service; license to provide telecommunications services in the Eastern Development Region. The operator has to provide at least two public access lines in each of 534 village development committees (VDC) and operate services in these VDCs for at least 10 years. License awarded to STM Telecom Sanchar Private Limited on November 21, 2003. The hub installation and commissioning will be completed in April 2004. Service roll out in all 534 VDCs will be completed by June 2005.	Bank Active Effectiveness 05/2002.