
**PRIVATE SECTOR DEVELOPMENT STRATEGY
— DIRECTIONS FOR THE WORLD BANK GROUP —**

Annexes

BACKGROUND PAPERS PREPARED FOR PSD STRATEGY PAPER

1. Private Sector Development: Entrepreneurship, Markets and Development – A Discussion Paper – SecM2001-0303, May 2001.
2. Private Sector Development: Activities of the World Bank Group – SecM2001-0305, May 2001.
3. Private Sector Development: The Role of Private Sector Development in Past Strategy Papers – SecM2001-0306, May 2001.
4. Private Sector Development Strategy – Issues and Options – A Discussion Document – SecM2001-0302, May 2001 (basis for external discussion).
5. Contracting for Public Services: Output-Based Aid and Its Applications – October 2001.
6. Output-Based Health Care: Paying for Performance in Haiti – August 2001.
7. Incentive-Based Subsidies: Designing Output-Based Subsidies for Water Consumption – June 2001.
8. Maintaining Roads: The Argentine Experience with Output-Based Contracts – June 2001.
9. Telecom Subsidies: Output-Based Contracts for Rural Services in Peru – June 2001.
10. Output-Based Education: The Evolution of Contracts for Schools in the U.K. – May 2001.
11. Direct Support to Private Firms – Evidence on Effectiveness – Forthcoming 2001.
12. Privatization in Competitive Sectors – The Record So Far – October 2001.
13. Private Participation in Infrastructure – A Review of the Evidence – October 2001.
14. Improving Access to Infrastructure, Services by the Poor: Institutional and Policy Responses – October 2001.

CONSULTATIONREPORT

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

There were three sets of dialogues: a) inside the WBG: with ten sector boards¹, several units in the Bank, regional chief economists, IFC managers and MIGA staff; b) externally with government, private sector and civil society stakeholders (in 17 cities in both developed and developing countries); c) meetings with regional development banks: AfDB, ADB, EBRD and IDB (*complete list of meetings in attachment 1*). In addition, an on-line discussion was carried out with civil society organizations moderated by the New Economics Foundation (*summary of on-line discussion in attachment 2*). The paper was also posted on the web site of the Rapid Response Unit of the Private Sector Advisory Services Group with invitation for comments. This consultation report attempts to provide a balanced picture of what came out of these discussions. It tries to faithfully summarize important points of view, in the process reflecting both areas of broad agreement as well as diversity of views.

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

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

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

commentators brought up an additional theme which they felt was relatively neglected in the paper, i.e., the need to address the social and environmental sustainability of PSD efforts.

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

Investment Climate

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

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

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

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

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

Some commentators felt that a number of important issues related to the investment climate were not adequately discussed by the paper. These include financial sector issues, need for good governance, some key investment climate issues in Eastern Europe such as manipulation of policy-making, and predatory practices by the state, and the need for safety nets and retraining. There was also a feeling, expressed in particular by many donors, that the role of the public sector in setting the investment climate was under emphasized. Participants sought reassurance that the WBG would continue to take capacity building seriously. Representatives from donor agencies argued that the strategy should address the different comparative advantages of donors and other development partners in effecting change in the investment climate.

Market access and unequal competition

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

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

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

Foreign investment

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

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

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

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

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

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

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

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

Small and medium enterprises

The subject of SMEs came up repeatedly in the discussions. Commentators described the problems faced by SMEs and suggested actions to deal with these. The problems mentioned include: a) restrictions of various kinds on SME operations, b) heavy taxation,

often by local governments; c) discrimination by financial institutions against SMEs; d) poor capacity of SMEs to adjust to difficult conditions, especially when the country as a whole is going through adjustment shocks.

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

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

Private provision of social services

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

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

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

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

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

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

coming in as managers of the facilities. Another donor agency staff suggested that lack of resources may be the main impediment to efficient public sector provision and, hence, it may be better to go for debt relief first and, only if that proves ineffective, go for private provision.

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

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

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

Challenges in private provision of social services

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

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

licenses to private doctors but are sometimes reluctant to do so because they fear increased competition.

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

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

Output-based aid and targeting of subsidies

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

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

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

Support for output-based schemes

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

Problems in targeting subsidies and implementing output-based aid schemes

The main problems mentioned fell in the following categories:

- ***Targeting the poor:*** Identifying the poor, ensuring that the poor are not left out and minimizing leakages to the non-poor and private providers is difficult. Means-testing is an option but is administratively expensive. Some developing

country government officials pointed out that it may be difficult for elected local government officials to allocate subsidies to some classes of voters and not others. NGOs asked what lessons can be learned from existing research about how to target effectively in different sectors and country conditions.

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

- **Cost-effectiveness:** Since the size of many OBA projects is likely to be small, this may increase transaction costs and lower cost-effectiveness of projects.

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

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

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

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

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

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

- unrestricted small-scale entry may give rise to quality problems (internal commentator); small systems lack scale economies thus leading to higher prices than integrated systems;

- small scale infrastructure may undermine the longer term development of large infrastructure systems; the short-term gains may not be worth the long-term problems; it will be difficult to consolidate these small units later;
- some (trade unions) thought that the private sector may not move in to provide services if entry is opened up; others were worried about the risk of over-investment, leading to over-capacity ; and
- consumers may not be willing to pay much to a private provider if there is an expectation that governance may improve and state-owned utilities may start delivering services in future at a lower price; hence, such schemes may work in isolation but not in conjunction with a state-owned utility.

Need to emphasize governance

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

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

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

Large scale private provision of infrastructure: competition and regulation

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

- how to formulate privatization strategies under declining interest by foreign investors in developing countries; and

- how to develop credible regulatory environments that strike the appropriate balance between consumer protection and attracting private investment.

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

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

Other points made were:

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

- Government capacity for regulating private providers and implementing both small-scale and large-scale private provision solutions should be enhanced through specialized technical assistance (donor agency); and
- In transition economies, the public utilities may be reaching a large section of the population, unlike in Africa. So privatization there may have different connotations. (Bank staff).

Shifting risks to the private sector

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

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

Environmental and social issues

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

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

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

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

Environment issues

Internal commentators from the environment family stated that, since environmental assets provide the basis for most private sector activity in most of the WBG's client countries, safeguarding them is not just a matter of public good but also of good business.⁵ They suggested that the strategy address the issue of how to apportion the responsibility of meeting the costs of environment-related "externalities" between the public and private sectors. The Environment Sector Board also argued that the paper should have a lot more in terms of developing pro-active strategies, measures and instruments to stimulate environmentally positive investment. An internal commentator wanted to see the strategy address the issue of using the Bank's enormous financial power, vis-à-vis all the goods and services whose procurement it finances each year, to help create demand for "green" products and production processes.

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

They also argued for:

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

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

- building environmental management capacity among SMEs or develop innovative/adapted forms of environmental regulation for SMEs.

Internal commentators also emphasized the need for good regulation. They argued that it is important to have very clear rules of the game with respect to environmental liabilities when privatizing sensitive sectors such as energy. There felt a need to explicitly address the adequacy of the existing regulatory framework when privatizing, especially since there is some perception of backsliding on environmental standards in many countries as they privatize. At the same time, they felt that it is necessary to correct the unrealistic provisions of the regulatory framework in many countries.

Other environment-related issues/questions

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

Gender Issues

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

The role of the state, private sector and community organizations

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

The role of the state

There was a range of views on this subject. Some commentators, mostly from trade unions and civil society, were uncomfortable with the notion of state failure. They felt that the paper assumed the absolute demise of the state and saw private provision as an end in itself. Trade unions felt that the WBG's first concern should be to analyze why the public sector is not working well and then try to help countries improve the functioning of their public sectors. They felt that many privatizations and deregulations has had serious problems but that these were glossed over in the paper. The on-line discussion with civil society organizations revealed similar sentiments but there was also recognition of state failure. Some civil society commentators suggested that one way to deal with this is to remove barriers to competition. Private sector participants were vocal about what they saw as serious failures of the state in delivering basic services and ensuring a climate conducive to investment.

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

The role of non-profit and community organizations

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

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

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

The scope for public-private partnerships at various levels of government was also mentioned. Civil society representatives argued strongly for three-way partnerships between state, private sector and community organizations and wanted these partnerships

to evolve in a democratic free-entry way, rather than in a top-down, engineered fashion. Internal commentators felt that the paper had not adequately emphasized the potential for partnership between the private and public sectors; such partnerships have been used effectively in the many areas of the WBG's work, such as on the environment.

It was suggested that the appropriate division of labor may vary across sectors. For example, civil society commentators argued that all three sets of actors can cooperate in areas such as education, human rights and social protection while, in other areas, such as in the utility sector, one set of actors may be better at delivery while others may be better at standard setting and monitoring.

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

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

The working of the World Bank Group

Unbundling

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

Rate of return disciplines

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

The comparative advantage of the WBG

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

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

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

Division of labor and coordination within WBG

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

Within the Bank, there was demand for better coordination between the work on PSD and on that on finance. Internal commentators also argued about the need for PSD-work to be

better coordinated with work on institutional issues in the PREM network. There were also suggestions for the PSD sector board to be reorganized on the lines of the poverty board with representation from all networks.

Implementation of the strategy

Relevance of PSD strategy to other strategies

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

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

Private sector consultations

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

Other implementation issues

Several commentators complained that the Issues and Options paper moved too easily from first principles to solutions, bypassing the complexities of implementation. They felt the paper was too narrow in focus, did not pay sufficient attention to implementation

details and did not provide adequate evidence to support its arguments. Some commentators wanted more examples so that the arguments come across in a more compelling way. To a large extent, the reactions came because commentators did not have access to the background papers and/or did not realize that this was not the strategy paper per se. Some commentators felt that it is necessary to provide an assessment of what has been achieved on the ground by previous strategies.

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

*Attachment I***List of meetings****Government**

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

Private sector

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

NGOs and trade unions

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

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

Multilateral agencies

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

World Bank Group***Sector Boards***

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

Others

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

Attachment 2

Key messages from on-line dialogue with civil society
(from report prepared by the New Economics Foundation)

1. Support for alternative organizations

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

2. Targeted subsidies can be highly problematic

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

3. Debt Reduction

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

4. Partnership approaches

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

5. Definitions/Terminology

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

6. Governance

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

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

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

8. One-size does not fit all.

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

9. Accountability

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

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

10. Future dialogue

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

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