An Evaluation of World Bank Investment Climate Activities

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**Abbreviations and Acronyms**

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>AFR</td>
<td>Africa region</td>
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<tr>
<td>CAE</td>
<td>Country Assistance Evaluation</td>
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<td>CAS</td>
<td>Country Assistance Strategy</td>
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<td>CEM</td>
<td>Country Economic Memorandum</td>
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<td>CICIC</td>
<td>Investment Climate Unit of the Investment Climate Department</td>
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<td>CPIA</td>
<td>Country Performance and Institutional Assessment</td>
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<td>EAP</td>
<td>East Asia Pacific region</td>
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<td>ECA</td>
<td>Europe and Central Asia region</td>
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<td>ESW</td>
<td>economic and sector work</td>
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<td>EU</td>
<td>European Union</td>
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<td>FDI</td>
<td>foreign direct investment</td>
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<td>FIAS</td>
<td>Foreign Investment Advisory Service</td>
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<td>FSAC</td>
<td>Financial Sector Adjustment Credit</td>
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<td>FY</td>
<td>fiscal year</td>
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<td>GDP</td>
<td>gross domestic product</td>
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<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
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<td>IC</td>
<td>investment climate</td>
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<td>ICA</td>
<td>Investment Climate Assessment</td>
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<td>ICRG</td>
<td>International Country Risk Guide</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>IFC</td>
<td>International Finance Corporation</td>
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<td>LAC</td>
<td>Latin America and Caribbean region</td>
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<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
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<td>MNA</td>
<td>Middle East and North Africa region</td>
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<td>OED</td>
<td>Operations Evaluation Department</td>
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<td>OEG</td>
<td>Operations Evaluation Group</td>
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<td>OEU</td>
<td>Operations Evaluation Unit</td>
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<td>OPCS</td>
<td>Operations Policy and Country Services</td>
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<td>PIBL</td>
<td>Private Sector Institution Building Loan</td>
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<td>PREM</td>
<td>Poverty Reduction and Economic Management</td>
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<td>PSA</td>
<td>Private Sector Assessment</td>
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<td>FSAL</td>
<td>Private Sector Adjustment Loan</td>
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<td>PSD</td>
<td>private sector development</td>
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<td>SAS</td>
<td>South Asia region</td>
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<td>SME</td>
<td>small- and medium-scale enterprise</td>
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<td>WBES</td>
<td>World Business Environment Survey</td>
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1. Introduction

Objectives of the Evaluation

1.1 A country’s “investment climate” (IC) is its environment for private sector activity. The quality of the investment climate is determined by the risks and transaction costs of investing in and operating a business, which in turn are primarily determined by the legal and regulatory framework, barriers to entry and exit, and conditions in markets for labor, finance, information, infrastructure services, and other productive inputs. Governments influence the quality of their countries’ investment climates through policies, institutions, and their relationship with the private sector. The quality of the investment climate is linked to poverty reduction by the impact of better investment climates on private sector activity, and thus on economic growth and employment.

1.2 Improving the investment climate of client countries is one of the two pillars of the World Bank Group’s1 (WBG’s) approach to development effectiveness and is central to the 2002 Private Sector Development Strategy. Despite the centrality of the topic, there has been no rigorous effort to date to analyze the relationship between the Bank’s investment climate activities in different countries and actual improvements in those countries' investment climates. To fill this gap, an evaluation of World Bank investment climate activities was conducted during 2002-2004 by the Bank's independent Operations Evaluation Department (OED). The OED evaluation was prepared alongside parallel evaluations conducted for other WBG units by the Operations Evaluation Group (covering IFC activities) and the Operations Evaluation Unit (covering MIGA). All three reports, along with an Overview, are available on OED's website.2

1.3 The current paper summarizes the results of the OED evaluation, addressing the following questions:

- **Relevance of Bank assistance**: What relative priority did the Bank attach to addressing investment climate issues among its total interventions? Were the policy and institutional areas emphasized in Bank operations consistent with current empirical research linking investment climate indicators with performance outcomes, and with the obstacles to investment as perceived by potential investors? Do the survey-based diagnostics used by the Bank provide good information about the quality of the investment climate, and do they lead to sound policy advice?

- **Effectiveness of Bank assistance**: Are Bank activities helping to get investment climate reforms implemented? Was the Bank effective in motivating client governments to undertake reforms, beyond what they would have done in the absence of Bank intervention? Was conditionality in lending operations helpful in supporting reform? What were the outcomes of Bank interventions, in terms of the quality of the investment climate and in terms of investment and growth?

1 The “World Bank Group” refers to IBRD/IDA, the IFC, and MIGA; the “World Bank” or “Bank” refers to IBRD/IDA only.

2 http://www.worldbank.org/oed/investment_climates/
1.4 The evaluation is based on the following components, which are available as background papers on the OED website (Annex 1 details the methodology used for this evaluation):

- a review of the literature on the drivers of investment and growth, and of the microeconomic factors that determine investment behavior.
- a review of investment climate issues in Bank strategy documents — institution-wide private sector development (PSD) strategies, Country Assistance Strategies (CASs), and Poverty Reduction strategy Papers (PRSPs).
- a description and analysis of the portfolio of IBRD/IDA lending operations that support improvements in the investment climate.
- a description and analysis of IBRD/IDA non-lending services including economic and sector work and survey-based diagnostic assessments.
- results of structured discussions with Bank staff and international investors.
- client consultations and country case studies for Indonesia, Romania, India, Mozambique, and Peru.

1.5 The remainder of this chapter presents recent trends in the quality of the investment climate in Bank client countries, and summarizes what the literature shows to be the main determinants of investment and growth.

**Global Trends in the Investment Climate**

1.6 Country-level indicators of policy and institutional performance, such as the World Bank’s Country Policy and Institutional Assessment (CPIA), the Heritage Foundation Index of Economic Freedom, the International Country Risk Guide (ICRG), and the Economist Intelligence Unit (EIU) Country Risk Service — agree that developing countries’ policies have, on average, improved modestly in recent years. Improvement is seen at both low- and middle-income levels (shown as IDA and IBRD country groups in Figure 1.1). Although there are some distinctive regional patterns, average ratings for the CPIA have also improved for every one of the Bank’s regions (Figure 1.2).

1.7 Improvements in the investment climate were greatest in transition economies — which started the reform effort from a lower base than the average — including some that joined the European Union on May 1, 2004 and those that aspire to EU accession.

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3 OED (2004a), p. 6. The CPIA assesses borrower countries’ policy and institutional frameworks annually with regard to their capacity to foster poverty reduction, sustainable growth and the effective use of development assistance. The CPIA is currently being redesigned to better differentiate sub-themes such as the “business environment.” The Heritage Foundation Index measures developed and developing countries’ performance with respect to 50 policy dimensions. The ICRG Risk Rating System is a proprietary service that rates the risks faced by investors in a country based on political instability, economic vulnerability, and ability to meet financial obligations. The Economist Intelligence Unit Country Risk Service is a proprietary service that rates risks faced by investors in a country, designed for commercial bankers, institutional investors, and corporate executives who invest in emerging markets.
Countries whose investment climates deteriorated were more diverse. Five of the 10 countries showing deterioration between 1999 and 2003 were in Latin America and the Caribbean, which suffered macroeconomic crises during the period. Significant reform occurred in environments that were conducive to change, driven either by crisis (macroeconomic crisis or transition from planned to market economies) or opportunity (e.g., EU accession, the chance to join regional agreements, a new regime).

1.8 Looking at the components of the CPIA (Figure 1.3), it is evident that current ratings are highest in some of the macroeconomic areas that were the target of “first-generation” policy reforms supported by the Bank: macroeconomic management, trade and foreign exchange regimes, and public debt management. Ratings are lowest in some institutional areas — property rights and governance, transparency, and the quality of public administration — that are commonly termed “second-generation” reforms. This suggests that the Bank needs to focus its assistance on these institutional issues, which are among the core investment climate themes that are the subject of this evaluation.

Figure 1.1: Investment Climate Trends in Developing and Transition Economies

![Figure 1.1](image1.png)

Source: OED (2004a)

Figure 1.2: CPIA by Region, 1999 and 2003

![Figure 1.2](image2.png)

Source: World Bank data
1.9 The Bank’s "Doing Business" project has started collecting data on the cost of doing business in 145 countries. Doing Business 2004: Understanding Regulation shows that regulation varies widely around the world, but that rich countries regulate business in a more consistent manner than do poor countries. For example, it takes two days to start a business in Australia, but 203 days in Haiti and 215 days in the Democratic Republic of Congo. It costs more than five times per capita income in Cambodia to start a new business, and over thirteen times in Sierra Leone. Across all sets of indicators included in the 2004 surveys, Bolivia, Burkina Faso, Chad, Costa Rica, Guatemala, Mali, Mozambique, Paraguay, the Philippines, and Venezuela regulate the most. Australia, Canada, Denmark, Hong Kong (China), Jamaica, the Netherlands, New Zealand, Singapore, Sweden, and the United Kingdom regulate the least.

1.10 Doing Business 2004 also shows that heavier regulation is associated with more inefficiency in public institutions and poor enforcement, as well as with worse economic outcomes. The costs of starting a business, going through bankruptcy proceedings, hiring and firing workers, and enforcing commercial contracts are associated with lower enterprise productivity and investment as well as with greater informality. Rigid employment laws are associated with fewer job opportunities for women, and regulatory restrictions on sharing credit information restrict access to credit particularly for small enterprises. The report recognizes the legitimate need for regulation to deal with market

4 The Investment Climate Surveys and Assessments represent another effort to improve on cross-country indicators of the quality of the investment climate.
failures. Two examples are credit rights — the legal rights of lenders to recover their investment if the borrower defaults — and the efficiency of enforcing property rights through the courts. Countries that protect such rights achieve better social and economic outcomes.5

1.11 The real issue is not “more” or “less” regulation, but the effectiveness of regulation (although some argue that, in some areas, “less” is a good proxy for “effective”). Over-regulation in developing countries comes from two sources: (a) a hangover of the past when the prevailing ethos was that the private sector was exploitative and had to be controlled, and (b) the wholesale adoption of regulatory systems from developed country models without any assessment of whether it was the right institutional model or whether the country had the institutional capacity to implement them. For example, Jamaica imported the British regulatory system in the 1980s with disastrous results, and has now shifted to much simpler rules-based regulation with arbitration provided by external courts.6

The Determinants of Investment and Growth

1.12 The literature review conducted for this study provides evidence on the factors most important for investment and growth. The literature shows that:

- At a broad level, policies and institutions7 determine growth outcomes. Countries with good policies and institutions have the highest per capita income growth rates.

- Macroeconomic and structural reforms are necessary conditions for growth, and can stimulate an initial growth spurt even in the absence of institutional reforms, but modern institutions are needed for sustained growth. Principal among these institutional factors are the security of property rights, the rule of law, and absence of expropriation risk; political factors (political stability, civil liberty, and democracy); and the absence of corruption and graft.8

- Certain best-practice principles are applicable to all institutional arrangements, such as transparency, accountability, competition, the rule of law, and the protection of property rights. However, the institutional arrangements needed to implement these principles are somewhat country-specific. For example, the system of private property rights and Anglo-American corporate governance is

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5 Ibid., pp. xv-xvi.
6 World Bank (1997).
7 This report defines “institutions” according to the literature on institutional economics: the “rules of the game”, i.e., the set of formal and informal laws and rules that determine how markets function. Under this definition of institutions, “organizations” are groups of individuals that implement and enforce the rules of the game (e.g., political bodies and regulatory agencies). See North (1990).
not the only institutional arrangement that enforces the principle of protecting property rights. China, with its hybrid system of property rights and a legal regime that is far from the Anglo-American system, has supported a tremendous amount of investment and entrepreneurial activity.\textsuperscript{9} An institutional arrangement that is successful in one country doesn’t necessarily transfer well to another country without modifications, and unorthodox arrangements often work.

1.13 At a microeconomic level, many different factors determine the investment behavior of firms. A more nuanced picture emerges, with considerable difficulty in pinning down a common set of factors influencing the investment climate. Econometric evidence suggests that business fixed investment is influenced by tax policy and fiscal incentives,\textsuperscript{10} product market regulations,\textsuperscript{11} and high barriers to entry.\textsuperscript{12} Results from the World Business Environment Survey (WBES) show that taxes and regulations, financing, policy instability and uncertainty, and inflation matter most for company growth and investment.\textsuperscript{13} There are important differences across regions: in South Asia, street crime imposes the leading constraint, but in Africa infrastructure is identified as the second-leading problem after financing. In Central and Eastern Europe, inflation ties with taxes and regulations as the leading constraint.

1.14 Some overarching issues (e.g., regulatory uncertainty) matter to most firms, but more specific constraints may be ranked differently by different firms, because firms are diverse. The relative priority of various constraints seems to depend on the size, age, input mix, and mobility of the firm and the industry in which it operates. Foreign investors care about different constraints than domestic investors do because of their greater mobility. Foreign direct investment (FDI) decisions are more heavily influenced by macroeconomic and political risk than are domestic investment decisions. Compared with domestic investment, FDI is more positively associated with privatization, a competitive environment, the level of technological development, and lower regulation; it is less influenced by the availability of domestic credit.\textsuperscript{14}

1.15 The WBES finds that, for most categories of obstacles, small and medium enterprises identify themselves as more constrained than larger firms. Firms that are private, smaller, newer, devoid of FDI, and that cater to the domestic market generally tend to report more acute business constraints than do firms that are older, larger, that export, that have FDI, or that are state-owned. In facing some obstacles to doing business,

\textsuperscript{9} OED (2004a) p. 13, from Rodrik (2003).
\textsuperscript{10} Cummins, Hassett, and Hubbard (1994); Fazzari, Hubbard, and Petersen (1988); Calomiris and Hubbard (1990); Hubbard and Kashyap (1992); Hubbard, Kashyap, and Whited (1994); Sakellaris (1994).
\textsuperscript{11} Alesina, Ardagna, Nicoletti, and Schiantarelli (2003).
\textsuperscript{12} Alesina, Ardagna, Perotti, and Schiantarelli (2002).
\textsuperscript{13} Batra, Kaufmann, and Stone (2003).
\textsuperscript{14} Batra and Mody (2003). It should be noted, however, that FDI may fluctuate in a country for reasons that have nothing to do with its investment climate — for example, economic cycles in source countries (particularly for investments in emerging market economies) and commodity prices (particularly for investments in Africa).
medium-size firms identify themselves as equally or even more constrained than do small firms.

1.16 As part of this evaluation, interviews were conducted with a small number of multinational corporations headquartered in the United States, Europe, and Japan. Participants were asked to discuss the importance of investment climate considerations in their investment location decisions worldwide. The interviews confirmed the diversity in the relative importance assigned to these considerations stemming from the diverse needs of the firms (Box 1.1). For some, investment climate conditions take second place to factors such as cheap labor and large markets. Other investors cited physical security, rule of law, and currency convertibility as critical factors determining their investment locations. The cost and time required to register a business were viewed as relatively unimportant by most of these international investors.

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16 Summarized in a background paper for the OED report.
Box 1.1: Diverse Factors Influence Foreign Investment Decisions

Interviews with multinational corporations conducted for this evaluation illustrate the diversity of factors that determined each company’s decision to locate or expand an overseas investment. Some quotations from participants:

“Other things being equal, we are drawn first in our investment decisions to large markets that are under-served and have growth potential. But we can operate in smaller markets as well. For example, the Dominican Republic, though a small market, has been a successful investment for us. The critical factors are that we can set a fair tariff and take money out when we want.” (U.S. telecom company)

“We are constantly weighing risk against reward in a search for new business opportunities, and the factors that enter into these calculations, as well as the weight we assign to them, can vary a lot from one setting to the next. There is no formula. For example, we don’t like labor conditions or the treatment of intellectual property in China, but there is no question we have to produce there. We also produce in some smaller countries — for example, Singapore and Ireland — either because we have confidence in their political and macroeconomic stability or because the advantages of factors such as lower labor costs and investment incentives outweigh our perception of risks.” (U.S. computer and information technology company)

“Strictly speaking, I can’t tell you the principles we use for choosing an investment location because we’ve been shrinking our operations for the past few years, but maybe something is said by how we have consolidated. Our remaining operations tend to be located where labor is cheap and where there is a large internal market. Regrettably, we had to close our production facility in Ireland, even though it had a superior investment climate.” (Japanese information technology company)

“We are the epitome of a “reputation-sensitive” company. We market our products to final customers and we need to be responsive to their mounting concerns, particularly in the areas of environmental and labor conditions. Above all, we have to protect our brand. These are the ‘investment climate’ issues that affect us most directly.” (U.S. footwear and apparel designer and distributor)

“Investment climate conditions do not dictate where we work, but are an important factor when we get there and can affect the time and costs and profitability of individual projects — for example, the time and costs of obtaining licenses and permits; local corruption; quality, availability, and employment conditions of the local labor force.” (U.S. construction and engineering company)

2. World Bank Investment Climate Activities

Strategic Focus

2.1 Although the term “investment climate” came into use fairly recently, the topic — under such names as “business environment” or “enabling environment” — has been a part of the Bank's private sector development (PSD) strategy documents throughout the 1990s. In the early part of the decade, at least as much attention was paid to other PSD
topics as was paid to the investment climate. In the transition economies, state-owned enterprise restructuring and privatization were at the core of Bank assistance. In low-income countries, the Bank emphasized the drain of dysfunctional state-owned enterprises, and advocated their privatization. The expansion of private investment in infrastructure during the mid- and late-1990s was supported in many countries by Bank operations. Financial sector reform predominated following Mexico’s devaluation in 1994 and the Thai devaluation in 1997. Various forms of direct assistance to firms — particularly in non-financial services — continued throughout the decade.

2.2 During the second half of the 1990s, the Bank began to shift its focus from “first-generation” reforms — macroeconomic stability and trade integration — to “second-generation” reforms involving improvements in the administrative, legal, and regulatory functions of the State. Greater emphasis was placed on institutional development as well as to addressing the social costs of PSD interventions, such as privatization-related labor retrenchment. Issues of transparency and corporate governance also were highlighted, especially after the East Asia crisis.

2.3 The past several years have witnessed a shift in emphasis in the Bank’s PSD strategy toward a clearer and more central role for the investment climate. In part this is due to the declining activity in both privatization and private investment in infrastructure. It also reflects the Bank’s broader corporate agenda: improving the investment climate is one of two pillars of the WBG’s approach to development effectiveness, and one of the “focal points” in the WBG’s corporate agenda.

2.4 The emphasis on the investment climate is especially noticeable in the 2002 Private Sector Development Strategy for the World Bank Group. The Strategy called for country-level assessments of the quality of the investment climate, undertaken in consultation with the private sector. Enterprise surveys were to be used to identify constraints from the perspective of firms, and to link the policy and institutional environment to the performance of firms. Regular, standardized surveys would allow inter-country comparisons as well as the ability to track the implementation and results of reform over time. Building on these assessments, the Strategy expected that policy-based lending would be a major vehicle for advancing investment climate reform efforts, complemented by technical assistance operations and free-standing advisory services.

Non-Lending Services

2.5 The World Bank is involved in a wide range of analytical and advisory activities on investment climate issues. Principal among these are economic and sector work on various investment climate topics and survey-based diagnostics of the constraints of doing business.

17 For a review of WBG PSD activities in the 1990s, see World Bank (2001a).
19 World Bank (2001a), p. 3.
20 World Bank (2002a) and (2003a).
2.6 **Economic and Sector Work.** Over the past decade the Bank has produced a large number of reports on investment climate issues. Analysis of investment climate topics is frequently part of economic reports and sector reports (for example, on industrial development, competitiveness, export development, governance, and small and medium enterprise development). A keyword search identified more than 2,800 reports and working papers produced since fiscal 1990 that at least touched upon investment climate issues. In addition to these formal vehicles of non-lending assistance, advice is also provided informally to governments and the private sector through discussions, sharing of information, and in-country seminars.

2.7 Evidence from the country case studies conducted for this evaluation indicates that the Bank’s ESW on investment climate issues has helped define the reform agenda and has been appreciated by clients — in fact, they encouraged the Bank to do more (Box 2.1). However, some of the officials interviewed suggested that recent reports have presented the same policy recommendations as earlier reports. While recommendations that were not adopted may bear repeating, this feedback suggests that the Bank may need to be more selective and focused in its choice of ESW.

2.8 What is striking is that, despite the quantity and quality of investment climate ESW that has been produced by the Bank over the past 10 years, many have observed that “we really don’t know very much” about good practice in institutional design, nor about the dynamics of reforms to improve the investment climate.21 While basic economic principles are well accepted (for example, the benefits of competition), there is less knowledge about the institutional arrangements to apply these principles (for example, laws governing competition and the organizations that implement them). These institutional arrangements are neither “one size fits all” nor completely country-specific. It would be useful for the Bank to develop a typology of country situations and institutional designs that would provide guidance on which types of arrangements work where, how the change process happens, how it can be supported and sustained, etc. — in other words, an understanding of what types of institutional arrangements are transferable in different country contexts. The Bank’s research and ESW have not yet provided enough of this knowledge of institutional design and the process of reform.

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21 Based on the literature review as well as input from the external advisory panel for this evaluation.
Box 2.1: Relevance of the Bank’s Analytical Work: Evidence from Country Case Studies

Evidence from the country case studies confirms the important contribution that high-quality, well-focused, and strategically timed ESW can make to the quality of the Bank’s lending operations and their impact on the investment climate. There were cases where this has worked well (Romania), others where important topics were missed (Indonesia), and other cases of repetition and redundancy (Peru), detailed below.

The Bank’s analytical work in Mozambique beginning in 1996 made relevant contributions to the process of removing microeconomic constraints to investment. Among these were the FIAS Administrative Barriers to Investment studies (1996, 2001) and Investment Climate Assessments (1997, 2002) that helped to identify the reform agenda. To facilitate a continuing dialogue between government and business concerning investment climate reforms, the Bank supported an annual private sector conference. Studies that focused on government red tape, such as the FIAS studies, detailed long lists of problems. Business leaders interviewed for this evaluation asserted that the recommendations were not sufficiently prioritized. They felt that there was not enough focus on selected priority issues, action plans for organizing to implement the reforms, monitoring arrangements, and mechanisms for accountability for success or failure.

In pre-crisis Indonesia, Bank reports consistently pointed out several structural weaknesses that could impede future private sector-led growth. Although these analyses were appropriate for Indonesia at the time, they lacked depth in one crucial respect. While weaknesses in the financial sector were well analyzed, the obvious connection to weaknesses in the corporate sector was not explored. It was well known that insider lending, stemming from joint ownership of banks and corporations, caused some of these bad loans. Borrowing was collateralized by inflated asset values and facilitated by weak accounting practices, which were not investigated. Thus, a comprehensive framework for Bank Group assistance to the financial and corporate sector was missing.

In Romania, the successful investment climate activities of the past few years appear to have been based on more intensive ESW. Among the reports produced were a 1999 FIAS report that identified the most important obstacles to business growth, which were incorporated in the conditionality of the First and Second Private Sector Adjustment Loans (PSALs I and II); Romania’s Evolving Legal Framework for Private Sector Development (2002), which addressed property rights, rules for entry and exit of productive activity, and rules for market exchange; and Financial Markets, Credit Constraints, and Investment in Rural Romania (2001) that provided the basis for the financial market components of PSAL I and PSAL II. Several of those interviewed for this evaluation indicated that the priority given to the investment climate by the government has been a result of the Bank’s enterprise surveys and analysis.

In Peru, the Bank engaged in a substantial amount of ESW on investment climate issues during the past 10 years, including a 1993 reports on measures needed to establish a competitive market economy; a 1994 Private Sector Assessment; a secured transactions analysis in 1997; and a 2003 Investment Climate Assessment. While the reports were of high quality, many of the recommendations contained in the later reports were similar to those in earlier sector work.

2.9 Survey-based diagnostics. Over the past decade, the Bank has employed several diagnostic tools to assess the quality of a country’s investment climate and the constraints facing private enterprises:
• Private Sector Assessments (PSAs), many of which were based on enterprise surveys to determine perceived constraints in the business environment.
• The World Business Environment Survey (WBES) and the Firm Analysis and Competitiveness Survey (FACS).\(^{22}\)
• The Regional Program for Enterprise Development (RPED) in the Africa Region, which combined enterprise survey data with productivity analysis and sector studies.
• FIAS studies of the administrative barriers to doing business.\(^{23}\)

2.10 More recently, the PSD Vice-Presidency has developed two new diagnostic tools: Investment Climate Assessments (ICAs, described in Box 2.2) and the Doing Business project (Box 2.3). These two instruments are at the core of the Bank’s current analytical work on the investment climate, and in particular are providing the means of tracking the performance of IDA countries on achieving PSD targets. The ICAs and Doing Business have tried to address these issues by providing standardized instruments with better quality control by the PSD Sector Board. Measuring the same variables in a consistent way allows benchmarking — comparisons across countries at a particular point in time, and tracking changes over time in a particular country. Objective and quantitative measures of the policy environment demonstrate to policymakers that change is possible, and give credibility to reform efforts.

\(^{22}\) The findings of the WBES surveys are summarized in Batra, Kaufmann, and Stone (2003).

\(^{23}\) FIAS was the subject of a 1998 evaluation by OEG, and is covered in the OEG part of the present evaluation.
Box 2.2: Investment Climate Surveys and Assessments

Investment Climate Assessments (ICAs) are designed to systematically analyze conditions for private investment and enterprise growth. Underpinning all ICAs is a standard core investment climate survey instrument (the Investment Climate Survey, or ICS), which allows the comparison of existing conditions and the benchmarking of conditions to monitor changes over time. The survey is administered to managers of firms and consists of a core set of questions as well as several modules that can be used to explore in greater depth specific aspects of the country’s investment climate and links to firm-level productivity. The core survey has 11 sections:

- **General information about the firm**: ownership, activities, location.
- **Sales and supplies**: imports and exports, supply and demand conditions, competition.
- **Investment climate constraints**: evaluation of general obstacles.
- **Infrastructure and services**: power, water, transport, computers, and business services.
- **Finance**: sources of finance, terms of finance, financial services, auditing, land ownership.
- **Labor relations**: worker skills, status and training, skill availability, over-employment, unionization and strikes.
- **Business-government relations**: quality of public services, consistency of policy and administration, customs processing, regulatory compliance costs (management time, delays, bribes), informality, capture.
- **Conflict resolution/legal environment**: confidence in legal system, resolution of credit disputes.
- **Crime**: security costs, cost of crimes, use and performance of police services.
- **Capacity, innovation, and learning**: utilization, new products, planning horizon, sources of technology, worker and management education, experience.
- **Productivity information**: employment level, balance sheet information (including income, main costs and assets).

To date, 8 ICAs have been posted on the ICA website. Most are conducted at the national level, although the India ICA focused on the state level. The number of firms in the sample has varied widely, in part due to the different size of the countries: from 1,032 in India to 659 in Bolivia, 576 in Peru, 223 in Nepal, 193 in Mozambique, and 98 in Bhutan.

More recently (since 2003), Rural Investment Climate Surveys have been piloted in Sri Lanka, Tanzania, and Nicaragua.
Box 2.3: The “Doing Business” Project

The Doing Business Project investigates regulations that enhance business activity and those that constrain it. Quantitative indicators on business regulations and their enforcement are being gathered that will allow comparisons across more than 145 countries, and over time. The indicators are based on assessments of laws and regulations, with input from and verification by local experts.

In contrast to the Investment Climate Surveys, information is gathered from surveys of experts rather than firms. The questionnaire is administered to local professionals experienced in their fields, such as incorporation lawyers and consultants for business entry, or litigation lawyers and judges for contract enforcement.

The Doing Business methodology aims for comparability across countries, so that most indicators are structured around a hypothetical firm: a limited-liability company that operates in the country’s most populous city; is domestically owned; has start-up capital of 10 times income per capita, paid in cash; performs general industrial or commercial activities; leases the commercial plant and offices; does not qualify for investment incentives or any special benefits; has up to 50 employees, all of them nationals; has turnover of at least 100 times income per capita; and has a company deed 10 pages long.

The Doing Business project is publishing a series of annual reports, each covering several topics. The first report, Doing Business in 2004: Understanding Regulation, focuses on starting a business, hiring and firing workers, enforcing contracts, getting credit, and closing a business. Doing Business in 2005 will discuss three topics: registering property, dealing with government licenses and inspections, and protecting investors. Doing Business in 2006 will cover paying taxes, trading across borders, and improving law and order. The Doing Business project has received high marks from external audiences as well as Bank staff for providing, for the first time, objective indicators of the costs of regulation and administrative procedures. At the same time, when using the survey results, some of the limitations of this approach must be recognized. As countries and industries differ in optimal firm size and structure, estimating the time required to set up a straw firm provides comparability but at the expense of some bias against countries with heavier reliance on the informal sector.

2.11 The design and methodology of ICAs and the underlying Investment Climate Surveys are better than those of the earlier surveys and assessments. However, there are some issues of relevance, and of the use of the information gathered in the ICSs. Interviews and discussions conducted for this evaluation — in the country case studies, international investor interviews, and focus groups of Bank staff — identified the following issues:

- **Duplication of existing work:** In some countries, the nature of investment climate constraints, and the actions required to solve them, are already known. Often, similar surveys have been conducted by the government, local universities or think tanks, the Bank, or other donors. The benefit of an additional survey may be limited to that of providing comparable data for cross-country comparisons.

  *In the Indian states of Andhra Pradesh and Karnataka, the nature of investment climate problems, and the actions required to solve them, were*
already known. Both state governments had a significant appreciation of the challenges faced by their states in restoring fiscal discipline, improving governance, and addressing constraints to private investment, particularly in the regulatory area. Many potential remedies had been identified, for example, the concept of a single window for license clearances.

One of the Peruvian reviewers of the ICA who was interviewed for this evaluation said, “We have known these things for 10 years — why do we need another report to say the same thing? The World Bank has ignored earlier reports on what needs to be done for the private sector. Why were the issues that had been identified not incorporated into policies?”

- **Survey fatigue**: Related to the issue above, firms sometimes complain that they are repeatedly asked to participate in similar surveys by different organizations. This is particularly a problem in smaller countries with a relatively small private sector.

- **Geographic focus**: Investment climate conditions can vary significantly by geographic area — across states, across municipalities, and even within municipalities. While ICSs routinely show variations in investment climate indicators across geographic regions, there may be a need to focus ICAs at the sub-national level, particularly in large countries.24

- **Sector or industry focus**: Similarly, investment climate conditions may vary significantly by industry (for example, telecommunications versus agro-industry), and these differences may not be captured in ICAs. In some countries the main constraints to private sector development may lay outside the scope of ICAs — for example, labor skills.

- **Unprioritized recommendations**: Earlier surveys and assessments often produced long lists of problems and proposed solutions, without a clear set of priorities. This problem is beginning to be addressed in ICAs, which use firms’ rankings or impacts on productivity to set priorities. Nevertheless, feedback from clients suggests that more effort is needed to identify priorities and sequencing:

  Business leaders in Mozambique who were interviewed for this evaluation said, “The list was presented to government as the things that needed to be fixed. But the list was far too long — government can’t fix everything. There was no credible effort made to prioritize what needed to be fixed first and what needed to be worked on in the longer run.”

The more fundamental issue with ICAs lies in how survey information is used to derive policy recommendations. Investment climate indicators tell the analyst, from the perspective of firms, “what hurts,” or even “what hurts the most, relatively speaking,” but not “what to do about it.” In other words, they provide “description” rather than

24 The recent state-level Investment Climate Assessments in India are an example of recent efforts to do this.
“prescription.” Examples of constraints typically identified by firms include high taxes, high interest rates, and the high cost of regulatory compliance. This does not necessarily suggest that taxes, interest rates, or regulations should be reduced. Economic and social objectives — fiscal stability, monetary management, environmental protection, labor protection — are the “benefit” side of the cost-benefit analysis that needs to be done to determine the optimal policy stance (see the example in Box 2.4). Survey-based instruments are not able to capture both sides of the analysis. In addition, they do not provide an understanding of the root cause of problems such as market failures.

Box 2.4: The Costs and Benefits of Reforming Labor Legislation in India
The India case study provides an example of an issue that is of concern to firms, but also has broader economic and social implications: labor regulations. Existing labor laws emanate from various acts, including the India Trade Union Act of 1926, Industrial Disputes Act of 1947, Minimum Wages Act of 1948, Companies Act of 1956, and Sick Industries Companies Act of 1985. The 1976 amendment to the Industrial Disputes Act makes layoffs, retrenchment, and closure illegal for industrial concerns with 100 or more employees except with the prior permission of the state government, which is rarely provided. The typical Indian firm reported having 17 percent more workers than it desired and that labor laws and regulations were the main reason why it could not adjust to the preferred level.

While Bank analytical work has identified labor regulations as an important constraint to private sector development and asserts that changing labor legislation will have significant economic benefits, it does not present an assessment of the likely impact of reforms on labor or the broader social costs that may arise as a result of worker displacement. Industry favors the use of contract labor to avoid regulations and lower costs, but such workers are generally not afforded the same level of job security, benefits, worker safety, and other protections as those covered by labor laws. As such, greater reliance on contract labor entails social costs. The point of this example is not to question the need for labor reform, but to suggest that further analysis is needed to assess the costs and benefits — both economic and social — of policy reform.

2.13 A further implication of the difficulty of drawing policy recommendations from enterprise survey information may be that the reforms that are proposed are relatively straightforward ones, such as reducing administrative barriers (licenses, inspections, etc.). For these types of regulations it is often true that less is better, since the beneficiaries of the barriers — for example, corrupt bureaucrats or incumbent firms — are not perceived to be worthy of continuing to receive benefits. In other words, the solution to the cost-benefit question is relatively straightforward. Again using India as an example, the Bank’s work on PSD issues in Karnataka and Andhra Pradesh has focused primarily on reducing transactions costs associated with regulations and administrative procedures. None of the Bank’s adjustment loans have directly addressed rigidities in labor markets, despite the widespread view — shared by the Bank — that labor regulations impose greater costs on companies.

Lending Operations

2.14 Volume and composition. The Bank’s Operations Policy and Country Services department (OPCS) and the Private Sector Development Board have defined a set of five “core” and five “non-core” investment climate themes as shown in Table 2.1. The
To identify the investment climate loan portfolio, this report defines three types of projects:

- **“Core IC” projects** contain at least one Core IC theme that is a primary objective.
- **“Non-Core IC” projects** are not Core IC, but contain at least one Non-Core IC theme that is a primary objective of the project.
- **“Secondary IC” projects** are defined similarly: at least one Core IC theme or Non-Core IC theme is a secondary objective of the project.

Under these definitions, a large share of the Bank’s portfolio is investment climate lending (Table 2.2 and Figure 2.1). Of the 2,891 closed and active Bank projects approved during FY1993-2003, 1,291 (45 percent) had investment climate objectives related to Core or Non-Core themes. The value of IC projects was nearly $123 billion, representing 52 percent of the Bank portfolio. Core IC projects (those having one or more Core theme as a primary objective of the project) amounted to 14 percent of the Bank’s portfolio (in terms of the number of projects), and Non-Core IC projects another 19 percent.

Total lending volumes overstate the significance of investment climate operations, since investment climate components are often included in larger projects (e.g., regulatory reforms in macroeconomic adjustment loans). The value of IC components (weighted by the importance of objectives using OPCS methodology) was about $55 billion, or 45 percent of the total value of the IC portfolio, and 23 percent of the overall Bank portfolio, over the fiscal 1993-2003 period.

The total value of all IC lending (Core IC, Non-Core IC, and Secondary IC) in the Bank’s portfolio experienced a significant increase in 1998-99 along with the Asian financial crisis (Figure 2.2). Since then, IC lending has fallen below the levels of the early- and mid-1990s except for a spike in fiscal 2002. As a proportion of overall Bank lending, the value of IC lending has been fairly stable except for FY98-99 and FY02. These trends are similar for all IC as well as Core IC projects. Within IC lending, the

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25 However, it should be noted that the assignment of themes to projects in the portfolio under the current Bank coding system is somewhat arbitrary and may not be 100 percent accurate. Sample checks carried out by OED showed that the potential for mis-classification is greatest for Non-Core IC projects.

<table>
<thead>
<tr>
<th>Table 2.1: Thematic Definition of the Investment Climate</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>CORE IC THEMES</strong></td>
</tr>
<tr>
<td>Judicial and other dispute resolution mechanisms</td>
</tr>
<tr>
<td>Legal institutions for a market economy</td>
</tr>
<tr>
<td>Personal and property rights</td>
</tr>
<tr>
<td>Corporate governance</td>
</tr>
<tr>
<td>Regulation and competition policy</td>
</tr>
<tr>
<td><strong>NON-CORE IC THEMES</strong></td>
</tr>
<tr>
<td>Tax policy and administration</td>
</tr>
<tr>
<td>Infrastructure services for PSD</td>
</tr>
<tr>
<td>Other financial and private sector development</td>
</tr>
<tr>
<td>Export development and competitiveness</td>
</tr>
<tr>
<td>Trade facilitation and market access</td>
</tr>
</tbody>
</table>
share of Non-Core IC projects declined significantly (from 25 percent of the Bank’s lending in fiscal 1994-98 to 14 percent in fiscal 1999-2003) as the shares of Core IC and Secondary IC projects increased.

Table 2.2: Investment Climate Lending, FY 1993-2003

<table>
<thead>
<tr>
<th>Category</th>
<th>No. Projects</th>
<th>% of Total Projects</th>
<th>Total Loan Value ($m)</th>
<th>IC Loan Value as % of Bank Portfolio Value</th>
<th>IC Component Value ($m)</th>
<th>IC Component Value as % of IC Loan Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>IC</td>
<td>1,291</td>
<td>45%</td>
<td>122,868</td>
<td>52%</td>
<td>55,441</td>
<td>45%</td>
</tr>
<tr>
<td>Core IC</td>
<td>418</td>
<td>14%</td>
<td>49,767</td>
<td>21%</td>
<td>25,002</td>
<td>50%</td>
</tr>
<tr>
<td>Non-Core IC</td>
<td>563</td>
<td>19%</td>
<td>48,641</td>
<td>21%</td>
<td>25,227</td>
<td>52%</td>
</tr>
<tr>
<td>Secondary IC</td>
<td>310</td>
<td>11%</td>
<td>24,460</td>
<td>10%</td>
<td>5,212</td>
<td>21%</td>
</tr>
<tr>
<td>Non-IC</td>
<td>1,600</td>
<td>55%</td>
<td>112,834</td>
<td>48%</td>
<td>5,355</td>
<td>5%</td>
</tr>
<tr>
<td>Other PSD[^c]</td>
<td>231</td>
<td>8%</td>
<td>16,613</td>
<td>7%</td>
<td>5,355</td>
<td>32%</td>
</tr>
<tr>
<td>Other</td>
<td>1,369</td>
<td>47%</td>
<td>96,221</td>
<td>41%</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td>TOTAL[^d]</td>
<td>2,891</td>
<td>100%</td>
<td>235,702</td>
<td>100%</td>
<td>60,796</td>
<td>26%</td>
</tr>
</tbody>
</table>

[^a]: Excludes Core projects that contain Non-Core themes.
[^b]: Consists of projects not included in the first three categories, but containing Core, Non-Core, or Other PSD themes of secondary priority.
[^c]: Excludes Core and Non-Core projects that contain “other PSD” themes: SME support, standards and financial reporting, state enterprise and bank restructuring and privatization, technology diffusion, and rural non-farm income generation.
[^d]: Includes amounts committed to all IC themes in the project, whether Core, Non-Core, or Other PSD.

Figure 2.1: Number of IC and Non-IC Projects, FY 1993-2003

Figure 2.2: Investment Climate Lending, FY93-03 (Number and Value of Loans)
Figure 2.3: Core IC Themes in the IC Portfolio

Data represent the number of occurrences of Core IC themes in Core IC, Non-Core IC, and Secondary IC projects.
2.19 The dominant Core theme in the IC portfolio is regulation and competition policy, which includes activities aimed at the elimination of monopolies, simplification of business licensing and registration requirements, reduction of barriers to FDI, developing regulatory frameworks, enactment of competition policy (Figure 2.3). However, the relative importance of this theme has declined slightly with an increase in projects aimed at other Core IC themes (judicial and other dispute resolution mechanisms, legal institutions for a market economy, and corporate governance). Among Non-Core themes, the most important are “other financial and private sector development” and “infrastructure for private sector development” (Figure 2.4). The former covers measures to strengthen institutions that support the private sector (investment and export promotion agencies, public-private consultative mechanisms); support restructuring or private enterprises, including corporate restructuring; and promote financial sector development. The latter are infrastructure projects that include components to improve sector regulation.

2.20 Increasingly, investment climate objectives are included as components in adjustment loans. Adjustment loans increased from 32 percent of Core IC projects in fiscal 1994-98 to 38 percent in fiscal 1999-2003, compared to an average of 17 percent for all Bank projects over the entire period.

2.21 Performance. OED rates project performance against stated objectives, and assigns ratings to the project’s outcome, institutional development impact, and sustainability. Table 2.3 shows ratings for Core IC projects, averaged over fiscal 1993-

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Figure 2.4: Non-Core Themes in the IC Portfolio

Data represent the number of occurrences of Non-Core IC themes in Core IC, Non-Core IC, and Secondary IC projects.

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26 OED assigns ratings according to the following criteria. Outcome measures the extent to which the project’s major relevant objectives were achieved, or are expected to be achieved, efficiently. Institutional development impact measures the extent to which a project improves the ability of a country or region to make more efficient, equitable and sustainable use of its human, financial, and natural resources through: (a) better definition, stability, transparency, enforceability, and predictability of institutional arrangements and/or (b) better alignment of the mission and capacity of an organization with its mandate, which derives
2003, compared to Bank-wide averages. Over the entire fiscal 1993-2003 period, outcome ratings for Core IC projects were better than the Bank average: 81 percent of Core IC projects were moderately satisfactory or better, compared to 77 percent for all Bank projects, and the difference is statistically significant at the 5 percent level. There was a marginal improvement in the outcome ratings over the 10-year period: 81 percent of Core IC project outcomes were moderately satisfactory or better during fiscal 1994-98, and 82 percent during fiscal 1999-2003. In contrast, the performance of the overall Bank portfolio improved significantly from 78 percent in fiscal 1994-98 to 83 percent in fiscal 1999-2003. Thus, the performance of the IC portfolio is declining relative to that of the Bank portfolio. The institutional development impact and sustainability of Core IC projects were slightly better than the Bank average, but these differences are not statistically significant.

Table 2.3: OED Ratings for Core IC Projects, FY 1993-2003

<table>
<thead>
<tr>
<th>Outcome (Mod. Sat. or better)</th>
<th>Inst. Dev. Impact (Substantial or better)</th>
<th>Sustainability (Likely or better)</th>
</tr>
</thead>
<tbody>
<tr>
<td>% No. Rated Projects</td>
<td>% No. Rated Projects</td>
<td>% No. Rated Projects</td>
</tr>
<tr>
<td>Core IC</td>
<td>81% 210</td>
<td>54% 209</td>
</tr>
<tr>
<td>Judicial/other dispute resolution</td>
<td>79% 14</td>
<td>50% 14</td>
</tr>
<tr>
<td>Legal inst. For market economy</td>
<td>88% 58</td>
<td>62% 58</td>
</tr>
<tr>
<td>Personal/property rights</td>
<td>91% 11</td>
<td>55% 11</td>
</tr>
<tr>
<td>Corporate governance</td>
<td>80% 10</td>
<td>50% 10</td>
</tr>
<tr>
<td>Regulation &amp; competition policy</td>
<td>81% 185</td>
<td>54% 184</td>
</tr>
<tr>
<td>Overall Bank Portfolio</td>
<td>77% 1366</td>
<td>49% 1355</td>
</tr>
</tbody>
</table>

Note: The number of rated projects is not the sum of projects listed by theme, since a project can have more than one theme. For this reason the average ratings for Core IC projects is not a weighted sum of ratings for individual themes.

2.22 Outcome ratings were lower in low-income countries than in middle-income countries (79 percent moderately satisfactory or better in low-income countries, compared to 83 percent in middle-income countries). There were also differences in project outcomes according the quality of the country’s macroeconomic environment (measured by the economic policy performance rating in the latest Country Assistance Strategy) and the performance of the financial sector (measured by the financial sector performance rating in the latest CAS). This suggests that the outcomes of investment climate operations are more likely to be successful in countries that have better macroeconomic and financial sector performance — although there is no evidence to suggest the direction of causality. Projects performed better in countries with good investment climates, as defined by a 2002 CPIA over 3.5: 85 percent had outcome ratings from these institutional arrangements. Institutional development impact includes both intended and unintended effects of a project. Sustainability measures the resilience to risk of net benefits flows over time. Note that OED Outcome ratings measure the degree of achievement of project objectives due to the project as well as to factors external to the project — in other words, outcomes are not necessarily attributable to the project alone.
of Moderately Satisfactory or higher compared to 69 percent for poor investment climate countries, and the difference is statistically significant at the 5 percent level.

2.23 OED outcome ratings are assigned to the project as a whole, so that the outcomes of individual project components may differ from the overall rating. When IC components performed worse than the overall project, the reasons were:

- **IC components formed a small part of the project**: Outcomes were more likely to be poor when IC components were accounted for a small proportion of project costs, or were not linked with the rest of the project. In adjustment operations, IC components were often overwhelmed by macroeconomic adjustment objectives and conditionality.
- **Insufficient supervision**: Related to the above, in some cases the IC components received less attention during supervision than other larger components of the project.
- **Lack of government ownership and commitment**: Reflected in slow implementation of reforms and lukewarm engagement in preparation and implementation.
- **Complex or ambitious project design**: Made it more likely for IC components to under-perform, even if the complexity did not pertain to the IC components themselves.
- **Underestimated political and social readiness**: A lack of broad political and social support inhibited the performance of IC components.
- **Overestimated institutional capacity**: IC components were adversely affected by a lack of broad institutional capacity.

3. Outcomes at the Country Level

3.1 Five country case studies were conducted for this evaluation — for Indonesia, Romania, India, Mozambique, and Peru — covering Bank lending and non-lending activities over the fiscal 1993-2002 period. Annex 1 describes the case study protocol. This chapter presents the main findings and lessons derived from these case studies with respect to the implementation, outcomes, and sustainability of investment climate reforms. It summarizes what worked, and what didn’t; the factors that led to success and failure; and lessons that can be generalized to the Bank’s investment climate activities. The chapter begins with a brief characterization of each of the countries and the investment climate strategy pursued by the Bank.

Typology of Countries

*Indonesia: Crisis Drives the Investment Climate Agenda*

3.2 The 1990s were divided into two periods by the East Asia financial crisis, which began in July 1997 with the devaluation of the Thai *bhat*. In less than two months, Indonesia’s currency depreciated 75 percent against the dollar; GDP fell by 13 percent in
1998. The proximate causes of the crisis were the rapid increase of unhedged short-term private external debt before 1997, and shortcomings in the banking system. The country’s chronically weak institutions, endemic corruption, and political instability amplified the financial crisis because no credible arrangement to deal with the crisis decisively and fairly was offered to restore investors’ confidence. An enterprise survey conducted in 2000 suggested that macroeconomic and policy instability and uncertainty were the leading concerns of Indonesian firms.

3.3 Before the crisis, Bank assistance on the investment climate dealt with protecting property rights, facilitating an efficient land market, and developing the accountancy profession. Analytical work emphasized trade and domestic regulations, improving governance, reforming the legal system, privatization, and land administration. After the crisis, the focus of the Bank’s lending operations shifted to macroeconomic stabilization and bank and corporate restructuring.

Mozambique: A Poor Country with Little Local Capacity

3.4 Despite fast growth during the 1990s, Mozambique remains one of the poorest countries in the world. Per capita income was only $200 in 2001, about 40 percent of the average for Sub-Saharan Africa. Adult literacy is only 56 percent, and there is an acute shortage of highly educated workers.

3.5 Beginning in the late 1980s and accelerating after the 1992 peace agreement, extensive policy reforms improved macroeconomic management; liberalized prices, exchange rates, and trade; privatized public enterprises; promoted financial deepening; and improved public investment. Even with the progress on first-generation reforms, Mozambique began the decade of the 1990s with an extremely poor investment climate. Incentives, institutional arrangements, governance stability, and physical infrastructure had to be either fashioned from whole cloth or rehabilitated. Added to this, a transition from plan to market had to be engineered in the context of the post-conflict recovery.

3.6 The Bank’s strategy during the 1990s moved from a first-generation set of macroeconomic reforms to second-generation reforms aimed at removing microeconomic barriers to investment stemming from antiquated laws and regulations, inefficient administrative capacity, and corruption.

Romania: Investment Climate Reforms Motivated by Opportunity

3.7 In the early years of transition, a flurry of reform activity was undertaken to promote a more open market economy. But most of the 1990s was characterized by economic and political instability; half-hearted reforms undertaken by successive governments resulted in a weak supply response from the economy. Both domestic and foreign investment were weak, there was little growth, and the incidence of poverty continued to rise.

3.8 The end of the 1990s was a watershed for Romania. Low growth and macroeconomic instability brought governments to office that were committed to reform.
Government commitment was “pulled” by opportunity: the prospects of NATO membership and integration with the European Union (EU).

3.9 The Bank’s assistance during 1999-2002 showed a stronger focus on the investment climate. Recent projects focused on institutional reforms critical for private sector development, including the reform of the legal environment for business, the reduction of regulatory burdens, and secured transactions reform to facilitate collateralization of assets for loans.

**India: Investment Climate Constraints at the State Level**

3.10 India’s economic reforms in the 1990s raised GDP growth to almost 6 percent per year between 1993 and 2003, fueled in part by external debt. Living standards improved markedly, and the number of people living below the national poverty line declined from 45 percent in the 1980s to 25 percent in 2002. Foreign direct investments and portfolio investments responded strongly to the first wave of reforms, and have fluctuated around $6 billion per year. While progress was substantial, economic performance has fallen below the target set by the central government in the years after liberalization — partly due to persistent and growing fiscal deficits, inadequate infrastructure (particularly power), and institutional constraints on private investment. The most important investment climate constraints are bureaucratic red tape and administrative procedures, inflexible labor markets, persistent trade protection, and lack of access to financing.

3.11 Investment climate conditions vary significantly across different states and even within states. The Bank’s recent Investment Climate Assessment for India shows that Maharashtra and Gujarat are perceived by firms to be the “best climate” states; Tamil Nadu, Karnataka, and Andhra Pradesh are “good climate states,” Delhi and Punjab are “medium,” and Kerala, West Bengal, and Uttar Pradesh are “poor climate states.” That entrepreneurs actually act on these perceptions can be seen in the investment rates for these states.

3.12 Beginning in the mid-1990s, the Bank began to focus greater attention on working with states that were strongly committed to reform. The Bank’s activities have supported broad packages of state-level reform efforts as well as sector-specific programs in power, water, transport, health, and education.

**Peru: Progress in Some Areas, Reversals in Others**

3.13 When President Fujimori was elected in 1990, Peru was verging on total disintegration. Hyperinflation, multiple exchange rates, the nationalization of the banking system, and a vicious terrorist movement had resulted in economic collapse. The government embarked on a comprehensive economic reform program that introduced market mechanisms into every sector of the economy. The response to these reforms was a surge in growth over 1993-97, a decline in inflation, buoyant foreign investment, and a fall in poverty.

3.14 During Fujimori’s second term, however, conditions deteriorated. External shocks, the El Niño effect, and reversals in the reform program all served to weaken the
The economy, increase uncertainty, and damage the investment climate. A new government was elected in 2001, promising to improve the economy and eradicate government corruption. However, confidence in the new government began to erode almost immediately, and the government has changed its stance on several important issues in response to public opinion. Attitude surveys indicate that the business community does not have confidence in the government, which it views as unstable and anxious to appease populist sentiment at the expense of continuing reform. The result has been a sharp decline in investment.

3.15 The Bank has undertaken a series of private sector assessments since the mid-1990s, but CASs during the 1990s did not focus on investment climate issues. This changed with the 2002 CAS, which increases the stress on institutional projects, particularly to continue property rights efforts and to modernize the judicial system.

**Lessons Learned**

*Investment climate reform is often driven by crisis or by opportunity*

3.16 Decisions by policymakers to take measures necessary to improve the investment climate are often motivated by urgency: on the negative side by crisis (macroeconomic, financial, political) or on the positive side by opportunity (the prospect of joining regional trade agreements, taking advantage of new technologies). The Bank has been successful in supporting reforms in both of these situations.

3.17 In Indonesia, the motivation was a negative one: the Asian financial crisis that began in 1997. Before the crisis, Bank reports consistently pointed out several structural weaknesses that could impede future private sector-led growth. To overcome these weaknesses, the Bank recommended good macroeconomic management, strengthening the financial sector, reducing international and domestic trade barriers, facilitating private investment, improving governance and reforming the legal system, improving land administration, and reducing excessive state ownership of productive assets. However, when Indonesia was perceived to be performing well and not in need of Bank resources, the Bank lacked leverage with the government to move it toward implementing structural reforms. The Bank’s usually strong influence with government “technocrats,” who had a voice in policy formulation and implementation, was muted during this period, perhaps because the reforms were politically difficult and did not seem critical for Indonesia’s growth.

3.18 During the crisis, the Bank had substantial leverage and influence despite frequent changes in governments. The Bank supported macroeconomic stabilization, bank and corporate debt resolution, and structural reforms including competition policy and governance and justice system reforms. Many of the structural reforms recommended by the Bank before the crisis became required policy actions in adjustment loans immediately following the crisis.

3.19 Political stability began to recover after the election of President Sukarnoputri. In the new political arrangement, the Soeharto-era “technocrats,” with direct access to the
President for decisions, have been replaced by inexperienced politicians with diverse interests and without clear decision rules or hierarchy. Decentralization has further complicated the decision process and created complications for the investment climate. With so many new players and diverse interests vying for decision authority, the Bank’s ability to influence policy has been reduced. While the investment climate has not improved very much, the Bank’s activities have probably prevented it from deteriorating. Eventually, these reforms are likely to improve Indonesia’s investment climate, especially for foreign investment but also for domestic investment. For the future, because the Bank has less leverage and influence with the government than during the crisis, it will have to adopt a strategy that appropriate to the new political landscape and persevere for a longer period to achieve its objectives.

3.20 The Indonesia case study offers lessons for Bank strategy and activities in countries where it has less leverage — in large countries where the economy is stable and growing, in democratic countries governed by a coalition of parties in which the decision process is diffuse and complicated, and/or when formerly central government decisions are devolved to regional and local authorities. In these countries, stakeholders determined to improve the country’s investment climate play a critical role. The Bank should be prepared to pursue investment climate reforms directly with several layers of government and indirectly through stakeholders. The Bank should be prepared to exercise patience and persist for long periods to achieve its policy reform objectives.

3.21 The Bank’s investment climate strategy in Romania during the 1990s can be divided into two periods. The early years (1992-98) focused on the movement away from a planned economy to one in which markets determined resource allocation and investment. Macroeconomic imbalances were a major concern. The second period, which had its genesis in a major economic crisis in 1999, was characterized by a much stronger dedication by the government to promoting the private sector as well as a rededication to the reform effort in general. The new government that came into power in mid-2000 adopted an economic program for 2001-04 with the goals of stimulating economic growth, reducing poverty and unemployment, combating corruption, and speeding up EU integration and NATO membership.

3.22 The Bank’s 2001 CAS evidenced the evolution of the Bank’s approach to investment climate reform from one that was based on macroeconomic conditions to one that was institutionally oriented. Recent projects have focused on the reform of the legal environment for business, the reduction of regulatory burdens, and secured transactions reform to facilitate collateralization of assets for loans. Successive private sector adjustment loans (PSALs) and public and private institution-building loans (PIBLs) supported these reforms.

3.23 The first PSAL was an ambitious attempt to support enterprise and financial sector reforms that could substantially reduce the pressure on the government’s finances. There were two major factors that motivated the government to undertake these reforms. First, in 1997-98 GDP contracted by more than 11 percent and the budget deficit increased for the fifth consecutive year to 5.5 percent of GDP. These factors, along with an unstable current account balance and mounting external repayment obligations,
increased pressure on the government, which moved in late 1998 to initiate an ambitious reform program. A second major factor was (and is) the prospect of accession to the EU in 2007. PSAL conditions were well coordinated with the milestones set out by the EU, and the government — along with a broad segment of society — supported the effort to “join Europe.” This was reinforced by NATO’s decision in November 2002 to invite Romania to join the alliance. Once the government understood the severity of the macroeconomic situation and wished to proceed with reforms, the Bank moved quickly to prepare the project.

3.24 Preparation of the PSAL provided an example of how high-quality analytical work and good collaboration among Bank Group units along with other donors can lead to high-quality lending operations. FIAS prepared an Administrative Barriers to Investment report with recommendations encompassing regulatory reform, corruption, company and tax registration, foreign exchange, property rights, standardization, employment, land and site development, and customs and international trade. Based on these recommendations, the government approved an action plan in September 2001 that is now being used to improve the investment climate. The government established an implementation group with broad representation from the Chamber of Deputies, the Chamber of Commerce, nongovernmental organizations, the business community, importers and exporters, and other members of civil society. The Bank worked closely with other donors (International Monetary Fund, EU, European Bank for Reconstruction and Development, and bilateral donors), which resulted in the transmission of a consistent message to the government.

3.25 The combination of the “push” of macroeconomic crisis, the “pull” of EU accession, the coordinated support of donors, and efforts to build broad support seem to be having a positive, though gradual, effect on the investment climate in Romania. One area of achievement has been increased access to credit as a result of secured transactions reform (Box 3.1).
Box 3.1: Romania: Secured Transactions Reform

In 1999 the Bank approved two private sector development loans for Romania: the first Private Sector Adjustment Loan (PSAL) and an accompanying technical assistance loan, the Private Sector Institution Building Loan (PIBL). One of the most important components of the PIBL was secured transactions reform. The first phase of the project supported the implementation of a Law of Secured Transactions, which was drafted with the support of the Bank. The law incorporated provisions that permitted movable property, both tangible and intangible, to serve as collateral for loans. The second phase of the project involved setting up the filing archive to permit the law to operate by recording pledges of property and establishing priority regarding which creditors have the first rights to repossess and sell the collateral in the event of default. The secured transactions framework had several innovations:

- The law abrogated all existing legislation affecting debt, so that there was no danger of ambiguity regarding the validity of pledges.
- The filing archive in which pledges are recorded is run by an association of lenders, so that the public sector is not involved. It is electronic and priority is determined electronically by the time when pledges are recorded.
- No documents are necessary to file a security interest. This allows internet-based filing, currently the only filing archive in the world to have this feature. The effect is to broaden coverage, especially in the rural areas, and to reduce costs.
- No notaries are involved in the process.
- Repossession takes place outside the court system. If repossession is not disputed, the creditor can simply collect the pledged property. In the event of a dispute, upon evidence of the validity of the debt, an officer of the court can seize the pledge property without the necessity of a court hearing. Very harsh penalties for wrongful repossession discourage creditors from abusing the system.

The impact of the law on lending has been dramatic. In the 18 months since the reform was implemented, there have been more than 400,000 loans against which security interests have been registered. Over 100 banks have registered security interests in the filing archive. Since there are only 38 licensed banks in Romania, the implication is that scores of non-Romania banks have been lending in the country against collateral and registering their security interests.

Of the security interests that have been registered and are current, nearly 20 percent represent non-bank secured loans. This is especially beneficial in rural areas that do not have bank offices. In addition, the geographic coverage has been extensive: there have been filings of security interests in 42 of Romania’s 43 counties. In rural areas, credit has been granted against diverse assets including cows and tractors.

The Bank’s analytical and advisory work has been key to motivating reform

3.26 Successful Bank interventions usually have started with high-quality analytical work that provided the policy framework for lending operations. The Bank’s analytical work has often helped to accelerate the process of reform.

3.27 In Romania, a comprehensive set of policy recommendations emerged from the FIAS administrative barriers study and other ESW. Based on these recommendations, the government approved an action plan that is now being used as a roadmap for measures to improve the investment climate. Several of those interviewed indicated that the priority
given to the investment climate by the government has been a result of the Bank’s enterprise surveys and analysis. Businessmen and representatives of business groups report that the investment climate is considerably better than it was a few years ago — for example, in the effort required to register a business — and that the involvement of the Bank contributed to this outcome.

3.28 In India, the Bank made an important contribution by focusing attention on specific issues, while placing them within a broader context. According to government officials involved in the reform process, the Bank helped sensitize the government to the gravity of the problem. The Bank drew attention to the significant cost of not reforming in terms of the ability of the government to address social needs within the states. Those interviewed highlighted the ability of the Bank to present recommendations in terms of an integrated strategy that reflected the significant interactions among different issues faced by the states. Government officials in Karnataka acknowledge that, while the need for regulatory and administrative reforms was broadly recognized within the government, efforts to implement them were sporadic and uncoordinated before the Bank’s analytical work and adjustment operations.

3.29 Interviews conducted in several of the country case studies suggest that clients would appreciate even greater emphasis on analytical and advisory work. In Peru, government officials indicated that they would like more sector work and technical assistance on investment climate and financial market issues: “The international financial institutions are becoming more like commercial banks. We ask for advice and they give us money,” one senior government official complained.

**IC conditionality has been important in strengthening the hand of reformers**

3.30 It is important to recognize that a country’s government is not monolithic. At any time, there are individuals within the government — top political leaders, senior government bureaucrats, party officials, and various formal and informal advisors — that will support certain reforms and others that will oppose them. The Bank’s loan conditionality played an important role in the political economy of reform in several case study countries by strengthening the hand of reform-minded policymakers and other stakeholders against those opposed to reform.

3.31 In Romania, many of those interviewed for this evaluation felt that the Bank’s conditionality has been important in assisting reformers in getting their programs adopted, particularly during the latter part of the 1990s and early 2000s. Conditionality and the need for Bank financing helped prevent backsliding on reforms.

3.32 In India, the Bank supported investment climate reforms in the states of Karnataka and Andhra Pradesh with state-level adjustment loans. All of these loans contained up-front triggers requiring the state government to take specific actions before loan approval and effectiveness. The adoption of triggers helped ensure the achievement of agreed actions. In Karnataka, the adoption of triggers related to deregulation contributed to the reform effort. The triggers were developed after extensive discussions between Bank staff and government officials. Once in place, they helped ensure that
actions were taken by the government even if some groups were opposed to particular reforms, recognizing that the loan might be jeopardized by failure to make adequate progress.

**Local champions often initiate reforms, but broad support is needed to sustain them**

3.33 It is important to have the backing of key politicians to spur reform. However, while much attention is paid to the role of senior political leaders, other stakeholders — professional civil servants, business groups, and the general public — are critical to sustaining reforms.

3.34 In Karnataka and Andhra Pradesh (India), political leaders were elected on a reform agenda and took steps upon assuming office to institute policy and institutional reforms. The Bank elected to work with these states precisely because officials demonstrated that they were willing to tackle pressing fiscal, governance, and administrative problems. Government officials and business leaders interviewed spoke of their concern over whether reform efforts could be sustained in the event of changes in political leadership. Lacking a strong institutional basis and grass-roots support, the reform agenda is in danger of facing difficulties in the event of electoral shifts. Many people pointed to the need to build support for reforms outside of government. It was suggested that there is a need for strong business associates at the state level with the capability for careful, objective analysis and the ability to voice concerns in the corridors of government and the court of public opinion.

3.35 The Mozambique case study indicates that the Bank did not work vigorously enough to build commitment in the government to manage and implement the reform process. The 1997 Action Plan for reform of administrative barriers was not thoroughly discussed by all the relevant ministries and agencies, nor did the government formally endorse it. The lack of ownership, support, and participation by the respective stakeholders resulted in poor implementation.

**Institutional issues are key**

3.36 The literature review for this evaluation provides evidence that cross-country differences in the quality of institutions explain a large share of the differences in growth, and may even “trump” other growth determinants. The case studies provide examples of countries where the Bank paid insufficient attention to institutional weaknesses, and as a result had little impact on the investment climate.

3.37 Although the Bank has done much to improve the financial sector in Mozambique, little has been done to address institutional weaknesses that continue to hamper lending to the private sector and investment in equities. Interviews called attention to three important areas where business leaders say the Bank should have been more involved in financial sector reform during the decade: improving financial information, improving contract enforcement mechanisms, and improving the land law and movable assets law to increase the private sector’s collateralizable asset base. It was argued that the Bank’s lack of attention to the underpinnings of financial markets — for
example, accounting standards and skills — is one of the reasons for continued high interest rates and lack of access to credit. Bank activities have supported programs in the legal area, but enforcement problems continue to cause banks to require more than 100 percent collateral for most loans.

3.38 During the second half of the 1990s, Bank activities in Romania strongly supported efforts to strengthen the country’s nascent institutions in order to improve the investment climate. Many of these efforts have been successful (for example, secured transactions reform) but others have been less successful due to institutional factors. By contrast to moveable property, the legal status of fixed property (land and buildings) remains unsatisfactory, and the problems are especially difficult in rural areas. The focus of the General Cadastre and Land Registration Project was on technical mapping — rather than ensuring that property owners receive a registered title — and has resulted in little change in the land market. Both domestic and foreign investors continue to complain that uncertainty over land ownership has caused delays and cost increases in investment projects. In some cases, planned investments have been cancelled. The Bank supported changes in the legal framework for business under the PSAL and PIBL, but there was insufficient focus on the institutions necessary to enforce the laws. As a result, the legal system remains weak, and governance is poor.

3.39 In Peru, contract enforcement remains lengthy and costly. Businesses still view the legal system as almost irrelevant — they usually confine transactions to those they know well. In surveys of Peruvian businesses, the overwhelming majority claimed that the court system did not adjudicate disputes impartially, delays were long, and judges were untrained in commercial law and open to influence.

3.40 OED’s recent Project Performance Assessment Report on three PSD projects in Guyana provides an illustration of Bank efforts to improve the investment climate in a low-income country. The assessment concluded that the Bank did not have a realistic understanding of the structure of institutional dynamics and incentives, the governance context (including a recognition of the implications of the ethnic divide between citizens of African and Indian descent), and management capabilities. As a result, all three projects failed to anticipate the risks of weak ownership, rent seeking, and poor management, which severely constrained the effectiveness of the projects.

The implementation of reforms can get bogged down at lower levels of bureaucracy if incentives haven’t changed

3.41 Professional civil servants are key to the success of reform efforts. The responsibility for the implementation of regulatory and administrative reforms often runs across a large number of government agencies and departments. Senior civil servants must understand, support, and assume ownership of reforms.

3.42 Bank investment climate activities in Mozambique beginning in 1996 made relevant contributions to the process of removing microeconomic impediments to investment. FIAS Administrative Barriers to Investment studies (1996, 2001) and Investment Climate Assessments (1997, 2002) helped to identify the reform agenda. To
improve private sector capacity to analyze and lobby for reforms, the Bank supported the formation and early operation of the Confederation of Mozambique Business Associations. To improve government capacity to analyze and implement reforms, the Bank provided assistance to establish a private sector development unit in the Ministry of Industry and Commerce, and provided technical assistance to the unit to work with the private sector on administrative and regulatory changes. To facilitate a continuing dialogue between government and business concerning investment climate reforms, the Banks supported an annual private sector conference.

3.43 These efforts, though modest in financial terms, helped the government make some improvements in administrative procedures and laws and regulations governing investment. But business leaders interviewed for this evaluation stated that the reforms undertaken to date are far from sufficient to ease the prevailing administrative and regulatory constraints to investment. Reforms require more than rewriting legal and regulatory frameworks. They must be coupled with capacity building to address weaknesses of executing agencies, and efforts to build political consensus and commitment by government leaders to adopt and implement required reforms. And even when there was a desire at the highest levels of government to reform administrative barriers to investment, this desire was not manifested into a shared vision or commitment adopted by all political parties, responsible ministries, and executing agencies. Reform implementation problems partly stemmed from the overlapping structure of government institutions and lack of clarity on responsibilities and accountability. But there also existed a widespread “passive resistance” from unmotivated executing agencies and officials, and corruption at all operational levels. These problems could not have been solved by reforming investment procedures alone — they required complementary civil service reform.

3.44 Indonesia’s legal and judicial system has been viewed for decades as unreliable for enforcing rights or resolving disputes. The government initiated a series of reforms since the Asian financial crisis, but follow-through has been disappointing and pessimism has grown about the pace of reforms. A recent assessment by the UN Special Rapporteur suggested that progress was poor. Political will to push through the reforms is lacking, and corruption in the institutions that enforce the laws has not been tackled. Indonesia’s political and economic elite benefit from the existing corrupt system and are not eager to change it. Without a powerful constituency, legal and judicial reforms have had limited impact.

3.45 The India case study concluded that legal and regulatory reforms should have been supported by efforts to build the capacity of relevant institutions. Most of those interviewed voiced concern about the extent to which reforms had been institutionalized. The concern related less to the particulars of laws and regulations, but more with the mindset and capabilities of government agencies and departments. In particular, people cited problems with lower-level officials and cited the need for training.

3.46 Finally, in Romania, the General Cadastre and Land Registration Project was designed to address the lack of an effective land market that have been identified as an issue throughout the 1990s. The project was intended to support a unified system of land
registration in the country, establish a cadastre system to provide up-to-date and unambiguous definitions of existing real estate parcels for land registration, institute a low-cost and reliable method for land transactions, and facilitate collateralization of this more fundamental and widespread asset. However, the outcome of the loan has been disappointing, in part because judges handling land issues were underpaid, many were unmotivated, and there was evidence of corruption in the system.27

*Modest, piecemeal efforts are less successful than a “big push” of reforms*

3.47 Bank activities in **Mozambique** have made relevant contributions to the process of removing microeconomic impediments to investment. But business leaders interviewed for this evaluation state that reforms undertaken to date are far from sufficient to ease prevailing administrative and regulatory constraints to investment. They felt that the Bank’s support has been too modest, too piecemeal, and too inconsistent to get the job done. They stressed that, if the Bank were really serious about increasing the pace and scope of these types of reforms, it should have developed a program with the government to make a “big push” to get the necessary changes, as in its adjustment lending for macroeconomic reforms, rather than the “partial program” it put together.

3.48 The Bank’s early focus on investment climate issues in **Peru** was apparent in a series of high-quality analytical reports throughout the 1990s. In fact, many of the later reports identified issues that had been raised in earlier reports: regulation, policy uncertainty, infrastructure, a weak judiciary, underdeveloped financial markets, and poorly protected property rights. Despite successive CASs that established private sector development as a priority, a comprehensive strategy for doing this was not prepared. Although critical constraints to PSD had been identified in ESW, they were not pulled together into a cohesive investment climate action plan. Partly as a result, there has been progress on some investment climate issues but little or no progress in others.

### 4. Conclusions and Recommendations

**The Investment Climate, Investment, and Growth**

4.1 Indicators of country-level policy and institutional performance show that the investment climates of developing and transition economies have improved modestly in recent years. Improvement is seen in both low- and middle-income countries, and across all Bank regions. The largest improvements were in transition economies — which started from a lower base — including countries that aspire to EU accession. Performance ratings are higher for macroeconomic conditions (macroeconomic management, financial stability, and revenue stability) than for some institutional areas (property rights, public

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27 The Bank and the Government of Romania have agreed to and begun implementation of the restructuring the General Cadastre and Land Registration Project to ensure its meeting the development objectives. The restructuring includes the integration of land registration and cadastre tasks into one function in one new agency and a re-design of the capacity building component of the project.
administration, transparency, and rules-based governance), suggesting that these areas
deserve attention.

4.2 The literature review conducted for this study provides evidence on the factors
most important for investment and growth. At a broad level, policies and institutions
determine growth outcomes. Macroeconomic and structural reforms are necessary
conditions for growth, and can stimulate an initial growth spurt even in the absence of
institutional reforms, but modern institutions are needed for sustained growth. Certain
best-practice principles are applicable to all institutional arrangements, such as
transparency, accountability, competition, the rule of law, and the protection of property
rights. However, the institutional arrangements needed to implement these principles are
somewhat country-specific. An institutional arrangement that is successful in one country
doesn’t necessarily transfer well to another country without modifications, and
unorthodox arrangements often work.

4.3 Evidence from the literature and from interviews with international investors
conducted for this evaluation indicate that different factors determine the investment
behavior of individual firms, because firms are diverse. For foreign investors, investment
climate conditions in host countries matter, but there are also firm-specific global
strategic factors that influence investment decisions, such as the size of the internal
market, low wages, and the actions of competing firms. Enterprise surveys show that
firms that are private, newer, smaller, devoid of FDI, and that cater to the domestic
market report more acute business constraints than do firms that are older, larger, that
export, that have FDI, or that are state-owned.

The Bank’s Strategic Focus and Operations

4.4 **Non-lending services.** The Bank’s economic and sector work has helped
motivate many governments to adopt integrated reform strategies. Nevertheless, there are
areas where more work needs to be done to provide guidance to clients as well as to Bank
staff designing investment climate interventions. Not enough is known about good
practice in institutional design, or about the dynamic process of changing institutions. It
would be useful to have a typology of country situations and institutional designs that
would provide guidance on which types of arrangements work where, how the change
process happens, how it can be supported and sustained, etc. — in other words, an
understanding of what types of institutional arrangements can be “exported” from one
country to another. The Bank’s ESW has not yet provided enough of this knowledge of
institutional design and the process of reform.

4.5 Feedback from clients collected for country case studies suggest that the Bank has
not been focused enough or selective enough in its ESW and diagnostic work on the
investment climate. Reports sometimes duplicate earlier work, and firm surveys are
sometimes very similar to existing surveys conducted by governments, think tanks, or
other donors. Investment climate diagnostics sometimes do not take into account the
heterogeneity of investment climate conditions across geographic areas (states and
municipalities) and across industries. In some cases, the Bank has not focused ESW
sufficiently on the highest-priority types of investment (for example, domestic versus
foreign) or highest-priority constraints (for example, labor issues). Investment climate diagnostics often produce long lists of problems and proposed solutions, without a clear set of priorities.

4.6 Enterprise surveys provide valuable information on the perspectives of the private sector, but are an insufficient basis for policy recommendations. The views of business on public policies need to be balanced with other economic and social objectives.

4.7 **Lending Operations.** Projects with investment climate objectives account for a large share of the Bank’s lending portfolio. Projects that have Core and Non-Core IC themes as primary or secondary objectives account for 45 percent of all Bank projects over fiscal 1993-2003, and 52 percent of project value. Core IC projects (those that have one or more of the five Core IC themes as a primary objective of the project) account for 14 percent of all Bank projects. However, the value of IC components is usually less than the total loan amount, averaging 50 percent of value for the Core IC portfolio.

4.8 With the exception of the expansion in lending during the fiscal 1998-99 Asian financial crisis, the Bank’s lending for investment climate reforms declined slightly until fiscal 2000 and has increased since then, with a significant spike in fiscal 2002. As a proportion of total Bank lending, however, IC lending has remained fairly stable. Within the IC portfolio, Core IC topics have increased relative to Non-Core topics; within Core topics, various regulations and competition policy are the most common objectives. Of Non-Core themes, infrastructure for PSD and other PSD and finance sector projects are most common.

4.9 Regionally, the Core IC portfolio is concentrated in ECA, LAC, and AFR; 87 percent are in low or lower-middle income countries. Increasingly, adjustment loans are the instrument of choice, rising from 23 percent of Core IC projects in fiscal 1993 to 31 percent in fiscal 2002. Although Core IC projects are somewhat more concentrated in countries with poor investment climates as measured by the CPIA, it is to a degree similar to all Bank projects.

4.10 Over the entire FY93-03 period, Core IC projects performed better than the Bank average: 81 percent of Core IC project outcomes were moderately satisfactory or better, compared to 77 percent for all Bank projects. Although this performance improved slightly over the period, the improvement was less than for the Bank-wide portfolio. Thus, the performance of the IC portfolio is declining relative to the Bank-wide average. Moreover, when the outcomes of IC components differ from overall project outcomes, they are often worse. A number of factors contribute to disappointing outcomes: apparent lack of attention and supervision when IC objectives are a minor part of larger projects; lack of government ownership and commitment; complex or overly ambitious project design; lack of overall institutional capacity; and political or social factors that were underestimated at project appraisal.

**Outcomes at the Country Level**
4.11 The country case studies conducted for this evaluation show that investment climate reforms are usually motivated by factors external to the Bank — either by economic or political crisis, or by the prospect of joining regional agreements — but that the Bank has helped governments push reform primarily through its intellectual contributions. Lending conditionality has also helped the process of reform by strengthening the hand of reformers and preventing backsliding. Even in poor, low-capacity countries, the Bank can make progress if the government is committed to reform.

4.12 Where results have been disappointing, they have mainly resulted from a lack of implementation of the laws and regulations adopted under Bank-supported reform efforts. Often the Bank has not understood or paid sufficient attention to institutional issues, for example, the skills and incentives that determine the behavior of authorities charged with implementing the reforms. The process of changing institutions takes time, and getting institutions right is highly country-specific.

4.13 Local champions often drive reforms, but broad support is needed to sustain them. The Bank has been more effective when it used its convening and coordinating role to build support among various segments of society, and engaged in a continuing dialogue with both the public and the private sectors.

4.14 In some countries, the Bank’s support has been too modest and piecemeal to make a significant difference in the quality of the investment climate. When the critical constraints to private sector development are pulled together into a cohesive action plan, investment climate outcomes have been better.

Recommendations

4.15 OED’s evaluation of World Bank investment climate activities proposes the following actions to Bank management to improve the relevance, effectiveness, and sustainability of Bank assistance for investment climate reform:

1. Pay more attention to institutions and the political economy of reform.

   - Do more analytical work on institutional arrangements and the political economy of reform, involving local organizations. This could include (i) a guidance note with a typology showing what types of institutional arrangements work in different country circumstances; (ii) assessments of a country’s institutional capacity constraints, incentives, barriers to changing behaviors, and training needs, to help design IC assistance and monitor progress; (iii) country case studies of IC reform successes and failures to gain a better understanding of how reform processes are motivated and sustained, and the role of different stakeholder groups.

   - Be less timid in dealing with vested interests and in building a balanced constituency for reform. Make better use of the Bank’s convening power to bring
the government together with the business community, as well as with consumer and labor groups, and local think tanks.

- Be more proactive in disseminating information — on investment climate constraints, the country’s reform agenda, the implementation of laws and the achievement of specific targets, and lessons from the reform experience of other countries. The Bank could facilitate research by academics by ensuring better access to investment climate data and research results.

- Make a stronger push for transparency and openness – to help create political will where it is weak, to enlist local oversight of potential government inefficiencies and abuses, and to improve the investment climate itself.

- Ensure that Bank staff develop a deep understanding of and sensitivity to country-specific political and business cultures, as well as key features that define the relationships between business and government.

2. Improve the focus and use of survey-based diagnostics.

- Focus Investment Climate Assessments on specific country needs. Make greater use of existing material and collaborate with other donors doing similar things to avoid duplication of effort.

- Take into account the heterogeneity of investment climate conditions by targeting diagnostic assessments on sub-national geographic areas or individual industries.

- Recognize that enterprise surveys represent only the views of the business community. Use survey-based diagnostics only as an input to making policy recommendations in order to balance business perspectives with broader economic and social concerns.

3. Do a better job of prioritizing and packaging IC reforms in lending operations.

- Give high priority to reforms that will build political and civil society commitment to continue the reform process — by focusing on problems that, if fixed, would have immediate positive impacts.

- Consider packaging a critical mass of microeconomic reforms and components (including civil service reform and training of public officials) into IC-focused adjustment loans, rather than piggy-backing small investment climate components to macroeconomic adjustment operations.

- Choose lending instruments appropriate to support the process of institutional change over a long period of time (e.g., programmatic adjustment loans). This will help ensure that changes in laws and regulations are actually implemented, and are sustained.
References


Hubbard, Glen; Anil Kashyap; and Toni Whited (1994). “Internal Finance and Firm Investment” Journal of Money, Credit and Banking.


Annex 1: Evaluation Methodology

Evaluation Framework

1. The chain of causality from World Bank investment climate activities to economic performance outcomes, illustrated below, has three main parts:

(1) Between Bank activities and the adoption of policy and institutional reforms.
(2) between reforms and actual changes in the investment climate.
(3) between changes in the investment climate and performance outcomes (firm-level productivity and profitability, and economy-wide productivity, investment, income, and employment).

Figure A.1: Logic Model for World Bank Investment Climate Activities

2. The Investment Climate Study focuses on the first parts of the chain — from Bank activities to investment climate outcomes — relying on a review of the literature to provide evidence on the relationship (3) between improved investment climates and final economic outcomes.

3. The evaluation addresses the following questions:

- **Relevance of Bank assistance:** What relative priority did the Bank attach to addressing investment climate issues among its total interventions? Were the policy and institutional areas emphasized in Bank operations consistent with current empirical research linking investment climate indicators with performance outcomes, and with the obstacles to investment as perceived by potential investors? Do the survey-based diagnostics used by the Bank provide good information about the quality of the investment climate, and do they lead to sound policy advice?

- **Effectiveness of Bank assistance:** Are Bank activities helping to get investment climate reforms implemented? Was the Bank effective in motivating client governments to undertake reforms, beyond what they would have done in the absence of Bank intervention? Was conditionality in lending operations helpful in supporting reform? What were the outcomes of Bank interventions, in terms of the quality of the investment climate and in terms of investment and growth?

- **Sustainability:** What is required for investment climate improvements to be sustained? How should reforms be sequenced?
• **Organizational issues:** Does the Bank’s organizational structure support good investment climate work?

4. The evaluation comprises the following components:

• A review of the literature on the drivers of investment and growth, and of the microeconomic factors that determine investment behavior.
• A review of investment climate issues in Bank strategy documents — institution-wide PSD strategies, Country Assistance Strategies (CASs), and Poverty Reduction Strategy Papers (PRSPs).
• A description and analysis of the portfolio of IBRD/IDA lending operations that support improvements in the investment climate.
• A description and analysis of IBRD/IDA non-lending services including economic and sector work and survey-based diagnostic assessments.
• Results of discussions with Bank staff and international investors.
• Client consultations and country case studies for India, Indonesia, Mozambique, Peru, and Romania.

**Literature Review**

5. A literature review was prepared in order to provide a conceptual framework for the Investment Climate Study (available as a background paper on the OED website). Theoretical and empirical literature on the investment climate, produced both inside and outside the Bank, was reviewed. Specifically, the literature review focused on the following topics:

• The relationship between economic growth and poverty reduction.
• The relationship between the quality of the investment climate and investment flows, both domestic and foreign.
• Aspects of the investment climate that make the most difference to investors, both domestic and foreign.
• The importance of the investment climate as a determinant of investment, relative to other factors (e.g., macroeconomic and political risk, labor costs, global investment strategies).
• Policy and institutional reform strategies that have had the most success in improving the investment climate.

**International Investor Interviews**

6. Interviews with large multinational investors were held in Washington D.C., Tokyo, London, and Brussels between early November 2003 and mid-January 2004. The main criteria for the selection of participants were: headquarters-based executives with a good knowledge of the overseas investment strategies and procedures in their respective companies; a willingness to be open and candid; and the ability to participate fully in meetings conducted in English. Although detailed prior knowledge of the World Bank and its programs was not intended to be a requirement for participation, familiarity with the Bank and its goals proved to be fairly strong. For example, two of the corporate
respondents, one in Washington and one in Tokyo, were former World Bank Group staff members, and at least four others, one in Washington, two in Tokyo and one in Europe, had negotiated or done business with the Bank in areas such as finance, procurement, and partnering.

7. To establish a common threshold level of knowledge about the Bank’s investment climate programs and the design and aims of the OED evaluation, all participants received briefing materials about 10 days before the meetings. These materials included (1) a discussion of the scope and definition of the OED evaluation, together with an attempt to place the evaluation subject matter in the context of the broader range of activities undertaken by the Bank Group in the name of “private sector development”; (2) a summary statistical analysis of the Bank’s “investment climate” loan portfolio; (3) examples of the two new diagnostic instruments (the “Investment Climate Assessments” and the annual “Doing Business” survey) developed to carry out the Bank’s recently initiated Private Sector Development Strategy; and (4) several questions to help guide the discussions.

8. A summary description of the corporate and industry-association participants is provided in Table A.1. Aggregate revenues for the corporate participants are approximately $735 billion. Total employment is approximately 1.4 million. Nine of the 17 participating companies are included in the 2003 World Investment Report (produced by the United Nations Conference on Trade & Development) list of the 100 largest non-financial transnational corporations.
Table A.1: Participants in International Investor Interviews

<table>
<thead>
<tr>
<th>Sector and Co.</th>
<th>Home Country</th>
<th>Revenues (US$bil)</th>
<th>Employees (000s)</th>
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<tbody>
<tr>
<td>Computer and information technology</td>
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<tr>
<td>Leading computer co.</td>
<td>US</td>
<td>90</td>
<td>315</td>
</tr>
<tr>
<td>Leading computer co.</td>
<td>Japan</td>
<td>38</td>
<td>118</td>
</tr>
<tr>
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9. Participants were asked the following discussion questions:

- Which country-level factors do you consider when making international investment decisions?
- How important are “investment climate” considerations in your investment decisions?
- Which investment climate considerations (if any) do you include in screening for investment locations? How much weight do you give to them?
Are the investment climate activities that are the focus of World Bank Group lending and advisory services the most important ones, from the vantage point of your company’s location decisions?

Can you provide examples of how investment climate improvements have affected the costs and risks in the developing countries where you invest? Do the improvements affect your company’s bottom line?

Is the quality of existing firm-level and country investment climate data (from private or other multilateral institution sources) a deterrent to making good investment decisions in developing countries for your company? Do the new World Bank instruments, i.e., the Investment Climate Assessments and the annual “Doing Business” survey fill a gap?

Were you aware of World Bank Group activities in the area of investment climate reform? Would more information about these activities (e.g., activity details, participating countries) affect your investment location decisions?

Is the PSD investment climate strategy, with its emphasis on generating internationally comparable survey data, and a common assessment methodology for the Bank’s operating regions, the best use of Bank Group resources to “lower the transaction costs and risks of investing in and operating a company”? (alternatives might include a stronger emphasis on implementing the Bank Group’s policy advice, measures to improve (increase) direct lending to and risk taking on behalf of the private sector, etc.).

Has the presence of IFC as a direct investor taking private sector risk in specific companies and sectors served as a demonstration effect or influenced your company’s perception of investing in a particular country?

Are you familiar with MIGA’s instruments that target improving the investment climate?

Have you ever used, or considered using, MIGA products or services (e.g., political risk insurance or information services for potential foreign investors such as IPAnet and FDI Xchange)? If so, have you found these products or services effective and useful?

How would you rate these MIGA products and services compared with similar products from other providers (e.g., political risk insurance from national or private investment insurers, information services from commercial providers, or other international organizations)?

When considering or undertaking an investment in a developing country, have you used the services of investment promotion agencies? If so, have you found these agencies’ assistance to be effective and useful?

Other topics?

**Bank Group Staff Discussion Groups**

10. OED, OEG, and OEU held joint discussion groups with Bank staff to get their feedback on World Bank Group investment climate activities. Invited staff were task managers of private sector development (PSD) projects, PSD specialists, country economists, and IFC investment officers. Two discussion groups were held: one on February 3, 2004, for the AFR, EAP, and LAC regions; and one on February 10, 2004,
for the ECA, MNA, and SAS regions. The results of the discussions are summarized in a background paper available on the OED website.

11. Participants were provided with background materials in advance of the meeting, which included (a) the objective and components of the evaluation, (b) the working definition of the investment climate, (c) a description of the investment climate portfolio, (d) project descriptions from OED evaluation summaries, and (e) findings from OED country assistance evaluations.

12. The discussion questions were:

**Relevance:**
- Have investment climate (IC) issues been given enough priority — relative to macroeconomic, rural, social, and human development issues — in the countries you are familiar with?
- Have the IC issues chosen for emphasis in Bank country strategies reflected the most important constraints to investment and enterprise performance?

**Instruments:**
- Have the instruments of Bank assistance (adjustment loans, technical assistance, diagnostic studies, etc.) been appropriate to country needs?
- Should IC constraints be tackled in stand-alone projects, as opposed to being components of larger structural adjustment loans?

**Diagnostics:**
- Did the Bank’s diagnostic work (Private Sector Assessments, Investment Climate Assessments, and other economic and sector work) provide a sound basis for policy dialogue and operations?
- How might these instruments be improved?

**Outcomes:**
- What factors seem to have led to good outcomes, or poor outcomes, in Bank IC projects?
- Can we expect good IC outcomes in countries with poor macroeconomic conditions?

**Organizational structure:**
- Are the mandates of the various Bank Group units dealing with the investment climate clearly defined in theory and in practice?
- Are there overlaps or gaps in responsibility?
- Do the Bank, IFC, and MIGA operate in areas of their comparative advantage, and are synergies being utilized?
- Has Bank-IFC coordination on PSD strategies in CASs worked well?
- Have there been areas of conflicting objectives between the Bank and IFC in policy or regulatory issues?

**Human resources:**
• What kinds of expertise are needed in the Bank to design and implement high-quality assistance on IC issues?
• Are these resources available?

Country Case Study Protocol

Activities Included

13. The set of World Bank activities to be included in the evaluation, covering the period fiscal 1993 through fiscal 2002, was taken from the previously constructed databases of lending operations and non-lending services. The set of activities included individual lending operations (closed as well as ongoing projects), surveys/assessments, ESW, advisory services, training and knowledge dissemination, and partnerships.

Unit of Analysis

14. The unit of analysis was the country. However, it proved useful to focus on particular organizations (e.g., a foreign investment promotion institution) or policy (e.g., commercial transactions law) as an embedded unit of analysis. This was appropriate when the institution or policy received sustained attention from the Bank over a period of time.

External Sources of Information

15. Prior to the mission, the following information was collected:

• Strategic documents: the CASs covering the period, as well as any relevant policy notes (e.g., dealing with private sector development).

• Project documentation: For each lending operation, the Memorandum of the President and the Appraisal Report.

• Existing evaluation material: Quality Assurance Group reviews and Project Supervision Reports (PSRs); for completed projects, the Implementation Completion Report (ICR) and Evaluation Summary (ES) and, where applicable, the Project Performance Assessment Report (PPAR); Country Assistance Evaluations (CAEs).

• ESW and surveys/assessments: surveys/assessments produced during the period (Private Sector Assessments, Firm Analysis and Competitiveness Surveys, World Business Environment Survey, Investment Climate Surveys, Investment Climate Assessments); relevant economic and sector work (e.g., reports on private sector development, or PSD chapters in Country Economic Memoranda).

• Investment climate indicators: Existing data on the constraints to private sector development, the cost of doing business, and country risk indicators.
- **Economic outcome indicators**: annual data on domestic and foreign investment, the share of private sector activity in GDP, private sector employment, productivity growth (if available), exports, GDP growth, and poverty indicators, from 1990 through the most recent year available.

**Persons Interviewed**

16. In headquarters, relevant staff and managers were interviewed to gain their perspectives on the objectives and targets of activities, how activities were implemented, and the results of the interventions.

17. In the field, persons interviewed included relevant government officials (policymakers and management in institutions receiving assistance) as well as representatives of the private sector to gain their perspectives on constraints to private sector development during the past 10 years, the relevance of policy and institutional reforms undertaken by the government, the effects of those reforms, and the remaining reform agenda.

**Evaluation Questions and Methodology**

18. The questions addressed in the case study, and sources of information used to form conclusions, are shown in the table below. Note that “outcome” refers to the efficacy of Bank strategy and activities, and includes Institutional Development Impact. Bank Group performance covered the effectiveness of the institution’s organization, knowledge sharing, etc. in contributing to intended outcomes.
### Evaluation Questions and Methods

<table>
<thead>
<tr>
<th>Questions</th>
<th>Sources of Information</th>
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<td><strong>Relevance</strong></td>
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</table>
| Did the investment climate themes chosen for emphasis in Bank strategy reflect the most important constraints to investment, employment, and growth of the private sector? | • Literature review  
• CASs, Sector Strategies  
• IC indicators  
• Surveys/assessments, ESW  
• Project documentation  
• Evaluation material  
• Headquarters and field interviews |
| Did Bank diagnostic work lead to the choice of relevant objectives for lending operations? | |
| Were the instruments chosen appropriate to country needs at the time? | |
| **Outcome (including Institutional Development Impact)** | |
| Were changes in the quality of the investment climate associated with changes in economic outcomes (foreign and domestic investment, productivity growth, sectoral and GDP growth)? | • Literature review  
• CASs, Sector Strategies  
• IC indicators  
• Surveys/assessments, ESW  
• Project documentation  
• Evaluation material  
• Headquarters and field interviews |
| Were the policy and institutional reforms adopted associated with changes in transactions costs and risks? Were private sector perceptions of risk improved? | |
| Were the adopted reforms actually implemented and sustained? Were necessary complementary actions taken? | |
| Did the Bank have an influence on the government’s decisions to adopt policy and institutional reforms? | |
| Were there other plausible explanations for outcomes, apart from Bank activities? | |
### Sustainability

What was the degree of government commitment to reform, and did the Bank correctly assess this commitment?

Was there sufficient government ownership of reforms?

Were the concerns of civil society (particularly the private sector) recognized and taken into account?

Have the policy and institutional reforms been sustained? Do the relevant institutions have enough capacity to continue their work?

Were temporary subsidies reduced or eliminated?
Were implicit budget subsidies (e.g., to newly privatized firms) reduced or eliminated?

- Headquarters and field interviews

### Bank Group Performance

Was relevant information about constraints to private sector development shared among the various WBG units involved in improving the investment climate?

Were activities undertaken by various units well coordinated?

Did the various units undertake activities that were in their comparative advantage?

- Headquarters and field interviews

### Borrower Performance

Did the Government own the process of reform and take a leadership role in the preparation, implementation, and evaluation of the project?

Were counterpart funds provided as required?

Did the Government sustain the necessary policy and institutional framework required to sustain the impact of the project?

- Headquarters and field interviews
Annex 2: Investment Climate Theme Definitions

Core IC Themes

32 Judicial and other Dispute Resolution Mechanisms

Includes activities aimed at:
- Improving the efficiency of the courts, simplifying court procedures, improving capacity of court personnel, and modernizing case management and court administration.
- Supporting the rehabilitation of courts and the provision of information technology.
- Strengthening institutions responsible for budget, planning, human resources, and court facilities; and those involved in rendering, publishing, and enforcing judgments.
- Improving the independence and accountability of the judiciary.
- Improving compensation, appointment, promotion, discipline, and removal procedures.
- Strengthening judicial and court personnel training programs/institutes.
- Publication of court decisions and statistics.
- Support for watchdog civil society organizations (CSO).
- Building legal framework for complimentary resolution of disputes.
- Supporting alternative dispute resolution (ADR).
- Supporting arbitration, mediation, conciliation, mini-trials, small claims courts, and other dispute resolution mechanisms.
- Supporting indigenous customary and traditional methods of dispute resolution.

34 Legal Institutions for a Market Economy

Includes activities aimed at:
- Identifying vulnerabilities in existing frameworks having a negative impact on economic growth.
- Assessment of prevailing legal and regulatory frameworks.
- Establishing and strengthening of the legal and regulatory frameworks and legislative process related to economic and commercial activities so as to promote private sector development and economic growth in a fair and competitive economy.
- Assistance with formulation of appropriate policies.
- Assistance with study, formulation and revision of laws related to such matters as banking, insolvency, contracts, property, commercial transactions, competition, trade and the private provision of public infrastructure services, including telecommunications, water supply, electrical power, and transportation.
- Assistance with the application and implementation of relevant legislation.
- Improving capacity of institutions responsible for the regulation of private sector activities, including commercial banks, secured transactions, capital markets, and the private provision of infrastructure services.
• Assistance with regulatory frameworks for the above and related matters.
• Research and dissemination of results thereof regarding policy directions.
• Training of staff, externally and internally.

Includes activities aimed at:
• Clarifying and strengthening personal and property rights, including gender based, children’s, indigenous peoples’ and other human rights, social protection, labor, health, civil rights, and criminal law.
• Supporting with land titling, family and succession laws, other property laws.
• Creating and maintaining land, personal property security and intellectual property registers.
• Supporting institutions responsible for clarifying and strengthening such rights.
• Landlord-tenant courts and alternative disorder resolution (ADR).

Excludes business related laws which would be coded under Legal Institutions for a Market Economy

38 Corporate Governance

Includes activities that focus on:
• Rights of shareholders.
• Equitable treatment of shareholders.
• Treatment of stakeholders.
• Disclosure and transparency.
• Duties of the board.
• Assessment of corporate governance institutional frameworks and practices through the preparation of country assessments.

Excludes activities related to corporate social responsibility issues.

40 Regulation and Competition Policy

Activities that promote deregulation and enhancement of competition and improve the legal and regulatory framework for financial and private sector development

Includes activities aimed at:
• Elimination or weakening of state monopolies in various sectors.
• Simplification of business licensing and registration requirements.
• Removal or reduction of barriers to foreign direct investment.
• Enactment or refinement of competition policy, including its legal basis.
• Development of regulatory framework, including legislation and regulatory capabilities, for private provision of infrastructure.
• Strengthening the supervision and regulation of financial institutions and markets.
• Regulating the provision of electronic financial services (e-finance).
• Regulation of microfinance institutions.
Non-Core IC Themes

28 Tax Policy and Administration

Includes activities aimed at improving the effectiveness, efficiency, and fairness of public revenue systems, including tax policies and tax and customs administration at national and subnational levels of government. This category includes activities related both to the economic analysis of tax policies and to the design and functioning of institutions related to tax and customs administration (as well as the links between policies and institutions, and between tax and customs).

Excludes activities related to the economic analysis of individual tariff policies (which falls under Trade and Integration) or activities that involve minor changes in tax rates or coverage, or changes in revenue administration that are not intended to affect or address systemic issues of revenue policy or administration.

39 Infrastructure Services for Private Sector Development

Includes activities aimed at:
- Development of infrastructural services such as transport, information technology and communications, energy and water, where the objective is to improve the conditions in which private businesses operate, e.g., a rural electrification program that aims to facilitate the growth of rural enterprises.
- Improving logistics and distribution systems.
- Supply chain infrastructure.
- Customs facilities and procedures.

Excludes infrastructure projects that have objectives other than private sector development, such as a rural electrification program whose main goal is to improve living conditions for the rural population, not facilitate growth of rural enterprises.

44 Other Financial and Private Sector Development

Includes activities that:
- Help establish or strengthen institutions that provide support to the private sector (e.g., establishment or strengthening of investment promotion agencies, export promotion agencies or technology development institutions, capacity building of private sector collective bodies and development of public-private consultative mechanisms).
- Support development of nongovernmental service delivery mechanisms, such as output-based aid schemes involving private provision.
- Small-scale contracting to private providers and nongovernmental organizations (e.g., under social funds, may be included if the development of private sector or nongovernmental organization provision is an explicit objective. If there is a strong SME development objective, it may be classified under Small and Medium Enterprise Support.
- Support restructuring of private enterprises, such as corporate restructuring.
- Address multiple sub-themes in promoting financial sector development (e.g., for work in diversifying financial systems, developing domestic debt markets, advising governments with small financial systems, designing new financial instruments for managing risk, and systemic restructuring policy advice).

**45 Export Development and Competitiveness**

*Activities that focus on the determinants of export growth and external competitiveness in developing economies.*

Includes activities aimed at:
- Trade liberalization (e.g., benefits of unilateral tariff reform, pattern of Effective Rates of Protection and impact on foreign direct investment).
- Promoting nontraditional exports.
- Countering anti-export bias.
- Export promotion and marketing activities.
- Market liberalization and access in services.
- Diagnostic country trade studies.
- Aspects of “new” trade agenda at the national level, such as competition policy, product standards, and the linkage between exports and labor or environmental issues.
- Implementation challenges (e.g., timetable for phasing in tariff reductions, handling of sensitive industries, dealing with fiscal impact of tariff reduction).
- Business facilitation.

*Excludes* regional trade agreements/integration, global liberalization.

**49 Trade Facilitation**

*Activities that focus on increasing the volume of international trade by reducing the costs and increasing the efficiency of transporting traded goods to consumers.*

Includes activities with the following as either primary or secondary objectives:
- Modernizing and/or reforming customs operations and administration.
- Streamlining and modernizing border-crossing procedures and documentation requirements.
- Regional (cross-border) programs that strengthen mechanisms of interaction and cooperation among border agencies (and between border agencies and the trading community) in order to increase the efficiency of border operations.
- Reducing corruption and smuggling and enhancing security at border crossings.
- Enhanced transport and supply chain security.
- Improving trade and transit logistics (i.e., port, maritime, air, and multi-modal transportation).
- Expanding access to transportation modes (air, land, and sea) for firms and other business entities whose primary goal is to engage in external trade.
- Expanding access in landlocked countries to ports and other border posts.
• Increasing the quality and efficiency of transportation infrastructure — roads, railroads, ports, and airports — with a direct impact on lowering the costs of transporting goods to/from borders.
• Support for information technology infrastructure to enhance e-commerce usage within the trading community.
• Regulatory and administrative reform and harmonization to expand trade.