THE BROOKINGS INSTITUTION

GLOBAL ECONOMICS

GLOBAL ECONOMY AND DEVELOPMENT BRIEFING

CAN INNOVATIVE FINANCING HELP CLOSE THE GAP ON THE MILLENNIUM DEVELOPMENT GOALS?

Monday, September 26, 2005

Falk Auditorium
1775 Massachusetts Ave., N.W.
Washington, D.C.

[TRANSCRIPT PREPARED FROM A TAPE RECORDING.]

MILLER REPORTING CO., INC.
735 8th STREET, S.E.
WASHINGTON, D.C. 20003-2802
(202) 546-6666

P R O C E E D I N G S

MS. BRAINARD: All right, good morning. I think we'll get started. I think we have a rolling cast. We'll be joined later by one more speaker.

Welcome this morning to an event which is looking at innovative ways to engage the private sector more in financing of global poverty and development.

We have a good group of agencies who are collaborating in this endeavor. And we have representatives of each of them, who I will introduce in turn.

Why don't I start. I think we'll say a few minutes at the top, and then we'll open it up for discussion with the audience. Why don't I start with Mr. Pierre Jacquet, who is the Executive Director for Strategy and the Chief Economist for the Agence for Francaise de Developpement of the French Development Agency, who I think is well known in this town having worked at the French think tank ministry (ph) and has been back and forth to the U.S. a great deal in that capacity. And his agency is very interested in the theory and has done quite a bit of work most recently.

MR. JACQUET: Thank you very much, Lael. Thank you and the Brookings Institution for hosting this panel.

Our purpose here is to invite us to think about a new paradigm of government aid as compared to the dominant product. And historically, of course, aid is always balanced between two kinds of mothers, one being poverty reduction and redistribution of income and the other one being promoting growth.

But the general paradigm behind that is the following. There is a wide spread in extreme poverty in a number of developing countries. In many of them, there is insufficient growth. And this points to inadequate public policies, inadequate pro-growth policies and poor governance. And in response the public aid program and the public aid authorities focus on government-to-government relations.

I think actions based on this paradigm are both necessary and useful. But my purpose here is to argue that the paradigm provides only part of the story and that much progress can be made in the world on the effectiveness of development assistance by moving to a more ambitious and more modern paradigm.

Note that there is a crucial limitation of ODA (ph). Even after a very substantial increase in aid, it's volume will always [inaudible] more as compared to international private capital flows and domestic savings. And in addition, we should think of the total volume of resources available to finance investment in developing countries.

As [inaudible] and [inaudible], this total volume is a combination of ODA, worker remittances, private flows, direct investment, foreign investment and so on.

The total volume of finance available is really under-generous and depends on the OPA (ph) communities for investment. So the general way to think about aid, which is to say, what are the needs of the developing countries and how do we supply these needs with adequate resources, is a little bit misplaced because what really matters is how do we help poor countries generate profitable investment opportunities.

And if we don't answer that question, we must still be very effective to some extent in reducing poverty and in developing social spending that we will miss one very crucial point, which is how to have growth in poor countries.

So in the new paradigm that we would have in mind, there is indeed widespread poverty, insufficient growth. But the diagnosis points to a failure of coordination between a number of stakeholders—the public sector, indeed, both domestic and foreign, but also municipalities, local governments, private firms from the informal as well as formal sectors, foreign firms, local populations.

Development is really this extraordinary mechanism for which all these stakeholders join forces to produce growth and poverty reduction. In particular, the current focus on poverty reduction with a strong emphasis on social spending has underestimated the role that the private sector, both domestic and foreign, is bound to play if we wish to advance towards the median development goals.

So this approach invites us to think of ODA as a potential catalyst, one that is a provider of ultimate resources. It is congenial to additional (ph) development in which ODA doesn't produce development and growth, but helps parts of the process to start at.

What are the operational consequences of this new paradigm? It invites us to consider development aid as a combination of two crucial complements. The first one is a specific expertise on several [inaudible] in development agencies in helping to conceive complex programs and projects that [inaudible] multiple stakeholders in productive activities that are geared toward reaching both domestic and international public good objectives, which in the poor, give access to [inaudible] services, access to health and education, advancing energy efficiency, fighting climate change, protecting bio-diversity. All of these are public policy objectives that could be reached in public-private partnerships.

The second component of what we call modern (ph) ODA, is a proficiency of donors in using a wide range of financial instruments from direct subsidies to market loans, warranties, [inaudible] firms and venture capital.

Each of these financial instruments is fit to serve specific beneficiaries and objectives. The key there and the originality lacks in mixing taxpayers' money with a number of other market-based financial instruments in a flexible and innovative manner.

That is, of course, a major departure from the conventional way to conceive ODA instruments as either direct concessional loans that in [inaudible] went above a given level.

The interest of such public-private partnerships is not only in [inaudible] structures and in the provision of basic services. They also hold many promises in the areas of health, education, empowerment of [inaudible] and many other users.

Now this is a theory (ph). Let me end with providing you with a couple of examples of what it means operationally.

The first example shows how there can be development finance with out subsidization. This is an example from Kenya, in which AFD has helped the largest Kenyan micro-financing institution, Kenfo (ph), to raise money on the Kenyan stock market by floating five year bonds for about 5.5 million euros.

The key here that our warranty allowed Kenfo to raise that money cheaper than it could have raised money from the local banks. But there is another advantage to that, which is to start building the kind of partnership between the micro-finance institution in Kenya and institutional investors that are key to the sustainability and effectiveness of the micro-finance initiative.

No subsidy there, market instruments. But you could argue that an agency like ours is a better place than the market-provided warranty because it answers (ph) particular information on the micro-financing institution, which we have [inaudible] a few years away.

A second example that could be given still, which in itself is [inaudible], shows how it is possible to integrate low income households in a social housing program through the local banking system. And the program consists in providing loans for ownership accession to poor households but above a certain level of income. And the whole idea there is to have the lower income households also access the program. And therefore, what we do basically is to provide a concessional loan, but the concessional aspect of the loan is geared to allowing low income countries access to this ownership accession program.

So again, what is interesting there that we were able to disintegrate, if you wish, what is called a concessional loan, which is a mix of a market loan and a subsidy, and really use the subsidy to reach the poorest.

It is a good base of aid, which allows the poorest income household to access credit that would be available only to higher income households. And what we do allows the banks to take that kind of risk. And without that, they wouldn't have taken the risk.

So I will stop there. But there are a number of examples that through innovative financing mechanisms, you are able to build public-private partnerships in which we engage the private sector into reaching social objectives. And I don't see how we can meet the millennium development goals if there are not many more of these experiments in developing countries.

Thank you very much.

MS. BRAINARD: Well, terrific.

Well, the second partner organization is the KFW Group from Germany. And Mr. Bruno Wenn, who is the Senior Vice President for Policy for Developing Countries, has also been focusing a great deal on this issue of catalyzing private sector involvement in the development process.

MR. WENN: Yes, thank you very much, Mrs. [Inaudible].

Ladies and gentlemen, I would like to share with you five points.

The first is I think there's broad consensus that there's a need for additional development funding if the MDGs are to be achieved by 2015. And I think also that the MDG discussion has improved the prospects for higher ODA.

However, an environment of budgetary constraints in most of the OCD countries, it is quite clear that out of budgetary sources we cannot meet the commitments being made.

So we need to find new sources and new instruments for development finance. But there is a widespread debate in what kind of instruments can be used. But the truth not be forgotten that we have already innovative financial instruments in place, which can be used more.

Lending mechanisms, which means the blending of budgetary funds with capital market funds provides innovative ways to leverage account aid flows to meet MDGs.

We in KFW, for example, we use very much the blending instruments. And for example, last year, we mobilized in addition to what we have received from other budgetary sources one-third in addition. And this is a very huge amount of 600 million euros. And the leverage is quite high with a grant of 20 to 30 million; we can structure a concession loan of more than 100 million euros.

The second point I would like to make is that the debate is focused very much on the external transfer of funds to developing countries, I think, which is sometimes forgotten that we also have to discuss how we can increase a local resource mobilization for development, broadening the text base, improving the text administration and then using cost covering charges, especially in the energy sector and water sector, in my opinion, an important part of local resource mobilization.

And it strengthens the local financial sectors, likewise of crucial importance, providing access to credit. And to reducing the cost of financial intermediation, it is vital for the economy as a whole and for especially the private sector.

Guarantees have been mentioned by Pierre. Development banks assist local banks to issue long term local bonds. Increase local financing by bilateral and multilateral development banks will help to develop the local financial markets.

We at KFW, we support very much the financial systems, for example, through innovative schemes such as credit guarantees funds, deposit insurance schemes, [inaudible] and especially micro-finance.

The third point I would like to make is that increasing the volume of development finance will not be enough. We have also to change the way in which we deliver our services. Harmonization and alignment are very crucial.

We—J BICK AFD and KFW Development Bank, for example, we are working very closely together with our colleagues from [inaudible] Bank and Asian Development Bank in Vietnam on the harmonization of disbursement reporting and procurement rules and also strengthen the local procedures in Vietnam.

In our partnership with AFD, for example, AFD administers projects on behalf of KFW. And we would do the same for AFD. And jointly, we are also administering projects of the European Commission. And by doing this, we are reducing substantially our internal costs but also the transaction costs for our partners.

The fourth point that I would like to make is that role of the private sector is crucial for achieving the MDGs (ph) in terms of employment and income generation. But what is actually needed, how we can more fully exploit the potential of the private sector given the perceived high risk. Creating the enabling environment for private sector development is of utmost importance. And reducing the cost of doing business, I hope that later on that Michael Klein will also say some few words on this.

Strengthening the local financial sector and providing instruments to mitigate the risk are needed to mobilize the private sector.

As bilateral development banks, along with other donors, help our partner countries to address these issues. And in this context, public-private partnerships are suitable because in doing this we can share risk. We can take over, risks, which are perceived to be high by the private investors.

And for example, we in KFW, we finance a lot of public-private partnerships in which we mobilize the international private sector, know how the management of infrastructure facilities. For example in the water sector, because the private sector here actually knows how to run public facilities efficiently.

And also output based aid is a very interesting instrument and a promising approach to mobilize the private sector and the provision of public services the poor.

For example, in Kenya, we support a project that provides poor women access to private and public health care, services for a water system. And some water systems allows the poor to pay for the services and to chose a provider that offers the best service to them.

And for the water system, private service providers have an incentive to extend the services to the poor.

And the last point I would like to make is why we work on flexible innovative and harmonized financial products. In our opinion, some broader attention to the reform of ODA is needed.

Pierre Jacquet has already mentioned that the system so far is very static and doesn't take into account innovative development financing. And we are of the opinion that few reformers of the ODA, we would set the right incentives to do more innovative development financing.

For example, guarantees as has been mentioned, to strengthen the local financial sector. For the time being, they are not counted as ODA, although they're important instruments to strengthen the local financial markets and to facilitate private sector investment.

So the message is, we can do more if the right incentives are in place. Please let's work on this.

Thanks.

MS. BRAINARD: Terrific.

The third partner in this initiative is the Japanese Bank for International Cooperation. And this morning we have Mr. Hiroto Arakawa, who is Director General of the Development Assistance Strategy Department to talk a little bit about the thinking there on the subject.

MR. ARAKAWA: Thank you.

I'd like to touch mainly on the infrastructure and how to finance that. Because now the MDG is very much popular among the people engaged in development. But in my sense, to some extent, infrastructure [inaudible] not properly touch on that to the extent that attention could be achieved.

But recently, the Jeff Sax (ph) report, or the Commission for Africa report, clearly points out that. The infrastructure provision, balanced infrastructure provision is quite crucial for tackling poverty.

And we have a lot of lessons and infrastructure projects, which could be totally contribute to the enhancement of the poverty situation.

And then along this conjunction, it is quite necessary to modernize massive volume of the funds to finance not only MDG, but also infrastructure as well. And therefore, the reason why this session on innovative financing theme is now being discussed here.

And in order to keep that balance in terms of this innovative financing argument, I'd like to touch on that to some extent on the other side of the argument. What is my sense—big pull rather than big push.

I mean, the financing is rather pushing supply side. On the other hand, the demand side should be properly addressed. And innovative financing are very much necessary of course, but well designed development programs or projects are very prerequisite for poverty reduction. The [inaudible] between financing issue like alternative financing or monetary phenomena and program or project issue. This is a real phenomenon. It will not hold (ph).

For instance, the major source for development deriving from domestic funds. And for instance, about 70 percent are a major part of the funds for infrastructure development are to be from domestic funds. And in this conjunction, therefore, broadening tax base or strengthening tax collection, very much crucial for ensuring the fiscal space.

And also, the mobilizing more domestic savings through credible financial systems like financial markets or financial rules and regulations also very indispensable.

And regarding the financing modalities, I'd like to touch on two things. One is sub-sovereign lending. And usually the government to government—essential government to essential government lending—is prevailing now. But we'd like to think of that sub-sovereign lending. As you know, most of the developing countries, particularly Asian countries, they are now experiencing so-called disenfranchisement.

And in this conjunction, in order to really materialize the sub-sovereign lending, actually there are a lot of things to be sorted out.

For instance, it is very much crucial that comprehensive decentralization—sorry, decentralization with authority and the framework to deal with that issue should be properly provided to the local government. And also, the fiscal management, including tax collection authority, should be in the hand (ph) of the local governments. And otherwise, the local government cannot be solvent.

And the other thing that is related to the financing for infrastructure is that the mixture or combination of public finance and private sector financing, which was [inaudible]. And in the case of former [inaudible] in Vietnam (ph), Japanese ODA lended, [inaudible] lending, assisted first power generation plant for the administration effects (ph).

And this first project covers not only power generation but also power transmission lines and also substations, which are very much commonly used by second generation facilities. And also, these transmission lines are some sort of public good with other independent power generation projects. Therefore, there should be some very good balance or combination between public sector financing and subsequent (ph) private sector so-called BLT or PPP type (ph) project financing.

The other example of the public sector financing and the other modalities, we have many water supply projects in the Philippines. And we finance a major part of their project costs in the local government projects.

But local government sometimes lacking in local funds. Therefore, they get the funds from the market. And they are not so much credible in the market, financial market. And the local market not truly developed yet.

Therefore, it is necessary to augment the credibility of the local government. In this conjunction, USAID is going to guarantee that issuing the bond by local government. So this is a kind of combination of the traditional way of financing and the guarantee scheme and the floating in the market but guaranteed by USAID.

So these are some examples that we can combine—traditional and new schemes. So this could be one of the things for thinking about the resource modernization in the future.

MS. BRAINARD: Terrific, thank you.

Well, now I'd like to go to the other side of the equation. We are honored to have with us this morning Finance Minister Ngozi from Nigeria, who has sat on both sides of the table for many, many years, a vice president at the World Bank and most recently in her capacity as Finance Minister of Nigeria. And we would be very interested to hear your reaction about whether the potential here is being realized. What are the missing instruments? What are the kinds of things that a country like Nigeria would benefit most from?

MS. OKONJO: Well, thank you very much. I listened very carefully to the proposals, what the colleagues are saying from the development agencies. And I don't have any quarrel or problems with that, because I think we sometimes tend to posit the debate as an either/or, you know, either public sector or the financing or private sector. But it's both.

I think that the fact of the matter is that, you know, tremendous resources are needed now, particularly on the African continent. We need at least a doubling of aid. That has been under discussion to 2015, if not more, in order to enable development to take place.

So we have to look at all mechanisms. But I think we have to look at them on two levels, the macro level where we talk of new instruments for capitalizing international flows, perhaps additional or at least front loading to what has been proposed now. Mechanisms like the International Finance Facility of the new tax on tickets that has been proposed by some countries.

On the macro level, I think the debate is going on. These things are being tried. And I think it's necessary to think what is the next generation of mechanisms for raising financing because ODA—I'm sure that after this great debate on the MDGs on financing, fatigue may have begun to have set in. And we have to be one step ahead to think of new ideas.

And that is why I'm particularly supportive of these other mechanisms that can raise resources from the markets, from the public. The tsunami response was an incredible one, but I think it just shows what around the world, what compassion, the willingness of people, you know, to plan to spend an extra $3 or $4, you know, just to make sure that people on the other side of the globe are doing better.

So there's appetite out there, even among the [inaudible] republic and developed countries to do something. So I think we ought to be thinking of those mechanisms.

But within—let me make two or three points now from the developing country viewpoint. The first is that for us or for me, ODA can only be a catalyst. Let me start out by saying Nigeria is not really a good example for an ODA country. We've never received much ODA. We have the lowest ODA per capita, the least developed countries at $2 per capita compared to $28 per capita on average for Sub-Saharan Africa.

So hardly any country gives us ODA, you know, because we have the image of a country that has oil, that has been corrupt, has had corruption problems in the past. So for the combination of that, we've never received much ODA.

Now that we had two decades of misrule, you know, the military. We now have a democracy, a new government that has been reforming very steadily for the past two years. And the dividends are coming in, you know, for Nigeria. But I want to correct the impression about being a rich country. We are not. Because even if oil prices double, we'll only be—right now we're 3.20 dollars per capita. Even if oil prices double, we'd still be $600 per capita, one of the poorest countries. But for this combination of factors, we haven't received much.

I mean in a way, it's okay. Because I personally believe that, you know, ODA is so small that it doesn't matter too much. But it can be very catalytic. In many countries in Africa, ODA takes on a preponderance of importance. Sixty percent of several countries' budgets is made of up aid. And it creates a huge dependency.

So we also have to think in that circumstance, what does ODA do? And I think it should be viewed very much in the catalytic fashion, which has been talked about by Pierre. I think ODA should be seen as a way to prepare the way for the private sector.

What are those market failures? Where, you know, the private sector will not be interested or be able to correct. And how can ODA help build infrastructure and even the private sector can come in as was said before. ODA can help set in place the environment. And when we talk about environment, it's not just policies. Because many African countries now are pursing very good policies. Several countries have been growing. Sixteen countries at least at over 5 percent since 1999.

So we are turning a corner, but you need this other environment that ODA can help create the infrastructure, the power generation, the availability of water supply, good ports, and customs procedures. So a mix of policies and hard nosed infrastructure are still needed. And that would become important.

It would also be important for the other side, which is very, very critical—education and health—you know, to help catalyze changes there.

But we have to look at domestic resource mobilization also. I strongly believe in that. So that point, you know, is critical. And in there, the reform of tax systems, raising of domestic savings, all of that was said before, but is important and should be done. And I want to let people know that many countries are now doing it. The Africa action plan of the World Bank that just came out has 12 countries that, you know, are the top performers and are doing very well. And some of these things with regard to raising domestic resources have been some of the highlights of their reform.

In my own country, we're focusing very much on that, believing that we have to rely as much as possible on our own domestic resources plus the oil income that we get. But we are not looking at oil [inaudible] because again there's a wasting asset. We are looking at non-oil diversification of the economy and broadening the tax base so as to catalyze an increase savings as a percent of GDP and so on.

So that is very important. I just have one caveat there. We have to recognize that there's a dilemma. I said before that there are several countries where aid makes up 60 percent of their budgets.

Now those countries you have to look. The sources of domestic resource mobilization can be limited in some case because they just don't have the sources of growth, you know. They just don't have what it—how do you mobilize resources when there's very little to mobilize. And there's some countries that will be in that category for some time.

So I've always had this thesis that in looking at the African countries perhaps with more detailed examination. What are those countries? Where there's going to be quite a bit of dependency or need because there aren't any other sources. And how will that be managed going forward? Where are those countries where there's potential to look at sustainable domestic financing? And what do they need to do to raise that? And where are those countries where there's even more potential than the neighbor to really take off.

So I think we have to look at that and we have to have more refined instruments for mobilizing in financing and for treating those countries.

So that's one essential point I'd like to make. The second one, and then I hope I'm not taking too much time, is that in doing this, we have to look at what that financing is getting us. So we need all tools, private sector and public sector.

I have listened to what is being said on guarantees at the micro level—we talked of macros—on the micro level in countries. You can use many mechanisms like guarantees and so on to catalyze financing.

But one right now, these examples that are being given are just examples. You know, there are projects. There are pilots. They've not really got all of the momentum because I still find that even on these mechanisms, USAID had given similar guarantees as France just talked about to a couple of institutions in my country to a hassle to take private micro-financing. But they're examples. The volumes are minimal. And you are still given, you know—they are not enough to make a difference. That's what I'm trying to say. That's what.

So we need to explore how do we multiple this. The second thing is that the institutions that are receiving the guarantees and the additional finances that has been raised are still very risk adverse. So they're still operating and lending the credit. They're still operating with rules of the game. They are very risk-adverse do that the money, the micro finance and so on, is still not getting down really, to those who need it.

Okay, so the top is being creamed off. They are the ones who are receiving this money. So you've got to think even if you bring in your mechanisms. How does this relief make a difference?

And I say this because yesterday at the Development Committee at the World Bank, the chief economist of the bank made a presentation for [inaudible] showing that the 12 countries that are top performers in growth will have had no appreciable change in their human development indicators.

So when it comes to maternal mortality, infant mortality, and all of the MDG indicators we're looking at, they look just as bad as the middle tier, which I think my country is one, whose performance is not among the top category and even the lower tier.

And this is what troubled me, really, in this presentation. If you've got the fastest growing, growing above 5 percent, good performance, they've done all of the policies that everybody is looking at. Mozambique, Ghana, Rwanda, Uganda, countries like that, for years, and they've been growing. But you cannot see any change where human development indicators are.

But what does it mean? That we really have to dig below because even if you're catalyzing this financing and flows (ph) are going in, these are not changing materially anything in the lives of the people.

So this is where we now have to look at what we said, delivery mechanisms and impact on the ground.

This additional financing that has been catalyzed, either locally or internationally, is it making a difference? The policies that are being done, are they making a difference? Is the type of growth appropriate? Are jobs really being created within the country, because the only things that can make a difference with this financing, innovative or traditional, is whether it's making a difference. And I think the international community needs to step back and look at these 12 examples.

My thesis is that the type of growth happening is not really leading to creation of jobs that can materially change the lives of the people. And those things can only happen when the private sector comes in massively to invest.

So I think that, you know, even with all of the innovative financing, we have to get back to the bottom line and see what are the delivery channels for the money that will be raised? What difference is it making on the ground? Is it really changing anything? And then, to look at that and say, who do we need to work with in order to make this aid have an impact?

Yesterday, I was saying in a session that, look, even with all of the reforms, if you look at those countries reforming, the volume of private sector investment in those countries, inflows of foreign direct investment or otherwise, has not really—has it really changed much? Are companies coming in to invest?

And I cited the example of Japan. Just give me a minute. If the [inaudible] countries that did so well, everybody conveniently forgets. They just tell you, do the right policies. You know, we'll help you create the environment and the private sector will come in to create jobs.

It didn't quite happen that way. The dirty little secret is that Japan had a deliberate policy to ask its private sector to invest in those countries because they believed in a good neighborhood policy.

So there were [inaudible] and it worked. But right now who is asking or channeling the private sector? No, we are told in Africa, just do the right policies and all will be well.

Well, we've got 12 countries doing the right policies and all is not well. So we have to ask ourselves whether the path we are going on are more deeper than innovative financing than catalyzing more flows. What is actually happening and how do we really make an impact?

So these are some of the things that I think we should think about. And you know, we have to think about working with local communities. The [inaudible] mechanism, yes that is good. We have to study whether that is producing results. And we have to look carefully at the soft sovereign lending that is becoming popular because we have to look at capacities too—service, those credits like you were saying and whether that is really appropriate.

So I posed a lot of questions and challenges. I haven't given answers, but I want us to think a little deeper and look at evidence-based work, evidence-based results or whatever you want to call it, that we have in front of us.

I think the answers are there. I just think we are sometimes lazy in the international community and we need to probe a little deeper.

My last word on this—I promise you—because I've talked too long—is how do you do that?

I strongly believe that you need to be on the ground, to really study the dynamics of development. And that too many agencies don't do that. They don't really understand what is going on on the ground. And I think that is where we need to work backwards if we are to make even these innovative mechanisms work.

Thank you very much.

MS. BRAINARD: Terrific.

Well, we have two panelists luckily to answer the very tough questions posed by Finance Minister Ngozi.

[LAUGHTER.]

MS. BRAINARD: So first, I'm going to turn to my new colleague, David de Ferranti, who is a new senior fellow here at the Brookings Institution and actually was colleagues for many years with both Finance Minister Ngozi and Michael Klein at the World Bank prior to that. And he is looking at some of these issues in his role now here at Brookings.

David?

MR. DE FERRANTI: Thank you. I'm going to try very briefly because you've been very patient as an audience. We want to get to questions and answers.

[Tape change, Tape 1B.]

MR. DE FERRANTI: I'm going to try and bring together a few of the themes that I heard so far and then leave you with two additional specific ideas to think about in this area of—financing.

The themes that I wanted to emphasize from what we've heard so far, first, it is important to work on many fronts at once. There is no silver bullet solution to development. I think our colleague from Japan mentioned you have to work on the pull side as well as the push side which I took to mean that all the things that need to be done within country are important for aiding the climate that can make the resources coming from outside as well as from inside to be effective. So we had some discussion about taxes, education, and domestic savings.

To give you a slightly different angle on that, think of how an economy develops, microfirms, so microcredit is important. Somewhat larger firms, the small end of small and medium enterprise, and there's an issue there which if we had time we could get into.

But then going up the scale above small and medium, it's very important to get the macropolicies right, and this rich other set of issues that have to do with creating an investment climate conducive to good development.

The second point, bringing together some themes, is that even thinking about all of that and even doing it, and I don't know anyone who's doing it better than Ngozi in Nigeria, in fact, that would be my solution to development, have Ngozi as your finance minister. But since not everyone can have that, my second general thought is that even doing that, some forms of innovative financing are needed, and you're heard that from all speakers and you heard it from Ngozi in terms of scaling up from small scale to do it in a much larger scale.

An innovative approaches in financing are needed partly because the existing approaches haven't taken us as far as we'd hoped to get, and also the available resource are clearly not enough to achieve the objectives. There's a gap between what's needed and what's forthcoming.

With that sort of context, picking up some of the themes before, there are a lot of ideas. One could easily write down and I did recently about 40 ideas, you've heard some here, subsovereign lending guarantees and so on. I just want to close with a mention of two among many we could talk about.

The first I will call performance-based sequencing of support, not a title that's going to win the award of easy to remember, so I will award a prize of $10,000 to whoever could come up with a better name. Let me explain what it is. Three parties. There's the country represented by its government, there's a consortium of what I'll call the first financiers, and there's also a consortium of what I'll call the second financiers. All get together and the country designs and leads the programs it wants to undertake, the financiers say, yes, we're prepared to support that.

The first consortium comes forward with resource right away so that the work can be done to achieve that program. The second consortium commits at the beginning, even sets aside the financing, to come in with resources as progress is achieved in pace with outcomes, in pace with results. This idea is not new, but it could be taken to a greater scale that might attract more financiers to come in, not only traditional bilateral donors, but also more foundations and even some corporations who are now getting into some foundation activities themselves. This approach has the advantage of being very results-oriented which is indeed a theme that many countries are hearing from their own constituencies and voters. And it also is a natural extension of what others have been exploring including the approach that was successful with polio eradication. In that case it was called buy down because it was buying down the first finance which was debt, but these two trenches of support can be loans, credits or grants.

The second idea I want to leave you with, and my last point, is that in addition to thinking about how public and public-private sources of finance can be more creatively designed and used. We also ought to take a look at what goes on in the private sector itself quite independently of actions that donors take and international aid organizations take.

Clearly, the private sector globally, locally and in the rich countries are investing in countries, and we could ask the question, using the existing instruments, things that the private sector is comfortable with because they know them, this is not theoretical concepts but proven already existing vehicles, we should ask the question to what extent and if so how can that activity and those instruments be enticed, be encouraged to extend so that the development impact is greater reaching countries that wouldn't get so much support others and Africa and Nigeria is a case in point and Ngozi is calling for that, and also reaching kinds of activities within countries that wouldn't get supported otherwise.

Here I think there is an interesting debate, a very promising debate going on including with a lot of interest from financial institutions in New York and elsewhere, and corporations, who are saying we are taking a look at what our mission is, we are realizing that it's good business for us to be good citizens as well, we are looking at corporate social responsibility, we are looking at foundations, why should we not also look at what we do in our mainline business so that we continue doing well financially but at the same time we're doing a bit more good developmentally. In the area of securitization, an instrument which is known to probably many here as CDOs, collateralized debt obligations, offer some real opportunities to do just that. Here the international institutions can come in with a little bit of backstopping whether it's guarantees or others that can make it attractive from a business standpoint for corporate and financial institutions to stretch their instruments further. Since those resources are many, many times larger than what the public sources can mobilize, there might be some real potential there.

MS. BRAINARD: The last speaker is Michael Klein who I think everybody knows as the most compelling and loudest voice within the World Bank Group for the private sector as Vice President for Private Sector Development for the Bank and as Chief Economist at the IFC, and also somebody who has straddled the public and private sectors in the past.

MR. KLEIN: Thank you for this introduction, and apologies for showing up late. I had to attend a meeting at the World Bank Group and I feel now like in one of these talk shows where they first talk amongst each other and then call this other guy in and say, did you really beat your wife? But she did it first.

[Laughter.]

MR. KLEIN: I haven't heard what has said before, so I will not even try, so I'll start arguing. The only person I heard saying something started off with Ngozi, so I'll start arguing with you.

First of all, is it really true that all sorts of things have been done and the private sector is not responding? Foreign direct investment in Africa, for example. Foreign direct investment levels in Africa have significantly increased over the 1990s to this day. The relative share of foreign direct investment as a share of total GDP in Africa is as high as anywhere else in the world. Actually, China has lower shares than a number of African countries. China is just big and a lot of stuff goes there. It's true of course Africa is dominated by mining oil and gas, but it's also true in other countries like Uganda, Tanzania where it's not driven by that.

Secondly, the reforms that have been undertaken in Africa very successfully over the last decade in reining in inflation, having more fiscal prudence, et cetera, so these macro type of reforms have led to what is not a 10-year record of improved economic performance across the continent, of course with some major problems still and still not satisfactory, et cetera, and not enough to deal with all the poverty issues that are there, but average growth rates are now positive per capita throughout the continent. The continent for the first time in a long time is reaching average growth rates at 5 percent or more of GDP. Trade levels are increasing and debt levels notwithstanding lots of debt problems still there are decreasing. So just so say there are some positive signs as well, it's just not all no response.

When we then look at what can be done to further this and should we go back to industrial policies, modeled on Japan or Korea, or is there something else that is possibly an explanation for an avenue for further improvements.

Two things. One, we recently compared the performance of firms in Africa between African textile producers and export processing zone producers in China. It turns out when you split productivity at the factory level from that at the firm level overall which would also include trading and dealing with government and what not, you find that at the shop floor level African firms perform almost as well or as well in some cases as the Chinese firms, and the maximum difference we've seen between the worst African firm and the best Chinese firm was 1 to 2, whereas when you look at the firm overall, the difference was 1 to 10, suggesting that business environment issues be they hard infrastructure constraints or soft constraints coming from the regulatory environment may actually matter quite a lot.

This brings me to the last point. When we look at this benchmarking project that we have done across the world of the complexity of regulations and the burden of regulations on domestic small and medium enterprises, they most difficult in Africa. A few countries have picked this up now, but mostly the continent has not taken this on board in terms of reforms. There have been very good things happening on the macro front, but there is a whole new alternative option short of industrial policy to deal with. A few countries have moved there. One that has been mentioned, Nigeria is actually one of those who has done most in the last year. Then we have to confront the possibility of making progress on the business environment front and whether we find that hopeful with the record of industrial policy that some African countries have—Steel Mill and things like that are monuments to misguided industrial policy. So the question is why would this change and where would this go.

MS. OKONJO: It's good to have a debate. First, before you came I had said that some countries are growing, have been growing since 1999, better than 5 percent, and Africa is at a turning point, and 12 countries have been singled out as the top performers.

But was disturbing was that yesterday—showed us at the Development Committee that these 12 best performing countries, Rwanda, Mozambique, Kenya, who have been reforming for so long, the human development indicators are no better than those who are not performing as well, and that was the big topic of discussion. It was troubling that even with all this growth you are not having any impact on the human being or changing anything that will lead to the MDGs and that was what led us to say of course growth is needed, but it's not enough.

The key question is the type of growth. What is really happening? Is this growth that is creating jobs? Is it growth that is doing something else? I still pose that challenge because if these people are top performers who have done so much and are being cited and yet it's not making any impact on the people, and maternal mortality was just as bad, infant mortality, HIV-AIDS, all indicators are not going the right way. So it's troubling, and I'm wondering, yes, on that side we have to look.

I'm also wondering whether we need to decompose and look at are jobs really being created, what is the nature of the jobs, and how can those jobs make a material difference, and that is why I said that it's frustrating that many of those finance ministers have said we've done so much but investment is not coming in at the level at which we would like to see that it come in. Jobs are not being created as fast.

I can tell you that Nigeria which is not included among this top is getting much more FDI, we are getting in the telecom sector $2 billion a year alone. We have the fastest growing telecommunications sector now in the world. We've gone from 450,000 land lines in 2000 to 16 million GSM lines today and counting. So I'm just wondering what is it that makes a difference. Is it really the reforms at the micro level? Yes, I would agree you need to do more, but even if you've done all of them, are you still going to get the kind of investment in some of these countries that is needed? Or is there a neighborhood effect that is preventing that, or what is it? So that's the challenge.

MS. BRAINARD: I also some disagreement out in the audience. Please identify yourself and your institution. Thank you.

MR. GORBACHEVSKY: I'm Francis Gorbachevsky, Booz Allen Hamilton. One of the most innovative financing techniques that's not theoretical that was completely overlooked have been the Enterprise Funds from Central Europe. They were set up by the U.S. government. I spent 15 years with them in Poland and Hungary. They were set up by the U.S. government to put money into the hands of the small entrepreneurs quickly. With the question you just asked, why isn't something happening because the small entrepreneurs are probably not getting capital to grow their businesses and that's really the engine of growth.

In Central Europe in the case of the American Enterprise Fund which isn't a theoretical example, the U.S. Congress put $240 million into a board of directors that had responsibility for helping promote private sector growth by making equity investments, loans, creating banks, creating small loan programs. They did tens of thousands of small business loans. They set up the first mortgage bank, they set up leasing banks, they set up agricultural banks that were then sold to the big players, and they also did equity investments. Not only that, they returned the money 4 years ago and have raised $800 million in private money to continue private equity in Poland.

I went over to the Hungarian Fund from the Polish Fund. We just started returning our money to the U.S. Treasury and set up a foundation in Poland. There's a foundation in Poland that has $240 million from the residue of the Polish Fund. Again, we're just setting the same thing up.

This model works, you mentioned David doing well by doing good, that's the subject of John Birklin's [ph] article in Foreign Affairs in 2001 that came out in October right after 9/11 and I don't think a lot of people read it, but he was advocating for Enterprise Funds across the developing world because that puts money into the hands of small entrepreneurs quickly. That's an innovative financing technique that hasn't been touched on.

MS. BRAINARD: I think that also gets to the issue that was raised by Finance Minister Ngozi that we've got a lot of pilots out there, why aren't these things getting scaled up. Do we know what works, and if so why aren't they getting scaled up?

MR. WENN: May I react on this? With regard to microfinance we are doing the same. Microfinance is a very good starting point to get excess to the poor but also to the small scale enterprises, but we have to see that according to our experience in Southeast Europe, it was much more easy than to establish micro banks in parts of Africa or in Asia.

And our experience is that downsizing of domestic banks doesn't work because they have not the right technique, they don't have the right culture, because microbanks in a sense are customer relations and relation banking. So what we are doing is we are creating new banks, new microbanks. We are trying now to establish a network of microbanks also together with our colleagues from IFC. Also to join the risk and mitigate some of the risks which are inherent in this.

We are providing equity and we started with some small funds of—funding, but today we have a lot of microbanks and we are assisting more than 90 microbanks all over the world which we now get market oriented funding and they can live with this. And we have also seen that there is a tremendous—

[End Tape Side A, Begin Side B.]

MR. WENN: [In progress] —microbanks because they will change the way in which the banking business is operating. We have seen wonderful examples in Bulgaria and Romania in which the commercial banks are now using the techniques of the microbanks. We have microbanks which have as a policy that within 48 hours they will finalize credit approval which is tremendous if you know how usually banks are functioning in developing countries.

What we are now trying to do which is the next strategic aspect is to get commercial banks involved in the business. So we have already sold some of the shares to commercial banks in Germany. We are trying now to get also some other international banks involved, and we have recently in Frankfurt we had a 2-day international conference on microfinance and the issue was why not so many commercial banks are trying to get involved in the business because it's highly profitable, the risks are not so high, and so it must be a very good business. But I think we have to ask ourselves whether we have the right approach and sometimes we are discussing all the things under the very restrictive issue of poverty relations that might prevent some of the commercial banks to come into the picture.

Then with regard to David, I would like to mention that we are now together with our colleagues from the Netherlands from—we are structuring a securitization of microfinance credits issued by NGO in Bangladesh to get for the first time the international capital market involved in the banking system in Bangladesh. If it works, hopefully by the end of this year we can finalize the deal, then this would be a pilot which would be very happy if it would replicate this also in other countries.

MS. BRAINARD: David, and then Pierre, and then we're going to go to a question over here.

MR. DE FERRANTI: First, thank you for raising this very important point. You're quite right, there is a lot that's going on.

What I would add is just that as I look at the experience, at the microcredit level there is a lot of activity and it's taking off. I would say for Latin America it's going to take off on its own. Micro enterprise development, in other words, not just the credit, the money, but also the training and so on is a tougher thing, so more work is needed on that.

But a gap that a number of people including Alan Patricof are drawing attention to is just above the micro because at the micro through sweat equity and your friends and relatives you can get a bicycle repair shop going, but if you have an enterprise at the micro level and you want to take that step up which is to get from a few hundred to several thousand, you need money. You're still too small to be terribly credit worthy. Your country probably doesn't have a well developed venture capital market that could lend to you. So you enter a death zone where so many enterprises die. Even if you could get money on loan terms, the nature of the expansion that you're doing doesn't permit you to keep up loan payments, so you really need equity.

That is a great gap and it's going to take very patient capital to go into that.

MS. BRAINARD: Pierre?

MR. JACQUET: What you said was—of what I tried to say about the microfinance experiment in Kenya, and precisely what is needed is how to go from successful microfinance into something more massive in a way and that sustains itself naturally. But indeed, I think the impact of microfinance on entrepreneurs is a very interesting experiment.

That brings us back to Ngozi's remark on how to make this massive instead of simply a small microeconomic experiment that we observe but still it's not a massive microeconomic impact. I think we should be confident about the fact that really development is a question of—and the situation nothing works, it's a poverty trap, a development trap, and a situation in which everything works. Our task is not to think about massive impact immediately, it's about unlocking the number of barriers to increasing returns, barriers to efficiency that prevent moving from the poverty trap or underdevelopment trap to the successfully development that you see occur.

This virtual circle by definition will work itself out. It won't work out because we will spend millions of dollars to have it move. I am confident that it can move out by itself and this is what the story of successful development in many of our countries has been about.

So really the question is unlocking the multiple barriers that are there and that can only be microeconomic—I don't know what the expression should be, but we need to put our hands to try to serve these things and to be considering that the rest can move along.

On this, and if I go back to innovative finance, I think there are at least three challenges for development institutions. One is to really think hard and discuss about the use of taxpayers' money, when it is legitimate to use taxpayers' money to help a productive activity to take hold. It's not obvious because taxpayers' money an also create distortions, and what we want is really undistorted productive capacity to take hold.

So an interesting question there is what are subsidies to be used for? I think there are many uses that we can think of. Certainly engaging the poor people and having them have access to credit or to basic services is something that market—is not likely to do by itself at least at the starting point. So it's certainly an area in which using subsidies may make a lot of sense.

But also any public good components of the private sector activity may need to be encouraged by subsidies. When I mention public good, it's local public good, but also international public good, energy efficiency, the fight against global warming, the fight against carbon emissions, the fight against—and so on. This may require public subsidies.

The point is to use these subsidies in an outward based framework in which we know what the service is going to be produced out of these subsidies, and that's a challenge for us donors to move into that direction.

The second challenge is to move away from the current definition of ODA, and Bruno Wenn mentioned that earlier. You need to keep in mind that the current statistical definition of ODA—considerably the way in which donors intervene. Why? Because they need to communicate on an ODA figure and, therefore, they need to provide the kind of instrument that is going to be counted as ODA and that in itself is a barrier to imagination. It's a barrier to innovation, to innovation in terms of finance. So we have a challenge there which is to help the community of donors through the DAC, the Donor Assistance Committee, to move to a definition of ODA that is more adequate given the needs of the developing countries and take stock of the considerable progress on financial markets that is happening internationally.

The third and final challenge, maybe there are others but these are the three major ones that I can think of, is to understand that it's not a question of putting money there, but it's a question also to help put in place the proper regulations.

For example, if we speak about public-private partnerships, by definition a partnership is a contract between a private actor and a public actor. As it happens in the past, many of these contracts have been really imbalanced and therefore not sustainable, and there is a key question there about how to imagine long-term sustainable contractual relationships between the private sector that needs profitability and to sustain profitability and the public sector which needs to understand that clarification is important, that cost recovery is important, at the same time to make sure that the social objectives are met through the public-private partnership.

MS. BRAINARD: I had a question back there, a question here and a question here. Why don't I just gather all three questions and then we can ask people to respond?

MR. : [Off mike] I have two remarks or one remark with a couple of aspects.

What is the incentive to use innovative instruments at a time when the discussion is more about aid volume, increasing the aid flows to the developing countries and not necessarily the quality and maybe also have a tendency to look rather into budget support than into very targeted, focused and difficult instruments? The incentive issue comes up and I would like to use two or three examples.

Mr. Wenn mentioned the necessity to charge, for example, for energy and water. What is the incentive for a government to charge for these services against the tendency maybe in the population to rather get water free?

A second aspect. For example, port services. What would be the incentive to establish the necessary business environment to make it attractive for an operator to engage in a profitable port service enterprise instead of saying we subsidize it at the expense of donor money?

A third example. That is referring to the microfinance area. When you look at 2006 World Development Report on equity, one of the issues is that access to capital is limited to large segments of the population and it's my impression that access to credit is also part of maintaining power in the country. So what would be the interest to encourage existing finance institutions that may serve the elite of the country to expand into a sector that is expanding the economic power or extending the participation of larger shares of the population?

In all three examples we face the issue of incentive for the partner country and for the donor country. The donor country is interested in a fast flux of its ODA which is easier through budgetary support than through project support or through innovative instruments, and the same incentive exists on the recipient's side. So what can we do about that?

MS. BRAINARD: That's a complicated question, so why don't I just turn quickly back to ask whether any of our panelists have something to say on that.

MS. OKONJO: Maybe I will say something. There are several incentives to do that. First of all, there is no country that is not aware that donor aid even with all the support and all the discussions we're having now in international consensus, there is no country that is not aware that this is not something that is a given. You can't just assume that every time you are going to—the discussion is predictability and sustainability of aid as well as quality.

That's what the developing countries are saying, that the aid they've been getting, even those for whom it's 60 percent of their budget, it's not predictable and the quality sometimes is not good. So that immediately acts as an incentive to start looking for your mechanisms that could be sustainable.

For instance, when you talk about water and charging for things, people recognize, finance ministers recognize, that they have to find other mechanisms that can be sustainable within their domestic environment so they are not just there waiting for this aid, because they don't know.

The second thing is results. I think you have to look at results, and they are aware that there is taxpayers' money, there is discussion from the donor side saying if we are there going to be giving out taxpayers' money, we better be getting results and so on and so forth, so they cannot take this for granted. That's a huge incentive.

The second thing I want to say is things like ports. I'll just give you an example of my country. What's the incentive for just reforming your ports and making them work better and not just hanging on and having subsidies and being inefficient while there's competition next door? People are not just waiting for aid. We are reforming our ports because if we don't reform we'll lose all our trade to Benin next door. They don't have any sources of financing as we do, so they are very, very good with port services and the ships and others are going next door and we are losing, so we are now reforming with concessions the two biggest ports already. We are reforming customs so that customs is not corrupt and inefficient. That's a huge incentive, competition.

So I think that there are ways and means to introduce. I don't think people are waiting lazily for this aid and saying once this aid flows we are not going to do anything because nobody guarantees you that even without the support you are going to be getting any aid predictably and sustainability. Thank you.

MS. BRAINARD: Michael?

MR. KLEIN: Ngozi has said the magic word, competition. Why do we have a debate about grants versus loans as one of the innovations? Because of HIPAA, because of the debt problems. Those things in the old way have been unsustainable.

Why are organizations like ours thinking hard about innovative financing mechanisms? Because aid from the private sector has come and said get out of the way or we have something better and this has put pressure. Then we compete amongst each other. Everybody wants to do something in Africa so how can you do it better. Then we accuse each other of using excessive amounts of subsidies. And that brings then the issue of making it transparent where it's sensibly used and what not.

Then on the port side it is exactly like this. There are lots of ports and governments don't find it hard to deal with user fee charging and the fiscal constraint drives that as well as competition. The politics of water enterprise are very different. But just to say that's one of those intractables where poor people pay a lot more for water per unit of water, 10 to 40 times as much depending on the country as people who are connected. But the people who are connected are the ones that get the subsidy and they put water pipe lines and then the other pipe lines go first to some people who have maybe more to say about where they go.

So this goes to your last question, to some degree, existing power structures stand in the way of doing new things. I would have thought that the big thing is disruptive changes, new types of technologies, newer globalization or all these things, openness, all of that puts pressure. Sometimes good things happen because people want to do the right things and do it, but I think more often than not it's disruptive change that you can't control.

That of course then also brings a downside and people being upset, but overall the 20th century is not exactly a quiet century or wasn't, but it has brought eventually more positive economic change than any other before.

MS. BRAINARD: We had I think a question over here.

MR. KOTESH: My name is Mahash Kotesh [ph], Structured Credit International. I'm a private sector person and I have a couple of comments and a question.

A quick one. While all the funds that you mentioned were successful, and I've read the Birklin article, it's excellent, it's not an unmitigated success story, the South African wasn't very successful, but generally speaking it's been a success.

The matter of ODA definitions to me is very central. Guarantees to date to not count as aid, ODA assistance, because they are not a flow, yet they have a great value for facilitation of local capital markets, for extension of maturities, for assumption of risks that may not be acceptable to local lenders, and for creation of a credit culture. There are many other benefits, too. I spent more than a decade in the guaranty industry in the United States at a major monoline company and I set up the first non-U.S. monoline in Asia called Asia Limited.

So I think that guarantees are a very powerful use and they are essential because in some respects the markets today are flush with money. There is so much liquidity in the world that's looking for places to park money at very, very tight spreads. You get financing of Brazil today which is unbelievably tight, the Philippines, et cetera.

So money is not the issue. Your strength is not the money you provide. Your strength is enabling others to bring in their money because they do not like the risks that they see, and this is why the money isn't going. If you look at Africa, Dr. Klein, it is not everywhere that the money is going—is up because of Angola, because of a few other major investments, not everywhere. So the problem is enabling people to go into places where the rule of law is not necessarily perfect, where guarantees may be required in order to facilitate investments, and these cannot be done on an a la carte basis, they are fine al la carte, but the guarantee frameworks in your multilateral agencies are a mess.

MEGA, you have OPIC, you have EXIM, you have IFC guarantees, you have USAID guarantees, guarantees from Garentco [ph]. There is a very great complexity of guarantees. The monoline industry in the U.S. provides trillions of dollars of guarantees, trillions. Talk about scale, look at that. Trillions of dollars of financings are provided in the U.S. with AAA guarantees no questions asked. Any payment default you get paid.

If you look at scale, you got to think about that, and I set up the first non-U.S. monoline guaranty company like that in Asia. It failed. Why? Because we were stuck with what I call downgrade risk. You talk about CDOs. I did the first CDO in the public markets at Kidder Peabody in 1989. I know that business backwards. This company was like a CDO, Asia Limited. It failed because we were hit by the financial tsunami. Somebody talked about tsunami. I think you did.

What happened was there was a downgrade of Indonesia, Korea, Thailand and our portfolio risk went from 15 percent or less to 35 percent or more and we lost our ratings. Had I at that time received a facility from your kind, and I went to some major kinds, major partners of your kind for downgrade risk cover to cover me precisely for that sovereign risk downgrade, the projects were not worse, the countries were worse. The company failed. It would still be there today. In 2 years we did $1.6 billion worth of guarantees, talk about scale, with $250 million in guarantee capital, $150 cash or quasi-cash, $100 cash, actually, and 50 callable, and $100 in—facility.

So it's six times and the potential was 30 times. So in the private sector if we had a public-private partnership, this company was a joint venture between ADB, GSIC, AIG, EPF, numerous securities, Bangkok Bank, Korea Long Term Credit Bank at that time and so on, and the private sector—I think that would be the way to go, and I think therefore we need to find a way to make your guarantee products work more effectively because the bilaterals that can take and could have taken that downgrade risk because they can take first loss, maybe the World Bank and the rest of them or the multilaterals could take a piece of the first loss or second loss, but you leverage guarantee capacity you could do a lot more.

MS. BRAINARD: I'm going to take a comment right there in the back and then Lex, and we'll finish up with some closing thoughts from the panelists.

MR. HOSKINS: Donald Hoskins, currently a professor at American University with my class right here, so I got to look good. This has to be a good question.

I just wanted to follow-up with the gentleman from the private sector because I too was an investor for quite a bit of time in the emerging markets, and the world is awash with cash. One of the problems is you are all fine economists and I think you believe in efficient markets until you deal with your own job and suddenly markets aren't efficient anymore. The private sector is unable to really assess risk accurately in developing countries, so we need to have all these mechanisms to help us figure it out.

I would suggest that you're looking in the wrong direction. Risks are in fact very high in developing countries and I would say that's the place to look. Actually, lower the real risks, put less attention on how to get money into projects and more attention at improving the projects, and that has to do with improving what I would call the entire infrastructure. And I would love a lot more attention being paid to entrepreneurship infrastructure, creating networks or facilitating networks. Business education needs to be dramatically improved. Networks of like-minded entrepreneurs need to be facilitated. Help nurture good ideas, and money is there.

Two experiences in running private equity funds in Latin America. One was purely private stockholders, shareholders, and it was easy going in and investing in great start-ups and opportunities in Latin America. Then I had one brief experience with a private equity fund that was funded by multilaterals. What was interesting there is that when I worked with the IFC and the IIC and these different entities of these multilateral institutions that are supposed to act like private investors, they were incredible risk averse. We were trying to invest in Peru at the time when Fujimori was fleeing to Japan and I said this is the greatest investment opportunity in the world. Look at all these opportunities. We can go in there and really buy cheap. They said, are you kidding? You got to be crazy.

So when you guys act like private sector actors, you don't do a very good job. So I suggest act like public sector employees and help governments create better infrastructure for business opportunities and the money will come.

[Applause.]

MS. BRAINARD: The last question up here for Lex Rieffel. I just wanted to note Lex is one of my colleagues here at Brookings as well and he has just done two really good pieces of analysis, one on Nigeria's debt, and there are policy briefs out in front which you should grab on the way out. And another one, the analysis of the first set of compacts for the Millennium Challenge Corporation which are also available on the front table. Lex?

MR. RIEFFEL: Thank you, Lael. I didn't mean to jump on a bandwagon. I didn't realize others were going to make comments along the same lines.

I had two questions. One is I was hired by the Institute of International Finance in 1994 to work on risk mitigation with the multilaterals for the private sector. I spent 3 years working with the IFC, with the World Bank, ADB, IDB and so forth to get guarantees working with the private sector from the financial community and I got nowhere. Is there any reason to think, and that was 10 years ago, that 10 years from now the situation will be any different?

My second question is that several people have commented about water sector privatization and some of the difficulties there. I have seen what seems to be a reversal in this area. We have some major municipal water supply privatization deals that were done in the last 10 years that are unwinding, that are being reversed. What's going on? You sound optimistic. You sound as though this is about to take off. I don't see it happening. So what am I missing?

MS. BRAINARD: Before I turn to the panelists, and gather your thoughts, I'd say there's probably a really good business to be made out there of venting or therapy sessions for people who have had bad experiences with the IFC and OPIC because I have a lot of these conversations.

With that I won't turn to Michael Klein first, but I'll give the panel an opportunity. Closing comments. Yes, go ahead.

MR. : A small input goes a long way. We have an experience in Indonesia. It's small, but small farmers get the benefit, very small input, small-scale irrigation. That project eventually was successful and at the time of the evaluation we interviewed all of the small farmers. The question is like this. What do you like to do if once your income gets higher? Ninety-nine percent of them replied to get education better for their kids, not vice versa.

So a small input is very, very influential in terms of the way of life and also for future life and the direction of doing their way of thinking in investing in education. So it's quite impressive for us.

The other thing is scaling-up. In my sense, scaling-up is very key and also it requires a very comprehensive approach. Otherwise it cannot be materialized. For instance, in the case of Vietnam, they are now enjoying a lot of influx of foreign investment. One of the major reasons is the provisions of infrastructure. Actually not only that, the eradication of obstacles of foreign investment and also there is improvement of trade and investment policies, and the so-called—policy.

In this conjunction, the PRSC is contributing a lot, not only project finance, but also—improvement by way through the PRSC, and under this PRSC there are lots of initiatives in order to improve the investment climate and are already included in that. This kind of macro level PRSC and the infrastructure provisions through financing could contribute a lot in order to scale-up the benefits of the growth.

Regarding what you said, under decentralization, some projects are decentralized and—owner but now returning to the center. We are now experiencing to some extent in the educational sector in the Philippines. Even in the educational sector, the responsibility of education has been already transferred to the local government. But due to lack of technical and financial capacity and the appropriate level of education, cannot be achieved by the local government. Therefore that authority or that kind of transfer is now returning to center. Therefore quality matters and, therefore, presumably it is very essential from the very beginning to look more carefully about the quality of the services. The quality matters in my sense.

MS. BRAINARD: Bruno?

MR. WENN: I would like to pick up some of the questions.

With regard to risk, I don't think that risks are very high in developing countries. They are perceived to be high because some of the private sector people there really don't know how to measure and estimate risk in developing countries. This is our experience we have made, and this is why in some countries we take the private sector in managing contracts so we don't ask them to provide risk capital. But through managing contracts they get better knowledge on what is going on in the country and the sector and so on. This is why I think that the work of UNDP together with Standard & Poor's is very important to get credit ratings for developing countries so that there is transparent information which is available then for the private sector. This is one of our roles.

With regard to guarantees, I fully agree that public development banks are not very good at issuing guarantees, but this is why we have subsidiaries which are exclusively working for the private sector in developing countries and they have developed the appropriate instruments.

Our primary role, indeed, is to help developing countries in establishing the right enabling environment which is conducive for the private sector and also to provide the infrastructure. That's our main business, and this was also the starting point of KfW Development Bank, and infrastructure finance is the core of our business.

Then with the private sector participation in the water, I am not very optimistic that we would see much movement with regard to privatization in the water sector. Also in Germany it's a highly controversial debate. But what we are arguing for is that at least the private sector should be engaged in the management of water facilities because they really know what to do and there is the right incentive system then in place. But again, we have then to establish the right regulatory framework.

I also see that there is a reversal in the debate, but looking to the specific projects, it turns out to me at least that something was missing with regard to establishing the right regulatory framework. So in our opinion we have to start first with the creation of an enabling environment before we take the private sector into the picture.

MS. BRAINARD: Finance Minister, any final thoughts?

MS. OKONJO: Yes. Let me just say that first I do believe that there is a lot of work to do be done on our own side in our own countries still on getting the policies right and taking away the microlevel impediments that would make a business work.

I agree that in many cases while you may say risk is high, they will have to deal with the perception. Sometimes it is the perception of risk and the neighborhood effect, that if you're performing well and your neighbor is not, people often don't even go in to see what you are doing. They just assume that the whole neighborhood doesn't work and so they don't come in.

There is a terrible information lag in this regard. Even with the formal institutions, you've got the CPI ratings in the World Bank, the country policy and institutional ratings which are used to determine what countries get, or the TI ratings. We find a 2-year lag. They don't recognize dynamics. It takes them time to see a country is changing and to get the news out, and sometimes by the time they do, the government that has done the changes is out of power and they don't get any support.

So we have to do something about information, faster recognition of changes. The ratings are good, I support them, but if we have a transparent mechanism. Also are there any ways and means we can get media internally and internationally to be more, I don't know what the word is, inquisitive, to take more of an interest in what is going on in these countries so they can have more positive stories? We can't change these perceptions unless that happens. If your perception of Nigeria is Ajaokuta Steel, for instance, Michael, of 10 years ago which has been solved, it's been privatized. In fact, we almost gave it away just to get away from that. If that's what you're going to repeat here, people are going to go around and say Ajaokuta Steel, and that's what is Nigeria is known for. How do we change that and get massive information out there that some of these countries are doing the right thing?

So that's one challenge that we need to have. It's so lazy and to say corruption in Nigeria, that's it. That's what people want to read without probing.

So the second thought that I have is the fact that we really need to pull the private sector in in terms of listening to them. The public sector needs to do that. Look at this wonderful story our colleague told about this monoline type of guarantees in East Asia. I think there are many more mechanisms out there, or the Enterprise Fund, that the news needs to get out and we need to get them, our public institutions, to listen, I mean our multilaterals, listen, draw them in and use this.

They are out there doing this business. Why don't we get them to say how can we structure these innovative mechanisms and scale them up working together in these countries? I don't think we are doing enough of that. Governments are not doing enough of that, I'll be the first to admit, but I want our multilateral institutions to do a lot more of that.

So I think I'll close with those thoughts and say we do have some way to go ourselves, but I want you to leave knowing that African countries are trying very hard and you can help by being ambassadors and spreading this word, it is not Africa corruption, it is Africa change. Thank you.

MS. BRAINARD: I have to interject a little anecdote. We were both up at the Clinton Global Initiative together and Mohammed Ibrahim who was the CEO of Celtel told a great story about when he originally was trying to persuade his U.K. partners to invest in mobile telephony in Uganda, his U.K. partners said, Are you out of your mind? No way, no how, are we going to invest in a country run by that crazy guy Idi Amin. It was at that point that Mo

Ibrahim had the flash, no wonder we've having problems here, Idi Amin has been gone for 15 years. So you're up against quite a big barrier there.

Last thoughts, Michael Klein?

MR. KLEIN: You can imagine that support group between IFC and OPIC.

[Laughter.]

MR. KLEIN: Financial engineering cannot get around basic risks. Our institutions, IFC at least, is not any better at financial engineering than private parties, and through the wonders of competition, private parties, not all of them, work well, many of them have bad perceptions, but others are risk taking and have good perceptions and eventually things would go. So policy will follow where policy is reasonable.

I think this defines where we should act. We should be at the interface with policy change and transactions. Our transactions should with the identification of the removal of policy constraints. Example of that are there, not enough, but they are there. Some key ones are the development of housing finance markets that go together with the development of property titling, registration systems, collateralization systems, the development of a market for nonperforming assets which requires a whole series of legal adjustments to make this possible, along those lines.

Finally, that is where scale comes from. Scale comes from policy. That's what affects everybody. Never ever will IFC, AFD, KfW and everybody else together have the kind of scale that the world needs, so I'll end with that.

MS. BRAINARD: Pierre?

MR. JACQUET: Thank you. First of all, let me tell you how much I enjoyed this discussion. I think we don't have enough of an opportunity to engage with the private sector in discussing how to improve together in a lot of developing countries in a way in which the private sector will find its own interest and where the development agency will be able to contribute to development.

I think that one of the failings in the past was to believe that public development aid would do the trick. No. We need to go at it together, and there is something in for everyone there because certainly successful development in developing countries means a lot of things in terms also of business activity and so on.

One of the paradoxes of the MDGs is that if the MDGs were to be met, think about the fantastic market that creates for basic services. So the paradox is that we have these markets aware of us and somehow there is some hesitation in believing that will happen, and we need to think about how to solve that.

I do believe as you suggested that when the private sector decides not to invest it generally is for good reasons, and in those cases the only role that makes sense for development agencies indeed is to help improve the business climate.

There are reasons for not stopping there though. One is imperfect information. We are not in perfect markets and you in the business sector don't necessarily have the proper information on the countries in which you think of or don't think of investing in. Collecting that information will be very costly because that information is a public good and that is where development agencies because they have experience in that field can help. Therefore, there is a case, and Bruno spoke about it, about playing that role because we do have in many cases, not always of course, superior information.

The second reason not to stop there is that building confidence is costly, there are fixed costs, and improving the business climate is not enough. We need to publicize it and we need to put some money in in terms of risk coverage just to convince the investor that this has taken place. So even if the world were perfect, when you start from an imperfect situation and you build perfection, generally the rest of the world simply doesn't know and we need to really be there to help notice that some improvement has taken place and part of the public-private partnership would allow to do that I believe.

Finally, I think you are very right to emphasize the fact that public-private partnerships have made a rather sobering record in the past, especially with water. Basic common-sense remarks. It's not because some of them have failed that we should discard the instrument that doesn't work. It doesn't work because we were not able to make it work, and PPPs in our own countries took years before becoming effective and efficient. So I would not dismiss the instrument simply because we have difficulties in having it work in some sectors like water.

In water we have a cultural problem. We need to explain to the people that water may be free, but water services are not. The whole idea that people would have free access to water is totally contrary to the sustainability of the water service delivery. So unless we have really been able to be on that stumbling block and convince people that paying for water is a key to the effectiveness and efficiency of the water service, there is little we will be able to do in terms of PPP. Public water delivery services have failed simply because they didn't care about cost recovery and, therefore, you had one year of water service delivery and then it collapsed because there is no maintenance and no system to ensure the sustainability of the situation. So we do have a cultural problem there into explaining and that requires more effort on our side.

And a final word about PPP regulation, we discussed about it. I think that we have fell into the very well-known trap that is we are so happy to sign the PPP contract that not enough attention has been put on the quality of the contracts and the long-term sustainability of the contracts meaning that one year after some of the parties discover that the contract was not sustainable from their own point of view and it collapsed. There are a number of examples in poor countries in which that happened.

Again, this is an inhibition to improve our approach to the regulation that helps the PPP function. Thank you very much.

MS. BRAINARD: David, the last 60 seconds or less

MR. DE FERRANTI: I'll concentrate in 60 seconds on just one heroic undertaking which is to try to offer a way to suggest that both Michael and Ngozi are right. If I heard Michael correctly, he's saying if you get the policies right and the performance right, the money will come. I think we'd probably all agree with that, but it's going to take a long time, that's what Ngozi is saying, and a lot of people are going to suffer if you want that long a time.

One thinks of the history of development in many countries including the now rich countries, public institutions, governments or international institutions decided to accelerate that process, and I think there is room for that, and I think that's the point Ngozi is making.

So to tie that back to the international institutions, particularly the World Bank, I just spent 6 years running the Latin America Program, just retired, and had to struggle with the financial complex of my own institution to get the freedom to use the instruments that are on the books. So to use guarantees that already approved you have to go on your knees. This isn't right. This is not the future for the Bank; it's not the future for the countries.

For the class, ask the question, Why is that happening? It's not because people are nasty. What's behind that? One thing that's behind that is that it is an institution with a board and the board sends conflicting messages; and it would be very helpful if board members—and we've got three countries represented on the board that could take the message back—to send a clarion call as to what the priorities are.

And final point, we have a new President who has just selected a new Financial Officer which will be announced imminently or has been today, that individual has an opportunity to use the instruments on the books and to modernize the approaches of the Bank to enter the 21st century.

MS. BRAINARD: Thank you very much. Please join me in thanking our panel for a stimulating discussion in a busy week.

[Applause.]

[END OF TAPED RECORDING.]

- - -