World Bank Group

The International Finance Corporation (IFC)

FY2005 Appropriation	FY2006 Scheduled Request	FY2006 Arrears Request	FY2006 Total Request
$0	$0	$0	$0

The IFC is a member of the World Bank Group. Chartered in 1956, the IFC was created to promote private sector development, foreign investment, privatization, and efficient financial markets in developing countries. To this end, the IFC makes loans and equity investments in private sector projects in developing countries for its own account, mobilizes private capital alongside its own resources, and provides advisory and technical assistance services to advance the development of the private sector.

For FY06, the Administration is not requesting any funding for the IFC.

Key Facts

- The United States is the IFC's largest shareholder, owning 23.7% of IFC's capital.

- The IFC is financially strong and maintains a AAA credit rating. This rating allows the IFC to leverage its capital base by selling bonds, thereby increasing its ability to lend funds.

- The IFC is involved with private sector projects, and lends without a sovereign guarantee. Thus, the IFC is fully exposed to the commercial risks of its investments. For WBFY04, IFC's net income totaled $993 million, up strongly from the previous year' $487 million.

- In WBFY04, IFC's Board approved $5.6 billion in new investments in 217 projects.

- At the end of WBFY04, IFC's committed portfolio totaled $17.9 billion (net of write-off adjustment), consisting of $13.4 billion in loans, $3.7 billion in equity investments and $1.1 billion in guarantees and other structured finance products.

- In addition to its operations, IFC operates a syndicated (B-loan) program under which IFC co-finances projects with commercial banks and other financial institutions, thus enabling IFC to leverage its resources. At the end of end WBFY04, commitments under the B-loan program totaled $5.5 billion.

- The IFC underwent a major internal reorganization in WBFY02 to streamline operations. Senior managers have been placed in the field to be closer to borrowers, and industry departments in Washington DC have been consolidated. The changes are designed to improve client service, broaden IFC's borrower base, and increase operating efficiencies.

- In 2003, the World Bank Group established a new vice presidency for Private Sector Development to coordinate work on investment climate. The new vice president was also named IFC chief economist.

Supporting U.S. Objectives

Encouraging Private Sector Development

The IFC focuses on promoting private sector development through specific investments and through the development of sound regulatory, supervisory, and legal frameworks for the private sector in developing countries.

To highlight the importance of investment climate and to promote reform, the IFC together with the World Bank has initiated the "Doing Business" project, which has developed quantitative indicators on business regulations and their enforcement across 145 developed and developing countries that can be tracked and compared over time. The topics include business regulation, labor regulations, contract enforcement, creditor rights, bankruptcy, registering property, and investor protection.

Small and Medium Enterprise Development

In particular, the IFC is actively engaged in developing opportunities for locally-owned small and medium-sized enterprises (SMEs) in emerging markets.

- In WBFY04, the IFC approved $820 million in funding for micro, small and medium enterprises, including $641 million in investments in financial intermediaries. For example, IFC made a $1.1 million investment in and a gave a $2 million local currency guarantee to a SME facility in Pakistan that would provide financial services to Pakistani SMEs.

- The IFC Board approved plans, in December 2003, for an investment to establish an Iraq Small Business Finance Facility of up to $200 million ($30 million for capacity building and a micro and small business finance component of up to $170 million). The facility will seek to work with existing banks and possibly establish a new microfinance bank in Iraq.

- Also, in December 2003, the IDA Board approved a private sector development project in Nigeria, the first project under a joint IDA/IFC program in Africa. The IDA financing will have three components: 1) technical assistance and training for financial intermediaries providing micro and small business loans, 2) capacity building for business advisory services and 3) policy dialogue with the government to remove legal and regulatory obstacles to SME development. IFC will support complementary investments in the financial intermediaries supported under the program and has approved investments in Business Partners International for a SME risk capital fund in Kenya and in Accion Microfinance to start a new microfinance institution in Nigeria.

- IFC provides technical assistance (funded by other official donors) to help small businesses and financial institutions to become more competitive and help the government improve the business climate through its family of SME facilities. IFC currently has eleven facilities supporting activities including: access to finance, capacity building, business enabling environment, company advisory assistance, business support services and investment services.

- The Private Enterprise Partnership (PEP) has been an extremely productive example of this SME-oriented technical assistance to the former Soviet Union. In particular, it has been instrumental in the development of leasing markets by working with governments in Russia, Armenia, Georgia and the Kyrgyz Republic to establish a legal framework for leasing.

- In September 2004, the IFC Board approved the new Private Enterprise Partnership for the Middle East and North Africa (PEP-MENA) to help promote SME development in the Broader Middle East and North Africa (BMENA). The facility will provide technical assistance to governments, financial institutions, and businesses in five specific areas: business enabling and regulatory environment, financial institutions and markets, the SME sector, restructuring and privatization of state-owned enterprises, and private sector and public-private partnerships. The IFC is putting $20 million of its own money into this $100 million, three-year facility. The U.S. is contributing $10 million in FY04 money and has pledged an additional $5 million. Other G-8 members and other interested donors have pledged another $28 million.

Technical assistance to facilitate privatization in WBFY04:

Since 1996, the IFC's Private Sector Advisory Services, has assisted in privatizations that have generated over $3.6 billion for governments through the sale of infrastructure businesses and concessions. New projects in 2004 include:

- <u>Madagascar:</u> The IFC has been hired to help structure and establish a series of hydropower independent power providers, by advising on regulatory aspects, helping to prequalify investors, and assisting the government in the tender process.

- <u>Romania:</u> The IFC is working with the government to implement public-private partnerships (PPPs) for the provision of health care services to public patients. The IFC is now implementing a series of pilot PPP transactions, including the introduction of private management in one of Romania's most important public hospitals.

Increasing Productivity and Encouraging Private Investment in Infrastructure

IFC increases productivity in developing countries by financing investment in capital equipment and basic infrastructure such as water supply and treatment, transportation, and electricity. For example:

- <u>Ghana</u>: In WBFY04, the IFC agreed to provide up to $60 million in loans to help a private company develop a 220 MW power plant and increase another plant's capacity by 110 MW.

- Pakistan: IFC provided a $6 million loan to help a private company expand and improve its cargo container operations.

Project Effectiveness and Results Measurement

IFC monitors the financial rate of return, economic rate of return and development impact of each project. IFC uses a corporate scorecard to measure its development impact as an institution, its performance in priority sectors and the quality of its work. In addition, IFC has introduced a sustainability framework to evaluate the value added by IFC in corporate governance, local economic development, environment, social development and labor force health and safety on individual projects. Since WBFY02, IFC's Annual Report has included a summary of its sustainability review. In WBFY03, this report focused on the Safeguards and Disclosure Policy Review and the Extractive Industries Review.

The Operations and Evaluations Group (OEG) conducts independent evaluations of IFC projects. OEG, which maintains an independent relationship with IFC operations and Management, reports through the World Bank's Director-General for Operations Evaluation, to IFC's Board of Directors. The WBFY03 Annual Review, presented to the IFC Board in 2004, identified a continued upward trend in the success rates for development outcomes and investment outcomes.

OEG looked at a sample of mature projects approved in 1995-97 and found that a higher share of projects had high development impact (58%) than high investment outcomes (49%) and that only 41% of projects had both. It also estimated that the projects evaluated in the real sector (e.g., manufacturing and agriculture) generated $1.8 billion in net benefits for members of society other than the owners and financiers of the projects. The study also found that a good or improving investment climate in a country is highly correlated with a successful financial outcome of IFC investments.

Corporate Governance

- IFC promotes strong corporate governance by its borrowers and beyond its direct client base. Corporate governance is an important component of the technical assistance provided through the IFC's private sector development facilities.
- Corporate governance is part of the IFC sustainability framework. IFC borrowers are encouraged to take action on corporate governance for their own benefit and to demonstrate its value to other firms in their markets.

Increasing Coordination with other IFIs

- IFC has played a leading role in the new World Bank Group private sector development strategy. This strategy encourages more collaboration between IFC and the World Bank's lending and policy advice to developing countries. The new Doing Business project involves a critical interaction between the World Bank and the IFC to assess the investment climates of countries and analyze which environments most effectively promote private sector development. The lessons taken from this analysis will be incorporated into World Bank reform programs with governments as well as IFC technical assistance.

- IFC and the World Bank operate joint "global product groups" in sectors such as telecommunications, mining, and oil, gas and chemicals. They also jointly operate the Private Sector Advisory Services and Foreign Investment Advisory Service, which advise governments on such matters as privatization and attracting foreign investment.

Responding to Financial Emergency

- Iraq: Despite the poor security environment, the IFC is proposing to offer trade financing for private businesses in Iraq, working through the Iraq National Bank (INB). The IFC Board also approved a $5 million investment in Credit Bank of Iraq (CBI) in partnership with National Bank of Kuwait (NBK). This will result in a 10% shareholding for the IFC and 75% for NBK.

- Turkey: Private sector lenders have been slow to increase credit availability despite the ongoing recovery from Turkey's financial crisis. The IFC has provided long-term financing to private companies and a bank credit line for SME finance to respond to private sector demand and demonstrate the potential of these industries.

- Argentina: IFC has been greatly affected by Argentina's financial crisis, since its portfolio of investments in the country was one of its largest portfolios. The IFC restructured two loans in 2004. However, IFC has looked for opportunities to stay engaged and support export opportunities. It approved a $100 million investment package, including $30 million in participation by private-sector parties, for an Argentine agriculture exporter.

Core Labor Standards

- In 1998, IFC adopted World Bank Group policies that prohibit the use of harmful child labor and forced labor in its projects. In WBFY02, the IFC issued a Good Practice Note, available on its website, which advises companies about how to develop policies that address harmful child labor in the workplace and the supply chain. Labor force health, safety and welfare are included in the IFC sustainability framework.

- The 2003 Review of IFC's Safeguards Policy noted that the Labor Policy does not treat the right to collective bargaining and freedom to organize and recommended that this issue be examined. In its response, management noted that gap areas identified in the Review, including core labor standards, will be addressed by updating the current safeguard policies. Treasury is using the opportunity of the update to support the incorporation of all the core labor standards into the IFC safeguards policy and the establishment of formal procedures to screen projects funded by the IFC for any impact on workers' rights.

Efforts to Improve Internal Controls

- IFC uses the internal controls system in place throughout the World Bank Group. The Internal Audit Department and the External Auditor review IFC's management controls annually. The Board Audit Committee reviews their observations and recommendations and discusses them with IFC management.

- Coverage of the World Bank's Anti-Corruption and Fraud Investigation Unit and telephone hotline includes the IFC.

Efforts to Improve Information Disclosure

- The IFC puts project summaries and environmental impact assessments for all projects in its pipeline on its website, which provides the public critical information on upcoming projects. The IFC's currently required disclosure period for environmental assessments, however, is not consistent with U.S. legislation.

- In April 2003, the IFC published the Compliance Advisor/Ombudsman (CAO) review of the IFC safeguard policies after providing a public comment period and incorporating public comments in its recommendations on revisions to IFC's safeguard and information disclosure policies.

- The IFC's Operations Evaluation Group (OEG) publicly releases abstracts of its annual review of IFC projects as well as abstracts of sector studies and country impact assessments. Guidelines and instructions used by staff for the evaluation of individual investment projects are also publicly available at www.ifc.org/oeg.

Efforts to Support Environmental Goals

- In June 2003, after extensive advice and guidance from IFC, ten major international banks adopted the Equator Principles, a voluntary set of guidelines based on the environmental and social guidelines and safeguard policies of IFC. These principles are being applied globally to the project finance activities of the original ten and several additional banks, which together represent the majority of the global project loan syndication market.

- The IFC has had procedures for environmental assessment and management in place since the early 1990's. In 1998, IFC's policy and procedures were updated and harmonized with those of the World Bank, following public consultations.

- In 2004, the IFC initiated a major overhaul of its environmental and social safeguards, which is expected to be completed in 2005. Based on early drafts of the new safeguards, the differences between IFC and World Bank safeguards are expected to widen.

- The IFC and MIGA jointly fund the Compliance Advisor/Ombudsman (CAO) to address external complaints and advise IFC/MIGA management on sensitive environmental and social issues. The CAO reports directly to the World Bank Group President. As noted above, in April 2003, the CAO released its final review of the IFC safeguard policies. The CAO will assess the IFC management's proposed overhaul of environmental and social safeguards against the recommendations in its own review.

- The IFC's Environmental and Social Review Unit examines potential projects for their potential effects on the environment and the people in the project area. For projects with significant environmental effects, environmental impact assessments (EIAs) and environmental management plans are required. Some projects entail the preparation of plans for resettlement of affected peoples.

- The IFC engages in capacity building to help firms improve their ability to evaluate and manage environmental and social issues. IFC staff assists small and medium-sized enterprises in analysis and planning, and, if needed, mobilizes technical assistance to support inexperienced borrowers. It holds workshops on a quarterly basis (jointly with other multilateral and bilateral development institutions) to help banks, funds, leasing companies, and other financial organizations learn to assess the strategic rationale for environmental and social management, perform cost-effective environmental and social risk management (ESRM) of investments, and implement value-adding environmental and social management techniques institution-wide.

In June 2004 the Environmental Business Finance Program, was launched. This new program will be established with $20 million in funds from the Global Environment Facility to support micro, small, and medium enterprises working on global environmental issues. Targeted businesses will include those active in renewable energy and energy efficiency, ecotourism, sustainable agriculture, and agroforestry.

- The Environmental Projects Unit (EPU) develops innovative, private-sector projects with environmental benefits, and mainstreams those investments within the private sector and IFC. The EPU collaborates with the Global Environment Facility (GEF) and other institutions to finance projects.

Opportunities for U.S. Business

- In WBFY04, the IFC committed $579 million for projects in which U.S. firms were involved.