

FIAS CONSULTATIVE COMMITTEE OF DONORS MEETING
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CIC/FIAS CRISIS RESPONSE UPDATE
(November 2009)

1. Context

It is now just over a year since the collapse of various US financial institutions in September 2008 precipitated a systemic global financial crisis and subsequently an unprecedented synchronized fall in global economic output and trade. World trade is likely to contract by 10% in 2009 – the first *fall* in world trade since 1945. Falling levels of economic growth have had direct negative impacts on poverty and vulnerability reversing years of gains in developing countries.

Although the crisis is global in scope it is not monolithic. Feedback from WBG regional offices shows very different impacts in different geographical settings. Emerging economies in Europe and Central Asia are particularly hard hit with growth predicted to be negative 6% in 2009. Emerging economies in Asia and Latin America are now showing positive growth after initial setbacks. Africa suffered a six month lagged impact and is likely to see growth of 1% in 2009 in comparison to 4.8% in 2008. These important differences mean crisis responses need to be differentiated and suited to local context.

Coordinated action through the new G-20 format including high levels of targeted public expenditure in the form of stimulus packages have prevented the worst case scenarios of economic collapse and recession. The mood at the recent WB-IMF annual meetings was described as optimistic, although many suggest that the world economy will need to adjust to a “new normal” with lower rates of growth, investment and employment. The current consensus is that:

- Economic vital signs including industrial production, trade and investment are picking up, but they are considerably lower than before the financial crisis;
- The gap between what the world can produce and what it is actually producing is expected to remain large which will depress future GDP growth;
- Unemployment will continue to be a problem for both developing and high-income countries.

For developing countries there are additional issues of sharply reduced private inflows, more restricted export opportunities and greater commodity price volatility. FDI is down as are revenues from commodity exports. Private capital flows to the poorest countries are projected to drop to \$13 billion in 2009, declining from \$21 billion in 2008 and \$30 billion in 2007. Even remittances which are thought to be more counter-cyclical are likely to fall by 10% in 2009

following years of growth. Smaller, poorer, conflict-affected countries are particularly dependent on remittances for an estimated 25-50% of their national income. Even with the crisis abating, the World Bank estimates that there will be an additional 90 million people in poverty by the end of 2010.

2. Implications for Investment Climate Reforms

The underlying causes of the financial crisis have focused attention sharply on the “better regulation” agenda. Numerous policy papers on financial sector regulation and wider macro-prudential regulation are contained in the WBG and IMF internet links below.

For developing countries, the crisis presents an opportunity – and the motivation - to get serious about reform. Investment climate reforms are a way to improve competitiveness within a more difficult economic environment. Support for private sector development via investment climate reform offers an inexpensive and effective way to mitigate the effects of the financial crisis on the real sectors. Investment climate reforms can help reduce the recessionary impact of the crisis by lowering the cost of doing business and increasing competitiveness. IC reforms cost a fraction of more traditional growth and employment measures such as infrastructure programs or increased government spending on social services, but they do require political commitment.

Doing Business 2010 revealed that the crisis has not dampened appetite for reform. In fact the results indicate the opposite. In the year since June 2008, 131 countries introduced 287 pro-business reforms—20% more than in the previous 12 months and more than in any year since the World Bank started the survey in 2004.

3. Adjustments to the CIC/FIAS Work Program

Against this background, CIC/FIAS has made a number of adjustments to its work program, as follows:

- **Developed and started implementing a new Insolvency product;**
- **Scaled up work under the Alternative Dispute Resolution (ADR) and Secured Transactions/Collateral Registries program; regrouped Insolvency, ADR and Secured Transactions under a “Crisis Cluster”;**
- **Scaled up “*Doing Business*” Reform Advisory, Trade Logistics and Business Taxation work;**
- **Re-focused Regulatory Governance and Investment Promotion.**

Details of the adjustments undertaken are provided below.

To assist in the financing of the scaling-up and expansion of the various crisis-relevant work program areas, CIC/FIAS has received US\$1.35 million of incremental funding support from donor partners such as Austria (OeEB) and Luxembourg; this support – currently allocated to the development and roll-out of the Insolvency product and scaling up of DB Reform Advisory – is

gratefully acknowledged. However, to sustain and broaden the crisis response in particular in the areas of Business Taxation and Trade Logistics Advisory, additional resources at the level of US\$3-4 million per year will be required over the coming 2-3 years. These resources will need to be mobilized under the IFC-wide crisis response resource mobilization initiative, and via additional, FIAS-specific targeted fund-raising. Separate notes are provided on the proposed crisis-related scaling up of Business Taxation and Trade Logistics and the related funding needs.

3a. Developed and started roll-out of a new Insolvency product

\$1.25 to \$1.5 trillion in developing country corporate debt is expected to mature this year, triggering a wave of corporate bankruptcies in 2009 and beyond. The insolvency TA will help countries strengthen their insolvency institutional and regulatory frameworks. Development of the Insolvency TA product began in January 2009 and the product was approved on May 15, 2009. Since then six projects have started in countries significantly affected by, or at risk because of, the crisis. These countries have been identified by analysis of several factors including gaps and maturing debt as a percentage of GDP, maturing debt as a share of reserves, the interest to expense ratio, short term debt to external debt, and total debt as a share of total assets. In addition to the TA, global knowledge management (KM) work is underway to help crisis-affected countries address specific insolvency issues. These are summarized below.

Table 1: Crisis-Related Insolvency TA Projects

Country	Workstream
Egypt	Development and implementation of out of court workout guidelines, and Legislative reform assistance
Latvia	Development and implementation of out of court workout guidelines
Pakistan	Development and implementation of regulatory framework for insolvency administrators
Romania	Development and implementation of out of court workout guidelines, and Legislative reform assistance
South Africa	Development and implementation of regulatory framework for insolvency administrators
Ukraine	Legislative reform; and request to implement insolvency administrator regulatory framework expected soon
Global KM	Development of toolkit for the implementation of out of court workout guidelines and insolvency administrator regulation Establishment of a CIC Insolvency Advisory Board

Results include the adoption by the Government of Latvia of out of court workout guidelines (August 2009) and the adoption of the “Abu Dhabi Declaration” by 11 MENA countries, calling

for insolvency reform in the region and recognizing the CIC insolvency TA being offered to client countries. In the next 6 months, additional TA requests are expected from Peru and Kazakhstan.

Proposed next steps include: (1) delivery of technical assistance under existing projects including the delivery of training workshops with respect to out of court workouts in Latvia, Romania and Egypt; (2) convening an advisory panel to finalize and disseminate toolkits; and (3) organization of a joint ECA training workshop with EBRD with respect to insolvency in South-eastern Europe crisis countries. (Contact: Mahesh Uttamchandani).

3b. Scaling up of Alternative Dispute Resolution (ADR), Secured Transactions/ Collateral Registries, Doing Business Reform Advisory, Business Taxation and Trade Logistics:

Alternative Dispute Resolution: The ADR team is developing ADR guidelines for sectors strongly affected by the crisis such as banking and construction. The team is also preparing a note on ADR as a crisis product. In Eastern and Central Europe ADR is implemented through a comprehensive crisis response initiative, mainly focused on out-of-court restructuring related to third parties. So far ADR activities have led to the return of over \$80 million of funds to businesses that were tied up in litigation. The ADR team continues to work to help reduce court backlogs for commercial cases. (Contact: Lada Busevac)

Secured Transactions and Collateral Registries: The secured lending team is accelerating its efforts to improve legal frameworks for collateralized lending and to establish new and improved collateral registries. (Contact: Alejandro Alvarez de la Campa)

Doing Business Reform Advisory (DBRA): increasing focus for Latin America and Eastern Europe on regulatory issues related to investor protection, creditor rights and contract enforcement. Over the last year the team has helped the governments of Colombia, Dominican Republic, Macedonia and Tajikistan strengthen investor protections through stricter management requirements and increased corporate transparency. Creditor rights also became stronger in the Kyrgyz Republic and Tajikistan with DBRA assistance, and court enforcement of contracts was sped up in Colombia. Continued assistance in these areas is planned for FY10. We expect to see even more reforms in Central Asia (particularly in Kazakhstan) and South America (Peru). (Contact: Melissa Johns)

Business Taxation: Requests from Yemen, Kyrgyzstan, Armenia, Georgia, Lao PR, Rwanda to undertake "quick win" crisis response tax administration simplification to lower compliance cost for taxpayers and improve efficiency of tax administrations ("doing more with less"). Work has started in Kyrgyzstan, Armenia, Lao and Rwanda. Results in Yemen include a 50 percent reduction in VAT compliance costs. In other countries we have developed and adapted a process mapping diagnostic tool. The real demand now is to get ready for post-crisis world: countries that have compromised their tax systems as a part of stimulus -Vietnam, Yemen, Georgia - want us to help them quickly simplify tax administration to remove existing obstacles to compliance before sustained growth returns. Proposed next steps are to set up a post-crisis response group. This group will leverage its knowledge base and capacity to provide advisory services to

countries which will need to rethink their optimal tax mix and streamline administration in an attempt to recoup revenues lost in the wake of the crisis. (Contact: Richard Stern)

Trade Logistics: In response to rising demand from Kazakhstan, Armenia, Mexico, Caribbean, Bangladesh, Nepal, India, Honduras, Montenegro, Albania, and other Eastern European countries for “quick win” reforms in trade logistics systems and services, we have accelerated efforts to assist several of these countries in further increasing their competitiveness through simplified and more efficient import and export documents and processes, risk based approaches to border inspections, and automated systems. Fast track projects have started in Colombia, Rwanda, Liberia, Burkina, Kazakhstan, Honduras, Armenia, Montenegro and Albania. Results include over 30 reforms in Rwanda, Liberia and Colombia alone within 18 months. In addition, the trade logistics team has initiated regional trade logistics programs in the East African Community and the Caribbean, and is planning a regional trade logistics program in Eastern Europe in collaboration with the EC. These regional programs will not only make transit more seamless, but will also help build larger, more efficient regional markets for these countries. Regional markets are critical when global markets are uncertain. Trade, fundamental to economic recovery and growth, is important post-crisis. We anticipate demand for trade logistics advisory assistance to increase further and more rapidly in the post-crisis world. We are gearing up to proactively address post-crisis needs when countries will embark on economic recovery and will require streamlined systems and services that facilitate their competitive entry/re-entry into markets. (Contact: Uma Subramanian)

3c. Re-focused Regulatory Governance and Investment Promotion

Business Operations and Regulatory Reform. The crisis has increased interest and demand for advisory services focused on the issues of regulatory quality and effectiveness. The main expected results are system and government-wide reforms which help clients: (a) effectively and rapidly reduce costs for creating and operating a business (providing relief for struggling companies) in the long-run; (b) limit the risk of backlash towards over-regulation; (c) regulate with more attention paid to regulatory risks and market-failures. In terms of implementation progress, regulatory quality tools such as *Regulatory Impact Analysis* (RIA) and other mechanisms supporting transparent and effective regulations are being developed and tailored to client countries context in Vietnam and Kenya. Proposed next steps are: (a) further development and mainstreaming of regulatory quality tools for reform; (b) development of regulatory quality indicator to measure/report the quality of regulatory institutions, processes and regulations; (c) identification of preconditions and sources of successful reforms. (Contact: Peter Ladegaard)

Investment Policy and Promotion (IP&P): The TA approach within IP&P has been refocused to reflect clients’ higher priority on retaining existing investors with less demand for assistance in new lead generation and investor outreach. The IP&P team has prepared a draft user advisory note on *"Investor Servicing and Aftercare"*. A number of best practice case studies have been developed looking at investor aftercare programs in the Netherlands, Czech Republic and others with the aim of drawing lessons that are relevant in the context of implementing investor aftercare programs in conflict affected and frontier countries. A number of projects have been developed focusing on investor servicing and aftercare activities. The objective of these projects is to help clients retain, expand and diversify existing foreign investors, while using direct

investor feed-back to work on enhancing the investment climate conditions. New or amended existing projects have added aftercare components in Rwanda, Macedonia, Cambodia and Brazil and a two day region-wide practitioners' workshop on aftercare has been set up for six Western Balkans countries on 1st and 2nd September 2009. (Contact: Robert Whyte)

4. Looking forward: adjusting to the “new normal” in the global economy

Despite – or perhaps because of – the crisis, demand for investment climate reform work remains strong. Developing countries, under strong domestic pressure to deliver jobs and growth, look to IC reforms as a practical and relatively inexpensive way to stimulate the growth of the private sector and of their economies.

At the recent IMF-WB annual meetings in Istanbul, WBG President Robert Zoellick, responding to the question “what would it take to build responsible globalization?” referred to “a balanced and inclusive global economy that needs multiple poles of growth – and not just adding China and India. Countries in Latin America, Southeast Asia, and a wider Middle East can assist in the future if they invest today. Over time, investments in Africa, a market of almost a billion people, can integrate its markets and become another source of growth. To build multiple poles of growth, we need to remove bottlenecks and boost productivity through investments in infrastructure and energy, private sector expansion, and regional integration linked to open markets. New poles of growth can be customers for the capital goods, services, and technology of developed countries”.

Key Internet links dedicated to the WBG and IMF crisis response:

World Bank crisis response: <http://www.worldbank.org/financialcrisis/>

WB FPD crisis response: <http://www.worldbank.org/fpdcrisisresponse>

IFC crisis response: <http://www.ifc.org/ifcext/about.nsf/Content/FinancialCrisis>

IMF crisis response: <http://www.imf.org/external/np/exr/key/finstab.htm>