

ANNEX 1. REGIONAL STRATEGIES

Sub-Saharan Africa

1. The year 2005 presents a window of opportunity for a renewed emphasis on supporting private sector development (PSD) in Africa. Government recognition of the importance of private investment in economic growth, improved macroeconomic management, and an increasing stock of diagnostic work for investment climate reform have been converging into new initiatives for addressing Africa's development challenges. In particular, the Commission for Africa, the Millennium Challenge Fund, and the NEPAD Investment Climate Facility all aim to enhance the effectiveness of private sector development and poverty alleviation efforts. Specific proposals under these initiatives are expected to be reviewed at the July 2005 G8 Summit, as well as at the Millennium Summit in September 2005.

2. In addition to an increasing commitment to private sector development from governments, there is a willingness within the private sector to invest in Africa. GDP growth in the region increased from 3.4 percent in 2003 to 3.6 percent in 2004. Macroeconomic management in several large countries has steadily been improving and the number of conflicts across the continent is down, increasing political stability. There is an increase in FDI into the region, and a growth in inter and intra-regional investment. There is an increasing interest by companies from South Africa to invest in other African countries and companies from other regions have renewed their interest in investing in Africa. Such a trend provides an important source of growth for Africa.

Box 1. *Moatize Coal Project in Mozambique (Advisory Assignment).* The Moatize Coal Deposit is one of the largest unexplored coal reserves in the world, estimated at about 2.4 billion tonnes. It is located in a remote region of Mozambique, about 600 kilometers from the port city of Beira. Over the last ten years, the government of Mozambique ("GOM") has been keen to promote the large-scale development of the deposit in anticipation of the economic and fiscal benefits that would accrue. In 2004, after several unsuccessful attempts to attract a coal developer, the GOM hired IFC's Advisory Services Department to assist with the selection of a coal developer and awarding of exploration rights to the Moatize Coal Deposit.

IFC designed a comprehensive selection process to create competition among potential bidders while ensuring transparency and credibility. After a competition amongst 10 companies, a company from Brazil was declared the winning bidder. The process turned out to be very successful for all parties. The process enabled the government of Mozambique to achieve its objectives to develop a large-scale mine while ensuring sustainable development through environmental management and community and social programs in the region. For the company and Brazil, the project supports its globalization strategy, and contributes to the company's product diversification while fulfilling a Brazilian strategic need to access coal, given the size of its domestic steel industry. For IFC, Moatize allowed the Corporation to play a pivotal role in facilitating a South-South investment that was transparent and competitive in nature. IFC is currently in early discussions with the company, to assist it with various programs on investments, community development, and other social issues.

3. The IFC portfolio in Africa has grown steadily and the quality has improved substantially. Today the largest country portfolio is Nigeria, representing 22.2 percent of the region's portfolio, mainly in financial markets and telecommunications. The second largest country portfolio is in South Africa, representing 17.3 percent of the region's investments. There has also been effort to increase investments in conflict-affected countries, such as the Democratic Republic of Congo.

4. In FY04, commitments in Sub-Saharan Africa totaled \$395 million, up from \$140 million in FY03. Identification of new investment opportunities has been the focus of IFC's expanded business development effort in the region. To this end, IFC has adopted a more systematic approach to client relationships by appointing sector leads, based in the Africa department's Johannesburg hub, to head business development in coordination with the relevant industry departments. In addition IFC has increased its local presence in countries such as Mozambique, Ghana, Senegal, and Madagascar.

Table 1. Sub-Saharan Africa

| | FY03 Actual | FY04 Actual | FY05¹ Plan | FY08² Indicative |
|---|------------------------|------------------------|----------------------------------|--|
| Commitments (\$mm) | \$140 | \$395 | \$300-\$385 | \$675-\$825 |
| FMTAAS Funding (\$mm) ³ | -- | -- | \$25 ⁵ | \$18-22 |
| Development Impact Score (%) ⁴ | 38.1% | 37.5% | N.A. | N.A. |

¹ The plan range as per IFC's FY05 Business Plan and Budget (IFC/R2004-0114).

² The indicative range for FY08.

³ Funding Mechanism for Technical Assistance and Advisory Services

⁴ Expanded Project Supervision Report (XPSR)— percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

⁵ Includes transition period from APDF to PEP Africa in FY05.

Strategic Priorities

5. Endorsed by the Board in 2003, IFC's Strategic Initiative for Africa focuses on enhancing support to SMEs, proactively developing investment projects, and addressing investment climate constraints. In these three areas, IFC is committed to a series of specific interventions.

6. **Enhanced support to SMEs.** IFC has taken several steps to enhance the support of SMEs. Pilot SME Solution Centers have been opened in Madagascar and Kenya. The IDA/IFC Africa MSME initiative has moved forward and a proposed \$25 million investment in a joint IDA/IFC partial credit guarantee product will be offered to local banks in Ghana. The goal is to roll out these programs to other African countries. To provide more efficient technical assistance, the Africa Management Services Company (AMSCO) has been reorganized and relocated to the Johannesburg hub to better serve its clients. IFC has also had several successes in its goal to increase SME funding operations including new microfinance investments in Angola and DRC and an IFC managed SME financing/TA facility in Mozambique.

7. **Growth in direct investment.** IFC sees several opportunities for growth of its direct investments. In the infrastructure sector, strong growth over the next 2 years can be achieved. However, to accomplish this, infrastructure projects must attract private capital. In Africa that requires extensive upfront project development work. Governments need to be reassured that transactions will achieve development results, while private investors need to be convinced that the process will be transparent, and risks fairly allocated. To meet these challenges, IFC has strengthened staffing in its regional headquarters in Johannesburg, and is partnering with DFID and other donors for an \$11 million grant to partially fund the costs of advisory and project development assignments.

8. IFC recognizes that it needs to make a concerted effort to firmly establish its brand name and become a significant player in Africa's financial markets. Currently, IFC has strong relationships with approximately 20 banks operating in Africa. The plan is to significantly increase this number in the next few years. The Corporation also plans to initialize several microfinance banks. Market reception to IFC's trade facility has been good and it is anticipated that disbursements will be made from this facility in the upcoming year.

9. Other areas of growth for IFC in Africa include agribusiness, oil, gas, and mining and general manufacturing. In the extractive industries, IFC will work closely with the World Bank and the IMF on governance and transparency issues. In agribusiness and general manufacturing the focus will be on smaller transactions, but on increasing the project pipeline. Finally, there is significant opportunity in South-South investments, not only with South African firms, but also helping clients from other countries such as China, Brazil, and the MENA region invest in the continent.

10. **Active Engagement in Improving the Investment Climate.** Improvement in the investment climate is fundamental to private sector development in Sub-Saharan Africa. Progress to date has been slow and governments have requested the World Bank Group provide some meaningful and ongoing assistance on implementation. IFC plans to address constraints in the investment climate through the design and execution of investment climate assessments (ICAs) in collaboration with the World Bank, support for public-private dialogue and private sector advocacy, and by providing assistance to improve the enabling environment for SMEs. For example, in Burkina Faso, in response to the government's request, IFC's Private Enterprise Partnership for Africa (PEP Africa), in collaboration with FIAS, is proposing a 30-month program to improve the business climate in Burkina Faso focusing on the following five components: (i) business registration and start-up, streamlining procedures to reduce time and costs; (ii) employment regulation, to encourage formal employment while preserving appropriate worker protections; (iii) contract enforcement, to improve the ability of firms to access the judicial system or alternative dispute resolution mechanisms for commercial matters; (iv) property registration, to simplify and reduce the costs of acquiring and registering property associated with private investment; and (v) business closing, to improve liquidation and bankruptcy procedures.

East Asia and the Pacific

11. East Asia and Pacific is one of the most dynamic economic regions in the world. This dynamism is underpinned by some of the highest levels of savings and investments in the world. In 2004, the region is projected to have grown by 8.2 percent. Strong growth in 2005 is forecasted at 7.5 percent. Partly due to the high domestic savings rates, banks in the region are generally liquid. The region is also characterized by rapid integration driven by the emergence of China as its economic center. Intra-regional trade and investment flows are growing in importance. Chinese companies are becoming important investors in countries within and outside the region. IFC sees an increasing role in helping regional companies expand outside their borders.

12. Countries in East Asia and the Pacific are also very diverse in terms of size, level of development, and the challenges the private sector is facing. China is a major emerging economic power with growing regional and global influence. It has a liquid banking sector and receives the largest share of FDI to emerging markets is going to China. Other "transition" (moving from central control to more of a free market) economies in the region including Vietnam, Mongolia, Laos and Cambodia are reforming and looking for ways to improve the business environment for their small and medium sized enterprises, while the market economies of Indonesia, Thailand, Malaysia, Korea, and the Philippines have made significant progress on corporate restructuring since the 1997 Asian crisis. Despite these positive developments, addressing the institution-building issues of financial sector development and corporate governance is still a long-term challenge. The banking sector is dominated by state banks, many countries suffer from weak legal institutions and transition countries still present difficult investment environments for private sector growth.

13. IFC's commitments in the region have grown steadily from \$573 million in FY03 to \$730 million in FY04. IFC has engaged in highly visible (with strong demonstration effect) banking and corporate sector restructuring with a strong TA component, provided liquidity through trade financing facilities and undertaken institution-building in the financial sector. Activities in transition economies have focused on supporting the growing role of the private sector, particularly local domestic private companies. In the frontier economies of the region, IFC's activities have concentrated on assisting the growth of SMEs through IFC and donor-funded project development facilities. The region hosts four such facilities: Mekong Project Development Facility (MPDF) for the Mekong region, Pacific Enterprise Development Facility (PEDF) for the Pacific countries, China Project Development Facility (CPDF) for the Western

regions of China, and Program for Eastern Indonesia SME Assistance (PENSA) for the remote islands of Indonesia.

Table 2. East Asia and the Pacific

| | FY03 Actual | FY04 Actual | FY05¹ Plan | FY08² Indicative |
|---|------------------------|------------------------|----------------------------------|--|
| Commitments (\$mm) | \$573 | \$730 | \$590-\$750 | \$900-\$1,100 |
| FMTAAS Funding (\$mm) ³ | -- | -- | \$11.5 | \$8-11 |
| Development Impact Score (%) ⁴ | 37.9% | 48.3% | N/A | N/A |

¹ The plan range as per IFC's FY05 Business Plan and Budget (IFC/R2004-0114).

² The indicative range for FY08.

³ Funding Mechanism for Technical Assistance and Advisory Services.

⁴ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

Strategic Priorities

14. IFC's strategy in the region is focused on (i) expanding business in the large markets of China and Indonesia; (ii) developing strong financial institutions with a focus on deepening the capital markets in the region; (iii) addressing the major infrastructure needs facing the region; (iv) helping domestic companies grow into global players, including support for South-South investments in the region and beyond; and (v) expanding IFC's coverage in frontier markets by deepening integration between the TA facilities and core business and supporting improvements in the business environment.

15. IFC's strategy in China is predicated on the value proposition of being the preferred partner for companies seeking to adopt international standards in governance, environmental, and social practices. Given the high liquidity in the region, established companies have good access to finance. The emerging localized companies need IFC financing, but they also require a lot of assistance in the areas of sustainability and globalization. IFC's strategy is to increase its China program by helping established domestic companies go global while at the same time investing in up and coming companies located outside of China's major industrial cities. IFC is strengthening business development capacity and broadening geographical coverage to increase its business development efforts in the country. Another challenge for China is to strengthen and deepen its financial markets so that savings are intermediated efficiently to productive investments. Supporting this process is a major part of the China strategy.

16. In Indonesia, IFC's primary focus will be to develop financial markets, and create model infrastructure projects. Indonesia's infrastructure needs are enormous as rapid growth and years of low investment in the sector are straining the regional infrastructure. At the same time, the government and investors are looking for ways to develop new models of infrastructure financing, some of them involving both public and private participation. IFC is uniquely positioned to respond to these needs in Indonesia given its previous experience around the world. The challenge will be to maximize the synergies between the IFC and the World Bank to advance the infrastructure agenda through policy advice and demonstration transactions involving public-private partnerships. Based on this strategy, and additional investments in agribusiness, infrastructure, oil, gas and mining and general manufacturing, there is the potential to grow the program in Indonesia significantly in FY06 and FY07.

17. In the smaller countries in the region, IFC's strategy will also address development of capital markets, and investment in infrastructure, but will put more focus on expanding its reach to SMEs and providing technical assistance on investment climate issues. Technical assistance in these countries will be aligned with potential investments where possible and encompass linkages programs, access to finance and corporate governance. Technical assistance will be done in close coordination with the World Bank

through a partnership which leverages World Bank expertise in policy advice and IFC's transaction experience.

South Asia

18. South Asia has been one of the fastest growing regions in the world. GDP growth in the region was 6.6 percent in 2004. The private sector has been at the forefront of the region's strong performance, as entrepreneurs throughout South Asia strive for international competitiveness and identify opportunities to expand operations within the region and beyond. However, longer term economic growth trends in the region remain dependent on the implementation of wide ranging structural reforms which would further remove constraints to private sector development. Private investment levels have been notably low in the region, with the manufacturing sector contributing a substantially lower share to GDP compared with East Asian countries.⁶ As a share of GDP, FDI also remains low.⁷ While growth of private enterprise in the region has been constrained by state-led development policies and heavily regulated markets, this has been changing as the countries in the region have continued to pursue market-oriented reform programs.

19. India, the most politically stable in the region, has experienced strong growth of around 6 percent per year in the last decade, led by growth in the least regulated services sector. The domestic industry is restructuring, privatization is starting to make headway, and there is progress in addressing the huge backlog of infrastructure investment. Companies are starting to look at India as a global outsourcing base, and knowledge-based industries continue to grow rapidly. In Bangladesh, poor governance, inadequate infrastructure and social and political instability have kept the costs of doing business very high. In Sri Lanka, the civil war hindered private investment, and the ceasefire signed in 2002 has not yet led to significant reconstruction. Both Sri Lanka and the Maldives have been severely impacted by the recent tsunami, with the fisheries and tourism industries suffering severe economic and financial setbacks. The long-term economic impact of the disruption and loss of housing and social infrastructure remains uncertain.

20. IFC's program in South Asia has combined direct investments in projects with high development impact with technical assistance to promote sustainable private-sector led growth. IFC has been steadily increasing its investment in the region since 2000 with annual commitments growing from \$296 million in 2001 to \$405 million in 2004. India currently accounts for 70 percent of annual commitments in the region. IFC's portfolio in the region is diversified across investments in manufacturing, infrastructure, financial sector, agribusiness, power, oil and gas, and healthcare. The expansion in IFC's portfolio to its current \$1.5 billion for the region has mainly been in long-term debt, aided by the introduction (in 2002) of local currency lending in India that is suited to sectors that do not generate foreign exchange.

Table 3. South Asia

| | FY03 Actual | FY04 Actual | FY05¹ Plan | FY08² Indicative |
|---|------------------------|------------------------|----------------------------------|--|
| Commitments (\$mm) | \$385 | \$405 | \$335-\$415 | \$500-\$600 |
| FMTAAS Funding (\$mm) ³ | -- | -- | \$5.1 | \$4-5 |
| Development Impact Score (%) ⁴ | 57.1% | 66.7% | N/A | N/A |

¹ The plan range as per IFC's FY05 Business Plan and Budget (IFC/R2004-0114).

² The indicative range for FY08.

³ Funding Mechanism for Technical Assistance and Advisory Services

⁴ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

⁶ 30-35% in East Asia against less than 20% in India, 16% in Bangladesh and Sri Lanka.

⁷ Less than 1% in the region vs. 4% in China and around 2-3% in many emerging market countries.

Strategic Priorities

21. IFC's strategy in the region focuses on: (i) promoting greater competitiveness in industry and services; (ii) integrating South Asia into the global economy by supporting FDI and helping South Asian companies expand regionally and globally; (iii) improving the quantity and quality of infrastructure through increased private participation, and public-private partnerships; (iv) strengthening domestic financial institutions; and (v) providing support to SMEs. IFC has been at the forefront in supporting regional industry's efforts to achieve international competitiveness in the face of declining tariffs. IFC investments will focus on supporting companies that are restructuring and/or expanding, investing in both first and second tier companies that are developing new markets and products, and working towards global best practices in corporate governance and environmental and social sustainability. In particular, IFC is identifying opportunities in India beyond the large commercial centers of Mumbai and New Delhi, including fast growing cities in the south, and is establishing a new office in the southern city of Chennai.

22. In view of the critical importance of improved infrastructure for sustained growth and poverty reduction, infrastructure is another high priority for IFC investment, TA and advisory work in South Asia. IFC is helping expand the availability of power, water and telecom services through investments and advice on PPPs. A key growth opportunity exists in helping governments meet their huge infrastructure needs. In the financial sector, IFC aims to strengthen banks and non-bank financial institutions through equity investments and technical assistance. IFC is working with partner institutions to develop sustainable SME financing. However, the slow pace of financial sector reform, high liquidity in domestic banking sectors and external borrowing restrictions by the Indian government have limited IFC's role in lending to financial institutions in South Asia.

23. In parts of the region where political instability and a difficult business environment limit investment opportunities, IFC's primary contribution to private sector development is through technical assistance to SMEs. This is delivered through the South Asia Enterprise Development Facility (SEDF), which works to improve the business enabling environment, strengthen providers of business development services, and help financial institutions lend to SMEs. SEDF currently operates in Bangladesh, Bhutan, Nepal and the North-East of India. A new SEDF program for Sri Lanka and the Maldives is under preparation, and will contribute to the recovery of SMEs in the tourism, agribusiness, construction and fisheries sectors following the tsunami. SEDF's business enabling environment program is closely integrated with FIAS programs in the region to improve the business environment for foreign investors.

Middle East and North Africa Department

24. Overall GDP growth for the MENA region in 2004 was 5.1 percent. However, the region tends to be more public-sector dominated than other regions and governments are struggling to address the most pressing economic problems, which are unemployment and the growing youth population. These can only be addressed in a sustainable way by an increased contribution by the private sector and many of the governments are recognizing that this implies changes. From Egypt to Pakistan to Morocco to Jordan, governments are embarking on reform agendas, and the outlook is optimistic.

25. The MENA region is undergoing a period of increased economic integration. Private companies throughout MENA are investing increasingly in other countries in the region in banking, construction materials, and telecoms. Other positive developments include improvements in the financial sectors of these countries with the introduction of new types of institutions and products.

26. Sectorally, oil and gas dominate many of the economies of the region, particularly the wealthy Gulf countries, but also the developing markets of Syria, Algeria, Iraq and Iran. While oil revenues have surged with the recent increases in oil prices, other countries with fewer resources have actually made more progress in liberalizing their economies (Jordan and Pakistan). Other dominant sectors for the region include tourism (although this has been affected by events in the region), manufacturing, and petrochemicals.

27. IFC's portfolio of investments in the region totals about \$1 billion. Over the past few years, annual commitments have ranged between \$185-\$280 million. Investments are diverse and held in fifteen out of the total nineteen countries/territories in the MENA region. IFC has been heavily involved in the financial sector, power, textiles and other manufacturing. IFC has recently been active in oil, gas and related sectors. IFC's activities encompass a diverse spectrum of projects from investing in the first microfinance bank in Afghanistan to supporting the first private sector bond issue in Saudi Arabia.

28. The IFC is currently undertaking an initiative to utilize the national currency paid-in capital from Saudi Arabia for on-lending to private sector clients. The first investments of this type are expected to be for the provision of housing finance. IFC has also invested with companies from the MENA region as they go beyond their own borders. For example, IFC has invested with an Egyptian cement company in Algeria, a ceramic tile manufacturer from the United Arab Emirates as it expanded into countries in MENA and South Asia, and a Jordanian pharmaceutical manufacturer as it expanded overseas. IFC has also invested in private sector infrastructure investments, including the power and transport sectors.

29. IFC has provided technical assistance to companies to help develop investment opportunities through the Trust Fund program as they develop laws and regulations affecting the business enabling environment. In FY03, IFC launched its first project development facility in the region to provide technical assistance aimed at SMEs in Algeria, Egypt and Morocco. That effort has since been expanded to support the entire region, focusing on a broader private sector development mandate. This initiative is known as the Private Enterprise Partnership for the Middle East and North Africa (PEP-MENA).

Table 4. Middle East and North Africa

| | FY03 Actual | FY04 Actual | FY05¹ Plan | FY08² Indicative |
|---|------------------------|------------------------|----------------------------------|--|
| Commitments (\$mm) | \$279 | \$186 | \$220-\$275 | \$450-\$550 |
| FMTAAS Funding (\$mm) ³ | -- | -- | \$5.8 | \$6-9 |
| Development Impact Score (%) ⁴ | 44.8% | 30.8% | N/A | N/A |

¹ The plan range as per IFC's FY05 Business Plan and Budget (IFC/R2004-0114).

² The indicative range for FY08.

³ Funding Mechanism for Technical Assistance and Advisory Services

⁴ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

Strategic Priorities

30. IFC's strategy in MENA is coordinated with the World Bank's strategy in the region. IFC aims to address the main challenges of the region which are employment creation and economic development. IFC's work focuses on how to support the movement of countries toward greater development and more open markets, through private sector participation. While IFC's traditional role in the region has been a provider of long-term capital, IFC's technical assistance (TA) is increasingly helping companies in the region introduce best global practices.

31. The PEP-MENA facility, which is largely donor funded, is operating out of the field office in Cairo. PEP-MENA is focusing on the financial sector, SMEs, capacity building and the business enabling environment (BEE). It is also focusing on public-private partnerships and privatization or restructuring of state-owned enterprises (SOEs), capitalizing on IFCs institutional experience. PEP-MENA will be organized to take advantage of synergies between IFC investments and technical assistance, for example in the housing market in Pakistan, as well as to do stand alone work such as institution building in frontier and post conflict countries.

32. On the investment side, IFC has taken large steps in strengthening its business development efforts in order to expand its program. The Corporation has placed senior business development officers in Cairo, Dubai, Islamabad, and soon in North Africa. IFC's investment program is focused in the financial sector, manufacturing, oil and gas, infrastructure, and health and education. Access to finance is a top priority for the SMEs within the region. IFC's efforts in frontier countries (e.g. Afghanistan and Iraq) are predominantly developmental, focusing on basic financial sector and private sector development. In infrastructure, there are opportunities for expansion in Egypt and Pakistan, especially in the power and transport sectors. In health and education IFC has an active pipeline, with promising projects in Jordan and Lebanon.

33. Another key area of opportunity for IFC is the promotion of inter-regional investments. The Dubai office will focus on leveraging the mobilization of private resource flows from the capital-rich Gulf countries to the FDI seeking North African and Middle Eastern economies and beyond. IFC could play an important role fostering such investments that would accelerate the integration of the region.

34. The MENA region is particularly challenged by political events and conflicts. IFC has remained active despite these events and maintains a diversified approach to keep business going during challenging times. In the longer term, IFC sees the potential for large scale investments in Iraq and possibly Syria and Iran. Through its technical assistance work in institution building, business environment and SMEs, the Corporation is adding value beyond financing. When the time comes, this reputation will allow IFC to leverage its experience and provide these countries with comprehensive solutions involving both finance products and capacity building services.

Central and Eastern Europe Department

35. The countries of the Central and Eastern Europe region can be divided into three groups when considering opportunities for IFC. At the more developed end of the spectrum, there are eight countries that have joined the European Union (Poland, Hungary, Czech and Slovak Republics, Slovenia, Latvia, Lithuania, Estonia). In these countries, the private sector has reasonable access to finance, although certain regions and sectors remain underserved. Average GDP growth in this sub-region was 4.8 percent in 2004.

36. In the middle are Russia and Ukraine. These countries have seen strong growth rates, with GDP in 2004 of 7.3 percent and 12.5 percent, respectively. Despite their recent economic successes, and improvements in the business environment, both present significant challenges to local and foreign private investors. Continued growth of the private sector is predicated upon further improvements in the business environment.

37. The private sectors of Belarus, Georgia and Armenia are at the less developed end of the spectrum, although GDP growth was strong at 6.8 percent in 2004. Belarus has shown little progress on reforms and privatization. Armenia's small and land-locked economy suffers from political conflicts with its neighbors and relatively weak financial intermediation, although it has made strides in improving the business enabling environment. Georgia's new government is making progress towards reducing

corruption and overregulation, and utilizing the country's geopolitical importance to jump start economic growth.

38. IFC's annual commitments in the region have been growing rapidly from \$616 million in FY03 to \$797 million in FY04. IFC has been deeply involved in the transition of Central Europe into the European Union since the 1980s, by financing more than \$2 billion (plus \$745 million syndication) for 265 projects spread across industries. IFC's projects have contributed to processes essential to EU accession such as privatizations, creation and strengthening of new financial institutions and products, and increases in the productivity and competitiveness of firms.

39. IFC's investment in Russia has grown dramatically over the last 3 years, with the IFC portfolio in Russia reaching 64 percent of the region's committed portfolio and exceeding 7 percent of IFC's total committed portfolio.⁸ IFC's investments have two main characteristics: first, most clients are now local sponsors; and second, IFC has focused on building long-term relationships with medium-sized independent private regional banks in order to reach SMEs. IFC has provided credit lines and tailored technical assistance to strengthen these banks. IFC has also been developing non-bank financial services, such as leasing, that are traditionally more accessible for SMEs; and third, IFC has dramatically increased its investments in Russian infrastructure, particularly transport and logistics. Responding to the positive signals, IFC also increased its investments in Ukraine over the last 2 years. IFC's investments in Ukraine focused on agribusiness, retail trade, and financial markets.

Table 5. Central and Eastern Europe

| | FY03 Actual | FY04 Actual | FY05¹ Plan | FY08² Indicative |
|---|------------------------|------------------------|----------------------------------|--|
| Commitments (\$mm) | \$616 | \$797 | \$655-\$825 | \$900-\$1,100 |
| FMTAAS Funding (\$mm) ³ | -- | -- | \$6.7 | \$6-9 |
| Development Impact Score (%) ⁴ | 65.0% | 77.3% | N/A | N/A |

¹ The plan range as per IFC's FY05 Business Plan and Budget (IFC/R2004-0114).

² The indicative range for FY08.

³ Funding Mechanism for Technical Assistance and Advisory Services

⁴ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

Strategic Priorities

40. In the new EU member countries, IFC is not promoting new business, and has closed all field offices there. IFC responds to opportunities only where the Corporation has a clear role in projects that contribute to EU accession processes, support a complex privatization, contribute to the introduction of new financial products, or promote inter-regional investment (i.e. from Central Europe to the south or east). In the rest of the region, IFC's strategic priorities include: (i) supporting local companies while improving transparency and corporate governance; (ii) catalyzing foreign investment, as foreign direct investment is still relatively low; (iii) introducing and developing new financial products; (iv) focusing on frontier markets with an emphasis on SMEs through both advisory work and the development of financial institutions; (v) building long-term partnerships with strong regional players; and (vi) promoting private sector investment in infrastructure. In Russia, a likely new area of engagement will be municipal infrastructure and sub-national finance. Financial markets will continue to be a key area, with a focus on the introduction of new financial products and strengthening institutions in the less developed regions of the Federation. Technical assistance will remain an important part of engaging in Russia, in particular in

⁸ Committed portfolio data as of January 31, 2005

housing finance, energy efficiency, and community and supply chain development linked to large investments.

41. Ukraine is likely to present significant opportunities for growth over the next 4-5 years. In Ukraine IFC will increase its resources and investment activity to respond to the positive signs generated by the new government's radical reform agenda. IFC will need to allocate adequate resources through further decentralization and local hiring to meet the rapidly growing demand for IFC financing across a wide variety of sectors, including agribusiness, financial markets, manufacturing and services, infrastructure, and chemicals. The Corporation will also maintain its advisory activities in Ukraine in order to enhance the attractiveness of IFC's value-added package to clients, improve the business enabling environment and the competitiveness of producers in key industries, and strengthen financial institutions. The frontier countries of Belarus, Armenia, and Georgia remain difficult markets to find many viable investments because of the small size of their overall economies (in the case of Georgia and Armenia) or of their private sector (in the case of Belarus). Therefore, IFC's overall investments are likely to remain limited to small projects that will require extensive technical assistance.

Southern Europe and Central Asia

42. Following Russia's financial crisis in 1998, all countries in SECA resumed growth by 2002. The growth came as a result of market reforms, the positive impact of prospective EU accession, resolution of some regional conflicts, and favorable prices in oil producing countries. The region grew 5.7 percent in 2003 and by 6.1 percent in 2004. In Southern Europe and Turkey, economic and political reforms are guided to a large extent by the EU accession agenda, and the business environment is improving. In Central Asia the pace of reforms is uneven. Private sector share of GDP is growing, ranging from 75 percent in Bulgaria and Albania to 25 percent in Turkmenistan. New and dynamic local businesses are emerging in all sectors of the economy, including in infrastructure. Access to finance is improving and loans to the private sector increased significantly in many countries. There is an increasing interest from foreign investors in the Southern Europe region.

43. As of December 2004, IFC held a portfolio of \$2.6 billion in the SECA region, of which \$1 billion was in Turkey. Three other countries – Romania, Bulgaria, and Croatia – have portfolios ranging from \$230-330 million each. Other countries in the region are small markets where IFC's portfolio is smaller. During the last three years IFC has increased its investments in the region about 250 percent. About 44 percent of IFC's portfolio in SECA is in the financial sector, given its key role in private sector development. IFC has been actively involved in the restructuring and privatization process of the financial sector in almost all the countries in the region and has been fostering the development of non-bank financial institutions, especially in housing finance and leasing. The general manufacturing sector is important for Southeastern European countries' economies in many ways and has been a priority for IFC operations. This sector is becoming more important within the context of globalization given the increasing shift of manufacturing activities from OECD countries to developing countries.

Table 6. Southern Europe and Central Asia

| | FY03 Actual | FY04 Actual | FY05¹ Plan | FY08² Indicative |
|---|------------------------|--------------------|----------------------------------|--|
| Commitments (\$mm) | \$587 | \$705 | \$610-\$775 | \$900-\$1,100 |
| FMTAAS Funding (\$mm) ³ | -- | -- | \$3.4 | \$4-5 |
| Development Impact Score (%) ⁴ | 69.0% | 73.7% | N/A | N/A |

¹ The plan range as per IFC's FY05 Business Plan and Budget (IFC/R2004-0114).

² The indicative range for FY08.

³ Funding Mechanism for Technical Assistance and Advisory Services

⁴ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

Strategic Priorities

44. SECA, a region where all countries except Turkey are transition economies, is changing rapidly. By 2007-08, Romania, Bulgaria and Croatia will all join the European Union (EU). Consequently, companies have urgent needs to meet EU requirements and the countries have large infrastructure requirements. In response, IFC has doubled its portfolio in the EU accession countries in the last two years to address the pressing needs of its clients. To continue to expand its role in EU accession countries, IFC is introducing creative new solutions, approaches, and products, especially in the financial markets.

45. IFC is also implementing a strategic shift from the restructuring and privatization of the financial sector to a greater focus on regional and country-specific infrastructure investments (power, gas distribution, transport) and telecom. Most countries in the region have limited resources and fiscal space to fund infrastructure projects; however, there have been growing challenges for private sector involvement in the sector. IFC has been seeking to address some of these problems by facilitating PPPs and providing a number of innovative financing, advisory, and project development activities. IFC, in close cooperation with the World Bank will continue to find ways to help attract private sector investments in infrastructure in the Southern European region.

46. IFC intends to make more equity investments, especially in Romania and Bulgaria and bring its experience in corporate governance and environmental and social sustainability to its clients. IFC will introduce more innovative structured finance, local currency finance and other products to the market. General manufacturing will also be important, but will be pursued in a more opportunistic manner. IFC will also focus on South-South investments, with an emphasis on inter-regional investment. For example, in the short-term there are opportunities in supporting Turkish outward investments in the Balkans and Russia, and Russian investments in Southern Europe. In the medium term, IFC anticipates potential Turkish investment in Iraq and other neighboring countries.

47. Technical assistance will be an important instrument to implement IFC's strategy in the region, enhancing the development impact of its activities, especially in frontier countries. IFC's TA and advisory services will continue to be multidimensional, including programs to improve the business environment in client countries, assist SME sector development through banking and microfinance institutions, and facilitate the privatization of key industries. IFC's technical assistance facilities in the region will play an important role in providing advice for the development and operation of projects in an environmentally and socially sustainable manner, implementing SME linkages and community development programs, and establishing a framework for constructive engagement with local and international NGOs.

Latin America and the Caribbean Department

48. During the last five years, the private sector in the region has gone from bust to recent expansion. The Argentine crisis, political uncertainties in Brazil and slowdown of the US economy had major impacts in Latin America. Access to international capital markets, as well as the appetite from foreign investors, declined considerably in 2001-02. In addition, the private sector experienced increased competition from other markets, particularly China, East Asia and India. In 2003, GDP growth was 2.0 percent. However, by late 2003, the region began to experience a turnaround, due in part to export growth fueled by increased commodity exports to China and a growing US economy. GDP rebounded strongly in 2004 with 5.5 percent growth. Across the region, country risks as perceived by the market have declined, supported by better economic performance.

49. Today the region's economy is growing steadily. Growth in 2005 and 2006 is expected at 4.2 percent per year and 3.7 percent per year respectively. The fiscal prudence of the last few years has encouraged strong capital flows and lower spreads. Many of IFC's traditional clients have greater access to capital, although market liquidity still mainly benefits the top tier companies. Despite these promising developments, the region continues to face some major challenges. The region still compares unfavorably with other emerging markets (other than Africa) when it comes to investment climate, domestic financial sectors, infrastructure and social tensions. These factors have hampered the development of a broad-based private sector and led to political ups and downs, as most of the benefits tend to flow to the existing establishment. In addition, red tape together with inefficient logistics and infrastructure represent a major cost.

50. IFC's activities in the region have responded to the needs of its clients and attending countries' circumstances. Commitments in FY04 reached \$1.2 billion, marking the third year in a row they exceeded the billion dollar mark. In the past, IFC tended to focus on helping the private sector overcome the financing constraints it faced by playing an important countercyclical role. This role was exemplified by IFC's trade financing facilities for Brazil in 2002-03 which helped viable export-oriented companies whose funding options were closed. Later on, as countries started regaining access to capital markets, IFC shifted its emphasis to providing long-tenor financing, which remains difficult to access in most countries in the region. Looking forward, IFC will focus on assisting the region to address the social and economic pressures that are limiting its growth and stability.

Table 7. Latin America and Caribbean

| | FY03 Actual | FY04 Actual | FY05¹ Plan | FY08² Indicative |
|---|------------------------|------------------------|----------------------------------|--|
| Commitments (\$mm) | \$1,261 | \$1,218 | \$1000-\$1,260 | \$1,350-\$1,650 |
| FMTAAS Funding (\$mm) ³ | -- | -- | \$7.3 | \$7-9 |
| Development Impact Score (%) ⁴ | 74.5% | 70.0% | N/A | N/A |

¹ The plan range as per IFC's FY05 Business Plan and Budget (IFC/R2004-0114).

² The indicative range for FY08.

³ Funding Mechanism for Technical Assistance and Advisory Services

⁴ Expanded Project Supervision Report (XPSR) – percent of XPSRs which scored “mostly successful and above” on the development outcome measure based on a 3 year rolling average.

Strategic Priorities

51. IFC's strategic priorities in the region focus on sectors with the greatest impact on alleviation of poverty, inequality and social pressure and which ensure more sustainable development of local infrastructure and financial markets. In the infrastructure sector, governments face fiscal constraints and are aware that private sector participation in infrastructure is needed if they are to meet the enormous needs of the region—estimated at \$70 billion per year. The challenge remains as to how IFC can advance on this front through adequate regulatory frameworks, independent regulators and strong buy-in from the population, given rising animosities in some countries to past privatizations and foreign investments. IFC will focus on creating public-private partnerships targeted toward logistics, utilities, and renewable energy industries. IFC will continue to strengthen ties with the World Bank in order to provide comprehensive solutions and support. There are also growth opportunities for the Corporation in municipal/sub-national finance, including technical assistance for improving the business enabling environment, and capacity building for regulators.

52. Advancing the sustainability agenda in the region is another priority for IFC. However, corporate social responsibility is still at a nascent stage in most countries, with the exception of Brazil and possibly Colombia. IFC will focus on industries that have the largest social impact, such as the extractive and

agribusiness industries. In the extractive industry projects, emphasis will be placed on tying IFC's financial investments with advisory work in consultation with the World Bank when synergies exist, on revenue management, local capacity building for efficient use of fiscal revenues and community engagement, in addition to our established assistance in environmental management. IFC will also continue to invest in the health and education sectors, introducing more innovative financial products. For example, in Brazil and Mexico, IFC is working on establishing new models for public-private partnerships in the health and education sectors. In addition, priority is being given within the financial sector to second tier banks and non-bank financial institutions (housing, microfinance and SMEs, credit bureaus).

53. Technical assistance is a critical component of IFC's strategy for the region over the next few years. Compared to other regions, technical assistance in Latin America has been relatively limited, owing in large part to lack of donor interest in private sector-oriented activities. IFC's Technical Assistance Facility for Latin America and the Caribbean, a multi-donor initiative launched in mid-2003, has greatly expanded IFC's ability to deliver technical assistance in the region, particularly in its four principal countries of focus (Bolivia, Honduras, Nicaragua, and Peru). The facility's work program focused on improving the business enabling environment by simplifying business regulations, deepening the local impact of IFC investments through linkages and corporate social responsibility, and strengthening frontier markets through country-specific targeted technical assistance. The facility has, during its first two years, achieved success in several projects, particularly simplifying business regulations. Over the next few years, the facility will build on its current work program by selectively delivering on *Doing Business* findings, supporting IFC investments in sustainability in sectors such as oil, gas, mining and agribusinesses, and working to differentiate the corporation through the value-added services that it can offer clients.

54. Finally, IFC will work with first tier companies in some of the region's larger countries when it has a specific role to play in helping these local and regional companies become more competitive in the global economy. Through assistance in technology transfer, better corporate governance and global environmental social standards as well as by helping companies make investments in other emerging economies, IFC can facilitate a large development impact.