



COMMONWEALTH SECRETARIAT

HARNESSING EXISTING FINANCING FACILITIES TO PROMOTE PUBLIC-PRIVATE PARTNERSHIP FOR INFRASTRUCTURE INVESTMENT AND SERVICE DELIVERY IN POST-CONFLICT COUNTRIES

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Final Report

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Finally, we would like to thank all parties we have consulted with for their time and insights. The list of parties and when they were consulted is provided in Appendix 10.

This study and its conclusions reflect the opinions of the authors and not necessarily those of the sponsors of this study.

LIST OF ACRONYMS

ADB	Asian Development Bank
AfDB	African Development Bank
CBO	Community based organisation
CHMF	Commonwealth Heavily Indebted Poor Countries Ministerial Forum
CIDA	Canadian International Development Agency
CSO	Civil Society Organisation
DFID	UK Department for International Development
EAIF	Emerging Africa Infrastructure Fund
EBRD	European Bank for Reconstruction and Development
ECA	Export Credit Agency
EU	European Union
FMO	The Netherlands Development Finance Company
HIPC	Heavily In-debt Poor Countries
IDA	International Development Association
ICSID	International Centre for Settlement of Investment Disputes
IFC	International Finance Corporation
IFF	International Finance Facility
LMI	Low and middle income
MDGs	Millennium Development Goals
MIGA	Multilateral Insurance and Guarantees Agency
NGO	Non-governmental organisation
OBA	Output Based Aid
OECD	Organisation for Economic Co-operation and Development
PCC	Post-Conflict Country
PCG	Partial Credit Guarantee
PPI	Private Participation in Infrastructure
PPP	Public-Private Partnership
PRI	Political Risk Insurance
Proparco	Société de Promotion et de Participation pour la Coopération Economique
Secretariat	Commonwealth Secretariat
Sida	Swedish International Development Cooperation Agency
SME	Small and medium size enterprises
TA	Technical Assistance
UN	United Nations
UNICEF	United Nations Children Fund
UNWFP	United Nations World Food Programme
USAID	United States Agency for International Development
UNCITRAL	United Nations Commission on International Trade Law

EXECUTIVE SUMMARY

At the 2004 Commonwealth HIPC¹ Ministerial Forum (CHMF) Meeting in Sierra Leone, Ministers expressed concern that HIPCs, and those countries emerging from conflict in particular, continue to experience severe shortage of investment in the provision and delivery of infrastructure services. The Commonwealth Secretariat and the UK Department for International Development (DFID) have sponsored this study to seek to address some of the issues highlighted at the meeting, including how could existing donor supported financing facilities be harnessed to promote public private partnerships (PPPs) for infrastructure investment and service delivery in post-conflict countries (PCCs).

This study examines the context of PCCs and the relevant implications on development and implementation of infrastructure PPPs. It then proceeds to suggest a number of high priority interventions that could be considered as a way of increasing the flow of finance to infrastructure projects in these countries, and suggests three model pilot projects through which these interventions could be tested.

Availability of finance is not necessarily the main obstacle frustrating flows of commercial investment into infrastructure PPPs in PCCs. Indeed, the constraints often occur earlier in the project cycle. They are principally related to: (i) a weak contractual environment in PCCs; and (ii) a general paucity of well structured and economically robust infrastructure projects. While these difficulties are common to many non-conflict affected low and middle income (LMI) countries, there are some key differences. Specifically, the investment risks tend to be greater in PCCs, not least the potential for renewed conflict, these risks are more difficult to mitigate and institutions are usually considerably weaker, often having been destroyed by war. The implications of these differences are that investor interest, including interest from donor supported financing facilities – the majority of which operate on commercial or near commercial basis – has been lower for projects in PCCs than in other LMI countries. This paucity of investment is particularly pronounced in water, sanitation and electricity sectors, and less so in more commercially attractive sectors such as telecoms.

The result is that PPPs will need to be funded by a combination of commercially priced finance, typically from specialist financing facilities, together with softer reconstruction aid, particularly if infrastructure services are to reach the poorest. Whereas commercial finance is hindered by a number of factors related to the nature of the investment

¹ Highly Indebted Poor Countries

context, a number of challenges are also found in delivering reconstruction aid, not least in procuring contractors / operators in an effective manner.

Addressing the constraints on the flow of commercial investment into PPPs in PCCs will, in the first instance, require improving the basic *contracting and contract dispute* resolution frameworks in these countries and within which investments can take place. Provided that these frameworks are in place, appropriate *structuring* of infrastructure PPP projects becomes crucial. Finally, and even with the best project structures, the severity of investment risks in many PCCs means that it is difficult for even financing facilities offering insurance / guarantees to provide cover. In such circumstances, additional donor grants, which ‘buy-down’ a degree of risk, may be required to *leverage* these resources.

Improving the effectiveness of reconstruction aid will, first of all, require improving the *coordination between humanitarian and development activities* of various donors and NGOs, and more specifically the transition from one to the other. In addition to this, it is crucial that the ability of both national government agencies and donors to manage the *procurement* and subsequent *implementation* of aid funded reconstruction activities, is strengthened. As part of such a procurement process, to the extent possible, tying of aid funding to specific outputs will be key to improving the reconstruction aid delivery (that is, *subsidy delivery*) in PCCs. Finally, any donor intervention to support infrastructure service delivery in PCCs will require *consumer buy-in* for it to be successful, which needs to take account of the specific PCC context within which the activity is taking place.

The pilots suggested to test some of these policies and interventions focus on three different types of PPP activities pertinent to PCCs:

- *PPP Pilot 1: Operations involving commercial, long term investments.* The example chosen includes greater involvement of MIGA in addressing big political risks such as war and expropriation in PCCs.
- *PPP Pilot 2: Small scale infrastructure activities.* The specific example chosen involves the provision of output based aid (OBA) subsidies, via microfinance providers, to increase demand side support for expansion of modern energy systems in rural areas.
- *PPP Pilot 3: Reconstruction of infrastructure.* The example chosen focuses on the provision of water services to poor and peri-urban areas within a city, using a combination of the international and local private sectors.

1. INTRODUCTION

This report has been prepared for the Commonwealth Secretariat as per the Terms of Reference for this study issued on 11th August 2004 (provided at Appendix 9) and subsequent discussions between Cambridge Economic Policy Associates (CEPA) and the Secretariat.

1.1. Background and objectives of the study

As the Terms of Reference indicate, during the Commonwealth HIPC² Ministerial Forum (CHMF) Meeting in Freetown, Sierra Leone, Ministers paid particular attention to the issue of investment in HIPCs, especially the promotion of Public Private Partnerships (PPPs). They noted that most HIPCs are conflict affected, have poor water, sanitation and electricity supply, inadequate communication, lack of investible capital and high risk associated with investment. Ministers recognised that these countries faced a wide range of daunting challenges and required a multi-faceted strategy to achieve the Millennium Development Goals (MDGs), given that HIPC debt relief alone cannot finance the development needs.

In this respect, they underlined the need to improve, modernise and expand physical infrastructure in these economies, including through expanded private participation, where appropriate. And whilst the international community in general, and the development partners in particular, have mobilised considerable financial resources to facilitate the partnership between Private and Public sectors in the provision of infrastructure services, most Post-Conflict Countries (PCCs) continue to experience severe shortages and paucity of investment in the provision of such services.

The Commonwealth Secretariat and the UK Department for International Development (DFID), recognising the importance of improved infrastructure services for tackling poverty, have sponsored this study to seek to address some of the issues raised at the CHMF meeting in Freetown.

1.2. Our approach to the study

When considering policy options to encourage and enable infrastructure investment and service delivery in PCCs, it is important to recognise that PPPs are inherently complex operational models and are not a panacea for the many challenges facing PCC economies.

² Heavily In-debt Poor Countries

PPPs, involving private finance, are challenging to put together even in OECD economies and are much more difficult to introduce in low and middle income (LMI) countries, especially those emerging from conflict. Availability of finance, however, is not necessarily the main obstacle frustrating flows of commercial investment into infrastructure PPPs in PCCs. Indeed the constraints often occur earlier in the project cycle. They are principally related to: (i) a weak contractual environment in PCCs, often making even basic contracting and contract enforcement difficult and thus raising the investment risks to unacceptable levels; and (ii) a general paucity of well structured and economically robust infrastructure projects within countries emerging from conflict, which are actually financeable – that is, the returns from investing in these projects are commensurate with the underlying risks of such an investment.

Without addressing these issues, it will be neither possible to attract private sector operators in PPPs nor investors and lenders. Whilst a number of financing facilities have indeed been set up to provide different forms of financial support to PPPs in low and middle income (LMI) countries, in the main they have a sustainability requirement and as such have been tasked to work along commercial lines. As a result, whilst they may be slightly less risk averse than private investors and lenders, they none-the-less also need environments within which they can manage their investment risks and look for well structured projects to invest in.

PCCs are, however, also recipients of reconstruction aid which can involve a role for the private sector in its delivery. As such, this paper also considers the role that PPPs might play in improving *reconstruction aid effectiveness* in PCCs, particularly as it relates to infrastructure reconstruction (as opposed to pure humanitarian aid). Such partnerships might take a number of forms, in many instances necessarily including the local private sector as well as international companies. Partnerships involving both are a particular area for consideration and may provide one of the best ways of ensuring that basic infrastructure services are delivered to the poor.

1.3. Structure of the report

Following this introduction, this report is structured as follows: in Section 2 we define the key concepts that are dealt with by this study; Section 3 establishes what makes PCCs different from other LMI countries; Section 4 examines the implications that these differences have on infrastructure PPPs in PCCs; in Section 5 we develop a number of

policy options and interventions; and in Section 6 we provides details of possible pilot projects to test some of the emerging recommendations.

2. DEFINITIONS OF KEY CONCEPTS

This study deals with a number of key concepts that we will identify and define in this section. These are: infrastructure services; Public Private Partnerships (PPPs) in infrastructure; Post-Conflict Countries (PCCs); financing facilities; and key investment risks. We discuss and define each of these in turn below.

2.1. Infrastructure services

When referring to and discussing infrastructure services, we focus on four main sectors. These include:

- power (generation, transmission, distribution of electricity);
- water (household use, irrigation) and sanitation (including solid waste disposal);
- transport (sea and air ports, roads, bridges, railways); and
- telecommunication (fixed and mobile telephony, internet).

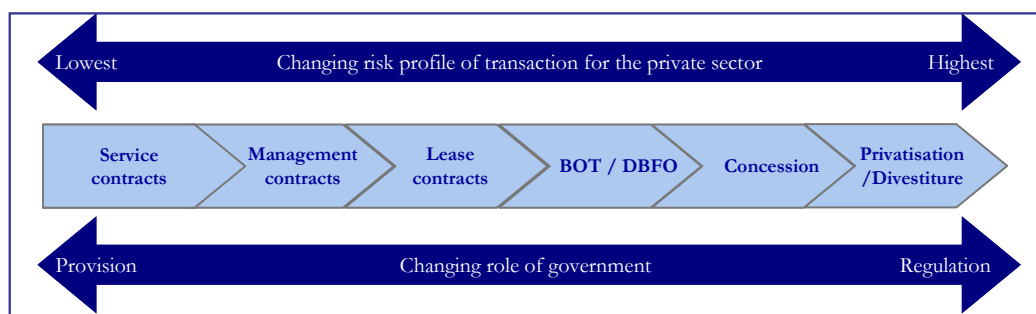
In addition, we also refer to the provision of electricity, and water and sanitation as basic infrastructure services, and consider, where applicable and for comparison purposes, investments by the private sector in natural resources extraction industries.

2.2. Public Private Partnerships (PPP)

The concept of a Public Private Partnership (PPP) is used to describe a wide array of different arrangements between the public and private sectors and often means different things to different people. We have, however, defined the concept of PPP from the perspective of typically risk averse investors and lenders – that is, as a means of investing in and / or delivering an infrastructure service in which the private sector assumes some degree of risk for investment and / or delivery. It is this transfer of risk to the private sector which is the cornerstone of a PPP.

PPPs therefore involve a spectrum of different combinations of risk allocation between public and private sector in any particular project, as shown in Figure 2.1 below.

Figure 2.1: The Public Private Partnership spectrum³



The primary stakeholders within such a PPP are public and private sponsors / infrastructure providers, who structure and deliver the PPP projects, and public and private financiers, who provide the required finance for the project to be taken forward. Table 2.1 below provides some examples of these.

Table 2.1: PPP participants

Private or public sector	Sponsors / infrastructure providers	Financiers
Private sector	<ul style="list-style-type: none"> • international or local companies • non-governmental organisations (NGOs) • community based organisations (CBOs) 	<ul style="list-style-type: none"> • commercial lenders • equity investors • insurance companies
Public sector	<ul style="list-style-type: none"> • national government ministries, departments, and institutions • commercially operated public sector owned utilities • publicly (donor) supported special purpose vehicles (e.g. InfraCo⁴) 	<ul style="list-style-type: none"> • OECD bilateral donors • multilateral donors • multilateral and bilateral DFIs • Export Credit Agencies

As Table 2.1 shows, we define project sponsors / infrastructure providers broadly. Importantly, we also include the various NGOs and CBOs within this definition as they are important vehicles for developing and delivering infrastructure services, albeit on a smaller scale, in many PCCs. These providers, in comparison to large international private firms, tend to deal with infrastructure needs on a village, community or neighbourhood level. Analysis and examples of these types of infrastructure providers are set out in Appendix 8.

³ Appendix 3 provides a brief outline of each of the stages on the suggested PPP spectrum.

⁴ Infrastructure Development Company – InfraCo. See appendix 4 for details of this initiative.

2.3. Post-conflict countries (PCCs)

We use the generally accepted definition of a conflict affected country as one where conflict causes at least 1,000 combat-related deaths per year, and where both sides in the conflict suffer at least 5% of these casualties.⁵ A post conflict country (PCC) is therefore one where a ceasefire, that is followed by a peace deal or an otherwise imposed settlement, reduces the mortality rate below this level. It should be noted, however, that such a definition – accepted as it is – is somewhat arbitrary, with some supposedly post-conflict countries being very similar to conflict zones.

We used a sample of 17 such countries⁶ to underpin our analysis in this study. In order to make the analysis more relevant to today's international policy environment, we considered those countries where the major hostilities have ended in the years since 1990 or are still ongoing, but at a regional level. In addition, the country selection featured PCCs from Africa, Asia and Latin America, including those that are members of the Commonwealth. Where appropriate, we have compared some key infrastructure PPP related characteristics of PCCs to those of other low and middle income (LMI) countries⁷.

In our analysis, we consider and classify PCCs within a dynamic framework, as they individually emerge from conflict and gradually begin to stabilise. We have sought to identify three indicative stages through which a PCC passes once a settlement is achieved. Experience to date suggests that the potential for PPPs in infrastructure, that is, for the private sector to assume a degree of risk in investing in and / or delivering a service, will increase over time and with the onset of greater stability – even though this can be a slow and not necessarily a linear process. In addition, in most environments emerging from conflict, the risks of reverting back to conflict are very high, especially in the immediate years following the secession of hostilities.⁸ In case of relapse into conflict, the chances of structuring PPPs diminish again. These indicative stages are depicted in Figure 2.2 below.

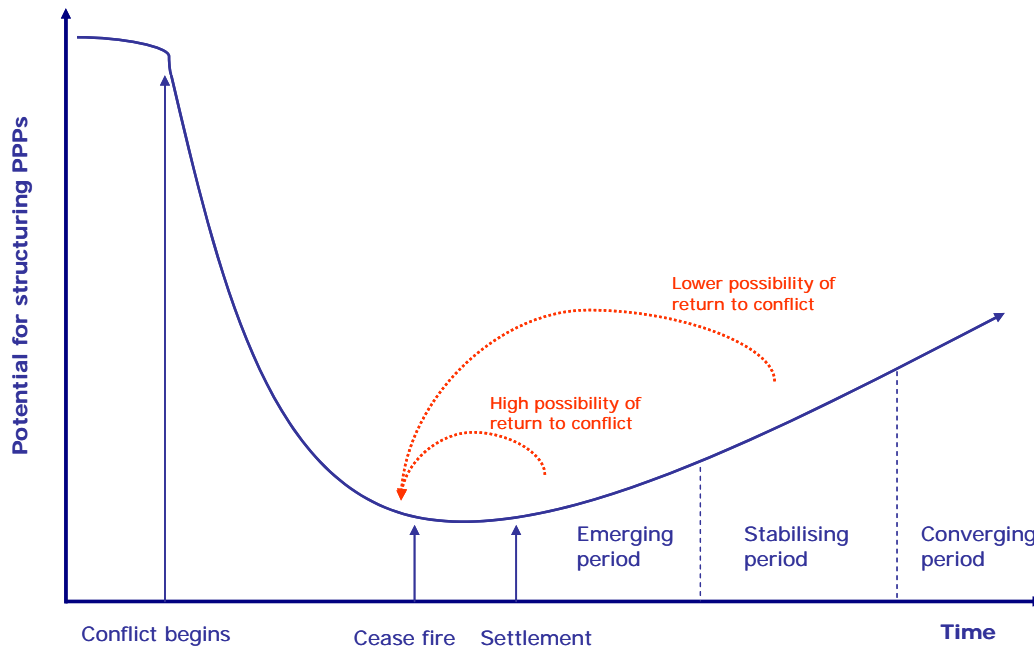
⁵ This definition was based on Singer, D.J. and Small M. (1994).

⁶ See Appendix 1 for countries considered.

⁷ Appendix 2 lists the low and middle income (LMI) countries, defined as such by the World Bank in 2003.

⁸ Work by Collier et al (2003) has estimated that a country reaching the end of a civil war faces a 44% chance of returning to conflict within five years.

Figure 2.2: Possible path of a PCC in relation to the potential for structuring PPPs



Source: *International Alert / CEPA*

The stages identified in the figure above – emerging, stabilising, and converging, cannot be seen as being rigid, although, as set out below, there appear to be some commonalities at similar periods after the conflict has ended.

- **Emerging:** This is the period in the first few years after the peace settlement. Countries during this stage of recovery tend to be characterised by extremely weak and fragile institutions, transitional governments and often an unstable peace settlement with a significant chance of relapse into conflict. The needs of the country are often focused on food security, shelter, repatriation of refugees, and the reconstruction of basic (and often temporary) infrastructure service delivery capacity. Countries that could be considered at this stage today might include Afghanistan, Angola, and Sierra Leone.⁹
- **Stabilising:** This is perhaps a period which begins three to four years after the settlement and in which there are the beginnings of a return to normality. Even though the danger of relapsing into conflict has abated somewhat, it is important not to underestimate the real presence of such a risk. The stabilising governance situation is likely to encourage greater macroeconomic stability and reintegration of governments into the international financial community. Longer term

⁹ Example countries for this and other periods are drawn from the sample of countries as set out in Appendix 1.

infrastructure needs start being addressed. Example countries that could be considered at this stage today include Ethiopia, Eritrea, and East Timor.

- **Converging:** Once five or more years have passed since the peace settlement, and provided that the country has not reverted to conflict, PCCs begin to converge, with respect to a number of PPP relevant characteristics, with other LMI countries. This is a process that inevitably takes longer in some countries than others, varying in its nature and context. At this stage, infrastructure needs are beginning to be met through city and / or national network solutions, where this is an appropriate infrastructure solution.¹⁰ Countries that could be considered at this stage today include Mozambique, Cambodia, Bosnia and Herzegovina, and Rwanda – the different paths to stability that these countries have taken show how disparate the convergence processes tend to be.

An additional category of countries are those that are currently experiencing a highly regional conflict or civil unrest but have a relatively stable central government and functioning national institutions. These countries, which today include Sri Lanka, Colombia, and Uganda, have a much closer profile, from a PPP perspective, to non-conflict affected LMI countries. Nevertheless, and even though the conflicts are localised, many international private sector investors can still be weary of significant involvement, especially outside the main urban areas.¹¹

2.4. Financing facilities

We consider a financing facility to be any public organisation operating on commercial or near commercial principles that::

- **provides finance to PPP infrastructure projects** – this refers to organisations that are able to provide *direct* funding to PPP infrastructure projects through loans and / or and equity; and / or
- **supports the financing of infrastructure projects** – organisations that are able to provide *contingent* products, such as guarantees and insurance, so as to enable financing of PPP infrastructure projects.

¹⁰ Even in non-conflict affected LMI countries, low population densities in rural areas and absence of industries, may make network solutions economically unfeasible in the short and medium term. Other types of solutions, for example, stand alone electricity generation and distribution systems may be better suited to the circumstances.

¹¹ Nepal is an example of a country where a regional conflict was initially ignored by many investors, given the stability in the centre. The civil unrest, however, has very quickly spread to affect most of the country.

It is important to reiterate that, even though many of these facilities are supported by the international donor community, most tend to operate on a near or full commercial basis. Indeed, many of them incorporate private finance as part of their capital base, such as the Emerging Africa Infrastructure Fund (EAIF), which reinforces commercial discipline. Such facilities will be as sensitive to the large risks inherent in financing projects in PCCs as most other commercial investors.

Table 2.2 below shows some examples of key financing facilities.

Table 2.2: Key financing facilities¹²

Types of institutions	Examples
Development Finance Institutions (DFIs) and development banks with private sector focus	IFC, ADB, AfDB, EBRD, EU DFIs (such as FMO, Proparco)
Special purpose debt and equity funds	EAIF, Nordic Development Fund, CDC Capital funds
Guarantee and insurance companies	MIGA, GuarantCo
Export Credit Agencies	UK's Export Credits Guarantee Department, Export-Import Bank of the United States
Microfinance institutions	Numerous local microfinance institutions
National and regional development banks	South African Development Bank, National Development Bank of Sri Lanka, Eastern and Southern African Trade and Development Bank

2.5. Key investment risks

As was mentioned earlier, a PPP approach to investing in and / or delivering an infrastructure service differs from the traditional public sector approach because the private sector assumes a degree of risk. The extent and nature of risk transfer is probably the most crucial aspect of structuring a successful PPP.

There are three key types of investment risk that need to be considered when structuring and financing PPPs in any environment. These risks can be categorised as:

- **Political / country risk.** This type of risk relates to the effects of conflict and civil unrest generally, possible expropriation of assets, breach or frustration of contracts, and the risk that private sector investors would not be able to repatriate the return on their investment. In infrastructure sectors, many of which are regulated, regulatory risk is also an important consideration.

¹² For further details of facilities mentioned see Appendix 4.

- **Financial risk.** The main elements of the financial risk are the exchange rate risk, which relates to the risk that the value of revenues (if they are in domestic currency) will significantly reduce in case of domestic currency devaluation, and interest rate risk – in case the project is funded in local currency, higher than expected local interest rates will deteriorate the economics of a project.
- **Commercial risk.** This type of risk is concerned with issues such as performance risk (i.e. the inability of the provider to deliver contracted services), the risk that the demand for services will not be sufficient, and / or that the services provided will not be paid for.

A more detailed consideration of these risk types is presented in Appendix 5.

Crucial to success of any PPP, wherever it is based, is that the investment risk allocation process leaves risks with the party who is best able to manage them. So allocating country risk, for example, to a private sector operator who cannot mitigate it, is likely to make private financing impossible (except in few limited circumstances). Project structures which limit themselves to the transfer of performance risk to the private sector are likely to be more feasible, as in many cases such risks tend to be controllable by the private sector. It is also a way of ensuring value for money from the public sector perspective.

In PCCs, however, all these risks are exacerbated by the conflict and its effects on the country's political, social and economic infrastructure, thus making any risk transfer to the private sector – including performance risk – very difficult. In the next section we focus on these risks as well as on the issues that make PCCs an even more challenging environment to structure infrastructure PPPs than other LMI countries.

3. WHAT MAKES PCCS DIFFERENT FROM OTHER LMI COUNTRIES?

Typically PCCs – with the exception of those with major natural resource wealth – are less attractive as investment destinations than are other, non-conflict affected LMI countries. This is primarily because:

- investment risks are greater in PCCs;
- these investment risks are more difficult to mitigate; and
- exceptionally weak institutional frameworks make conducting business in PCCs extremely difficult, time-consuming and expensive.

We consider these issues in turn.

3.1. Investment risks in PCCs are greater than in other LMI countries

Whilst investors in PCCs face all the investment risks that are present in other LMI countries, there are also a number of factors that make key investment risks, as described in the previous section, greater.

3.1.1. Political / country risks

Table 3.1 below describes some factors which increase the political / country risks that are likely to be faced by investors in PCCs as opposed to those in other LMI countries.

Table 3.1: Factors exacerbating the political / country risks of investing in PCCs

Exacerbating factors	Description
Risk of renewed conflict and the ongoing insecurity	Countries that have emerged from conflict tend to have a much greater chance of relapsing into conflict. The threat of conflict and other forms of violence, towards people or assets, are the most important risk that will be considered by any potential investor and / or operator in a PCC.
Weak governance and institutions	PCCs tend to have an extremely low level of effective governance and very weak institutions. The legislative process tends to be severely disrupted, much of the legislation introduced is not adhered to and law enforcement is often ineffective, particularly where the PCC situation reflects a change in the political-economic national system. As a result, property rights are weak and / or not protected and the ability to enforce contracts is very low. The risk of contractual breach or its frustration is therefore extremely high, as is the risk of expropriation of infrastructure assets by the emerging, usually unstable and transitional, government.
Depleted foreign currency reserves	Foreign currency reserves are typically much lower in PCCs than in most other LMI countries, having been exhausted during and after the conflict (mainly through large spending on armaments). This exacerbates the currency transfer risk, that is the inability of the private sector operator or investor to convert their domestic currency earnings into foreign currency and repatriate them.

For these reasons, political / country risks in PCCs are exceptionally high and as such are one of the principle deterrents to private sector participation in most infrastructure sectors, especially those where risks are inherently higher, such as water and sanitation and electricity.

3.1.2. Financial risks

In the Table 3.2 below, we indicate a number of factors that can contribute to greater financial risks in PCCs than in other LMI countries.

Table 3.2: Factors exacerbating the financial risks of investing in PCCs

Exacerbating factors	Description
Large scale government borrowing	Extremely low tax revenues, combined with significant defence spending and the need to finance post-conflict reconstruction, forces PCC governments to increase borrowing substantially and usually as the only means of financing its budget (apart from donor contributions). This tends to lead to extremely high and volatile domestic interest rates.
Disrupted macroeconomic processes	Severely disrupted macro-economic and monetary processes, and a collapsed central and commercial financial banking system, combined with the government's printing of money to finance fiscal deficits, increases the risks of hyperinflation and large currency devaluations.

Financial risks, that is, volatility of domestic interest rates and likelihood of exchange rate devaluation, are risks that are present in the vast majority of LMI countries as well. Whilst they are exacerbated by conflict in PCCs, these risks are not easy to manage in any PPP transactions outside the OECD markets.

3.1.3. Commercial risks

The front-end costs and risks of structuring viable infrastructure investments are high in most LMI countries, but particularly so in PCCs. These costs and risks are often out of line with the modest expected return and many investors are therefore deterred from entry.

The low expectation of return in these environments is driven principally by two factors:

- **Low demand:** The specifics of PCC market conditions, which are characterised by a generally impoverished consumer base, contribute to perceived low levels of demand for services to be provided by the PPP.
- **Non-payment:** Many PCCs, as do some LMI countries, suffer from poor payment discipline by customers.

These commercial risks are often heightened by the nature of the international community's humanitarian and reconstruction aid responses in many PCCs. Following the ceasefire and any peace settlement, the very difficult humanitarian situation attracts substantial flows of humanitarian aid to the country. Such aid is dominated by grants provided by bilateral and multilateral donor organisations to the UN agencies and international NGOs to deliver services on the ground.¹³ It finances the provision of

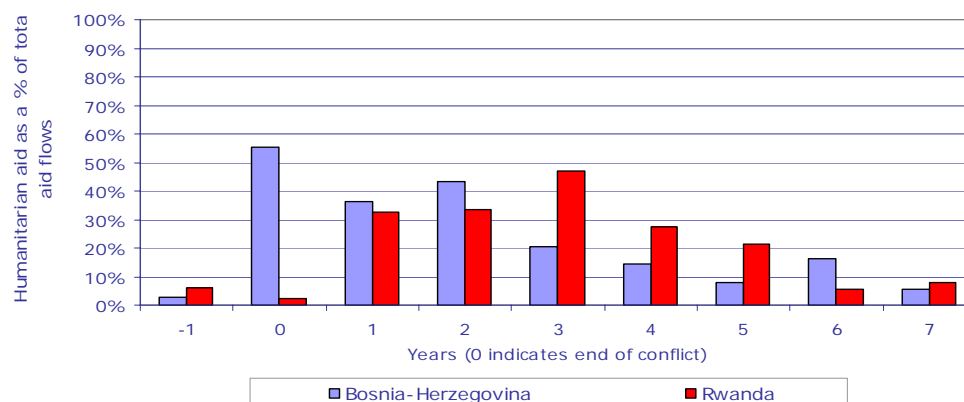
¹³ For example, there are over 100 international NGOs and over 2,000 international NGO staff working in or related to the conflict in the Darfur region in Sudan. (Source: Consultations).

food, water, shelter and medical attention, as well as basic and most urgent reconstruction of facilities to provide these services locally.

These large aid inflows, while necessary to relieve immediate hardship, can have major distorting effects on price signals within the country's infrastructure markets. Goods and services are mostly provided for free during this period, creating a level of expectation that cannot be funded in the long term. Once funding dries up, the subsequent need for payment for services causes a number of problems. Customers may be unwilling to pay even low user charges, especially if some form of unrestricted access to these services is provided for many years after the conflict has ended.¹⁴ Planning the transition between the immediate post conflict humanitarian need and what is required as regards sustainability of services in the long term does not always take place.

Bosnia and Herzegovina and Rwanda are good examples of countries whose immediate post-conflict period was characterised by substantial humanitarian aid flows, relative to other aid they received – as shown in Figure 3.1 below.

Figure 3.1: Humanitarian aid as a percentage of total aid flows for Bosnia and Herzegovina¹⁵ and Rwanda



Source: OECD's Development Assistance Committee (2004)

Finally, even the ability of the private sector to manage the performance risk in many PCCs is affected by the ongoing insecurity in the country and dangers of reoccurrence of full scale conflict and / or civil unrest.

¹⁴ The emphasis here is on the undesirability of *unrestricted* access to free or heavily subsidised services for all, regardless of their ability to pay for them. Vulnerable population elements should continue to receive support but their eligibility needs to be defined and used as means of accessing such services. This needs to be done to avoid the tendency in many LMI countries for the urban better off customers, that tend to be connected to networked infrastructure solutions, to receive subsidised services, while the poorer rural and peri-urban communities are left without any access at all.

¹⁵ By way of an example, payment collection rates in Bosnia and Herzegovina's water and sanitation sector of below 50% since the end of conflict (EBRD 2001), may have been influenced by such large flows of humanitarian aid.

Table 3.3 below summarises the additional commercial risks that are likely to be faced by investors in PCCs.

Table 3.3: Factors exacerbating the commercial risks of investing in PCCs

Exacerbating factors	Description
Greater poverty	PCCs tend to be extremely poor nations, with a mutually enforcing causality between conflict and poverty – poverty often induces conflict and conflict is one of the prime causes of poverty. ¹⁶
Ill defined property rights	Most PCCs, and especially those that have had prolonged chronic conflicts (such as Sierra Leone, Cambodia, Angola) have very weak and ill defined property rights.
Inflows of humanitarian aid	Large inflows of humanitarian aid to post-conflict countries can have a major distorting effect on price signals within the country's infrastructure markets.
Dangers and costs of collecting payment	Lack of law enforcement capability and an armed population, in particular if the demobilisation process was not fully completed, makes enforcing payments very difficult, costly, and often dangerous.
Risk related to renewed conflict or civil unrest, and ongoing insecurity	The risks associated with renewed conflict and any insecurity issues make transferring even the performance risk to the private sector difficult. The private sector will be reluctant to accept responsibility for delivering targets in environments where civil unrest or full scale conflict could severely frustrate their efforts or destroy assets.

Clearly the severity of risks in PCCs is a considerable deterrent to private sector participation in infrastructure PPPs, however, the fact that investment risks exist is not in itself unique to PCCs. The particular difficulty is the fact that these risks tend to be higher than in those LMI countries not affected by conflict and that such risks are also more difficult to mitigate in PCCs.

3.2. Mitigating investment risks in PCCs is more difficult

Varying degrees of investment risks are present in all PPP transactions, whether they be based in OECD countries or post-conflict / LMI countries. Most OECD country investment risks, however, can be mitigated through a variety of guarantee, insurance and hedging products that are available to investors through capital markets or government agencies, such as Export Credit Agencies (ECAs). Many such products are also available, albeit to varying degrees, to support investments in some more advanced LMI countries but are very rarely available for investments in PCCs.

¹⁶ See Collier et al (2003) for discussion on causality between conflict and poverty.

In Table 3.4 below, we list some of the products and mechanisms that are available to mitigate different types of risk and also provide details of PCC specific difficulties which reduce the availability of such products in these countries.

Table 3.4: Investment risks and mitigation opportunities in PCCs

Risk	Mitigating mechanism	PCC difficulties
Political / country risks	Political Risk Insurance (PRI) products. Such insurance products tend to be provided by national ECAs and MIGA.	Many PCCs are completely off-cover for providers of such insurance products. Even if any PCCs are actually on-cover, insurance products are still very difficult to obtain and are often extremely expensive.
Financial risks	Hedging products. Such products insure holders against unexpected movements in interest rates or exchange rates, and are available in more developed financial markets.	Financial markets in PCCs tend to be severely underdeveloped and as such are not able to provide hedging products. In fact, there is little difference in the availability of such products in post-conflict or LMI countries.
Commercial – market and payment risks	Targeted subsidy programmes can strengthen demand for services by augmenting incomes, supporting vulnerable population segments and, to some extent, encouraging payment discipline.	Large flows of humanitarian aid to PCCs tend to be less targeted to specific population segments. Provision of free infrastructure services on a large scale suppresses demand for private sector provided services and can have adverse effects on demand and payment discipline.
Commercial – performance risks	Private sector investors are generally able to internalise performance risk and manage it within the organisation.	In PCCs the risk of renewed conflict and physical violence makes even the transfer of performance risk difficult.

3.3. PCCs tend to have weaker institutions

An exacerbating feature of both the level of risk severity and the ability to mitigate such risk is the fact that PCCs are characterised by exceptionally weak institutions and legal frameworks, which have collapsed as a direct result of the conflict. Legislative processes and the law enforcement capability tend to be limited, courts are rarely seen as being impartial mediators in contractual disputes, and in some countries the level of corruption in many public institutions can be high.

In addition to official institutional decline, conflict also tends to destroy much of the country's social fabric, creating conditions of mistrust and a greater propensity for

criminal activity. Human resource capacity to manage businesses is also severely constrained.¹⁷ All these things make conducting business in PCCs extremely difficult, time-consuming, and very expensive.

As we discussed in this section, there are some important differences between PCCs and other LMI countries with respect to developing and financing infrastructure PPPs. They relate primarily to the greater severity of investment risk, the lower ability of involved parties to mitigate that risk and the weaker institutional capacity, whether official, commercial or social, in PCCs. In the following section, we consider what the implications of these differences are on structuring of and investing in infrastructure PPPs in PCCs.

4. IMPLICATIONS FOR PPP INVESTMENT IN PCCS

Greater investment risks, lower opportunities for mitigation and weaker institutional capacity in PCCs have tended to reduce investor interest, including interest from donor supported financing facilities, in these countries and as compared to other LMI countries. This has been particularly pronounced in basic infrastructure sectors where risks are highest and returns lowest, such as water and sanitation, and electricity.

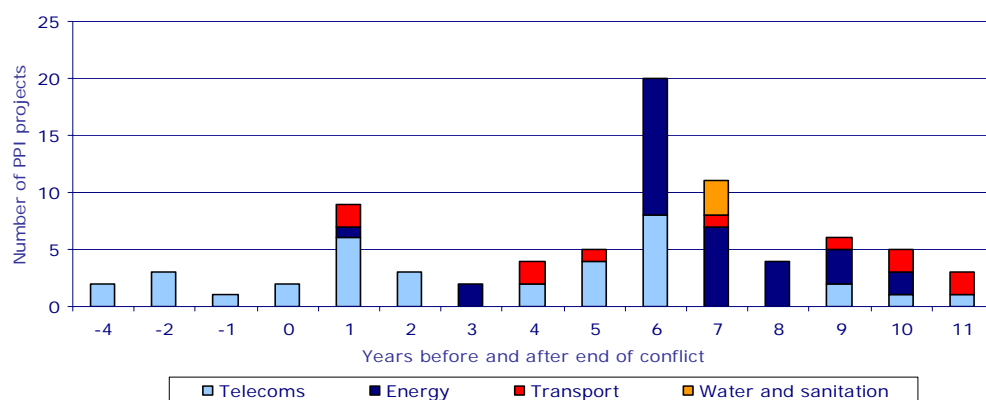
As discussed in section 2.4 above, the vast majority of financing facilities operate on commercial or near commercial basis. They have obligations to their sponsors (donors, governments, and private sector) to manage funds under their disposal in a sustainable manner and will therefore not invest in poorly structured and high risk infrastructure projects.

The data for the incidence of infrastructure projects with private sector participation, many of which have been supported by various financing facilities, is shown in Figure 4.1.¹⁸

¹⁷ During one of our consultations it was noted that in Afghanistan (but similar to many other PCCs) there is a great deal of entrepreneurial capacity at a very small scale (that is individual or family level), but very little capacity to scale up these activities into larger organisations without a great deal of technical assistance. This makes investing in PCC businesses very risky and expensive, as training needs are very acute and many expatriate managers may be required to manage operations at the start.

¹⁸ The principal source for this data is the World Bank's Private Participation in Infrastructure (PPI) database. This data, collected by the Bank from official as well as national and international press sources, principally records relatively large projects, mainly shows infrastructure PPP investments of over US\$1m.

Figure 4.1: Incidence of private participation in infrastructure (PPI) projects¹⁹



Source: PPI database, World Bank (2004)

Some sector focused observations from this data are set out below:

- **Telecoms.** Telecoms, and more specifically mobile telephony, dominate the conflict and immediate post-conflict period in all the PCCs we considered. This robustness principally reflects the short time required for the investor to recover their initial investment, driven by the ability to premium price. Even in places like Somalia, which has not had a functioning government for many years and is one of the least stable business environments in the world, mobile telephony and the internet are a booming industries, all run by local private sector entrepreneurs.²⁰
- **Transport.** Investments in the transport sector are also recorded in some countries relatively soon after a peace settlement has been reached. These investment are, however, focused mainly on either sea or air ports. Such concentration is explained by the greater bankability of these ‘enclave’ projects, which tend to provide hard currency earnings and can, at least to some degree, be insulated from any instability in the rest of the country.
- **Energy.** In the energy sector, or more specifically electricity, private sector involvement does not seem to be feasible for up to six to seven years after the settlement. Even at this stage, the private sector has been more willing to become involved in electricity generation and less so in more downstream and riskier activities, such as distribution. A small number of distribution activities

¹⁹ Data relates to: Afghanistan, Angola, Azerbaijan, Bosnia and Herzegovina, Cambodia, El-Salvador, Eritrea, Ethiopia, Mozambique, Rwanda, Serbia and Montenegro, and Sierra Leone.

²⁰ Source: www.bbc.co.uk (19th November 2004)

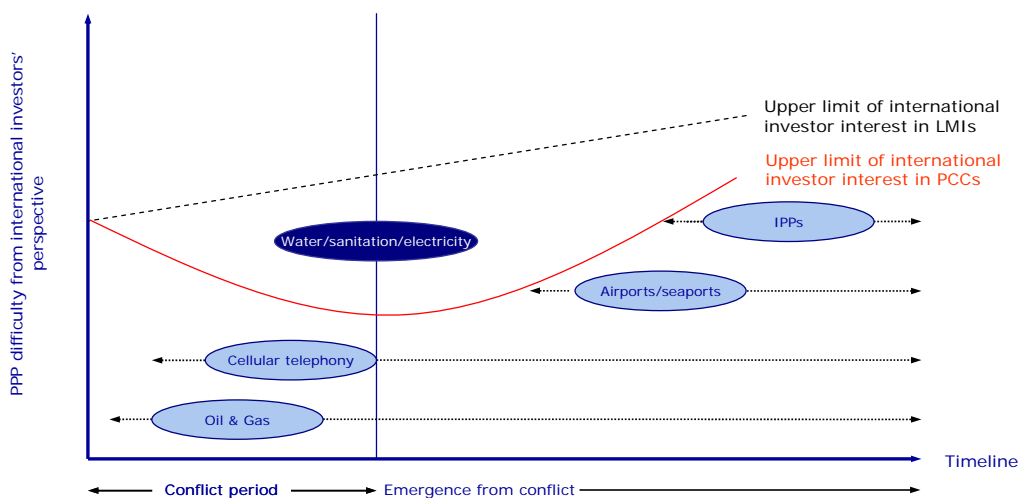
are noted, but they tend to be conducted through less risky management or lease contracts (i.e. non-investment participation by private sector) as opposed to concessions which require some degree of investment.

- Water and Sanitation.** Only a few projects have been noted in the water and sanitation sector, and much later in the post-conflict period. In the few examples that do appear, the private sector has only been involved through less risky management or lease arrangements, whether in water and sanitation on its own or when it was bundled together with the provision of electricity, as was the case in Rwanda.²¹

In addition to these four sectors, most **natural resource extraction** activities tend to be more resilient to conflict and post-conflict environments. Although there are differences between these activities²², the fact that investors have little choice but to extract the resource where it is found and the relative certainty of substantial foreign currency revenues from its sale, seem to be enough, in the majority of cases, to overcome the large transaction costs and risks involved.

Based on this data, Figure 4.2 provides a stylised representation of investor interests in different sectors in PCCs, during the conflict and once the country starts to emerge from conflict.

Figure 4.2: Overview of international private sector interest in different infrastructure sectors in PCCs



²¹ Consultations with a number of international water providers confirm that their interest in the water sector is restricted to management contract type transactions.

²² Not all natural resource activities are the same, with some being more resilient to PCC risks than others. For example, diamonds, because of their high value and ease of transport, are far more resilient than say mining of zinc, which requires longer transport routes and larger mining operations.

The key message from preceding analysis is that the implications of higher investment risks, greater difficulty of mitigating these risks, and the generally weaker institutional capacity in PCCs, all act as strong barriers to investor interests in infrastructure PPPs in these countries. In particular, investments in water, sanitation, and electricity seem to be outside the scope of what is financeable by international investors in PCCs and for many years after the conflict has ended.

The analysis also suggests, however, that in the absence any acceptable public sector solution the demand for these basic infrastructure services is not left entirely unmet. Smaller scale local infrastructure entrepreneurs are usually present in many PCCs during and after the conflict and as such form an important element of the infrastructure PPP landscape in PCCs. It follows that, in addition to considering ways of promoting and enabling investments and activities by the international private sector, it is important for this report to consider issues related to the local, smaller scale, private sector providers of infrastructure services (see Appendix 8 for the discussion on these types of providers).

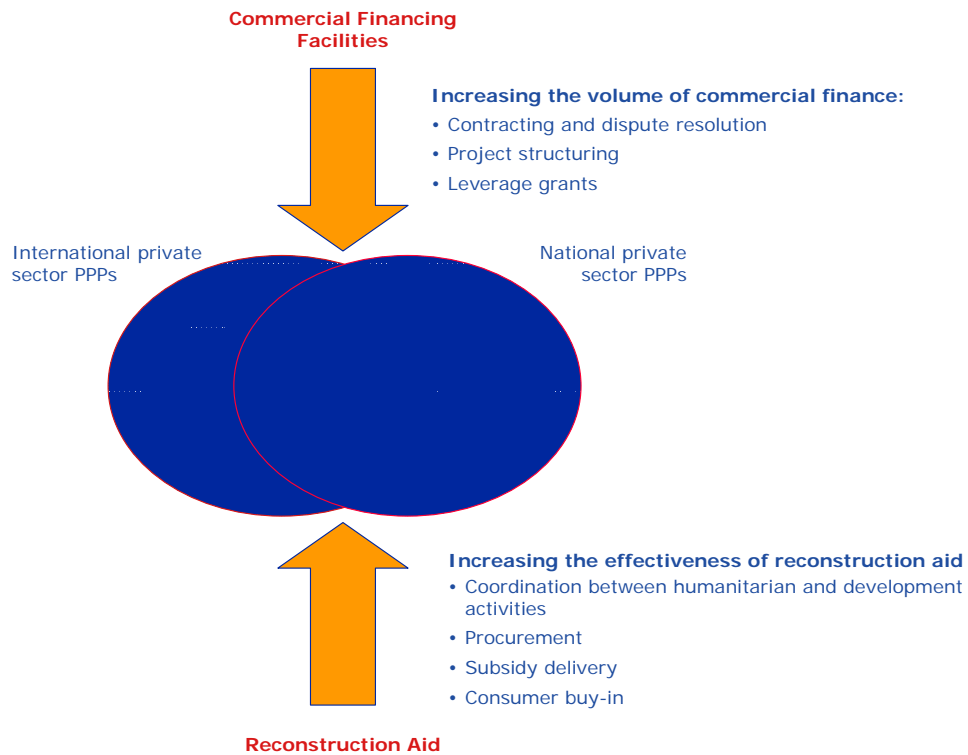
5. DEVELOPING POLICY OPTIONS AND INTERVENTIONS

In these preceding sections of the report, we have sought to describe the *context* within which the donor community and the Commonwealth Governments are hoping to harness the existing financing facilities to promote infrastructure PPPs in PCCs.

In this section, we now seek to propose a number of policy options and interventions through which it may be possible to promote PPPs in PCCs and to increase their access to finance, given the constraints identified.

The overall aim is to engage international and local private sector entities within PPPs in order to stimulate delivery of infrastructure services in PCCs and particularly to the poor. As illustrated in Figure 5.1 below, PPPs may involve international or local private sectors, or both, depending on specific country circumstances and the infrastructure sectors in question. For instance, whereas the international private sector is engaged in some sectors – mainly telecoms – early on in the post conflict period it has particular difficulties in electricity and water distribution.

Figure 5.1: Financial flows and PPPs



The resulting PPPs will need to be funded by a combination of commercially priced finance, typically from specialist ‘financing facilities’, together with softer reconstruction aid, particularly in terms of reaching the poorest.²³ Whereas commercial finance is hindered by a number of factors related to the nature of the investment context, a number of challenges are found in delivering reconstruction aid, not least in procuring contractors / operators in an effective manner. Thus, as illustrated in Figure 5.1, policy interventions aimed at harnessing commercial financing facilities and improving the effectiveness of parallel reconstruction aid, need to be supported by a number of key initiatives.

Whilst there are many things that need to be done to address the numerous issues that make interventions in PCCs difficult, we have focused on those which we believe should be prioritised. These are explored in more detail below.

²³ One significant source of such reconstruction aid may be the International Financing Facility (IFF). The IFF involves the securitisation of the future years’ aid budgets of a number of countries, with the aim of ‘front end loading’ an extra US\$50bn of aid, with the aim of accelerating the achievement of the Millennium Development Goals (MDGs), to what would otherwise be the case based on current projections. To date a number of EU countries have made strong political commitments to the IFF concept.

5.1. Interventions to harness existing commercial financing facilities

Addressing the constraints on the flow of commercial investment into PPPs in PCCs will, in the first instance, require improving the basic *contracting and contract dispute* resolution frameworks in these countries and within which investments can take place. Provided that these frameworks are in place, appropriate *structuring* of infrastructure PPP projects becomes crucial. Finally, and even with the best project structures, the severity of investment risks in many PCCs means that it is difficult for even financing facilities offering insurance / guarantees to provide cover. In such circumstances, additional donor grants, which ‘buy-down’ a degree of risk, may be required to *leverage* these resources. These three issues are discussed in turn.

5.1.1. Contracting and contract dispute resolution

At a very basic level, investors and participants in PPPs need to have the confidence that contracts they enter into will be honoured and that there are mechanisms in place to ensure enforcement or compensation in case of contractual breach. In many PCCs, and as discussed earlier in the report, the conflict tends to substantially weaken the business and legislative environments, introducing considerable uncertainty in business dealings.

Development of local legislative frameworks and contract enforcement capability will inevitably take time in any PCC. In the meantime, therefore, one of the most effective steps in attracting private investment will be to ensure the ability to use dispute resolutions that can operate in a weakened judicial environment, such as arbitration, and dispute review boards and adjudicators.

In case of international investors the availability of international arbitration (for both the contract with the government and contracts with other third parties, such as sub-contractors, lenders etc.) is a key factor in attracting private sector investment.²⁴ Where countries wish to allow use of non-judicial methods (or where in policy this is allowed but the basis not clear etc.) an important early step is to remove legal obstacles and

²⁴ The breakdown in the court system in Iraq has meant that some international contractors, for example, entered all their contracts with local contractors under European or US laws and deferred all disputes to United Nations Commission on International Trade Law (UNCITRAL).

provide clear authorization for domestic contracting authorities to agree on dispute settlement methods, and particularly international arbitration.²⁵

These mechanisms have their limitations, however, when the local private sector is involved. In such cases it is important for legislation to allow non-judicial methods of contract dispute resolution through using local (and independent) dispute review boards and adjudicators – which might, for instance, be supported by international experts.

Further discussion on these issues is set out in Appendix 7.

5.1.2. Structuring of infrastructure PPP projects

Successful project structures will both allocate investment risks to parties in the PPP that are best placed to manage them and provide structures that mitigate these risks to acceptable levels. In most instances, the sponsorship of projects will be carried out by governments, with support from existing donor facilities (such as DevCo for example). It is difficult to overemphasise the importance of high quality project design, together with active sponsorship, in making an infrastructure investment opportunity attractive to both international and local investors.

Although the importance of active sponsorship is not always recognised, the importance of good project design has been increasingly accepted by the international donor community. To this effect, there are a number of donor supported facilities which have been set up in the last decade to deal with this issue, as set out in Table 5.1 below.

Table 5.1: Existing facilities aimed at providing project design support²⁶

Facility	Web address, if available
Project Development Facility (DevCo)	www.ifc.org/ifcext/psa.nsf/Content/DevCo
Infrastructure Development Company (InfraCo)	In progress of being launched
Slum Upgrading Facility (SUF)	www.unhabitat.org/suf/
Water and Sanitation for Urban Poor (WSUP)	www.wsup.com
African Project Development Facility (APDF)	www2.ifc.org/sme/html/apdf.html
UNDP's Public-Private Partnerships for the Urban Environment (PPPUE)	http://pppue.undp.org

For these facilities to succeed and for more well structured PPP infrastructure projects in PCCs to be offered to investors, there needs to be a greater take up of the services

²⁵ Early focus should be on ensuring that the country is a party to Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958, and in agreeing to resolution of disputes under the International Centre for Settlement of Investment Disputes (ICSID) regime (in case of foreign investors).

²⁶ Further details on each of these entities is provided in Annex 4.

offered by them. Moreover, greater awareness of such facilities and their capabilities would reduce the temptation to create expensive new institutions. A first step, in this respect, might be the creation of a global portal which will help direct governments to suitable means of support that already exist.

5.1.3. Grant funding to leverage existing financing facilities

Even with the best project sponsorship, however, the severity of investment risks in PCCs, as explored in Section 3 of this report, often still creates sufficiently high barriers to prevent commercial investment flows into these countries. In such cases, the donor community could provide grant funding to absorb the additional PCC investment risks and as such leverage the resources of existing financing facilities, such as MIGA, and DFI guarantee departments – that is by enabling these facilities to provide guarantees and insurance products, which they would not have otherwise been able to do because of high risks.

Work has already been done in developing such approaches and in particular with respect to MIGA operations. Over the last few years MIGA has been able to rely on donor funded trust funds in order to provide political risk insurance (PRI) for investments in PCCs where it would not have otherwise been able to do so. This model has been tried in Bosnia and Herzegovina, Afghanistan, and the West Bank and Gaza.²⁷ Approaches can be based on arrangements whereby the donor supported fund operates on either a ‘co-guarantee’ or ‘first loss’ basis.

We understand that a similar approach is currently being developed by DFID, the Commission for Africa, and MIGA, which is considering ways of enlarging the scope of the trust fund mechanism to cover a wider selection of countries in sub-Saharan Africa.

We now turn to discussing policies that could improve the effectiveness of reconstruction aid.

5.2. Improving the effectiveness of reconstruction aid

In the first instance, improving the *coordination between humanitarian and development activities* of various donors and NGOs, and more specifically the transition from one to the other, will significantly improve the effectiveness of reconstruction aid in PCCs. In addition to

²⁷ Further details on MIGA / Trust Fund operations are provided in Appendix 4. For a review of MIGA’s experience in Bosnia and Herzegovina see Bray (2004).

this, it is crucial that the ability of both national government agencies²⁸ and donors to manage the *procurement* and subsequent *implementation* of aid funded reconstruction activities, is strengthened. As part of such a procurement process, to the extent possible, tying of aid funding to specific outputs will be key to improving the reconstruction aid delivery (that is, *subsidy delivery*) in PCCs. Finally, any donor intervention to support infrastructure service delivery in PCCs will require *consumer buy-in* for it to be successful, which needs to take account of the specific PCC context within which the activity is taking place. These four issues are discussed in turn below.

5.2.1. Coordination between humanitarian and development activities

There is a particular need to improve the transition from the immediate post-conflict humanitarian activities and those that are aimed at supporting the medium to long term development of a PCC – so that the former do not hinder the implementation of the latter.

The difficult interface and transition between these two types of aid activities have been the subject of much debate within the international donor community.²⁹ As was discussed earlier in the report, humanitarian aid – while undisputedly necessary to deal with immediate emergency situations in PCCs – does tend to leave a legacy of distorted markets and consumer expectations which are often very difficult to deal with during the delivery of development / reconstruction focused aid (that is, aid which is more directed at building longer term self sustainability of a country). These are extremely difficult issues, but it is important that transitions strategies are found if the problem of the ‘aid tap’ being turned off overnight is to be avoided. Some possible ideas that might assist this include:

- Developing exit strategies for humanitarian interventions as soon as possible. *Plans* need to be developed on how humanitarian aid – that is provision of water or electricity for free for example – will turn into reconstruction / development aid – that is providing support to the national utility or the private sector to

²⁸ Ministry of Finance or other special purpose agencies set up to procure reconstruction and other infrastructure related services. Given finite donor and budgetary resources any such capacity building is likely to be focused on central agencies in the first instance, with a roll out programme at a later stage.

²⁹ For example see Schiavo-Campo, 2003; or the United Nations Development Programme, World Bank, and United Nations Development Group’s Practical Guide to Multilateral Needs Assessments in Post-Conflict Situations (2004).

provide these services at a sustainable price. Keeping the local stakeholders informed about the intentions of the programme will also be important.

- Humanitarian aid stage could be blended into the reconstruction / development aid through *declining subsidies* for infrastructure services, thus slowly moving service delivery to cost recovery levels of tariffs. Continuing with targeted subsidies may, however, be necessary to support vulnerable segments of the population for considerably longer periods of time – here, however, the targeting of such subsidies is crucial (see discussion below).
- To the extent possible given practical difficulties, reconstruction / development type activities might commence as soon as possible in the post conflict environment, which will help demonstrate to consumers that they will be receiving better services even though they would potentially have to pay for them.

5.2.2. Procurement

A robust procurement capability is crucial in delivering a PPP strategy. As regards infrastructure PPPs, it is arguable that all too often there has been too much of a focus on developing complex regulatory capabilities, whilst the need for basic procurement skills is either taken as a given or else ignored.

A key tenet of a desirable procurement policy within PCCs is the ability of the public sector to achieve an acceptable level of performance risk transfer to the private sector, tying (aid) funding, to the extent possible, to specific and verifiable outputs.³⁰ Moreover, it is also desirable that the international private sector subcontracts an appropriate proportion of the activities to local suppliers, although it is important to recognise that there may be some tradeoffs as regards the potential for risk transfer.

The traditional method for procurement by the public sector of goods, services and infrastructure is to procure delivery against an input specification, with payment to be made for the costs of the inputs, plus a profit margin (i.e. a cost plus payment). There may be scope, however, even in the immediate post-conflict situation, to improve the effectiveness of reconstruction aid by using less traditional procurement methods, and, in particular, by a greater focus on performance based (or output based) procurement

³⁰ It should be noted, however, that it is only sensible to transfer performance risk where it is deemed to be controllable. Alternatively to transfer uncontrollable performance risk will either not be possible or will take place at such a cost that it does not represent value for money.

mechanisms. In such procurement, the technical specifications set out in the tender will specify the desired outcome or deliverables, which outcomes will be measured in order to determine performance and how. The release of funds will then be conditional on achievement of those deliverables, with performance risk residing with the contractor.

The extent to which the private sector operators in such environments will accept additional risk associated with output based procurement, however, will need to be assessed on a case by case basis. Indeed, consultations have suggested that for some contractors there is a sense that the donors or national contracting authorities need to take on more, not less, of the risk if they are to get greater private sector involvement in the most difficult of post conflict environments.

The desirability of transferring performance risk to private sector operators, however, needs to be balanced with another policy objective, that of involving local private sectors as sub-contractors to the main (international) reconstruction firms. The tension arises because in many instances the work conducted by local contractors in PCCs presents an uncontrollable risk for the main contractor – especially as local providers tend to be unable to provide performance guarantees or have an established reputation. Given the pro-poor advantages of involving local providers – for improving local employment opportunities and building local private sector capacity – the contracting donors and / or national authorities may need to be prepared, where possible, to allow some form of risk pass through back to themselves within such performance based reconstruction arrangements.³¹

Finally, it is also important to note the distinction between building more straightforward procurement capacity and ability to structure more complex PPP arrangements that involve longer term investment from financing facilities and other investors. Capacity building interventions might arguably be more focused on more basic processes, whereas structuring more complex PPPs is likely to require greater external advisory input, which, as discussed above, could be sourced through a number of the already existing donor facilities.

Further discussion on the procurement issues is set out in Appendix 7.

³¹ It is possible that contracts could provide for a gradual ‘tightening up’ of the performance regime as risks become more controllable.

5.2.3. Improving subsidy (aid) delivery mechanisms

As discussed in the section above, an important aspect of the procurement process, is the ability of the providers of aid to condition the release of such funds on delivery of specific and verifiable outputs by the contractors. Output Based Aid (OBA) approaches – which are currently receiving significant support from a number of international donors, in particular UK’s DFID and the World Bank – incorporate this principle and as such could be an important way of improving the delivery mechanisms for reconstruction aid.³²

It is generally accepted that the rehabilitation and delivery of basic infrastructure services (that is water and electricity in particular) in post conflict environments will be funded, to a large extent, by reconstruction aid, with some form of continued subsidy to support the poorest for many years. Low affordability among the PCC population and the often high costs of delivering the service combine to render such donor subsidies necessary.

There is, however, scope to improve the delivery of aid or subsidies to reduce the gap between affordability and cost of service delivery. To date there has been a tendency by the donors to focus their aid efforts on the use of input based specifications and cost-plus contracting structures to finance delivery of a particular infrastructure service. This has had the effect of reducing the incentives for efficient delivery of services and increasing the risk of non-delivery, with little recourse available to the funders. The shift, therefore, needs to be towards tying the release of aid or subsidies to specific outputs – that is output based aid.

In summary, the OBA approaches are:

- provided within a performance-driven regime – that is subsidy payments are provided to the recipient upon delivery, and verification, of pre-agreed outputs;
- explicitly identified and as such are not ‘hidden’ within subsidised lending programmes;
- targeted so as to impact the desired recipients and not others; and

³² Global Partnership for Output Based Aid (GPOBA), a recently established donor supported facility, is dedicated to coordinating the development efforts aimed at improving and implementing OBA subsidy approaches in donor activities. Further information on GPOBA, and its contact details, are provided in Annex 4.

- efficient, with the use of competition (or benchmarking) to determine the least level of subsidy required to deliver a particular service.

In addition to the way that reconstruction aid or subsidy provision is structured, it is also important to consider how such funding is disbursed. Given the institutional and legislative environments in most PCCs, many private sector operators may not be prepared to accept breach of contract risk with the national government, that is the risk that they may not be paid the subsidy once they had delivered the pre-agreed outputs. This may happen for a number of reasons, including third party creditors laying claim to government funds or unexpected emergencies – such as floods – placing rival demands on finite public resources.

A way around this is to channel reconstruction aid and subsidies directly from donors to the recipients and not via budgetary support to the government, although it is important to emphasise that government still plays an important verification and monitoring role. This provides an opportunity for relevant government officials to build up their PPP contracting and implementation capacity. With time, and as the situation in the country stabilises and governance improves, it is likely that more private sector operators will be willing to accept government contract risk in such circumstances.

These issues are discussed in both Appendix 6 and Appendix 7.

5.2.4. Consumer buy-in and sensitisation

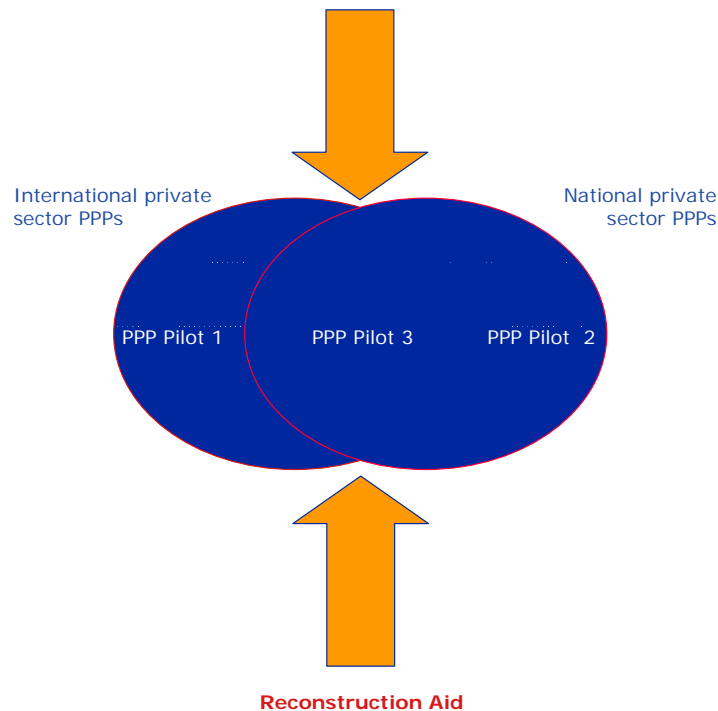
Achieving consumer buy-in is likely to involve consultations and option development with the users of services to determine the most appropriate infrastructure services. This is an ongoing process which could involve recognising the work of local community organisations (Community Based Organisations, Civil Society Organisations) to enable end users to vocalise their infrastructure needs and to coordinate their response in a PCC environment, where local power structures may have disintegrated. Given the sensitivities that characterise PCCs, it is important that there is an awareness of this in developing infrastructure solutions. Failure to do so can result in unforeseen problems where proposed solutions may actually aggravate pre-existing tensions.

6. TESTING POLICIES AND INTERVENTIONS THROUGH PILOT PROJECTS

Whereas the previous section examined some of the general interventions required to increase financial flows to PPPs, in this section we consider some of the outline pilot

projects to which these approaches might be wholly or partially applied, as illustrated in Figure 6.1 below.

Figure 6.1: Pilot projects



The pilots suggested are indicative and not comprehensive, but attempt to focus on different types of PPP activities pertinent to PCCs. The three chosen areas are:

- *PPP Pilot 1: Operations involving commercial, long term investments.* This area will typically involve those sectors where there is more of a private sector appetite for investment risk, but where there are political risk impediments to private sector involvement. The example chosen includes greater involvement of MIGA in addressing big political risks such as war and expropriation in PCCs.
- *PPP Pilot 2: Small scale infrastructure activities.* This type of activity refers to small or micro-scale private sector entrepreneurial activity, related to infrastructure development and provision, which is too small to warrant interest from international operators. Such activities tend to be almost exclusively engaged in by national private sector stakeholders, who typically fund the infrastructure themselves. The specific example chosen involves the provision of OBA subsidies, via microfinance providers, to increase demand side support for expansion of modern energy systems in a rural area.

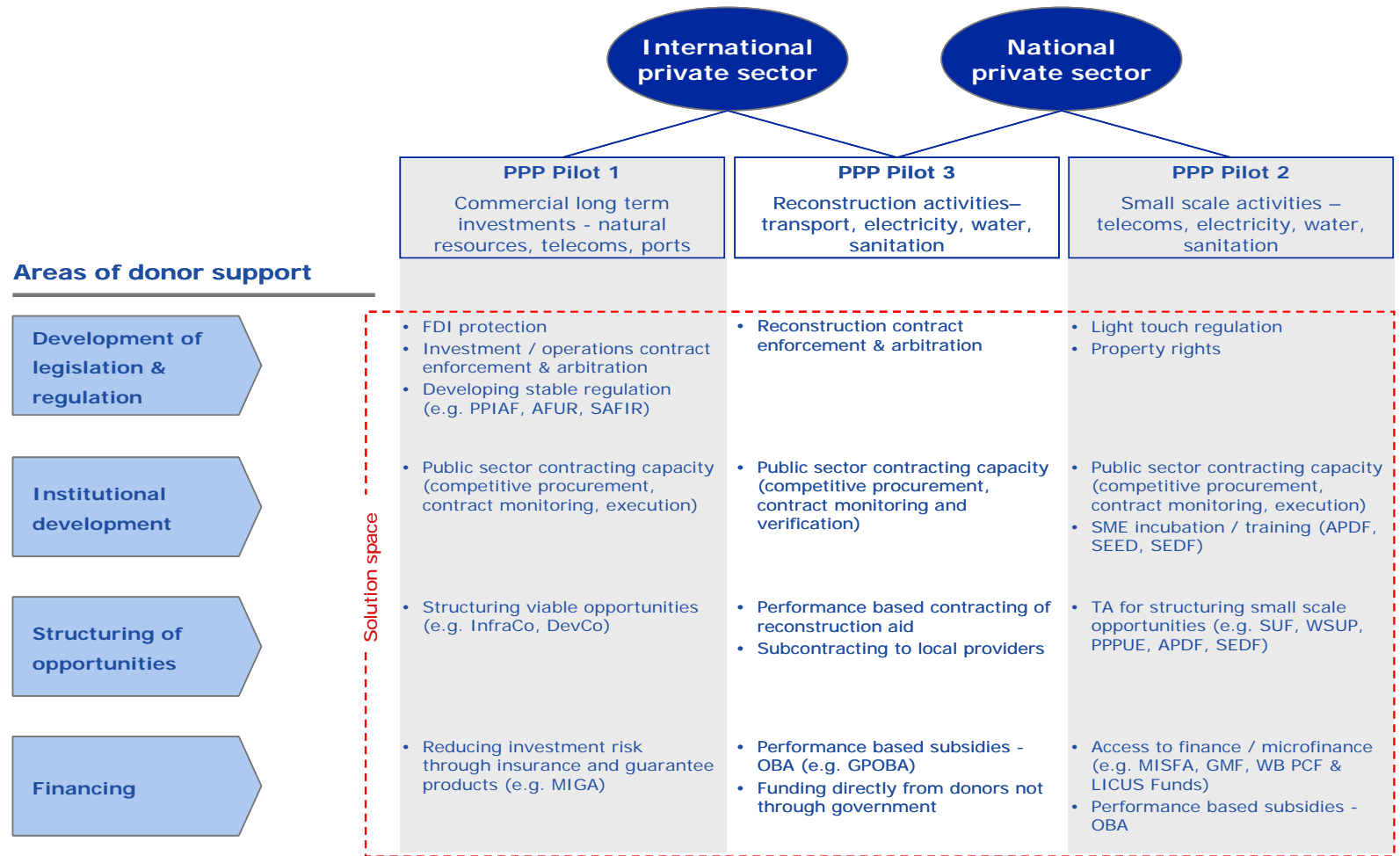
- *PPP Pilot 3: Reconstruction of infrastructure.* This area of activity refers to donor-financed reconstruction in PCCs, which may span different infrastructure sectors. There is potential for both international and national private sectors to be involved in these activities, which range from upgrading transport links such as roads and railroads to rehabilitating / repairing electricity or water and sanitation utility assets. The example chosen focuses on the provision of water services to the poor and peri-urban areas of a city, using a combination of the international and local private sectors.

We have grouped pertinent issues that need to be addressed in each of these pilots into four broad types:

- Assisting the development of appropriate **legislative** and **contractual / regulatory** procedures to encourage and support different areas of activity. This is likely to involve, for example, supporting the establishment of arbitration and / or other mechanisms for contract dispute resolution.
- Providing support for **institutional development** related, in particular, to procuring infrastructure PPPs by national authorities and donors themselves.
- Supporting activities aimed at appropriate **structuring** of infrastructure PPP opportunities across different areas of activity.
- In combination with other donor supported activities providing appropriate **financing**, including grant funding, to address some of the barriers to the lack of investment flows to infrastructure PPPs in PCCs. This could involve reducing risks for existing financing facilities to provide insurance and guarantee products and / or strengthening demand for a particular service through demand subsidies.

Figure 6.2 below, illustrates how these issues relate to each of the pilots.

Figure 6.2: PPP Pilots



Below we present the three possible pilot projects in more detail. It is our understanding that the sponsors of this study may decide to pursue one or more of these at a later stage. For this reasons we have focused our presentation more on the overall structure that these projects could take and the issues that will be tested through their implementation. We have not wanted to prescribe detailed implementation – something which can only be done once a more detailed feasibility study is carried out for each project and by the implementing sponsor.

6.1. PPP Pilot 1: Grants to leverage MIGA resources

This pilot project builds on the work already undertaken by MIGA in post conflict countries such as Bosnia and Herzegovina and Afghanistan, and essentially explores the possibility of using donor grant funding as a means of bringing MIGA into PCC markets earlier than it would have been able to do otherwise.

As a modification to the structures already used by MIGA, where such trust funds have been country specific and where MIGA has had to come to a separate arrangement with the fund for each individual investment being insured, this pilot scheme proposes that the trust fund is regional and has a portfolio approach to projects. This, in fact, is an approach that is currently being discussed between DFID, the Commission for Africa, and MIGA. It is of course possible that other Commonwealth states might either seek to join these arrangements or else seek to replicate the structures outside of Africa.

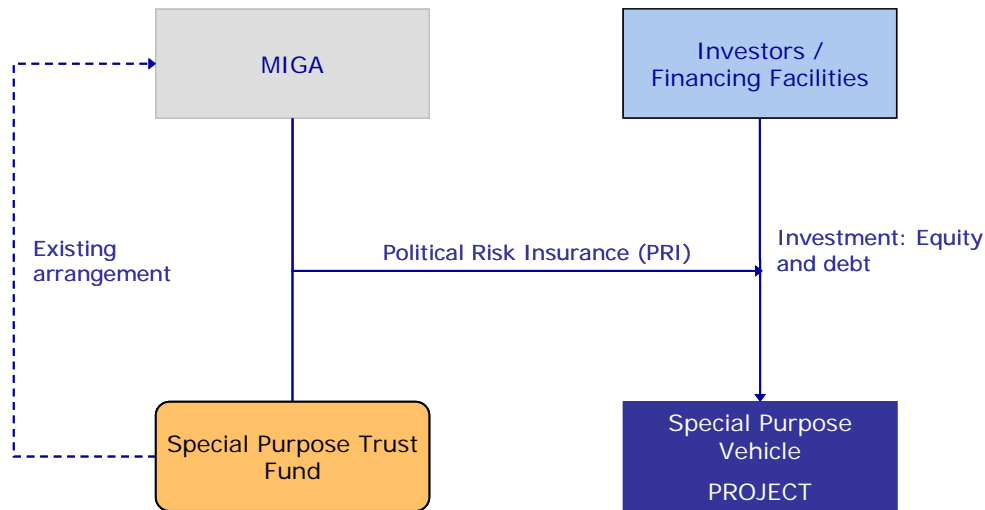
The key elements of this structure are:

- The cover could be provided to any financing facility (such as a DFI) seeking to support an investment / loan within an eligible PCC.
- The special purpose Trust Fund would share the risks with MIGA on either a co-guarantee / insurance or first-loss basis. Thus, in the case of a US\$1m policy:
 - MIGA might underwrite say 60% or US\$600,000 and the Trust Fund the other 40% or US\$400,000. This means that in case of a call on the policy, MIGA would pay out only 60% of the value of any claim.
 - In case of a first loss arrangement, the Trust Fund would pay out for any claims amounting up to the US\$400,000, with MIGA only paying out for realised claims incurred over and above this.

- The arrangements could also be structured on a project portfolio basis, spanning a number of countries. This would provide diversification benefits and has the potential to reduce the transaction costs in arranging insurance cover on each individual project.

The structure of such a relationship is depicted in Figure 6.3 below.

Figure 6.3: PPP Pilot 1 structure



Given that work on such an approach is already progress, it is likely that it will be tested in the sub-Saharan African context. The sectors can vary as can the particular countries in the region.³³

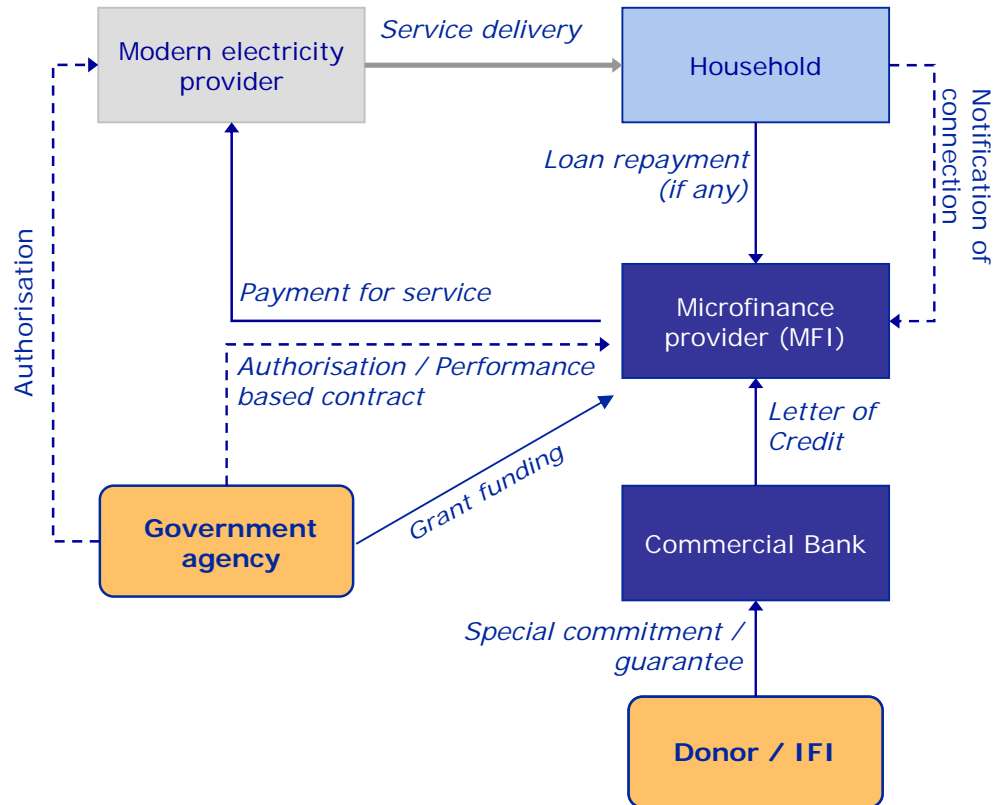
6.2. PPP Pilot 2: Building demand in rural areas for modern energy services

The second type of a PPP Pilot would focus on strengthening demand for the expansion of modern energy services in rural areas, through the use of demand side OBA subsidies and microfinance institutions. In many rural areas, latent demand for modern energy services exists and tends to be met through alternative consumables such as kerosene and batteries. Often the principal constraint to greater use of modern energy services is the high capital cost of connecting households to electricity grids which then translates into high and in many cases unaffordable electricity prices.

³³ It is important to note that MIGA is currently reviewing whether to alter its constitution to allow it to provide PRI cover for loans or bond issues where it is not providing cover to equity investors.

The proposed structure, as presented in Figure 6.4 below, is aimed at providing a basic grant subsidy per household to contribute towards a service quality of choice with any additional financing requirements being met through micro-credit support.

Figure 6.4: Pilot project 3 structure



In practice, the project might work on the following lines:

- The household decides on the nature of modern energy service it requires. This may be fixed line service, solar equipment, micro-hydro-equipment, self mini / micro generation sets (for personal use or possible sale of excess).
- A payment mechanism is set up for installation of service / provision of equipment:
 - Household arranges connection / delivery of equipment with approved modern energy service provider and notifies the microfinance provider (which may be a specialist institution or else an NGO with the requisite capabilities).

- If the household requires a service level in excess of the available grant (which might be set at a base level) an additional micro-finance loan is applied for. The microfinance provider is responsible for agreeing the credit.
- Payments to the service provider are made directly by the microfinance institution and upon confirmation by the customer that the agreed service has been provided.
- Customer repays any loan on agreed terms and conditions.
- Donor funding can be channelled into the country to local banks through financial arrangements (for example, special commitments / Letter of Credit).
- Government authority pre-approves modern energy suppliers and microfinance institutions eligible to manage subsidies. Continued authorisation is contingent on entities meeting pre-agreed performance targets, for instance:
 - approved electricity supplier – connection within a certain time from request by customer; maintenance of the connection / equipment according to agreement with customer; and
 - approved microfinance provider – prompt payment to the approved modern electricity supplier; efficient management of subsidies.
- Approved providers extend the reach of their services by marketing them to the population.

This type of arrangement, which is reliant on different service providers, requires a more stable post-conflict country, which has established financial institutions, including microfinance providers, providers of modern energy service, and a relatively developed legislative / contracting system and institutional capacity. Examples may include countries like Mozambique, Uganda or Sri Lanka.

6.3. PPP Pilot 3: Procuring reconstruction of a water system

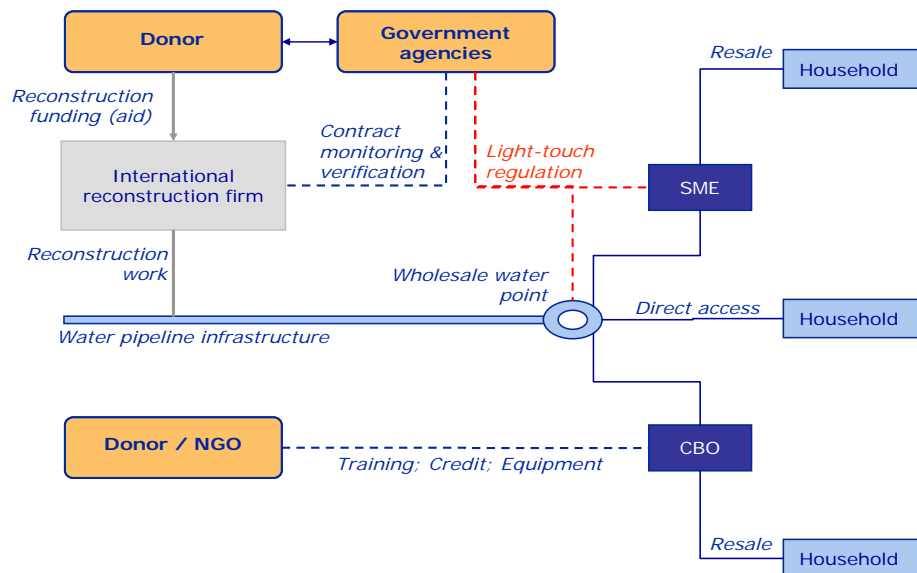
We envisage that the PPP Pilot 3 would be a reconstruction project, using private sector contractors, in an urban / peri-urban area.

This project comprises two components:

- In the first instance, donors contract with an international private sector reconstruction firm to build-out or rehabilitate the main water pipeline for a city. Whilst richer households may already be connected to services, it is unlikely that the poorest and / or peri-urban areas are connected and such a project would be aimed at extending the water service to these customers. The international company would be responsible for operating trunk pipes and running the commercially viable part of the network.³⁴ The work is carried out under a performance based contract and could involve substantial subcontracted elements to local firms. The project is funded by reconstruction monies.
- A subset of this project would also include structuring the distribution of the service to households from the wholesale water point. This element could include local small scale (private sector) providers – engaged either by the local government or the main reconstruction contractor – to maintain and exploit the water point for onward delivery to households. As a means of ensuring water access by the poorer households, there need not be exclusive arrangements with any one small scale provider for the exploitation of the water point and households can have access to water at wholesale prices directly.

Figure 6.5 below presents an overview of the project structure, with its various components.

Figure 6.5: PPP Pilot 3 structure



³⁴ Reconstruction funds might be limited to common / trunk network aspects – including bulk water supply – with richer households being responsible for funding repairs to their own mains connections.

Other aspects of the scheme include:

- Government monitoring and verifying of the performance contract awarded to the operator.
- 'Light touch' regulation, for instance of water quality, of SMEs / CBOs providing services.
- Potential capacity building support provided by donors or NGOs to SME / CBO suppliers.

There will need to be regular contact between all stakeholders to address the many issues that will arise from time to time. Such arrangements might be possible in a one to two years post conflict environment.

APPENDIX 1: POST-CONFLICT COUNTRIES CONSIDERED

The PCC dataset we considered is shown in Table A1.1 below.

Table A1.1: A selection of post conflict countries¹

Country	Conflict dates	Conflict details
Afghanistan	1979 – 1989 1989 – 2001	Soviet invasion Civil war, US intervention
Angola	1975 – 1991 1992 – 2002	First UNITA civil war Second UNITA civil war
Azerbaijan	1991 – 1994	Separatist / interstate war
Bosnia & Herzegovina	1992 – 1995	Civil / ethnic war
Cambodia	1970 – 1991	Civil / interstate wars
Colombia	1984 – ongoing	Regional ongoing violence
East Timor	1975 – 1999	Civil unrest / war of independence
El Salvador	1979 – 1992	Civil (guerrilla) war
Eritrea	1974 – 1991 1998 – 2000	Civil war Interstate war (with Ethiopia)
Ethiopia	1974 – 1991 1998 – 2000	Civil war Interstate war (with Eritrea)
Mozambique	1965 – 1975 1976 – 1992	War of independence Civil war
Russia Federation	1994 – 1996 1999 – ongoing	Regional conflict (Chechnya) Regional conflict (Chechnya)
Rwanda	1990 – 1994	Ethnic conflict
Serbia & Montenegro	1998 – 1999	Regional conflict (Kosovo)
Sierra Leone	1991 – 1996 1997 – 2002	Civil war Civil war
Sri Lanka	1983 – 2002	Regional ongoing violence
Uganda	Late 1980s – ongoing	Regional unrest in northern Uganda

¹ We used various sources to determine details of a particular conflict and its end date, including: International Peace Research Institute (Centre for the Study Civil War), Schwartz et al 2004, Collier & Hoeffler 2001, Collier 2002, www.globalsecurity.org, Peace Pledge Union Online, UK Foreign and Commonwealth Office, World Bank country data.

APPENDIX 2: LOW AND MIDDLE-INCOME COUNTRIES

Table A2.1 provides the list of Low and Middle-Income Countries.

Table A2.1 Low and Middle Income countries (World Bank classification 2003)

Country	Region	Income group
Afghanistan	South Asia	Low income
Albania	Europe and Central Asia	Lower middle income
Algeria	Middle East and North Africa	Lower middle income
American Samoa	East Asia and Pacific	Upper middle income
Angola	Sub-Saharan Africa	Low income
Antigua and Barbuda	Latin America and the Caribbean	Upper middle income
Argentina	Latin America and the Caribbean	Upper middle income
Armenia	Europe and Central Asia	Low income
Azerbaijan	Europe and Central Asia	Lower middle income
Bangladesh	South Asia	Low income
Barbados	Latin America and the Caribbean	Upper middle income
Belarus	Europe and Central Asia	Lower middle income
Belize	Latin America and the Caribbean	Lower middle income
Benin	Sub-Saharan Africa	Low income
Bhutan	South Asia	Low income
Bolivia	Latin America and the Caribbean	Lower middle income
Bosnia and Herzegovina	Europe and Central Asia	Lower middle income
Botswana	Sub-Saharan Africa	Upper middle income
Brazil	Latin America and the Caribbean	Upper middle income
Bulgaria	Europe and Central Asia	Lower middle income
Burkina Faso	Sub-Saharan Africa	Low income
Burundi	Sub-Saharan Africa	Low income
Cambodia	East Asia and Pacific	Low income
Cameroon	Sub-Saharan Africa	Low income
Cape Verde	Sub-Saharan Africa	Lower middle income
Central African Republic	Sub-Saharan Africa	Low income
Chad	Sub-Saharan Africa	Low income
Chile	Latin America and the Caribbean	Upper middle income
China	East Asia and Pacific	Lower middle income
Colombia	Latin America and the Caribbean	Lower middle income

Country	Region	Income group
Comoros	Sub-Saharan Africa	Low income
Congo, Dem. Rep.	Sub-Saharan Africa	Low income
Congo, Rep.	Sub-Saharan Africa	Low income
Costa Rica	Latin America and the Caribbean	Upper middle income
Côte d'Ivoire	Sub-Saharan Africa	Low income
Croatia	Europe and Central Asia	Upper middle income
Cuba	Latin America and the Caribbean	Lower middle income
Czech Republic	Europe and Central Asia	Upper middle income
Djibouti	Middle East and North Africa	Lower middle income
Dominica	Latin America and the Caribbean	Upper middle income
Dominican Republic	Latin America and the Caribbean	Lower middle income
Ecuador	Latin America and the Caribbean	Lower middle income
Egypt	Middle East and North Africa	Lower middle income
El Salvador	Latin America and the Caribbean	Lower middle income
Equatorial Guinea	Sub-Saharan Africa	Low income
Eritrea	Sub-Saharan Africa	Low income
Estonia	Europe and Central Asia	Upper middle income
Ethiopia	Sub-Saharan Africa	Low income
Fiji	East Asia and Pacific	Lower middle income
Gabon	Sub-Saharan Africa	Upper middle income
Gambia, The	Sub-Saharan Africa	Low income
Georgia	Europe and Central Asia	Lower middle income
Ghana	Sub-Saharan Africa	Low income
Grenada	Latin America and the Caribbean	Upper middle income
Guatemala	Latin America and the Caribbean	Lower middle income
Guinea	Sub-Saharan Africa	Low income
Guinea-Bissau	Sub-Saharan Africa	Low income
Guyana	Latin America and the Caribbean	Lower middle income
Haiti	Latin America and the Caribbean	Low income
Honduras	Latin America and the Caribbean	Lower middle income
Hungary	Europe and Central Asia	Upper middle income
India	South Asia	Low income
Indonesia	East Asia and Pacific	Lower middle income

Country	Region	Income group
Iran	Middle East and North Africa	Lower middle income
Iraq	Middle East and North Africa	Lower middle income
Isle of Man	Europe and Central Asia	Upper middle income
Jamaica	Latin America and the Caribbean	Lower middle income
Jordan	Middle East and North Africa	Lower middle income
Kazakhstan	Europe and Central Asia	Lower middle income
Kenya	Sub-Saharan Africa	Low income
Kiribati	East Asia and Pacific	Lower middle income
Korea, Dem. Rep.	East Asia and Pacific	Low income
Kyrgyz Republic	Europe and Central Asia	Low income
Lao PDR	East Asia and Pacific	Low income
Latvia	Europe and Central Asia	Upper middle income
Lebanon	Middle East and North Africa	Upper middle income
Lesotho	Sub-Saharan Africa	Low income
Liberia	Sub-Saharan Africa	Low income
Libya	Middle East and North Africa	Upper middle income
Lithuania	Europe and Central Asia	Upper middle income
Macedonia, FYR	Europe and Central Asia	Lower middle income
Madagascar	Sub-Saharan Africa	Low income
Malawi	Sub-Saharan Africa	Low income
Malaysia	East Asia and Pacific	Upper middle income
Maldives	South Asia	Lower middle income
Mali	Sub-Saharan Africa	Low income
Malta	Middle East and North Africa	Upper middle income
Marshall Islands	East Asia and Pacific	Lower middle income
Mauritania	Sub-Saharan Africa	Low income
Mauritius	Sub-Saharan Africa	Upper middle income
Mayotte	Sub-Saharan Africa	Upper middle income
Mexico	Latin America and the Caribbean	Upper middle income
Micronesia, Fed. Sts	East Asia and Pacific	Lower middle income
Moldova	Europe and Central Asia	Low income
Mongolia	East Asia and Pacific	Low income
Morocco	Middle East and North Africa	Lower middle income

Country	Region	Income group
Mozambique	Sub-Saharan Africa	Low income
Myanmar	East Asia and Pacific	Low income
Namibia	Sub-Saharan Africa	Lower middle income
Nepal	South Asia	Low income
Nicaragua	Latin America and the Caribbean	Low income
Niger	Sub-Saharan Africa	Low income
Nigeria	Sub-Saharan Africa	Low income
Oman	Middle East and North Africa	Upper middle income
Pakistan	South Asia	Low income
Palau	East Asia and Pacific	Upper middle income
Panama	Latin America and the Caribbean	Upper middle income
Papua New Guinea	East Asia and Pacific	Low income
Paraguay	Latin America and the Caribbean	Lower middle income
Peru	Latin America and the Caribbean	Lower middle income
Philippines	East Asia and Pacific	Lower middle income
Poland	Europe and Central Asia	Upper middle income
Romania	Europe and Central Asia	Lower middle income
Russian Federation	Europe and Central Asia	Lower middle income
Rwanda	Sub-Saharan Africa	Low income
Samoa	East Asia and Pacific	Lower middle income
São Tomé and Príncipe	Sub-Saharan Africa	Low income
Saudi Arabia	Middle East and North Africa	Upper middle income
Senegal	Sub-Saharan Africa	Low income
Serbia and Montenegro	Europe and Central Asia	Lower middle income
Seychelles	Sub-Saharan Africa	Upper middle income
Sierra Leone	Sub-Saharan Africa	Low income
Slovak Republic	Europe and Central Asia	Upper middle income
Solomon Islands	East Asia and Pacific	Low income
Somalia	Sub-Saharan Africa	Low income
South Africa	Sub-Saharan Africa	Lower middle income
Sri Lanka	South Asia	Lower middle income
St. Kitts and Nevis	Latin America and the Caribbean	Upper middle income
St. Lucia	Latin America and the Caribbean	Upper middle income

Country	Region	Income group
St. Vincent and the Grenadines	Latin America and the Caribbean	Upper middle income
Sudan	Sub-Saharan Africa	Low income
Suriname	Latin America and the Caribbean	Lower middle income
Swaziland	Sub-Saharan Africa	Lower middle income
Syria	Middle East and North Africa	Lower middle income
Tajikistan	Europe and Central Asia	Low income
Tanzania	Sub-Saharan Africa	Low income
Thailand	East Asia and Pacific	Lower middle income
Timor-Leste	East Asia and Pacific	Low income
Togo	Sub-Saharan Africa	Low income
Tonga	East Asia and Pacific	Lower middle income
Trinidad and Tobago	Latin America and the Caribbean	Upper middle income
Tunisia	Middle East and North Africa	Lower middle income
Turkey	Europe and Central Asia	Lower middle income
Turkmenistan	Europe and Central Asia	Lower middle income
Uganda	Sub-Saharan Africa	Low income
Ukraine	Europe and Central Asia	Low income
Uruguay	Latin America and the Caribbean	Upper middle income
Uzbekistan	Europe and Central Asia	Low income
Vanuatu	East Asia and Pacific	Lower middle income
Venezuela	Latin America and the Caribbean	Upper middle income
Vietnam	East Asia and Pacific	Low income
West Bank and Gaza	Middle East and North Africa	Lower middle income
Yemen, Rep.	Middle East and North Africa	Low income
Zambia	Sub-Saharan Africa	Low income
Zimbabwe	Sub-Saharan Africa	Low income

APPENDIX 3: THE PUBLIC-PRIVATE PARTNERSHIP SPECTRUM

Below we provide a brief outline of different points along the PPP spectrum.²

Service contracts

Individual aspects of infrastructure provision (e.g. specific tasks such as meter reading, pumping station operation, solid waste transport) are contracted out to a private contractor for periods from a few months to a few years. It is expected that an increase in efficiency and operational cost reductions would yield savings. Asian Development Bank (ADB) estimates that such savings may be about 20 - 30% when compared with public provision. Contracting out is a powerful tool to challenge the public provider, particularly labour interests, and generates efficiencies. However, these benefits may not reach the poor as service contracts are confined to bettering the service to existing customers (in LMI countries these are generally better off segments of the population).

Management contracts

For a fee - often performance related or profit sharing - a private management team runs the public operation, wholly or in part. A management contract, which does not greatly challenge the existing system, can be an attractive first step to private sector involvement but may not tackle the problems of entrenched interests and reluctance to charge viable tariffs. Because such contracts are short - typically 5 years - and do not directly link investment to service provision, they usually, as mentioned above, focus only on improving service to existing customers rather than extending service into new (in particular poor) areas.

Lease contracts

Usually up to 15 years long, lease contracts typically give the private operator full control over supplying services and recovering tariffs, in exchange for payment for use of the fixed assets, which remain the responsibility of the public agency. Because services in developing countries often need some level of investment to upgrade distribution systems, reduce leakage, and extend services, the “enhanced lease” concept has been developed. Under an enhanced lease, small improvements are the responsibility of the operator, and major investments for treatment and disposal facilities, for example, remain

² Adapted from: Asian Development Bank (2002): Beyond Boundaries: Extending Services to the Urban Poor.

the responsibility of the government. Enhanced leases give national contractors a good opportunity to become involved in serving secondary towns.

Build-operate-transfer (BOT) contracts

BOT and its many variations (such as Design Build Maintain, Design Build Finance Operate etc.) are primarily used for specific large, one-off investments in infrastructure provision (e.g. water production plant, power plant, wastewater treatment plant, sanitary landfills). For up to 30 years, the length depending upon the size of investment that has to be amortized, the operator provides guaranteed levels of goods and services in exchange for guaranteed prices, although usually including some amount of demand risk. The operator takes the risk to design, build, and operate the facility at specified quality standards in exchange for a guaranteed cash flow (off-take). Efficient production/provision is critical to serving all customers, but unless the distribution and/or collection network is also upgraded or extended to poor unserved areas, the efficiency gains of BOTs may be gradually lost and never reach the poor.

Concessions

Lasting an average of 25 years, these contracts transfer all responsibilities for capital investment and operation and maintenance (O&M) to a private operator. The fixed assets legally remain the property of government, and the operator might pay a fee to use them. Tariffs may be lowered by reducing the capital amounts to amortize, which will benefit the poor if they are connected. Concessions with clear coverage targets toward universal service for all citizens - including the poor - can be an excellent means of using the skills of the private sector to leverage investment, provide high-quality service, relate to customers, and collect a viable tariff. Under this arrangement, the government continues to regulate the tariff level through its regulatory system and monitors the quality of service provision. For a number of reasons (including institutional difficulties and differences in opinion on tariff regimes) concessions have not been very successful so far, with many being dismantled after the euphoria of late 1990s.

Divestiture (Privatisation)

Under the most radical form of private sector involvement, existing operations and assets are sold to the private sector, perhaps with a time-limited license. Like the concession,

divestiture has the same potential to use license conditions and regulation to ensure universal service coverage.

APPENDIX 4: RELEVANT (FINANCING) FACILITIES

In this appendix we provide some background details on the relevant financing and other facilities available from the some of the largest providers of finance and reconstruction aid for infrastructure development in LMI countries. In Section 1 we focus on the World Bank Group Institutions, followed by summaries of some of the other key facilities relevant to infrastructure provision and post-conflict reconstruction.

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A4.1 THE WORLD BANK GROUP

The World Bank Group consists of a range of institutions whose mission is to fight poverty and improve the living standards of people in the developing world. The Group provide loans, policy advice, technical assistance and knowledge sharing services to low and middle income countries to reduce poverty. The Group is made up of the following institutions:

- The World Bank (made up of the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA))
- The International Finance Corporation (IFC)
- The Multilateral Investment Guarantee Agency (MIGA)
- The International Centre for Settlement of Investment Disputes (ICSID)

A4.1.1 The World Bank

The World Bank is one of the biggest providers of finance for infrastructure development in low and middle income countries. It provides finance through both grants and investment and structural adjustment loans.

Grants

The World Bank Group grants are designed to encourage innovation, co-operation between organisations and to increase the participation in projects of local stakeholders. The grants are either funded directly or managed through partnerships. Listed below are some of the mechanisms through which the Bank distributes grants for infrastructure related activities:

Investment Lending

Investment loans provide financing for a wide range of activities aimed at creating the physical and social infrastructure necessary for poverty alleviation and sustainable development. Over the past two decades, investment lending has, on average, accounted for 75 to 80 percent of all Bank lending.

The nature of investment lending has evolved over time. Originally focused on hardware, engineering services, and bricks and mortar, investment lending has come to focus more on institution building, social development, and building the public policy infrastructure needed to facilitate private sector activity. Projects range from urban poverty reduction

(involving private contractors in new housing construction, for example) to rural development (formalizing land tenure to increase the security of small farmers); water and sanitation (improving the efficiency of water utilities); natural resource management (providing training in sustainable forestry and farming); post-conflict reconstruction (reintegrating soldiers into communities); education (promoting the education of girls); and health (establishing rural clinics and training health care workers).

- **Eligibility.** Investment loans are available to International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) borrowers not in arrears with the Bank Group.
- **Disbursement.** Funds are disbursed against specific foreign or local expenditures related to the investment project, including pre-identified equipment, materials, civil works, technical and consulting services, studies, and incremental recurrent costs. Procurement of these goods, works, and services is an important aspect of project implementation. To ensure satisfactory performance, the loan agreement may include conditions of disbursement for specific project components.
- **Instruments.** The large majority of investment loans are either Specific Investment Loans or Sector Investment and Maintenance Loans. Adaptable Programme Loans and Learning and Innovation Loans were recently introduced to provide more innovation and flexibility. Other instruments tailored to borrowers' specific needs are Technical Assistance Loans, Financial Intermediary Loans, and Emergency Recovery Loans.

Development Policy Lending

Development Policy loans provide quick-disbursing assistance to countries with external financing needs, to support structural reforms in a sector or the economy as a whole. They support the policy and institutional changes needed to create an environment conducive to sustained and equitable growth. Over the past two decades, development policy lending—previously called adjustment lending—has accounted, on average, for 20 to 25 percent of total Bank lending.

Development Policy loans were originally designed to provide support for macroeconomic policy reforms, such as in trade policy and agriculture. Over time, they

have evolved to focus more on structural, financial sector and social policy reform, and on improving public sector resource management. Development Policy operations now generally aim to promote competitive market structures (for example, legal and regulatory reform), correct distortions in incentive regimes (taxation and trade reform), establish appropriate monitoring and safeguards (financial sector reform), create an environment conducive to private sector investment (judicial reform, adoption of a modern investment code), encourage private sector activity (privatization and public-private partnerships), promote good governance (civil service reform), and mitigate short-term adverse effects of development policy (establishment of social protection funds).

- **Eligibility.** Development policy loans are available to IBRD and IDA borrowers not in arrears to the Bank Group. Eligibility for a development policy loan also requires agreement on monitorable policy and institutional reform actions, and satisfactory macroeconomic management. Coordination with the IMF is an essential part of the preparation of a development policy loan.
- **Disbursement.** Funds are disbursed in one or more stages (tranches) into a special deposit account. Tranches are released when the borrower complies with stipulated release conditions, such as the passage of reform legislation, the achievement of certain performance benchmarks, or other evidence of progress toward a satisfactory macroeconomic framework. Funds may be disbursed against a positive list of specific imports needed for the operation, or subject to a negative list of prohibited expenditures (e.g., military and luxury items). Since 1996, the negative list has typically been used.
- **Instruments.** The new policy OP/BP 8.60 applies uniformly to all development policy lending, replacing the previous different types of lending (e.g., RILs, SALs, SECALs, SNALs, PSALs). Development policy operations in PRSP (Poverty Reduction Strategy Paper) countries may continue to be called ‘PRSCs’ (Poverty Reduction Support Credits), because this is by now a well-established ‘brand name’.

The table below summarises a number of the key instruments used by the World Bank, frequently in partnership with other donors and organisations, to address issues relating to infrastructure and reconstruction in LMIs.

World Bank Instrumentswww.worldbank.org**African Forum for Utility Regulation**

The African Forum for Utility Regulation (AFUR) aims to support the development of effective utility regulation in Africa. The Forum was established in September 2000 as an informal arrangement to facilitate the exchange of information and lessons of experience between African regulators, and to support capacity building efforts in the region. AFUR focuses on issues related to the regulation of energy, telecommunications, and water and sanitation, with a particular emphasis on topics that are common across sectors. The Forum focuses primarily on region-wide issues and developments, although it may also contribute to activities at the sub-regional level.

<http://www1.worldbank.org/afur/index.asp>**Africa Rural and Renewable Energy Initiative**

AFRREI is designed to promote private-sector led rural development, with a primary focus on innovative design of, and financing for, rural electrification projects, utilisation of renewable energy resources (solar, small hydro, biomass from waste), and improved supply and utilisation of "traditional fuels" (primarily wood and charcoal) for heating and cooking. The Africa Rural and Renewable Energy Initiative (AFRREI) formulates World Bank operations aimed at scaling up rural energy access and renewable energy market development in Sub-Saharan Africa. AFRREI was launched in October 1998 to formulate the "next generation" of projects aimed at scaling up rural energy access and renewable energy market development. AFRREI's focus has been mainly on rural electrification.

www.worldbank.org**Bank-Netherlands Water Partnership (BNWP)**

The BNWP is a new programme to improve delivery of water supply and sanitation services to the poor. BNWP enhances performance of World Bank operations in the water supply and sanitation sector and supports a broad sector reform agenda with a strong poverty focus. BNWP supports the international effort to reach the Millennium Development Goals, especially to halve – by 2015 - the proportion of people without access to potable water.

<http://wbi0018.worldbank.org/water/bnwp.nsf>**Consultative Group to Assist the Poorest (CGAP)**

CGAP is a consortium of 28 public and private development agencies working together to expand access to financial services for the poor in developing countries. CGAP was created by these aid agencies and industry leaders to help create permanent financial services for the poor on a large scale (often referred to as "microfinance"). CGAP is a resource centre for the entire microfinance industry, where it incubates and supports new ideas, innovative products, cutting-edge technology, novel mechanisms for delivering financial services, and concrete solutions to the challenges of expanding microfinance. CGAP serves four groups of clients: development agencies, financial institutions including microfinance institutions (MFIs), government policymakers and regulators, and other service providers, such as auditors and rating agencies.

<http://www.cgap.org/index.html>

World Bank Instrumentswww.worldbank.org**Cities Alliance**

A global alliance of cities and their development partners committed to improve the living conditions of the urban poor through action in two key areas: City development strategies (CDS) which link the process by which local stakeholders define their vision for their city, analyse its economic prospects and establish clear priorities for actions and investments, and City-wide and nation-wide slum upgrading to improve the living conditions the urban poor. Launched by the World Bank and United Nations Centre for Human Settlements (UN-Habitat) in 1999, Cities Alliance members include all the G-7 governments plus Brazil, Netherlands, Norway and Sweden, the Asian Development Bank, UN-Habitat, the United Nations Environment Programme, the World Bank, and local authorities, represented by United Cities and Local Governments (UCLG) and Metropolis. Alliance partners have joined forces to expand the level of resources reaching the urban poor, by improving the coherence of effort among on-going urban programmes, and by more directly linking grant-funded urban development cooperation with investment follow-up.

www.citiesalliance.org**Development Marketplace**

Early stage seed funding is provided to entrepreneurs with poverty fighting ideas to promote their development projects. Entrepreneurs are linked with partners that have the resources to help them implement their proposals. Since 1998, more than \$16 million has been awarded to 330 groundbreaking projects identified through global competitions and Country Innovation Days.

www.developmentmarketplace.org**Energy Sector Management Assistance Programme (ESMAP):**

The Energy Sector Management Assistance Programme (ESMAP) is a global technical assistance programme which helps build consensus and provides policy advice on sustainable energy development to governments of developing countries and economies in transition. ESMAP also contributes to the transfer of technology and knowledge in energy sector management and the delivery of modern energy services to the poor. ESMAP was established in 1983 under the joint sponsorship of the World Bank and United Nations Development Programme (UNDP) as a partnership with UNDP in response to global energy crises.

www.esmap.org**Financing Energy Services for Small-Scale Users (FINESSE)**

FINESSE focuses on the formulation of policy, institutional/regulatory framework and capacity development to provide technically feasible and economically viable RE technologies and energy efficiency services to residential, commercial, agro-industrial and institutional energy users in developing countries. The main form of support is loans and grants, and is delivered through technical assistance, demonstration projects, export and investment support. It is funded by the World Bank, US DOE, Netherlands (DGIS) and UNDP. The FINESSE programme aims to accelerate the commercialisation of renewable energy technologies through pre-investment activities and the creation of the conditions and mechanisms for the credit sector to on-lend to small-scale energy users. FINESSE secures the involvement of small-scale operators, supporting franchise operations and enabling the local manufacture of key components.

www.worldbank.org

World Bank Instrumentswww.worldbank.org**Global Environment Facility (GEF)**

GEF is an international mechanism for providing new and additional grants to achieve global environmental benefits in climate change, biodiversity, international waters and ozone-layer depletion. It is an independent financial organisation that provides grants to developing countries for projects that benefit the global environment and promote sustainable livelihoods in local communities. The GEF is a financial mechanism structured as a trust fund that operates in collaboration and partnership with the three implementing agencies (UNDP, UNEP, and the World Bank) for the purpose of achieving global environmental benefits.

GEF Small Grants Programme.

Managed by the UNDP for GEF, Established in 1992, the GEF Small Grants Programme (SGP) embodies the very essence of sustainable development. By providing financial and technical support to projects in developing countries that conserve and restore the natural world while enhancing well being and livelihoods, the SGP demonstrates that community action can maintain the fine balance between human needs and environmental imperatives. The SGP links global, national and local-level issues through a transparent, participatory and country-driven approach to project planning, design and implementation. Grants are made directly to non-governmental organisations and community-based organisations in recognition of the key role they play as a resource and constituency for environment and development concerns around the world.

www.thegef.org**Global Partnership for Output Based Aid (GPOBA)**

GPOBA was established as a multi-donor trust fund in January 2003, by UK's DFID and the World Bank. The goal of GPOBA is to provide increased access to reliable basic infrastructure and social services to the poor in developing countries through the wider use of OBA approaches. The primary outputs of GPOBA are pilot demonstration projects and related activities to identify and disseminate lessons of experience on the design and implementation of OBA schemes. GPOBA will demonstrate and document OBA methods of supporting the sustainable delivery of basic services (water, sanitation, electricity, telecommunications, transportation, health and education) to those least able to afford them and to those currently without access. The GPOBA has carried out work in a number of post-conflict countries including Mozambique, Rwanda and Cambodia.

www.gpoba.org**Global Village Energy Partnership (Linked with ESMAP)**

Global Village Energy Partnership is a partnership that brings together developing and industrialized countries, and others in an effort to ensure access to modern energy services by the poor. Part of GVEP's work relates to enabling finance to reach village energy projects, local entrepreneurs and consumers. The Global Village Energy Partnership Financing Facilitation service line seeks to bridge the gap among financiers, entrepreneurs and consumers with the goal of increasing investment in village energy projects and programmes through five products and services: business planning and operations for entrepreneurs; training for finance intermediaries; linking partners to financing sources worldwide; design of risk mitigation instruments and leveraging investment financing for energy/poverty/development projects from public and private donors and investors.

www.gvep.org

World Bank Instrumentswww.worldbank.org**Highway Development and Management Tools (HDM -4) Partnership with PIARC**

The International Study of Highway Development and Management Tools (HDM-4) project has been developing new knowledge and technology for planning investments in road infrastructure since 1993. The HDM-4 project has been sponsored by the World Bank, the Asian Development Bank, the UK Department for International Development (formerly ODA), the Swedish National Road Authority and other bodies. The responsibility for coordinating the international implementation of the new highway investment planning tool (HDM-4) is with PIARC, the World Road Association.

www.worldbank.org/html/fpd/transport/piarc.htm**Investor Councils in Africa**

This is a new initiative of the World Bank. The purpose of Investor Councils is to increase understanding between the government and companies driving private investments, to identify and accelerate government measures to address impediments to reform for an improved investment climate.

Market solutions for Development

The mission of the Market Solutions for Development (MS4D) programme is to support and advance the Bank's strategic objective of creating a favourable investment climate, as a means of assisting client countries to achieve sustainable growth, generating employment and reducing poverty. The programme has the objective of promoting new thinking, sharing new knowledge, disseminating best practices on building institutional capacity, and creating appropriate market institutions to achieve pro-poor growth with governance.

www.worldbank.org/wbi/marketsolutions**Norwegian Trust Fund for Private Sector Development and Infrastructure**

The NTF-PSI provides grant resources for World Bank Group activities aimed at mainstreaming investment climate, governance and infrastructure services for the poor. The NTF-PSI will fund energy, water, urban development, transport, infrastructure, and private sector development activities across the Bank and IFC. It is intended to help develop Bank and client country capacity, promote inclusion of these cross-cutting issues into World Bank operations, and foster cooperation between different units in the World Bank Group, with United Nations institutions, and with other external agencies and groups. Activities in the bottom three categories of the Development Assistance Committee (DAC) List of Aid Recipients (Least Developed, Other Low-Income Countries, and Lower Middle-Income Countries) can be supported. Half of the funds are earmarked for Africa.

www.worldbank.org/infrastructure/ntfpsi.nsf

World Bank Instrumentswww.worldbank.org**Post-Conflict Fund and LICUS Trust Fund;**

To help the World Bank respond rapidly to early reconstruction situations, support partnerships, and foster a better understanding of post-conflict reconstruction, a new grant facility - the Post-Conflict Fund (PCF) - was established in August 1997 as part of a larger Bank Development Grant Facility. The PCF makes grants to a wide range of partners (institutions, nongovernmental organisations, United Nations agencies, transitional authorities, governments, and other civil society institutions) to provide earlier and broader World Bank assistance to conflict-affected countries. Grants are focused on the restoration of the lives and livelihood of war-affected population, with a premium placed on innovative approaches to conflict, partnerships with donors and executing agencies and leveraging resources through a variety of funding arrangements. The PCF aims to enhance the Bank's ability to support countries in transition from conflict to sustainable peace and economic growth with grants ranging between \$25,000 to \$1 million. To date, the PCF has approved 136 grants of a total value of \$66 million.

In 2004, the World Bank Post-Conflict Fund Secretariat also took on administration of the \$25 million Low Income Countries Under Stress (**LICUS**) Trust Fund (established in 2002), with many of the countries in the classification also affected by conflict. The Fund is designed to support LICUS with the most severe conflict and institutional problems to implement the reforms necessary for re-engagement with the international community and to address urgent social needs through a coordinated multi-donor approach.

www.worldbank.org**World Bank Public-Private Partnership in Infrastructure Programme (PPPI)**

The PPPI is one of the World Bank Institute's 'Learning Programmes', although it does not currently focus on PCCs. The goal of the PPPI programme is to support developing countries' efforts to establish a sound regulatory and business environment conducive to the development of public-private partnerships for the provision of affordable and sustainable infrastructure services. The Infrastructure programme aims at:

- Providing knowledge and expertise on options and mechanisms for securing public-private partnerships in the provision of infrastructure services;
- Exposing policymakers in developing countries to the principles and foundations of effective regulation;
- Educating regulators and competition authorities on modern economic and financial regulation tools;
- Investing in the next generation of regulators and watchdogs by working on the development of university teaching and research programs on the economics of regulation and finance; and
- Providing a better understanding of the constraints on and the interests of main contracting parties in an infrastructure project transaction.

The **Water Programme** is an additional World Bank 'Learning Programme' which addresses global water challenges by strengthening institutions for better water management and delivery of water and sanitation services. The Programme operates within the framework of the existing Bank policies and strategies on water resources management and sanitation, as well as other related sectors, including environment, rural development and health.

World Bank Instrumentswww.worldbank.org**South Asian Forum for Infrastructure Regulation (SAFIR)**

SAFIR is designed to assist in the building of regulatory capacity in the electricity, natural gas, telecommunications, water, transport and other sectors. SAFIR aims to provide high quality capacity building and training on infrastructure regulation, and related topics, in South Asia. It aims also to stimulate research on the subject by building a network of regional and international institutions and individuals that are active in the field. It hopes to facilitate effective and efficient regulation of utility and infrastructure industries, initiate beneficial exchange of knowledge and expertise, and encourage global best practices. SAFIR is supported by a grant from PPIAF.

www.safir.teri.res.in**Sub-Saharan Africa Transport Policy Programme**

The Sub-Saharan Africa Transport Policy Programme (SSATP) is an international partnership to facilitate policy development and related capacity-building in the transport sector of sub-Saharan Africa. The programme has 5 main components: Road Management Initiative (RMI) component issues address institutional and financial development issues; Rural Travel and Transport Programme (RTTP) component strategies are being pursued, sometimes alongside RMI initiatives; the Urban Mobility (UM) component has successfully pursued a clean air agenda and is now turning to developing sustainable mechanisms and appropriate institutions for addressing mobility and transport needs of the urban poor. The importance of the Trade and Transport (T&T) component is now recognized in terms of the contribution it can make to reducing the obstacles to interstate and transit traffic, reducing transport cost and improving the competitiveness of African production and ultimately, promoting growth. The Programme has been active in a number of PCCs including Mozambique, Uganda, Ethiopia and Côte d'Ivoire.

www.worldbank.org/afr/ssatp**Water and Sanitation Programme**

Administered by the World Bank, The Water and Sanitation Programme (WSP) is an international partnership of the world's leading development agencies concerned with improving sector policies, practices and capacities to serve poor people. The goal of WSP is to alleviate poverty by helping the poor gain sustained access to water and sanitation services. In practical terms, WSP provides targeted support to national and local governments, local communities, and their support organisations. The WSP maintains regional and country offices in Africa, Asia and Latin America and engages with partners in the field to develop innovative solutions to the obstacles faced by poor communities in obtaining water and sanitation services. It provides advice to policymakers to help adopt improved policies and strategies and to undertake institutional reform; it also provides advice to strengthen the investment programs and projects of its clients and partners.

www.wsp.org**WB Group Infrastructure Economics and Finance Departments**

The World Bank Group has created the 'Infrastructure Economics and Finance' department to strengthen the understanding of the practical implications of analytical infrastructure economics and to develop instruments and approaches for infrastructure finance. The overall theme is to leverage the amount of private capital per unit of available public resources, which is key to the effectiveness of the Bank's role in the infrastructure sectors. The Department, established as a cross-sectoral unit supporting the regions in the Bank, has a dedicated infrastructure advisory group to provide advice and support in the efficient design and development of PPP schemes including issues related with economic regulation, competition and market structure, as well as developing innovative mechanisms to support infrastructure finance. The Infrastructure Advisory Services department offers advice in the following areas: policy frameworks for transaction design and PPP structures; economic regulation; delivery of infrastructure services to the poor; infrastructure finance and public sector risk management. The Group is also responsible for mainstreaming the use of OBAs schemes and manages the Global Partnership for Output Based Aid (GPOBA).

World Bank Instruments

www.worldbank.org**World Bank Guarantees Programme**

The World Bank guarantee instruments aim to help accelerate growth in developing countries by mobilizing private financing for infrastructure development and other projects. The World Bank offers three kinds of guarantees:

- **Partial Risk Guarantees (PRGs)** cover private lenders against the risk of a public entity failing to perform its obligations with respect to a private project. PRGs ensure payment in the case of default resulting from the non-performance of contractual obligations undertaken by governments or their agencies in private sector projects.
- **Partial Credit Guarantees (PCGs)** cover private lenders against all risks during a specific period of the financing term of debt for a public investment. PCGs are specially designed to extend maturity and improve market terms.
- **Policy Based Guarantees (PBGs)** help to improve governments' access to capital markets in support of social, institutional, and structural policies and reforms. PBGs are offered to countries with a strong track record of performance with a satisfactory social, structural, and macroeconomic policy framework and a coherent strategy for gaining (or regaining) access to international financial markets.

IBRD Hedging Products provide borrowers with risk management capabilities for projects, lending programs or sovereign asset-liability management. The hedging products include interest rate swaps, interest rate caps and collars, currency swaps and, on a case-by-case basis, commodity swaps.

www.worldbank.org**A4.1.2 International Finance Corporation (IFC)**

The International Finance Corporation, a member of the World Bank Group, operates on a commercial basis. It invests exclusively in for-profit projects and charges market rates for its products and services. It provides the following funding products to the private sector investing in low and middle income countries:

- **Loans for IFC's own account (A-loans):** Most A-loans are issued in leading currencies, but local currency loans can also be provided. The loans typically have maturities of 7 to 12 years, but can be extended to as long as 20 years. Grace periods and repayment schedules are determined on a case-by-case basis in accordance with the borrower's cash flow needs.
- **Equity Finance:** IFC is a long-term investor and usually maintains equity investments for a period of 8 to 15 years. When the time comes to sell, IFC prefers to exit by selling its shares through the domestic stock market in a way that will benefit the enterprise, often in a public offering. To ensure the participation of other private investors, the Corporation generally subscribes to between 5% and 15% of a project's equity - normally a maximum of 35%.
- **Quasi-Equity Finance (C-loans):** IFC offers a full range of quasi-equity products with both debt and equity characteristics to private sector projects in developing countries. Among other instruments, the IFC provides convertible debt and subordinated loan investments, which impose a fixed repayment schedule. It also offers preferred stock and income note investments, which require a less rigid repayment schedule.

- **Syndicated Loans (B-loans):** IFC's is able to lend in two important ways: (i) through the syndication or 'B loan' program; and (ii) through the securitization of IFC's own portfolio of loans. The syndication programme allows participants, primarily commercial banks, to enjoy the advantages of IFC's status as a multilateral institution. By participating in the B loan program, participants benefit from preferred creditor status. The B loan helps mitigate country risk for banks, providing them an opportunity to participate in well-structured, market-priced project and corporate loans in countries which otherwise might not seem attractive to lenders.

IFC Instruments	www.ifc.org
<p>Africa Project Development Facility</p> <p>The Africa Project Development Facility (APDF) was established in 1986 as a multi-donor initiative helping African small and medium enterprises (SMEs) to develop "bankable" business plans and secure project financing. Headquartered in Johannesburg, with regional hubs in Abidjan, Accra, Johannesburg and Nairobi, and offices in Lagos and Cape Town, it facilitates access to a wide set of business development services for local SMEs and the organisations in Sub-Saharan Africa. It has now broadened its mandate to include capacity building for SMEs, consulting services, business associations, and local financial institutions. APDF also works closely with its sister organisation the African Management Services Company (AMSCO), which provides management support, training, and corporate governance assistance. APDF's new five-year cycle includes Business Advisory Services (BAS) such as: (i) Development of business plans, due diligence and valuations, (ii) Business diagnosis, and (iii) Financial structuring and fund raising.</p> <p style="text-align: right;">www2.ifc.org/sme/html/apdf.html</p>	
<p>Foreign Investment Advisory Service (FIAS)</p> <p>FIAS helps developing and transition country governments design initiatives to attract foreign direct investment. FIAS advises on laws, policies, incentives, institutions, and strategies. FIAS works only at the request of governments, on topics identified by the government and agreed to by both parties. This ensures the relevance of the assistance and lays the basis for active partnership. The Service offers much more than one-way advice and written reports: through interactive workshops and roundtable meetings that often include business executives and other stakeholders, it helps governments chart technically and politically practical paths to change.</p> <p style="text-align: right;">www.fias.net</p>	
<p>Global Microfinance Facility Ltd</p> <p>The IFC created this \$30 million investment company in 2004. The Facility has been developed as a commercially viable approach to helping microfinance institutions (MFIs) access medium-term local currency funding from domestic or foreign banks. The Facility will provide credit enhancement products at commercial terms to MFIs through local commercial banks who would not otherwise lend to them. These products will include standby facilities (letters of credit, letters of guarantee, and direct funded loans or deposit products) to local commercial banks, primarily to support local currency lending to MFIs. The Facility will also make direct loans to MFIs for liquidity management.</p> <p style="text-align: right;">www.ifc.org</p>	

IFC Instrumentswww.ifc.org**Mekong Project Development Facility**

Launched in 1997 and headquartered in Hanoi, the Mekong Project Development Facility (MPDF) supports the development of private, domestically-owned SMEs in Vietnam, Lao PDR, and Cambodia. It promotes development of the formal private sector in through two main activities: (i) providing SMEs with direct advisory assistance leading to improved access to capital and improved technical and managerial performance; (ii) and helping to generally improve the local business environment through SME support services development programs. The Facility is managed by the International Finance Corporation (IFC), and is financed by a number of donor countries and institutions including: Asian Development Bank (ADB), Australia, Canada, Finland, IFC, Japan, Norway, Sweden, Switzerland, and the UK.

www.mpdf.org**Programme for Eastern Indonesia SME Assistance (PENSA)**

The PENSA Development Facility was established to strengthen small and medium enterprises (SME) in eastern Indonesia, supporting expansion of the SME sector as a vital base toward creating jobs, higher incomes and sustained economic growth. PENSA products and services are targeted toward providing increased avenues of financing to SMEs, as well as technical assistance and capacity building initiatives drawing on IFC links with the business community, the World Bank Group, donors, NGOs, and other partners. Core programmes include improving access to capital, improving business performance and improving the business environment. Based in Denpasar, Bali, PENSA is managed by the IFC East Asia/Pacific Dept., and jointly funded by IFC and the governments of Australia, Canada, Japan, the Netherlands, and Switzerland.

Southeast Europe Enterprise Development (SEED) (IFC)

SEED is a five-year, \$25 million initiative managed by the International Finance Corporation (IFC) to strengthen small and medium enterprises (SMEs) in Albania, Bosnia and Herzegovina, FYR Macedonia and Serbia and Montenegro. SEED's activities are co-financed by the governments and aid agencies of Austria, Canada, Greece, The Netherlands, Norway, Slovenia, Sweden, Switzerland and the United Kingdom. The programme was known as the Balkan Enterprise Facility during its initial planning. One of SEED's principal tasks is that of improving and meeting demand for high quality consulting and training services within the SME sector. Since its inception in September 2000, SEED has focused its efforts on (i) increasing competitiveness of SMEs in the region, (ii) strengthening business development services (BDS) markets, and (iii) improving the business environment for SMEs.

www2.ifc.org/seed**A4.1.3 Multilateral Investment Guarantee Agency (MIGA)**

MIGA's mission is to promote foreign direct investment into developing countries, in order to support economic growth, reduce poverty and improve people's lives. It promotes FDI into developing countries through guarantees, technical assistance, and legal services. Among conflict-affected countries, Europe and Central Asia account for the largest number of projects (22) supported by MIGA and lay claim to the highest dollar amount, with \$406 million in coverage. Latin America received the second largest share in terms of dollar value, at \$378 million in guarantees for 9 projects. The agency also provided \$351 million in guarantee coverage for 12 projects in Asia and \$304 million for 10 projects in sub-Saharan Africa, while the Middle East and North Africa received guarantees worth \$21 million for 3 projects. Sectorally, infrastructure accounts for the lion's share of guarantee coverage to conflict-affected countries, claiming \$686 million.

MIGA Instrumentswww.miga.org**MIGA Trust Funds**

MIGA Trust funds play an important role in enable MIGA to underwrite projects in conflict-affected countries. They allow the agency to be financially prudent while facilitating urgently needed foreign investment in inherently riskier environments. Three of the Trust Funds are described below:

In partnership with the European Commission, MIGA established a special **Investment Guarantee Trust Fund for Bosnia and Herzegovina** in 1997. The 10 million euro fund provides long-term insurance to eligible small- and medium-sized investors from EU member countries and a number of East European countries. The relationship is structured as follows:

- Any involvement is considered on a project by project basis
- The Trust Fund will underwrite a maximum of US\$2m for any one project
- MIGA has 1:5 leverage on this (i.e. for a guarantee of US\$10m, the Trust Fund would underwrite US\$2m, with MIGA underwriting the other US\$8m)
- In case of a claim, the payout would be split between the two in that proportion (i.e. in case of a US\$1m claim, the Trust Fund would pay 20% or US\$200,000 and MIGA the other 80% or US\$800,000).

The **Trust Fund for Afghanistan** has capital provided to it by IDA, DFID and the ADB. Afghanistan was considered a greater risk than Bosnia and Herzegovina and as a result MIGA has a slightly different structure for the fund:

- Any involvement is considered on a project by project basis.
- MIGA was also able to achieve about the same leverage in Afghanistan as it did in Bosnia – about 1:5.
- In case of a claim, however, the Trust Fund in Afghanistan takes the first loss and up to the amount it has underwritten.

In cooperation with the Palestinian Authority, MIGA also administers a **Trust Fund for the West Bank and Gaza**. This Trust Fund is unique in that the West Bank and Gaza is not a member of MIGA. The \$21 million fund, begun in 1998, is supported by the Palestinian Authority, European Investment Bank, and government of Japan. MIGA has received applications for approximately \$20 million in potential new investments in the West Bank and Gaza in infrastructure, manufacturing, real estate, services, telecommunications and tourism.

MIGA Technical Assistance

Since its inception, MIGA has provided technical assistance for capacity-building and information dissemination services to 23 conflict-affected countries, including Cambodia, Croatia, Guatemala, Mozambique, the Philippines and Yugoslavia. Regardless of a country's conflict status, MIGA provides technical assistance to promote foreign investment, provided that the government is pro-private sector. At the government's invitation, MIGA works with a country's investment promotion agency (IPA) to help develop national investment strategy. The agency coordinates closely with the Foreign Investment Advisory Service (FIAS) of the World Bank, which works to get the right regulatory frameworks into place. The agency can also serve as the voice of the private sector to encourage the fine-tuning of laws and policies.

MIGA Instruments	www.miga.org
<p>MIGA Investment Guarantee Services</p> <p>Loan guarantees and insurance against non-commercial risks such as expropriation, breach of contract, or war are available to eligible investors for qualified investments in developing countries. MIGA provides investment guarantees against certain non-commercial risks (i.e., political risk insurance) to eligible foreign investors for qualified investments in developing member countries. In terms of 'War and Civil Disturbance' protection MIGA's coverage protects against loss from damage or destruction of tangible assets caused by politically-motivated acts of war or civil disturbance in the host country, including revolution, insurrection, coups d'état, sabotage, and terrorism. For equity investments, MIGA will pay the investor's share of the least of the book value of the assets, of their replacement cost, or of the cost of repair of damaged assets. For loans and loan guaranties, MIGA will pay the insured portion of the principal and interest payments in default as a direct result of damage to the assets of the project caused by war and civil disturbance. War and Civil Disturbance coverage also extends to events that, for a period of one year, result in an interruption of project operations essential to overall financial viability.</p>	
<p>MIGA Investment Marketing Services</p> <p>MIGA's Investment Marketing Services Department works to equip investment promotion intermediaries with knowledge, tools, and techniques to strengthen their capacity to attract and retain foreign direct investment. To this end, MIGA provides both "hands-on" operational assistance to promotion intermediaries and a range of investment information services to assist member countries and firms contemplating direct investments in the developing world. MIGA's work emphasizes the transfer of best practice in FDI promotion, and MIGA's online information services support and leverage capacity-building efforts by linking investors directly to relevant information on investment opportunities and business operating conditions in developing countries.</p>	
<p>MIGA Mediation and Legal Services</p> <p>MIGA, on a selective basis, encourages the settlement of investment disputes between member countries and investors who are not MIGA guarantee holders. This service aims to fill a gap in international law remedies currently available to foreign investors in their disputes with host countries, where diplomatic solutions are not practical for some, and formal arbitration may be too costly for others.</p>	

A4.1.4 International Centre for Settlement of Investment Disputes (ICSID)

ICSID	www.worldbank.org/icsid
<p>International Centre for the Settlement of Investment Disputes</p> <p>ICSID was established under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the Convention) which came into force on October 14, 1966. ICSID is an autonomous international organisation. However, it has close links with the World Bank. All of ICSID's members are also members of the Bank. ICSID provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries. Recourse to ICSID conciliation and arbitration is entirely voluntary. However, once the parties have consented to arbitration under the ICSID Convention, neither can unilaterally withdraw its consent. Moreover, all ICSID Contracting States (including many PCCs), whether or not parties to the dispute, are required by the Convention to recognize and enforce ICSID arbitral awards.</p>	<p>www.worldbank.org/icsid</p>

A4.2 BILATERAL DONORS

Bilateral Donors
<p>DFID - Conflict and Humanitarian Affairs Department (CHAD)</p> <p>CHAD is the UK Department for International Development's (DFID) department for issues relating to conflict and humanitarian affairs, including emergencies and disasters. Among other things, CHAD provides advice and support for emergency response preparedness and contingency planning, and directly manages some humanitarian programmes. Whenever possible, they rely on agencies which are well-established in the countries that have local knowledge and expertise in the region to undertake emergency relief activities.</p> <p style="text-align: right;">www.dfid.gov.uk</p>
<p>EU Humanitarian Aid Office (ECHO)</p> <p>ECHO is the service of the European Commission responsible for humanitarian aid, established in 1992. It's mandate is to provide emergency assistance and relief to the victims of natural disasters or armed conflict outside the European Union. Activities include the urgent delivery of goods and services such as essential supplies, foodstuffs, medical equipment, medicines, fuel, water purification teams, medical teams and logistical support. These services and goods are delivered through ECHO partners. Since 1992, ECHO has funded work in more than 85 countries, worth a total of more than €500 million per year. In response to humanitarian emergencies, partner NGOs and international organisations can submit project proposals to ECHO at any time of the year, but they need to be in-line with the current ECHO strategies.</p> <p style="text-align: right;">www.eu.int/comm/echo</p>
<p>Netherlands Ministry of Foreign Affairs - Stability Fund and PPP Approach</p> <p>The Stability Fund finances activities that enhance security in poor countries where there is, or has recently been, a conflict. This is new to Dutch foreign policy. The fund enables a rapid, targeted deployment of financial resources and is therefore a valuable addition to the other foreign and development policy instruments. The Stability Fund supports activities that aim to create a stable and safe environment as soon as possible in conflict and former conflict regions. After a conflict, it usually takes many years for everything to return to the way it was. Dutch embassies present proposals for activities to be supported and international organisations such as the UN usually carry them out, although developing countries can also do it themselves.</p> <p>The Dutch Government has also initiated a new focus on Public-Private Partnerships in developing countries in support of the Millennium Development Goals. A call for proposals which ended in March 2004 requested ideas for Public private partnerships (PPPs) which would should make a clear contribution to poverty reduction and sustainable development in Dutch foreign policy partner countries, preferably in sub-Saharan Africa. PPP ideas needed to focus on the themes Water and Sanitation, Energy, Health, Agriculture, and Biodiversity, but could not be used for large scale infrastructure project. The Netherlands' contribution to an individual partnership is set provisionally between a minimum of € 0,2 million and a maximum of € 1,0 million (total amount). The private partner needs to supply at least 50% of the funding.</p>
<p>SIDA Division for Humanitarian Assistance</p> <p>Within the Swedish International Development Agency (SIDA), humanitarian assistance is administered by the Division for Humanitarian Assistance in the Department for Cooperation with NGOs and Humanitarian Assistance (SEKO). Humanitarian Assistance is the second largest item of expenditure for SIDA, with the objective of alleviating problems related to armed conflicts of natural disasters, including mine actions, education, water and sanitation and food security. Assistance is channelled primarily through UN agencies, the International Red Cross groups and Swedish NGOs active in zones affected by humanitarian disaster, with some funds also channelled through international and local NGOs.</p> <p style="text-align: right;">www.sida.se</p>

Bilateral Donors

USAID - Office of U.S. Foreign Disaster Assistance (OFDA)

This office within USAID is responsible for providing humanitarian assistance in response to international crises and disasters, and is part of the Bureau for Democracy, Conflict and Humanitarian Assistance (DCHA). Its activities focus on directly channelling funds and/or relief supplies to US missions abroad once a 'disaster' is declared, with a large part of the relief assistance being channelled through NGOs, UN organisations and international organisations. The total budget for OFDA is over \$390 million per year, and is earmarked for activities related to disaster relief, rehabilitation and prevention, mitigation and preparedness.

www.usaid.gov

USAID Office of Transition Initiatives (OTI)

The OTI was created within USAID's Bureau for Democracy, Conflict and Humanitarian Assistance in 1994 to provide special assistance to countries in a period of transition between war and stability. The assistance is fast, flexible, short-term assistance for projects to build democracy and peace. OTI undertakes activities to lay foundations for long-term development by promoting reconciliation, jumpstarting economies and helping stable democracy take hold. First, OTI specifically encourage a culture of risk-taking, political orientation, and swift response among its staff and partners. Second, OTI is funded by a separate "Transition Initiatives" budget account with special authorities that allow immediate spending where it is most needed. Finally, OTI create an innovative contracting mechanism that preserves the principle of competition while allowing quick start-up in new countries and direct grants to small, indigenous organisations. The initiatives include work related to media programming, technical assistance to government institutions, election processes, civil-military relations. They are not related specifically to very basic humanitarian assistance, however they do fill a gap for small-scale transitional development activities. For example, an \$8,000 project in Burundi was designed to promote small-scale infrastructure reconstruction and generate new economic opportunities. The budget for the OTI was \$50 million in 2003.

www.usaid.gov

A4.3 MULTILATERAL PROGRAMMES AND TRUST FUNDS

Multilateral Programmes and Trust Funds

Afghanistan Reconstruction Trust Fund

The Afghanistan Reconstruction Trust Fund (ARTF) provides a coordinated way for donors to help the Interim Administration of Afghanistan. Funded by 24 donor countries, and jointly managed by international aid agencies, the Trust Fund helps with priority projects and programs to rebuild Afghanistan and facilitate the return of skilled expatriate Afghans to the country. It also provides short-term emergency funding for salaries of civil servants. ARTF supports the recurrent and capital costs of the Government and finances priority projects and programs to rebuild Afghanistan and facilitate the return of skilled expatriate Afghans to the country. The Trust Fund is jointly managed by the World Bank, the United Nations Development Programme, the Asian Development Bank, and the Islamic Development Bank. The projects have included emergency telecommunications projects, power supply projects and microfinance projects.

www.worldbank.org/artf

Global Facilitation Partnership for Transportation and Trade (GFPTT)

The GFPTT aims at pulling together all interested parties, public and private, national and international, who want to help achieve significant improvements in transport and trade facilitation in WB member countries. Initially a WB initiative, it is now has membership from over 150 public and private firms, national and international organisations.

www.gfptt.org

Multilateral Programmes and Trust Funds

Microfinance and Investment Support Facility Afghanistan (MISFA)

Established in 2003, MISFA is an intermediary financing facility which has identified microfinance as one of the core needs for securing sustainable development in an immediate post-conflict environment. In an almost total absence of formal banks, the MISFA was established to serve as a national, multi-donor mechanism that provides qualified local microfinance institutions with grants and loans for lending capital and institutional capacity building. In addition to providing saving and lending facilities on a small scale, MISFA also provides training and technical assistance as well as opportunities for networking and business partnerships. It is hoped that MISFA can provide a model of public-private collaboration in rebuilding the Afghani economy, with both the government and donors participating in its governance. Ten microfinance institutions have been approved for funding totalling over \$18 million.

www.misfa.org

Public-Private Infrastructure Advisory Facility (PPIAF)

The PPIAF is a multi-donor technical assistance facility aimed at helping developing countries improve the quality of their infrastructure through private sector involvement. Launched in July 1999, PPIAF was developed at the joint initiative of the governments of Japan and the United Kingdom, working closely with the World Bank. PPIAF pursues its mission through channelling technical assistance to governments in developing countries on strategies and measures to tap the full potential of private involvement in infrastructure and identifying, disseminating, and promoting best practices on matters related to private involvement in infrastructure in developing countries.

www.ppiaf.org

Trust Fund East Timor (World Bank and Asian Development Bank)

The Trust Fund for East Timor (TFET) is a multi-donor trust fund that has supported reconstruction and development activities since early 2000. TFET donors are Portugal, the European Commission, Japan, Australia, UK, Finland, USA, Ireland, New Zealand, Italy and the World Bank Post Conflict Fund. Current TFET programs are underway in agriculture, economics and institutional capacity building, education, health, small enterprise development, roads, power and petroleum sector technical assistance. All TFET projects are implemented by Government Ministries. The ADB manages TFET projects aiming to rehabilitate roads, ports, water utilities, telecommunications and power, with the World Bank in charge of TFET projects in the sectors of health, education, agriculture, private sector development and economic capacity building. The World Bank and the ADB work together in community development projects including microfinance.

www.adb.org

Multilateral Programmes and Trust Funds

Water and Sanitation for the Urban Poor (WSUP)

WSUP has been set up as a Management Partnership between WaterAid, CARE, WWF, Thames Water, Halcrow, Unilever, and Cranfield University. It is aimed at providing technical assistance to low income and least developed countries in the development of water and sanitation services specifically for the urban poor. WSUP are setting up two pilot projects in Bangalore and in East Africa, to test how their partnership will work in action.

In practice, WSUP's approach is to identify a project and to undertake a scoping mission which is followed up by contacts from the local CARE or WaterAid office or whichever member of the consortium has in-country contacts. WSUP will then initiate a feasibility study looking at demand and affordability and will undertake a needs assessment for the local water supply. Projects will only be selected where at least 50,000 inhabitants could be served by the supply. In addition, WSUP will only focus on areas where there is capacity in country already, for example, there is already a basic municipal water supply and private contractors are available to carry out construction. WSUP aims to work mainly with the local municipal water supply company and to develop capacity within that entity to be able to manage their own water business. Once the feasibility study has been completed, WSUP is then obliged to engage in competitive tendering to obtain the contract to carry out work for the local water supply company in a consultancy sense. WSUP will work with the local water supply company to help them select contractors and in effect to help them work more like a private sector firm, in terms of contracting and performance standards. WSUP aim to remove their own project managers within, say 15 months of project start and to handover project management responsibilities to local managers who WSUP have trained for the role.

www.wsup.org

A4.4 PRIVATE INFRASTRUCTURE DEVELOPMENT GROUP (PIDG)

The Private Infrastructure Development Group (PIDG) is a group of donors collaborating to finance infrastructure development in LMIs. The founding members are the UK Government's Department for International Development (DFID), the Swedish Government acting through the Swedish International Development Co-operation Agency, the Netherlands Minister for Development Co-operation and the Swiss State Secretary for Economic Affairs of the Government of the Confederation of Switzerland. Below are a number of initiatives partially or entirely funded through the group.

PIDG

DevCo is an untied multi-donor facility established by IFC and the United Kingdom's Department for International Development (DFID) to support IFC's privatization advisory work in infrastructure. As part of its involvement with PIDG, the Dutch Ministry of Foreign Affairs (MOFA) has also agreed to contribute funds to the facility. DevCo supports transactions in the poorest nations to increase private sector involvement in the provision of infrastructure structure services. The additional funds help defray the costs of expert consultants who work with teams to prepare infrastructure projects for private sector investment. DevCo funds also help defray IFC's project development costs associated with identifying projects for DevCo to support. This mandate extends beyond the narrowest definition of infrastructure to include: water, sanitation, electricity, telecommunications and ICT, transportation, housing, solid waste handling and other physical infrastructure services.

PIDG**Emerging Africa Infrastructure Fund (EAIF)**

EAIF is a \$305million public-private partnership fund providing long-term debt finance on commercial terms to finance the construction and development of private infrastructure in sub-Saharan Africa. The Fund was launched on 30th January 2002. Development of infrastructure and the involvement of the private sector are the two key points of focus for the Fund: infrastructure development is seen as a pre-requisite for economic growth and the private sector is seen to be best able to identify and manage risks associated with such development in many sectors so as to ensure assets and services perform over time. The Fund is able to consider investment in any country in Sub-Saharan Africa.

www.emergingafricafund.com

GuarantCo (in development) is a company which will address market failures in local currency financial markets in developing countries. GuarantCo will provide guarantees of local currency funding of infrastructure by domestic financial institutions and municipalities. It will cover all Least Developed Countries and Low Income Countries, including those in Central Asia.

Infrastructure Development Company (InfraCo) is a new company designed to overcome barriers to infrastructure project development in low-income countries. InfraCo will identify, create and structure viable business opportunities in the infrastructure sector of poorer developing countries and then take these to the market for onselling to private sector operating companies. InfraCo will focus on the inadequacy or gap in the pre-development/promotional phase of private infrastructure projects. Infrastructure for InfraCo refers to energy, flood protection, irrigation, ICT, transport, water and sanitation. It also includes investments at the very local level (urban sanitation) through to regional/cross-border initiatives.

A4.5 UNITED NATIONS PROGRAMMES**UN Facilities****UN World Food Programme (WFP)**

Set-up in 1963, the WFP is the United Nations frontline agency in the fight against global hunger. In 2003, WFP fed 104 million people in 81 countries, including most of the world's refugees and internally displaced people, spending over \$3 billion. They receive their funding and food supplies primarily from governments (the US government is the largest donor), as well as from corporate and individual donations. When a disaster, natural or man-made, strikes anywhere in the world and an official request is made for WFP food aid, the Agency draws up an Emergency Operation (EMOP). WFP's emergency operations cover four main kinds of emergency: Sudden disasters (natural or technological disasters which affect food access and/or cause population displacements, and which require special UN coordination procedures); Slow-onset disasters, notably droughts and crop failures; Refugee crises; Complex emergencies, involving such elements as conflict, widespread social and economic disruption and large population displacements, and requiring special UN co-ordination procedures.

www.wfp.org

UN Facilities

UNICEF

UNICEF's mission is to provide special protection for the most disadvantaged children: victims of war, disasters, extreme poverty, all forms of violence and exploitation, and those with disabilities. During an emergency UNICEF focuses on meeting the basic needs of women and children as well as protecting their fundamental rights. This is done in the first instance through assessing the situation on the ground, providing medical help and nutritional monitoring, safe water and sanitation facilities and eventually provision of schooling and basic community/social services (i.e. prevention of HIV/AIDS). As of early 2003, UNICEF has a direct presence in some 60 countries designated as acutely unstable or with pockets of instability and emergencies.

www.unicef.org

UN High Commissioner for Refugees (UNHCR)

UNHCR is one of the world's principal humanitarian agencies, its staff of more than 6,200 personnel helping 17.1 million people in 115 countries. As a humanitarian, non-political organisation, UNHCR has two basic and closely related aims – to protect refugees and to seek ways to help them restart their lives in a normal environment. It has an annual budget of around \$1 billion, the capacity to provide not only legal protection but also material relief in major emergencies, and the ability to help increasingly diverse groups of dispossessed people. UNHCR is funded almost entirely by voluntary contributions, principally from governments but also from intergovernmental organisations, corporations and individuals.

www.unhcr.ch

UNDP Thematic Trust Funds

The UN Development Programme has established a number of thematic trust funds to support UNDP work. Two of these relate to PCCs and infrastructure.

The **Thematic Trust Fund for Crisis Prevention and Recovery** supports UNDP work in crisis countries by making additional funds available where core resources are lacking. It is a more flexible and responsive co-financing instrument designed for rapid approval of proposals and swift disbursement of funds at the country level. Donors can contribute directly to the Trust Fund, contributing to seven key service lines: conflict prevention & peace-building, recovery, security sector reform & transitional justice, disarmament and demobilisation, mine action, natural disaster reduction and aiding with the development of reconstruction strategies.

The UNDP **Thematic Trust Fund for Energy and Environment** acts to compliment other UN programmes relevant to energy and the environment. Their work includes (among other things) supporting public-private partnerships at the local urban level to meet basic environmental services and working on the Community Water Initiative to enhance and promote community based water supply, sanitation and watershed management.

www.undp.org/trustfunds

UN Facilities

Slum Upgrading Facility SUF

The UN-HABITAT are in the early stages of creating a new multi-donor Slum Upgrading Facility (SUF) which will act as an “accelerator” mechanism, comprising proactive advisory services supported by short term grants, dedicated to implementing investment in slum upgrading, housing and municipal infrastructure. The idea behind SUF is that it will work as a tool of leverage to make more projects in the slum infrastructure area happen. The SUF will not provide an additional capital financing facility, but is intended to be an enabling mechanism, designed to “kick start” slum upgrading, housing and municipal infrastructure projects. The aim is to extend existing solutions to financing slum upgrading by leveraging off local capital markets and developing local business in the area.

The SUF will create a sub national approach to developing existing and new projects, focusing on decentralised infrastructure development through private enterprise. It aims to provide some form of coordinated gap filling approach to alleviating poverty in slum areas rather than continuing the cycle of individual projects implemented without coordination. The idea behind SUF is of essentially creating opportunities for small scale providers to leverage off local capital markets to build out essential infrastructure without donor intervention. In this way, the facility will work to develop credit ratings for municipalities to mobilise local capital to fund projects in a sustainable manner. This remains a concept at present and is due to be tested through a series of pilots throughout the developing world but will be hugely dependent on the efficacy of the managing consultant who is currently being selected.

www.unhabitat.org/suf

The Public-Private Partnerships for the Urban Environment

The Public-Private Partnerships for the Urban Environment (PPPUE) programme is UNDP's initiative in support of alleviating poverty through public-private partnerships in poor cities throughout the developing world. The core goal of the programme is to increase the access of the urban poor to basic services such as water, sanitation, solid waste management and energy by promoting inclusive partnerships between local government, business and communities.

UNDP PPPUE facility supports the development of such innovative partnerships at the local level. Focusing on assisting small and medium-sized cities, PPPUE works with all potential stakeholders, including investors, providers, regulators, users, and experts to meet the challenge of providing basic urban environmental services.

The management structure reflects PPPUEs arrangement as a multi-partner and multi-donor facility. While the PPPUE Consultative Group, consisting of contributing donors, UNDP senior managers, and a PPIAF representative provides strategic leadership, the PPPUE National Programmes are implemented by the respective UNDP Country Office in selected programme countries. The PPPUE Trust Fund allows donors to contribute to PPPUEs general activities or to specific projects.

<http://pppue.undp.org>

A4.6 EUROPEAN DEVELOPMENT FINANCE INSTITUTIONS

Development Finance Institutions or DFIs, are specialised development banks that are wholly or part-owned by national governments. Development finance is a specialised sector of the financial industry, and aims to bridge the gap between commercial investments and state-sponsored development aid, in the form of public and private-sector development projects. Whereas commercial banks often serve as vehicles for private individuals or companies to invest in relatively low-risk projects, these DFIs facilitate investment in high-risk countries such as LMIs. The financial support these banks bring to high-risk projects also serves as an impetus for the involvement of

private-sector capital, bringing in such diverse actors as commercial banks, investment funds and private individuals or companies. DFIs often act in cooperation with governments and other organisations in providing funds for technical assistance, feasibility studies, and business and management consultancy, as well as serving as channels for policy implementation in the areas.

Development Finance Institutions

Belgian Investment Company for Developing Countries (BIO)

The Belgian Investment Company for Developing Countries (BIO) supports private sector development in developing countries, by providing long-term financing to micro, small and medium-sized enterprises at market conditions and in an environmentally sustainable and socially responsible manner. BIO focuses especially on supporting SMEs, since it is exactly these entrepreneurs that are faced with a number of constraints, of which lack of access to finance is regarded as the most important one. It operates in post-conflict countries, including Angola.

www.b-i-o.be

CDC Capital funds (CDC Group)

CDC is a wholly UK government owned funding facility that invests its funds through third party fund managers. The investments are aimed solely at the private sector and in order to overcome the scarcity of long term risk capital, particularly equity capital, which is one of the factors constraining the private sector in the developing world.

CDC have a preference for directing funds at poorer countries, and aim to channel at least 50% of funds are directed to sub-Saharan Africa and South Asia, and there is a preference for funds which provide expansion finance, though propositions for early stage or venture capital are also considered.

The three fund managers CDC presently uses are:

- Actis Capital LLP - a leading private equity manager of investments in emerging markets, created from CDC in 2004.
- Aureos - a specialist private equity manager of investments in small and medium size companies in emerging markets.
- ShoreCap (new fund established in 2005) is an international private equity company which invests in small business banks and regulated microfinance institutions in developing and transitional economies in Asia, Africa and Eastern Europe.

www.cdcgroup.com

Compañía Española de Financiación des Desarrollo (COMIDES)

Operating since 1990, COFIDES provides cost-effective financial support for projects in developing, transition and emerging countries in which Spanish companies are involved as investors. With resources of €46 Million, COFIDES is majority owned (61%) by the Spanish Government through different public institutions. The remaining 39% is held by the three largest Spanish commercial banking groups (BBVA, SCH and Banco Sabadell). COFIDES invests its own resources or mobilises third party funding from different instruments managed by COFIDES. Thus, COFIDES manages two Spanish Government trust funds recently established to support Spanish investments abroad (FIEX and FONPYME) and co-financing facilities established with Multilateral Financial Institutions such as the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD) and the Inter-American Development Bank (IADB) / Multilateral Investment Fund (MIF). COFIDES has supported projects in 43 different countries and has today a global investment capacity of nearly €600 million with an upper limit of €25 million per individual project.

www.cofides.es

Development Finance Institutions

Danish Investment fund for Developing countries (NORFUND)

Norfund makes risk capital investments through profitable private enterprises in most countries in Africa, Asia, Latin America and the Balkans. Any country with a GDP under US\$ 5185 per capita is eligible for investment. They can provide equity and debt financing for new business ventures, expansions, management buy-ins and buy-outs. Norfund can invest in most sectors of the economy as long as the investment offers opportunities for growth, profitability and local development. Norfund commenced operations in 1998 and is a separate legal entity with limited liability. Its capital base at the end of 2003 was valued at approximately NOK 2 billion. All capital is supplied by the Norwegian state. NORFUND has invested in post-conflict countries, including Angola.

www.norfund.org

Deutsche Investitions und Entwicklungsgesellschaft (DEG - Germany)

DEG, member of KfW banking group, is one of the largest European development finance institutions for long-term project and company financing. The aim of DEG is to establish and expand private enterprise structures in developing and transition countries, and thus create the basis for sustainable economic growth and a lasting improvement in the living conditions of the local population. For more than 40 years, DEG has been financing and structuring the investments of private companies in developing and transition countries. DEG invests in profitable projects that contribute to sustainable development in all sectors of the economy, from agriculture to infrastructure and manufacturing to services. It also focuses on investments in local money markets in order to facilitate reliable access to capital locally. By providing 5.6 billion euros of finance, it has achieved a total investment of over 37 billion euros.

A new **Balkan Accession Fund** has been established through DEG. The Fund provides mezzanine capital for small and medium-sized enterprises in EU accession countries. The new fund was initiated by the Romanian-American Enterprise Fund (RAEF) and the Bulgarian-American Enterprise Fund (BAEF). DEG is one of the foundation investors. Besides RAEF, BAEF and DEG, the Dutch development finance institution FMO is among the main investors. Other commitments come from Bulgarian, Romanian and US institutional and private investors.

www.deginvest.de

Finnish Fund for Industrial Cooperation Ltd (FINNFUND)

Finnfund is the Finnish development finance company that provides long-term risk capital for private projects in developing countries. Apart from co-investing with Finnish companies they finance ventures that use Finnish technology, cooperate with Finnish partners on a long-term basis or generate major environmental or social benefits. The terms of financing are market-related. They do not extend soft loans but are ready to share risks by providing long-term financing for promising projects in challenging markets, where the availability of such financing from commercial sources is often highly restricted. Funding can be in the form of equity capital, mezzanine financing or long-term investment loans. Whatever the form, they seek to be a financial investor with a minority funding share in a project managed by the industrial sponsor, typically a Finnish parent company.

www.finnfund.fi

Development Finance Institutions

FMO Netherlands Development Finance Company

The FMO was formed in 1970 through a partnership between the Netherlands Government and Dutch financial institutions, industry and trade unions. The FMO supports the private sector in developing countries in emerging markets through the provision of loans, participations, guarantees and other investment promotion activities. The goal is to contribute to economic and social growth in these countries and, together with the private sector, obtain healthy financial returns. With a portfolio of over 2 billion euros, the FMO provides financing for private companies and financial institutions in some 40 developing countries and emerging markets.

The **FMO LDC Infrastructure Fund** supports the development and improvement of social-economic infrastructure in less developed countries (LDCs) defined as having annual per capita income of below \$3000. The fund is designed to stimulate private investors to invest in LDCs and provides long-term financing for projects in energy, telecoms, transportation, environmental and/or social infrastructure. It can extend subordinated debt, make equity investments or provide grants for the development of new projects. In general, the investment horizon will vary from 10 to 20 years.

www.fmo.nl

Nordic Development Fund (NDF)

NDF is a Nordic multilateral development financing institution, funded from the development cooperation budgets of the five Nordic countries (Denmark, Finland, Iceland, Norway and Sweden). The capital of NDF amounts to SDR 515 million (Special Drawing Rights) and EUR 330 million. The overriding objective is to contribute to poverty reduction. NDF also promotes environmental sustainability, equality between women and men, participatory development policies with respect for human rights, good governance and efforts to combat corruption. NDF grants very long-term credits on concessional terms to public sector projects. NDF can also provide financial support for private sector activities in developing countries without government guarantee.

www.ndf.fi

PROPARCO

Proparco is a subsidiary of the Agence Francaise de Developpement (Afd), dedicated to private sector financing. Created in 1977 and specialising in venture-capital, PROPARCO has gradually diversified its activities and developed numerous partnerships on an international scale. PROPARCO provides equity, loans, guarantees and financial services in developing countries, including post-conflict countries.

www.proparco.fr

Swedish Investment Fund for Developing Countries (SWEDFUND)

Swedfund International is a risk capital company owned by the Swedish state. It offers risk capital and competence for investments in Central and Eastern Europe, Africa, Asia and Latin America. Swedfund invests together with companies wishing to establish or expand operations in these regions. Strategic partners must be prepared to share the financial risk with Swedfund and to take the operative responsibility. Swedfund offers risk capital in the form of share capital, loans, guarantees and part-financing of leasing agreements. Decisions regarding investments are based solely on business principles.

www.swedfund.se

A4.7 REGIONAL/THEMATIC DEVELOPMENT BANKS

Regional / Thematic Development Banks

African Development Bank (ADB)

The **Emergency Multi-sector Reconstruction and Rehabilitation Programme (EMRRP)** is a tool used by the ADB to help shift countries from stabilization to recovery following conflict. The overall purpose of the of the EMRRP is to initiate the long-term process of reconstruction and economic rehabilitation. These programmes are used in a post-conflict situation to facilitate the coordination of reconstruction in a number of critical sectors including infrastructure (transport, water, electricity, etc), delivery of social services and community development. Funding for EMRRP is usually sourced from a combination of government funds, international development assistance and a variety of bilateral donors.

In 2004 the ADB approved new general policy guidelines for an **Arrears Clearance Programme** assisting post-conflict countries (PCCs) to clear their arrears to the Bank Group. The policy guidelines stipulate that arrears clearance programs for PCCs must: (i) create an opportunity for a sustainable normalization of relations with the Bank Group; (ii) lead to positive net transfers to the PCC; (iii) be configured on a case-by-case basis in close coordination with other International Financial Institutions (IFIs) and the Donor community; and (iv) comply with other key financial policies and practices of the Bank Group. To date, Burundi and Congo have both benefited from this new programme.

www.afdb.org

Asian Development Bank (ADB)

ADB supports private sector projects with clear development impact in the financial sector or infrastructure sector. Its role is to mobilize funding from local and foreign sources, not to compete with these sources or substitute for them. ADB offers the following funding products:

- Equity investments: ADB provides equity investments in order to facilitate the launching of new ventures or the privatization of state-owned enterprises. Investments are made directly or through financial intermediaries such as investment funds.
- Loans: ADB provides loans, without government guarantees, to private sector projects and enterprises. In general, these loans are denominated in the major international currencies, however, local currency financing is also available in selected countries.
- Complementary financing scheme (CFS): ADB's CFS is available for private sector projects in which ADB is a direct participant, but these loans are funded by commercial lenders with ADB acting as 'lender of record'. Although CFS loans do not provide co-financiers with recourse to ADB for debt service, such loans do enjoy the same privileges and immunities given to ADB direct loans. These include: (i) exemption from withholding taxes and from restrictions on payments of principal and interest; (ii) sharing of ADB's preferred creditor status; (iii) access to ADB's projects appraisal and loan documentation to facilitate credit analysis and due diligence; and (iv) possible reduction in provisioning requirements in the co-financier's home country.

www.adb.org

Regional / Thematic Development Banks

Inter-American Development Bank

Private Sector Development Department. To mobilize private financing for infrastructure, the IDB created the Private Sector Department in 1995. The Department has primary operational responsibility for the Bank's financing of private investment in infrastructure and capital markets development activity and capital markets initiatives. Investment areas include energy, water and sanitation, transportation, communications and capital markets. Products include structured and corporate finance lending, political risk and credit guarantees, capital market initiatives and trade financing. In theory, this finance and investment can be used for post-conflict countries and has been in the past (Colombia, Nicaragua) but it needs to meet quite a lot of stringent commercial criteria.

The **Multilateral Investment Fund (MIF)** was designed as a new type of technical assistance mechanism to stimulate innovation and extend beyond existing bilateral and international assistance instruments for Latin America and the Caribbean. The central goal is to use both grants and investments to demonstrate new ways to develop micro and small enterprise, build worker skills, strengthen environmental management and improve the functioning of financial and other markets. Typically, technical assistance grant projects are in the \$1-1.5 million range. MIF's investment fund portfolio currently consists of 12 microfinance investments, 35 investment funds and one guarantee facility. These funds are each managed by an independent private sector company, investing in small businesses (fewer than 100 employees and \$5 million in annual sales) in sectors including agriculture, environment, and energy efficiency and information technology. The MIF commitment of \$173 million in these funds has helped to leverage an additional \$294 million from almost 50 other co-investors.

www.iadb.org

Inter-American Investment Corporation

The IIC is a multilateral investment institution that is part of the Inter-American Development Bank (IDB) Group. The IIC promotes and supports the development of the private sector and the capital markets in its Latin American and Caribbean member countries by investing, lending, innovating, and leveraging resources as the institution charged with fostering the development of small and medium-size enterprises. The IIC provides long-term financing in the form of direct loans; direct equity or quasi-equity investments; lines of credit to local financial intermediaries for on-lending in the form of smaller loans; agency lines with local financial institutions for joint lending; investments in local and regional private equity funds; and guarantees for and investments in capital market offerings. Profitability and long-term financial viability are pre-requisites for consideration for IIC financing, although other issues are taken into consideration (job creation, resource and technology transfer, etc). The IIC's target market comprises companies with sales ranging from \$5 million to \$35 million.

www.iic.int

International Monetary Fund - Subsidisation for Emergency Post-Conflict Assistance

In May 2001, the IMF established an administered account for subsidizing emergency post-conflict assistance to low-income members eligible for the IMF's Poverty Reduction Growth Facility (PRGF - the PRGF is the IMF's low-interest lending facility for low-income countries). Directors agreed it would be desirable to provide emergency assistance to low-income countries on concessional terms in the early post-conflict period before the country had moved to a PRGF-supported programme, and would enable bilateral donors to provide interest subsidies for this purpose through a multi-donor administered account established by the IMF. Grant contributions made by members to the administered account have since been used to subsidize the rate of charge on post-conflict emergency assistance to PRGF-eligible members to 0.5 percent per annum, the same interest rate as that charged on PRGF loans.

www.imf.org

Regional / Thematic Development Banks

Islamic Development Bank Infrastructure Fund

The IDB Infrastructure Fund is the first private investment vehicle to focus on infrastructure development in the Islamic world. The Principal Sponsor of the Fund, the Islamic Development Bank (IDB), has committed US\$250 million. Emerging Markets Partnership (EMP) has been appointed as Principal Adviser to the Fund. The Fund will mobilize and redirect investment capital to Muslim countries and increase foreign direct investment. The Fund will also spur the development of national and regional capital markets through public listing of companies in which the Fund invests.

www.isdb.org

A4.8 EXPERT CREDIT AGENCIES

Export Credit Agencies

UK's Export Credits Guarantee Department (ECGD)

ECGD is the UK's official export credit agency. It is a separate Government department reporting to the Secretary of State for Trade and Industry. It provides the following services:

- **Exporters:** ECGD insures exporter against the risk of not getting paid by overseas buyers for reasons such as buyer default or insolvency, war or lack of foreign exchange.
- **Investors:** ECGD protects UK companies' investments overseas against the political risks of war, expropriation, lack of foreign currency, and breach of undertakings by host governments.
- **Lenders:** ECGD guarantees loans provided by UK banks to overseas borrowers who want to buy from the UK.
- **Other insurance products:** (i) Hedging against exchange rate fluctuations; and (ii) Unfair calling of performance bonds.

www.ecgd.gov.uk

Export – Import Bank of the United States

The Export-Import Bank of the United States (Ex-Im Bank) is the official export credit agency of the United States. Ex-Im Bank's mission is to assist in financing the export of U.S. goods and services to international markets.

Ex-Im Bank does not compete with private sector lenders but provides export financing products that fill gaps in trade financing. It assumes credit and country risks that the private sector is unable or unwilling to accept.

Ex-Im Bank provides working capital guarantees (pre-export financing); export credit insurance; and loan guarantees and direct loans (buyer financing).

Over the 70 years of experience, Ex-Im Bank has supported more than \$400 billion of U.S. exports, primarily to developing markets worldwide.

www.exim.gov

Export Credit Agencies

Islamic Corporation for the Insurance of Investment and Export Credit

The Islamic Corporation for Insurance of Investments and Export Credits (ICIEC) is a 50% owned subsidiary of the Islamic Development Bank. ICIEC offers Islamic compatible insurance products for investments and export credit. The objective of ICIEC, as defined in its Articles of Agreement, is to enlarge the scope of trade transactions and the flow of investments among Member States. In fulfillment of this objective ICIEC provides export credit insurance and reinsurance to cover the non-payment of export receivables resulting from commercial (buyer) or non-commercial (country) risks; and foreign investment insurance and reinsurance against country risks, mainly the risks of exchange transfer restrictions, expropriation, war and civil disturbance and breach of contract by the host government. Membership in ICIEC is open to the Islamic Development Bank and countries which are members of the Organisation of the Islamic Conference (OIC).

www.iciec.com

A4.9 INTERNATIONAL HUMANITARIAN NGOs/FOUNDATIONS

Instruments

Disaster Relief Emergency Fund (DREF)

The DREF was established in 1985 under the International Federation of Red Cross and Red Crescent Societies (IFRC), the world's largest humanitarian organisation. The DREF is the Federation's main tool in providing seed capital to start operations in times of disasters - both natural and conflict/humanitarian-related. It is an unearmarked fund with allocations provided on a recoverable basis, which allows immediate release of funds and start up of emergency operations prior to any donor response to emergency appeals. At the moment, funds available in the DREF stand at about \$6 million and can be distributed within 24 hours.

www.ifrc.org

Gatsby Foundation

Since the 1980s the Foundation have supported a small number of targeted poverty alleviation programmes in selected African countries. The themes are: support for small-scale enterprise in East Africa and Cameroon, the enhancement of education in South Africa, and the search for sustainable agricultural development in eastern, western and southern Africa. In all three themes the Trustees seek to work through long-term relationships with organisations offering capacity to develop and deliver high-quality projects. In the case of small-scale enterprise support, that has involved the establishment of four local micro-finance trusts.

www.gatsby.org.uk

Medecins Sans Frontieres

Médecins Sans Frontières (MSF) is an international humanitarian aid organisation that provides emergency medical assistance to populations in danger in more than 80 countries. In countries where health structures are insufficient or even non-existent, MSF collaborates with authorities such as the Ministry of Health to provide assistance. MSF works in rehabilitation of hospitals and dispensaries, vaccination programmes and water and sanitation projects. Along with the Red Cross organisations, MSF is one of the primary international organisations which can be found on the ground in even the most difficult conflict and post-conflict situations.

www.msf.org

APPENDIX 5: KEY INVESTMENT RISKS

Table A.5 below presents the attributes of key investment risks.

Table A.5: Key investment risks

Risks		Explanation
<i>Political/ Country</i>	<i>Conflict</i>	Infrastructure assets could be destroyed or seriously damaged. Actual (or threatened) war is the biggest barrier to PPPs.
	<i>Expropriation</i>	Government could claim property rights over infrastructure assets, i.e. re-nationalisation, without compensation to the private investors, for example on the back of a change in government; social upheaval; or war.
	<i>Contractual breach / frustration</i>	Government, potentially as a result of a change in rules, could decide to breach its contract with the private sector partner by, for example, failing to make payments or changing legislation that was contractually committed to. At the very least, the investor would need to enter into expensive negotiations with government; at worst, it could lose a substantial part of its investment.
	<i>Currency transfer</i>	Revenues from most basic infrastructure projects (such as water and sanitation, energy) accrue in local currency. Foreign investors must therefore be confident that they will be able to convert and repatriate their earnings. Although capital markets may be fully liberalised at the time of investment, government has the right and the power to implement capital controls with immediate effect, consequently locking in any existing investment. Such a situation is most likely to occur when the domestic currency comes under severe (usually downward) pressure either as a result of national macroeconomic volatility or international contagion. Currency transfer is far less of a concern for national investors, who do not usually need to move funds abroad.
	<i>Regulatory</i>	Regulatory risk arises when key decisions about pricing and the extent of competition within a market, lie with a regulator (often prone to significant government pressure) or government itself rather than within a contract.
<i>Financial</i>	<i>Interest rate</i>	To the extent that projects are financed domestically, the project may be exposed to interest rate risk as the relative underdevelopment of capital markets in most low-income nations makes hedging of that risk prohibitively expensive, if not impossible. If domestic interest rates were to rise significantly – as a result of the government needing to finance a burgeoning fiscal deficit, for example – the financing costs of the project would clearly rise, reducing returns and/or increasing the likelihood of default. This is not such an issue with respect to foreign borrowings in convertible currencies, as interest rate risk can often be hedged cost effectively.

Risks		Explanation
	<i>Exchange rate</i>	Although raising finance on the international market mitigates the interest rate risk discussed above, it exposes the project to exchange rate risk if the project's income stream is in local currency, as funding its financing costs requires foreign exchange, creating a currency mismatch. This is therefore an issue of particular relevance to infrastructure projects (although less so in the case of airports, ports and international telecommunications). To the extent that such currency risk cannot be effectively hedged in many LMI countries, a sharp depreciation in the local currency would raise the cost of finance. Financing in domestic currency, i.e. matching income and financing revenues, avoids this risk.
<i>Commercial</i>	<i>Performance</i>	Many of the risks attached to the private sector partner's ability to deliver its contractual obligations, such as cost overruns, can largely be internalised. This is essentially an issue of whether or not a company is competent in its chosen infrastructure service sector.
	<i>Market</i>	Uncertainty about the level of demand that will be realised is a feature of most investment projects. However, this uncertainty is exacerbated in the case of infrastructure, where investments are 'lumpy' and predominantly upfront, and in LLM countries, where there may be no precedent. The main barrier to uptake is lack of affordability, which is often exacerbated by poor and expensive project design.
	<i>Payment</i>	Payment risk arises where the purchaser of the infrastructure service – whether this be government or the consumer – fails to pay.

APPENDIX 6: LEGAL AND INSTITUTIONAL FRAMEWORK FOR PPPs

An important step to increase investment into PPPs is to put in place an enabling legal and institutional environment. In this regard a clear framework, strong institutions and effective governance will be as important in improving the PPP investment climate as the contents of any particular laws or organisational structures.

The legal and institutional framework for PPPs is likely to be particularly weak or unclear in PCCs, especially where the conflict has seen or followed the demise of a particular socio-economic model. The conflict will typically have destabilised traditional legal relations and rights while the changes in the socio-economic structure or governing regime may mean there is a lack of meaningful precedents or a relevant history of practices that otherwise might make up for deficiencies in the legal framework.

Legal / Regulatory Climate

Improving the general legal and regulatory framework for investment will help attract investors into infrastructure.

However, implementing a best-practice enabling environment takes time and energy. In the immediate post-conflict reconstruction period, there may not be scope to introduce significant legal or regulatory reforms to protect or promote private investment in infrastructure, nor capacity to implement such laws. A framework for infrastructure investment will be only one of many pressing concerns at this stage. Therefore, the initial approach should be to develop mechanisms to enable infrastructure investment within the existing environment and to mitigate the risks arising from the weak or absent governance framework. An early focus should be on clarifying the existing legal framework, quickly removing major constraints on investment in PPPs and clarifying government policy pending more detailed legislation.

Transparency and Certainty

Enhancing the transparency and definitiveness of the existing legal environment will be as important as the introduction of new, private sector friendly laws. Certainty as to the applicable laws and procedures enables an investor to plan for possible obstacles and likely costs in advance. Programmes should aim to clarify the applicability of laws and regulations inherited from different historical periods and regimes prior to the conflict.

Donor funding might usefully assist in producing an early ‘map’ of the existing legal environment for PPP related issues.

A focus on simple measures to enhance transparency would be useful – such as policy statements to clarify the Government’s position on PPPs or on other uncertain areas of the law relevant to PPPs, manuals and guides to investing in the relevant country and the use of ‘one-stop shops’ to provide advice to investors on applicable laws and assist in complying with business regulations.

Following such a review, early work could focus on removing any unsuitable barriers to investment in PPPs in the existing/inherited laws. In this regard, the following are common and important issues to be addressed at an early stage:

- Provisions in the law that prohibit the private delivery of infrastructure services (e.g. legal monopoly of state enterprises).
- Provisions that permit unwarranted and uncompensated expropriation of assets.
- Harmful barriers on market entry such as restrictions on foreigners investing in, or holding an interest in, infrastructure assets.
- Unclear provisions concerning the authority of different government entities to enter PPPs.
- The laws on sovereign immunity.
- Property ownership rights and titling procedures.
- Excessive regulatory burdens created by multiple, complex and non-transparent business regulations (which increase the scope for corruption in a weak environment)

Priority Reforms

As attention turns to more fundamental legal reform, the focus in PCC environments should be on introducing simple and transparent laws and regulations that will provide the basic framework within which to conduct PPPs but that are appropriate in the local context and do not undermine what remaining social capacity/property rights there are.

A wide range of laws and regulations relating to the investment climate will be important to potential investors (and particularly foreign investors) in infrastructure, including bankruptcy and security laws, contract law, company law and tax laws.

While all of these are important, some priority areas for enabling PPPs in infrastructure are likely to include:

- Early introduction of basic investment protection law and clarifications that it applies to infrastructure investments. Such a law should recognise and protect both foreign and domestic investment in infrastructure, and in relation to foreign investment protect rights to repatriation of profits, ownership of assets and protection against inappropriate expropriation or nationalisation and appropriate rights to employ foreign nationals.
- Development of a framework for recognising and protecting property rights of the PPP private sector partner and in a broad sense – rights in land, in the infrastructure assets, and of particular importance, rights under the PPP “contract” (whether a license, agreement or concession). This includes creating a clear basis in law for the relevant PPP contractual/licence arrangement; and the ability to enforce property rights, particularly contracts – including rights to choose alternative dispute resolution mechanisms such as arbitration.
- Protecting the property rights of other participants in the PPP structure will also be important. For example, customers are more likely to pay for connections where their rights to property are secure.
- Implementing a legal and institutional framework for fair and transparent procurement of infrastructure PPPs.
- Developing stable, predictable and appropriate regulation for the relevant infrastructure sectors in which the PPPs will take place.
- Clarifying the legal authority of government parties to enter PPPs (including at sub-national levels).

In designing institutional arrangements, reforms need to build on existing informal institutions and traditions.

PPP Governance Framework

Over time the reform process should move to developing an effective PPP specific governance framework. In this regard, donor supported facilities such as PPIAF may be of assistance (see Box A6.1 below). The purpose of this framework is to establish

procedures and structures that will attract private investors while also ensuring that PPPs are sustainable, reflect value for money and are in the public interest.

Amongst other things, a PPP governance framework will establish clear rules and procedures regarding:

- the infrastructure activities that may be subject to PPPs;
- the contractual/legal basis for granting rights in PPPs (e.g. concessions, licences);
- procedures for award of PPP contracts (including mechanisms to address unsolicited proposals);
- the powers of the granting/contracting authority and approving authorities, and the organisational roles; and
- approval procedures (including budgetary approvals) and timelines.

At least initially resources may best be directed to producing a single governance framework for PPPs in infrastructure (rather than sector specific laws which will take longer to develop and will be subject to available capacity.)

Box A6.1: A legal and institutional framework for governance of PPPs in Cambodia

A legal and institutional framework for governance of PPPs in Cambodia

Unlike some other PCCs, Cambodia has seen a reasonable level of private investment in the infrastructure in the period following the secession of hostilities in the early 1990s.

However, a country report sponsored by PPIAF identified a number of barriers to continued viable and desirable private investment in infrastructure. That report recognised the importance of the governance framework of private investment (the role of the public sector as the ‘partner’ in PPPs).

PPIAF subsequently funded a project to develop and implement an institutional and legal framework for private investment in infrastructure that would promote effective PPP structures, particularly in the water, electricity, transport. Working with the government of Cambodia, a Government policy on Private Participation in Infrastructure (PPI) was developed – an important tool in institutionalising PPPs and in giving the private sector a clear indication of the governments commitment to PPI.

The study reviewed existing institutional frameworks, organisational structures and roles and existing practices. Funding for the study also supported the preparation of a draft law and regulations implementing the policy on PPI. In recognition of the importance of building capacity in the organisations that would be responsible for implementing PPPs, the project also prepared a capacity building programme the purpose of which is to:

- Create a common understanding of the PPI policy and process in Cambodia and of the roles and responsibilities of individual institutions.
- Equip sector ministries and other contracting authorities in sector planning and in the design, award and implementation of PPI projects.
- Developing the capacity of the Ministry of Finance and other specialist agencies involved in providing important support, checks and balances on the PPI process.

A legal and institutional framework for governance of PPPs in Cambodia
<p>The programme has recommended the appointment of a long-term advisor to the government to co-ordinate the training process.</p> <p>The capacity building programme is currently in its final stages of development, and will be implemented over a two to three year period with funding from the World Bank and other donor agencies active in Cambodia.</p>

Contract Enforceability

Laws and regulations in themselves will not be sufficient to create a favourable climate for financing or investment in infrastructure, particularly where there is an absence of appropriate organisations, capacity or willingness, to effectively and fairly monitor and verify performance and to protect and enforce rights.

The ability to effectively and fairly verify performance, and enforce contractual rights (including protecting those from political interference) is of particular importance to PPP investors due to the nature of PPPs in infrastructure. Relevant features include: the often very long term nature of the arrangements, the gap between investment and cost recovery/profits, the fixed asset nature of the projects, the complexity of the contractual arrangements, the many players involved and the highly political nature of the services delivered.

Private investors' rights under a PPP will only represent secure rights to the extent they can be effectively enforced. In many PCCs the judicial system is weak and judges (and regulators where they exist at all), are not independent or lack capacity to fairly enforce investor rights.

An early focus of any donor funded reform programme will be building capacity in the judicial sector. However, this alone may not be the solution and in any event will take time.

One of the most effective steps in attracting private investors will be to ensure the ability to use dispute resolutions that can operate in a weakened judicial environment, such as dispute review boards, adjudicators and arbitration.

The availability of international arbitration (for both the contract with the government and contracts with other third parties, such as sub-contractors, lenders etc) is a key factor in attracting foreign private sector investment.

In the case of contracts with the government, legal systems often contain limits on freedom to decide on dispute prevention or settlement methods. Where countries wish to allow use of non-judicial methods (or where in policy this is allowed but the basis is not clear) an important early step is to remove legal obstacles and provide clear authorization for domestic contracting authorities to agree on dispute settlement methods, and particularly international arbitration. It is also essential that procedures be put in place to enable effective enforcement of such arbitration awards³.

With regard to other contracts, any inappropriate restrictions on choice of law or dispute resolution methods need to be removed and rights clarified. For certain contracts international arbitration will not be an option (for example, PPPs in which the investor is domestic, or contracts with customers/consumers). In this case, building capacity of judiciary remains important, as does establishing other domestic dispute resolution mechanisms, such as domestic arbitration courts important to encourage local investors⁴ and customer complaint procedures/ombudsmen.

In an environment where monitoring, verification and enforcement capacity is weak, the parties may also wish to employ contractual structures that protect and insulate contract rights (and particularly any obligation by the government to make payments to the private sector partner). Such structures may require an enabling legal environment.

For example, where a fee payable to the private sector investor by the government is in fact to be funded under a development assistance programme (e.g. under an OBA scheme) it may be possible to structure the disbursement mechanisms to ensure payment in accordance with the contract (e.g. separating the funds from government control, to be paid directly to the private sector investor on performance, via donor backed L/Cs, escrow accounts or trusts).

Monitoring and Regulation of Contracts

PPP's impose certain contractual obligations on the investor, which might include connection of new customers, defined levels of investment, installations etc, and which need to be monitored and regulated. This function can potentially be filled by the local contracting authority, a national regulator, a specific agency or even a utility. However,

³ Early focus should be on ensuring that a party to Convention on Recognition and Enforcement of Foreign Arbitral Awards of 1958, and in agreeing to resolution of disputes under the ICSID regime (in case of foreign investors).

⁴ For example, a new law establishing a domestic arbitration court and procedures in Angola is viewed as an important step in enhancing the PPP investment climate in that country (where dispute settlement through the courts can take up to 10 years). Source: ECA, Partex, Consult. 2003, *A Country Framework Report for Angola: Opportunities for Private Participation in Infrastructure* (PPIAF Funded).

where there is concern about the capacity or independence of such entities to carry out those functions fairly and effectively other mechanisms will be required. Creating viable, effective, independent regulation may be a goal, but is very hard to achieve, even in countries with developed institutions and strong capacity.

In this case, some options include:

- Providing for regulation and investors' rights in/through the contract, with monitoring and verification functions assigned to independent third party auditors/adjudicators.
- Where regulators exist their capacity, independence or legitimacy may be enhanced through contracting out regulatory functions to reliable entities. These may be consultants, individuals, other government entities (in country or outside, e.g. at regional level) or NGOs.

However, the apparent reduced risk of such mechanisms needs to be balanced against the fact that decisions by national institutions may be viewed in some cases as more legitimate and so enhance sustainability⁵. Over time, the objective is to establish reliability and creditworthiness of government obligations (and payment mechanisms), and more generally, to enhance the capacity of the public part of the 'partnership'.

Public Sector Capacity Building

A complementary focus to strengthening the legal and institutional framework will be building capacity in the public sector to support PPP arrangements. This extends not only to building capacity of the judiciary and other monitoring and dispute resolution institutions or entities. Just as importantly, it means building capacity in the contracting authorities responsible for the award and management of PPPs and in those other organisations that must act as a check and balance on the PPP process so as to ensure effective, well designed PPPs meet public requirements.

PPPs require the government to perform a "partnership" role. Their responsibilities include identification and design of projects, assessment of projects proposed by the private sector (e.g. unsolicited proposals), design of the PPP concession arrangements (including complex issues relating to pricing, rules and performance targets) assessing and managing budgetary implications, managing the award of the PPP opportunity,

⁵ World Bank. *World Development Report*, 2005

effectively negotiating the ‘contract’, and monitoring performance. The government must have strong capacity to carry out this partnership and monitoring role. Policy ambitions in the realm of PPPs need to be limited to the capacity of the government at various levels to implement the policy.

PPP capacity building should be seen as an integral part of public administration and economic management reform programmes. Improvements in fiduciary management (procurement, financial management and audit) are of key importance in ensuring effective and value for money PPPs. An early area of attention for donors is public sector capacity building for traditional procurement – many donor programmes to date have funded “value for money” training programmes. These programmes need to extend to and incorporate elements relevant to PPPs. Even from a very early post-conflict stage, investors will appear who are interested in investing in infrastructure, or similar services under ‘PPP’ type arrangements, (see discussion in relation to the reconstruction phase in Appendix 7).

Facilities such as PPIAF can be used to assist in designing both the legal and institutional frameworks for the governance of PPPs in infrastructure and for developing appropriate training programmes to build institutional capacity, (see box A6.1 above). Donors may provide additional technical assistance support by placing PPP advisors alongside key government ministries (such as the Ministry of Finance).

Depending on the political and social capacity and structure of the country in question, addressing weakened capacity may call for simple, centralised mechanisms, or a focus on decentralisation to regional and community levels (or a combination of both). A useful interim tool may be to expand on “one stop shop” ideas used to promote general investment in order to facilitate PPPs.

Toolkits prepared by various donors may also provide a useful basis for training (such as PPIAF funded toolkits on Private Sector Investment in Infrastructure and the ADB funded “Best Practice” manuals on private investment in infrastructure).

APPENDIX 7: PROCUREMENT AND CONTRACTING PRACTICES

This appendix considers how the procurement and contracting of infrastructure operators by donors and governments in PCCs, and the nature of the technical assistance provided by donors in the procurement area, particularly in the reconstruction phase, may impact on the effective flow of financing (including reconstruction aid) to sustainable infrastructure development.

Current practices appear to suffer from a number of weaknesses, including:

- Generally, the poor coordination between immediate reconstruction and humanitarian activities and longer term development goals.
- A focus on traditional procurement techniques, to the exclusion of alternatives that may make better use of private sector strengths and that might better target reconstruction aid.
- An absence in the reconstruction stage of attention to PPP structures (and provision of technical assistance to support the design or assessment of PPPs) .
- Limited engagement of the local private sector in the reconstruction process and/or focus on building local private sector capacity to invest in infrastructure.

Addressing these issues may improve the delivery of financing to infrastructure in PCCs. Even in the early post-conflict reconstruction period it is important to link reconstruction aid to longer-term development goals⁶, to lay the foundations for long-term delivery of infrastructure through PPP arrangements, to enhance the delivery of reconstruction aid intended to improve access to infrastructure services, and to support local private sector investment in infrastructure.

Procurement and Contracting practices - increasing effectiveness of reconstruction aid

The traditional method for procurement by the public sector of goods, services and infrastructure is to procure delivery against an input specification, with payment to be made for the costs of the inputs, plus a profit margin (i.e. a cost plus payment).

⁶ Recent joint report by the US Centre for Strategic and International Studies and the association of the United States Army (AUSA) noted, for example that “despite more than a decade of experience in post-conflict reconstruction, [the US Government] lacks a deliberate program for linking immediate post-conflict needs with medium and long-term development...”. [*Achieving Socio-Economic Well-Being in Post-Conflict Settings*”, June 9 2002]

IFIs and other donors have over recent years promoted the use of methods for procuring infrastructure services that shift risks onto the private sector (such as PPPs, concessions etc). However, they continue to use the traditional input-based, cost-plus procurement method for procurement done by them directly (particularly in a post-conflict environment, in awarding reconstruction and rehabilitation and new build projects). There is little emphasis on procurement as a financing technique.

Performance based procurement

There may be scope, even in the early post-conflict environment, to improve the effectiveness of reconstruction aid by using less traditional procurement methods. In particular, by a greater focus on performance based (or output based) procurement mechanisms which shift some performance risk to the private sector and better link payments to specific and verifiable outputs.

In performance based procurement, the technical specifications in the tender will specify the desired outcomes or deliverables, those outcomes that will be measured in order to determine performance and how. Outputs will be designed to meet a functional need in terms of quality, quantity and reliability. The tender will not prescribe the inputs the contractor must provide/use or the work method it must employ.

There is some indication that donors are giving more consideration to such techniques in their own procurement. The most recent version of the World Bank's Guidelines for Procurement under IBRD Loans and IDA Credits includes a paragraph providing for the use of 'output based procurement'⁷. However, this paragraph is not supported by guidance on how to carry out such procurement or the Bank's requirements in this regard. Consultations with procurement agents acting on behalf of donors in current PCC environments suggest that there has been no effort to promote use of such techniques in reconstruction procurement, and such agents continue to be required to carry out traditional input based procurement.

There is some concern that developing output based specifications is more complex and time consuming, requiring additional skills. However, consultations suggest that in many cases, such mechanisms may save time and simplify procurement in a PCC environment where a lot of time is spent developing input specification that will be viable in the difficult environment. Shifting this onus onto private sector entities who may be more

⁷ Defined as "a competitive procurement process... resulting in a contractual relationship where payments are made for measured outputs instead of the traditional way where inputs are measured".

familiar with the particular service required or the environment in which it is to be provided may in fact save time and avoid mistakes in specifications, as well as improving the effectiveness of reconstruction aid.

The extent to which the private sector operators in such environments will accept additional risk associated with output based procurement will need to be assessed. Consultations suggest that for some contractors there is a sense in fact that the donors need to take on more, not less, of the risk relating to reconstruction work (at least in relation to the risks of using local sub-contractors (see below) and arising from the poor security environment) if they are to get greater private sector involvement.

Targeting reconstruction aid and subsidies.

A step beyond output based procurement is use of structures that more effectively target aid towards specific (typically pro-poor) outcomes, such as output based aid structures (OBA).

One focus of donors in the reconstruction and post-reconstruction development will be on expanding infrastructure services to the poorest areas/social groups. Such infrastructure investments may not be attractive to the private sector without the support of subsidies (whether from reconstruction aid or the local government).

The traditional mechanism for providing subsidies to a project in order to make it commercially viable has been through capital grants (the advantages of which are that the budgetary impact can be estimated with confidence and the impact is of a short-term nature). Grants towards operating expenses have also been common. In both cases such grants are untargeted and do not provide any incentive to managers to improve efficiency.

However, structured correctly, the provision of periodic subsidies through mechanisms such as 'output based aid' may present a better tool to introduce performance incentives, accountability and targeting of infrastructure service provision, while still making the project attractive to the private sector. For further information on OBA see Box 7.1 below.

*Box A7.1: Output Based Aid***Output Based Aid**

OBA is a strategy for supporting the delivery of basic services – water, sanitation, electricity, telecommunications, transport, health care etc – where policy concerns would justify public funding to complement or replace payment by the user. The central principle is the contracting out of service provision to third party, usually a private firm, with payment of public funding or aid being tied to the actual delivery of services to targeted users.

OBA approaches have been developed and based around:

- Reducing the costs of infrastructure provision through the payment of connection subsidies; and/or
- Transitional subsidies to cushion the move to cost recovering tariffs; and/or
- Provision of ongoing subsidies to targeted, disadvantaged groups (e.g. through delivery of payment to an operator of the difference between a lifeline tariff paid by the household and the full tariff, but only on actual delivery of the service).

Properly structured OBA techniques will achieve two key objectives: mitigation of certain key risks facing the private sector (such as market risk (e.g. due to inability to pay) and payment/collection risk), while on the other hand achieving transfer of certain performance risk to the private sector operators who are best placed to manage the construction, management and delivery of the service.

OBA mechanisms are being employed or planned in a number of PCCs. For example, in Cambodia an OBA scheme to promote private sector small-scale providers of water is under implementation (with total funding of c US\$.1.75m). Private operators will design, build and run water supply and sanitation systems through subsidized concession-style arrangements, bid for on the basis of the lowest subsidy they require for serving each of the four pilot towns. Subsidies are principally only paid after the targeted households eligible for subsidised connection are in fact connected. WB. [For further information see GPOBA Project Brief “*Access to Water through Small-Scale Providers in Cambodia*”, www.gpoba.org]

In Mozambique, OBA elements were incorporated into that country’s first concession to generate, distribute and supply electricity in the rural area of Inhumbane Province. To tackle extremely low levels of connectivity, OBA was used to close the funding gap of connections. Payment of subsidies is contingent on physical verification of household connections. Now further schemes are being developed.

The World Bank has sponsored establishment of Global Partnership on Output Based Aid (GPOBA) to assist in the design and development of pilot OBA projects, and to help identify and disseminate emerging knowledge. GPOBA is able to contribute to the funding of subsidized payments of the provision of services under OBA Schemes.

Such techniques do raise new challenges – particularly in countries where the government institutions are weak, are not considered credit-worthy or the economic and institutional environment is uncertain, as is the case in many PCCs. As OBA is a future cash-flow mechanism rather than an up front grant, that cash-flow must be sufficiently

credit-worthy to attract private investment⁸. More general discussion of issues relating to contract enforceability can be found in Appendix 6.

In addition, the design and implementation of OBA mechanisms requires a certain level of organisational capacity. Targets need to be appropriate and sufficiently defined and there needs to be an effective system of monitoring to ensure that subsidies have been used for intended purpose and disbursed correctly according to agreed milestones.

Contracting Capacity

Building the capacity of both donors and the local government to effectively procure, contract and implement aid funded reconstruction will therefore be essential.

Consultations suggest that the focus on traditional procurement is as much a reflection of the limitations in the training and capacity of those responsible for procurement within the donors (and, as a result, of the procurement agents they employ) as it is of the contingencies of a post-conflict environment.

Experiences in PCCs suggest that, even in the early post-conflict period, there will be at least some private sector interest in PPP type structures in infrastructure. However, donor agents and local governments are generally poorly equipped to respond to such interest due in part to the focus on traditional procurement methods.

Building capacity to design and procure investment in infrastructure may be more important and effective in terms of attracting investors and delivering value-for-money projects than, for example, an early focus on developing complex regulatory capabilities for each infrastructure sector.

Given the complexity of assessing, structuring and negotiating PPP arrangements, capacity building will need, initially, to be supported by external technical assistance, which might include placing advisors alongside key government ministries, and the use of short term contracts for key contracting support positions to inject capacity.

For further discussion of these issues, see Appendix 6.

Local private sector

Efforts to increase private investment in infrastructure typically concentrate on attracting the foreign private sector into infrastructure investment. However, in many PCCs the

⁸ Von Klauy, S and Goswami, U. 2004. "Credit Enhancing Output Based Aid", an OBA Working Paper, www.gpoba.org

local and regional private sector may be an equally important potential PPP partner, given particularly their local knowledge and likely higher tolerance for local risks. As a result, greater attention should be paid to involving the local private sector in infrastructure investment where they have the capacity to do so, or, where capacity is limited, on building capacity and providing organisational support.

Engaging the local private sector

While donors are typically genuinely concerned to encourage local private sector development, consultations and studies suggest that there is not sufficient focus on effectively engaging the local private sector in post-conflict reconstruction. It is generally felt that neither donor procurement guidelines nor national procurement legal frameworks are geared towards best use of local suppliers or contractors.

In many cases the procurement procedures, or the way they are implemented in practice, may work against the involvement of the local or regional private sector. Aspects identified in consultations to have this effect include:

- the emphasis on international competitive tenders (and, in relation to some donors, the requirement that only international contractors or contractors from a particular country may be awarded reconstruction contracts)⁹;
- the use of complex and costly documentation and processes (which many local bidders are unable to understand or are inexperienced in working under);
- the requirements for substantial bid bonds and performance securities, and other ‘eligibility requirements’ that may exclude local suppliers or contractors; and
- emphasis on and practice of grouping various procurements into larger lots (‘bulking of orders’), which may place the order out of the capacity of a local supplier.

There may be room for donors to simplify these procedures to take account of the limited capacity of the local private sector in meeting these requirements and to better accommodate the barriers to their involvement, without undermining the needs for accountability and to ensure good quality contractors, with successful track records, who can deliver the urgent reconstruction needs. IFIs such as the Asian Development Bank

⁹ For example, all US government aid agencies (such as USAID) are required to award contracts to US companies (who may, and typically do, sub-contract the work)

(ADB) and World Bank recognise, in their procurement manuals, that adjustment to facilitate the use of the local private sector may be desirable in certain circumstances. However, this is subject to the overriding requirements of economy and efficiency and the availability or interest of foreign bidders dictating the choice of procurement method. Procurement agents are assessed on their meeting these overriding objectives rather than on achieving more developmental goals of local private sector development.

There may also be scope for contracting procedures to incorporate a requirement that international contractors make greater use of local private sector contractors and in so doing, build capacity within the local private sector. In some PCCs this has already become a donor requirement¹⁰. However, there are limitations to how far this approach might work in practice, in isolation of donor support. Particularly in PCCs, the willingness or ability of international contractors to use local suppliers (even where the local private sector is highly skilled, such as in Iraq) may be inhibited by various factors, including:

- The poor links that often exist between the external private sector and local private sector (in these environments it is often difficult for the international private sector to identify or build a relationship with local contractors who may be capable of joining in a tender).
- The very real security concerns which leave international contractors reluctant to use “unknown” local companies.
- The inability of many local contractors to give adequate financial security (performance bonds) required for taking on contracts, due in part to collapse/absence of local banking system that often follows a conflict situation etc. – even if donors themselves were not to require these, head contractors will see these as important in any decision to sub-contract and who to subcontract to.
- The practical difficulties in paying local contractors (again, reflecting a collapsed banking system).
- In some cases limited ‘western’ style management skills of the local private sector, required by donors and international contractors.

¹⁰ For example, this has been a usual requirement of USAID in relation to procurements funded by it in Iraq

- The considerable costs and time delays involved in letting numerous, smaller contracts so as to accommodate local capacity.

Donors need to recognise these limitations when seeking to move the risk of use of the local private sector on to the international contractor. Where greater involvement of the local private sector is considered desirable for developmental reasons, donors may need to find ways to reduce and better share in the risk of their use. One option may be to provide financial mechanisms to support local private sector in giving of performance guarantees. Contracts may need to be structured to accommodate and not penalise the head contractor where additional time and costs are incurred in order to let more contracts to local firms.

Donors also need to pay attention, from an early stage, on enhancing the supporting environment for the local private sector and building local private sector capacity, and providing financing for this purpose.

Capacity building and institutional support

Steps to support the environment for local private sector to operate and to engage with donors and international private sector might include:

- At an early stage, establishing a roster of local companies that retain capacity to support infrastructure repair work and who could immediately begin work with donors/international contractors.
- Facilitating business support organisations that will support local and regional business communities and their links with external private sector – these can likely best be provided by the private sector itself but with government support and, where needed, financing. (They might include, for example, an early focus on rebuilding chambers of commerce or other private sector organisations, where such organisations exist).
- Providing training on donor or government procurement procedures and, in relation to PPPs, on participating in PPP tenders.¹¹

¹¹ For example, in conjunction with a small-scale water pilot OBA project in Cambodia in order to mitigate some risks and attract small, local bidders, the IFC financed training on World Bank bidding and procurement procedures and other relevant topics. Source: GPOBA Project Brief “*Access to Water through Small-Scale Providers in Cambodia*”, www.gpoba.org

APPENDIX 8: SMALL SCALE PROVIDERS IN PCCs

Introduction

Small scale entrepreneurial activity is crucial to PPPs in PCCs, particularly as regards water and electricity distribution. The aim of this appendix is to provide more information on the role of small scale providers in PCCs and issues affecting their greater engagement. We draw on information across low and middle income (LMI) countries, although examples have been drawn from PCCs wherever possible. The observations have been grouped into the four types of issues identified in Figure 6.2 in the main body of the report – that is:

- legal, regulatory and contractual issues;
- institutional needs;
- the need for project structuring and procurement of opportunities; and
- ways of financing such providers.

Legal, regulatory and contractual issues

There are many issues of legal, regulatory and contractual nature that affect the development and operations of small scale providers of infrastructure in PCCs, with three being of key concern. The first of these is the difficulty faced by small scale operators as a result of ill defined land tenure and weak property rights; the second suggests that any economic regulation needs to be proportional with the stage of development within the sector – that is not stifle early entrepreneurial activity; and, finally, the constrained ability of many small scale providers to operate effectively in PCCs means that international contractors often find it difficult to contract with such providers and are unlikely to accept delivery obligations which are contingent on small scale providers' performance.

Land tenure and property rights

Ill defined land tenure and weak property rights are critical impediments to successful growth of small scale private sector providers of infrastructure. Two key aspects of this are:

- Without clear and secure land ownership the private sector entrepreneur is not able to use land as collateral to raise finance. Land is likely to be the entrepreneur's most valuable asset and one which will often be preferred as collateral by any lending institution.¹²
- Weak property rights and risk of expropriation or damage of assets – especially high in PCCs – is a strong disincentive for entrepreneurs to invest in service provision.

In addition to assigning and protecting land ownership rights of individual private operators, allowing access to community land, for example for small scale electricity generators connecting up a local village, would also be helpful in allowing the local business to develop.

In developing the legal system in a PCC, it is very important to take these issues into account.

Proportionate regulation

Proportionate regulation involves balancing the need to regulate – for instance for reasons of public safety – with creating an environment that is conducive to entrepreneurial activity. Costly and complex regulation is likely to hinder growth of nascent private enterprise within infrastructure sectors.

Governments – and donors – need to take more notice of how regulation affects the growth of the private sector in infrastructure provision and look to regulate only where there are issues of public safety, excessively high consumer prices and / or where service is underprovided. Having said this, even a high priced service for example is often better than no service at all, with high prices encouraging new investment into the sector. In time, however, as the investment increases and with it the market power of certain firms, there may be a need to phase in tighter (economic) regulation.

This pattern can be seen in Somalia for example, as shown in Box A8.1 below. On the one hand, small scale providers have flourished in the absence of any regulation in the country, but on the other, some form of regulation is likely to be helpful in due course.

¹² To act as collateral land needs to be owned and not only leased. This, for example, is a barrier to many Zimbabwean farmers who have recently migrated from Zimbabwe into Mozambique. Many have only been able to secure long term leases on the land they work. Without actually owning it, they are not able to raise the required finance to develop their farms.

*Box A8.1: Small scale operators in Somalia***Case study 1: Small scale operators in Somalia**

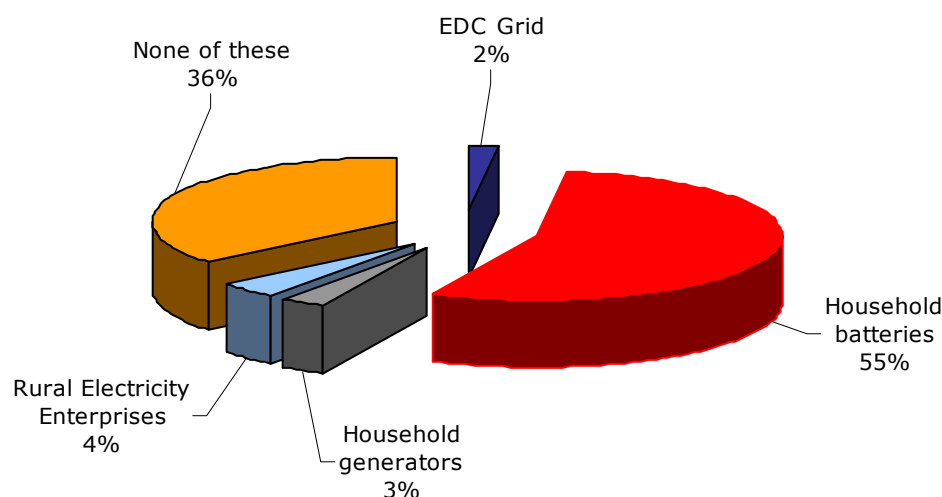
Electricity, telephony, transportation and water services have been provided in Somalia mainly by small scale private entrepreneurship. Whilst this private sector activity and investment in this most difficult of environments is impressive, there are a number of problems that are beginning to appear in such a 'laissez faire' environment.

- Telecom operators have not interconnected so calling from one network to another needs to be routed through the international gateway. Telecoms licences have not been issued and a new entrant could feasibly come into the market and use the spectrum currently used by another operator.
- Small private generators sprang up to provide electricity to households based on their consumption needs although prices are relatively high compared to international norms, with there being no means of determining whether they are cost reflective or excessive.
- Local businessmen can only pay their international partners if they have a registered offshore office.
- Safety standards in the airline sector are purely in the hands of the private sector.
- The lack of doctor and nurse certification leads to variable quality of healthcare.

Unfortunately, in a country as unstable as Somalia, with no centralised authorities, it is difficult to see how any desired regulatory powers might be brought to bear. Realistically, it may be considerable time before any form of regulation emerges and has any effect on the provision of infrastructure services.

The growth of small scale private enterprise in infrastructure service delivery in the absence of regulatory frameworks can also be seen in another PCC, Cambodia. The fact that national institutions in Cambodia – including those providing any form economic regulation – have been all but destroyed in the prolonged and brutal civil war has not stopped many small scale electricity providers setting up businesses in rural areas. With only 2% of the country's population having access to the national grid, the small scale providers were the main source of electricity to large proportion of the population. Figure A8.1 shows the breakdown of electricity supply options in Cambodia.

Figure A8.1: Options for electricity supply in Cambodia¹³



Source: Schwartz et al (2004)

The same study reported that nearly 15% of small energy enterprises in Cambodia, which were in existence eight years after the end of conflict, had established themselves and begun distributing electricity before the conflict ended (i.e. before the signing of the peace agreement and during the least institutionally stable period). In order to sustain and grow this sector, the Cambodian government needs to be very careful not to ‘regulate’ such enterprises out of existence as the need for their services is clearly high.

Contracting and contract monitoring and enforcement

Involving local (often small scale) private sector organisations in reconstruction and delivery of infrastructure services in PCCs has numerous benefits: it builds capacity within the local firms, creates national sustainability in developing and maintaining these services, and improves local employment opportunities.

The desire to involve local small scale firms, however, needs to be balanced with the fact that it is very difficult for international contractors, who are often the holders of main donor-funded reconstruction contracts, to accept risks within their contracts which are contingent on small providers’ performance. Local small scale providers, initially at least, rarely have the required skills to manage complex business processes, tend to have constrained working capital facilities – thus finding it difficult to accept performance

¹³ Schwartz et al (2004)

based payments – and, in most cases, are unable to issue performance bonds to the main contract holders.¹⁴

The case study in Box A8.2 below, from the Niassa Province in Mozambique, shows how difficult it sometimes is to use local small scale entrepreneurs in delivering infrastructure services.

Box A8.2: Small scale Water PSP in Niassa Province Mozambique

Case study 2: Small scale Water PSP in Niassa Province Mozambique

Local small scale private providers or *empreiteiros* were contracted to construct waterpoints (boreholes or water pumps) for villages in the Niassa Province as part of the country-wide water privatisation programme. The National Water Policy set out the minimum level of service in rural areas as each borehole serving 500 households within a radius of 500 metres. In practice, however, the eight pilots embarked upon failed to reach that number of people within the defined area – in some cases as few as twenty households might be served by one borehole.

Quality of service

The pilots reported very low levels of service, including cases where the *empreiteiro* built the water point but then did not supply essential equipment such as a pump handle and bucket, rendering it useless to the local community. Projects that have been completed by private *empreiteiros* have been of such low quality that many communities have returned to the unsafe water conditions they were previously using and most projects have broken down with insufficient maintenance.

Monitoring and contracting

The monitoring role of the government proved ineffective because of lack of required funding and capacity to carry out the work. Many inspections were not carried out until projects were completed, and small private companies did not receive the technical support they needed. In addition, there was no uniform system of contracting. Depending on the donor, contracts to the private sector were either given directly or through a bidding process. Competitive bidding for contracts has not been widely followed.

The key message emerging from this and other case studies, and our consultations, is that if the donor community and / or national governments would like to see greater involvement of smaller scale local enterprises (as subcontractors to international firms in reconstruction projects) they may need to be prepared, where possible, to allow some form of risk to pass through back to themselves. That is, they need to recognise that services provided by small scale providers are often an uncontrollable risk to the international firms and will have to be absorbed by the contracting authorities themselves. With time, and as the local private sector develops its capacity, transfer of performance risk needs to gradually increase away from the public sector providers of funding.

¹⁴ Performance bonds are bank guarantees in favour of purchaser of services that can be called upon if the service provided failed to meet the contractual obligations of the provider.

Improving the managerial and technical capacity of small scale private sector – where it exists – should therefore be an important policy intervention. Large scale training programmes, which are sometimes proposed as a remedy, are often extremely expensive and can be difficult to carry out in practice, and thus potentially unrealistic in the first few years after the conflict. In the meantime, however, greater use of competitive but very simple procurement processes could contribute to greater incentives for the small scale providers to get up the learning curves themselves. Winning and then doing projects is likely to be the best way of improving capacity of small scale providers and as such create opportunities for them to enter the reconstruction value chain.

The Niassa Province case study also shows how without adequate monitoring and contract enforcement capability within local government, small scale led projects may fail. In this case, it is important to note that government authorities may not always be best placed to perform the contract monitoring and verification function. Engaging local communities to input into the monitoring process could be another way of doing this.

Institutional needs

As mentioned in the main body of the report, many important institutions in PCCs tend to be seriously eroded by conflict. In such an environment it is essential to utilise and build on any existing and operational institutional structures in the country to support the development of small scale enterprises. In addition, and in infrastructure in particular, existing and / or any new institutional arrangements need to encourage and enable the customers to voice their preferences for the type of service they require (and are able to pay for), hold governments accountable where appropriate and organise themselves into providers of services (through Community Based Organisations for example). Finally, more systematic approaches to building institutional capacity of customers and governments to create and operate infrastructure projects, as piloted by a number of international donors, need to be tested.

Utilising existing institutional structures

In PCC environments, where many institutions have been destroyed as a result of conflict, it will take time for new institutions to emerge and develop. In these circumstances, therefore, it is important to build on institutional structures that are already in place. This might take the form of an organisation which had an effective

presence during the period of conflict, such as the Red Cross, as the case study in Box A8.3 below shows.

Box A8.3: Utilisation of existing institutional structures – the Red Cross

Case study 3: Use of Red Cross

The Red Cross's continued presence in war-torn countries such as Mozambique has enhanced its credibility as an effective provider of humanitarian as well as reconstruction assistance.

The Red Cross symbol is well-known across the local communities of Mozambique and it is even reported that after the Peace Accord was signed, intervention was better received by the local community from the local Red Cross society than from the Government. The International Federation of the Red Cross works in a way that its involvement in a country begins with assistance during and after conflict on a humanitarian basis, such as food aid or providing water and sanitation facilities for refugee camps and then moves to longer term reconstruction aid.

An organisation such as the Red Cross has a local network in place, which was originally conceived for emergency assistance but is now recognised to provide a suitable platform for providing non-emergency development activities such as infrastructure provision.

It is organisations such as these, and their institutional networks in the country, that could be the first to support the development of small scale enterprise and integrate the service of such enterprises into infrastructure provision activities.

Voice of the customer and customer led projects

For small scale, customer led, infrastructure projects to succeed, there needs to be an effective dialogue between local government and informed customers.

Currently, NGOs often step in to bridge the gap where the link between customers and government is weak. Both NGOs and donors, however, sometimes can be responsible for forcing agendas onto local customers based on their own interests and approaches. For example, customer consultation is not wholly effective if coordinated by an NGO who feeds ideas to the customer leaders and suggests what the customers may want. In a post conflict situation, maybe the best that can be done initially is to provide a safe forum for customers to meet together to discuss their needs. This approach could also incorporate provision of skills on how to communicate effectively with government and propose customer led infrastructure solutions – which may be run by cooperative (thus 'private' – that is non-governmental) small scale organisations.

The case study presented in Box A8.4 below, shows how a municipal level forum, successfully facilitated by CARE International has led to the introduction of small scale – customer led – infrastructure in impoverished areas in Luanda, Angola, and has articulated a voice for the customers to converse effectively with local government.

*Box A8.4: LURE Project Angola: Effective Community Participation***LURE Project Angola: Effective Community Participation**

Luanda Urban Rehabilitation and Enterprise (LURE) project was set up in Luanda by CARE International in 1999. The LURE project was one of CARE Angola's first attempts at working on a rehabilitation project as opposed to a war-induced emergency effort. The project began with primary aim of poverty reduction through three main areas of intervention:

- Improving access to urban services through infrastructure investment
- Improving quality of service through community local level management
- Improving household livelihood security through access to micro credit

However, it soon became clear that links between customers and local government were weak and NGO interventions were constantly required to achieve progress. So the emphasis was turned to building capacity within the customer groups to hold local government more accountable.

The LURE project has highlighted the fact that it is not just lack of information and credit that construct barriers to infrastructure provision but institutional barriers as well. The LURE project has worked to transform an ad hoc network of micro credit practitioners into a small enterprise development forum aimed at promoting the interests of small and medium enterprises. The Forum not only looks into credit and micro finance best practice but also facilitates a dialogue between the state and small enterprise activists to ensure that barriers are minimised.

Key results of fora that have been set up in Luanda include:

- A water pipeline was set to be laid through an impoverished part of the city to serve an affluent area only. Through community articulation of this particular issue, access was granted to the communities who lived in the areas where the pipes were being laid. Standpipes were connected to the pipeline granting access to clean water for local customers.
- Customers organised their own form of rubbish collection. Initially the people would collect their own rubbish and then make a small payment for the rubbish to be taken away. From this initiative of private rubbish collection, local firms have arisen in the communities who organise the process and collect small payments.

A more systematic approach

The international donor community has began approaching the issues of both customer and government institutional development, and particularly the capacity to develop commercially viable infrastructure projects, in a more systematic manner. One such example is the UN-HABITAT led Slum Upgrading Facility, a special purpose facility which is being set up to act as an intermediary or 'accelerator' mechanism for infrastructure customers and small scale businesses to engage in infrastructure investment and service delivery, as presented in Box A8.5 below.

*Box A8.5: An 'accelerator' mechanism – Slum Upgrading Facility SUF***Slum Upgrading Facility SUF**

A number of international donors are in the early stages of creating a new multi-donor Slum Upgrading Facility (SUF) which will act as an “accelerator” mechanism, comprising proactive advisory services supported by short term grants, dedicated to implementing investment in slum upgrading, housing and municipal infrastructure. The idea behind SUF is that it will work as a tool of leverage to make more projects in the slum infrastructure area happen. The SUF will not provide an additional capital financing facility, but is intended to be an enabling mechanism, designed to ‘kick start’ slum upgrading, housing and municipal infrastructure projects. The aim is to extend existing solutions to financing slum upgrading by leveraging off local capital markets and developing local business in the area. In this way, the facility will work to develop credit ratings for municipalities to mobilise local capital to fund projects in a sustainable manner.

The SUF will create a sub national approach to developing existing and new projects, focusing on decentralised infrastructure development through private enterprise. It aims to provide some form of coordinated gap filling approach to alleviating poverty in slum areas rather than continuing the cycle of individual projects implemented without coordination.

Local institutional capacity will best be built up through learning-by-doing. As such, pilot projects led and implemented by donor facilities like the SUF will be a good means of achieving this. Apart from transfer of skills, implementing projects on the ground will hopefully establish working relationships between the customers, local authorities, and any emerging private sector entrepreneurs (individuals or cooperative customer groups), thus building a degree of sustainability in these processes.

Project structuring and procurement of opportunities

Trying to achieve the sometimes incompatible aims of introducing international / regional expertise into a PCC infrastructure environment, transferring at least some level of performance risk to the contractor and the desire to involve local (usually) small scale providers in such opportunities, will require appropriate structuring of projects within which this could take place.

We have already mentioned the difficulties that are faced by the international private sector in contracting with small scale local subcontractors and the possible policies that donors or governments could pursue. An additional policy could be, however, to support, where appropriate and possible, regional providers to either share their experiences with local private sector provider / customers or to expand their activities into these environments. A good example of replication of regional experience in telecoms, from Tanzania and into Democratic Republic of Congo (DRC), is presented in Box A8.6 below.

*Box A8.6: Replication of regional experience***Shivacom's replication of experience in a developing country to DRC**

Shivacom, a private Tanzanian owned firm, acts as a distributor for Vodacom, the mobile operator, in Tanzania and has been very influential in helping Vodacom to increase its customer base in a highly competitive environment. Vodacom launched operations in September 2000 and have grown to a customer base estimated at over 700,000 in 2005. Shivacom sells Vodacom SIM cards and prepaid airtime and has been effective in introducing lower denomination airtime vouchers to enable lower income users to own and use a phone. Through Shivacom's effective distribution network which relies upon local contacts and entrepreneurial style, Vodacom has retained its dominant market position. Vodacom then invited Shivacom to set up similar operations in the DRC where Vodacom had acquired a mobile license. Thus Shivacom was able to replicate its experience of working in an environment with a highly evolving technology and demand, low affordability and poor credit records. After launching service in 2002, Vodacom's market share rose to 47% by the end of the year. Shivacom currently has 1 outlet in Kinshasa.

More elaborate project structuring activities, which may or may not involve international providers of services, are also being tested in the marketplace. A public private partnership type facility, Water and Sanitation for the Urban Poor (WSUP), has recently been set up to pilot a number of project structuring and procurement approaches. As the case study in Box A8.7 below shows, it has specific intentions of involving the local private sector in the development as well as the running of the infrastructure solution.

*Box A8.7: Water and Sanitation for the Urban Poor (WSUP) facility***Water and Sanitation for the Urban Poor (WSUP)**

WSUP has been set up as a Management Partnership between WaterAid, CARE, WWF, Thames Water, Halcrow, Unilever, and Cranfield University. It is aimed at providing technical assistance to low income and least developed countries in the development of water and sanitation services specifically for the urban poor. WSUP are setting up two pilot projects in Bangalore and in East Africa, to test how their partnership will work in action. In the meantime, WSUP are actively looking for other projects and aim to run two projects a year and will be seeking funding for projects beyond the pilots.

In practice, WSUP's approach is to identify a project and to undertake a scoping mission which is followed up by contacts from the local CARE or WaterAid office or whichever member of the consortium has in-country contacts. WSUP will then initiate a feasibility study looking at demand and affordability and will undertake a needs assessment for the local water supply. Projects will only be selected where at least 50,000 inhabitants could be served by the supply. In addition, WSUP will only focus on areas where there is capacity in country already, for example, there is already a basic municipal water supply and private contractors are available to carry out construction. WSUP aims to work mainly with the local municipal water supply company and to develop capacity within that entity to be able to manage their own water business. Once the feasibility study has been completed, WSUP is then obliged to engage in competitive tendering to obtain the contract to carry out work for the local water supply company in a consultancy sense. WSUP will work with the local water supply company to help them select contractors and in effect to help them work more like a private sector firm, in terms of contracting and performance standards. WSUP aim to remove their own project managers within, say 15 months of project start and to handover project management responsibilities to local managers who WSUP have trained for the role.

Consultation with WSUP partners confirmed that the private sector will seek out local private

Water and Sanitation for the Urban Poor (WSUP)

sector contractors where possible to aid project completion, reduce project costs and most importantly make the project sustainable in the long term with local capability to maintain and rebuild where necessary.

Ways of financing small scale providers

A number of studies have shown that small scale providers generally lack third party finance to fund their activities.¹⁵ While in some places micro-finance institutions have managed to contribute to reducing the financing gap for smaller scale infrastructure providers, much more needs to be done. Table A8.1 below shows, for example, an estimated breakdown of the financing structure for small scale private providers of electricity in Cambodia, which reveals the relatively low level of medium to long term third party finance in the capital mix of such infrastructure providers.

Table A8.1: Financing structure of small scale private providers of electricity in Cambodia

Financing structure of small scale private providers of electricity in Cambodia			
Equity			
Owners equity	49%		
Debt			
Family borrowing	22%	}	Loan tenors: 85% are 12 months or less Range of interest rates: 1% to 2% per month
Informal debt	23%		
Micro-finance	6%		

Source: Schwartz et al (2004)

In cases where capital costs of providing the service are significant – as they are in many rural areas – microfinance related responses may not be sufficiently large.

Some of the approaches that can be used for financing small scale private sector providers of infrastructure include: (i) use of microfinance institutions, where capital costs of service provision are reasonable – often extending existing networks within urban environments; and (ii) use of rural development funds for more expensive opportunities in rural areas, where greater investment may be needed to roll out infrastructure programmes. We consider each in turn below.

¹⁵ See for example Schwartz et al (2004)

Microfinance responses

Small scale providers tend to lack access to formal lines of credit in PCCs because markets are not developed enough to assess the credibility of a service provider and their ability to repay a loan. Instead small scale entrepreneurs rely on family loans, informal money lenders or informal supplier credits (as shown in the Cambodia example above).

Supporting infrastructure specific microfinance institutions targeted at potential small scale providers could entice more players into the market, based on the community banking, group lending, or rotating savings and credit association models. Microfinance institutions could also be used as conduits for performance driven, output based aid subsidy approaches – through on lending subsidised loans it receives from donors or government.

In addition, microfinance institutions tend to be very resilient to conflict and post conflict situations, as the case study from Liberia shows in Box A8.8 below.

Box A8.8: Microfinance in a conflict / post conflict environments

Microfinance in Liberia

The Local Enterprise Assistance Program (LEAP) of the Association of Evangelicals of Liberia started operations as a micro finance institution (MFI) in 1994 in Monrovia whilst fighting was ongoing in parts of Liberia outside of Monrovia. When fighting broke out in Monrovia in 1996, LEAP suspended operations. LEAP uses the village banking model as the basis for all its new clients. The client base reached over 5,000 by 1997, with an average loan size of \$87, with most clients (99%) female. One of the greatest challenges in making LEAP work has been in moving from the mentality of handouts to a loan based principle. At the heart of this is making clients understand that they will receive greater benefits if they are able to continue accessing finance rather than receiving a one off gift.

LEAP demonstrates that it is possible to set up an MFI during a time of conflict but that it helps to tie it to an enduring institution such as the Association of Evangelicals so that if key members of the MFI are affected by the conflict, or leave the country, then there is enough responsibility within the related institution to continue coordination.

Financing of small scale infrastructure operators, through microfinance institutions, is likely to have a better chance of success in more urban environments where customer density is high and thus capital costs per connecting a customer (usually from existing networks) is lower than in rural settings, demand can be relatively high and there is scope for prices to reflect the true cost of service provision (including the cost of capital).

Rural development funds

In a rural environment, where demand and affordability are much lower, sufficient private financing – through microfinance institutions or otherwise – is likely to be more

difficult to secure. In such settings, it may be necessary for government and / or international donors to support the financing of infrastructure projects, especially given the often high capital costs of infrastructure provision in these areas. One solution that is starting to emerge in many developing countries is the creation of a rural telecoms or rural electrification funds, or multi-sector funds. Such funds are usually financed with a percentage of revenue collected from national and urban operators in the sector, such as the mobile operators, and can be supplemented by donor contributions if necessary. The fund is then used to subsidise rural operations through meeting capital costs of network expansion for example. It could also be used to support any micro-lending facilities in rural areas, aiding the development of small scale local private enterprise.

Conclusions

Small scale entrepreneurial activity in infrastructure sectors of PCCs is very important. These entrepreneurs are able to operate in very difficult environments, have a good knowledge of local realities and are often prepared to accept more risks than international or regional players. They are also often the only source of basic infrastructure services – such as water and electricity – to large segments of the population in a PCC. They do, however, face many difficulties which affect their greater engagement in reconstruction efforts.

Many PCCs have ill defined land tenure and weak property rights, which is major constraint on scaling up any small scale activities. Legal reform needs to have this as a priority issue. Overly cumbersome and disproportionate regulatory regimes – often advocated by some within the international donor community – risk stifling entrepreneurial activity, especially in the early years of sector development. Small scale providers also often find it very difficult to win contracts from international reconstruction firms, as these are unlikely to accept delivery obligations which are contingent on small providers' performance.

Institutional needs of such providers – who may be customers as well – and the local government in dealing with them are also great. Existing and / or any new institutional arrangements need to encourage and enable customers to voice their preferences for the type of service they require (and are able to pay for), hold governments accountable where appropriate and organise themselves into providers of services (through Community Based Organisations for example). More systematic approaches to

institutional development, as piloted by some donors, are being tested in such environments.

As the managerial and technical capacity of small scale providers improves, they will have greater opportunities to enter the reconstruction value chain. Introduction of competition into small scale provision and simpler procurement methods could result in more small scale providers winning projects and increasing their capacity through learning-by-doing.

Finally, lack of appropriate finance is also an issue for small scale providers. Currently third party medium to long term finance forms a very small part of many such enterprises, with the majority of funding sourced from personal resources or informal channels – which limits the scaling up of opportunities and can be very expensive. Some approaches that can be used for financing small scale private sector providers of infrastructure include: (i) use of microfinance institutions, where capital costs of service provision are reasonable (often in urban environments); and (ii) use of rural development funds for more expensive opportunities and mainly in rural areas.

APPENDIX 9: TERMS OF REFERENCE FOR THE STUDY**TOR for study on how best to harness existing financing facilities to promote private public partnerships for infrastructure investment and service delivery in post-conflict countries****Background**

1. During the Commonwealth HIPC Ministerial Forum (CHMF) Meeting in Freetown, Sierra Leone held from 2-4 March 2004, Ministers paid particular attention to the issue of investment in HIPCs, especially the promotion of private sector partnerships (PPP). They observed that most HIPCs are conflict affected, have poor water, sanitation and electricity supply, inadequate communication, lack of investible capital and high risk associated with investment. Ministers recognised that these countries faced a wide range of daunting challenges and required a multi-faceted strategy to achieve the Millennium Development Goals, given that HIPC debt relief alone cannot finance the development needs.

2. In this respect, they underlined the need to improve, modernise and expand physical infrastructure in their economies, including through expanded private participation, where appropriate. And whilst the international community in general, and the development partners in particular, have mobilised considerable financial resources to facilitate the partnership between Private and Public sectors in the provision of infrastructure investment, not without some degree of success mainly in emerging markets, most post-conflict countries (PCCs) continue to experience severe shortages and paucity of investment in the provision of essential services. As a way forward, the Ministers mandated the CHMF Chair to consult with Commonwealth and other donors with a view to facilitating targeted investment promotion and promoting private public partnerships for infrastructure investment and service delivery.

3. During the CHMF meeting in Freetown, Ministers observed that most of the HIPCs are either emerging from conflict or mired in conflict. Although donors often provide significant amounts of aid for reconstruction and rehabilitation, these countries struggle in the early years after a conflict to absorb aid due to a wide range of capacity constraints. They noted that donors focused on more rehabilitation efforts during the immediate post-conflict years. The role of the private sector may not be recognised during these years as new governments of conflicted affected countries prioritise policies and interventions during the process of reconstruction. Such governments may have a

vague or detailed knowledge of the potential role of the private sector in the provision of infrastructure services. Therefore there are benefits to developing strategies for attracting investment in infrastructure in the immediate post-conflict period.

Objective of the study

4. In pursuance of this mandate, and given the severely constrained macroeconomic environment of most PCCs, which are mainly HIPCs, the study is aimed at examining how best to harness existing financing and other facilities for promoting private-public partnerships (PPP) and private sector participation (PSP) for infrastructure investment and service delivery in PCCs, particularly to the benefit of those most in need. The study will also attempt to examine broad categories of post-conflict countries relative to country uniqueness, commonalities and state of infrastructure development.
5. The study will cover, inter alia, the following areas:-
 - a. The situation as regards access to water, sanitation, electricity, communications and other basic infrastructure services in PCCs.
 - b. The characteristics and needs of infrastructure service providers and services in PCCs.
 - c. Existing institutional structures (or appreciation of previous institutional structures) for infrastructure delivery –both for private sector financed and privately financed infrastructure.
 - d. Identify project development structures (i.e. provide the relevance and applicability of institutional, legal and constitutional structures) that are, or should be, in place to facilitate PPP initiatives.
 - e. Existing financing and other facilities, provided by bilaterals, multilaterals, regional bodies, foundations and others, aimed at promoting infrastructure PPP and PSP in general (including facilities addressing the enabling environment, pre-investment costs and deal structuring, small-scale service providers, local currency, equity, debt and guarantee financing, operational support, and capacity building).
 - f. Identify past experiences in, or any existing or planned financing facilities or initiatives that seek to promote, PPP or PSP in infrastructure in PCCs with special reference to specific success models which may be useful for other countries.
 - g. The suitability of existing financing facilities to the needs of PCCs (with particular attention to local and sub-regional service providers) – and the interest of facility managers (and the principal funders of these facilities) in developing services for PCCs.

- h. The impediments facing PCCs in accessing these facilities and examine the level of leveraging that is possible/desirable for governments of these countries in attracting private investment.
 - i. Review and assess how other existing facilities, including loan guarantees by Multilateral Development Banks and Export Credit Agencies at source countries, could become a better and more viable source of mitigating some of the risks associated with FDI in infrastructure projects in PCCs.
 - j. Suggested measures to improve the accessibility of PCCs to these facilities, including how best to build capacity within PCCs to make better use of these resources.
 - k. Proposals to better target and tailor these facilities to respond to the specific needs of PCCs.
 - l. Seek to identify (if possible) the key common elements/themes of any policy initiatives in this area that could be replicated across different environments, and to isolate those features that would need to be tailored to meet each country's specific needs.
 - m. Explore ways further to enhance the developmental benefits of PPP in infrastructure development in PPCs and, in particular focus on the actions needed to maximize poverty reduction through the creation of sustainable employment opportunities, the establishment of links with local and/or sub-regional resources/operators, and stimulation of the indigenous private sectors .
6. It is expected that at a later stage, the recommendations of the study could be implemented in a (small) number of strategically chosen pilots in order to evaluate and test the feasibility of the proposed approach – and its applicability internationally. The consultants should recommend how these pilots should best be undertaken, including outline design, timetable, costing and terms of reference for implementation.
7. In this regard, the sponsors of this study and the ensuing pilots, envisage that the design, choice, and the modus operandi of these pilots will be such that these will cover a diverse geographical area, include countries at different levels of development and post-conflict institutional structure, and that sufficiently meaningful operational policy recommendations could be derived and presented to CHMF within a period not exceeding 18-24 months from the date of the launch of the pilots.
8. Consultants will be expected to identify various funding options for the pilot phase, and provide advice to the sponsors in securing funding.

9. Consultants will also be expected to identify specific projects that could be piloted and to that effect they should provide a brief project profile, not exceeding two pages, covering:

- i. Project background
- ii. Brief project description
- iii. Project objectives and scope
- iv. Project demand drivers
- v. Project cost
- vi. Estimated annual revenue streams and revenue sources
- vii. Project risk assessment
- viii. Project viability assessment
- ix. Project implementation structure

Study parameters

10. It is expected that the consultants will undertake a literature and internet review, plus telephone and e-mail consultations with key informants. It is estimated that some [...] man days should be adequate for research, consultations, analysis and report writing, plus a further ... man-days for discussing and finalising the draft report. The total cost of the consultancy, including incidental expenses, should not exceed [£x]

11. The report should be no longer than 30 pages, 1.5 space 12-point script, plus a 2-page executive summary. Background and other material should be structured in appendices.

12. The Commonwealth Secretariat (ComSec) would like to put the study under way as quickly as possible. ComSec with support from DFID will finance the study, and cover the costs of presenting its outcomes to the seventh meeting of the CHMF, scheduled for February/March 2005. ComSec will be seeking the assistance and close collaboration of DFID in drafting the TOR, identifying a suitable expert(s) and in carrying out the pilots, if and when this is deemed necessary.

13. Before the completion of the study, it would be extremely useful to hold a consultative Round Table involving some key stakeholders to discuss the outcome and the directions towards which the pilot projects should be focused. Based on the feedback from the Round Table, the consultants should finalise their report and submit the findings and way forward to the next year's CHMF. The cost of holding the roundtable should be included in the fee to be paid to the consultants.

Experience required

14. From the nature of PPP work in infrastructure, it is critical that a multi-disciplinary team is drawn that can address the structural issues of PCCs in infrastructure. Therefore, the team must successfully demonstrate previous experience relating to the successful delivery of projects in these areas.

15. In particular, consultant(s) are sought with substantial knowledge and experience of:-

- a. Infrastructure service provision
- b. Financing of infrastructure investment and operations
- c. Commercial financial markets
- d. PPPs in infrastructure service provision
- e. Facilities funded by donors, governments and others concerned with infrastructure PPP and PSP
- f. Small-scale infrastructure service providers
- g. The needs and priorities of the poor in terms of infrastructure services
- h. Post-conflict countries, ideally in the Commonwealth
- i. Development economics
- j. Report writing for donors
- k. Solid legal grounding
- l. Some experience in successfully commissioning PPP-related activities in the developing countries (preferably Commonwealth PCC)

Time frame

- Submission of proposals: Friday 17 September, 2004
- Selection of successful submission: Friday 8 October, 2004
- Submission of first draft: Friday 17 December, 2004
- Round Table meeting: to be held by 15 January, 2005
- Submission of second and final draft: Friday 18 February, 2005
- Presentation of Study to the seventh CHMF: end of February/early March, in capital

Invitation to submit proposals

16. Applicants are invited to submit proposals of 5-7 pages maximum without annexes or attachments (proposals of greater length will be returned unread – CVs should be summarized within the 5-7 pages), outlining the proposed approach to the consultancy, and the experience and competencies of the consultant(s). Proposals should be received by Prof. Andreas Antoniou, tel. 20 77476260, fax 20 77476235, e-m

a.antoniou@commonwealth.int, at Commonwealth Secretariat, Marlborough House, Pall Mall, London SW1Y 5HX, before Friday the 17 of September, 2004.

17. Applicants should be aware that, if appointed, they would be ineligible to bid for work on implementing of any the resulting pilots.

APPENDIX 10: CONSULTATIONS CONDUCTED

During the course of this assignment we have consulted the following people.

Consultations carried out to date	Date
Ben Pickering Humanitarian Programme Officer DFID - British Embassy Khartoum	27 th January 2005
Thomas Gilchrist Thames Water and WSUP Programme	31 st January 2005
Pierre Van Hoeylandt Managing Director Afghanistan Capital Partners	31 st January 2005
Doug McCabe Project Manager Afghanistan Capital Partners	31 st January 2005
Mark Cordingley Severn Trent Water International	1 st February 2005
Tanil Somaiya Shivacom (Vodacom dealer in Democratic Republic of Congo)	1 st February 2005
Richard Franceys Senior Lecturer in Water and Sanitation Management Silsoe, Cranfield University	1 st February 2005
Simon Trace WaterAid	2 nd February 2005
Rhiannon Tusker South and West Africa Programme Manager CARE International UK	2 nd February 2005
David Sanderson CARE International South Africa	2 nd February 2005
Peter Baur, Project Manager Rural Water Supply Programme, Water Management Consultants	2 nd February 2005
Mary Njoroge, IFC's African Project Development Facility (APDF)	2 nd February 2005
Rachel Warren Crown Agents	2 nd February 2005
Geoff Fishbourne Crown Agents (Technical Services)	2 nd February 2005
Alex Park Crown Agents - procurement department	4 th February 2005

Consultations carried out to date	Date
Chris Harvey Crown Agents - procurement department	4 th February 2005
Robert Fraser International Federation of the Red Cross	8 th February 2005
John Lawson Africa Manager, Halcrow	8 th February 2005
Monique Koning Team Leader New Initiatives and Products, MIGA Operations Group	11 th February 2005
Diane B. Jones FINCA USA	11 th February 2005
Eugenio Langa Country Manager, Crown Agents Mozambique	14 th February 2005
Debra Boyer Micro-Finance and Investment Support Facility (MISFA)	21 st February 2005
Mike Dyson Slum Upgrading Facility (SUF)	21 st February 2005
Jordan Schwartz World Bank	22 nd February 2005
Mukami Kariuki World Bank	22 nd February 2005

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APPENDIX 13: CONSORTIUM CONTACT DETAILS

Consortium contact details for this study are provided in Table A13.1 below.

Table A13.1: Consortium contact details

Name	Position / responsibility	Contact details
Mark Cockburn	Director, CEPA Project direction	Tel: +44 (0) 20 7291 3970 Fax: +44 (0) 20 7636 5629 e-mail: mark.cockburn@cepa.co.uk
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