



Donors Committee

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Inquiries to: Mr. Bernardo Guillamon (extension 1583)

Remarks: The attached report is one of the evaluations of the first “Groups” of MIF projects—Alternative dispute resolution (document MIF/GN-78-2), Micro-finance (document MIF/GN-78-3), Financial reform and capital markets (document MIF/GN-78-4). The summary report (document MIF/GN-78-1) brings together the initial findings from each report on the evaluations and attempts to derive general lessons and conclusions. Together, the work advanced this year in the evaluation account for approximately one third of the total universe of MIF projects which are to be evaluated by OVE during 2002-2003.

Although transmitted separately, the reports (MIF/GN-78-2, MIF/GN-78-3, MIF/GN-78-4) should be read as a single work, with the summary report (MIF/GN-78-1) providing an integrating overview of the three detailed “Groups” evaluation reports.

The Spanish translation of this document will be distributed shortly.

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MIF/GN-78-4

***Evaluation of MIF Projects:
Financial Reform & Capital
Markets***



Office of Evaluation and Oversight, OVE

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ACRONYMS AND ABBREVIATIONS

ASBANC	Asociación de Bancos del Perú
BVL	Bolsa de Valores de Lima
CNV	Comisión Nacional de Valores
CNBV	Comisión Nacional de Bancos y Valores (México)
COPRI	Comisión de Privatización
DO	Development Objectives
FDI	Foreign Direct Investment
FELABAN	Federación Latinoamericana de Bancos
IAIS	International Association of Insurance Supervisors
IDB	Inter-American Development Bank
IFB	Instituto de Formación Bancaria
INDEVAL	Instituto de Valores (México)
IOSCO	International Organization of Securities Commissions
IP	Implementation Progress
IPO	Initial Public Offering
LAC	Latin America and the Caribbean
LDC	Less Developed Countries
MIF	Multilateral Investment Fund
MOU	Memorandum of Understanding
MPPMR	MIF Project Performance Monitoring Report
NAFTA	North American Free Trade Agreement
OVE	Office of Evaluation and Oversight
PCR	Project Completion Report
SGR	Sociedad de Garantía Recíproca
SME	Small and Medium Enterprises
SPSS	Supplemental Pension System Secretariat (Brazil)
TD	Tabulated Data
TdP	Telefónica del Perú
US GAAP	United States General Accepted Accounting Principles

EXECUTIVE SUMMARY

The MIF is a multilateral organization with a mandate to assist in the development of the private sector in Latin America and the Caribbean. In recent years, the MIF has increasingly emphasized performance and achievement of results. In pursuance of accountability, this evaluation measures the performance of MIF projects in the areas of financial reform and capital markets development. MIF operations are judged for their consistency with country priorities, Bank policy and a set of project design characteristics desired by the MIF.

Chapter One describes the policy, institutional and legal/regulatory environment when the MIF began operations in the early 1990s. The MIF inherited a legacy of enormous economic and financial difficulties in Latin America and the Caribbean. At the beginning of the decade, financial legislation, policies and institutions were in almost complete disarray. The development of banking systems and capital markets were being held back by volatile capital flows, financial repression and state interventionist policies.

Capital inflows into the region exhibited a “go and stop” behavior throughout the 1990s. Heady markets contributed to record capital inflows that fueled asset price bubbles. The boom was invariably followed by a bust that sent asset prices and market institutions crashing. Multiple banking crises occurred in nearly every LAC country distracting the attention of policy-makers and diverting scarce resources from development needs.

The MIF’s financial reform and capital market development efforts were directed toward changing a strong legacy of market distortions. Financial reform addressed the problems of inadequate economic and financial *policies* such as lax monetary policy, fiscal deficits, interest rate policy and directed credit. The fragility of *institutions* such as central banks, state-owned development banks, supervisory bodies, commercial banks, stock and commodity exchanges, investment companies and broker/dealers, pension funds and insurance companies were the subjects of strengthening programs. And, finally, financial reform of the *legal and regulatory environment* involving property rights, commercial codes and bankruptcy acts, banking and securities laws and pension and insurance legislation were addressed.

Although significant progress in financial reform and economic growth were achieved in the first half of the 1990s, the pace of reform was interrupted continually in the second half of the decade by serious economic and financial crises. The financial reforms were significant and seem destined to last, but the progress of financial reform and capital markets development throughout the decade was a case of two steps forward and one step backward.

Chapter Two reviews the evolution of MIF strategies in the financial and capital market areas. MIF strategy, as per the Establishing Agreement, is supposed to support country priorities and be congruent with Bank Group financial policy. In the years since the Establishing Agreement, MIF financial strategy has undergone numerous refinements. The “Perry Report of 1996”, the “Working Group Report of 2000” and various annual budget submissions have been instrumental in delineating those refinements. The MIF

policy paper GN/-41-7 “MIF Strategies, Priorities and Principal Operations Guidelines for 1997 and 1998” established the following general guidelines for financial and capital markets activities:

- a. “Development and strengthening of capital markets;
- b. Establishment and strengthening of adequate regulatory and supervisory framework for financial markets; and,
- c. Development of proper regulatory and supervisory framework for private pension systems”.

The Working Group Report subsequently introduced the concepts of “core activities” and project clusters or “lines of activity” and the dictum that MIF projects should exhibit the characteristics of relevancy, innovation, effectiveness, efficiency, sustainability, additionality and adequate evaluation.

Through the end of 2001, the MIF had funded a total of 466 projects of which 51 operations, comprising seven percent of total MIF resources were directly related to the financial reform and capital market areas.

Over time, six “areas of interest” emerged de-facto:

1. *Financial Supervision* – “developing and enforcing the rules of the game”
2. *Capital Markets* – “enabling access to capital and investment liquidity”
3. *Financial Infrastructure* --“building the foundation for more efficient financial markets”
4. *Pension Reform* – “democratizing the access to capital markets, while reasserting the role of the private sector”
5. *Insurance Reform* – “ensuring asset preservation and transaction completion” and,
6. *Commodity Exchange Development.* – “bringing the benefits of modern financial tools to the agricultural markets”

The projects in this group had been unusually relevant to the development of the private sector. Financial Supervision, Capital Markets, Insurance and Pension Reform initiatives had a direct or indirect effect on practically all financing activities of the private sector. Particular attention was directed towards C and D countries, where about three-quarters of MIF operations occurred and the immediate and direct effects of the MIF projects were significant in terms of GDP.

Innovation and additionality of these projects were also unusually high. Innovation meant in many instances the transfer of international best practices in supervision and financial

markets organization. However, this was not the only type of innovation promoted by the MIF, because in some cases, innovations not tested elsewhere were introduced as new financial products or new legislation. Additionality was also high, particularly in regulatory areas where incumbents had a short-term interest in maintaining the status-quo of non-transparent, closed markets.

Sustainability has been a struggle. MIF resources were badly needed to promote change. After MIF resources were depleted, more than 75% of the executing agencies had difficulties covering their costs. The majority of those agencies are public and in charge of financial supervision. This highlights the importance of budgetary commitments from the countries and a good alignment of goals.

Effectiveness and efficiency and other characteristics related to the design and execution of projects had been weak. This may be a reflection of the complexity of the tasks at hand. It was found that some projects failed to accomplish a part of what they set out to do; that they significantly under-optimized the use of resources; and that the measuring mechanisms were incapable of tracking results. However, for an innovation-seeking fund like the MIF, a fair number of mistakes will be experienced and lessons learned will be an important part of the project results.

Chapter Three summarizes the results of an in-depth evaluation of the fifty-one financial reform and capital market projects. They include completed projects and those currently in implementation. The evaluation comprised in-depth Case Studies of selected projects and standardized Project Briefs for all the others. The results of a survey sent to all MIF executing agencies and visits by the evaluating team to the executing agencies were also factored in. The Case Studies and Project Briefs were prepared by interviewing executing agencies, project beneficiaries, Bank and MIF staff and consultants, competitors, strategic partners and other relevant parties. Supporting written information was also gathered from government and industry sources in the countries where the projects took place. These included feasibility or sector studies, project design documents, consultant terms of reference, plans of action, MPPMRs and official Bank correspondence.

Most projects take significantly longer to execute than initially planned. There are two very long delays in processing a project: the first delay is the time between project request and its subsequent approval; and the second delay is the time between project approval and first disbursement. These two delays amounted to almost two years on average for financial reform and capital market projects.

Financial reform and capital market projects (from initial project request to final disbursement) have run five years or more. The MIF now has a decade of experience in which the majority of its projects has run five years or longer and frequently there have been follow-on projects. Despite this experience, the MIF has been reluctant to increase the implementation time frame for its projects or to enter into multi-stage projects. With respect to institution building, this may be unrealistically short. This issue needs to be examined by the MIF.

Chapter Four presents a compilation of the findings and conclusions derived from the evaluation of MIF activities in the financial reform and capital market clusters. There are specific findings that are related to the thematic areas of financial reform and capital markets and general findings that are related to administrative or procedural matters and affect all MIF project activity. The conclusions are:

A. Thematic Areas of Financial Reform and Capital Markets

- There is little doubt that the MIF needs to stay involved with the financial and capital markets of LAC countries as demands are unlikely to be satisfied by other providers;
- MIF implicit strategy in financial reform and capital markets development does not recognize that the MIF has special characteristics that should influence its behavior. A detailed declaration of priorities and objectives is a first step and resources should be earmarked or allocated to support these priorities. The MIF organization will need to adapt and align itself to the new strategy so that its know-how and capabilities are employed in the most efficient manner;
- MIF objectives in the financial reform and capital market areas fall into two distinct classes: long-term, infrastructure building objectives and short-term, market-responsive objectives. Planning horizons, resource allocation and the supporting organizational structure are different for each class of objectives. Long-term, infrastructure-building objectives are more efficiently addressed through the development of core resources and expertise that provides support to individual projects. The MIF could consider creating a Centralized Services¹ that provide support to this group of projects. There are significant economies of scale in the development of core resources. Developing them de novo for each project is both ineffective and inefficient;
- MIF assistance is more effective when executing agencies are capable of efficient project administration. The timing and sequence of projects could be based upon executing agencies that are institutionally strong enough to undertake reform and development efforts. In a country with a history of poor performance, based on institutional weaknesses, MIF projects should be simple, single-purpose operations that concentrate on redressing institutional debilities. Early stage projects could be concentrated on institution-building and not reform or development efforts;
- MIF assistance is more effective when there is a strong policy environment. In the absence of a strong policy environment, the MIF could concentrate its resources in helping countries to bolster the legal/regulatory environment for financial and capital markets. These could be multi-stage projects where stage

¹ This does not imply an increase in MIF personnel; centralized services can make use of the MIF's current technical capacity or could be obtained through a MIF technical cooperation or a management services contract.

one represents strengthening the policy environment and subsequent stages are not activated until the policy environment has been strengthened.

- MIF assistance is more effective when governments and executing agencies are committed to the goals of the project. If a country has a history of poor performance based on an unwillingness to take politically difficult decisions, the MIF should consider only non-financial operations such as feasibility and sector activities that help to overcome policy weaknesses.
- Lack of independence of some of the executing agencies from political special interest groups had, in the past, conspired against project effectiveness. Moreover, the lack of independent supervisory agencies has been a contributing factor to banking crisis and financial fraud. The MIF could consider assistance based on good performance in tackling these governance challenges. In the next decade, the MIF should also concentrate on helping supervisory agencies develop the means to enforce existing legislation.

B. MIF Internal Processes – A re-examination of project planning, implementation and evaluation

- Executing agencies are the main building block of the MIF project distribution channel, therefore the MIF could re-examine its desired profile of the typical executing agency, and perhaps establish a set of guidelines for the selection process. Beyond the executing agencies, the MIF could consider forming long-term relationships with other strategic partners that share its quest for innovative solutions.
- The MIF may want to redefine projects as products that serve the needs of clients in terms of customer service promises, response times, minimum quality standards and service packages, etc.; they may have to re-align internal incentives to increase the focus on quality management, foster the reporting of accurate information that leads to a constructive spirit in solving implementation difficulties. Moreover, the MIF should consider reassigning responsibilities during project execution so that the original purpose and intent of the project is not lost. To accomplish this, the Bank/MIF should consider re-involving the project team in mid-term evaluations and participation in the MPPMR process and during key events of project execution.
- The MIF's regional projects in finance and capital markets have been particularly difficult to administer. Regional projects posed special administrative difficulties given the number of players involved in each project. This is an area of continuing concern to the MIF, and this issue needs to be explored with respect to the special design characteristics of regional projects.
- The MIF should develop means to widely share innovations and lessons learned during the development, execution and closure of projects. The MIF needs to develop an “institutional knowledge” database that gathers project documents,

terms of reference, action plans, progress reports and evaluations into electronic versions that can be fed into a MIF-sponsored web page.

- Moreover, the MIF could publish a roster of consulting firms and experts, without express or implied endorsement, and make these firms' names available upon request to executing agencies.
- The MIF needs to reinvigorate its monitoring and evaluation functions. Project goals should be explicit, well defined and subject to measurement. The MIF should ensure that every project budget has provided funding for monitoring and evaluation and every project should be evaluated. These results should be fed back into the system.
- There should be a renewed effort to design and write clear project documents. Some documents have hastily written descriptions of the central problem to be solved; inaccurate budget estimates have caused budget deficiencies to burden executing agencies; project design has not noted the institutional relations and lines of communication as they existed before the project; goals and objectives should be written with evaluation in mind; and, inter-agency cooperation agreements are inherently difficult and their use should be carefully thought out.
- Operations need to be designed with more flexibility to accommodate the inevitable changes that will occur in projects. The MIF Donors could consider giving more discretion to authorize project changes in the Country Offices and providing for more participation of the Project Team that designed the operation.
- The rate of disbursement can be a valid measure of project success when goals are tied to disbursement. In most MIF technical cooperation projects evaluated, disbursements were tied to the attainment of specific goals and therefore the rate of disbursement was a valid measure of success in the project.
- The MIF's counterpart funding policy is the source of significant problems; there are large variations in the application of this policy between Country Offices; project budgets draw no distinction between cash and in-kind counterpart funding; and, counterpart funding cannot be tracked on a timely basis. The MIF should re-examine its counterpart funding policy and the improvement of the tracking system with the Bank.
- Country Office seminars on the Bank's project procedures for local executing agencies should be extended to include MIF executing agencies.
- The MIF and the Bank, perhaps through Project Review Missions, need to formalize a dialogue directly with the executing agencies about the progress and problems encountered in project execution.
- The MIF/Bank's international bidding requirements for contracting goods and consultant services were found to be subject to sometimes-lengthy delays. While

these procedures are admittedly slow, over time, they have proven their worth. Some of the countries do not have a history of transparency in awarding public contracts and the MIF/Bank's bidding procedures have been well thought-out and designed expressly to lend transparency to the process. These procedures have served the MIF/Bank and its clients well and the extra effort involved is a small price to pay to maintain the MIF and the Bank's excellent reputations in this area. The MIF may want to explore the use of price references for commonly purchased items and benchmarks for consultant services to speed up acquisition times, but for the most part, the evaluation of these projects indicates that the MIF/Bank's international bidding procedures should remain unchanged.

I. THE LEGACY THE MIF INHERITED – THE CONTEXT OF FINANCIAL REFORM AND CAPITAL MARKETS

- 1.1 This Chapter seeks to give the reader an appreciation of the enormous difficulties under which the MIF began operations (Annex I contains an expanded review of the context). At the beginning of the 1990s, financial legislation, policies and financial institutions were in almost complete disarray from the financial repression and state intervention practiced in the 1980s. Although significant progress in financial reform and economic growth were achieved in the first half of the 1990s, the pace of reform was interrupted continually in the second half of the decade by three serious economic and financial crises – the latest of which we still labor under.
 - 1.2 Capital inflows exhibited a “go and stop” behavior throughout the 1990s. Heady markets contributed to record capital inflows that fueled asset price bubbles. The boom was invariably followed by a bust that sent asset prices and market institutions crashing. Multiple banking crises occurred in nearly every Latin American and Caribbean (LAC) country distracting the attention of policy-makers and diverting scarce resources from development needs. The progress of financial reform and capital markets development was a case of two steps forward and one step backward.
 - 1.3 Notwithstanding, financial policy and institutions in the LAC region are clearly stronger entering the new millennium than they were at the beginning of the 1990s. The LAC region with its more than 400 million inhabitants and enormous untapped potential is likely to continue being a growth reservoir for the world. The challenge moving forward will be to keep building, while consolidating the progress realized in the last decade.
- A. The Lost Decade of the 1980s - Financial Repression and State Intervention²**
- 1.4 The decade of the 1980’s has been called the “lost decade” for developing economies. There was an enormous amount of foregone growth and development potential. The situation was brought about primarily by a collapse in private capital inflows, especially foreign commercial bank credits, in what has often been dubbed the “LDC Debt Crisis”.
 - 1.5 The proximate cause of the crisis was a loss of confidence on the part of foreign creditors. Developing country debt service burdens started looking unsustainable in the face of a commodity price decline that began in the early 1980’s. When the LDC debt crisis hit in 1982, the drying up of foreign capital inflows was swift. Bank lending and net portfolio investment reversed abruptly. Foreign direct investment (FDI) remained fairly stable, but could not offset the reversal of the other capital flows.

² This section relies heavily on the World Bank’s, *World Development Report 1989* to reconstruct the state of financial markets at the end of the 1980’s before many of the financial reforms began in Latin America.

- 1.6 The almost-tenfold increase in oil prices from 1973 to 1980 unleashed a chain of events that impacted directly the financial viability of many LAC countries. Western banks recycled petro-dollars into emerging market lending, initially at low but variable interest rates to LAC and other developing areas. To fight inflation caused, in part, by the oil price increases, interest rates rose in developed countries. The resulting deceleration in economic activity in developed countries resulted in lower imports from LAC and other emerging markets. Coupled with higher oil bills and higher interest rates, a perception of higher lending risk grew gradually with respect to LAC countries.
- 1.7 Between the years 1983-89, Latin America and the Caribbean suffered a net capital outflow averaging nearly \$17 billion per year comprised of a \$21 billion per year outflow of commercial bank and suppliers' credits and a net inflow of \$4 billion per year of direct foreign investment. The comparable figures for the rest of the developing world were a net \$9 billion inflow comprised of a \$4 billion outflow of commercial bank and suppliers' credits and a net inflow of \$13 billion of portfolio and foreign direct investment.
- 1.8 What seems to be a deeper, more enduring reason for the LDC debt crisis was over-dependence by Latin American and Caribbean economies on foreign commercial bank debt. Since the nineteenth century LAC countries have been slow to create policies, institutions and the environment that would encourage the growth of domestic financial markets. This has made the region, historically, more dependent upon external credit for investment capital than other regions of the developing world.
- 1.9 This situation remained as capital flows recovered in the 1990s. In the period from 1990-94, when capital flows restarted to emerging markets, short-term, interest-sensitive portfolio investment represented 66 percent of gross inflows in Latin America compared with only 24 percent in Asia. On the other hand, long-term direct foreign investment in Latin America was only 30 percent of gross inflows compared with 45 percent in Asia. Thus the LAC region started the 1990s with the same explosive financing mix that had brought about the crisis of the 1980s: a large exposure to volatile short-term bank debt and portfolio investment and comparatively less foreign direct investment
- 1.10 The prevailing doctrine of the 1980's was an over-reliance on government control and an under-reliance on private financial markets to allocate saving and investment. The result was financial systems in Latin America and Caribbean that were in a state of almost complete disrepair by the end of the decade. The *central banks* of many countries were frequently not independent of the ministries of finance. They were directed to provide credit to favored sectors of the economy and to purchase government debt to finance central government and

- state enterprise deficits. The central bank balance sheet was also a popular place to bury the losses from government bailouts of the banking system.³
- 1.11 Lax monetary policy, banking system bailouts, central bank financing of public sector deficits and the provision of credit to favored sectors of the economy had a devastating effect on *price stability*. Price increases which had averaged 62 percent a year for the region in 1981-82 climbed to nearly 500 percent a year by 1990.⁴ As compared with other middle income emerging markets, LAC was much worse off.
 - 1.12 *Interest rate policy* was fixed by the government without regard to the level of inflation sometimes causing negative real interest rates to persist for long periods of time. Commercial bank profitability usually suffered and long-term instability of the banking system was chronic. Cheap credit encouraged a heavier reliance on commercial bank financing which discouraged the development of corporate bond and other non-bank capital market institutions.
 - 1.13 Expansionary fiscal policy attempted to offset declining private activity in the 1980s and *fiscal deficits* resulted. These were frequently large as a percent of GDP, sometimes reaching 10 percent. Budget deficits contributed even further to the weakness of the financial system.
 - 1.14 *Directed credit* was a popular tool of governments seeking to provide credit to priority sectors or favored groups. Governments used central banks, state-owned development banks and the private markets to direct credit. Credit was generally allocated without regard to the efficiency of the project, the risk of the project or the administrative costs so that whatever financial institution the government selected to funnel credit could be expected to suffer losses.
 - 1.15 *State-owned development banks*, under the direct control of the ministries of finance, were used as mechanisms for directing credit to favored sectors. These institutions suffered all of the pitfalls of directed credit. They granted loans without regard to costs, risk or ability to repay. Their cost structures became bloated over time from political hiring. Sometimes the favored sectors (i.e. agriculture, industry, exports, housing, small business, rural development, artisans and cooperatives) became so numerous that governments found themselves subsidizing the majority of the credit markets. The accumulated losses of these institutions represented a significant percent of the nation's output so that writing off their bad loans or closing them down was a painful exercise. Bank supervisory agencies, lacking political independence, were directed to practice "regulatory forbearance" and to ignore the growing insolvency problem of the public development banks. This undermined the credibility of bank supervision in the financial markets. Eventually, the general public became aware that government banks needn't be repaid and a culture of "no payment" was bred.

³ Gerard Caprio, *Safe and Sound Banking in Developing Countries: We're Not in Kansas Anymore*, World Bank Policy Research Working Paper, January 1997, page 6.

⁴ World Bank, *World Development Indicators*, various years.

- Perhaps the most pernicious aspect of public development banks was their manipulation by government officials as a source of corruption. Too frequently these institutions were coerced into granting unsecured loans to government officials and their political supporters with little or no prospect of recovery.
- 1.16 *Commercial banks* were also required to join central banks and development finance institutions in channeling credit to favored sectors or in financing government deficits. Banking systems soon fell into a state of dependency, where management lost their ability to assess risk and operate competitively and they become dependent on the government for profitability and business direction.⁵ Many commercial banks were part of an economic or industrial group and engaged in insider lending to dangerous levels. Typically they were poorly capitalized and managed, usually resulting in an insolvent banking system.
- 1.17 *Supervisory bodies* such as the banking, insurance, pension and securities commissions in the early 1990's were seldom performing an adequate oversight function. They were typically under funded, had poorly trained staff and were not independent of the government. They were charged with enforcing antiquated financial legislation and their internal norms were badly in need of reform.
- 1.18 Only a few *stock exchanges* have had a lengthy history in Latin America, first appearing in Argentina, Chile and Uruguay more than 150 years ago. But most have been more recently developed with the latest exchanges being formed in the early 1990's. These relatively new exchanges usually started operations in a chaotic fashion, fueled by temporary emerging market debt frenzy. Their trading, clearance, settlement and custodial rules were poorly established and did not meet international standards. The concept of a self-regulatory organization (SRO) was not enforced and investor protections were rudimentary.
- 1.19 *Commodity exchanges* were in no better shape. Most countries did not have organized cash commodity markets and just a few had organized commodity exchanges where forward transactions could be conducted. State marketing boards dominated agricultural pricing and distribution leaving little room for market-based commodity exchanges to function. Not all farmers were aware of the cash prices that products were selling for in the provincial and capital cities.
- 1.20 *Investment companies and broker/dealers* are a relatively new development in emerging financial markets but an area of growing activity and importance. Brokerage houses in LAC are typically subsidiaries of commercial banks and there has been a lack of independence between the commercial bank and investment bank functions. In the past, they have been insufficiently capitalized by their commercial bank parents to safely undertake dealing and underwriting activities.

⁵ Honohan, Patrick, *Banking System Failures in Developing and Transition Countries: Diagnosis and Prediction*, Bank for International Settlements, Basle, Switzerland, January 1997

- 1.21 *Property rights, secured lending and the system of justice in LAC* were areas ripe for reform. The enforcement of contracts that seek to assign and transfer property rights from the owner to creditors has been problematic in LAC. Latin American property legislation and the courts have tended to favor the property owner over the rights of creditors in foreclosure proceedings. It is costly and time consuming for lenders to foreclose on defaults and has been a significant burden in promoting financial markets through the use of secured lending and collateral. Moreover, there have been myriad problems with the difficulty and clumsiness in recording property ownership, transfer of title and the recording of claims or liens on collateral.
- 1.22 *Banking laws* were mostly antiquated pieces of legislation in LAC. Prior to the financial reforms of the early 1990's, banking laws and bank supervision were principally concerned with the mechanics of bank operations such as compliance with monetary policy, reserve requirements and foreign exchange dealing.
- 1.23 *Insurance and pension legislation* in much of LAC was similar to the banking laws in that they were more concerned with the mechanical operations of these institutions than with their prudential supervision. Similar to banks, insurance and pension funds were viewed as a source of funding for government deficits and their portfolios were normally filled with low interest yielding government paper. *Securities Legislation* in LAC was among the most neglected areas of the non-bank financial system. Many of the smaller countries did not have specialized securities legislation and depended upon 19th century civil and commercial codes and companies acts.

B. A Sea Change - Financial Reform in the 1990s

- 1.24 In 1990, key LAC policymakers and the development community met in Washington, DC to agree upon a set of principles to guide economic and financial reform in the region in the coming decade. These principles would later become known as the "Washington Consensus". By this time, the former Soviet Union and other state planned economies had fallen and market principles everywhere were on the ascendancy. The Washington Consensus embodied the ideological triumph of market economics. An historic political decision was made by most countries and international financial institutions to install market reforms in Latin America and the Caribbean. The fundamental goals of the reform were: fiscal discipline, tax reform, restructuring the priorities of public investment towards areas such as basic education and health, market-determined interest rates, competitive exchange rates, liberal trade policies, openness to foreign direct investment, privatization, deregulation and respect for property rights.⁶
- 1.25 The countries of Latin America and the Caribbean thus embarked on a remarkable economic restructuring and financial reform process after a decade of lost growth

⁶ Inter-American Development Bank Research Department, *Taking Stock: Lessons Learned After More Than a Decade of Structural Reform*, in *Latin American Economic Policies*, Vol. 17, First Quarter, 2002.

and isolation from external capital flows. Governments throughout the region, to greater and lesser extents, proceeded to dismantle the apparatus of state intervention in the financial sector and to allow for a greater influence of market forces. They achieved clear and substantial progress on deficit reduction and the ending of hyperinflation. And, the 1990s were a period of expanded investment and economic growth. Less progress was made on privatizations, but still there is substantially less state involvement in the financial systems now than in the 1980s.

- 1.26 Three banking and financial crisis marked the decade and had important consequences for the development of financial markets. The first event was the so-called “Tequila Effect” that started with the December 1994 devaluation of the Mexican peso. The second crisis was the East Asia and Russian crisis beginning in 1997-98. Finally, in 2000-2002, we are again in the midst of a financial and banking crisis in Argentina. To date, the problem has been localized to Brazil, Uruguay and Paraguay and general contagion has not spread to the rest of LAC or emerging markets in general.
- 1.27 This instability has had a negative effect on public perceptions regarding economic and financial reform. The Latin American and Caribbean public have formed an impression that the reform process has not produced as many benefits as previously hoped and has been accompanied by highly painful social costs. Moreover, recession, banking crisis and falling stock markets have followed closely the reform process and in the public mind may be associated with it.
- 1.28 We seem to have entered a post-Washington Consensus era, in which consolidating the achievements of the past decade, while solving the pressing needs of the private sector, will require a more flexible approach to interventions. Because of its inherent flexibility, the MIF may be uniquely positioned to rise to this challenge and play an instrumental role in the years to come.

II. MIF FINANCIAL REFORM AND CAPITAL MARKETS STRATEGY

2.1 This chapter summarizes MIF strategy in the financial reform and capital market areas (Annex II contains a detailed review of the strategy). All relevant MIF and Bank documents were analyzed in search of an implicit or explicit strategic intent towards the financial reform and capital market areas. These include the Agreement Establishing the MIF, the Perry Report of 1996, the Working Group Report of 2000, Country Papers and various MIF policy and budget documents are reviewed to develop a sense of how MIF projects have actually supported their strategy and how this strategy has evolved over the past decade. Finally, the evaluation methodology developed by OVE is introduced as a means to systematically address the wide spectrum of strategic objectives pursued by the MIF.

A. MIF Financial Reform and Capital Market Strategies

2.2 In the words of the Working Group on MIF strategy ...“the MIF was given a broad and flexible mandate to address rapidly changing private sector development needs.” And in view of the significant evolution of MIF over the last decade, it is fortuitous indeed that the MIF charter was flexible enough to permit activities that could not be anticipated at the time of its founding.

2.3 The Perry Report noted the broad general nature of MIF strategy as described in its founding Agreement and believed that it was insufficiently focused and could not serve as an effective guide for moving the MIF forward. Perry noted that the Agreement was silent on the allocation of resources among eligible countries and projects. The Perry Report sought to focus MIF strategy so that it could be an instrument for innovation and simultaneously meet the current development agenda of the IDB and the countries in the region.

2.4 With respect to the financial and capital markets, the Perry Report proposed four areas for the MIF to concentrate on:

- a. “Development of a legal, regulatory, contractual and supervisory environment that *promotes private investment in infrastructure and public services* ...
- b. Development of the legal, regulatory and supervisory environment *for private sector participation in social security* (e.g., pension funds) ...
- c. Development of *local capital markets* ...
- d. ...the MIF could support, in the countries that require it, *development of the general investment setting* (legal framework, promotion and supervision of competition, etc.)”. [MIF Task Force Report, 30 September 1996 page 15.]

- 2.5 In March 1997, the MIF adopted some of the Perry Report recommendations but changed the emphasis and thrust of many others. These recommendations were submitted to the Donors Committee in policy paper MIF/GN-41-7 “MIF Strategies, Priorities, and Principal Operational Guidelines for 1997 and 1998.” This document expanded the regulatory and supervisory activities to all financial markets and not just infrastructure and pension regulation. The MIF Policy Paper GN-41-7 recognized that a great deal remained to be done in the regulation and supervision of financial and capital markets and included this as an activity under Facility 1:
- a. “Development and strengthening of *capital markets*;
 - b. Establishment and strengthening of adequate regulatory and supervisory framework for financial markets; and,
 - c. Development of proper *regulatory and supervisory framework for private pension systems*”.
- 2.6 The MIF’s annual budget documents often contained a discussion of the strategic and operational objectives for the forthcoming year. In the documents for budget years 1995, 1996, 1997 and 1998, the financial and capital market strategies remained fairly constant. The MIF would continue to focus its financial reform efforts on improving the regulatory and supervisory framework for financial markets, including infrastructure regulatory agencies and pension supervision and the continued development of domestic capital markets. The 1998 Budget document specifically stated that the strategies discussed in budget documents were to be consistent with the MIF’s official strategy as written in GN-41-7.
- 2.7 In July 2000, the Working Group on MIF Strategy noted how drastically the world had changed since the MIF was established in 1993, but that the MIF had been flexible in helping the Region to cope with the transition to a global market economy. The MIF had notable successes in micro-finance and alternative dispute resolution and was developing an enviable reputation in the Region for risk-taking and innovation. But these successes were being clouded by an increasingly difficult implementation situation. For example, meeting conditions precedent was becoming increasingly difficult in financial and capital market projects and delays of more than 12 months between signing of the contracts and first disbursements were not uncommon.
- 2.8 The Working Group proposed a number of recommendations to retain the best of what the MIF had accomplished in the past, but to increase the efficiency of project implementation in the future. With respect to financial and capital market projects, these include:
- a. “MIF projects should keep their principal characteristics of innovation, demonstration effect, sustainability, partnership and additionality”. The concept of additionality is particularly important in financial sector and

capital market projects. Projects that seek to improve supervision, market transparency and remove barriers to entry are not necessarily in the best interest of current financial market participants. In these cases, MIF funds are essential to get the project underway and improve the supervision and regulation of markets for the public good.

- b. To better focus MIF activity, the Working Group introduced the concept of “core activities”. According to the Working Group Report, “The MIF can maximize its development impact by focusing most of its resources on small enterprise development, micro-enterprise, improving market functioning and financial sector reform and capital market development.” Hence, by this statement, “financial sector reform and capital market development” had become an officially recognized “MIF core activity”.
- c. It was further defined that, within the core of financial and capital market activities, MIF projects would focus on market transparency measures, regulatory reform, supervision and capital market development.
- d. The Working Group also proposed the concept of “project clusters” comprised of a group of related projects that could be supported by a technical expert and would mitigate many of the design and implementation problems encountered in MIF projects. It was pointed out, that specialized expertise in financial and capital markets was especially important to effective project design and implementation.

B. The Implicit MIF Strategy

2.9 The MIF set out to complement and supplement the Bank Group’s reform agenda with a flexible and innovative approach. Over time, six “areas of interest” emerged de-facto:

1. *Financial Supervision* – “developing and enforcing the rules of the game”
2. *Capital Markets* – “enabling access to capital and investment liquidity”
3. *Financial Infrastructure* --“building the foundation for more efficient financial markets”
4. *Pension Reform* – “democratizing the access to capital markets, while reasserting the role of the private sector”
5. *Insurance Reform* – “ensuring asset preservation and transaction completion” and,
6. *Commodity Exchange Development.* – “bringing the benefits of modern financial tools to the agricultural markets”

- 2.10 By the end of 2001, the MIF had approved 51 projects in the areas of Financial Reform and Capital Markets Development. Almost US\$60 million of MIF funding were committed to these operations. MIF activity in these areas accounted for 11% of total MIF projects and 7% of total committed investment to that date. Projects related to “Financial Supervision” and “Capital Markets” absorbed almost two thirds of the MIF funding in the financial reform and capital market areas, with the remainder of the funding spread across the other four areas of interest.
- 2.11 Interventions have come in sequences where projects can be characterized as first, second or even third generation, according to their design characteristics. Almost all areas of interest have already experienced more than one generation of projects, with the exception of Insurance and Pension Reform that were started later in 1998.
- 2.12 Financial Supervision, Capital Market and Pension Reform projects tended to be larger, averaging US\$1.5 million per project. Financial Infrastructure and Insurance projects averaged in the neighborhood of US\$1 million per project, and Commodity Exchange projects were much smaller, on the order of US\$0.5 million per project.

Table 2.1: Sequence of MIF Financial and Capital Market Projects

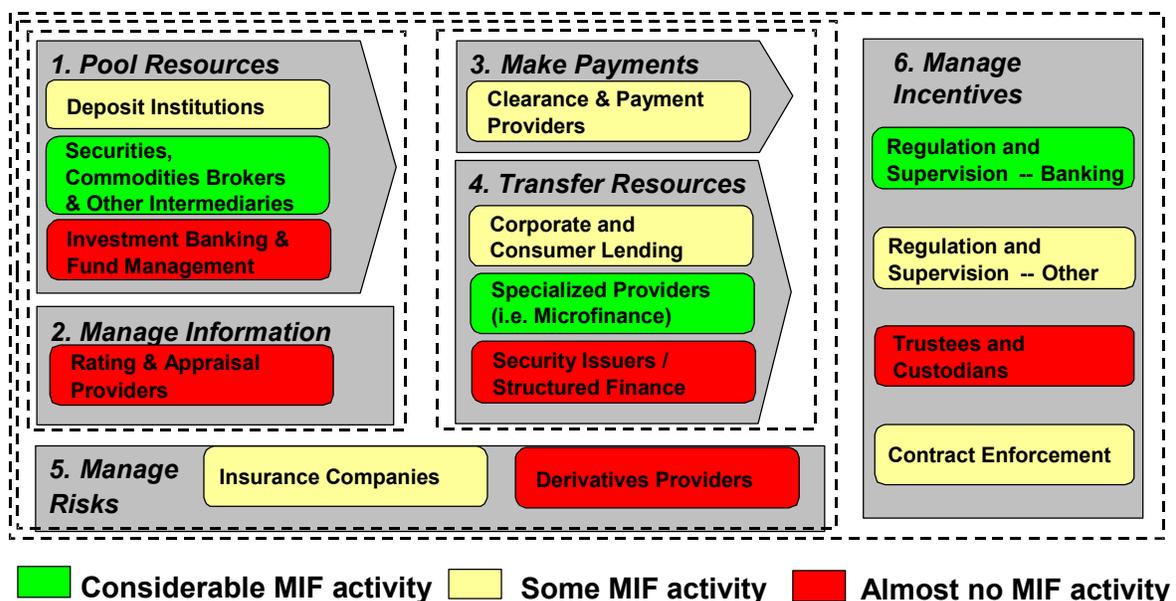
YEARS	1994	1995	1996	1997	1998	1999	2000	2001	Projects	US\$ M	Average
Financial Infrastructure (FI)	<i>Financial Infrastructure (FI)</i> 3.0 projects / US\$ 3.06M			<i>Financial Infrastructure (FI)</i> 7.0 projects / US\$ 5.73M					10.0	8.78	0.88
	Generation 1			Generation 2							
Financial Supervision (FS)	<i>Financial Supervision (FS)</i> 2.8 projects / US\$ 6.51M		<i>Financial Supervision (FS)</i> 8.7 projects / US\$ 10.13M						11.5	16.64	1.45
	Generation 1		Generation 2								
Insurance (IN)	<i>Insurance (IN)</i> 3.6 projects / US\$ 4.06M								3.6	4.06	1.14
Capital Markets (CM)	<i>Capital Markets (CM)</i> 4.0 projects / US\$ 8.06M			<i>Capital Markets (CM)</i> 7.9 projects / US\$ 10.82M		<i>Capital Markets (CM)</i> 3.0 projects / US\$ 20.01M			14.9	20.89	1.40
	Generation 1			Generation 2		Generation 3					
Pension Reform (PR)	<i>Pension Reform (PR)</i> 4.1 projects / US\$ 5.96M								4.1	5.96	1.47
Commodity Exchanges (CX)	<i>Commodity Exchanges (CX)</i> 4.0 projects / US\$ 1.68M			<i>Commodity Exchanges (CX)</i> 3.0 projects / US\$ 1.45M					7.0	3.13	0.45
	Generation 1			Generation 2							
YEARS	1994	1995	1996	1997	1998	1999	2000	2001	51.0	59.46	NA

Source: IDB data compiled by Office of Evaluation.

C. The Universe of Financial Sector Activity

- 2.13 Despite the fact that the MIF ended up concentrating its efforts in six areas of activity, the universe of financial and capital market needs grew larger every day. A wave of consolidation in the financial industry in the 1990's created large financial institutions that set out to deliver universal services, from commercial banking, to insurance, to investment banking. At the same time, a number of financial services specialists emerged as dominant players in their respective industries, such as credit card processing and credit rating agencies.
- 2.14 Today, financial and capital markets have become so sophisticated that it is easy to forget their *raison d'être*. Regardless of how specialized markets are or how large financial institutions have become, they must satisfy basic financial needs that have remained unchanged over time and geography. A review of those basic financial needs is a useful departure point for evaluating MIF activities relative to the universe of financial needs.⁷
- 2.15 Myriad financial activities take place under the basic financial needs categories: pooling resources; managing information; making payments; transferring resources; managing risks; and managing incentives. The MIF did not set out to address all of these needs, nor should it be judged as if it had an obligation to do so.

Table 2.2: MIF Activity within the Universe of Financial Market Needs



- 2.16 The MIF did pioneering work in many of these areas, but lacked a strategic blueprint. Questions that could have served as a guide for action were not asked.

⁷ This analysis follows the model of Dwight B. Crane and Zvi Bodie, *Form Follows Function: The Transformation of Banking*, Harvard Business Review, March-April 1996.

For example: (1) what should the MIF do and what should it refrain from doing? (2) how should the MIF do it? (3) in what order should each type of intervention be carried out? And (4) who should do what?

- 2.17 An assessment of MIF activity in the financial reform and capital markets areas finds that there are opportunities in areas where activity has been less intense to date, such as Investment Banking & Fund Management issues, Rating & Appraisal Providers, Specialized Credit Providers, Security Issuers and Structured Finance Dealers, Trustees and Custodians and Derivatives Providers.
- 2.18 It is evident that the MIF has developed an enviable network of private and public sector executing partners, a relatively faster decision-making process, a familiarity with best practices at the regional and global levels and a powerful capability to summon strategic players. These achievements have made the MIF the most important source of grant resources in the region. However, none of these characteristics were nurtured or utilized as the justification for MIF interventions.
- 2.19 Likewise, the same project-based approach was utilized for very different objectives. Long term, reform-type objectives were implemented in single tranche, short execution projects. The same approach was utilized to address short-term, market-responsive projects meant to address the immediate needs of the market without any modification of the time consuming administrative requirements applied to all projects.

D. An Introduction to OVE Evaluation Methodology for this Group of Projects

- 2.20 An initial finding of this evaluation was that MIF projects in the financial reform and capital market development areas were very diverse and did not seem to follow a strategic blueprint. The open nature of MIF's strategy towards the sector left ample room for different thematic areas to be undertaken. The separation between financial reform and capital markets projects blurred as several initiatives pursued multiple objectives and global financial players started integrating the industry. No particular pattern seemed to apply to all projects.
- 2.21 Therefore, to assess a decade of MIF project activity, OVE had to develop a methodology to evaluate the MIF program. What resulted was a methodology that used a variety of tools. The evaluation comprised visits by the evaluating team to most of the executing agencies in charge of the projects. It also incorporated the results of a survey sent to all MIF executing agencies. In addition, the evaluation was supported by in-depth Case Studies of a representative sample of the projects and standardized Project Briefs on all the other projects (Appendix 1 contains an example of a Case Study, and Appendix 2 of a Project Brief).
- 2.22 The results have been compiled using a standardized methodology that measures projects against seven dimensions that OVE and the MIF agreed were important

- to highlight the particular performance of MIF projects. The first three dimensions, relevance, effectiveness and efficiency, are typical of all evaluations.
- 2.23 Relevance measures the degree to which the interventions match a market need. In the case of MIF, needs are more difficult to ascertain, as they pertain to the private sector, within which many different participants play a role.
 - 2.24 Effectiveness measures the extent to which stated goals were actually achieved. It does not, however, assess the appropriateness of the goals, a dimension that gets captured within relevance.
 - 2.25 Efficiency deals strictly with the input-output relationship. Namely, the amount of inputs, financial or otherwise, that was necessary to achieve a particular output. The dimension falls short of addressing events that go beyond the outputs, such as outcomes or impact, as those dimensions get captured under effectiveness and relevancy, as long as they had been made explicit goals of a particular project.
 - 2.26 The other three evaluative dimensions are specifically tailored to the MIF. These are the dimensions of innovation, sustainability and additionality. Innovation relates to the degree to which a particular intervention introduces products, services or processes that are new to a particular market. In some cases, not only would they be new to a local market, but they would also be untested anywhere else. Furthermore, successful innovations would likely be imitated, producing what we call “demonstration effect”.
 - 2.27 Sustainability relates to the ability of the executing agencies to carry on with the provision of the goods or services produced via the projects, even after MIF funding ceases. Executing agencies are critical to the sustainability of interventions, as it is the process by which they are selected, monitored and institutionalized that they become owners of the results.
 - 2.28 Additionality measures the extent to which MIF participation has been essential for the intervention to take place. There is an additional meaning to additionality which we call “catalytic effect” that comes about when related products or services are produced without even having had the benefit of direct MIF funding.
 - 2.29 Finally, a separate dimension relates to evaluation issues. Evaluation characteristics are instrumental to the development of accountability. For instance, without appropriate evaluability at the project design stage, there are no clear goals to maintain accountability. Monitoring and impact evaluations are also essential feedback loops that enable improvements in current and future interventions. The absence of those characteristics as built-in components of the project design leads to the production of sub-par results and a cycle of repeated mistakes.
 - 2.30 Due to their design, a majority of MIF projects are technically impossible to evaluate. Only about one third of MIF projects in the financial reform and capital market development areas have developed a baseline against which to assess

implementation progress. Even fewer projects have developed outcome indicators beyond those measuring the narrow implementation progress of project activities.

- 2.31 The utilization of this methodology gives a structure to an evaluation exercise that otherwise would have faced significant challenges. Findings and lessons learned are offered as a forward-looking, learning opportunity.

Table 2.3: MIF Evaluative Dimensions

EVALUATIVE DIMENSIONS	PROJECT STAGES		
	A. EX-ANTE	B. EXECUTION	C. EX-POST
1. RELEVANCE	1.A Needs Diagnostic	1.B Demand for Services	1.C Market Generation
2. EFFECTIVENESS	2.A Risk Prevention	2.B Flexibility	2.C Project Output
3. EFFICIENCY	3.A Resource Allocation	3.B Administrative Management	3.C Productivity
4. INNOVATION	4.A Product Innovation	4.B Process Innovation	4.C Demonstration Effect
5. SUSTAINABILITY	5.A Partner Analysis	5.B Partner Monitoring	5.C Institutionalization
6. ADDITIONALITY	6.A MIF Value Added	6.B Synergies	6.C Catalytic Effect
7. EVALUATION	7.A Evaluability	7.B Monitoring	7.C Impact Evaluation

III. EVALUATION OF FINANCIAL REFORM AND CAPITAL MARKET PROJECTS

- 3.1 This chapter summarizes the results of an in-depth evaluation of fifty-one financial reform and capital market projects (Annex III contains a detailed description of the evaluation of the projects). The list includes completed projects and those currently in implementation between the years 1993 to the end of 2001. The evaluation comprised visits by the evaluating team to 72% of the executing agencies in charge of those projects. It also incorporated the results of a survey sent to all MIF executing agencies and the completed responses on the part of 53% of those agencies.
- 3.2 In addition, the evaluation is supported by in-depth Case Studies of 37% of the projects and standardized Project Briefs of the remaining 63% of the projects. The Case Studies and Project Briefs were prepared by interviewing executing agencies, project beneficiaries, competitors, strategic partners and other relevant parties.
- 3.3 Bank Group documentation such as Country Papers, project documents, mid-term and final evaluations, project completion reports (PCRs) and MPPMRs were also analyzed. Supporting written information was also gathered from government and industry sources in the countries where the projects took place. The MIF project files maintained in Country Offices were a particularly rich source of information. These included feasibility or sector studies (when they existed), project design documents, consultant terms of reference, plans of action, MPPMRs, official Bank documents for time extensions, transfers of budget resources between categories and official Bank correspondence.
- 3.4 The results have been compiled using a standardized methodology that measures projects against seven dimensions that OVE and the MIF agreed were important benchmarks against which to measure projects: relevance, effectiveness, efficiency, innovation, additionality, sustainability, and evaluability. In addition, general portfolio statistics on project execution have been compiled to serve as quantitative benchmarks.

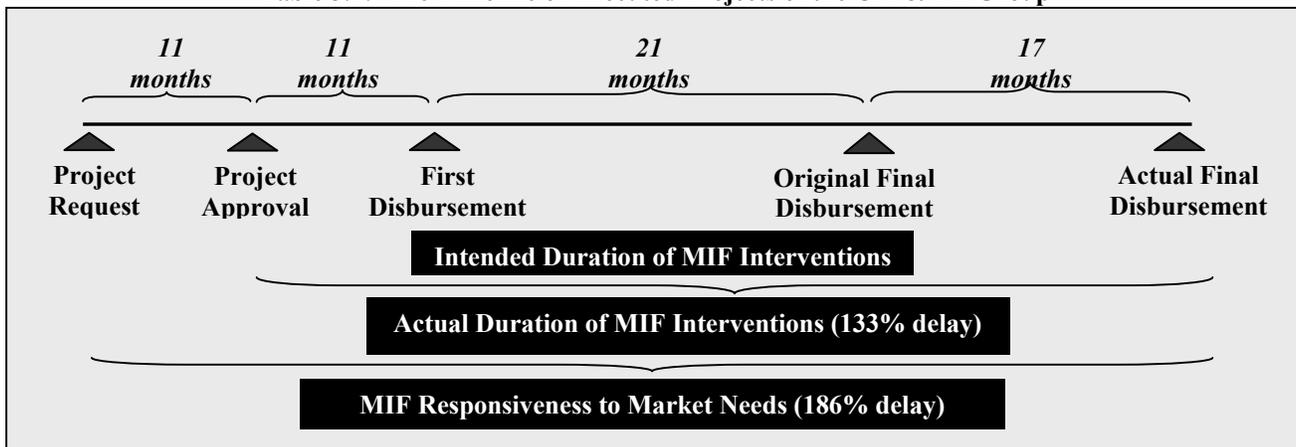
A. Portfolio Analysis of the Financial Reform and Capital Markets Projects

- 3.5 With information contained in the MIF Project Performance Monitoring Reports (MPPMRs) and information gathered from the Executing Agencies, the evaluating team developed several metrics related to time elapsed during the project life-cycle, such as the time between approval and first disbursement or the time extension as a percent of the original disbursement period.
- 3.6 It becomes clear immediately that most projects take significantly longer to execute than initially planned. The average project is designed to be executed in 28 months, but it actually takes 47 months from the time of approval until final disbursement. Of this delay, an average of 11 months is spent meeting conditions

precedent to the first disbursement. An additional 8 months are spent on project delays during execution.

- 3.7 To assess the MIF’s responsiveness to executing agency requests, we have built a metric that starts counting from the time each request for technical cooperation is officially logged onto the Bank’s system. Such a metric is intended to provide an indication of the lag between when the MIF received the project request from the executing agency and when the project is approved by the Donor Committee.⁸ This delay averaged 11 months, making that an average project planned for 21 months of execution actually take a total of 60 months from request to final disbursement, when delays of 11 months, 11 months and 17 months are added before and during execution, due to approval, first disbursement and final disbursement delays respectively.

Table 3.1: The Timeline of Executed Projects of the CM & FR Group



- 3.8 There are two very long delays in processing a project: the first delay is the time between project request and its subsequent approval; and the second delay is the time between project approval and first disbursement. The first delay represents the time that Country Offices take in forwarding project proposals to Headquarters and the Headquarters approval process. The second delay between project approval and first disbursement can be attributed to the inability or unwillingness of executing agencies to implement projects in a timely fashion.

- 3.9 Financial reform and capital market projects (from initial project request to final disbursement) have run five years or more. This confirms the experience of the World Bank and other multilateral development institutions that institution-building is a lengthy process⁹. It has been found that development of the legal/regulatory framework and capacity strengthening of regulatory bodies such

⁸ Even this metric underestimates the delay between official receipt of the project request and its approval, since informal project preparation may take place for months and even longer than a year before the executing agency forwards an official request. Only the official request is logged onto the Bank’s system and project time elapse begins. Thus the official indicator underestimates the actual delay that takes place between the first expression of interest by a potential executing agency and the MIF’s official response.

⁹ World Bank, *Annual Review of Development Effectiveness, 2001*, Washington, DC.

as bank, securities, insurance and pension supervisory agencies may take a decade or longer.

- 3.10 The MIF now has a decade of experience in which the majority of its projects have run five years or longer and frequently there have been follow-on projects. Despite this experience, the MIF has been reluctant to increase the implementation time frame for its projects or to enter into multi-stage projects. The MIF has insisted on single-stage projects that are implemented in an 18 to 24 month period. With respect to institution building, this may be unrealistically short. Moreover, by designing short project execution periods in its loan documentation, the MIF has been earning low marks for project implementation progress (IP) as few, if any, projects are completed in this time frame.
- 3.11 In addition to the time measurement data, the MPPMR's also provide an assessment of other implementation progress (IP) and the likelihood of reaching development objectives (DO). In 2000 and 2001, there was a total of 31 financial reform and capital market projects being tracked by the MPPMR system.¹⁰
- 3.12 In 2000, eight financial reform and capital market projects were reported as having had unsatisfactory implementation progress ("yellow flag")¹¹ and an additional five were also classified as having had a low probability of attaining their development objectives ("red flag").¹² In 2001, the number of financial reform and capital market projects that were classified as unsatisfactory or "yellow flag" and as very unsatisfactory "red flag" fell to four each. In 2002, the number of "yellow flags" fell again to three but "red flag" projects remained at four.
- 3.13 Between the first MPPMR's prepared in 2000 and those prepared in 2001 and 2002, the reported IP and DO results seem to have improved steadily after 2000. Since it is unlikely that implementation progress and achievement of development objectives improved markedly from one year to the next, another dynamic may have been at work. According to some interviewed, the first round of MPPMR's in 2000 generated pressures for cancellation of under-performing projects under not very clear rules. In turn, this created a strong incentive the following years to show conformance with project objectives so that projects would not be cancelled. The method in which MPPMR information is collected and its subsequent use given to the findings during the first round of MPPMR's may have altered the transparency of the process and diminished its value as a management tool. An

¹⁰ The MPPMR system was implemented starting in 2000. About 16 financial reform and capital markets projects had already concluded execution by that time and therefore were never tracked by the MPPMR system. In the years 2000, 2001 and 2002, the number of financial reform and capital market projects tracked by the MPPMR system are 22, 23 and 26, respectively.

¹¹ A yellow flag project is defined as any project that has unsatisfactory (U) implementation progress or a low probability (LP) of obtaining its development objectives.

¹² A red flag project is defined as any project that has very unsatisfactory (VU) implementation progress, an improbable (I) chance of obtaining its development objectives or the combination of unsatisfactory (U) and low probability (LP).

important advance was the introduction in 2002 of a protocol of automatic triggers for project cancellation, which could simplify and make cancellations into a less painful process.

B. Relevance

- 3.14 MIF project relevance was defined as the extent to which MIF projects were directed toward key themes and requirements that would allow financial and capital markets to grow. These key growth needs and removal of “bottlenecks” to market growth are usually well identified by country policy-makers and the Bank in the Country Papers and MIF project documents.
- 3.15 Overall relevance of MIF projects in the areas of financial reform and capital markets is fairly high, as a reflection of the influence of financial matters on the private sector. However, a finer judgment on relevance would reveal a number of areas of opportunities for improvement: sufficient “due diligence” should have been undertaken so that projects were directed toward quantitatively important industries; the project should have engaged the key players in the industry and there should have been a demand for this type of intervention. Mechanisms should have been incorporated into the project so that clients and markets could have provided “feedback” to the Bank/MIF that would analyze the cost and quality of the financial and capital market services, the willingness of clients to pay for these services and their willingness to become “stakeholders” in the project.
- 3.16 The evidence indicates that less than 30% of the projects were guided by diagnostic or sector studies. During the design stage, it was found that MIF financial reform and capital market projects tended to use informal means to verify that a project had a good likelihood of being relevant to the country and sector priorities.
- 3.17 Despite this lack of market knowledge, a clear majority of projects in financial reform and capital markets seem to have been in accord with country strategies, Bank strategy and industry needs. Perhaps this was a reflection of the fact that needs were so diverse, that it was difficult to work on a subject where there was not an underlying need. Less than 15% of financial reform and capital market projects were regarded as non-relevant to the context of the country, the context of the private sector or the context of the financial industry. However, with few exceptions, project documents did not provide evidence of the country’s strategy as laid out in Country Papers and how a project will help to fulfill those objectives.
- 3.18 The relevancy of a project is highly dependent on the definition of its intended beneficiaries. According to data gathered during the evaluation, about one third of the benefits accrued to the executing agencies themselves, not being significantly relevant to any other party. The general public receives one fourth of the benefits, financial institutions of the country about one fifth, with the

remainder split among SME's and Investors. Overall, it seems that projects in the financial reform and capital market area benefited first the executing agencies themselves, later the financial institutions and the general public; and lastly, the SME's and investor community. It is interesting to note the three tiers of perceived benefits that derive from these findings and whether it was the intent of the MIF to relegate to last place the SME's and private investors as project beneficiaries

- 3.19 Executing agencies and/or their clients are presumably more inclined to pay for services that are relevant for them. However, notwithstanding the strong indications of relevancy above, almost half of the clients displayed a low or very-low inclination to pay for the services provided under the projects. That is, about half of the services provided under MIF projects would no longer be paid for upon termination of the project, casting doubts on the long-term sustainability of these projects.
- 3.20 Finally, we measured the perception of services received under financial reform and capital market projects, in terms of affordability and quality as judged by the final client. This is necessarily a subjective evaluation, but the question does give an indication of the general level of "market satisfaction". A small percentage of the respondents (18%) rated project services provided under financial reform and capital market projects as both high in quality and affordability. Almost half of the respondents (49%), however, had mixed reactions to the results; with some projects being characterized as providing affordable services but also low quality and other projects being characterized as not affordable but having achieved high quality. Almost one-third (30%) of the respondents characterized the projects as neither affordable nor high quality, raising significant questions as to the project design objectives and/or implementation capabilities.

Box 3.1: When the Poor May Stand to Lose its Deposits – A Case of High Relevancy

Half a million small savers representing fifteen percent of the banking system's deposits are in unregulated micro-finance institutions. And with small deposits in micro-finance institutions growing by 10% per year, the danger gets larger each year. This was the case in Bolivia in 1993-1996 when unregulated micro-finance institutions experienced rapid growth in small deposits and some of them started to have difficulties. A failure of this magnitude would have dire consequences for the banking system and poverty alleviation.

In Bolivia, the MIF responded with the Strengthening of the Intendancy of Non-Bank Entities (ATN/MT-5946-BO) project. This MIF project, begun in 1997, set out to impose capital standards and prudential regulations on micro-finance institutions and to establish a credit bureau to track the risk of retail borrowers. For the first time, the Bolivian public could get information on the financial condition of non-bank financial institutions and have an informed view of where they should put their savings.

Similarly, the micro-finance institutions could now get credit information on six hundred thousand retail borrowers. Thirty-five micro-finance institutions became members of the credit bureau and collectively they make up to five thousand credit inquiries each day. Deposit and loan growth have resumed in Bolivia's micro-finance sector, and although solvency problems have not been banished forever, they remain under the Intendancy's tight control.

The MIF's intervention was relevant and timely. The project, along with an improving economy, helped the Intendancy of Non-Bank Entities to stem the tide of micro-finance failures through their capital strengthening and merger with stronger institutions. And, in the economic slowdown of 2000-2001, the strength of micro-finance institutions was tested again and they performed relatively better than the Bolivian commercial bank sector.

C. Effectiveness

- 3.21 Effectiveness measures the extent to which stated project goals were actually achieved. It does not, however, assess the appropriateness or ambitiousness of the goals, a dimension that gets captured within relevance. Overall effectiveness of the financial reform and capital markets projects is fairly high as well, but mostly because goals are not ambitious enough. However, a number of elements stand out as key to improving overall effectiveness, such as how well the project adapted to unforeseen internal administrative events and external financial crisis. Banking and financial crisis have been reoccurring events that can change project goals and in fact were the most commonly cited reason for poor project effectiveness. Moreover, political changes frequently caused executing agencies to alter their priorities and require design changes. Political instability and leadership changes were cited as the second most frequent cause for poor project effectiveness.
- 3.22 It was not unusual for executing agency priorities to change or for a severe financial crisis to occur that required the project design to adapt to the new circumstances. It was found that financial reform and capital market projects were able to adapt to the changing needs of clients, external events and to required changes in the original project design only in about one-half of the cases. In the other half of the cases, the evidence indicates that although government and executing agency priorities had changed, the project design was not altered and the project continued disbursing as originally planned.
- 3.23 The comparative inability of projects to adapt to changing circumstances was due, in part, to a certain lack of flexibility on the part of the Bank Group. According to evidence derived from country office documents, mid-term evaluations and MPPMRs, three quarters of the projects faced a low flexibility on the part of the Bank Group when circumstances changed during execution. In some exceptional cases, however, MIF has shown that it can significantly increase project effectiveness by being responsive and flexible.
- 3.24 Although in the great majority of cases the evidence indicates that the Bank / MIF acted with speed when administrative changes were required, this swiftness was not accompanied by “flexibility to accommodate changes” when they become necessary “to better achieve project results”. A rigorous execution of planned project activities seems to have been the primary objective of the Bank Group, regardless of the changing circumstances during project execution. This turned out to be a dangerous proposition, as projects planned for execution over an average of 28 months, actually took more than twice the time from the request by the executing agency.

Box 3.2: When Political Change Undercuts Effectiveness – The Case of Brazil’s Supplementary Pension System

Brazil’s private pension system needed an overhaul. In 1977, Brazilian law permitted private pension plans to supplement benefits provided under the public social security system. The accumulated contributions amounted to more than 13% of Brazilian GDP, but the supervisory authority had insufficient resources to oversee the system and was badly in need of training and modern information technology.

In early 1998, the MIF approved a project for the Supplemental Pension System Secretariat (SPSS) of the Ministry of Social Security (BR-5949, Supervision of Private Pension Funds). The MIF would help the SPSS to update the legal framework for private pension operation in Brazil; develop new actuarial models; and, train and equip the SPSS so that it would be capable of overseeing this growing system.

From the beginning, the project encountered problems. There was a failure to gain consensus on a key piece of legislation that would have made the Secretariat independent. Moreover, the effectiveness of the agency was compromised by the shortage of resources and personnel turnover. Delays compounded and the project is now in its fourth year of execution. The project was clearly addressing a relevant problem, but a series of adverse events seriously delayed the project. However important steps were achieved and the MIF intervention was instrumental in supporting technical studies of the legal framework and helping to improve the quality of supervision of private pensions of millions of Brazilians. In the end, it seems likely that the goals of the project may yet be realized, but the path has been arduous.

Box 3.3: Evolving Challenges of Financial Sector Reform and MIF Flexibility

A booming stock market, expansionary government policies and the issuance of high-interest debt securities, increased the profitability of Jamaica’s financial sector but masked its inherent weakness. High inflation encouraged the overvaluation of real assets, especially property, which often served as a guarantee for bank loans. The overheating economy subsequently caused the Government of Jamaica to take anti-inflationary measures, which quickly led to a severe liquidity and solvency crisis in several large insurance companies and asset values plummeted.

The crisis was not confined to insurance companies. The banking industry was also ailing; the insurance and banking sectors had, over the preceding years, become inextricably linked. Wide-ranging conglomerates owned banks, insurance companies and non-financial institutions and all were interconnected in a web of related party transactions. By late 1996, the Jamaican Government recognized that the entire domestic financial system had reached a state of distress; the investments of more than 500,000 Jamaican depositors, policyholders and pensioners were now at risk. Urgent action was needed to rescue and rebuild the financial sector. The companies approached the Government for assistance.

At the beginning of 1997, a new Government body was formed -- FINSAC Limited, (the Financial Sector Adjustment Company Limited). FINSAC was to develop a bailout plan for the whole financial system, but was understaffed and lacked the required expertise. In January 1998, the GOJ and the Bank entered into an agreement for the joint funding of technical and advisory assistance aimed at the strengthening of insurance regulation and supervision. FINSAC was appointed as the executing agency for this project. Additional funds were committed by the Bank in a sector reform program (1268/OC-JA). By March 2000, the Bank and the Ministry of Finance and Planning had developed a better insight into the seriousness of the situation and established a Task Force to complement the agenda of FINSAC. In April 2001 a new integrated regulatory body, the Financial Services Commission (FSC) was established with the mandate to monitor and regulate the insurance industry, pension funds, and the securities industry. The MIF approved the GOJ’s request to use project funding to assist in providing technical and advisory services to the Task Force and the newly formed FSC.

Despite a worsening of Jamaica’s macroeconomic situation and financial losses that represented 10% of the GDP, the financial sector reform program eventually achieved success. The MIF’s swift authorization of resources for the formation of a unified supervisory body helped to accelerate the rescue of the Jamaican financial system.

D. Efficiency

- 3.25 Efficiency deals strictly with the input-output relationship. Namely, the amount of inputs, financial or otherwise, that was necessary to achieve a particular output. The dimension falls short of addressing events that go beyond output, such as outcomes or measuring impact, as those dimensions should get captured under effectiveness and relevancy, as long as they had been made explicit goals of a particular project.
- 3.26 The most important determinant of project efficiency is time management. Project administrative and fixed costs accumulate as time passes. Disbursement rates are a good proxy for project advance, as disbursements are usually tied to project milestones.
- 3.27 Overall financial reform and capital market projects ranked poorly in terms of project efficiency. The loss of efficiency in projects, to a large extent, resulted from poor planning of activities during the project design stage. Less than 30% of the projects had adequately detailed the project activities, the resources that would be necessary for project completion or the time schedules for the various activities that would take place.
- 3.28 Similarly, just 10% of the projects had sufficiently detailed terms of reference for consultants and had adequately defined the budgets by project output or products. A somewhat better 35% of the projects had budget details by component.
- 3.29 Executing agencies had quite different views than the MIF on how they would have ordered budget priorities. In almost one-half of the financial reform and capital market projects, executing agencies would have boosted budget allocations for computer equipment, software systems and for training. Some of the public agencies were particularly interested in overseas training budget allocations, as funding for these activities from internal budget resources could usually not be found. Conversely, executing agencies would have reduced budget allocations for the legal and regulatory framework, consulting and institutional development.
- 3.30 MIF projects encountered serious delays, sometimes exceeding a year and a half. The data indicates that the most months were lost on getting legislation passed to enhance the legal/regulatory environment; an average of 19 months per project. The next largest delay (13 months) was in contracting consultants followed by implementation problems for particularly troublesome project components.
- 3.31 We have found evidence that the rate of disbursement can be a valid measure of project success when project goals are tied to disbursements. In most MIF technical cooperation projects, disbursements are in fact, tied to the attainment of specific goals defined within the project's sub-components. It was found that the rate of disbursement is positively associated with the completion of goals by project sub-component. This is an important finding and justifies the MIF's concern with maintaining a timely rate of disbursement in its projects.

- 3.32 The administrative requirements that posed the most problems for executing agencies were listed as contracting for goods (21% of projects had problems), contracting for consulting services (21% of projects had problems) and in meeting the requirements for disbursements (18% of projects had problems). Overall, 42% of projects had some kind of problem with Bank contracting procedures.
- 3.33 It was found that the ability of executing agencies to comply with Bank/MIF administrative and procedural requirements depended heavily upon how well Bank personnel (Headquarters and Country Office) had communicated the Bank's regulations to the executing agencies. The importance of good communication was highlighted. The evaluating team collected frequent comments on how well regarded and helpful the Bank's project implementation workshops were for the Bank's own projects. These workshops should be extended to MIF projects as well.
- 3.34 Executing agencies that have had previous experience working with the MIF/Bank or other bilateral and multilateral organizations were more likely to be more efficient at project administration. The evaluation examined a number of issues that dealt with executing agencies experience with the MIF and Bank and how well informed they were of MIF/Bank administrative procedures and requirements for project execution.
- 3.35 Somewhat less than one-half of the executing agencies had previous experience with the Bank, be it directly or through its key managers. More than 80% of the agencies had previous experience with the Bank or other bilateral or multilateral donor organizations and thus were acquainted with some administrative procedures and requirements.
- 3.36 Almost half of the executing agencies have not had previous experience with the MIF or Bank and therefore communicating Bank administrative procedures and requirements would have been crucial to project efficiency. However, it was found that only about one-fourth of executing agencies had received information on the MIF and Bank administrative procedures and requirements, including information on acquisitions, contracting and disbursements. The administrative difficulties reported above by the executing agencies are likely to be related to their lack of knowledge of MIF/Bank procedures.

Box 3.4: Implementation Performance and Development Objective Indicators for Financial Reform and Capital Market Projects by Institutional Nature of Executing Agency¹³

The question is often asked: Are private sector executing agencies more efficient at executing MIF projects than public sector executing agencies? The a priori presumption is that public executing agencies are more burdened with bureaucratic procedure and political interference than private entities and that this should result in less efficient project performance. In the Annual Performance Report of the MIF Technical Assistance Portfolio (MIF/GN-59, February, 2001), private sector executing agencies were found to have “more favorable” IP and DO indicators in both A&B countries and in C&D countries. The Report looked at all MIF projects in implementation, and on a global portfolio basis, found that private sector entities had faster disbursement times by a wide margin.

OVE again tested this hypothesis with respect to the financial reform and capital market clusters only and found that project performance appears to be roughly equal regardless of the institutional nature of the executing agency. Although the private sector appears to have been marginally more efficient at IP and DO performance than public sector executing agencies the differences were found to be small and not statistically significantly different. For example, in the Annual Performance Report, for all clusters in the MIF portfolio, the number of months between project approval and eligibility was 11 months for public sector executing agencies and 7 months for private sector executing agencies. For the financial reform and capital market clusters only, the number of months between approval and eligibility for the public and private sectors were found to be 8 months and 7 months, respectively.

The different results between the Annual Performance Report and this evaluation may be due to the fact that financial reform and capital market projects typically work with central banks, finance ministries and supervisory agencies. These types of public agencies are known to be among the better-run ministries and public agencies in government. Moreover, financial reform and capital market projects almost always have a legal/regulatory component that must await legislative or executive branch approval. It may be that public and private sector executing agencies are equally dependent upon the passage of enabling legislation and this waiting period cancels out any efficiency differences.

Box 3.5: When Good Ideas Aren’t Enough – A Project Falter on Poor Efficiency

The project team set about to create a credit guarantee system for SME’s that would entice commercial banks into this type of lending. The project design was based on an innovative Argentine law to create a reciprocal guarantee company (SGR) that would guarantee commercial bank loans to small and medium firms. This company would operate under a new legal framework to be developed in the project and would be regulated by an entity within the Central Bank of Argentina that also would be developed in the program. It was hoped that commercial banks would now be willing to lend to SME’s with the guarantee of a well-regulated entity like the SGR.

But as innovative and as relevant as the idea was, the project design omitted crucial details that would later haunt the project. The role of the commercial banks was important to the project’s success but communications and negotiations with them were inadequate from the beginning. Similarly, the supervisory role of the Central Bank was also crucial to the project’s success, but they never seemed fully committed to the project and subsequently left the project altogether. These omissions of process and procedure can ruin the efficiency of project implementation. The project ultimately experienced three years of delay, hurting its efficiency significantly. Although in the end, an SGR system was established in Argentina, very possibly as a direct result of the MIF project, the path was difficult.

¹³ See Annexes for underlying data

Box 3.6: Regional Projects – Complex Designs Doomed to Inefficiency or a Hidden Opportunity?

It was found that regional projects posed special administrative difficulties given the number of players involved in each project and in each country. Their design should be simple and when complexity cannot be avoided, these operations should be broken into several simple sequential steps.

For example, the MIF funded three regional stock exchange projects to harmonize clearance and settlement procedures within a large number of exchanges in the Central American and Caribbean regions. In the TD questionnaire, the projects were characterized as having been only marginally successful, in part, because of the large number of exchanges involved. They were asked to solve complex technical issues in a harmonized fashion. Moreover, in some cases there was no tradition for regional cooperation.

Similarly, the MIF funded a LAC-wide regional project to train banking and securities supervisors so that financial supervision could be harmonized throughout the region (ATN/MT-5855- RG). There were at least three levels of complexity including, the inter-relationship between banking and securities authorities, the harmonization of supervision across the entire LAC region, and the large coordination effort required by the project itself. Again, only marginal results were achieved due to the complexity of the project and the large number of players involved in the project.

There may be however, an interesting aspect related to regional projects. It is probable that many results of consulting work or information systems developed during the course of a project could be useful to other countries. Regional projects were an attempt by the MIF to leverage those economies of scale and utilize elements across countries. The implementation, however, still poses many challenges, in part, because project personnel are not assigned to implementation across countries.

E. Innovation

- 3.37 The innovativeness of a project is defined in terms of the delivery of a new product or service or the improvement in the process or method of delivering an existing product or service. Innovation in projects was also demonstrated in terms of the amount of attention and inquiries the project attracted from outside entities, the degree of imitation of the project by others or its adoption into the “mainstream” of project ideas.
- 3.38 During the course of the evaluation, about half of the projects were classified as having some innovative elements. About forty-two different innovative elements were identified over a sample of 28 projects, which gives a fairly high ratio of 1.5 innovative elements per project. Innovation in financial and capital markets was most often related to new products (24% of the projects) followed by innovation in the processes for service delivery (19% of the projects), innovations in the legal /regulatory framework (12% of the projects) and innovations in financial technology (7% of the projects).
- 3.39 Overall, it appears that many MIF financial reform and capital market projects have incorporated innovative elements in their design and have managed to implement innovative products and processes. The evaluating team performed an independent evaluation in this area, concluding that many of the areas developed through the projects are perceived as innovations not only by the executing agencies, but also by the rest of the market participants in each one of the countries.

Box 3.7: Expect Lots of Visitors When You Innovate – The Bolivian Case is Becoming a Worldwide Benchmark for Microfinance Regulation

When officials from a dozen countries around the world visit your project, you must be innovating. Bolivia is a recognized leader in micro-finance institutions. More than most countries, micro-finance is disproportionately large in the Bolivian banking system in terms of deposits and loan volume. And micro-finance in Bolivia is a growing industry. They have successfully reached out to difficult markets and play a key role in financing poor households and micro-enterprises.

The growth and formalization of micro-finance institutions in Bolivia has occurred in part, due to their tight regulation. Unlike many countries, micro-finance institutions in Bolivia are as tightly regulated as commercial banks. The public, and especially the poorest segment of the public, has placed its confidence in micro-finance institutions that enjoy lower risk ratings than commercial banks. But this wasn't always the case. Before the MIF's Strengthening of the Intendancy of Non-Bank Entities (ATN/MT-5946-BO) project micro-finance institutions, in Bolivia as elsewhere, were having difficulties in operating in the regulated financial sector, given conditions for entrance (i.e. capital requirements), provisioning levels, and inappropriate supervision by the regulators (i.e. lending based on capacity and willingness to repay rather than on collateral). The MIF project helped the Bolivian authorities to develop innovative credit technology for micro-finance supervision and to impart this "know-how" to micro-finance institutions, as well as to adapt to a regulatory framework of greater competition in the provision of microfinance services to lower income segments of the population. This is what has attracted all the attention.

The MIF project financed the creation of an innovative micro-finance supervisory agency and credit risk management technologies especially for micro-finance institutions. The creation and operation of a successful credit bureau on line, with a registry of more than 600,000 borrowers reduced the information gap that usually restricts the access to credit of micro enterprises, reduced transactions costs, and lowered the barriers to entry for micro-finance institutions. Moreover, the bureau compiled information from non-regulated entities achieving a degree of information sharing that was new in Bolivia and LAC.

This was a key step in the consolidation of the microfinance industry in Bolivia, creating a facilitating environment for institutions to provide financial services to lower-income segments of the population. The success enjoyed by the Bolivian microfinance regulation project encouraged its implementation by the MIF elsewhere in the LAC region and has spawned a host of imitations around the world. The demonstration effects from this project have been remarkable and strengthen financial reform in frontier areas commonly overlooked.

Box 3.8: The Judiciary Goes to School – Peru's Bankers Host Innovative Training

The judiciary occupies a key position in Western society and so their views matter. For various historical reasons, a legacy of debt non-repayment had developed in Peru and the country's judiciary had become increasingly unfriendly toward lenders rights. This ultimately works to the disadvantage of the borrowing poor when even their collateral is not considered secure by lenders. If all segments of society are to enjoy access to credit, some kind of balance between borrower and credit rights must be struck.

The Association of Peruvian Banks (ASBANC) decided to do something about this. What if Peruvian judges could get a glimpse into the problems that bankers encounter when they make loans and try to recoup these loans in the face of an antagonistic judiciary? ASBANC held a series of seminars for Peruvian judges on the need to recognize creditor rights. And the MIF assisted this effort.

Peru's financial system had recently been opened to foreign competition and domestic bankers were ill prepared to meet this challenge. ASBANC asked the MIF for help with the institutional strengthening of IFB and with the design of training courses for Peruvian bankers (PE-5879, Program to Assist the Bank Training Institute, IFB).

The judiciary training program was one of many training modules developed under this program and was a huge success. The judiciary training module has attracted widespread attention. The Federation of Latin American Bankers (FELABAN) has adopted the IFB judiciary training program. IFB is now developing a

training module for its national Congress and is delivering (via internet and television) Latin America's first long-distance bank training programs.

This is a case of serendipity. Although the specific intervention was not anticipated in the original project document, the design of the project did allow for ... "conceptualizing and delivering a range of banking and financial training services". It is an example of what is possible when resources are placed at the disposal of innovative people and they are free to experiment.

F. Sustainability

- 3.40 Sustainability relates to the ability to carry on with the provision of the goods or services produced via the projects, even after MIF funding ceases. Even though the benefits of the reform sometimes outlive the executing agencies themselves, sustainability usually depends on the efficacy of the executing agencies institutional strengthening. An outcome that the evaluation found to be inextricably linked to the process by which executing agencies are selected, their level of commitment to the projects and on whether the services generate enough financial resources for their continuance.
- 3.41 Almost 90% of the projects failed to conduct an evaluation of executing agencies in terms of their institutional or financial capacity or their operational abilities. Similarly, almost 75% of the projects failed to analyze previous, relevant experience of the executing agencies, with similar type of projects.
- 3.42 The evaluating team assessed independently the quality of resources committed by executing agencies. Overall, we encountered a high level of commitment to the projects, both in terms of the assignment of high quality counterparts to projects and in terms of integration of projects into the mainstream of the organization's work.
- 3.43 The high commitment of executing agencies to financial reform and capital market projects is indicated further by the fact that more than 80% of executing agencies had assigned suitable and high quality technicians to the project; provided adequate budget and organizational support, adequate physical facilities and maintained work conditions conducive to institutional strengthening throughout the life of the project.
- 3.44 However, in the area of financial support, the executing agencies seemed ill prepared to provide on-going support for the future sustainability of projects. Of the thirty-three financial reform and capital market services sampled, only eight (24%) covered their costs with the existing level of fees. The remaining services would require a significant increase in fees in order to be sustainable. About six services (18%) would have had to boost their fees by at least 20%. Even more seriously, the remaining 19 services (58%) would have had to boost their fees by at least 50% to assure the financial sustainability of the projects.

- 3.45 More than 75% of executing agencies run continuous deficits. About 50% of all executing agencies run annual deficits larger than US\$200,000 per year. Another 25% of the agencies run annual deficits between US\$50,000 and US\$200,000. These deficits are somewhat biased upwards by the presence of public executing agencies whose objective is supervision and not strict budgetary balance. The data, however, gives an indication of the need for supplemental resources to keep the services and the agencies operational. The combined deficits of all the supervisory agencies engaged by the MIF in both the financial reform and capital market runs on the order of US\$6 to US\$12 million annually, a figure comparable to annual MIF project approvals in the area.
- 3.46 The inability of executing agencies to commit cash counterpart funds and to generate fees for their continued operation is a serious issue. The MIF's use of counterpart funding as a test of the executing agencies commitment to the project has been a burden to many executing agencies. Many of these agencies are truly resource constrained and project delays have resulted from the executing agencies' inability to assign resources to the programs. The criteria for recognition of resources as counterpart contribution is also highly variable and allows for normal operating expenses to be recognized and, in some cases, to be artificially augmented in order to facilitate the fulfillment of counterpart requirements.

Box 3.9: If at First You Don't Succeed – The Case of Panama's Securities Commission

The odds seemed insurmountable. The Congress delayed more than two years passing securities legislation and private interest groups were mounting a lobbying effort to soften the impact of regulation. Budget support for the new Commission was late in coming and getting consultants on board was bogged down in contractual procedures. Would Panama's new "Comisión Nacional de Valores" ever get on top of the burgeoning growth in the country's capital markets and its serious problem with money-laundering?

Persistence paid off. Despite myriad project implementation problems Panama's Comisión Nacional de Valores (with the help of ATN/MT-5785-PN, Strengthening the Securities Commission) has evolved into a credible securities supervisory authority with a better degree of independence from the Ministry of Finance. The CNV of Panama has signed memoranda of understanding (MOUs) with the International Organization of Securities Commissions, the Council of Securities Regulators of the Americas and with Ibero-American Institute of Securities for specialized training and sharing of information. The CNV is now an active participant in the international struggle against money laundering in that country's offshore banking center. In MIF terminology, the CNV has achieved sustainability.

The problems associated with institutional strengthening of Panama's CNV are not unusual. These are complex undertakings involving the legislative and executive branches of government, the public and private sectors, the MIF, Bank and consulting firms all interacting with the executing agency. But in the end, the sustainability of the project will be determined by the persistence and desire of the executing agency to reform and modernize itself.

Box 3.10: A Learning Curve – The Case of MIF Supported Commodity Exchanges

MIF funded several projects in support of commodity exchanges. More than US\$3 million of MIF resources have been committed to projects in seven countries. Most beneficiaries were undercapitalized, private companies with good intentions, but little experience in the business.

An example of this was a project in Panama. This country was late in joining the General Agreement on Tariffs and Trade and opening up agricultural trade with its Central American neighbors. Its domestic agricultural marketing system was under state domination and inefficiencies abounded. When the private

sector turned to the MIF for help in establishing a modern commodity exchange (ATN/MT- 6665-PN Commodity Exchange Support Program), there could be no doubt as to the project's relevance and need.

But the need for a project does not guarantee its ultimate sustainability. After an initial surge in interest and trading activity by the private sector, the Bolsa Agrícola y Industrial S.A. (BAISA) has run into problems. BAISA's volume and margins are deteriorating. Its annual income is now less than one-half what would be necessary for its long-term viability. The continuing operational problems of BAISA rest, in large part, due to its low initial capitalization. The MIF's contribution to the project was relatively high and BAISA's low counterpart funding cast doubts on its commitment to the project.

After much trying, the MIF project development system seemed to be learning from past mistakes. A too "green" project request was turned down in Peru and strict new requirements were placed on a request from Venezuela. A Venezuelan project was funded for BOLPRIAVEN S.A. in 2000. This time, savvy, well-connected managers developed a viable business with the help of MIF. More than 100 shareholders capitalized the company, representing almost all of the industrial buyers of commodities in Venezuela. Shareholders committed to bring their purchasing needs to BOLPRIAVEN. In addition, the commercial banking system provided volume to BOLPRIAVEN by pledging investment in commodity-based investment certificates held in their portfolios. It seems that after several unsatisfactory experiences, the MIF found a way to absorb key lessons on how to support the development of dynamic commodity exchanges.

G. Additionality

- 3.47 Additionality measures the degree to which MIF resources were instrumental in promoting the project. We also distinguished a second sense of additionality in the assessment of whether the project held important lessons for similar projects or offered insights into how executing agencies and/or the MIF can manage similar projects or processes.
- 3.48 Overall, the evidence indicates that the MIF ranks high on additionality in finance and capital market projects. In a majority of cases, these projects would not have taken place without MIF assistance. More specifically, in somewhat more than one-half of projects, there was strong evidence collected by the evaluating team that the projects likely would not have been realized without the financial assistance of the MIF.
- 3.49 With regard to the second sense of additionality, that is, the ability for a project to impart important lessons to other MIF projects, there is strong evidence that the processes used by the MIF to achieve coordination among projects and to systematically bring additional value-added to other projects are not effective.
- 3.50 The evidence indicates that the MIF has a relatively higher contribution during the design phase, when some lessons learned from other projects are incorporated. This value-added, however, almost entirely disappears in the execution phase where previously ineffective approaches are attempted again and again. This pattern, however, seems to be broken in the fortuitous cases in which a knowledgeable professional in the Country Office is in charge of monitoring similar projects.

- 3.51 The relationship of MIF projects with the rest of the activities of the Bank Group was marginal at best. In more than 80% of the cases analyzed, no additionality was derived from synergies with Bank Sector Reform and Multisectorial Credit Programs. Only in about 20% of the cases, where the executing agencies of both the MIF and the Bank projects coincided, was there some degree of interaction. Such interactions were also more likely in countries like Costa Rica and Uruguay where country planning was more integrated. In addition, the coordination among MIF projects in the same country was also limited to less than one third of the projects, except for cases like Bolivia, where the MIF executing agencies coincided under the same organization.
- 3.52 Finally, two issues related to additionality need to be resolved: (1) Role of MIF vis-à-vis the rest of the Bank Group and (2) Approach to working with already accomplished, profitable executing agencies, where purely financial additionality may have been questionable.

Box 3.11: Additionality While Working With The “Winners” – The Case of Mexico’s INDEVAL

Mexico’s entry into the North American Free Trade Agreement (NAFTA) brought profound changes in how the country’s financial sector would do business. Under the Treaty, the country committed itself to the very highest prudential standards and safe and secure clearance and settlement systems were key among these concerns.

Stocks trading in the Mexican stock exchange were still dependent upon their brokers to perform the clearance and settlement function. This was too much risk and not in accordance with best international practices or with the NAFTA Treaty. The Institución para el Depósito de Valores (INDEVAL), which had been the clearinghouse of the Mexican Stock Exchange since 1978, decided to embark upon a far reaching program to become the counter party to each trade and effect first bilateral and then multilateral netting of transactions. Few stock exchanges in the world had this capability. They turned to the MIF for assistance in this endeavor.

The project was a complex undertaking and had seven subcomponents: a) the regulatory framework for the operation of a clearinghouse; b) a financial plan of clearinghouse fees and operating cost; c) internal auditing standards consistent with Mexican and international standards; d) a financial safeguard system that would measure risk from each clearinghouse member and require initial and callable capital contributions from members; e) the project will revise INDEVAL’s organizational structure, by-laws, operating procedures and corporate governance; f) risk management training will be provided to the staff of INDEVAL, the Mexican Stock Exchange and the securities regulatory authority CNBV; and, g) domestic and foreign investors would be informed of the results of the project to encourage their greater use of the Bolsa Mexicana.

Despite the complexity of the project, the goals of the project were surpassed. Secure clearance and settlement, at least in part, contributed to the Bolsa Mexicana’s ability to grow many fold since the project and INDEVAL is financially self-sufficient and has long-term sustainability. The MIF helped INDEVAL to get badly needed legislation and bring in world-class advice.

But this project also highlights a potential contradiction between working with competent and well-organized executing agencies and the additionality characteristic. Frequently the most competent executing agencies are also the most self-sufficient and perhaps not in dire need of MIF resources. If so, this means that the MIF will only be working with the least fortunate executing agencies and we should expect many troubled projects. It must also be noted that in the case of INDEVAL, although financial additionality may not have been as high, there was significant additionality from MIF explicit commitment to technical support for the passage of vital legislation. Moreover, the MIF facilitated the use of world class consultants from the largest clearinghouse in the world.

Box 3.12: How Less Than \$1 Million in MIF Resources Helped Generate More Than \$50 Million in New Business for Private Insurers in Bolivia

In 1998, Bolivia overhauled its nearly century-old insurance law to bring it into accord with current international standards. The new insurance law created a modern system for regulation, oversight and independent supervision that was expected to bring transparency, efficiency and better creditworthiness to the fledgling insurance industry. As part of the new law, foreign companies were allowed into the market. At the same time, a mandatory 35% capital reserve increase was imposed on existing companies, partly to motivate them to merge with foreign ones. Additional limitations were imposed on the investment portfolio of insurance companies, especially limiting the holdings of real estate.

Insurance premiums have grown to about US\$102 million in 2001, almost double the volume registered in 1995. In the same period, the capital of insurance operators grew from US\$26 million to US\$64 million and investments under their management from US\$34 million to US\$228 million. Insurance premiums as a percent of gross domestic income also doubled from 0.8 percent to 1.6 percent.

A MIF project was approved in 2000 to help strengthen the insurance regulatory body. The newly created Superintendencia de Pensiones Valores y Seguros (SPVS) was charged through its Intendencia de Seguros with regulating the sector and fostering private participation. However, the new entity lacked adequate technical expertise, especially in actuarial issues and the capability to audit and monitor the 19 insurance firms in the industry. Moreover, funding of the entity was based on a percentage of the assets of the underdeveloped insurance industry.

In good part, as a result of the MIF project, the SPVS managed to automate its supervision systems bringing them into conformance with the “General Core Principles of Insurance Supervision for Emerging Markets” as established by the International Insurance Supervisors Association. In addition, with the lead of the SPVS, new business was generated for the private insurance industry. The life insurance component of the Bolivian pension system was put out to bid for private insurers to manage. As a result, a reduction in the cost of insurance benefited more than 675,000 Bolivians and the insurance industry added more than US\$40 million in annual premiums. Additionally, the SPVS, in collaboration with the private sector, launched a mandatory auto insurance liability coverage that added another US\$10 million to the annual premiums of private insurers. The less than one million dollar MIF project had been instrumental in strengthening supervision and in bringing more than US\$50 million in new annual business to the private insurance industry and providing private business and citizens with improved access to high-quality risk management services.

H. Evaluability

3.53 This dimension examines the extent to which financial reform and capital market projects were designed to yield measurable results. Were the indicators appropriately defined? Was an adequate level of resources budgeted for project evaluation activities? And were project evaluations conducted objectively, in a timely fashion and did they provide valuable lessons learned that were later disseminated?

3.54 A caveat is important here. An unknown, but perhaps significant, portion of MIF project output is not easily measured. To some extent, the MIF has been operating as a laboratory for development ideas and has been in the business of “changing perceptions about the world”. During our interviews and interactions with executing agencies, we found that exposure to international best practices has had a significant impact on the way public and private executing agencies think and do business. Needless to say, this is difficult, if not impossible, to

- measure. Therefore, for some of the more innovative MIF projects, it is possible that some of what the MIF has accomplished will go unmeasured as the indicators are qualitative and subjective.
- 3.55 We have distinguished three elements of a project's evaluability: *baseline data* which is usually collected in feasibility or sector studies during the design stage of a project; *project goals* that are stated in measurable terms; and, appropriately selected *benchmarks* that are also stated in measurable terms.
- 3.56 Overall, the evaluability of financial reform and capital market projects has been very low. Only about 20% of the projects have fully developed baseline data, against which to compare project results. Only 25% have established a complete set of goals against which to measure project results. Virtually no projects used benchmarks to help in the definition of project goals and to guide project execution. Taken as a whole, less than 20% of all the projects met minimal evaluability criteria, meaning that they had adequate baseline data, goal indicators and project benchmarks.
- 3.57 The Project Performance Monitoring Reporting system (MPPMR system) that MIF started to conduct in 2000 was often the only formal monitoring mechanism. However, it was found that project monitoring content was highly informal, depending heavily upon the personal initiatives of project officers in Country Offices. Despite its undeniable merits, the MPPMR mechanism sometimes failed to expose serious issues in a timely fashion. For example, only in one-quarter of the cases MIF project performance was tracked in any additional depth by means of intermediate project evaluations.
- 3.58 With respect to project final evaluations, an anomaly was found. A majority of financial reform and capital market projects ended up allocating financial resources to perform final evaluations, but only about one half of the projects had budgeted resources for evaluation activities. Notwithstanding, almost \$ 1 million were specifically budgeted for evaluation activities according to project documents. Actual evaluation expenditures were even higher as many projects ended up redirecting some of the resources originally budgeted for contingencies and general expenditures.
- 3.59 The evaluation component of MIF projects seem to be treated more as an administrative requirement than a useful management tool to advance institutional learning and promote lessons learned for future project design. Final evaluations are often kept in the country offices files without any further use. The MIF needs to examine closely the purpose of project evaluation, how they are done and how this information is utilized.
- 3.60 Finally, impact evaluations were rarely planned or conducted, leaving MIF with an incomplete understanding of the aggregate results of the interventions or their medium /long term implications.

Box 3.13: The Need to Measure – Evaluability in MIF Projects

Ideally, each MIF project would begin with a diagnostic study that provides baseline data, implementation progress would be monitored throughout the life of the project and the impact or results of the project would be evaluated at the end. Donor governments, more than ever, are looking for accountability and measurement of results, so these requirements will increase in future MIF operations.

MIF projects have always provided for a final evaluation and frequently for mid-term evaluations in particularly innovative or difficult projects. Since 2000, semi-annual reviews of MIF projects in implementation have been provided by the MIF Project Progress Monitoring Report (MPPMR). Still, the majority of MIF projects do not provide baseline data from which to measure progress.

The biggest deficiency in the evaluability of MIF projects evaluated has been the generic nature of project goals. “To develop private capital markets”, or to “lower the cost of intermediation” are so general as to be immeasurable. The “how, what and when” need to be specified if we are hope to measure the dimensions of MIF projects.

Box 3.14: The Impact of Democratization of Capital Markets in Peru

By the end of the decade of the 1980s, Peru had experienced its worse economic crisis in its modern history. The economic deterioration severely affected living standards and impoverishment rose while social and political fragmentation increased. Beginning in 1990, Peru embarked on a wide-ranging economic and financial adjustment program. Economic stabilization soon followed monetary and fiscal reform and goods and factor markets were opened up to foreign competition. A vigorous economic expansion was fueled in part by an extraordinary inflow of private foreign capital. Led by direct foreign investment, capital inflows jumped nearly five fold in 1993 and helped to fund the privatizations of public enterprises. The domestic banking system also experienced strong growth in deposits and demand for credit. Real GDP grew by nearly 9 percent on average for 1993-1995.

A MIF technical cooperation approved in 1995 (ATN/MT4909-PE) sought to increase and diversify the ownership and participation of Peruvians in state-owned enterprises undergoing privatization; to improve the regulatory framework of capital markets; and the institutional strengthening of the country’s stock exchange. Three different executing agencies participated: the Commission to Support Private Investment (COPRI), the Securities Commission (CONASEV) and Lima Stock Exchange (BVL).

Since then, an enviable track record of first class security issuances has ensued. The general public displayed an astounding level of interest in the capital markets, even on initial public offerings. The Citizens Participation Program (PPC) led by COPRI carried out more than 200 IPOs with special conditions for the general public. Shares in telecommunications, energy and mining companies were offered to the public.

Some of the issuances, such as Telefónica del Peru (TdP), managed to place 76% of the total capital issued in the hands of a large number of individual subscribers contributing amounts of US\$ 1,000 or less. Overall, individual Peruvian investors subscribed over 25% of Telefónica’s capital, but in other cases, such as the electrical supplier Luz del Sur this ratio climbed to 83% of total capital. In good part with the help of MIF, more than 400,000 Peruvians invested in the stock market for the first time and became partial owners of large privatized companies. TdP is already considered a case study and a landmark in the long process of recovering the trust of international investors in Latin America.

I. Summary of Project Performance

3.61 All projects analyzed were given a ranking corresponding to their relative performance in the seven dimensions utilized for this evaluation. Ordinal rankings were assigned indicating, in relative terms, a low, a medium low, a medium, a medium high and a high performance. The same methodology, scale and ordinal rankings were utilized by OVE in all of the evaluations of MIF projects conducted in parallel with the present one, which provides some degree of comparability across MIF Groups of Projects in areas different from Financial Reform and

Capital Markets. The overall rating of medium for this group of projects constitutes a promising result, as Financial Reform and Capital Markets development are complex tasks. As derived from the evidence, MIF can take well deserved credit for a good number of breakthrough activities in these areas and for having executed them at a level of performance comparable with other areas of MIF activity, such as Alternative Dispute Resolution or Microfinance activities.

Table 3.2 - Ranking of MIF Characteristics by Areas of Interest

Areas of Interest	Relevance	Effectiveness	Efficiency	Innovation	Sustainability	Additionality	Evaluation	AVERAGE
Financial Infrastructure	Medium	Medium	Low	High	Low	Medium	Medium	Medium
Financial Supervision	High	Medium	Medium	High	Medium	High	Low	Medium High
Insurance	High	Medium	Medium	Medium	Medium	High	Low	Medium High
Capital Markets	High	High	Medium	High	Medium	High	Low	High
Pension Reform	High	Low	Low	Medium	Low	Medium	Low	Medium Low
Commodity Exchanges	Low	Low	Medium	High	Medium	Medium	Low	Medium Low
TOTAL RATINGS	High	Medium	Medium Low	High	Medium Low	Medium High	Low	MEDIUM

- 3.62 The relevance of projects in the financial reform and capital markets groups had been unusually high for the development of the private sector. The exception was for commodity exchanges which had a low relevancy. These initiatives have had a direct or indirect effect on practically all financing activities of the private sector. In some cases, like in C and D countries, the direct effects of the MIF projects were very significant in terms of GDP and number of beneficiaries, dealing in some cases in areas whose importance was comparable to 10% or more of the GDP and the project reach extended over hundreds of thousands of beneficiaries. Five of the six areas of interest in these clusters were ranked high or medium high and after 1996, there was a tendency for the relevancy score to rise.
- 3.63 The effectiveness of projects in these clusters was average. Their effectiveness score was brought down by the pension and commodity exchange areas. In pension reform, there were just five projects and a poorly performing project in Nicaragua brought down the overall effectiveness score for the group. Similarly, in the area of commodity exchanges, the first projects done in this area were not effective and this lowered the score for the group as a whole. Over time, effectiveness seems to have declined somewhat from the early years and recently has stabilized at an average level. It was found that the effectiveness scores earned in this evaluation were significantly lower than the effectiveness or development objectives (DO) scores recorded in the MPPMR's. Almost two-thirds of the projects were ranked higher in terms of effectiveness in MPPMR's than in this evaluation. Just 3% of the financial reform and capital market projects in this evaluation were ranked higher in terms of effectiveness than by the MPPMR system.
- 3.64 Efficiency has been weak. This may have been a reflection of the complexity of the tasks at hand and the large number of players involved in these projects, but nonetheless a renewed efficiency effort is warranted. Financial infrastructure and

- pension reform projects scored lowest on efficiency and only the capital markets area was high. Over time, there was a decline in efficiency from the first two years of activity and the efficiency of projects has stabilized at a moderately low level more recently. Similar to the effectiveness characteristic above, it was found that the efficiency scores earned in this evaluation were significantly lower than the efficiency or implementation progress (IP) scores recorded in the MPPMR's. One half of the projects were ranked higher in terms of efficiency in MPPMR's than in this evaluation and in just 10% of the cases was the converse true.
- 3.65 The financial reform and capital market clusters scored high on innovation. Just insurance and pension reform scored average in terms of innovation while the other four areas of interest had highly innovative elements. Innovation meant in many instances the transfer of international best practices in supervision and financial markets organization. However, this was not the only type of innovation promoted by the MIF. In some cases, innovations that were not tested elsewhere were introduced; such as new financial products or new legislation. Innovation was very high in the early years of the MIF and declined somewhat in 1997-2000 before recovering to high levels in more recent years.
- 3.66 Sustainability has been a lingering struggle. MIF resources were needed to get the projects started, and subsequent to the completion of projects, more than 75% of the executing agencies had difficulties covering their costs. The majority of those agencies were public entities in charge of some sort of supervisory duty. This highlights the importance of budgetary commitments from the countries and a good alignment with their overall goals. Sustainability was particularly low in financial infrastructure and pension reform projects. On a more positive note, however, there appears to be a recent tendency for project sustainability to rise from earlier levels.
- 3.67 Additionality was also high, particularly in regulatory areas where market participants had a short-sighted interest in maintaining the status quo and capturing the short-term benefits of non-transparent, closed markets. Additionality has been particularly important in the C & D countries where 75% of the financial reform and capital market projects occurred. Not surprisingly, additionality has been highest in financial supervision, insurance and capital market areas. Over time, there has been no discernable change from the relatively high trend of additionality.
- 3.68 The evaluation characteristic scored lowest of all of the dimensions. In the early years of the MIF, some of the financial infrastructure projects had completed diagnostic studies in the project design stage allowing this area of interest to achieve an average score. All of the other areas of interest scored low on evaluation although there has apparently been a slight recent improvement. Notwithstanding this, the evaluation characteristic warrants a strong improvement effort as the current process fails to adequately capture lessons learned and disseminate these results.

IV. SUMMARY OF FINDINGS AND CONCLUSIONS

4.1 This chapter presents a compilation of the findings and conclusions derived from the evaluation of MIF activities in the financial reform and capital market clusters. The findings fall into two categories: specific and general. Specific findings are those related to the thematic areas of financial reform and capital markets. The general findings are related to administrative or procedural matters that affect all MIF project activity and not just financial reform or capital markets.

A. Thematic Areas of Financial Reform and Capital Markets

4.2 There is little doubt that the MIF needs to continue being involved with the financial and capital markets of LAC countries, as a number of priority areas continue undeveloped and previously familiar areas require additional follow up work.

4.3 MIF implicit strategy in financial reform and capital markets development does not recognize that the MIF has special characteristics that should influence its behavior. A detailed declaration of priorities and objectives is a first step and resources should be earmarked or allocated to support these priorities. The MIF organization will need to adapt and align itself to the new strategy so that its know-how and capabilities are employed in the most efficient manner;

4.4 MIF objectives in the financial reform and capital market areas fall into two distinct classes: long-term, infrastructure building objectives and short-term, market-responsive objectives. Planning horizons, resource allocation and the supporting organizational structure are different for each class of objectives. Long-term, infrastructure building objectives are more efficiently addressed through the development of core resources and expertise that provides support to individual projects. The MIF could consider creating a Centralized Services¹⁴ that provide support to this group of projects. There are significant economies of scale in the development of core resources. Developing them de novo for each project is both ineffective and inefficient;

4.5 MIF effectiveness depends heavily on executing agencies capabilities for project implementation. The timing and sequence of projects could be based upon executing agencies that are institutionally strong enough to undertake reform and development efforts. In a country with a history of poor performance, based on institutional weaknesses, MIF projects could be simple, single-purpose operations that concentrate on redressing institutional debilities. Early stage projects should be concentrated on institution building and not reform or development efforts.

¹⁴ This does not imply an increase in MIF personnel; centralized services can make use of the MIF's current technical capacity or could be obtained through a MIF technical cooperation or a management services contract.

- 4.6 MIF assistance is more effective when there is a strong policy environment. In the absence of a strong policy environment, the MIF could concentrate its resources in helping countries to bolster the legal/regulatory environment for financial and capital markets. These could be multi-stage projects where stage one represents strengthening the policy environment and subsequent stages are not activated until the policy environment has been strengthened.
- 4.7 MIF assistance is more effective when governments and executing agencies are committed to the goals of the project. If a country has a history of poor performance based on an unwillingness to take politically difficult decisions, the MIF could consider only non-financial operations such as feasibility and sector activities that help to overcome policy weaknesses.
- 4.8 Lack of independence of some of the executing agencies from political special interest groups had, in the past, conspired against project effectiveness. Moreover, the lack of independent supervisory agencies has been a contributing factor to banking crisis and financial fraud. The MIF could consider assistance based on good performance in tackling these governance challenges. In the next decade, the MIF could also concentrate on helping supervisory agencies develop the means to enforce existing legislation.

B. MIF Internal Processes – A re-examination of project planning, implementation and evaluation

- 4.9 Executing agencies are the main building block of the MIF project distribution channel, therefore the MIF could re-examine its desired profile of the typical executing agency, and perhaps establish a set of guidelines for the selection process. Beyond the executing agencies, the MIF could consider forming long-term relationships with other strategic partners that share its quest for innovative solutions.
- 4.10 The MIF may want to redefine projects as products that serve the needs of clients in terms of customer service promises, response times, minimum quality standards and service packages, etc.; they may have to re-align internal incentives to increase the focus on quality management, foster the reporting of accurate information that leads to a constructive spirit in solving implementation difficulties. Moreover, the MIF could consider reassigning responsibilities during project execution so that the original purpose and intent of the project is not lost. To accomplish this, the MIF could consider re-involving the project team in mid-term evaluations and participation in the MPPMR process;
- 4.11 The MIF's regional projects in finance and capital markets have been particularly difficult to administer. Regional projects posed special administrative difficulties given the number of players involved in each project. This is an area of continuing concern to the MIF, and this issue needs to be explored with respect to the special design characteristics of regional projects.

- 4.12 The MIF could develop means to widely share innovations and lessons learned during the development, execution and closure of projects. The MIF needs to develop an “institutional knowledge” database that gathers project documents, terms of reference, action plans, progress reports and evaluations into electronic versions that can be fed into a MIF-sponsored web page.
- 4.13 Moreover, the MIF could publish a roster of consulting firms and experts, without express or implied endorsement, and make these firms’ names available upon request to executing agencies.
- 4.14 The MIF needs to reinvigorate its monitoring and evaluation functions. Project goals should be explicit, well defined and subject to measurement. The MIF should ensure that every project budget has provided funding for monitoring and evaluation and every project should be evaluated. These results should be fed back into the system.
- 4.15 There should be a renewed effort to design and write clear project documents. Some documents have hastily written descriptions of the central problem to be solved; inaccurate budget estimates have caused budget deficiencies to burden executing agencies; project design has not noted the institutional relations and lines of communication as they existed before the project; goals and objectives should be written with evaluation in mind; and, inter-agency cooperation agreements are inherently difficult and their use should be carefully thought out.
- 4.16 Operations need to be designed with more flexibility to accommodate the inevitable changes that will occur in projects. The MIF Board of Directors should consider giving more discretion to authorize project changes in the Country Offices proving the participation of the Project Team that designed the operation.
- 4.17 The rate of disbursement can be a valid measure of project success when goals are tied to disbursement. In most MIF technical cooperation projects evaluated, disbursements are tied to the attainment of specific goals and therefore the rate of disbursement is a valid measure of success in the project.
- 4.18 The MIF’s counterpart funding policy is the source of significant problems; there are large variations in the application of this policy between Country Offices; project budgets draw no distinction between cash and in-kind counterpart funding; and, counterpart funding cannot be tracked on a timely basis. The MIF should re-examine its counterpart funding policy and improving the tracking of the Bank.
- 4.19 Country Office seminars on the Bank’s project procedures for local executing agencies should be extended to include MIF executing agencies.
- 4.20 The MIF and the Bank, perhaps through Project Review Missions, need to formalize a dialogue directly with the executing agencies about the progress and problems encountered in project execution.

- 4.21 The MIF/Bank's international bidding requirements for contracting goods and consultant services were found to be subject to sometimes-lengthy delays. While these procedures are admittedly slow, over time, they have proven their worth. Some of the countries do not have a history of transparency in awarding public contracts and the MIF/Bank's bidding procedures have been well thought-out and designed expressly to lend transparency to the process. These procedures have served the MIF/Bank and its clients well and the extra effort involved is a small price to pay to maintain the MIF and the Bank's excellent reputations in this area. The MIF may want to explore the use of price references for commonly purchased items and benchmarks for consultant services to speed up acquisition times, but for the most part, the evaluation of these projects indicates that the MIF/Bank's international bidding procedures remain unchanged.
- 4.22 Below, we have presented a summary of results of MIF project activity in the financial reform and capital market clusters. The substantial progress realized in these areas cannot, of course, be entirely attributed to MIF activity. The MIF, however, was frequently the first multilateral institution to venture into these areas and began a reform process that likely will not be reversed.

Table 4.1: Summary of MIF Financial and Capital Market Results by Area of Interest

Functional Areas of Intervention	Industry Status After MIF Intervention
<p><u>Financial Infrastructure:</u></p> <ol style="list-style-type: none"> 1) Modernize banking, securities, pension, insurance and bankruptcy codes; 2) Property registries; 3) Accounting and auditing standards; 4) Commercial bank training. 5) Credit guarantees; 6) Agricultural investment funds; 7) Strengthen non-traditional SME credit institutions. 	<p><i>An improved legal/regulatory environment and greater efficiency and competition in markets has been achieved in those countries with MIF projects, particularly in C&D countries, i.e.:</i></p> <ol style="list-style-type: none"> 1) Antiquated financial legislation has been rewritten in virtually every MIF country; 2) Reduced creditor information and property registry costs and speedier transactions in several LAC countries; 3) IAS or US GAAP accounting and auditing standards adopted in several LAC countries; 4) Commercial bank training to encourage the adoption of best practices provided in several countries; 5) Created legal and institutional framework for a private reciprocal credit guarantee agency in Argentina; 6) Developed pilot investment fund that will allow farm land to be collateralized as agricultural investment and attract institutional investors to this sector in Peru; 7) Developed a credit technology that allows non-traditional lenders to improve their ability to monitor SME credits on cost-effective basis in several LAC countries.
<p><u>Financial Supervision:</u></p> <ol style="list-style-type: none"> 1) Banking; 2) Securities; 3) Pension; 	<p><i>Savers, investors and markets now have better prudential oversight through: modern supervisory norms; institutions strengthened through staff training; and, modern information and communications systems installed:</i></p> <ol style="list-style-type: none"> 1) Helped several LAC banking authorities to partially meet Basel Committee standards and to develop special supervision capabilities for Microfinance;

Functional Areas of Intervention	Industry Status After MIF Intervention
4) Insurance; 5) Credit union and cooperative supervision.	2) Helped several LAC securities authorities to partially meet IOSCO recommendations for broker/dealers; 3) Helped several LAC pension authorities to meet IFPA recommendations for pension system oversight; 4) Helped a few LAC insurance authorities to meet IAIS recommendations for insurance industry oversight; 5) Assisted several LAC banking authorities to develop credit monitoring models for non-traditional financial institutions.
<u>Capital Markets:</u> 1) Stock exchanges; 2) Bond market standardization; 3) Credit rating agencies; 4) Privatization participation; 5) Securities depositories and payment systems	<i>The MIF promoted non-bank credit and investment alternatives to commercial banking system in several LAC countries:</i> 1) Promoted equity issuance in twenty-three LAC countries through safer securities exchanges; 2) Lower cost of public debt auctions; wider market for government securities through uniform, book-entry instruments; improved public debt management policy in three small LAC countries; 3) Promoted ratings of domestic firms, banks and securities issues to provide better information to institutional investors and retail investors in several LAC countries; 4) Increased and diversified the ownership of privatized state-owned enterprises in several LAC countries; 5) More than two dozen stock exchanges and securities depositories in LAC now partially meet G-30 standards for clearance & settlement in securities exchanges;
<u>Pension Reform</u>	Recapitalized and redesigned pension systems that are actuarially solvent and pay sustainable benefits; privatize state-run pension systems or allow partial private pension accounts, private pension administrators and private pension investment accounts in several LAC countries.
<u>Insurance Reform</u>	Promoted greater use of risk management through the development of efficient and cost-effective insurance markets; Assisted regulators and industry with current actuarial tables for country; contributed to increase private provision of insurance services in several small LAC countries.
<u>Commodity Exchanges</u>	Developed bonded warehouses, cash and forward commodity markets for standardized contracts that started allowing some farmers to meet short-term credit needs through collateralized warehouse receipts. Publicized commodity price and volume transactions in half a dozen LAC countries.

Source: Compilation of results of this evaluation.