THE MULTILATERAL INVESTMENT FUND

MIF REPLENISHMENT:

OVERVIEW
STATUS OF RESOURCES
AND
ACTION PLAN

MARCH 3, 2004
I. INTRODUCTION

1.01. At the 2003 Annual Meeting in Milan, IDB Governors established a Special Committee to guide the process of MIF Replenishment (MIF/CA-5-1). They stressed the importance of working to expand MIF’s membership base and clarifying MIF’s role within IDB Group efforts to promote private sector development.

1.02. Over the past year, the External Review Group on the IIC presented its report (CII/GN-180-7) and Management undertook a review of the full range of IDB Group instruments addressing private sector development, preparing a Private Sector Strategy for presentation to Governors at the 2004 Annual Meeting in Lima.

1.03. As a result, the central role played by the MIF within the IDB Group support to private sector development has been clarified. Of all the projects undertaken by the IDB Group in the past ten years, MIF has funded nearly all those for microfinance, two out of every three targeting SMEs and one of every three for financial sector reform. At the close of 2003, MIF had approved over $900 million1 in 590 projects.

1.04. MIF resources are focused on reducing poverty by building grass roots economic growth. Projects act as prototypes, filling the gap between research and diagnostics, and full implementation of an idea. They introduce innovative approaches and directly engage the private sector in the development process. They enable progress on difficult reform issues and can respond quickly to urgent needs that arise.

1.05. MIF projects are particularly important to assist the smaller and less developed countries of the Region (C&D Countries) where there is a narrower domestic base of expertise in specific issues, and where standard models need greater adaptation to gain support. These countries receive over two-thirds of MIF projects and the majority of funding.

1.06. The Working Paper of MIF Replenishment, provides a detailed description of how MIF has fulfilled its role over the past ten years. Designed as a background document to inform the replenishment process, it reviews MIF achievements, outlines why this kind of instrument is more needed now than ever, identifies key lessons, and proposes a strategic framework to focus MIF resources for the future.

1.07. The following paper notes the key elements of the background document, reviews the status of funds and presents the proposed strategic framework. It also requests Governors to endorse an action plan that would enable consultations and negotiations to replenish MIF resources to be completed by late 2004. This concerted effort is needed, if MIF is to continue without interruption. It typically takes two years or more to complete the various parliamentary and budgetary processes needed to provide funds, and MIF resources are projected to be almost fully committed by the end of 2006.

II. PROGRESS OVER THE PAST YEAR

---

1 Net of Cancellations, US$ 842.5 million
2.01. **The extensive analysis of all IDB Group instruments that support private sector development has highlighted the distinct role played by MIF initiatives.** It is clear that MIF’s role continues to be critically important to developing the kind of economic growth needed to reduce poverty in the region. MIF supports broadly based private sector growth by advancing new thinking, promoting reform in the business environment, particularly those most important for small firms, and then assisting these firms to benefit from change.

2.02. **MIF initiatives complement and leverage** not only the actions of other members of the IDB Group, but other multilateral and bilateral agencies (over 30 partners), national development entities throughout the Region, and numerous international and national NGOs and private sector organizations. It is uniquely positioned to support new solutions to stubborn problems by energizing agents of change in the public sector and directly engaging private sector partner organizations.

2.03. **80% of MIF projects are undertaken in direct partnership with private sector organizations** which finance half the cost. This network of over 400 business associations, industry groups, foundations and NGOs, is a vital asset to focus efforts on the most important concerns and help ensure that changes will reach those who need them most.

2.04. **MIF has built an unequalled range and depth of experience on how to improve the growth prospects for small business.** Its 590 projects are addressing those aspects of the business environment that are the most critical for SMEs as well as strengthening the capacity for these enterprises to benefit from market change.

2.05. In microfinance, MIF pioneered a new, distinct approach in Latin America and the Caribbean which has allowed microcredit to grow beyond reliance on donated funds. MIF initiatives have focused international attention on the importance of remittances, leading to lower transmittal costs and new ways to harness these flows to increase growth potential for the smallest enterprises. Including the counterpart funds of its partners, MIF projects have put over $1.8 billion to work, making it the largest provider of technical assistance to the Region.

2.06. **The Office of Evaluation and Oversight (OVE) found MIF a very effective and innovative instrument that is making an important contribution in highly relevant areas.** In its summary of the findings of its 2003/2004 evaluation of over 80% of MIF projects, OVE reported that MIF addressed crucial private sector development issues, piloted important new concepts and enabled reforms that otherwise would not have happened.

"The evaluation results indicate that the MIF has focused on highly relevant issues, built effective partnerships for the promotion of change, and consistently demonstrated a high level of innovation in its operations. Projects have generally been effective, and in a number of areas the MIF has initiated major change processes in the region with only a small contribution of its own resources.... While the (evaluation) findings suggest there are substantial opportunities for improvement in the future, the MIF has already clearly established itself as a powerful ally for private sector development in the region."

---

2 MIF/GN-78-16 3 March 2004
2.07. OVE found that MIF interventions were central to the progress achieved in microfinance, remittances, skills standards and credentialing systems, venture capital market development, alternative dispute resolution, and quality management systems (ISO). Important contributions have been made in the areas of environmental management, financial sector reform, regulatory reform and the framework for private sector investment in infrastructure. Early results from newer areas such as clean production are showing significant promise.

2.08. The clarification of the central role played by the MIF within IDB Group support to private sector development has now opened the way to move forward on the process of MIF replenishment. A concerted effort is needed, if MIF is to continue without interruption. It typically takes two years or more, to complete the various parliamentary and budgetary processes needed to provide funds, and MIF resources are projected to be almost fully committed by the end of 2006.

III. STATUS OF RESOURCES

3.01. Each year, the independent audit and annual information statement of the MIF contains a Special Purpose Statement of Changes in Fund Balance which reports on how many funds remain. This report records final approvals and administrative expenses, reports on the impact of variations in exchange rates, and includes any reflows from loans and investments, as well as funds that return when projects are cancelled or completed with some resources remaining.

3.02. Using the same approach to project the future status of MIF resources, it is expected that approximately $38 million in MIF resources will uncommitted by the end of 2006.

<table>
<thead>
<tr>
<th>Remaining funds at end of year</th>
<th>US$ millions</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>337.2</td>
</tr>
<tr>
<td>2004</td>
<td>236</td>
</tr>
<tr>
<td>2005</td>
<td>135</td>
</tr>
<tr>
<td>2006</td>
<td>38</td>
</tr>
</tbody>
</table>

3 The most recent report is MIF/FN – 12 16 April 2003
IV. PROPOSED STRATEGIC FRAMEWORK MIF2

4.01. Creation of the MIF ten years ago was a bold step. It established a new way to realize change in the region, to more deeply involve the private sector itself in the development process, and to focus special attention on the needs of the smallest members of the business community. MIF replenishment offers the opportunity for all members of the IDB to reinforce and further demonstrate commitment to supporting equitable growth in the region.

4.02. MIF has proven to be an effective instrument, playing an essential role in IDB Group efforts to promote broadly based economic development. MIF has been fulfilling an important role, bridging the gap between research and problem identification, and full implementation of reforms. It has established a solid track record as an innovative, responsive mechanism that is effective in building economic resiliency, strengthening SME competitiveness and increasing growth prospects and improving integration into the economy for microenterprise.

4.03. MIF2 offers the opportunity to further strengthen MIF’s development impact, increasing the focus on development results, and incorporating the lessons of experience. Conditions in the region have changed a great deal over the decade since MIF was established. Much has been learned about the importance of sound institutions and incentives, the need to keep pace with international norms as markets become increasingly integrated, the vital role of micro and small business, and the importance of the quality (not just the quantity) of economic growth. MIF has done well in the past; it must also do so in the future.

4.04. MIF’s competitive niche can be made more explicit, clearly focusing resources on initiatives where the issue is both important to private sector development and is one where MIF as an instrument can have a significant impact. MIF’s role in building knowledge about what works - and what doesn’t - can be reinforced; MIF’s network of private sector partners can be more deeply engaged in furthering socially beneficial economic growth.

4.05. The proposed strategic framework for MIF2 shows how MIF fits as part of the overall IDB Group private sector strategy. Indeed, it has been developed in tandem with the proposed Private Sector Strategy. Not only has MIF been an active participant in the process, but the in-depth evaluation of over 80% of MIF projects that was undertaken by the OVE during 2002/2003 provided important input for its development.

4.06. MIF would maintain the flexibility and responsiveness of the current Agreement, by describing strategic level objectives and assigning the Donors Committee to guide the development of operational priorities used to identify specific projects. It builds on the extensive analysis that has been undertaken by the IDB Group over the past year, embodies the recommendations of the OVE studies, and reflects the views of the network of partners MIF has built up throughout the region.

4.07. MIF success has been strongly associated with openness to innovation, flexible response to changing circumstance and new opportunities, and close partnership with private sector groups.
Most importantly, the deepest results have arisen from concentrated effort over time on a particular development topic, with MIF funding a succession of innovative initiatives as the issue evolved. The proposed framework strives to orient resources, while also recognizing the central ongoing role played by Donors in shaping priorities.

4.08. **MIF2 would emphasize the importance of measuring development results.** In addition to ensuring that the outcome of individual projects can be measured, it would also be designed to assess: a) how well MIF resources are filling their particular development niche; b) assessing the degree of innovation; c) whether the concepts tested were relevant and useful, and; d) the degree to which initiatives contributed to useful knowledge about private sector development. Specific approaches to assess the development impact of each type of initiative and disseminate this knowledge throughout the Region are introduced in the background paper.

4.09. **The role of the MIF would be more explicitly described.** The original agreement recognized the central importance of improving the general business environment and the climate for investment. The proposed framework for MIF2 would build upon this experience, concentrating MIF resources even more on those kinds of initiatives where demonstration projects can make a difference and where MIF expertise in small business concerns gives it competitive advantage.

4.10. It increases the emphasis on building the capacity of small business and on demonstrating new financial mechanisms to increase their access to appropriate financial services. It recognizes that MIF’s network of private sector partners is an important asset, and proposes new ways to involve the private sector in the development process.

4.11. The proposed strategic framework would focus MIF resources on three goals, with basic areas of intervention to further orient resources.

<table>
<thead>
<tr>
<th>Improving the Business Environment</th>
<th>Building Competitiveness of Smaller Firms</th>
<th>Engaging the Private Sector as Partners for Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Public sector entrepreneurship to change regulatory, institutional framework</td>
<td>• Demonstrating new financial mechanisms</td>
<td>• Advance socially responsible approaches to business and environmental management</td>
</tr>
<tr>
<td>• Meeting the challenge of trade integration</td>
<td>• Strengthening managerial and technical capacity</td>
<td>• Increase private sector involvement in policy formation</td>
</tr>
<tr>
<td>• Helping markets work better</td>
<td>• Developing private sector networks</td>
<td>• Demonstrate new ways to do business</td>
</tr>
<tr>
<td>• Financial sector and capital market reform</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
4.12. **Proposed goal and types of initiatives:** focusing on those issues of primary importance to SMEs, promote efficient, fair and transparent institutional and market practices that introduce new ideas, advance the implementation of best practice and encourage the application of international norms and standards. Projects focus where MIF’s agility allows it to meet urgent needs that other instrument cannot, where its experience in nurturing innovation can help create new solutions to stubborn problems, and where working models are needed to pilot reforms, building experience and support for larger programs (which can be assisted by other parts of the IDB Group or other development entities.) Initiatives in this group emphasize increasing incentives to becoming formal, lowering the costs and risks of productive activity, and expanding business opportunities. Projects are most often implemented in partnership with a public sector counterpart.

**Basic areas of activity:**

4.13. **Promoting public sector entrepreneurship:** Changing institutions requires specific technical expertise, significant energy, and political will. MIF should support those reformers – the entrepreneurs of the public sector – who are willing to take the risk of introducing new ways to improve the laws, regulations, procedures, and policies that impact on business and investment.

4.14. **Meeting the challenge of trade integration:** As markets integrate, countries must align their regulations, standards and norms of practice with regional and international benchmarks and requirements, or risk making their economies uncompetitive. To help ensure that small firms benefit from these changes, MIF should promote application of international practice, emphasizing broadly based private-public sector consultation, and the development of local certification and advisory service capacity.

4.15. **Improving how markets function:** Where targeted technical assistance is needed to implement recommended actions, or to build consensus for further reform, MIF should support initiatives to improve regulatory structure and practice, increase competition and broaden participation and access.

4.16. **Financial sector and capital market reforms:** MIF projects should advance larger reform initiatives where small technical assistance programs are the most appropriate instruments to promote needed change, or where a multi-faceted approach is needed to progress a change such as property reform to enable secured transactions, increasing small business credit. MIF’s proven track record in quickly mobilizing resources is particularly important in the financial sector where immediate technical assistance is needed to help countries deal with sudden crisis.

4.17. **Relationship to IDB Group and other Initiatives:** MIF initiatives build on the analytic work done by other development institutions (such as the World Bank ‘Doing Business’ reports, FIAS reports, CAF and CABEI or research by bilateral development agencies) as well as the knowledge base of the IDB Group itself. Projects are coordinated with other IDB Group initiatives through the Private Sector Strategy process and are more useful where it is important to foster innovation, demonstrate new approaches and build consensus for further reforms.
BUILDING THE COMPETITIVENESS OF SMALLER FIRMS:

4.18. **Proposed goal and types of initiatives:** to support ongoing innovation to increase the potential of microenterprise and small business to generate income, create jobs, and grow in a sustainable fashion. Projects address the underlying issues of building competitiveness. They are most often implemented with private sector counterparts, and aim to create distinctive regional approaches to competitiveness issues, creating new norms and stimulating development of new models.

**Basic areas of activity:**

4.19. **Demonstrating new financial mechanisms:** MIF should build on its pioneering work in the use of equity as a development tool to support initiatives that introduce new ways to increase the supply, range and quality of financial products particularly those designed for micro and small business. Utilizing the full range of MIF’s equity, debt and grant mechanisms, initiatives should advance concept that a continuum of financial services should be available to support growth from smallest through to larger firms. Establishing working models is the best way to attract private sector interest in offering more financial services and credit for small business. Promising techniques include factoring, leasing, use of guarantee mechanisms and securitization.

4.20. **Managerial and Technical Capacity:** MIF should test innovative and demonstration initiatives to build resilience and adaptability to quickly changing market realities, promoting application of internationally accepted financial management and reporting methods. Projects should focus on increasing growth potential, taking an integrated approach to identifying operational and managerial constraints, and advancing those financial and institutional changes needed to increase competitiveness. Projects should seek leveraged impacted beyond the individual initiative, and only be undertaken where the business environment is sufficiently conducive to realizing results.

4.21. **Developing Private Sector Networks:** Institutions such as chambers of commerce, trade associations and NGOs are of particular importance to micro and small firms. They play a vital role in conveying information about market change, and voice the views of their members in dialogue with the public sector. MIF should promote communication among these private sector institutions that are working to help the very small enterprises respond to new incentives and seize economic opportunities.

4.22. **Relationship to IDB Group and other development efforts:** These projects tend to be highly innovative, are usually undertaken with private sector partners and serve to energize the private sector side of needed reforms. In general they support the IDB Group’s strategic direction of focusing on underserved markets and contribute to the knowledge among development institutions on how to address micro and small enterprise needs.
ENGAGING THE PRIVATE SECTOR AS PARTNERS FOR CHANGE:

4.23. **Proposed goal and types of initiatives:** to promote broadly based participation in the economy, and deepen the involvement of private sector in development issues, advancing the effective application of business techniques in addressing social concerns. Initiatives in this group have a high level of innovation, piloting new concepts and introducing new ways to harness business motivations for development goals. They are most often implemented with private sector counterparts.

**Basic areas of activity:**

4.24. **Advancing socially responsible approaches to business:** Often known as Corporate Social Responsibility, this encompasses a range of activities that link business decision-making with good corporate governance, environmental responsibility, worker health and safety, and respect for communities and the society as a whole. Initiatives promote the understanding that it is good business to follow such practices, and that a firm cannot achieve its full potential completely isolated from the success of its workers or of other firms in its economy. MIF should raise awareness among the business community, pilot initiatives and share knowledge as the concept is applied. *Environmental management* is a key aspect. MIF should build on its early work in introducing cleaner production techniques to further promote innovative methods to demonstrate that it is a benefit not a cost, promoting eco-efficient production, and building private sector capacity.

4.25. **Increasing private sector involvement in policy formation:** Identifying the obstacles to private sector growth and sequencing appropriate policy response calls for an active participation by a well-informed business community. Broadly-based, grass roots groups such as Chambers of Commerce, industry associations, consumer and environmental organizations share and build useful commercial knowledge and express their members views in policy making forums. This is particularly important in involving micro enterprise as their very informality constrains their ability to convey their needs to government institutions.

4.26. **Demonstrating new ways to do business:** MIF should work support initiatives that test and establish working models of effective new approaches to business. Such approaches as encouraging large firms to help their smaller suppliers implement more effective environmental management models, or working with value or supply chains to promote more sustainable business practices can have a significant multiplier effect on business attitudes and practices.

4.27. **Relationship to IDB Group and other development efforts:** More deeply involving the private sector in development is an important element of the IDB Group private sector strategy. MIF’s network of over 400 leading private sector organizations throughout the Region is a significant asset in this respect, enabling new concepts to move beyond discussion into implementation.
V. REACHING MIF2 - SCOPE OF WORK AND PROPOSED ACTION PLAN:

5.01. The proposed work program for the Special Committee of Governors on MIF Replenishment is:

   **April/May 2004:** informal consultations on proposed strategic framework and burden sharing

   **July 2004:** Meeting of the Special Committee of Governors: for consideration of the proposed strategic framework and initial discussion of potential burden sharing.

   **Further meetings would be scheduled as decided** by the Committee, in order to achieve agreement by the end of 2004.

5.02. The replenishment process offers an important opportunity for all IDB Members to assume a role in the MIF commensurate with their participation in the IDB as a whole. Given the essential role played by the MIF, those Members that do not belong to the MIF are not participating in a central aspect of IDB efforts to develop the private sector. At present, 32 of 46 IDB member countries are Donors to the MIF. Non-regional members of the MIF are Japan, Spain, Italy, Portugal and the Netherlands. Regional MIF Donors include the United States, Canada and 25 of 26 beneficiary countries.

5.03. While it is still premature to address the details of contribution levels and burden sharing, Management recommends a Replenishment in the order of $500 million which would permit MIF operations to be extended an additional five years.