From 1985 to 2002 private financial flows to developing countries increased almost tenfold, and during this same period went from being one third the size of total official flows to developing countries, to more than double official flows.¹ From multinational corporations to philanthropy to remittances, the private sector and private capital are finding their way into developing markets in greater numbers annually. However, this growing role in development raises many crucial concerns about the sustainability, redistributive powers, long-term scope, and environmental and social benefits of private sector investment. Much time and literature has been devoted to topics like microfinance and public-private partnerships in recent years, and depending on the perspective the private sector’s role in development can either seem like a silver bullet for poverty reduction that effectively evades corrupt governments, or a snatch-and-grab attempt by big business that increases inequality and reduces social standards and governability. While opinions vary, what is certain is that the private sector will continue to have a growing importance in development, and requires the attention of all concerned with development to determine just where their role lies.

Through its International Finance Corporation (IFC), the World Bank has been engaging with the private sector on development work since 1956—long before the recent debate began—and an examination of its recent experiences provides key lessons on how best to engage the private sector for development work that helps achieve the goal of poverty reduction. In this essay I will focus on the IFC and its work with the private sector, as well as offer several suggested ways in which it can improve its work in development and poverty reduction. While the IFC is only a small part of the world of private-sector development, I believe the lessons drawn from its experiences provide valuable guidelines for the entire development community on how to effectively engage the private sector for development that keeps in mind issues of equity, sustainability and poverty reduction.

The IFC is an affiliate of the World Bank that was established in 1956, and provides equity to invest in the private sector when capital can not be secured from private investors. Like the rest of the World Bank it focuses on developing countries, where private capital has often been hard to secure given the perceived risks of limited or instable markets, precarious or erratic governments, and high costs of doing business due to corruption and institutional inefficiencies, to name just a few commonly-cited rationales. The IFC also provides technical advice and capacity to private firms—large, medium, small and micro in size—as part of its efforts to help develop and improve the private sector in the countries in which it operates. The IFC’s structure parallels the World Bank, with 179 of the World Bank’s 185 members on the IFC, the same president, board of governors, and board of directors, and a proportional voting system based on capital contributions to the IFC. Finally, the IFC shares the World Bank’s overall mission, as stated on www.ifc.org:

To fight poverty with passion and professionalism for lasting results. To help people help themselves and their environment by providing resources, sharing knowledge, building capacity, and forging partnerships in the public and private sectors.²

In recent years the IFC has played a role of growing importance in the World Bank’s operations, making it one of the fastest-growing of the World Bank’s institutions.³ The growth of the IFC in size and role reflects an increased emphasis by the World Bank on the private sector. This is seen through World Bank initiatives launched in the past decade like the Business Partners for Development program (BPD), which develops global networks of business, civil society and state mechanisms, and the Private Sector Development Strategy (PSDS), which includes components like privatization of state-run sectors and development of new private markets. When the PSDS was launched in 2002, the World Bank, in its Executive Summary, noted that:

Private sector development is critical for poverty reduction in two major ways. First, private markets are the engine of productivity growth and thus create more productive jobs and higher incomes. Second, complementary to government roles in regulation, funding and provision, private initiative can help provide basic services that empower

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² www.ifc.org
³ Bank Information Center online: http://www.bicusa.org/en/Institution.6.aspx
the poor by improving infrastructure, health and education – the conditions for sustainable improvements of livelihoods.⁴

The growing private sector component of the World Bank’s work has led the IFC to assume a more prominent role amongst World Bank agencies. But even more significant than its increased number of projects and funds is how the IFC is interacting with the branches of the World Bank that are more directly linked to poverty reduction efforts. In the same 2002 document, responsibilities for the various aspects of the PSDS is divided between various branches of the World Bank, including the IBRD/IDA, which is to “focus on investment climate and related institution building, improvements of governance, legal and regulatory systems, financial sector policies and public financing,” while the IFC “pursues demonstration projects that promotes the credibility of government policies, provides additional financial services in local markets and provides political risk protection to co-financiers.”⁵ This intra-institutional crossover is what Tannenbaum refers to as the “unbundling” of development projects,⁶ which has the potential to take advantage of the different skills of the World Bank branches to achieve better, more efficient outcomes that have greater poverty reduction potential. At the same time this unbundling creates the risk that differing approaches and competing philosophies within each branch of the World Bank could muddle overall World Bank strategies in countries and regions. With these benefits and risks in mind I will now briefly look at the general logic behind private sector development for poverty reduction, before analyzing the successes and failures of the IFC itself.

_Private Sector Development and Poverty Reduction: Cause or Solution?_

Looking beyond the confines of the World Bank there is evidence of a shift in viewpoints regarding the private sector and its role in development. As de Ferranti argues, “the notion that market players . . . have no interest in contributing to helping global development has been overturned by growing evidence that many want, at least with a small portion of their assets, to ‘not only continue doing well financially but also doing some good developmentally.’”⁷ This is a sentiment shared by many development institutions and even governments, who have come to rely on the private sector more

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⁵ World Bank, 2002, pg. 65, all citations.


and more. Some of the principle arguments for the private-sector’s role in development include the following:

*Entrepreneurship is a necessary component of development, as it creates growth, which in turn benefits a large portion of the population by creating new industries, jobs, and innovations.* A 2006 World Bank analysis of entrepreneurship and new firm development in 95 countries demonstrated “a positive and significant relationship between economic and financial development and entrepreneurship.” Of course entrepreneurship itself is also dependent on institutional factors like efficient registries, property rights, and lack of corruption that the private sector do not directly impact, so this assertion should be cautioned with the note that entrepreneurial environment is just one of many important institutional factors that impact growth and its ability to combat poverty.

*The private sector can operate more efficiently than the public sector, and so provide crucial services like health and basic needs at cheaper prices and with higher quality and customer service.* This may explain why governments are turning to the private sector already, via an increasing number of public-private-partnerships (PPPs), and have even developed special governmental units solely responsible for promoting and coordinating PPPs.

*The private sector has a greater capacity to take risks in developing responses to poverty, as it does not have to worry about its political lifespan and can invest in risky projects with high rates of failure but also great potential impact.* This is true not just of private business, but also in philanthropy, which through new actors like the Gates Foundation is applying business-model approaches to poverty reduction, including strategic targeting of particular issues and regions, an emphasis on quantitative outcomes, and diversifying risk by support multiple start-up projects focused on the same development issue.

*Projects built through market mechanisms can have long-term sustainability because they are self-subsisting, and will not need further injections of aid.* This argument posits market solutions as a way to help countries escape the debt-cycle and assume ownership of their own development in the long-run, instead of relying on outside assistance that is often tied to conditions and limits autonomy.

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Just as there are advocates of the growing role of the private sector in development and poverty reduction, there are also those who caution of pitfalls, particularly when private sector involvement comes at the expense of the state. In the same article where he speaks of the private sector’s increased interest in social outcomes, de Ferranti also cautions about putting too much faith in the market as a solution to poverty, arguing that “the quest for innovative financing options needs to be properly and compellingly rooted in the overall objective of reducing poverty . . . There is always the risk that fascination with instruments will weaken focus on the ultimate objectives that the instruments are intended to serve.”

Several other common critiques of the private sector’s role in development and poverty reduction include:

*Privatization of formerly state-run services has in many cases led to the poor and rural populations not receiving vital social services.* This is of particular concern in areas like water, education and health, as they are basic components of quality of life and human development. In reviewing the World Bank’s track record on health policy reforms, Nuruzzaman cautions about the disproportionate affects of market-based health care reforms, since “better-off groups are rather benefited as market provisions allow them to approach private sector service providers and buy their required health services in the market place,” while for the poor “lack of resources effectively denies them access to private medical care and this is a common problem in many developing countries.”

*While market mechanisms have helped many smaller entrepreneurs grow their businesses, they often miss the truly poor,* who may have limited engagement in the formal economy, and to whom things like business development credit are far less useful than basic services and aid. Even microfinance, one of the most popular financial mechanisms for poverty reduction, is not immune to this criticism. In her article “Microfinance Misses its Mark,” Aneel Karnani points out that microfinance has been more beneficial to those living above the poverty line, who have more capacity to take risks necessary to grow or launch a business than the truly poor populations we should be targeting.

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10 De Ferranti, 2006. Pg. 16.
Who will regulate the private sector, and where is their accountability? Unlike governments, private businesses are not directly accountable to the general public, and are only able to be controlled to the extent that effective regulatory mechanisms exist, something that is often lacking in developing countries with weak governance systems. This raises the risk of private companies exploiting the special concessions granted them by groups like the IFC and host governments in a way that exacerbates inequity and poverty. While the 2002 PSDS reports disputes this, arguing that “in a number of countries private firms may be easier to regulate than public ones due to the arms-length relationship between them and the authorities,” this still does not address the greatest question regarding private-sector growth and poverty reduction: If private-sector growth is so vital to development, then why have we seen so many cases where private sector-led growth has actually increased inequality instead of reducing it? This is a broader development issue that includes factors beyond this essay’s focus on the IFC, but it is an important question to keep in mind as we review the IFC’s efforts to address poverty via market-based development projects.

The IFC: Balancing Poverty Reduction and Private Development

The IFC’s growing role in the World Bank’s development strategy has placed it in the middle of a controversial development debate on the role of the private sector. To greater and lesser extent the IFC and its projects display both the positive and negative attributes of private-sector development in addressing issues of poverty. In addition to the broader themes mentioned in the preceding section, there are several issues particular to the IFC’s operations and its position as part of the World Bank that impact its ability to address poverty issues through its work with the private sector.

One of the most common criticisms of the IFC is that by providing capital at favorable terms to large companies (including subsidiaries of multinationals with dubious human rights records like Shell) “rather than promote development and alleviate poverty, the IFC uses taxpayer dollars to subsidize multinational corporations and businesses connected to local elites.” A brief scan of many IFC-funded projects lends some credence to this claim, especially in natural resource areas like mining. This includes a loan of $125 million to Newmont Mining Corporation in Ghana, a project that came under strong criticism from the civil sector for environmental concerns such as water contamination and the estimated displacement of 9,500 subsistence farmers. While the Ghanaian case is alarming,

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at the same time the IFC has responded to these criticisms by developing several environmental impact assessment and monitoring tools, as well as programs that target small businesses and the low-income populations they operate in. One such example is the Strengthening Grassroots Business Initiative, which provides a package of financial and technical services to grassroots businesses, with a focus on replication of their models and a scaling up of their operations. This and other IFC initiatives to help small and local business sectors will be examined in greater detail in the following section.

Another common critique of the IFC’s lending policies is that as a for-profit entity its lending tends to focus on the most profitable projects, which may not always be the most beneficial for poverty reduction. For example, a quick glance at the IFC’s website shows projects like a 2003 loan for the “Astana Tower” project in Kazakhstan, which provided $5 million of a total $22 million for a “business and shopping center [that] will generate commercial development and boost related support services as commerce and business activity grows in Astana.” Astana is the new capital city of Kazakhstan, and the IFC project summary argues that there is a growing need for government, business and foreign investor office space and services, which this project would address. While there may be indirect benefits to the poor from creating a business and shopping center that is targeted towards the government and foreign firms, it is a relationship that is hard to prove directly, and so calls into question whether IFC investments like these align with the World Bank’s mission of poverty reduction, and whether these types of projects wouldn’t be better left to private banks and financiers to fund instead of the IFC.

A counter-argument to the question of the IFC’s financing of projects like the aforementioned Kazakhstan project is that it serves a valuable role as a middle-man between governments and private investment, as IFC involvement brings credibility needed to attract capital investment in the country. For specific projects the IFC can “lend credibility to projects that might otherwise be considered too risky,” which may in fact have potential positive long-term outcomes for development that investors may not be able to immediately recognize. Also, the case could be made that it is not fair to condemn the IFC, as they have been thrown into the poverty reduction debate just recently, and in a way that is outside their traditional mandate as a for-profit branch of the World Bank focused on

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16 http://www.ifc.org/ifcext/eca.nsf/Content/Kazakhstan_investment%20table
large-scale, private-sector development. However, regardless of whether or not it is a fair position to place the IFC in, the reality is that they have been placed within this debate, and as the next section demonstrates, the IFC has in fact responded to criticisms about its impact on poor populations in developing countries through specific organizational changes and launching of new programs.

**Evaluating the IFC’s Impact: Case Studies of Environmental and SME Sectors**

In order to better frame both the mixture of critiques and praise the IFC has received for its recent work in private-sector development, it is useful to look at two areas where the IFC has responded to criticisms by implementing new internal organizational structures and external programs that better take into account the needs and rights of the poor: Environmental concerns, and small and medium enterprise financing.

**Environmental Concerns**

During the 1990s the IFC received considerable negative backlash for the environmental impacts of some of its projects, in particular those involving infrastructure projects or natural resource extraction. Perhaps most famous of these was the case of the Pangue Dam in Chile, which brought together environmentalists, indigenous populations, international advocacy networks, and even U.S. and Chilean government officials against the IFC’s loan to build the dam. Given the large scale of many of the projects they finance, as well as the fact that they often involve natural resources, it is logical that environmental impact would be a primary issue of concern for the IFC. Furthermore, because these projects involve extraction of local resources, as well as potential resettlement of populations and environmental spillovers like contamination of water supplies, there is an added concern for how these projects can negatively impact poor communities, especially rural communities. Finally, there is the issue of how the profits from these natural resource projects are redistributed, either via sales in cases like mining, or via provision of services in the case of a hydro-electric dam.

Due to the pressures it faced in the 1990s on its environmental record, the IFC has made considerable improvements in its environmental policies and monitoring systems. This includes the boosting of environmental staff from 1 in 1989 to 99 in 2000; a system that classifies projects as A, B, and C based on environmental impact; adoption of World Bank environmental standards in 1993; an Environmental and Social Review Unit in 1998; and an Environment and Social Risk Rating system
in 2001. In her 2005 analysis of the changing environmental policies and practices of the IFC, Susan Park goes as far as to conclude that “the IFC has become more accountable to peoples and ecosystems affected by IFC projects, demonstrating that it has become a true sustainable development financier.”

As Ms. Park notes, the improvements in environmental governance and monitoring at the IFC are quite extensive and noteworthy. More importantly, they lend credence to the idea that large institutions like the IFC can effectively receive criticism, address concerns, and implement effective new policies. However, there are still two important concerns that relate to the IFC’s environmental performance. First, they continue to support projects that receive wide-spread criticism for their negative environmental impact. The IFC has become involved in a dispute between Argentina and Uruguay over a Uruguayan pulp mill Argentina claims will pollute their shared waterway, for which the IFC is providing a $170 million loan to the Finnish company building the plant. Second, while there has been much reform of policies at the IFC to ensure environmental sustainability, this has not been matched by equal reforms that assure natural resource extraction projects will provide sufficient benefit to the local population, and not just to the corporations the IFC finances to conduct these projects. More redistributive mechanisms attached to financing of natural resource extraction would be helpful to assure that the IFC not only supports sustainable environmental practices, but also sustainable economic development that addresses the needs of the local poor. Many developing countries have experienced what is called the “resource curse,” where natural resource development actually increases poverty and hinders equitable growth by leading to things like state-capture and corruption. Keeping this in mind, the IFC should be particularly cautious when assessing proposed projects in this sector, so it does not continue to get linked to development projects with dubious environmental, economic and human rights results.

Small and Medium Enterprise Financing
As I noted above, one of the main criticisms of the IFC is that it provides corporate welfare to large multinationals through favorable loan terms. This assertion operates in conjunction with a call for more investment in small-scale entrepreneurs and businesses, which could contribute to poverty

19 Park, 2005.
reduction by increasing local incomes via local ownership of businesses and new job opportunities. In the same way that the IFC addressed environmental concerns surrounding their natural resource and infrastructure projects, they have also made efforts to address this criticism through new initiatives focused on small and medium-sized enterprises (SMEs).

The two main ways in which the IFC has engaged SMEs is through their participation in the World Bank’s Rural, Micro Finance and Small Enterprise Development initiative, and their own Strengthening Grassroots Businesses Initiative (SGBI). In the broader World Bank initiative the IFC plays the role of “developing financial institutions that serve SMEs by investing in commercially sustainable leasing companies and microfinance organizations.”21 In this way the IFC is able to use their strengths in the areas of finance to work with other World Bank institutions that have complimentary capacities in other fields to create greater access to finance for entrepreneurs in poor and underserved communities in the developing world.

The IFC-run SGBI program has a similar financial component, but also includes a good deal of technical assistance to the participating SMEs. This includes a three-step process of business assessment, planning, and implementation; coordinated business ventures with multiple businesses in a sector/community; and an emphasis on taking successful projects and replicating them elsewhere. One of the cases highlighted on the IFC’s website is Honey Care in Kenya, which has trained local farmers as beekeepers, provided guaranteed prices and helped commercialize their honey.22 The SGBI program is significant particularly because of the technical assistance component that works in combination with financial tools. As de Ferranti notes, local businesses “once they get above the very small, need major management strengthening as much as or more than money,”23 and it is likely that without IFC programs in their communities, local SMEs would not have access to such highly trained staff and technical capacities, which are key to expanding their businesses and in turn community development. While it is still uncertain just how low-income of populations the IFC reaches through its SME programs, considering their traditional focus on large-scale projects in fields like infrastructure and natural resource extraction, these projects represent a shift in the right direction if the IFC is to truly become an agent of poverty reduction.

Recommended Reforms of the IFC to Better Address Poverty

While the IFC has made significant steps to address some of the most pressing concerns about its impact on poor populations in the countries where it operates, there are still several more measures they could take to improve their impacts on poverty reduction. Based on the preceding analysis of the IFC’s strengths and weaknesses in serving poor populations, I am recommending three reforms that include organizational and programmatic changes the IFC could make to better link private sector development with poverty reduction:

Environmental Reforms

The environmental reforms at the IFC have possibly been the most significant of all organizational changes made since the 1990s, but by focusing in large part on extractive projects the IFC still operates in a problematic dichotomy of development vs. environment. This is problematic because it can only lead to a case of trade-offs, and not the exploration of symbiotic relationships between development and the environment. This is why despite the reforms made in the ’90s and ’00s, the IFC to this day finds itself supporting projects with negative environmental impacts. To remedy the continuing environmental concerns raised by its large-scale projects there are two areas where I would like to see the IFC place an increased emphasis in the coming years: Renewable energies and organic/sustainable agriculture.

Renewable energy projects such as wind, ethanol, and even more experimental industries like tidal energy, provide a great opportunity for the IFC to continue to support large-scale, private ventures, but at the same time promote environmental sustainability. Here I would also like to see them seek out partners based in the countries where they are operating, or if there is a lack of capacity, create a multi-actor partnership between a local company and a foreign firm with experience in the relevant energy sector. Renewable energy is a large potential growth market, and it is important that developing countries’ populations both benefit from its potential as well as develop their own firms in renewables. National renewable energy firms are important both to reduce future energy costs as well as poor countries’ dependence on volatile foreign energy markets like oil, where sudden price shocks can have a ripple-effect across their entire economy.

With the IFC’s increasing emphasis on SMEs, many of which are in the agriculture sector, projects centered around organic and other sustainable food sources would be an effective way to combine growth and sustainability in a way that targets the largest concentration of poor—the rural,
agricultural communities in developing countries. The organic market is growing rapidly in industrialized countries, and offers a price premium over conventional agricultural products. Since many small farmers can not compete on scale with large agro-industry, identifying organic and other niches where their small size is actually an advantage could lead to beneficial development and poverty reduction outcomes in poor, rural communities. However, many poor farmers in developing countries face significant barriers to entry in these markets through lack of quality control, marketing capacities, market access, and finances to pay for organic certification. The IFC has the technical capacities and the financial resources to work with farmers to build their ability to improve quality, obtain certification, and access high-return niche markets. Already the IFC is working with farmers on similar projects centered on improving business and technical capacities, so a special organic markets project could use this template as a guide to quickly and efficiently launch the new program.

Social Conditionality on Loans

Conditionality is a term that is filled with negative connotations in developing countries, as it brings back memories of austerity plans and other heavy-handed IFI policies. However, the IFC could benefit from developing a set of social conditionalities that it requires firms seeking IFC financing to agree to. These conditionalities should have a particular emphasis on redistributive measures to ensure that revenues channel back into the local and national economy to provide for growth with equity, especially in the area of natural resource extraction. If properly designed and monitored, such conditionality could mean IFC-funded projects provide true tools for poverty reduction by making sure revenues are properly invested back into their communities of origin, with a particular emphasis on poor and at-risk populations. This could take the form of new social service programs in areas like health, education and nutrition, or private-sector development of small and micro-enterprises. The important thing is that a share of profits is in fact returned to the communities. Also, by setting criteria for partners’ behavior the IFC will limit future confrontations with local populations and civil society that have occurred when the firms they finance act against the interests of the local population, and discredit the IFC by association. A caveat to this reform is that it may cause some potential borrowers not to use the IFC’s services, and so could reduce the IFC’s total revenue. However the growing emphasis on Corporate Social Responsibility, especially in large multinationals for whom public relations and branding matters greatly, leads me to believe that this is a concept more private developers will be open to considering than at any time in the past.

Be a Nexus for Innovation
In May, 2006 the IFC, HSBC and Microsoft announced a partnership to provide low-cost personal computers across the world, with consumers paying $200 up front, HSBC covering the remaining $400 balance consumers pay in later installments, and IFC covering HSBC’s risks assumed by covering the $400 balance.\footnote{“World Bank, Microsoft Marketing Prepaid Computers,” \textit{eWeek}, May 24, 2006.} This is just one example of an innovative private-sector development project the IFC is supporting. Others have included SME stock exchanges,\footnote{JaeHoon Yoo, “Financing Innovation: How to Build an Efficient Exchange for Small Firms,” \textit{Viewpoint}. World Bank, March 2007.} and an equity fund to finance commercial healthcare projects in Africa, jointly supported by the IFC and the Gates Foundation.\footnote{Andrew Jack, “IFC Plans African Healthcare Funds,” \textit{The Financial Times}, April 30, 2007. Pg. 6.} While these initiatives do not benefit the poorest of the poor, who can not afford computers or seek financiers on SME stock exchanges, they do show that the IFC is open to creative development solutions. As it occupies a unique position between the private sector, IFIs, and the governments they work with, the IFC has the capacity to help connect private-sector innovators to institutions and governments interested in using market tools to address poverty just as it has on the aforementioned computer and stock exchange projects. By scaling-down their innovative policies to target the poorest segments of populations, I believe the IFC could help business, IFIs, and governments work together to find novel solutions to the persistent problem of poverty that can not be cured by growth and development alone.

\textit{Conclusion}

As it climbs out of obscurity within the World Bank and assumes a more prominent role, the IFC will certainly experience more growing pains, particular as it tries to balance its traditional large-scale, private-sector development approach will a need for more poverty reduction efforts. The numerous criticisms and praise of private sector development, and the mixture of beneficial and negative impacts of IFC projects on the poor show that the debate is still open on what the IFC’s best role is in working with IFIs, governments and the private sector in a way that balances growth with social concerns. However, it is this author’s conclusion that, just like the private sector itself, the IFC has great potential to adapt and innovate as needed, and ultimately better incorporate itself into broader poverty reduction efforts.
References


