



Where Opportunities Emerge.



Millennium Challenge Account Implementation Plan based on Ukrainian IPCTF experience

May 10, 2002

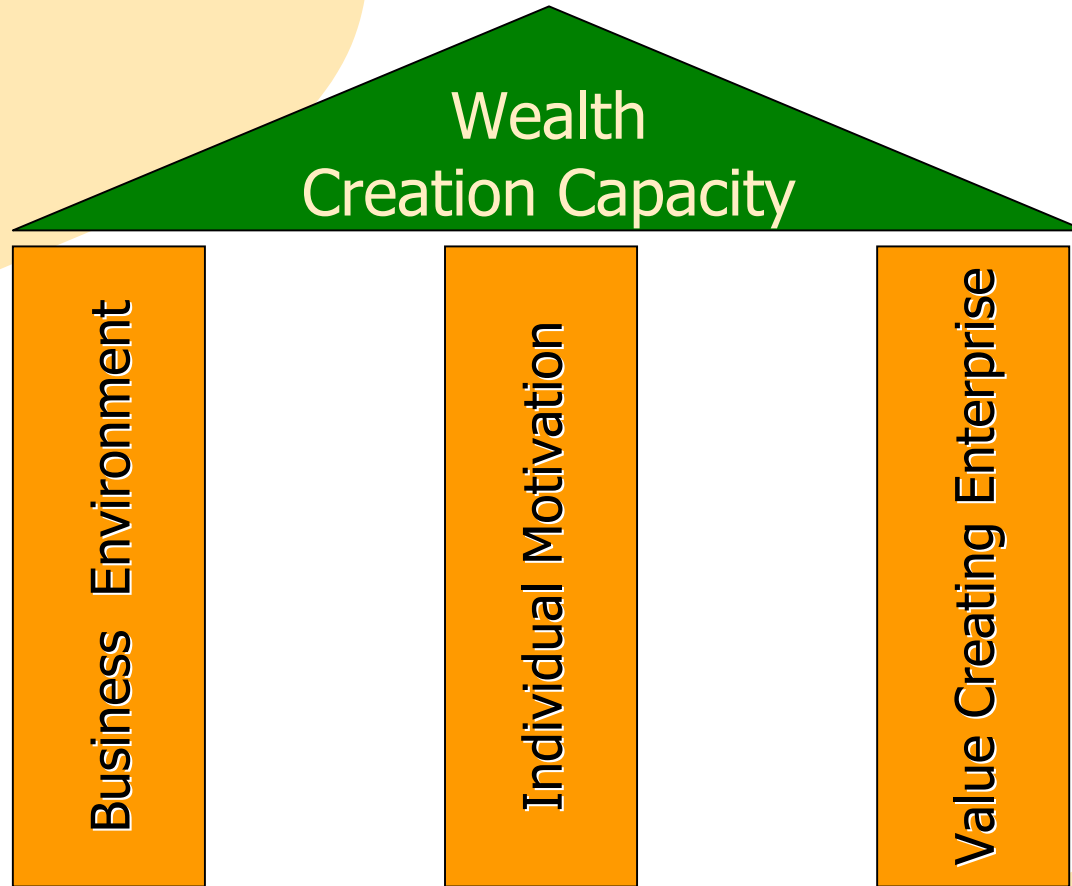
Washington, DC

Michael Bleyzer

Developed and Developing Nations - Assured Interdependence

- The polarization in the world is growing leading to envy and instability
- Wealth redistribution idea is flawed and outdated
- Instead replication of wealth creation capacity is needed
 - This can only be accomplished through a combination of precisely targeted aid and active engagement
- Methodology and tools are necessary to develop implementation plans and measure progress

Three Pillars of Wealth Creation Capacity



Aid Can Actually Be Counterproductive

- Many of the old models of economic development assistance are outdated. Money that is not accompanied by legal and economic reform are often wasted. In many poor nations, corruption runs deep. Private property is unprotected. Markets are closed. Monetary and fiscal policies are unsustainable. Private contracts are unenforceable
- When nations refuse to enact sound policies, progress against poverty is nearly impossible. In these situations, more aid money can actually be counterproductive, because it subsidizes bad policies, delays reform, and crowds out private investment
- In sound policy environments, aid attracts private investment by two to one

President Bush, March 14, 2002

Millennium Challenge Account (MCA)

- **Good governance.** Rooting out corruption, upholding human rights, and adherence to the rule of law are essential conditions for successful development
- **The health and education of the people.** Investment in schools, health care, and immunization provide for healthy and educated citizens who become agents of development
- **Sound economic policies that foster enterprise and entrepreneurship.** More open markets, sustainable budget policies, and strong support for development will unleash the enterprise and creativity for lasting growth and prosperity

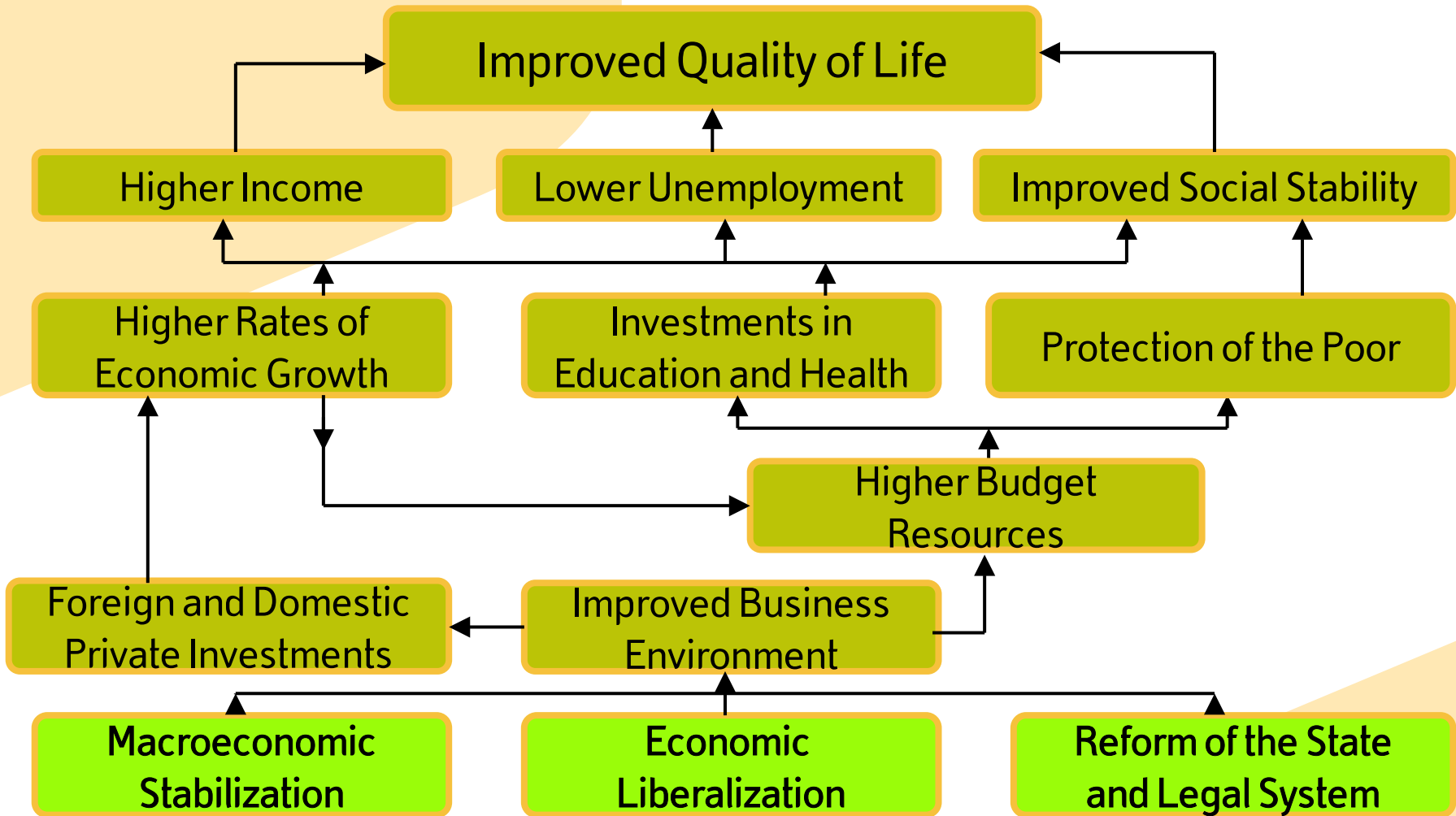
More from President Bush

- *I have an ambitious goal for the developed world, that we ought to double the size of the world's poorest economies within a decade*
- The world's help must encourage developing countries to make the right choices for their own people
- Millennium Challenge Account will have a set of clear, concrete and objective criteria for measuring progress

Bottom Line

- First Measure - Economic Growth (sustainable, measurable, focus on economic development, reducing poverty)
- Encourage the right choices (use of proceeds tied to overall goals of MCA)
- Criteria for measuring progress (movement towards market economy, democracy, stability)

Why Transition?



Benchmarking Government Policies

- SigmaBleyzer launched its first effort to benchmark government policies in transition economies in 1999
- Thunderbird Corporate Consulting Group led by Professor Krishna Kumar was retained to benchmark selected countries and build an econometric model of a transition economy based on the key drivers identified through benchmarking and statistical analysis
- The International Private Capital Task Force (IPCTF) was launched in 1999
- In 2000 SigmaBleyzer continued developing IPCTF framework and in 2001 hired a group of graduating Oxford MBAs to expand IPCTF framework to all FSU countries

Benchmarked Countries

- Argentina
- Chile
- Hungary
- Poland
- Russia
- Ukraine

Countries Included in Statistical Analysis

Angola, Argentina, Armenia, Azerbaijan, Belarus, Bolivia, Botswana, Bulgaria, Burkina Faso, Cameroon, Chile, Colombia, Costa Rica, Croatia, the Czech Republic, Ecuador, Egypt, El Salvador, Estonia, Ethiopia, Ghana, Hungary, India, Indonesia, Jordan, Kazakhstan, Kenya, Lithuania, Malawi, Moldova, Morocco, Mozambique, Nigeria, Peru, Philippines, Poland, Romania, Russia, Senegal, Slovak Republic, South Africa, Tanzania, Tunisia, Turkey, Uganda, Ukraine, Venezuela, Vietnam, Zambia, and Zimbabwe.

Key Drivers / Policy Action Groups

- ***The study pre-condition is macroeconomic stabilization, resulting from sound fiscal and monetary policies.***
- Initially 70 investment drivers were identified, analyzed and grouped into the following key government policy actions, which stimulated foreign direct investments in successful transition economies:
 - 1. Liberalize and De-Regulate Business Activities**
 - 2. Provide Stable and Predictable Legal Environment**
 - 3. Enhance Governance & Reform Public Administration**
 - 4. Remove International Capital & Trade Restrictions**
 - 5. Facilitate Financing of Businesses**
 - 6. Eliminate Corruption**
 - 7. Reduce Political Risks (non-economic country risks)**
 - 8. Expand Country Promotion**
 - 9. Rationalize Investment Incentives**

MCA and IPCTF

President Bush	IPCTF Framework
<p>Good governance. Rooting out corruption, upholding human rights, and adherence to the rule of law are essential conditions for successful development</p>	<ul style="list-style-type: none"> ⇒ 2. Provide a Stable and Predictable Legal Environment ⇒ 3. Enhance Governance & Reform Public Administration ⇒ 6. Eliminate Corruption ⇒ 7. Reduce Political Risks (non-economic country risks) ⇒ 8. Expand Country Promotion
<p>Sound economic policies that foster enterprise and entrepreneurship. More open markets, sustainable budget policies, and strong support for development will unleash the enterprise and creativity for lasting growth and prosperity</p>	<ul style="list-style-type: none"> ⇒ 1. Liberalize and De-Regulate Business Activities ⇒ 4. Remove International Capital & Trade Restrictions ⇒ 5. Facilitate Financing of Businesses ⇒ 9. Rationalize Investment Incentives ⇒ <i>Sound fiscal and monetary policies (framework pre-condition)</i>

Benchmarking Results

UKRAINE	RUSSIA	POLAND	HUNGARY	CHILE	ARGENTINA
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Business Liberalization Score

18	49	87	80	89	62
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Legal Environment Score

17	62	99	93	89	65
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Financial Sector Score

10	39	62	68	74	39
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Governance and Privatization Score

29	30	89	82	80	65
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Benchmarking Results

UKRAINE	RUSSIA	POLAND	HUNGARY	CHILE	ARGENTINA
Political Risk Score					
65	49	83	82	71	75
International Capital Controls & Foreign Trade Score					
63	45	78	79	84	69
Corruption Score					
15	21	41	52	74	35
Governmental Promotional Effort Score					
20	30	80	100	90	75
Tax and Investment Incentives Score					
31	48	78	82	63	70

IPCTF Ratings include reviews of the following indexes

- World Bank ratings
- Heritage Foundation Index of Economic Freedom
- Euromoney Indexes
- UNDP index
- Transparency International Index on Corruption
- International Country Risk Guide
- EBRD indexes

Proposed Action Plan for Ukraine

Liberalize and De-regulate Business Activities

1. Finalize and communicate widely the Government's De-regulation Policy, consistent with international standards, and rapidly implement it to simplify and facilitate registration of new businesses, the operations of existing businesses, and import/export of goods.
2. Establish an appropriate on-going mechanism to liberalize business activities, establish deregulation priorities, and monitor legislation to support business liberalization.
3. Eliminate current incentives to excessive Government intervention, such as the right of some agencies to retain part of the fines they impose on businesses.

Provide Stable and Predictable Legal Environment

1. Create an independent and incorruptible judiciary, separate from the Executive branch.
2. Pass well-conceived new laws or modify existing legislation as needed to provide a more favorable framework for business, including the civil code, the labor code, the criminal code the tax code and others.
3. Establish an efficient legislative process to coordinate and expedite the drafting of laws and regulations.

Enhance Corporate and Public Governance and Accelerate Privatization

Corporate Governance

1. Demonstrate corporate financial discipline by closing 10-20 big loss-making state companies within next two years.
2. Enact the Joint Stock Company Law of Ukraine to modernize Ukrainian corporate governance legislation.
3. Require all publicly traded (listed) companies to use international accounting standards and to provide regular reports and audited annual financial statements.

Public Governance

1. Implement public administration reform to reduce the size of state agencies, raise salaries of key civil servants, and redefine the Government's role as that of supporting -- not replacing -- private activities.
2. Extend administrative reform to local bodies.
3. Reduce shadow economy activities by drastically cutting red tape and lowering cost of compliance with laws in effect.

Privatization

1. Secure the quick approval and implementation of the Land Code to promote private ownership and registration of land.
2. Encourage the independence of the State Property Fund (SPF) by passing the Law on the State Property Fund and subordinating it to the Executive branch.
3. Take early actions to prepare state companies for privatization (including actions to protect minority shareholder rights and transfer social assets to local authorities) and complete expeditiously the privatization of energy sector and other major enterprises under clear and transparent procedures.

Reduce International Capital and Foreign Trade Restrictions

1. Liberalize foreign exchange transactions and eliminate restrictions on foreign direct investments in certain sectors - insurance, publishing, broadcasting and telecom.
2. Reduce restrictions to imports and exports, including high import duties, the critical import list, export quotas, duties, indicative prices, advance deposits, forex surrender requirements.
3. Simplify and expedite custom services, including procedures for custom clearances and for certification of imported products.

Facilitate Business Financing by the Financial Sector

1. Increase the independence of the banking sector, including the NBU, improve and enforce commercial bank supervision and prudential regulations.
2. Strengthen the Securities and Stock Market State Commission mandates in security-related activities of all financial institutions.
3. Accelerate the adoption of the Law On the Institutions of Joint Investments.

Eliminate Corruption

1. Undertake measures to “prevent” corruption, reducing the opportunities for corruption and making corruption more difficult to undertake, starting with key areas such as barter and the energy sector.
2. Develop the legal framework needed to ensure better enforcement of anticorruption measures and impose visible, harsh, swift and certain penalties for corruption of Government officials.
3. Get public support for anti-corruption programs by making people aware of their rights and the rules of the game.

Reduce Political Risks

1. Demonstrate an understanding of the importance foreign investors place on expropriation, including “creeping expropriation”.
2. Bring tax collectors and local authorities under the control of the central administration.
3. Government enterprises in competition with private business in the same sector should not get preferential treatment.

Expand Country Promotion

1. Announce and disseminate widely the Government's policy and commitment to implement strong market oriented policies and show implementation progress.
2. Vocally support foreign investment by changing the attitude of officials at central and local levels.
3. Require all Ukrainian embassies abroad to have their commercial section strengthened, and to go on sales drives to better disseminate business opportunities.

Rationalize Investment Incentives

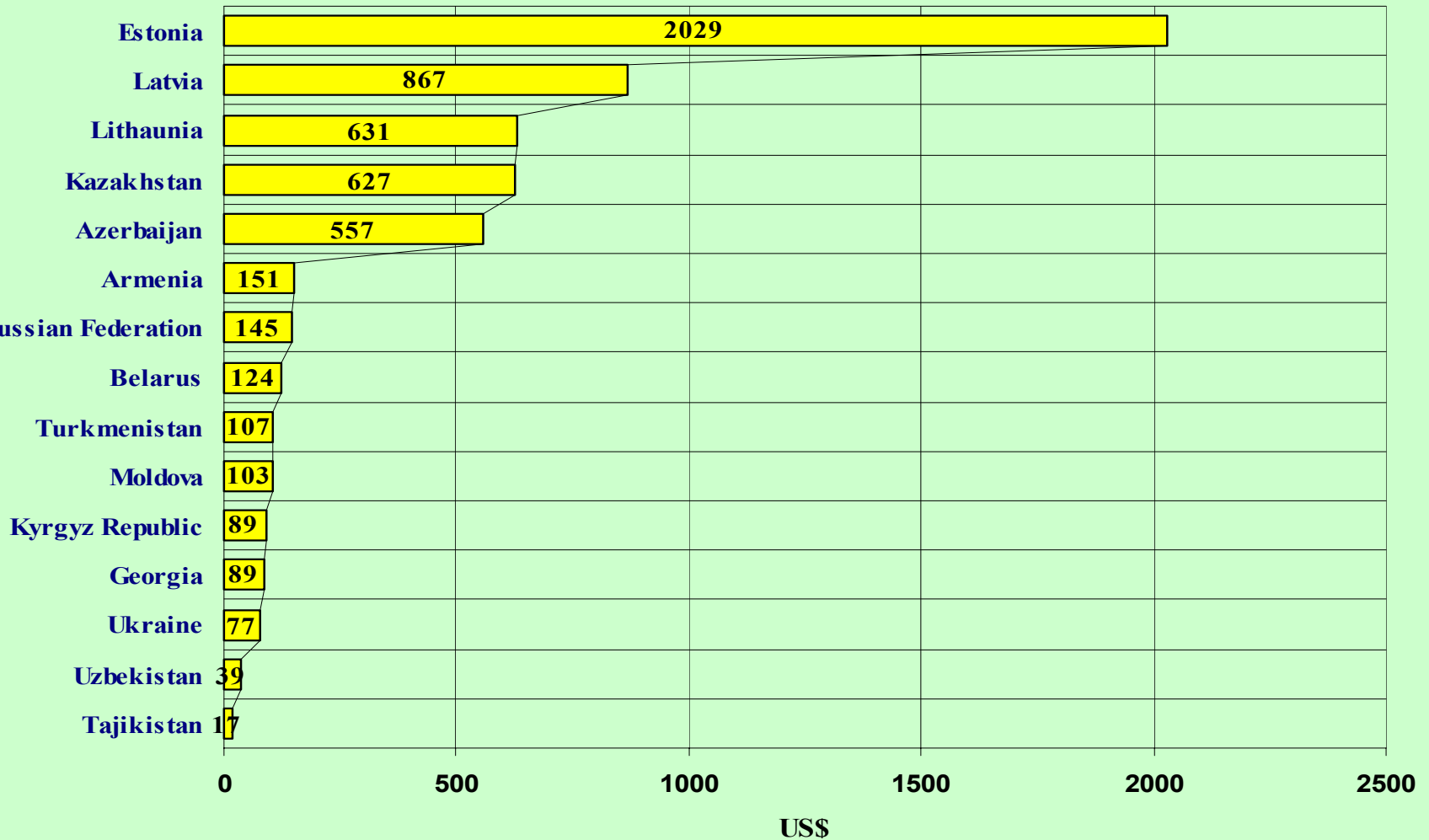
1. Institute a level playing field by eliminating any special incentives for particular sectors, companies or geographical zones.
2. Enact the new Tax Code that would decrease the number of taxes and surcharges, reduce tax rates, eliminate tax privileges, and rationalize the value-added tax, personal income tax, and corporate income tax systems.
3. After a rational Tax Code has been passed, aim to minimize subsequent tax changes by imposing a moratorium.

IPCTF Effort Milestones

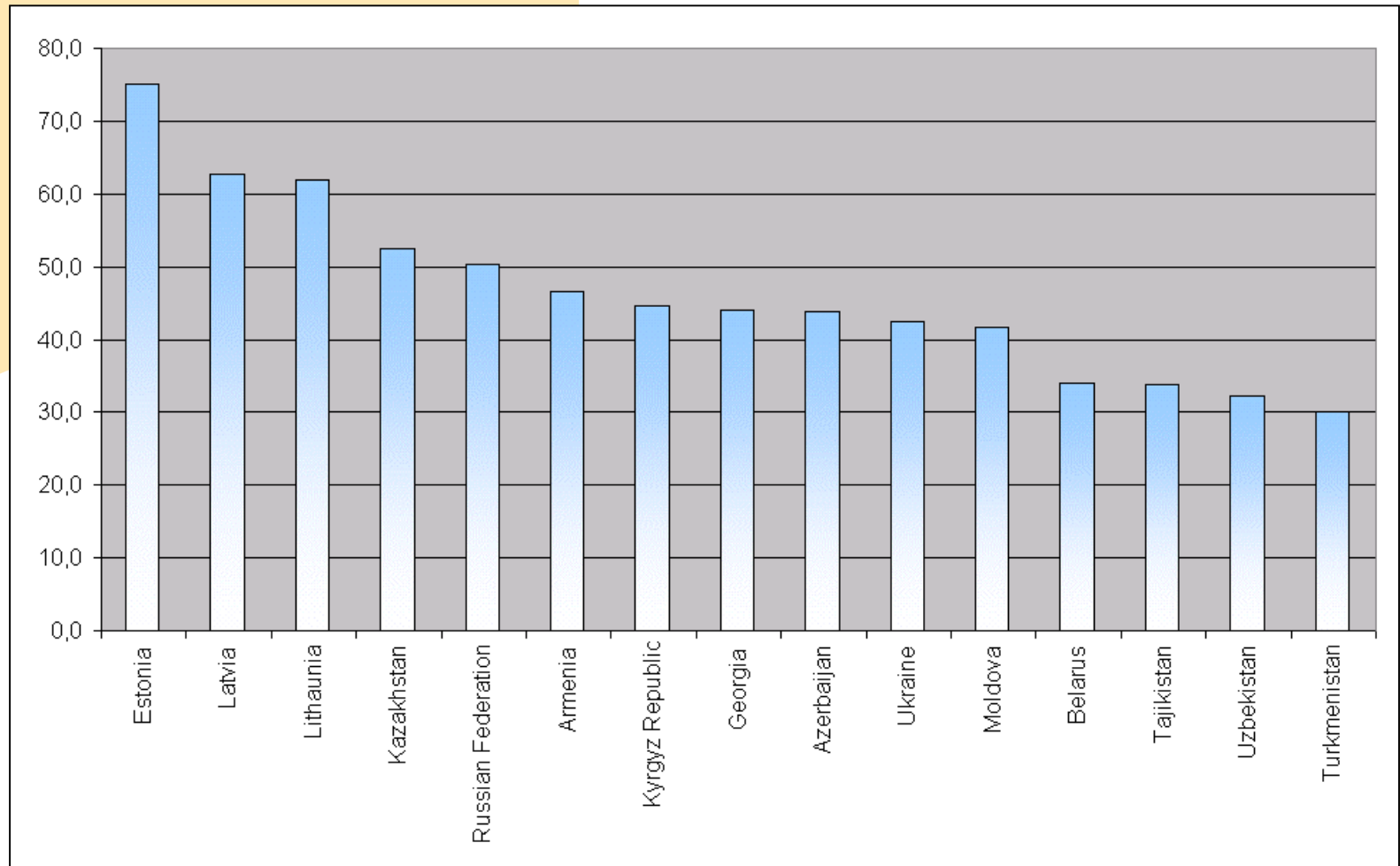
- IPCTF creation – 1999
- Benchmarking, drivers identification, framework development, econometric modeling, Action Plan development – 2000
- Presentation to Cabinet of Ministers (Yushchenko PM) – February 28, 2001
- Final report published – April 22, 2001
- Ukrainian President signs a decree to improve investment climate based on the IPCTF recommendations – July 12, 2001
- Bleyzer Initiative to complete transitions in FSU countries is developed, IPCTF framework applied to 15 countries of FSU – 2001
- A number of Laws passed consistent with the Action Plan
- Cabinet of Ministers (Kinakh PM) approves Government Program to implement the decree – December 2001
- Action Plan for Ukrainian Government program for 2002 – 2010 being developed – 2002
- MCA initiative is announced by President Bush – March 2002

Cumulative FDI per Capita

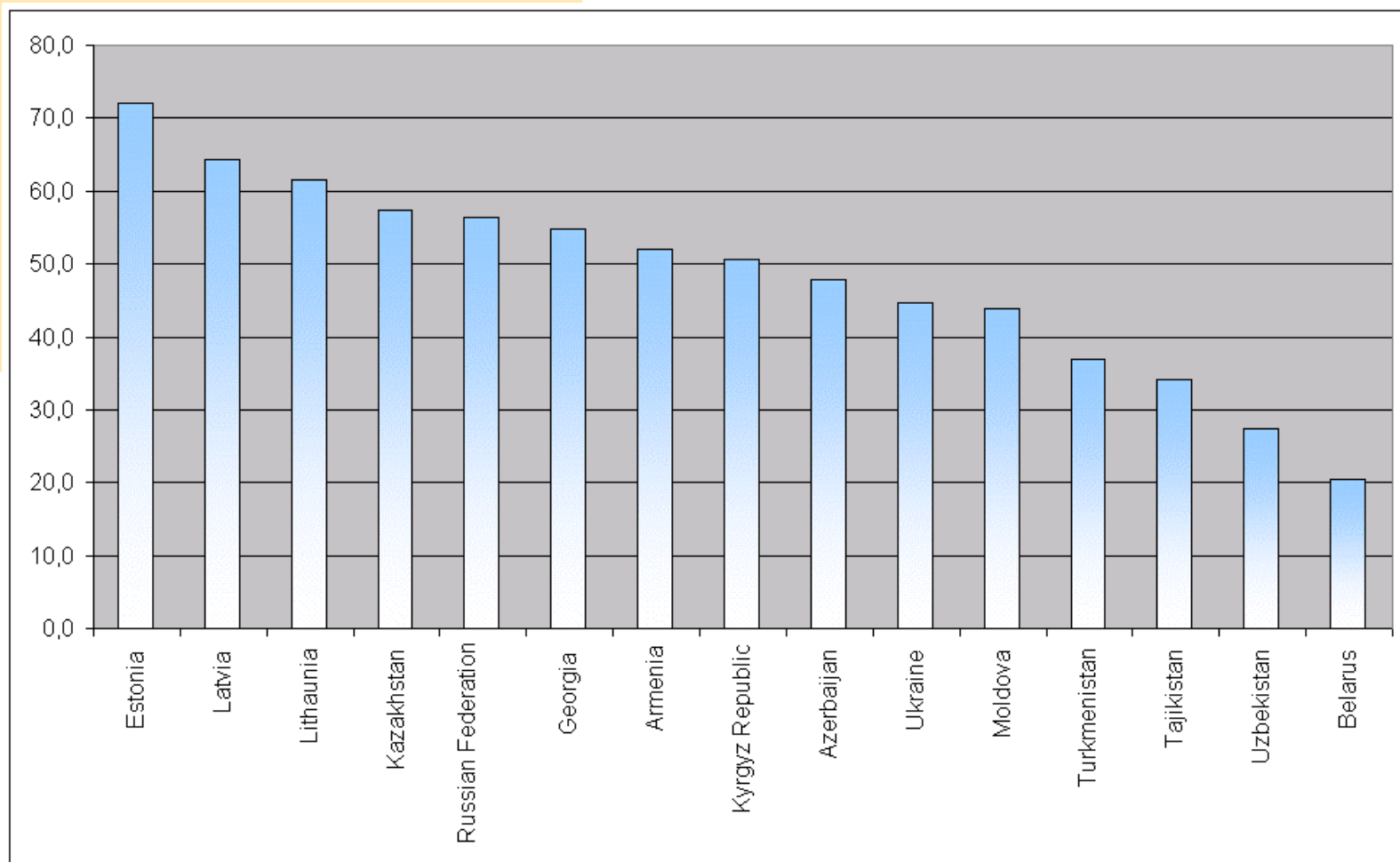
Cumulative FDI per Capita to FSU Countries, 2000



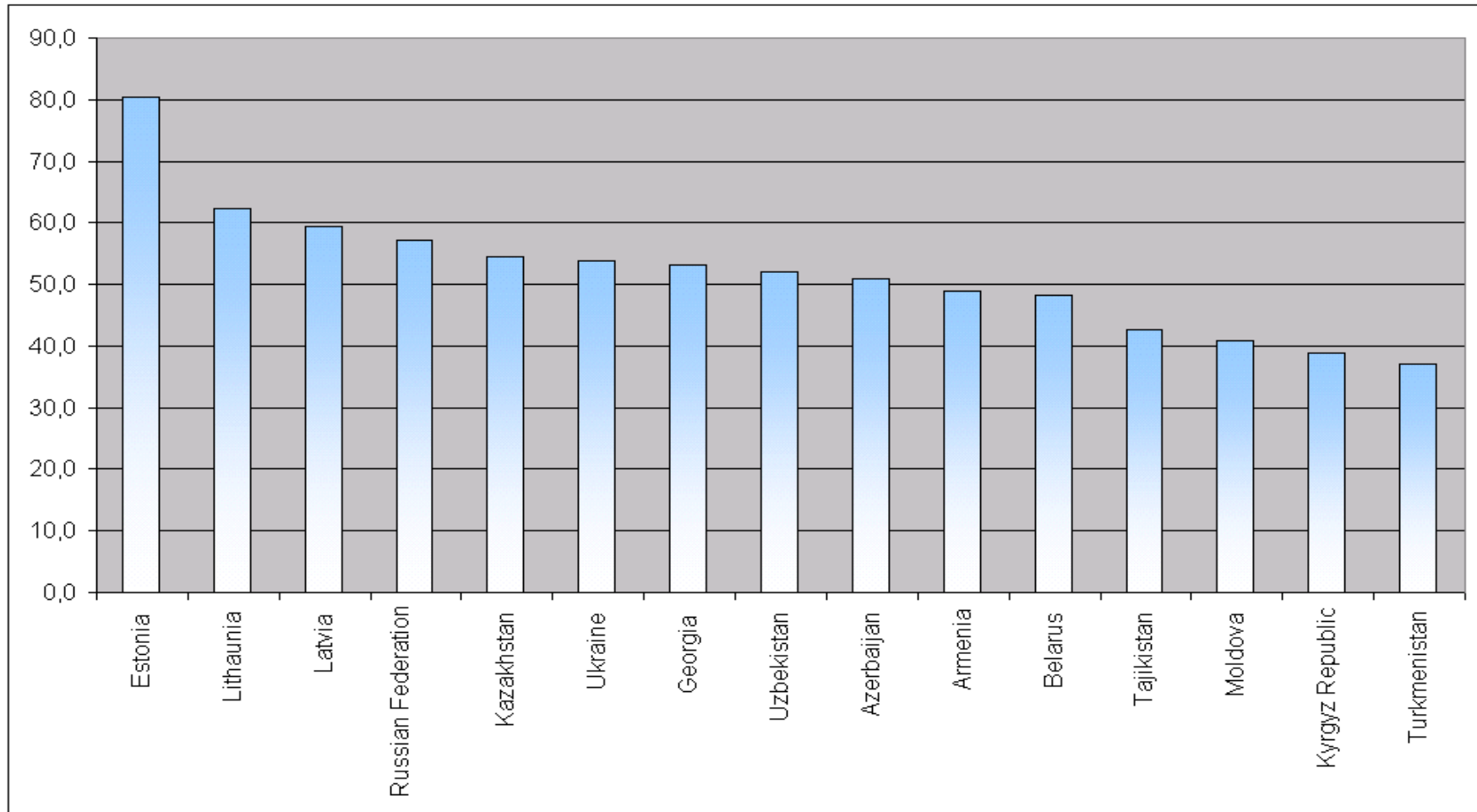
Average IPCTF Rating of the FSU Countries



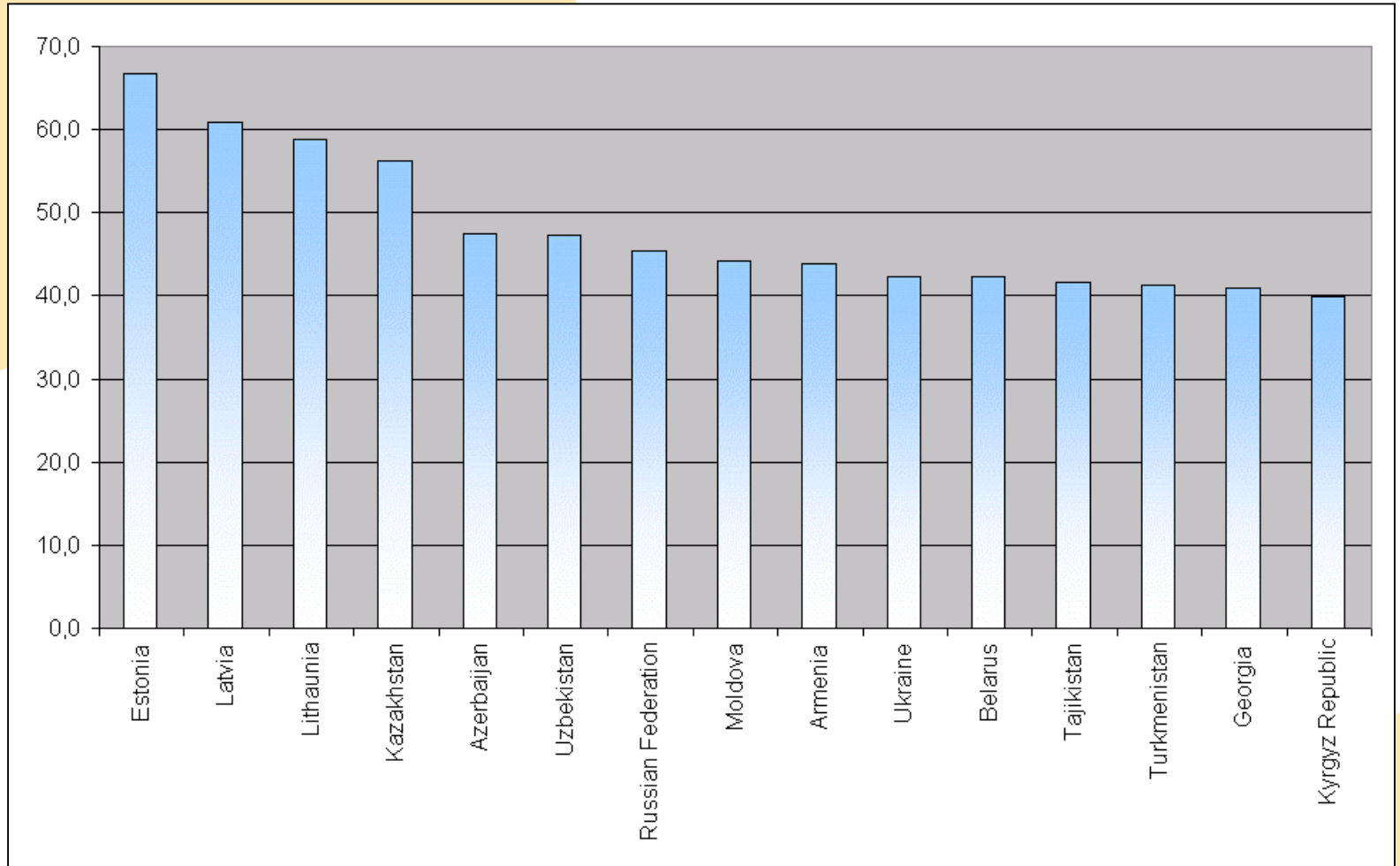
IPCTF Ratings: Business Liberalization



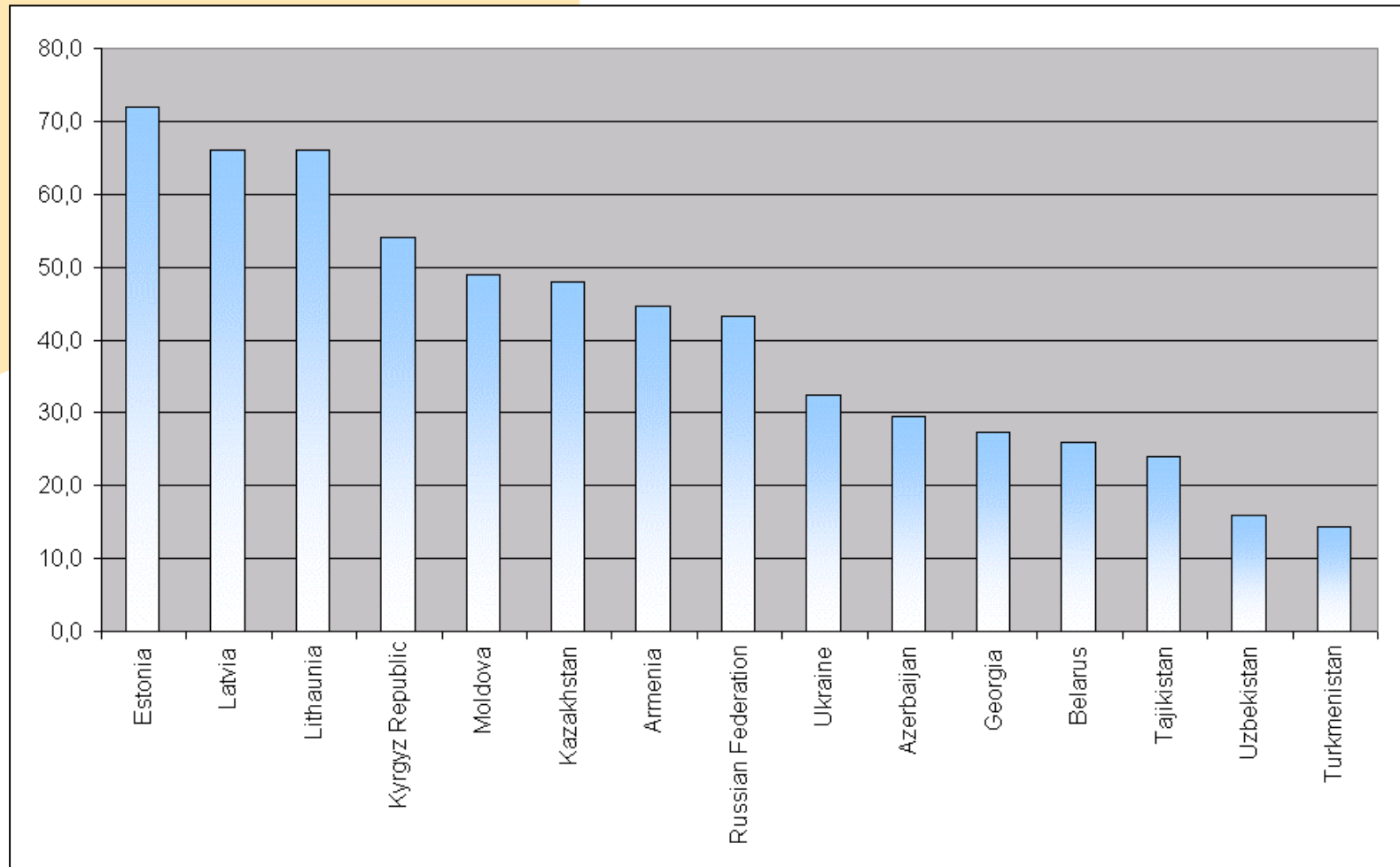
IPCTF Ratings: Legal Environment



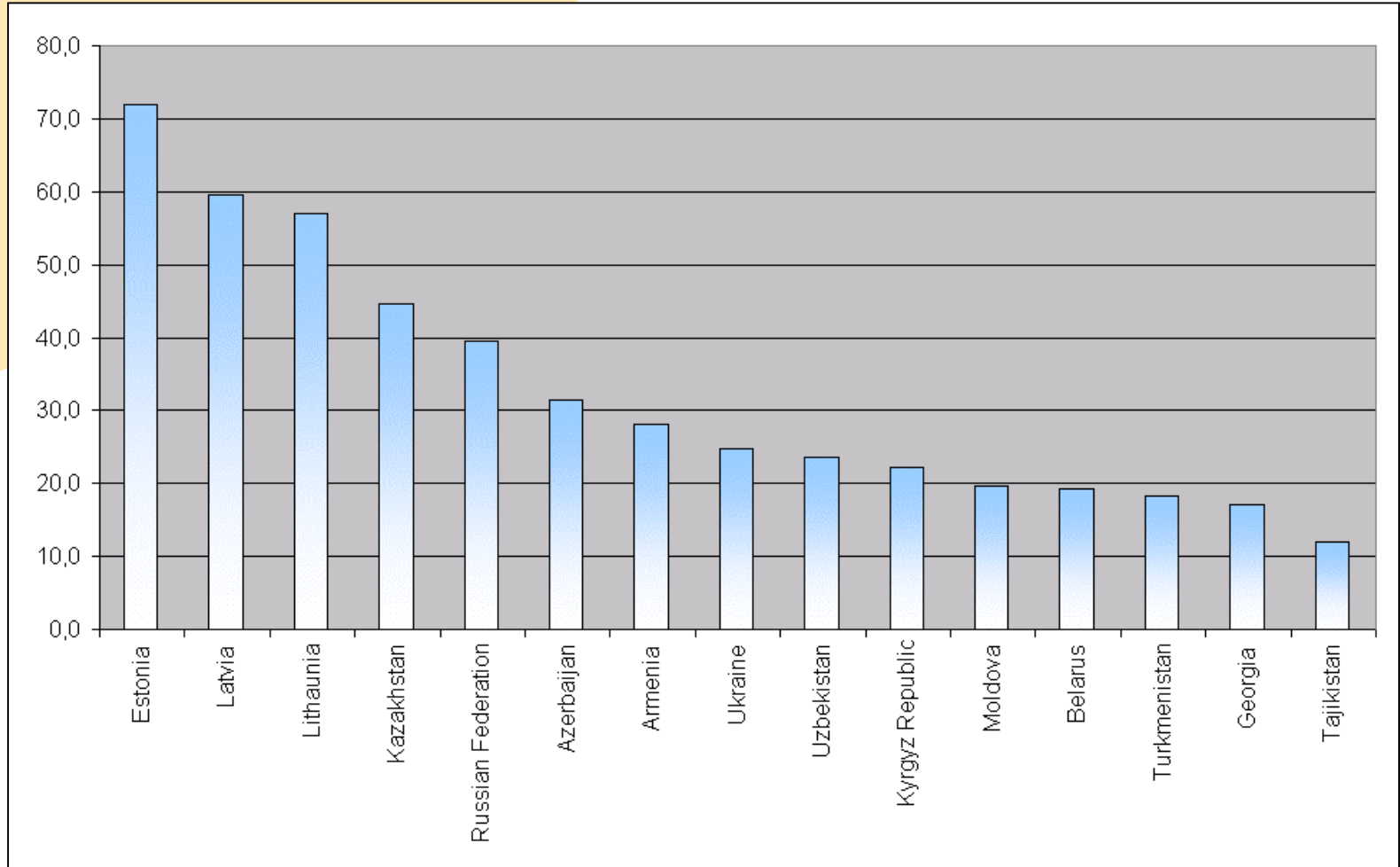
IPCTF Ratings: Financial Sector



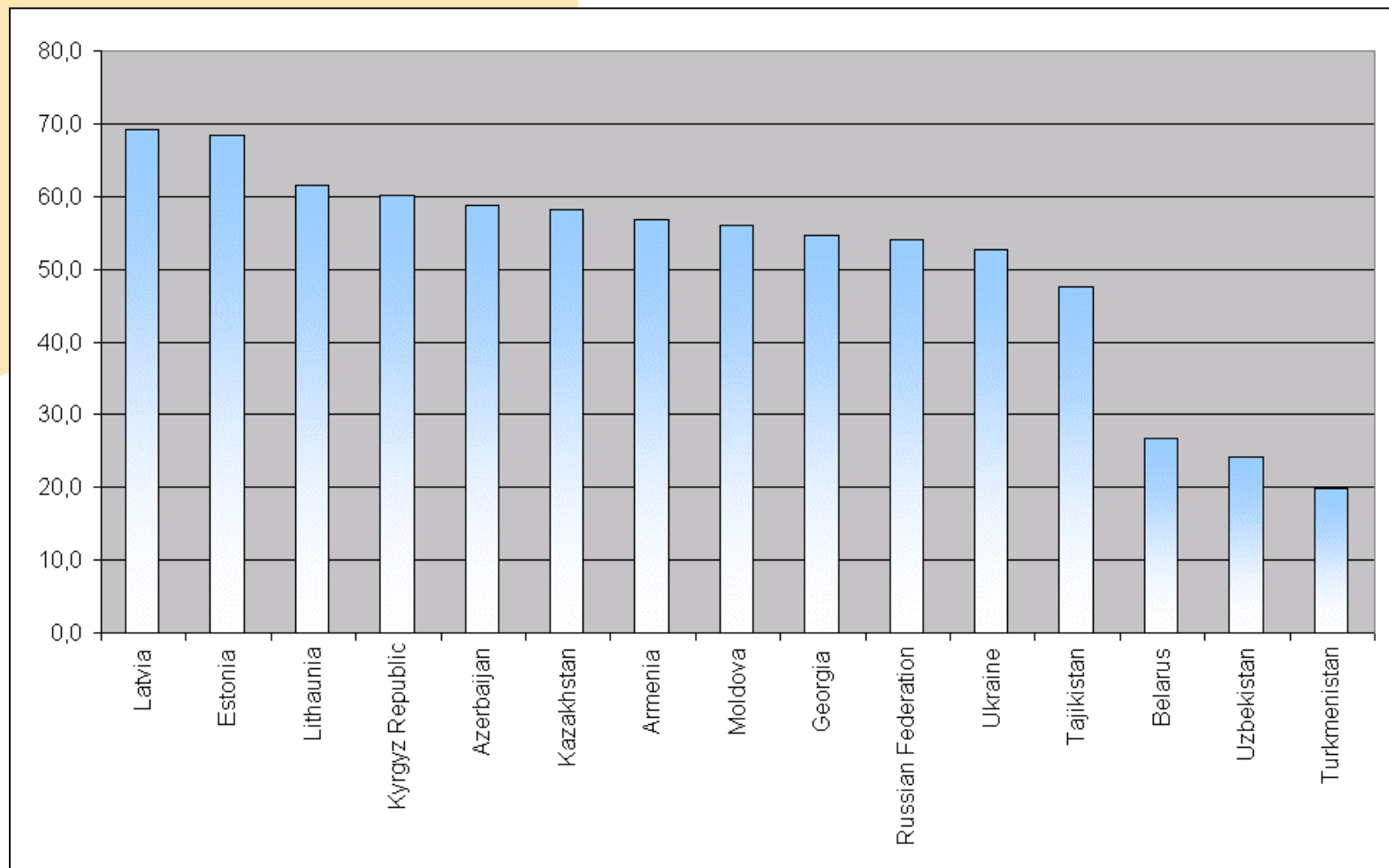
IPCTF Ratings: Governance and Privatization



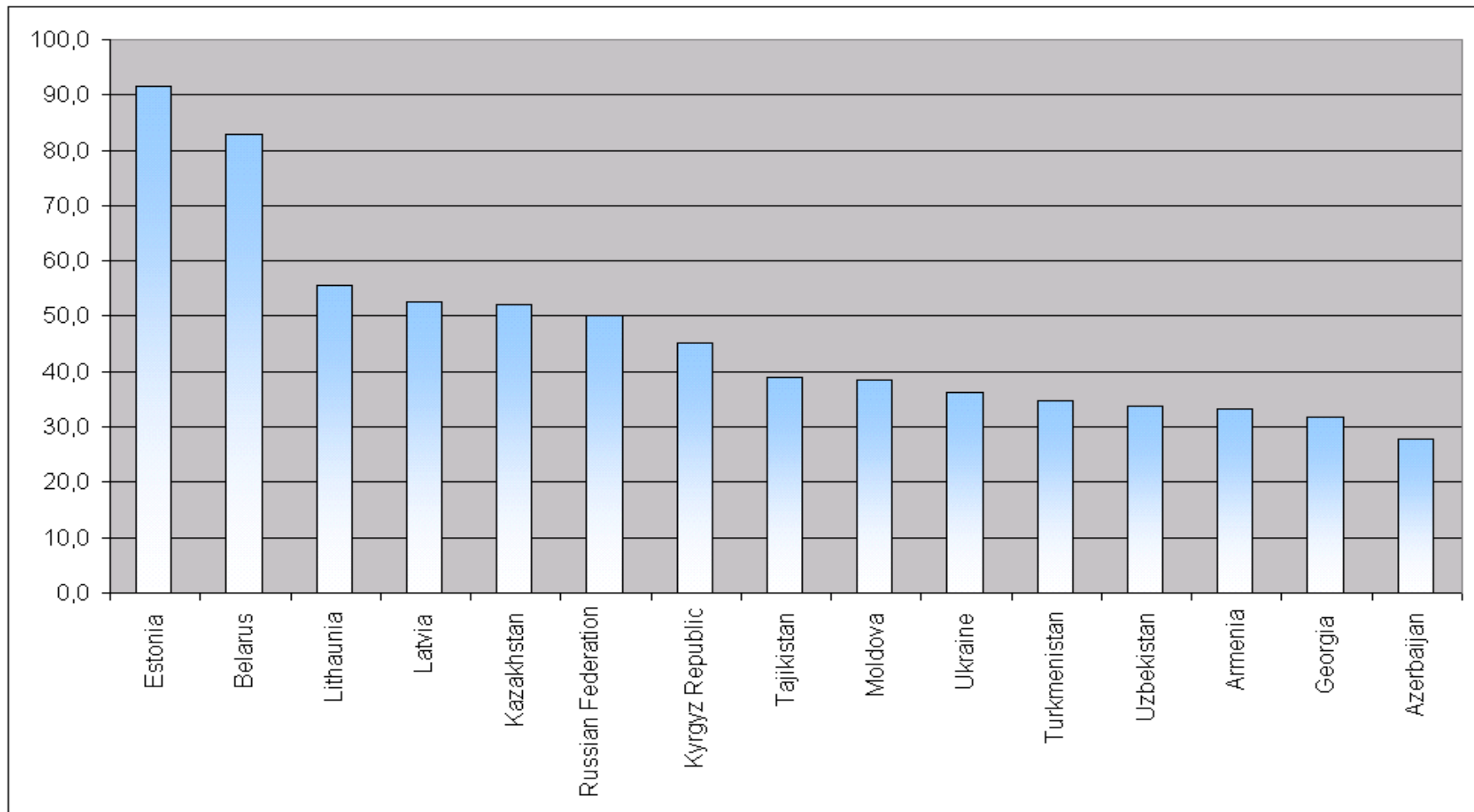
IPCTF Ratings: Political Risk



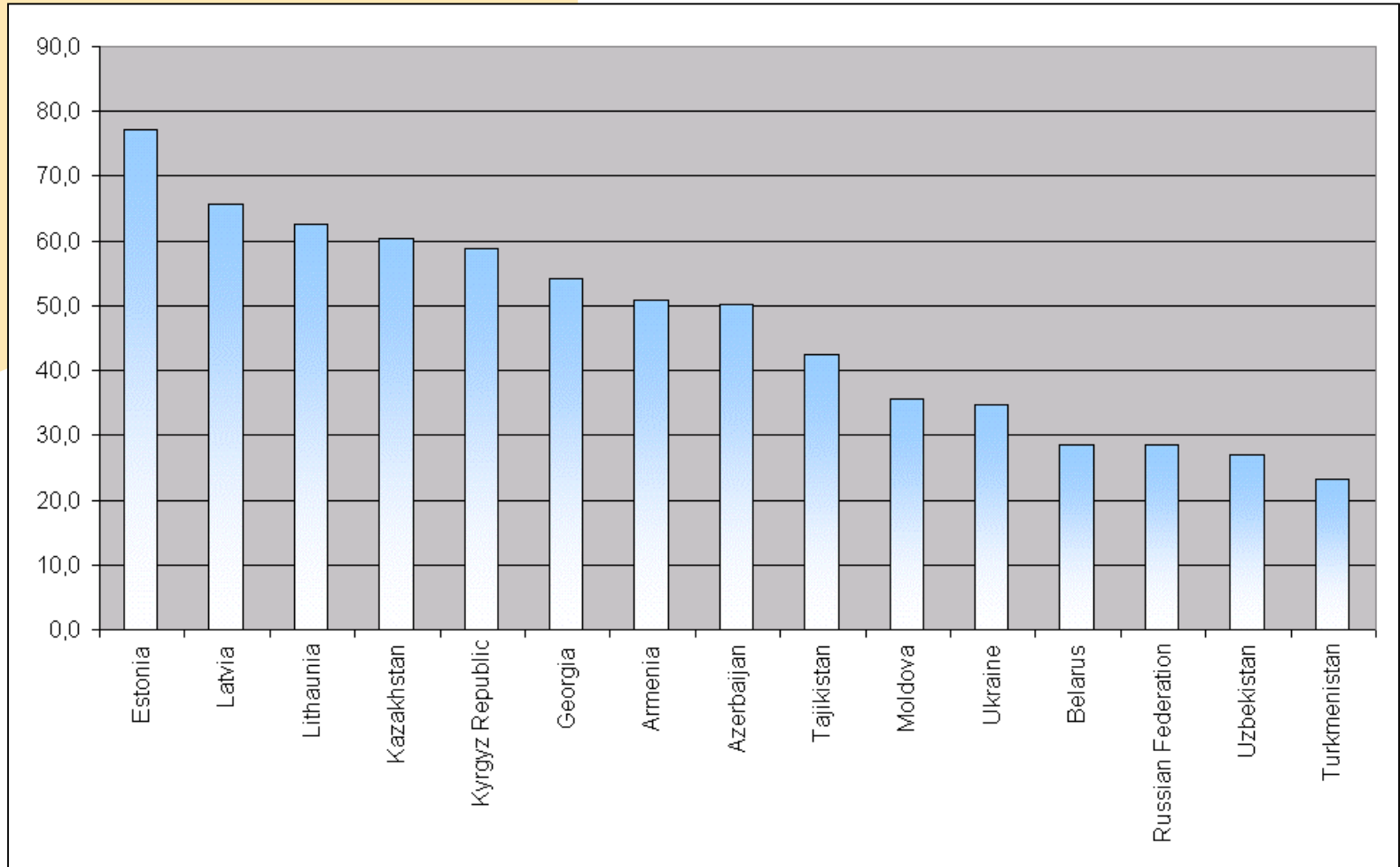
IPCTF Ratings: International Capital Control and Foreign Trade



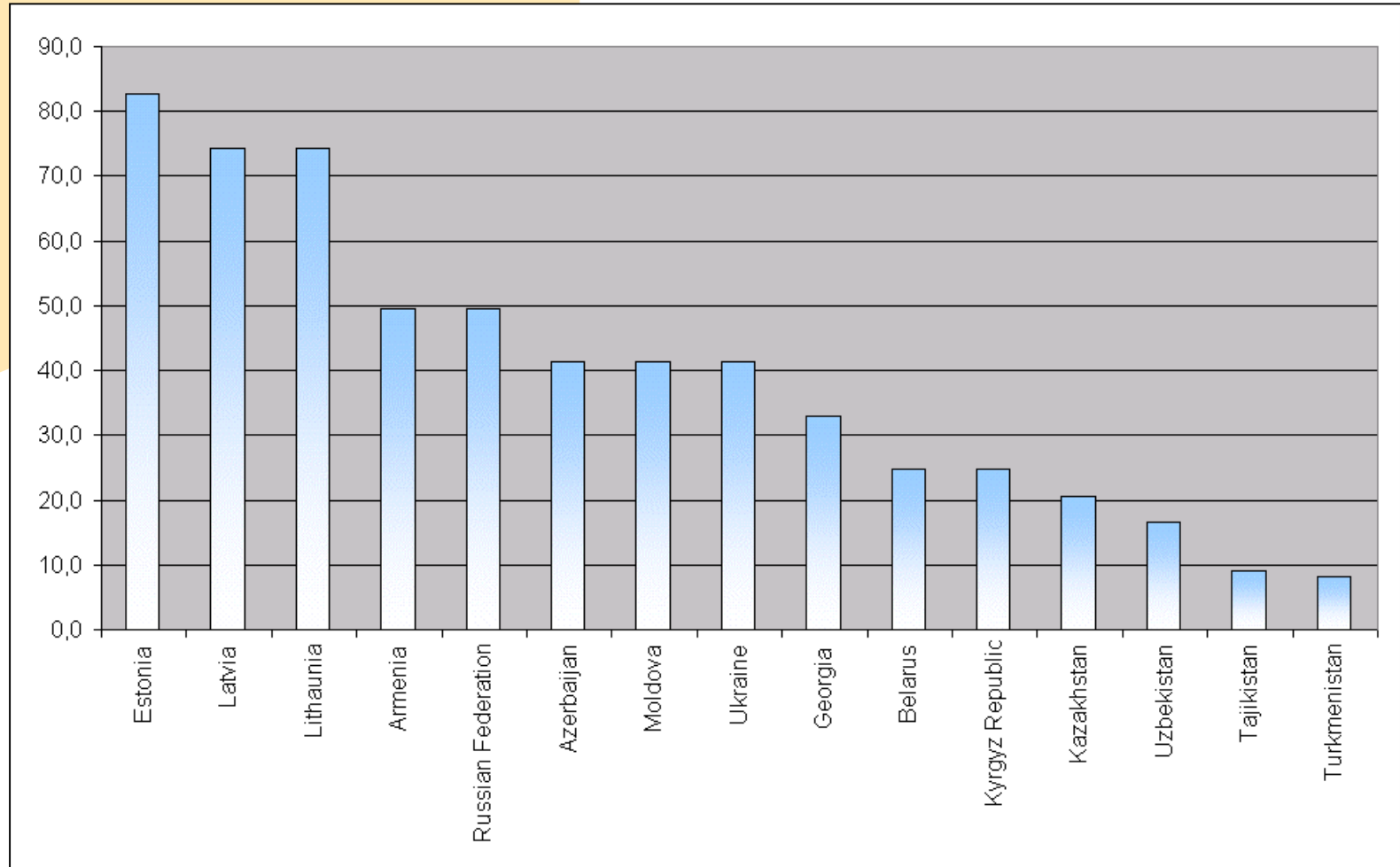
IPCTF Ratings: Corruption



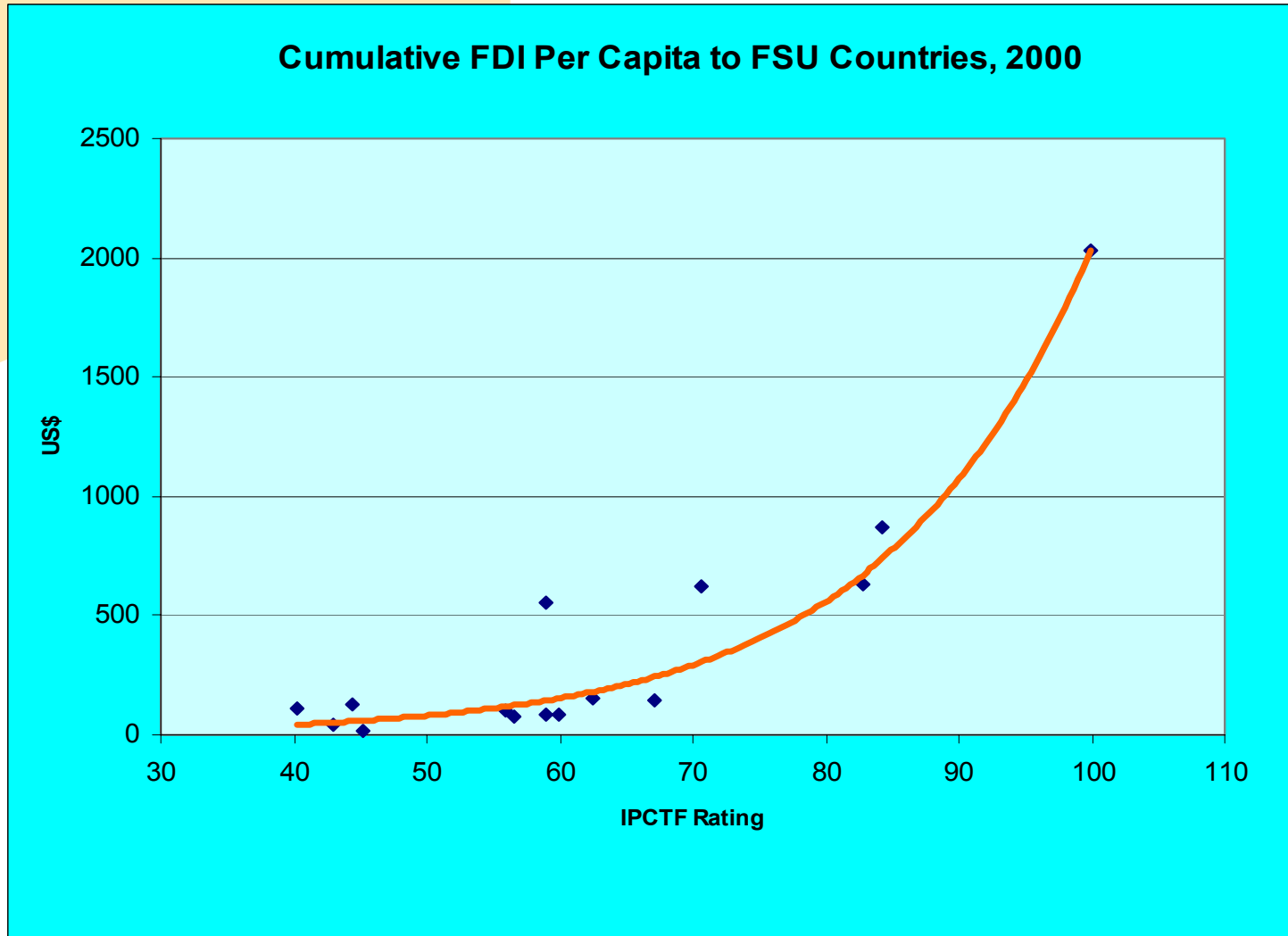
IPCTF Ratings: Tax and Investment Incentives



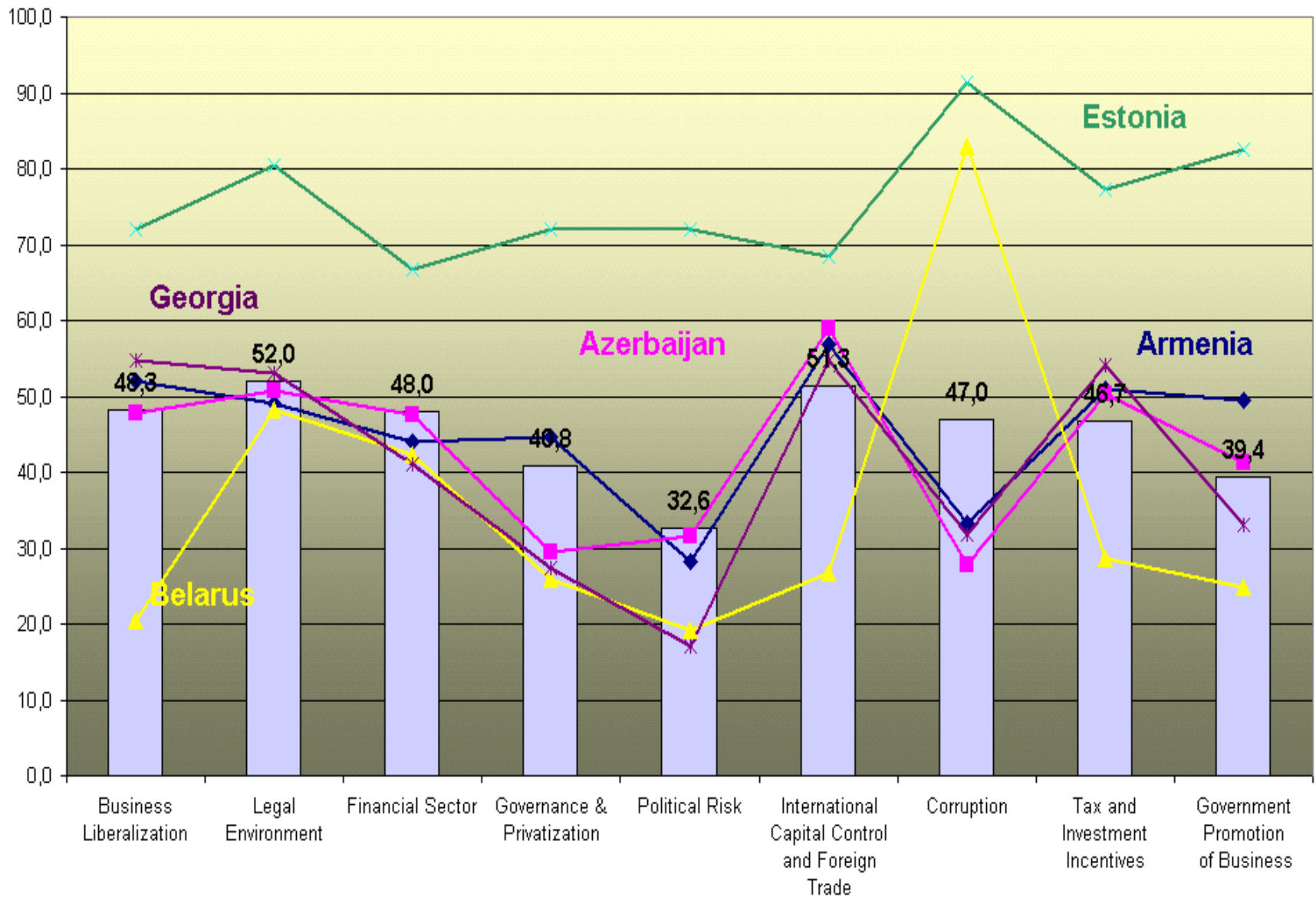
IPCTF Ratings: Country Image and Promotion



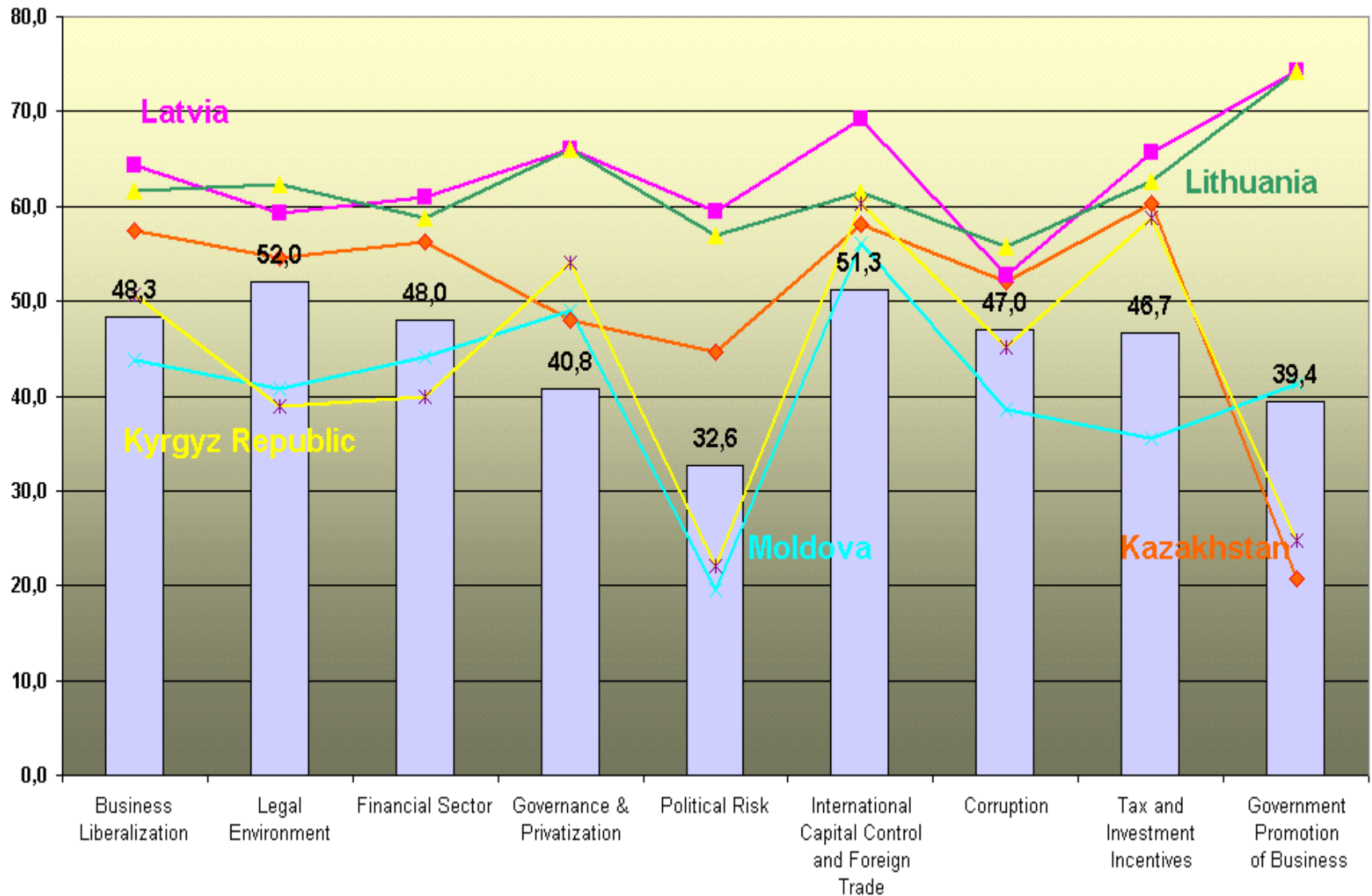
Relationship between FDI and ICTF Ratings



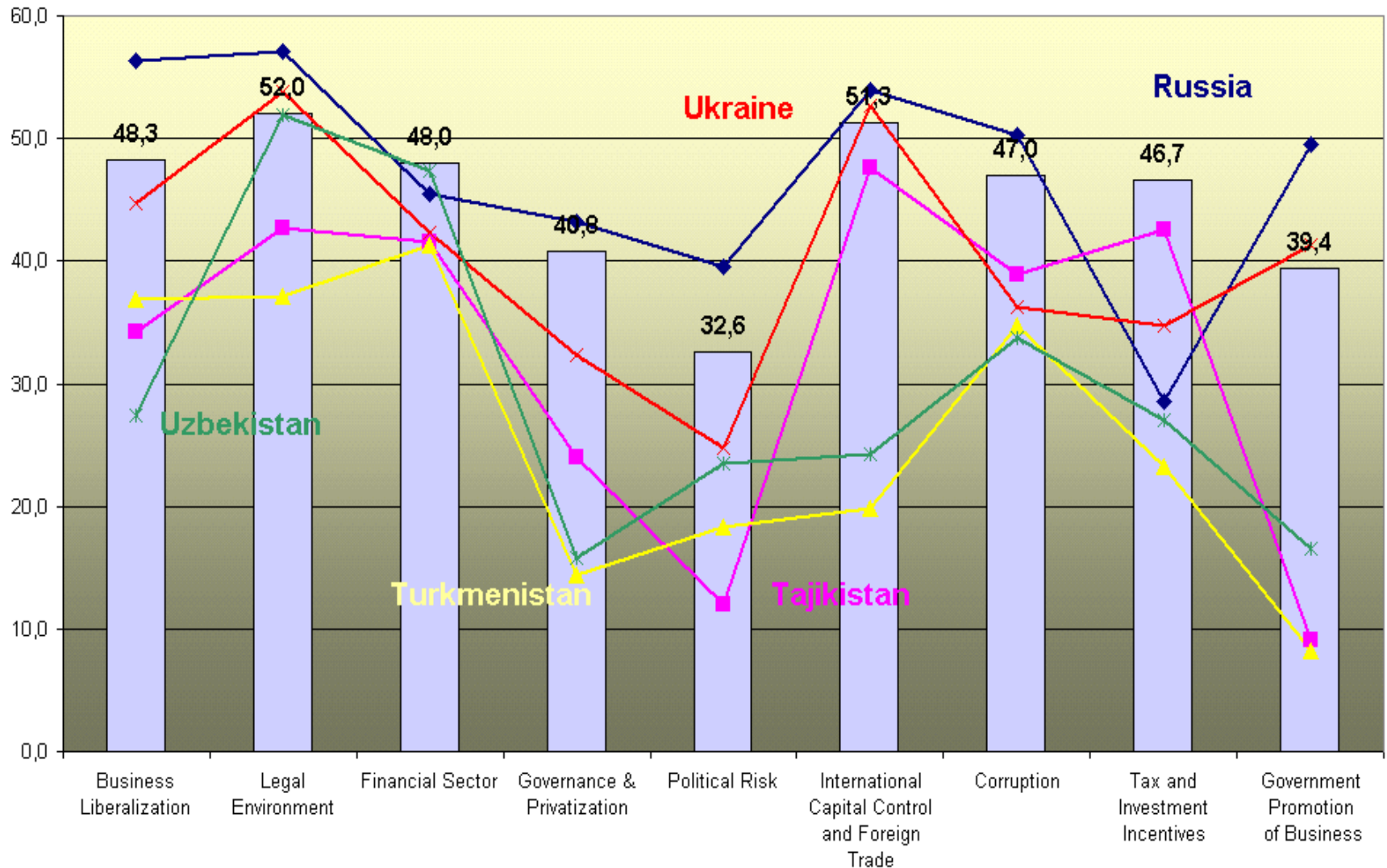
Benchmarking Analysis for FSU Countries, 2000-2001



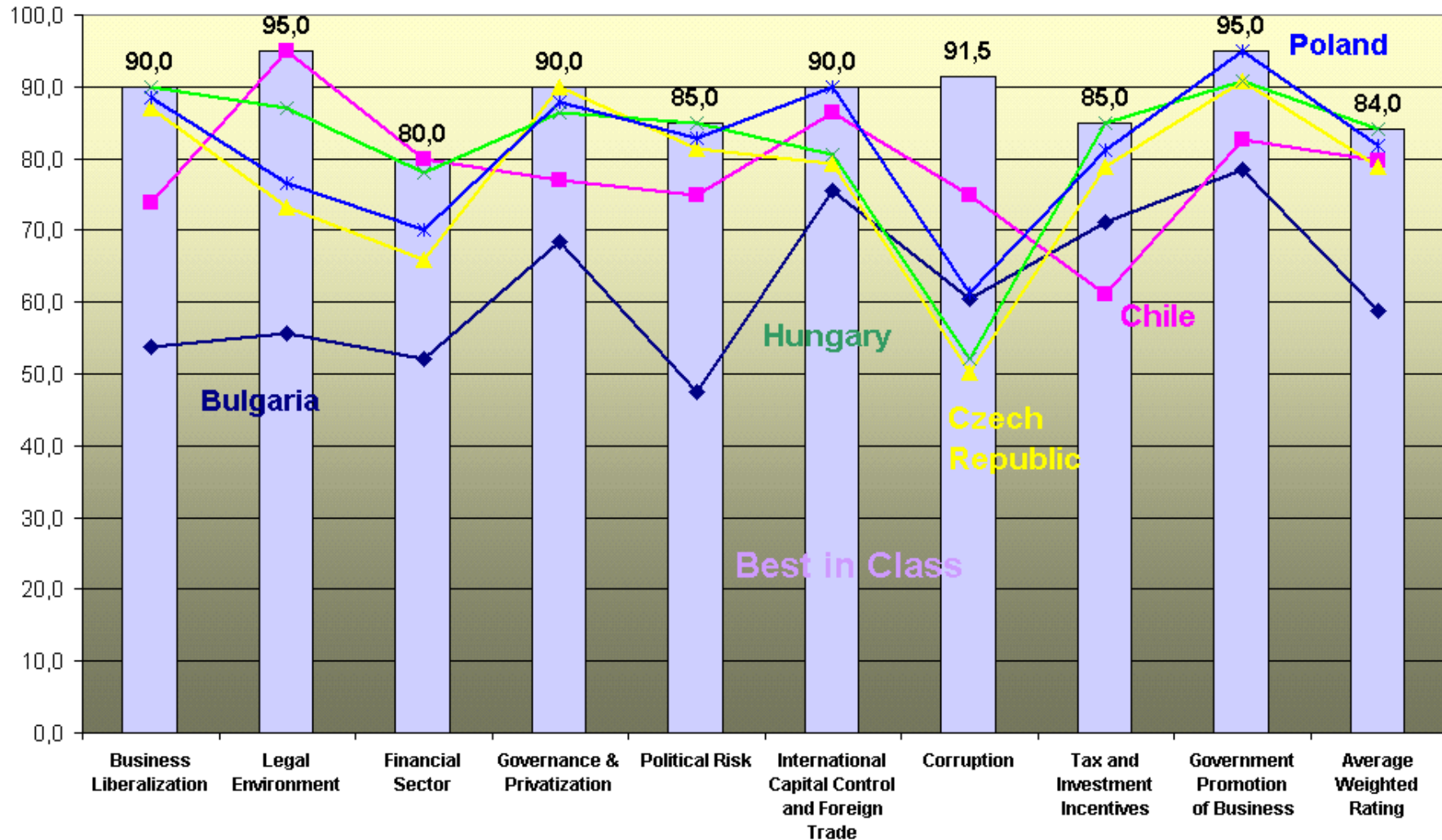
Benchmarking Analysis for FSU Countries, 2000-2001 (continued)



Benchmarking Analysis for FSU Countries, 2000-2001 (continued)



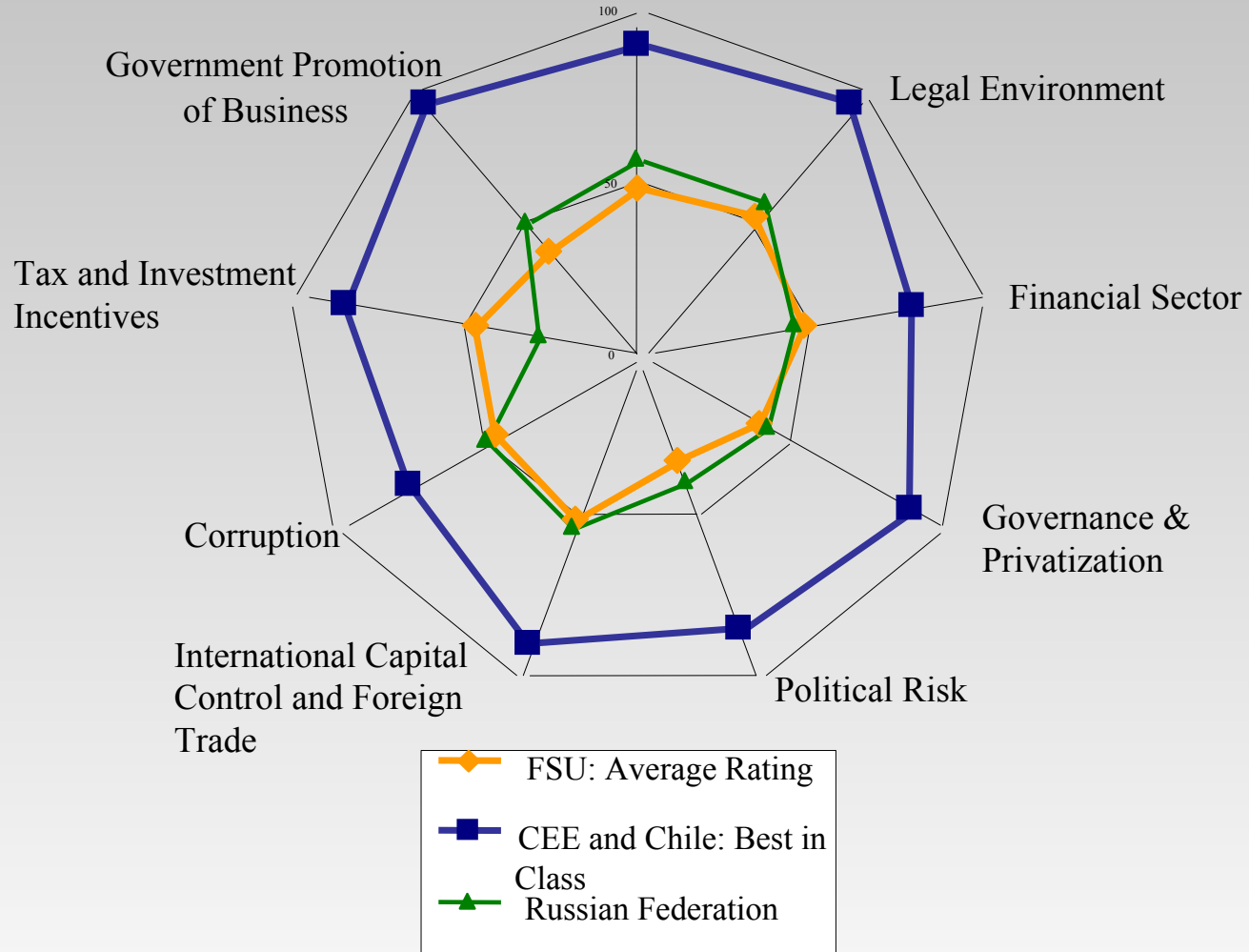
Benchmarking Analysis for CE Countries and Chile, 2000-2001



IPCTF NONAGON

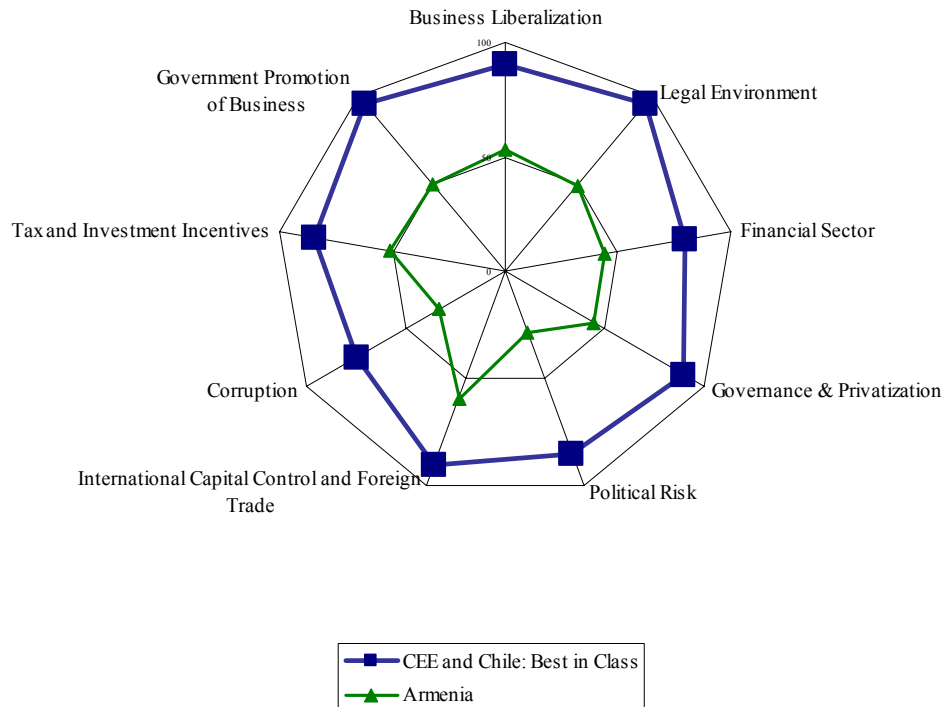
Best in CEE, Chile and FSU Countries

Business Liberalization

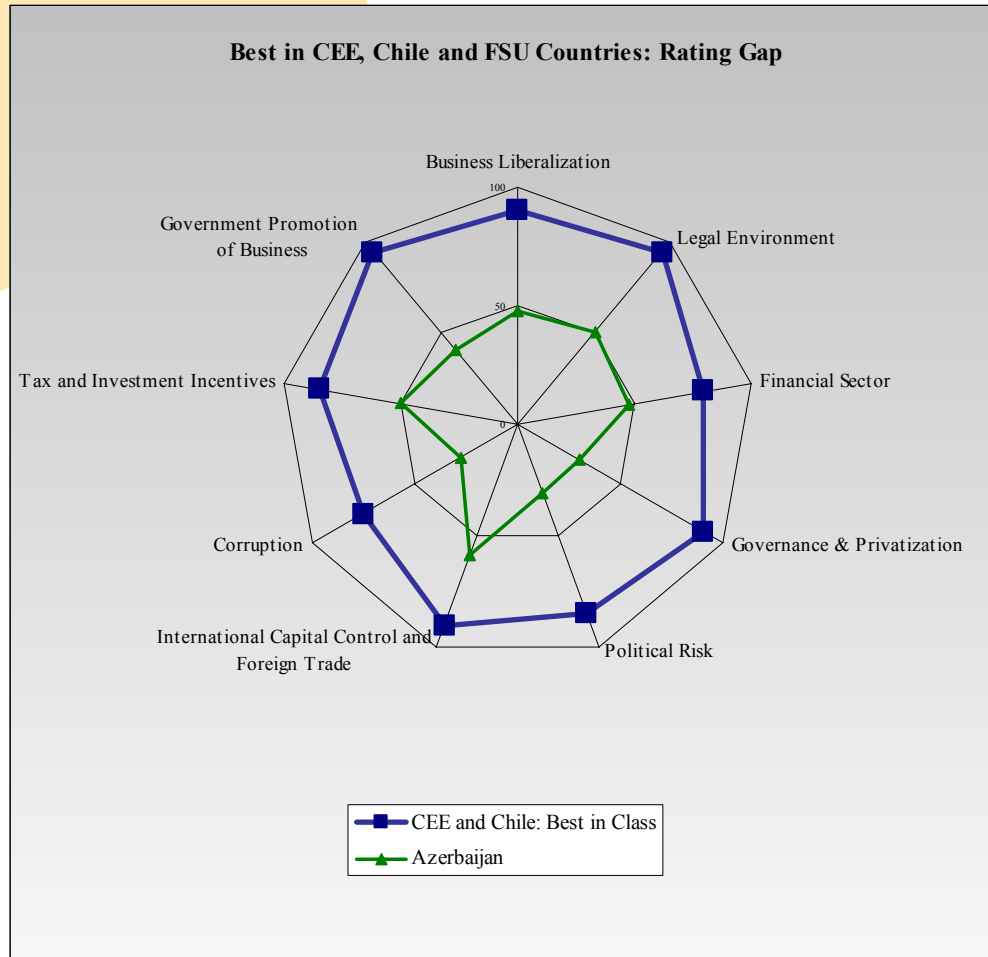


Armenia

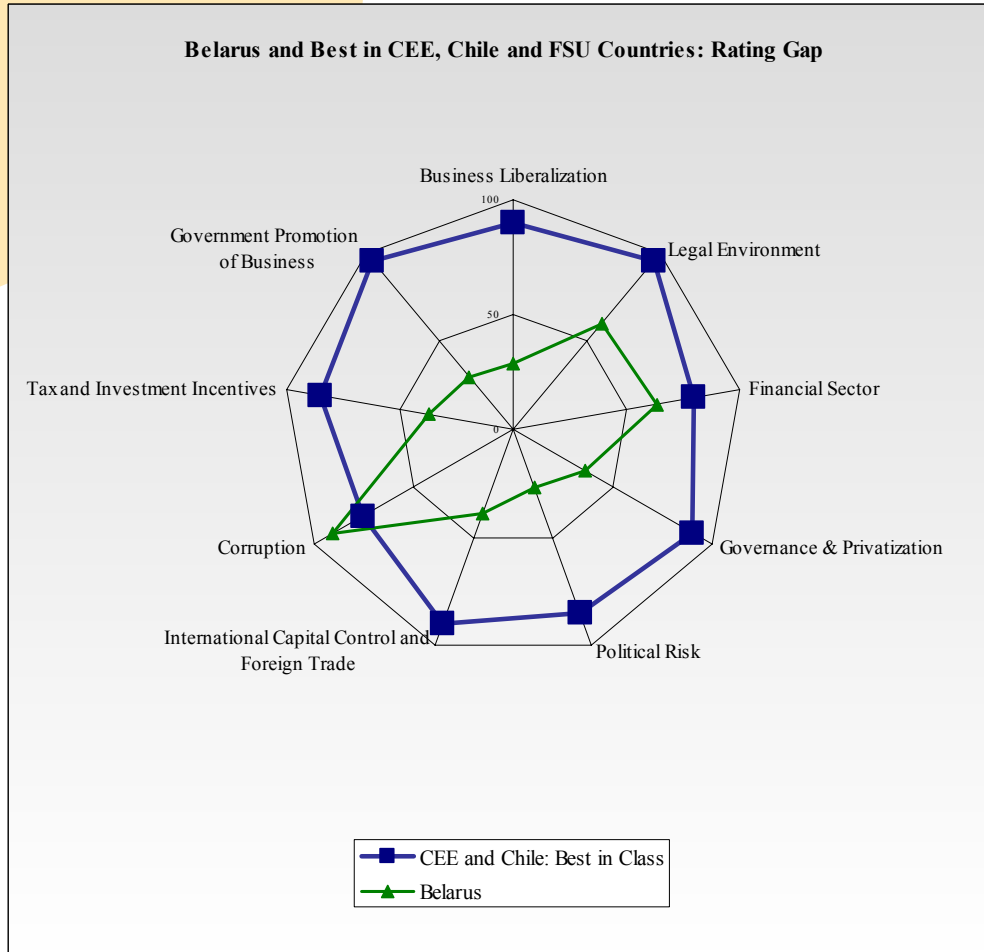
Best in CEE, Chile and FSU Countries: Rating Gap



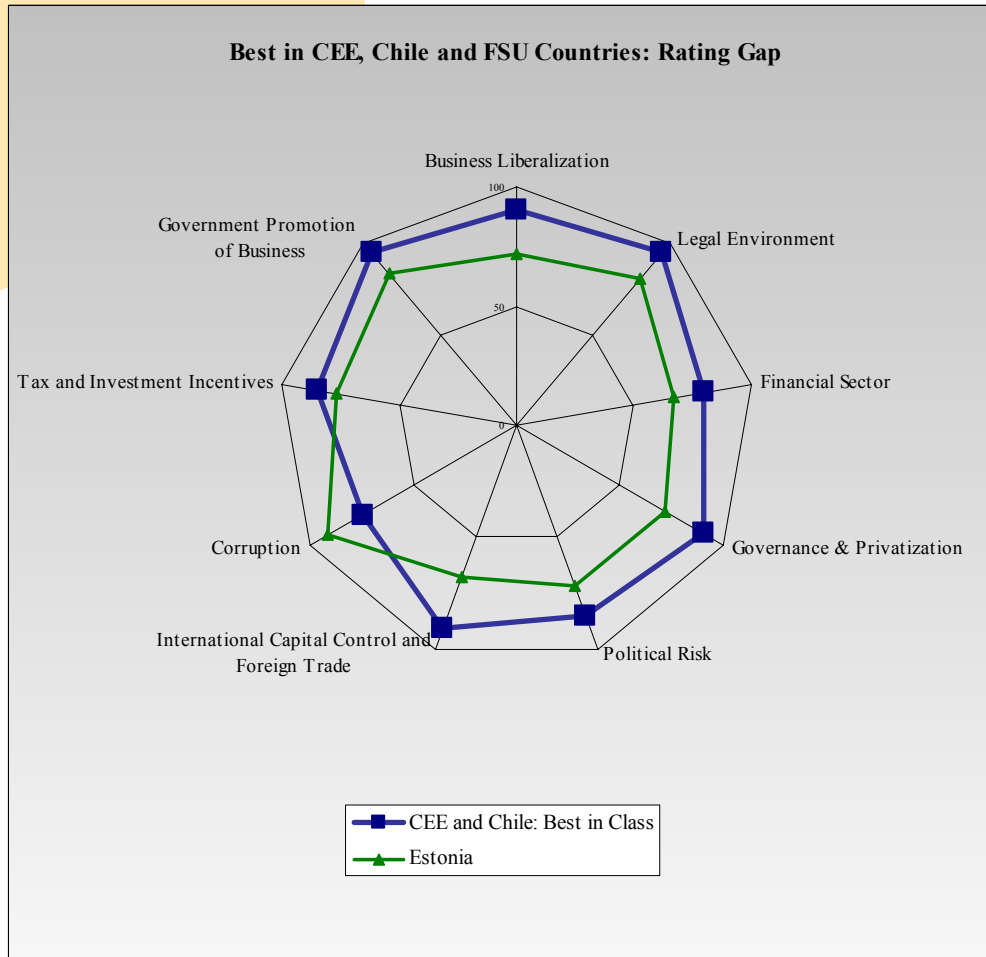
Azerbaijan



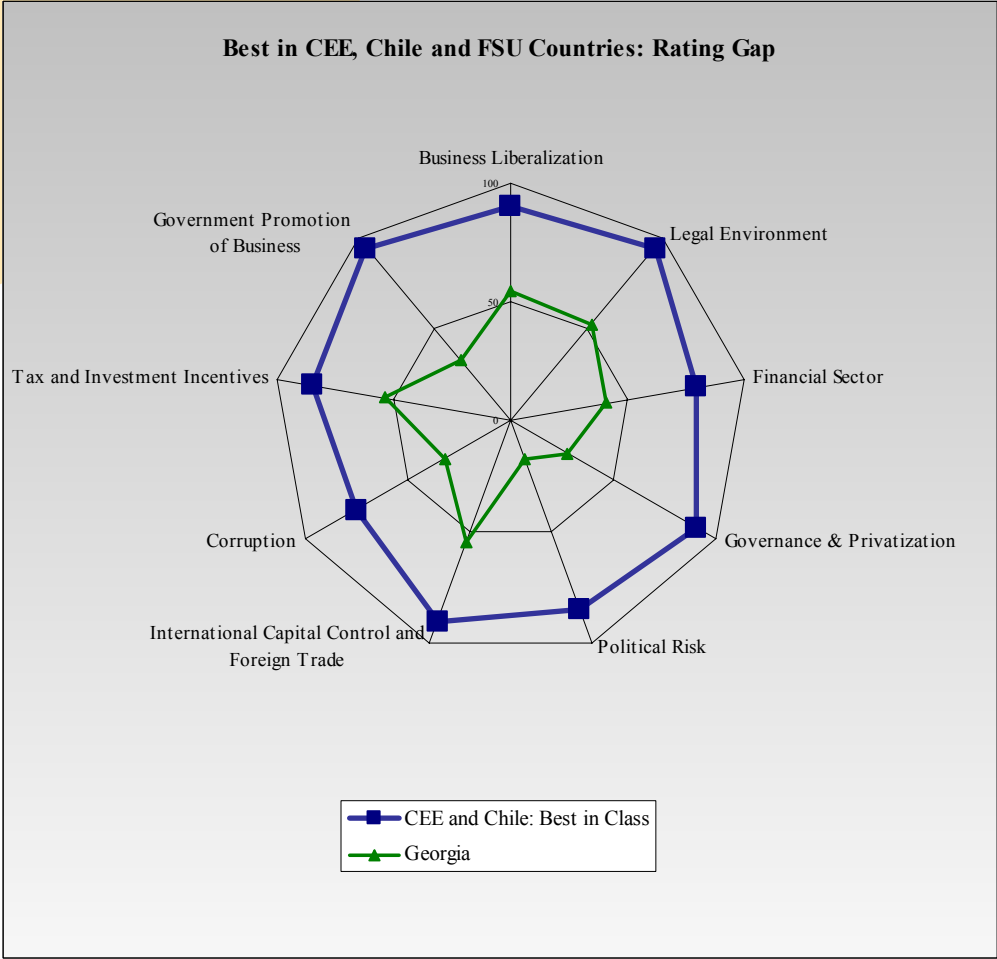
Belarus



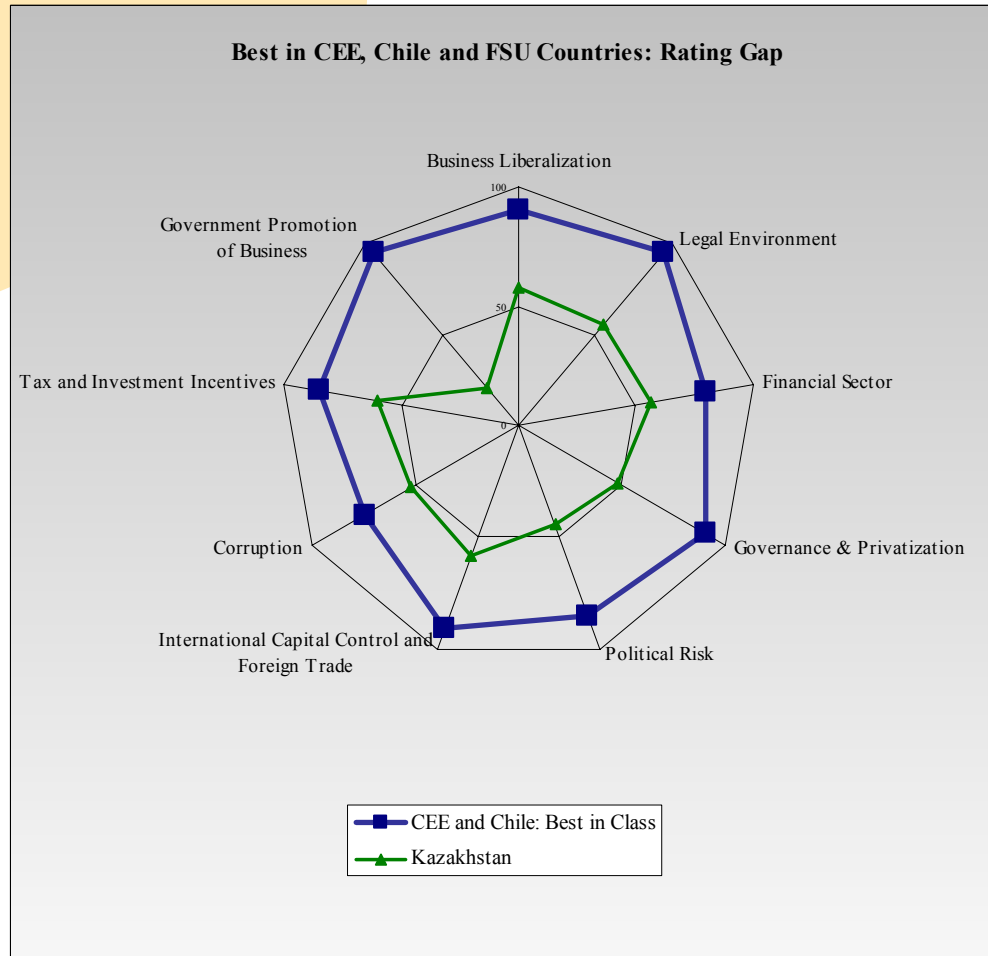
Estonia



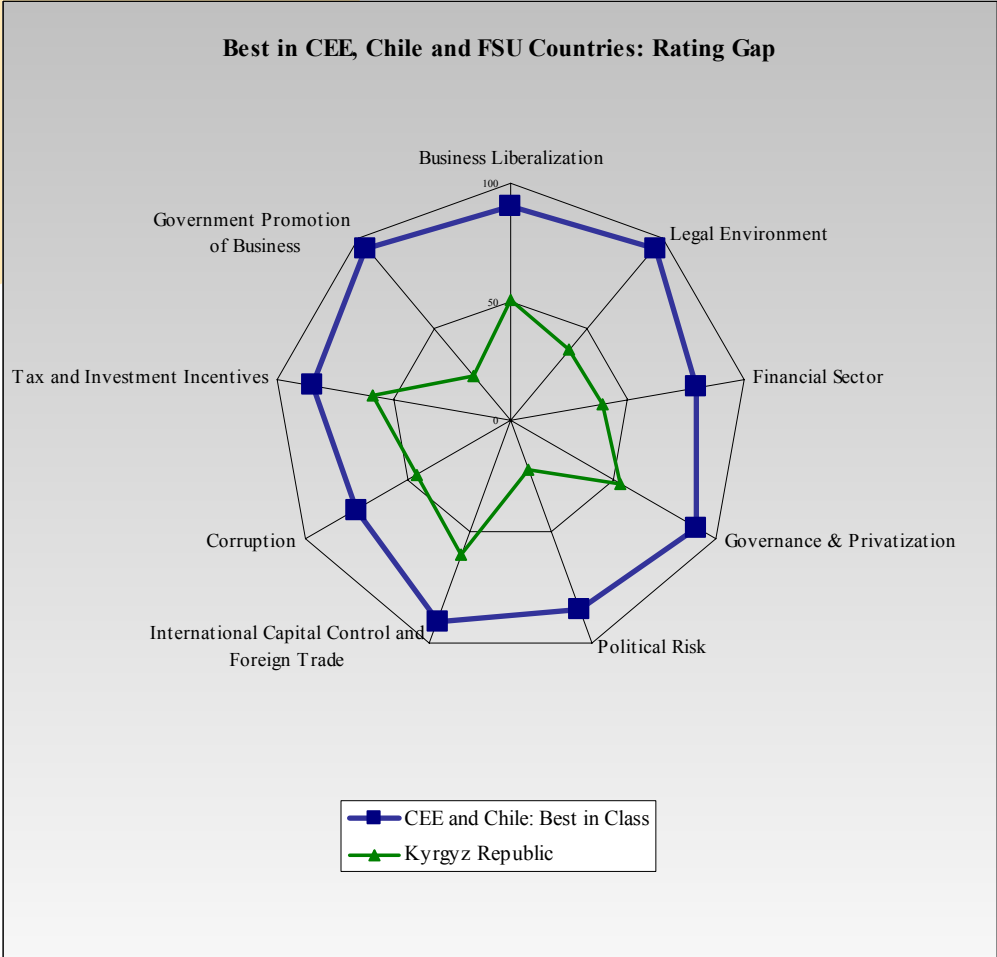
Georgia



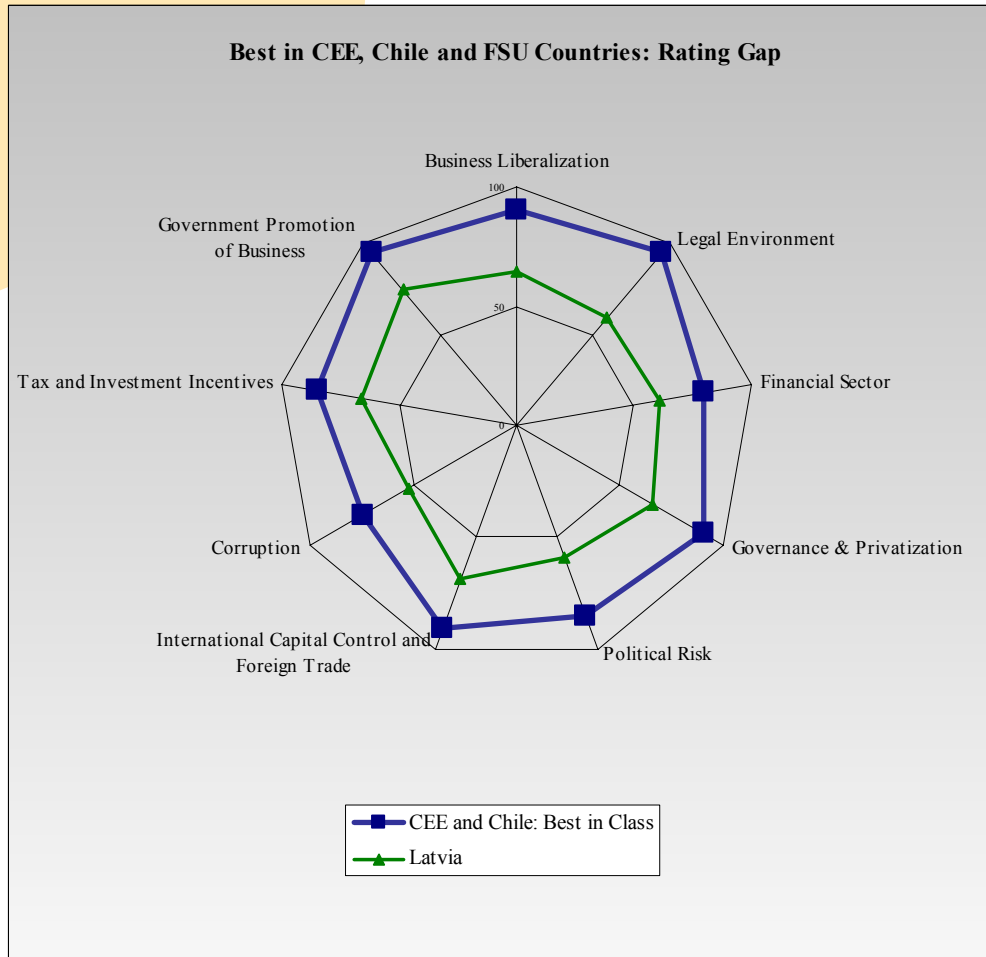
Kazakhstan



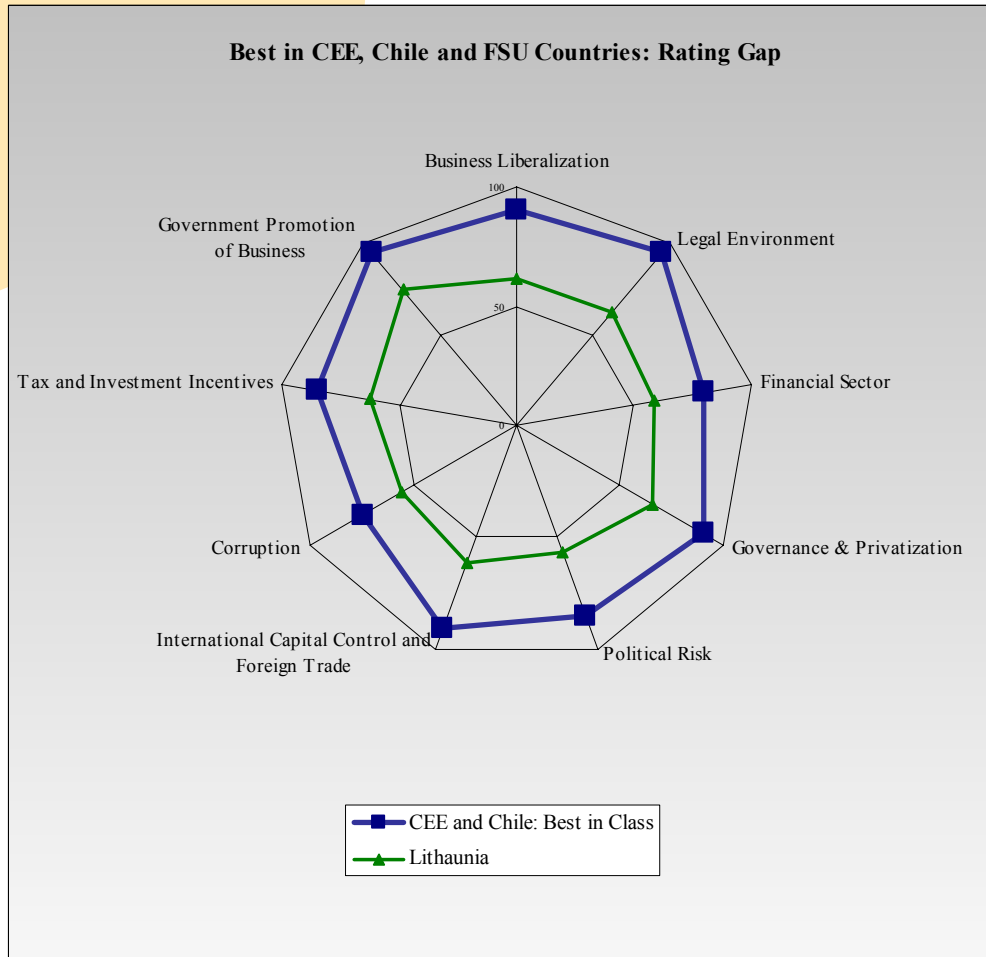
Kyrgyzstan



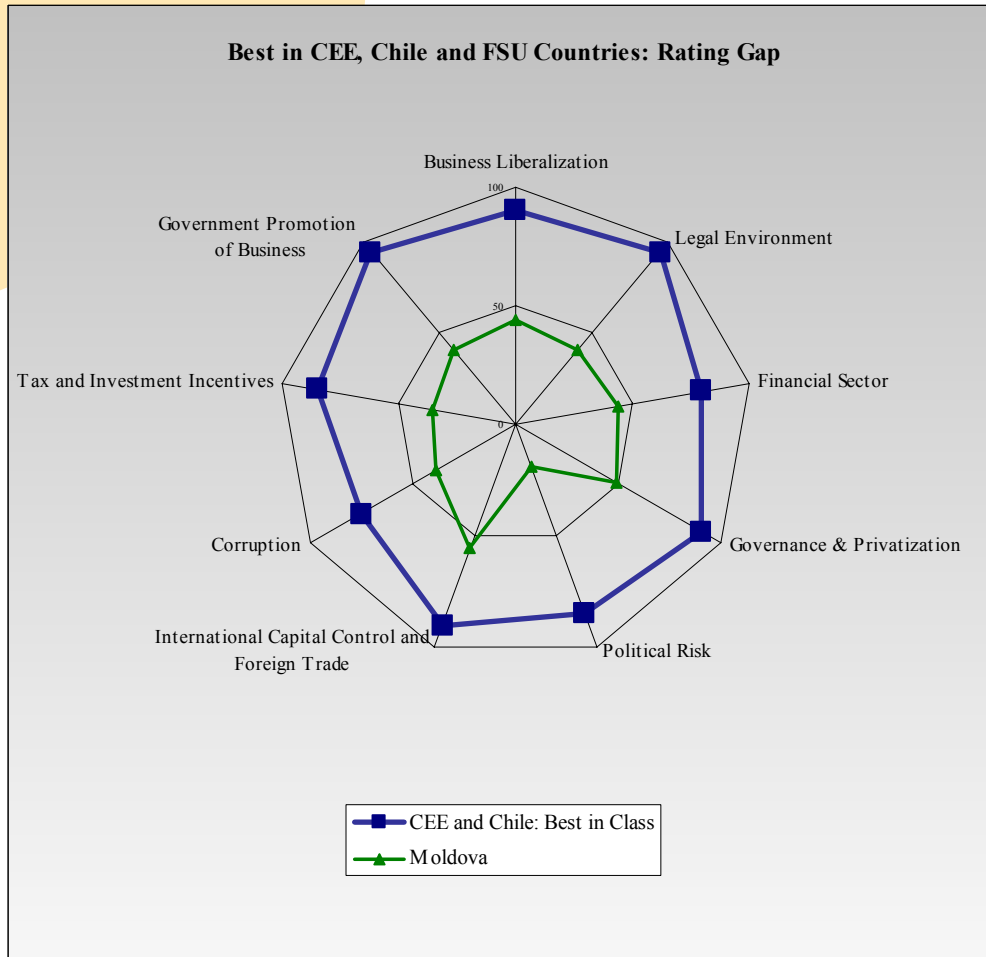
Latvia



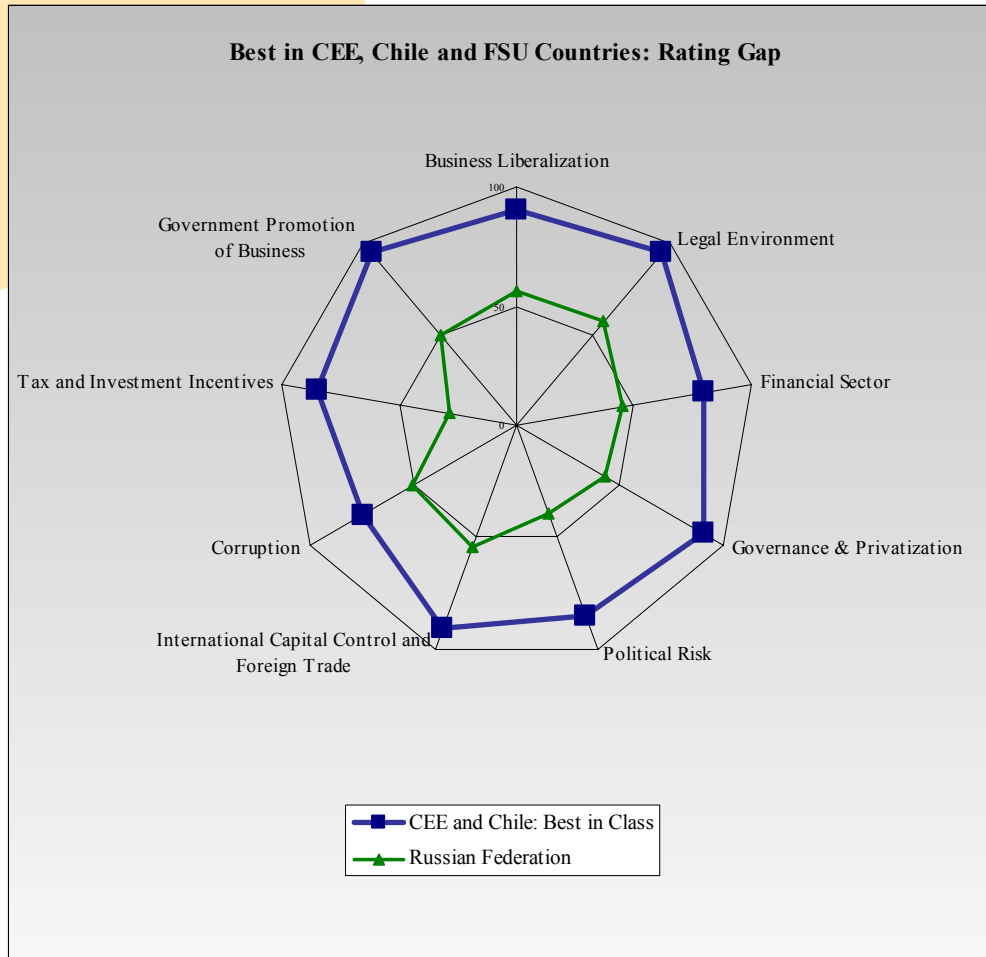
Lithuania



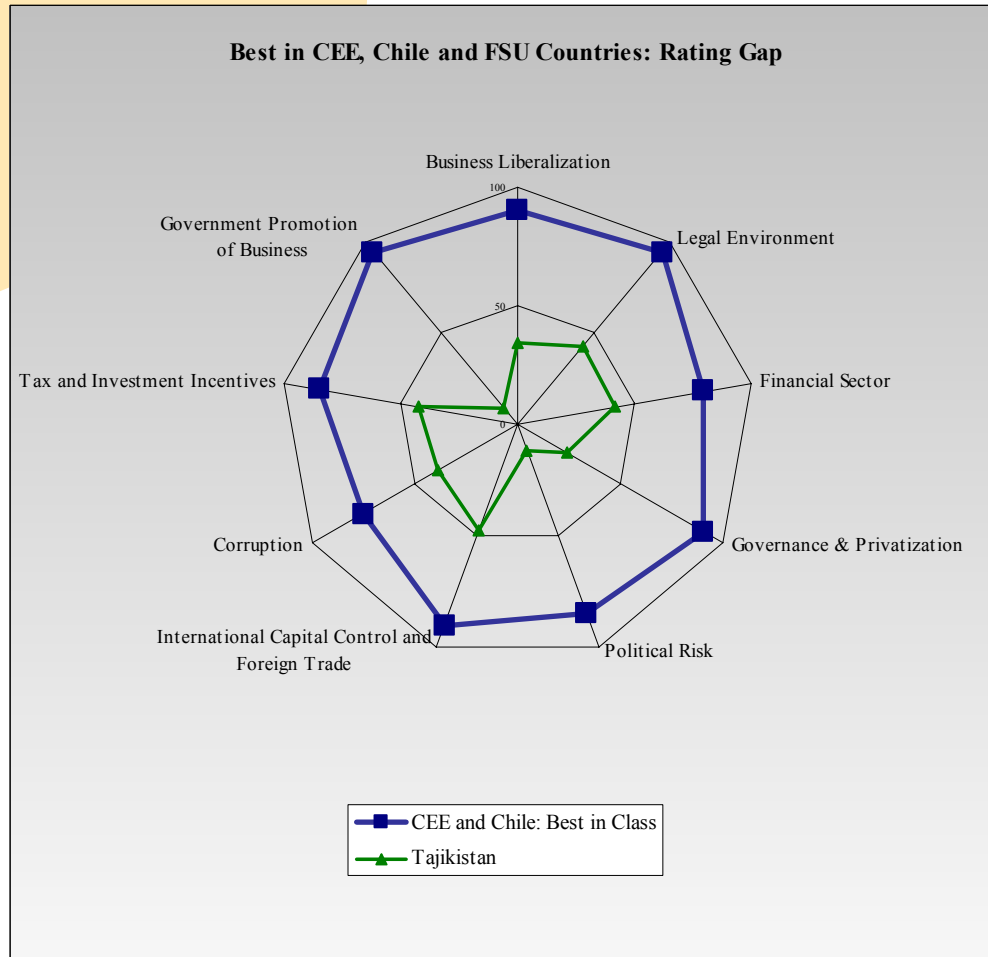
Moldova



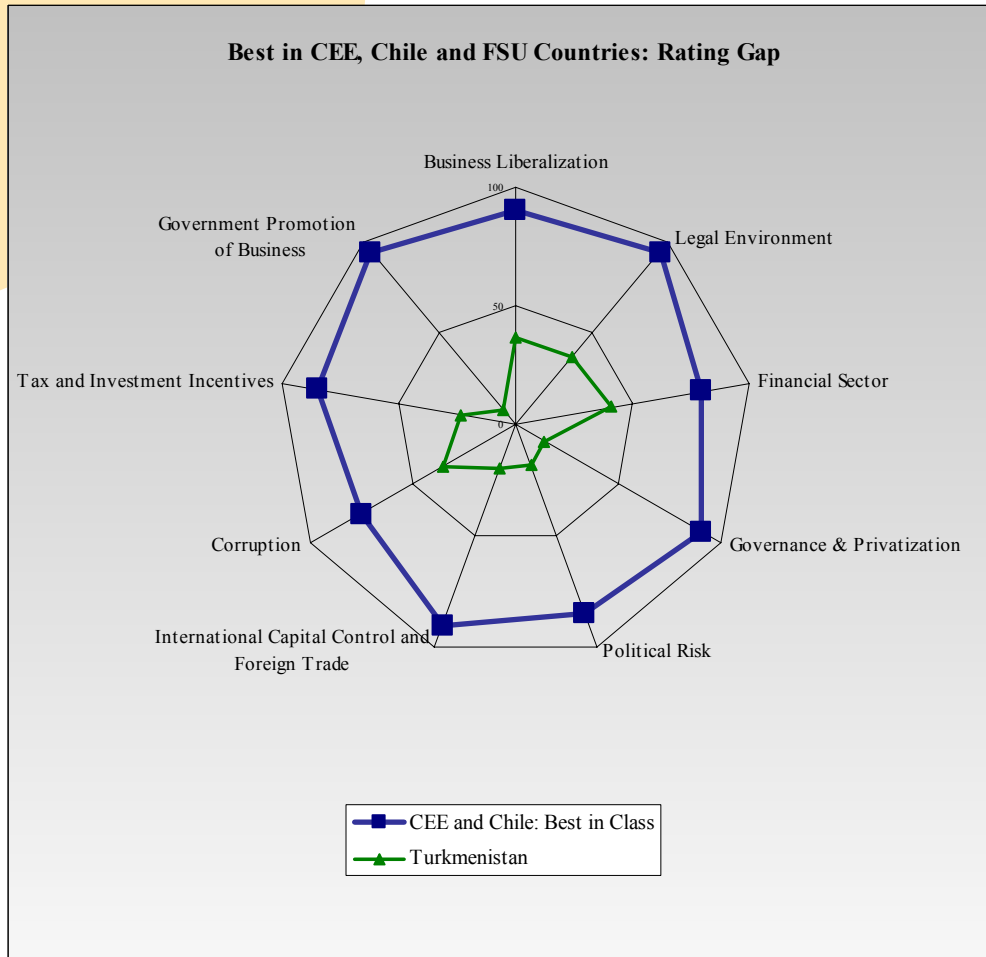
Russia



Tajikistan

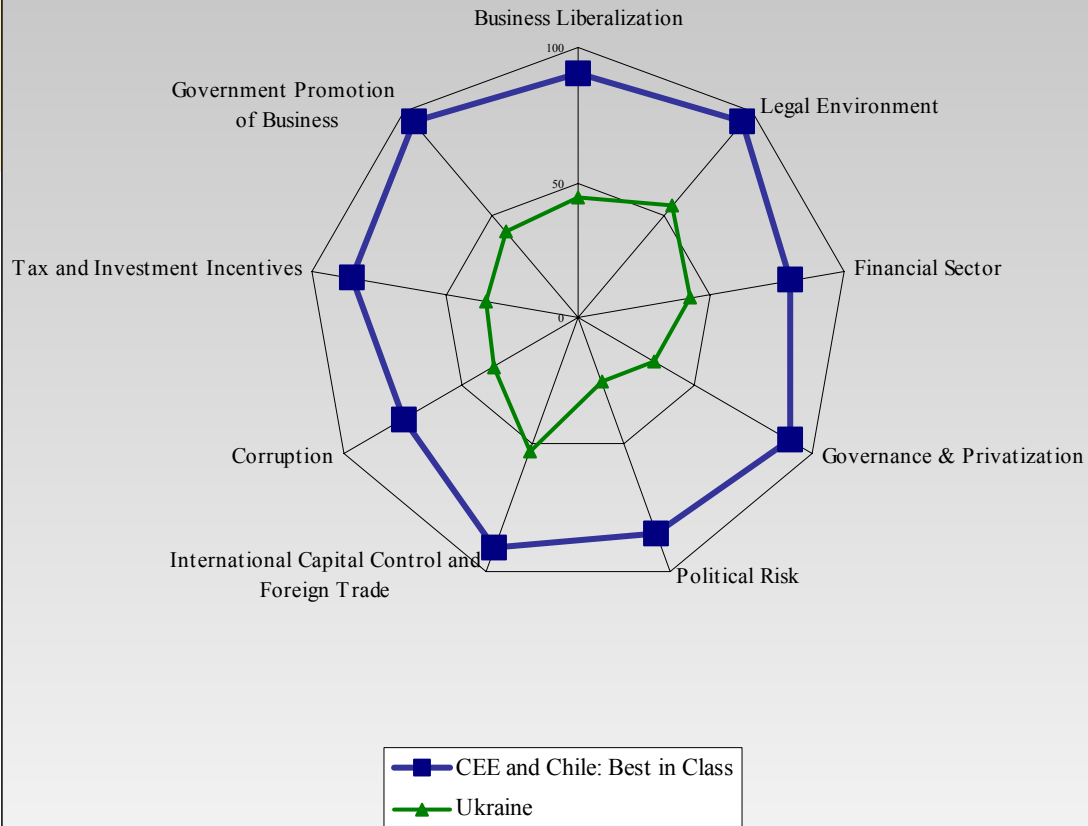


Turkmenistan

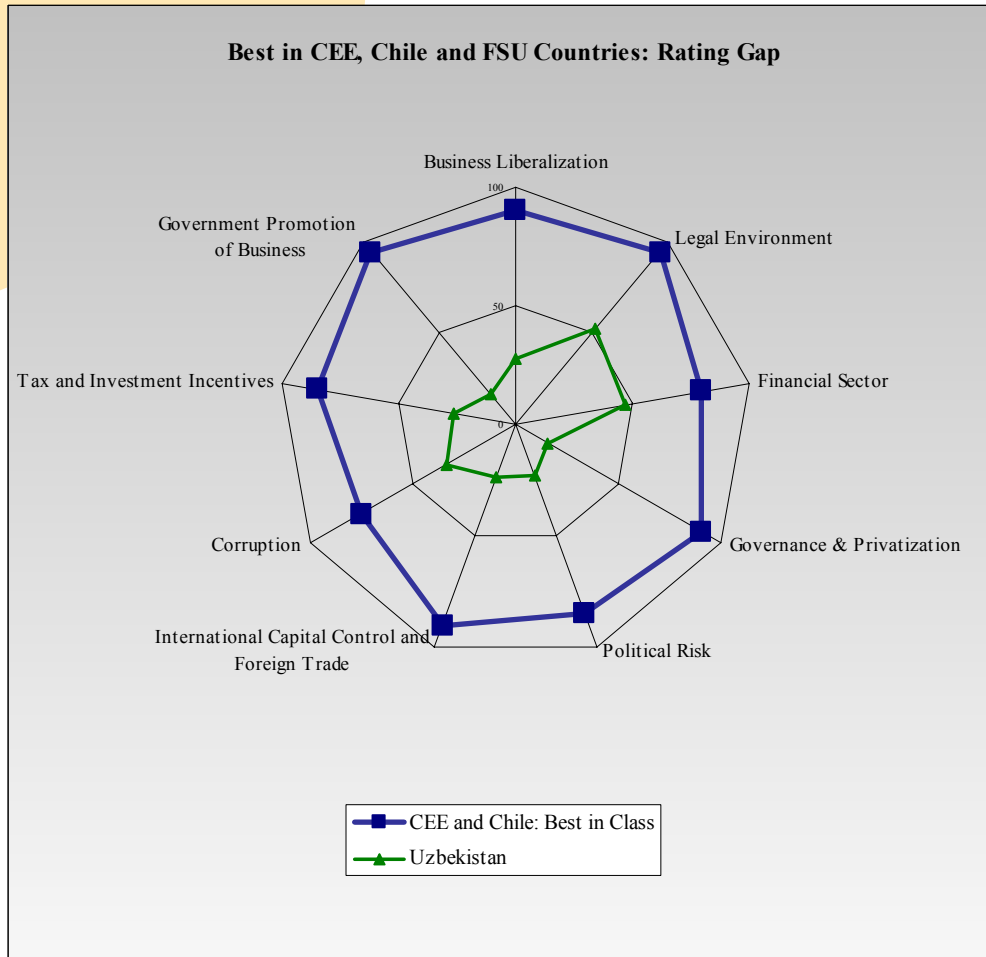


Ukraine

Best in CEE, Chile and FSU Countries: Rating Gap

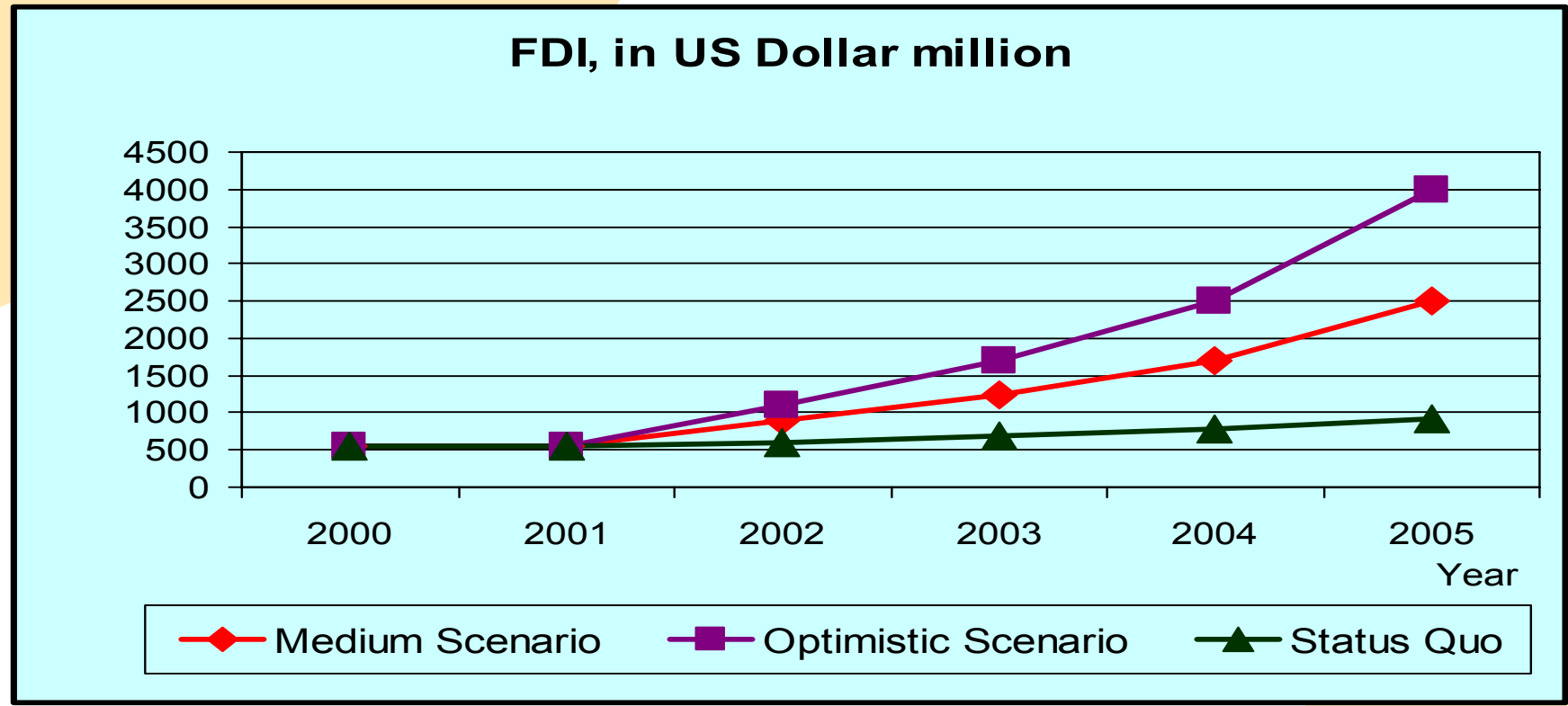


Uzbekistan



FDI For Ukraine- Possible Scenarios

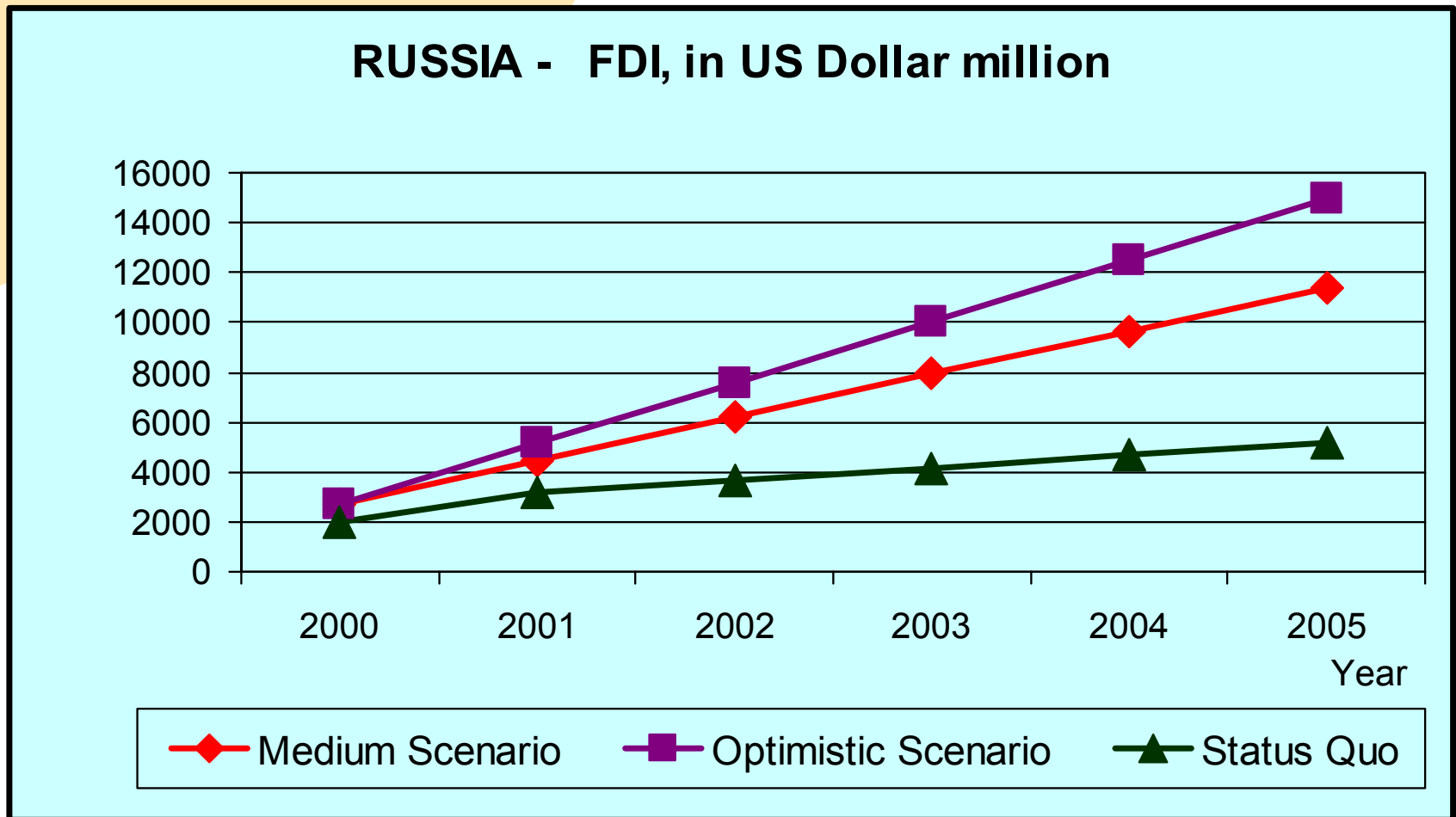
- Ukraine's government policies will determine the FDI flows over the next 5 years



- The **Middle Scenario** would generate an incremental GDP growth rate of about 4% per annum.

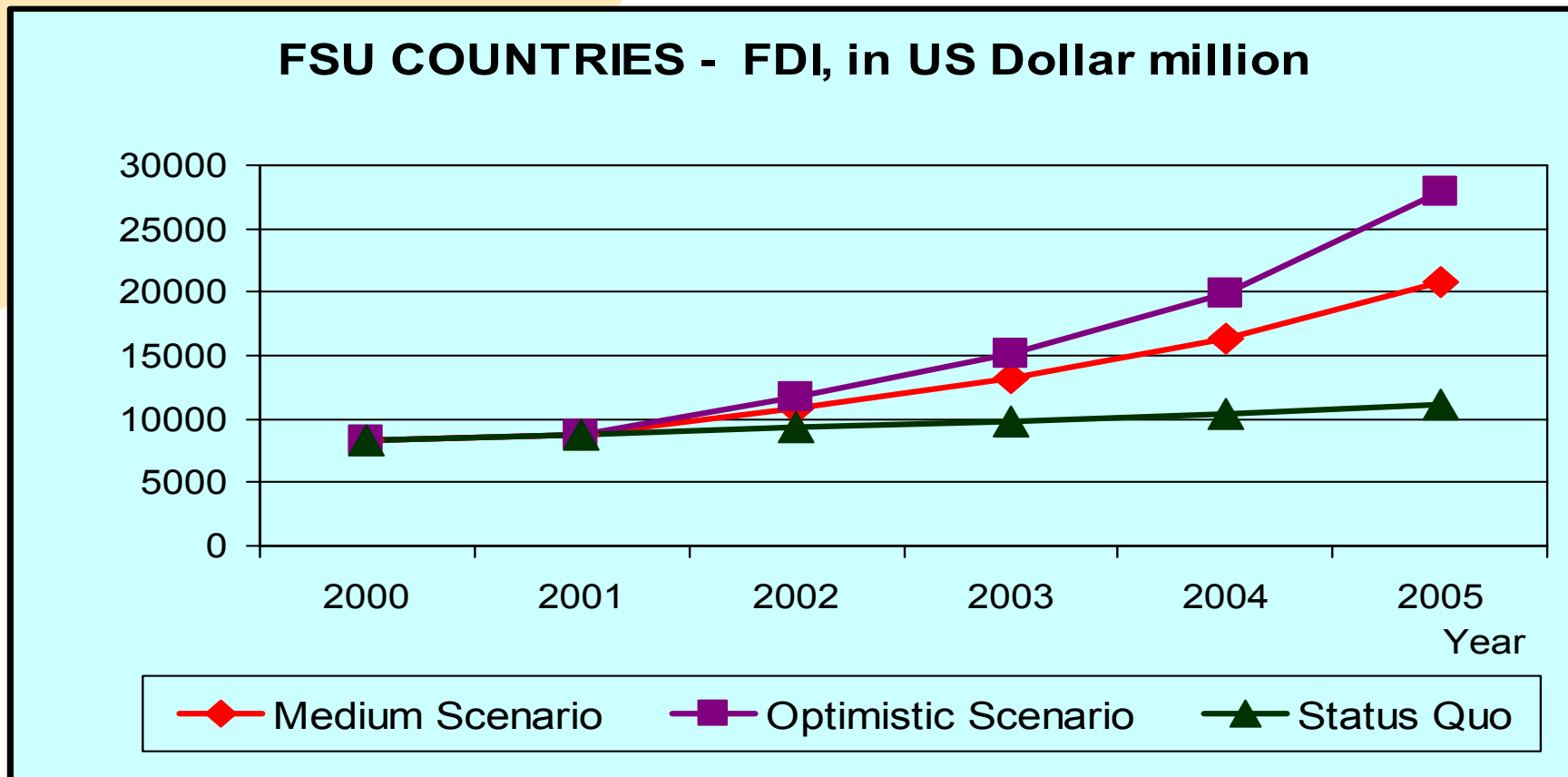
FDI For Russia- Possible Scenarios

- Russia's government policies will determine the FDI flows over the next 5 years



FDI For FSU- Possible Scenarios

- Government policies in the FSU will determine the FDI flows over the next 5 years



IPCTF Framework – A Tool for Action

- A generic prescription for government policies based on benchmarking and best practices definition
- Low correlation between FDI flows and “natural characteristics” (e.g., location, size, resources, etc.)
- High correlation between government policies and FDI flows
- Private Capital likes Uniformity and Business Standards
- **Measuring economic impact of government policies based on the gap between a given country and the best in class in each of the nine government policy areas**
- Econometric model of a transition economy predicting FDI flows based on government policies
- Priorities for 9 points may be different in different countries but all will need to be addressed to attract stable flows of FDI
- IPCTF Framework provides a **comprehensive tool** for building consensus and developing an **Action Plan** for **any transition economy**

Unique Features of the IPCTF Methodology

- “Quantifies” statistically the relative importance of individual economic policies (investment drivers) on FDIs and economic growth.
- Permits establishing priorities for Government action, based on the above quantification of policy impacts.
- Provides with “formulas” that calculate the increases in foreign direct investments over time, if the country were to narrow its policy gap with the best-in-class countries.
- We believe that other economic reform indexes say nothing about the relative importance of individual policy reforms. There is no attempt to quantify their relative impact on real economic performance.

Unique in the World

- We have not seen any other index or a framework anywhere in the world that uses all of the following:
 - Benchmarking Government Policies
 - Identifying best practices in government policies
 - Measurements based on gap analysis
 - Measuring statistical significance of different economic policies
 - Measuring / quantifying impact of economic policy changes on investments and therefore economic growth
 - Predicting future flows of investments using non-linear mathematical model where the values of regression coefficients are not constant but change depending on the value of the individual indexes. This allows to account for evolving relative importance of each of the nine policy action groups

Financial Assistance to FSU Countries

- Must be focused on **Economic Growth through the development of private enterprises.**
- Minimize government-to-government money transfers and blind pools of money
- The use of proceeds is just as important as the conditionality of lending
- Reduce adjustment lending and budget deficit financing
- Maximize equity investments and grants in place of debt
- Leverage private capital investments with financial assistance dollars
- **But structure financial assistance as “private equity funds” managed by money managers from private sector whenever possible!**

BLEYZER INITIATIVE

- Replicate the Developed countries Wealth Creation Capacity in Developing Countries, beginning with FSU countries
- **Refocus** multilateral and bilateral assistance to FSU countries on the creation of market economies and stronger private sector
- Use IPCTF framework to create capital-friendly environment in the FSU countries and attract private equity capital
- Focus most financial assistance on creating private businesses – SMEs and conditions for large multinationals operations in the FSU countries
- Leverage private capital with donor's money
- Implement comprehensive coordinated assistance program to the FSU countries: **use donor capital to create the environment, which attracts private capital**

BLEYZER INITIATIVE

Action Plan for 2000-2002

- Convince US and EU governments at the most senior levels of the need to **actively** support the creation of market economy and democracy in the FSU countries to sustain economic growth
- Build an alliance of developed countries to promote the market-economy-focused program in FSU countries and later in Africa, Asia and other developing countries to achieve stability and improved security in the World
- Use IPCTF framework as broad conditionality for all financial assistance to the developing countries
- Work with the FSU countries' governments to create specific Action Plans for each country using IPCTF framework
- Create a series of satellite private equity funds in the FSU countries to advance Action Plans implementation (later in other countries)
- Publicize the program in the Western press to attract private capital

MCA Operational Principles

- Develop an “IPCTF-like” framework to provide a roadmap for developing countries
- Use the framework to assess current status and measure progress of a given country
- Create motivation for an individual in developing countries through private property ownership and education
- Invest in value creating enterprise development through “private equity funds” linked to TA grants

MCA Operational Principles (cont-d)

- Conduct periodic benchmarking and best practices identification to maintain the framework of the “development policies”
- Determine the country participants in the program using one or several of the following approaches:
 - Strategic importance
 - Current state of development
 - Demonstrated commitment
 - Open sign-up process for any country
 - Regional approach
- The country participants must agree with the program and understand its value beyond potential financial aid

MCA Operational Principles (cont-d)

- Work in partnership with country participants to develop their individual Action Plans using the framework
- Conduct annual ratings of all country participants utilizing the framework and award MCA distributions based on the ratings and predefined distribution formula
- Structure MCA distributions as grants and “private equity funds” to be invested in the countries receiving annual awards
- Focus the use of the award capital to advance a country towards the goals set by its Action Plan
- Actively publicize and promote the program in the world