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Transfer of Real Resources to Developing Countries)



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**STRENGTHENING THE WORLD BANK'S ENGAGEMENT
WITH IBRD PARTNER COUNTRIES – IMPLEMENTATION REPORT**

Attached for the October 21, 2007, Development Committee Meeting is a background report entitled "Strengthening the World Bank's Engagement with IBRD Partner Countries – Implementation Report," prepared by the staff of the World Bank.

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STRENGTHENING THE WORLD BANK'S ENGAGEMENT WITH IBRD PARTNER COUNTRIES: IMPLEMENTATION REPORT

EXECUTIVE SUMMARY

1. The World Bank has made considerable progress in converting the recommendations on *Strengthening the World Bank's Engagement with IBRD Partner Countries*, endorsed by the Development Committee at the 2006 Annual Meetings in Singapore, into operational proposals.¹ (Annex A provides the Summary and Recommendations of the paper presented to the Development Committee.) This effort and the parallel evaluation of the Bank's work in middle-income countries (MICs) conducted by the Independent Evaluation Group² have confirmed the importance of the strategy outlined in the Development Committee paper. MICs are an increasingly diverse group and IBRD's response to their evolving needs must be to expand the menu of services it offers them. Customization, at the core of the Bank's business model for MICs, is being validated as a workable approach by experience with new Country Partnership Strategies (CPSs).
2. Members of the Bank have stressed in consultations, and in discussions at the Board, that the Bank continues to play an important role in supporting the large and differentiated development needs of MICs. They have also stressed that they expect the Bank to play an increasing role in global public goods issues.
3. The recommendations in *Strengthening the World Bank's Engagement with IBRD Partner Countries* covered three business lines—strategy and coordination services, financial services, and knowledge services—and the two related areas of Bank Group synergies and international cooperation and partnerships. Progress in each area is summarized below.
4. ***Strategy and Coordination Services.*** The greatest progress in this area has been made at the country level. Recent CPSs are embedding the relevant components of the menu of services offered by IBRD, depending on clients' needs and requests. A parallel paper to the Development Committee, *Global Public Goods: A Framework for the Role of the World Bank*,³ proposes a number of steps to achieve better integration of global public goods (GPGs) with country strategies; strengthen Bank capacity for analytical and financial support to countries for GPG-related activities; and mobilize additional concessional resources and develop innovative financing instruments.

¹ See *Strengthening the World Bank's Engagement with IBRD Partner Countries* (DC2006-0014), September 2, 2006.

² See *Development Results in Middle-Income Countries: An Evaluation of the World Bank's Support*, 2007, Independent Evaluation Group, The World Bank.

³ See *Global Public Goods: A Framework for the Role of the World Bank* (DC2007-0020), September 28, 2007.

5. **Financial Services.** In recent years, the nonfinancial cost of doing business with the Bank has been one of the main concerns raised by the Bank's borrowers, including its IBRD members. While maintaining quality, the Bank has made considerable progress in reducing preparation times for investment lending operations through the streamlining of procedures, particularly through the introduction of simple and repeater loans and additional finance loans. Further reductions are expected from a reform of the investment lending policy, which is being developed. These reductions positively impact the cost of doing business as delaying loan preparation and implementation reduces the value of the funds and the investment in present value terms. An increased focus on institutional capacity building in the fiduciary and environmental and social safeguards areas is promoting more effective use of public resources. It also furthers a more sustainable use of natural resources and protection of the livelihoods of poor people, and has the added benefit of expanding opportunities for the use of country systems and reducing nonfinancial transaction costs.

6. Management has also completed a review of the transparency and competitiveness of loan pricing and the World Bank Executive Board has approved on September 27, 2007 a significant simplification and reduction in IBRD loan and guarantee pricing.⁴ The overall cost of new IBRD loans has been reduced on average by 25 basis points, returning the all-in cost of new borrowing back to 1998 levels. The current pricing for new Fixed Spread Loans is approximately LIBOR +10 basis points and for Variable Spread Loans about LIBOR flat.

7. In addition, IBRD is taking steps to ensure that its banking products evolve to satisfy the changing needs of clients. This includes the development of contingent instruments to help countries better deal with unexpected liquidity needs arising from exogenous shocks. Proposals will be presented to the Board for improving the existing Deferred Drawdown Option instrument. The World Bank Group is also responding to financial market gaps by developing market-based solutions to help countries deal with catastrophic risk.

8. **Knowledge Services.** Management has considered how best to strengthen the links between research and operational work in MICs, including by tapping capabilities MICs themselves possess. It continues to examine options for improving the management of knowledge resources, though more time will be needed to develop actionable proposals. Management also undertook a review of experience with the provision of fee-based services; a Board paper on the role and scope for fee-based services is under preparation.

9. **World Bank Group Synergies.** Progress can be reported in the context of the establishment of a Bank-IFC Vice Presidency for Finance and Private Development, in preparing joint CPSs, and in the establishment of Groupwide senior management positions. In November 2006, the joint IBRD-IFC Subnational Department (SND) was

⁴ See *Recommendations for Simplifying and Improving the Competitiveness of IBRD New Loan Pricing* (R2007-0196), September 19, 2007; see also *Recommendations for Simplifying and Improving the Competitiveness of IBRD New Loan Pricing - Corrigendum* (R2007-0196/1), September 21, 2007.

created, and it is on the way to scaling-up the business. SND also helped create, in July 2007, a multidonor technical assistance facility that helps subnational entities improve their institutional capacity and creditworthiness so they can access market-based financing on their own account and without sovereign guarantees.

10. ***International Cooperation and Partnerships.*** Work with multilateral development banks (MDBs) is under way on financial management, procurement, and safeguards, with a focus on improving and relying on country capabilities. Management has distilled lessons from the Bank's experience with blending and cofinancing with partners other than IDA and has proposed elements of a more structured approach to engage with donors, foundations, trust funds, global programs, and carbon finance, and to provide institutional support to staff.

11. ***Conclusion.*** Implementation of the recommendations for World Bank engagement in IBRD partner countries has been focusing over the past year on the development of specific proposals. A number of these have already been implemented by Management, with the Board being kept informed; some have been considered by the Board (for example, on country systems, new financial products, and support for global public goods); and others will be presented to the Board for consideration as the proposals are finalized (for example, on the reform of the investment lending policy and fees for services.) The recommendations for Bank engagement emerged from direct consultations with MIC shareholders, MDBs, and interested bilateral agencies, and as such the recommendations cover the principal areas of MIC concerns. Management will continue to give high priority to this work and will press ahead with implementation.

STRENGTHENING THE WORLD BANK'S ENGAGEMENT WITH IBRD PARTNER COUNTRIES: IMPLEMENTATION REPORT

I. INTRODUCTION

1. The World Bank Group (WBG) faces new challenges and opportunities in IBRD partner countries. Since these countries are predominantly middle-income countries (MICs) and most MICs are eligible for IBRD funding, the terms MICs and IBRD partner countries are used interchangeably in this report.¹ As a group, IBRD partner countries are still home to over 70 percent of the world's poor living on less than \$2 per day (including in China and India.) Over the past two decades, many of these countries have profoundly improved their economic management, achieved considerable growth, and gained access to capital markets. Yet many MICs continue to have limited access to capital and risk management tools or remain vulnerable to volatile flows of private capital. Critical infrastructure and social services often are seriously underfinanced, and in many countries there are major inequality issues.

2. **Member Expectations.** IBRD is a development cooperative and its members expect it to deliver development solutions tailored to their diverse country needs. Such needs differ widely—for example, investment-grade countries often are interested in innovative tools and services that can help them address complex problems, such as increasing inequality in the country and the country's role in addressing regional and global externalities, whereas many lower middle-income countries continue to need support for capacity building and for reaching the Millennium Development Goals. IBRD provides three categories of services—financial, knowledge, and strategic and coordination services—in support of national development programs and the global priorities of the international community. These global priorities include a growing need for collective action to address climate change and other issues crossing national borders. Recognizing the key role of major MICs in this area, shareholders expect the Bank to prioritize its engagement in global programs and support MICs' participation in collective action in a manner that reflects countries' own priorities. Finally, members consider Bank Group engagement in MICs crucial to the brokering of development knowledge and South-South partnerships and learning opportunities.

3. **Bank Response.** In September 2006, the Bank presented to the Development Committee *Strengthening the World Bank's Engagement with IBRD Partner Countries*,²

¹ IBRD currently has 77 member countries that are eligible to receive its services—the IBRD partner countries. The group comprises 69 middle-income countries, 5 (creditworthy) low-income countries, and 3 (non-borrowing) high-income countries. Of these, 56 countries are eligible for IBRD funds only and 15 countries are eligible for both IBRD and IDA funds. Another 18 middle-income countries, which are eligible for IDA funds only, are not included among the IBRD partner countries. All figures relate to FY08.

² See *Strengthening the World Bank's Engagement with IBRD Partner Countries* (DC2006-0014), September 2, 2006.

a strategy paper that expands on previous actions to enhance support to MICs.³ Ministers strongly endorsed the corporate statement on IBRD's role (see Box 1), while recognizing that as MICs develop they will eventually graduate from IBRD lending. (The strategy set out in that paper, its objectives, and the recommendations are summarized in Annex A.) The strategic priority is to refine and customize the menu of services in five areas:

- financial services, focusing on innovative products and streamlined procedures to reduce the cost of doing business;
- knowledge services, focusing on enhancing the Bank's capacity to deliver customized expert advice;
- strategy and coordination services, focusing on country partnership strategies and support for global public goods;
- World Bank Group synergies to enhance the provision of well-integrated public/private sector services; and
- international cooperation and partnerships, focused on strengthening countries' fiduciary and safeguard systems and developing a menu of options for blending financial support in cases of market failure and lack of affordability.

Box 1. Corporate Statement

The IBRD is a development cooperative which works with member countries to promote sustainable, equitable, and job-creating growth; to reduce poverty; and to address issues of regional and global concern consistent with the Bank's mandate. It helps members achieve results by delivering flexible, timely and tailored financial services, knowledge services, and strategic advice, while using its convening capacity as appropriate to further members' specific objectives. It seeks to enhance its impact by working closely with IFC and MIGA, capitalizing on MICs' own accumulated knowledge and development experiences, working closely with the IMF and other multilateral development banks (MDBs) and collaborating with the development community.

4. ***Purpose of this Paper.*** In the April 2007 meeting of the Development Committee, Ministers requested a report on implementation of the recommendations of the strategy paper at their next meeting. This paper to the Development Committee meeting in October 2007 responds to that request.

5. ***Structure.*** The paper is organized as follows: Section II sets strategy implementation in the context of development needs and provides a broad overview of what has been achieved so far and what still needs to be accomplished; and Section III reports in more detail on the implementation of each of the recommendations of *Strengthening the World Bank's Engagement with IBRD Partner Countries*.

³ See *Enhancing World Bank Support to Middle Income Countries. Second Progress Memorandum* (SecM2005-0560), December 1, 2005.

II. STRATEGY IMPLEMENTATION

6. In the year since the strategy was endorsed by the Development Committee, the role of the World Bank Group in MICs and the need for adapting the business model have become even clearer. The broad-based demand for IBRD services at the country level has been confirmed in the present round of CPSs, as has the urgency of bringing forward proposed innovations that enable Bank staff and their country counterparts to design customized programs of high relevance to the respective countries. The appropriateness of the strategy has been confirmed by the Independent Evaluation Group's (IEG's) recent evaluation of Bank support to MICs,⁴ which highlights past achievements in the support for growth and poverty reduction and emphasizes key remaining challenges to which the strategy responds. Furthermore, the attention of the international community to the need for collective action to address such issues as climate change and the spread of communicable diseases has continued to grow, as has shareholder support for Bank involvement in global programs and awareness of the need to broadly engage the MICs as partners in setting the agenda for GPGs and addressing the issues. Also, while the global financial environment has been highly supportive of emerging market countries in recent years, credit cycles remain an important characteristic of global capital markets and mean that the Bank will need to maintain a role in assessing financial sector vulnerabilities (for instance, through the Financial Sector Advisory Program) and the capability to engage in crisis lending.

7. ***IEG Evaluation.*** IEG's review of World Bank support to MICs has confirmed the important Bank role in these countries and the need to further strengthen the Bank's engagement by improving the quality of IBRD services (see Box 2). IEG's review covered the FY95-06 period and its recommendations are well-aligned with the priorities of the business model set out in *Strengthening the World Bank's Engagement with IBRD Partner Countries*.⁵

⁴ See *Development Results in Middle-Income Countries: An Evaluation of the World Bank's Support*, op. cit.

⁵ See the management response to the review in *Development Results in Middle-Income Countries: An Evaluation of the World Bank's Support*, ibid, p. xix.

Box 2. Main Recommendations of IEG’s Evaluation of the Bank’s Experience in MICs

Draw on MIC Capacity

The Bank should more systematically draw upon and develop each country’s own expertise. To this end:

- Management should require that Country Assistance Strategies (CASs)/CPSs—along with significant assignments of analytic and advisory services—plan clearly to do this;
- the Bank should identify incentives and obstacles to MICs’ involvement in the governance of global programs, including by producing an inventory of governance arrangements for global programs which it supports, and conducting a formal consultation exercise with MICs (and other developing countries).

Demonstrate Best Practice

Bank projects and programs must:

- be selected in partnership with clients to go beyond conventional approaches and clearly demonstrate how the projects/programs will add to best practice development activity in the respective country setting;
- show whether, when, and in what way they are expected to play a catalytic role, being scaled up using resources beyond those initially provided by the Bank.

Country programs, prepared in full partnership with MIC clients, must pay renewed attention to achieving greater effectiveness in three pressing and complex issues: combating corruption, reducing inequality, and protecting the environment. Programs should draw on the full range of Bank and other resources available to meet these challenges.

The Bank could more actively share best practice and encourage arrangements for knowledge transfer across countries, regions, and sectors, by: (i) giving more weight to this goal in strategically managing staff rotation; (ii) ensuring that research and policy work goes beyond general principles and focuses on specific country-by-country needs; and (iii) reviewing the performance of the Networks on this dimension.

Enhance the Bank’s Agility

The Bank should set up a program to test new approaches for a selected group of countries, through:

- a much more decisive push on the existing pilot for the use of country systems—significantly increasing by mid-FY08 the number of countries and projects actually implementing the new approach;
- offering the selected MICs a new menu of support incorporating features such as fast-track procedures, faster response times, and more flexible Bank strategies;
- accelerating the development and deployment of: (i) new financial instruments, such as those helping countries manage external shocks; (ii) existing and new products that help tackle subnational challenges; and (iii) new arrangements—with clear, consistent, and user-friendly guidelines for fee for service technical expertise, including for project design and supervision.

8. **Country Partnership Strategies.** CPSs are the key point of interaction between the Bank and its partner countries; they indicate countries’ priorities in the demand for services and reveal the institution’s ability to customize its response. Given the diversity among countries, such CPSs must differ widely from country to country. Since September 2006, eight CPSs have been presented, or are in the process of being presented, to the Board—Chile, China, Colombia, Panama, Peru, Russia, South Africa, and Turkey. The first thing shown by these documents is the broad spectrum of development priorities for which these countries expect IBRD services, confirming the analysis presented in the strategy paper. (See Box 3.)

Box 3. Thematic Priorities in Selected CPSs

No single theme or sector dominates the new CPS generation, but the following are both common and prominent.

- **Inequality**, across economic classes, geographical regions, types of workers, or ethnic groups (for instance, in Colombia, China, Peru, and South Africa). The underlying concern is less about redistribution than about equity—about a society of opportunity for all.
- **Public sector management**. This emerges with respect to institutional capacity at the national (for example, Panama) and, particularly, subnational level (including in China, Colombia, Peru, Russia, and Turkey). The emphasis is on the ability of state, provincial, and municipal governments to deliver local services in a fiscally sustainable way. These services range widely, from infrastructure to social assistance.
- **Trade and integration**. The idea of making globalization a tool for growth, for social mobility, for technological modernization, and for geo-strategic relevance permeates the development path of, and the WBG assistance to, several large MICs (such as China, Russia, South Africa, and Turkey).
- **Private participation in infrastructure**. All surveyed CPSs reveal their countries' concern with infrastructure gaps, either as constraints to growth or as roots for disparities in regional development (such as in Chile, China, Peru, and Russia). The World Bank Group (WBG), especially IFC and MIGA, is seen as an additional tool to attract private investment into “frontier projects”—that is, those that, without public enhancement, are not favored by markets.
- **Environmental sustainability**. MICs uniformly recognize in their development strategies the environmental impact of national and global practices, and call upon the WBG as a partner for both local action and global advocacy (including in Chile, China, Peru, and South Africa). Climate change and clean energy are recurrent issues in the surveyed CPSs. The instruments for intervention vary, with IBRD lending to environment-related projects in some cases, but analytic work informing government actions across sectors in most countries.

9. **Customizing Support to MICs**. No less important, recent CPSs show that the Bank's country and sector teams and their country counterparts are responding to the diversity of countries' development needs and are indeed making use of enhanced flexibility and process and policy changes to customize services, pushing at the frontier of what currently is possible for the institution. Notably, the results agenda has gained traction in MIC CPSs. (See Box 4.)

Box 4. Characteristics of Country Partnership Strategies

In varying degrees, recent CPSs depart from the previous practice of Country Assistance Strategies, reflecting a new type of relationship, one not based on assistance but on mutual responsibilities. Specifically, new CPSs:

- are flexible, in that they do not promise specific projects in specific years or volumes—a reflection of the menu approach;
- may concentrate on a single sector (for example, all lending in infrastructure) or may be spread across the development spectrum—depending on the client’s preference;
- may plan no support in themes and sectors that, in themselves, are important—but for which the client prefers to draw on its own, or other development partners,’ analytical and financial resources;
- exhibit greater flexibility in the use of lending scenarios, triggers, or conditions, and move away from loan-by-loan navigation;
- are rich in frontier products—sovereign asset management, subnational finance, private-public partnerships, contingent lending, insurance, and the like;
- give preference to frameworks for programmatic and jointly-funded knowledge generation—over self-standing, WBG-delivered reports;
- show IFC, MIGA, and IBRD working in a more synergetic way—at times proposing interventions that are complementary in the solution of a single problem (such as land titling and private micro-credit are to urban poverty);
- incorporate the results agenda while being realistic in terms of expected countrywide results—a recognition that the World Bank Group’s contribution to the client’s overall development is surgical but limited, and that attribution is particularly difficult in MICs;
- leave the door open for new, unspecified initiatives—in the expectation that the World Bank Group’s menu will continue to expand as envisaged in the strategy paper; and
- build on the MICs’ role in regional and global matters—from climate change to trade, from migration to pandemics, from piloting best-practices to emerging donors. They recognize the leadership role a country like South Africa plays in its region, and cover cooperation on the emerging donor role of MICs, such as Russia.

10. ***Implementation Overview.*** The implementation of the strategy is proceeding, with various actions completed and others awaiting decisions by the Board or raising implementation issues that require more time to resolve. (A detailed report on the status of each action is provided in Section III.)

- Results have been achieved in the adaptation of CPSs that integrate changes into Bank operations as they become available, in the introduction of innovative financial services, in the approval of a major simplification and reduction of loan and guarantee pricing, and in the reduction of some of the nonfinancial costs of doing business with the Bank, notably through shorter processing times associated with additional financing.
- The Board has endorsed a new approach to the use of country systems, though important implementation issues remain to be resolved.

- More time is needed to resolve important issues in the organization of improved knowledge services.
- Longer term, to effectively address the challenges of development, the Bank will need to adapt its operating model not only to MICs but more broadly to serve the wide range of countries that make up the institution, from fragile states to investment-grade countries. This is the focus of the Long-Term Strategic Exercise.⁶

11. **Urgency.** The urgency of completing the implementation of the recommendations laid out in the strategy paper is underpinned by the CPSs, which show that the menu of services is currently less attractive to countries than it could be. In particular:

- enhancing cooperation with countries on GPG issues and integrating it into CPSs hinges on the implementation of proposals advanced in the framework paper to the Development Committee⁷, notably bridging the partial disconnect between country programs managed by the Regions and work on global issues managed by the Network Anchors;
- stronger financial support for countries' priorities depends on the outreach effort with borrowing members following the pricing reform and on the availability of various banking products that would enhance the Bank's ability to provide additional innovative financial solutions;
- greater agility of Bank response to specific country needs depends on the reform of the investment lending policy framework, which is in the development stage, and on decisions regarding the greater reliance on country capabilities;
- critically important for the Bank's role is progress on improved knowledge services for MICs, including strengthened links between research and operations, between the experiences of Organisation for Economic Co-operation and Development (OECD) and non-OECD countries, and between country and global issues.

III. IMPLEMENTATION OF RECOMMENDATIONS

12. This section reports on the implementation of each of the recommendations. Actions cover three business lines—enhancing strategy and coordination services, financial services, and knowledge services—and two closely related areas: achieving stronger Bank Group synergies and deepening the cooperation with development partners in MICs.

A. Strategy and Coordination Services

13. The World Bank Group provides strategy and coordination services at the country level primarily through its CPSs and at the global level through its support for regional and

⁶ See *Report on the Long-Term Strategic Exercise* (SecM2007-0372), August 27, 2007.

⁷ See *Global Public Goods: A Framework for the Role of the World Bank*, op. cit.

global public goods. On both levels, the World Bank also helps coordinate funding (for example through multidonor trust funds) and uses its convening capacity to help broker agreements.

14. **Country Partnership Strategies.** Members are seeking additional progress in delivering higher-quality, more focused World Bank Group CPSs, reflecting country-specific priorities and serving as platforms for more flexible assembly and delivery of the portfolios of expertise and financing. As shown by the recent experience, moving to better CPSs is a matter of developing practice, not necessarily changing the existing policy framework (OP/BP 2.11, *Country Assistance Strategies*), which provides ample opportunity for flexibility and customization. Operations Policy and Country Services (OPCS) is preparing a good practice note to staff that collects existing good practice in the assembly and delivery of portfolios of expertise and financing and advises on additions to the menu of services and on new modalities (see Box 5). The note will pay particular attention to the following:

- the need for **differentiated CPSs** that reflect the diversity of MICs and their demand for services (for example, between emerging market economies and lower middle-income countries without significant market access);
- the use of **results frameworks** that justify Bank actions in terms of expected results for country development and global concerns, but are commensurate with the actual level of Bank involvement in a country's programs;
- the integration of support for action on **regional and global externalities** into the strategy (including, if appropriate, support for a country's donor role); and
- the incorporation of a **country's own analytic work** in strategy design and Bank operations.

This note will be issued in the course of FY08, once other critical actions (for example, on assessing country capabilities, banking products, and financing of GPG work) have been accomplished.

Box 5. Latin America and the Caribbean

In March 2007, the LCR Regional team put forward a business strategy that brings together a menu of analysis, advice, new financing tools, country dialogue, implementation support, partnerships, intra-institutional synergies, and convening power. The strategy is branded around development solutions for the most complex challenges that the region will face in the next five years ("tomorrow's issues," such as technological lags, alternative energy sources, citizen security, climate change adaptation, quality of life, demographic transition). Those solutions are to be customized according to the clients' preferences and realities—from IDA to investment-grade MICs. Knowledge services are a central part of the menu, whether bundled or unbundled with financing, at the national or regional level, included in the loan charges or for a fee. Early results from the implementation of the strategy have been encouraging, in terms of quality of country relationships (for instance, Peru), innovation (catastrophic insurance for the Caribbean), and advisory work (leadership in regional research.)

15. **Global Public Goods.** At the global level, members expect the Bank to prioritize strategic themes for its engagement and develop a forward-looking menu of financial

options to enhance support for high-priority global undertakings. This is the subject of a parallel report to the Development Committee, *Global Public Goods: A Framework for the Role of the World Bank*.⁸ The paper proposes criteria for the Bank's involvement; examines the Bank's role in five key areas (environmental public goods, communicable diseases, international financial stability, the global trading system, and knowledge for development); and presents proposals for enhancing the Bank's effectiveness, including financing modalities. Proposals advanced in the parallel report that are of particular relevance for the MIC strategy include the following.

- To enhance cooperation with countries on regional and global public goods in a manner that reflects national priorities, Management will explore how best to ensure a more systematic treatment of these concerns as part of the Bank's country dialogue, analytic work, and sector strategies. Any demand for Bank services resulting from this treatment would be reflected in CPSs.
- To strengthen its capacity for advisory services and lending related to GPGs, the Bank will continue to upgrade its staff expertise in areas of emerging priority. While a core group of high-level experts must be retained in-house, the Bank should also ensure increased access to high-quality external experts in order to maintain the necessary cadre of skilled people.
- Additional resources could catalyze lending interventions, particularly related to environmental GPGs. Carbon finance, Global Environment Facility, and donor grants already show the potential for blending. Going forward, the Bank will take stock of the existing trust fund portfolio to identify overlaps and gaps, consolidate along thematic and regional lines, and engage in consultations with donors to fill the gaps.
- Management will continue to support new financing instruments that address large externalities and innovation gaps, and that contribute to leveraging private resources in key areas, particularly climate change and communicable diseases. Modalities under consideration include World Bank Group integrated approaches, public/private partnerships, new carbon finance mechanisms, enhanced subnational lending, and the possible use of transfers from net income.
- The Bank also will work closely with MICs to develop and disseminate ideas that could facilitate broader consensus on the shape of a durable and equitable regulatory framework—post 2012—to reduce greenhouse gas emissions.
- To increase action at the regional level in support of GPGs, the Bank will continue to act as an honest broker to bring together countries for collective action, and will enhance lending for multicountry investments.

B. Financial Services

16. The World Bank Group provides financial services through four entities that, taken together, provide a broad menu of financing, credit enhancement, and risk

⁸ See *Global Public Goods: A Framework for the Role of the World Bank*, op. cit.

management tools to the sovereign and subsovereign public sector and to private business in developing countries.

17. IBRD members have indicated that they want these financial services to be attractively priced, flexible, and offered in a customized and cost-effective manner. The Bank's implementation strategy focuses on four areas: (a) reducing nonfinancial costs of doing business with IBRD, (b) reviewing loan pricing, (c) accelerating implementation of a flexible and responsive banking business providing customized financial solutions, and (d) introducing market-based solutions in response to expressed borrower demand. While many of the recommendations are specific to IBRD, also included are World Bank Group instruments such as the subnational financing facility and IFC product innovations for natural disasters.

1. Nonfinancial Costs of Doing Business

18. The main concern expressed by borrowers related to IBRD's financial services business is the high cost they face in complying with the Bank's lending procedures—that is, the nonfinancial costs of doing business with the Bank. These procedures provide benefits such as ensuring technical quality and upholding environmental and fiduciary standards. But the associated costs may be higher than necessary to ensure the benefits. Management is undertaking a survey to quantify these costs. The Bank's response focuses on the two major cost components: streamlining Bank procedures for investment lending to drastically reduce preparation times and enhance the agility of response to member demands while maintaining quality and standards, and increasing the use of country safeguard and fiduciary systems in Bank investment lending operations, where mutually agreed and verifiable standards are met.

19. ***Streamlining Procedures.*** The work on streamlining Bank procedures concentrates on the investment lending instrument, which accounts for almost 70 percent of the funds committed in FY05-07. Although investment lending practice has significantly evolved over the years to meet the changing needs of member countries, the Bank's formal policies and procedures have not kept pace, resulting in inefficiencies in the response to client demands.

- In parallel with the development of the strategy paper, major progress was achieved through simplification of procedures, such as fewer and shorter reviews, for simple and repeater projects, which has resulted in 10-11 months of preparation time (from identification to Board presentation) for such projects. Another successful innovation has been additional finance operations (OP/BP 13.20, *Additional Financing for Investment Lending*), which save on processing time by building on ongoing projects that justify scale-up or address cost overruns, financing gaps, emergencies, or additional components.⁹ The average preparation time for these operations in FY07 was only 4.9 months. As described below, to increase the Bank's agility to

⁹ See *Enhancing World Bank Support to Middle Income Countries. Second Progress Memorandum* (SecM2005-0560), December 1, 2005.

respond quickly to clients' needs, efforts are also continuing to achieve drastic reductions of preparation times in other investment lending operations, while maintaining quality and standards in the institution's other increasingly innovative projects and in its growing infrastructure portfolio. Support for capacity building in the areas of country public financial management and environmental and social safeguards, while primarily aimed at supporting greater development effectiveness of the use of public resources, and more sustainable management of natural resources and protection of poor people, is also expected to contribute over time to a further reduction of loan preparation times, and thus to reductions in the nonfinancial costs of doing business with the Bank.

- Since September 2006, further progress has been made through the issuance of OP/BP 8.00, *Rapid Response to Crises and Emergencies*, and its application in lending operations. This policy enables the Bank to respond more rapidly to a wider set of crises and emergencies than the previous OP/BP 8.50, and to more effectively coordinate with donors. The policy is likely to further reduce the average preparation time for investment lending operations.
- Ongoing efforts focus on the reform and rationalization of the policy framework for investment lending, which currently is governed by more than 30 policy statements. The objectives of the reform include aligning investment lending policy with the new business model, embedding a risk-based model of internal controls, rebalancing attention and resources between the stages of preparation/approval and supervision/implementation, and creating a single principles-based investment lending policy that would govern operations from concept to completion. OPCS has shared the reform concept with Executive Directors in a technical briefing in May 2007. The reform proposal, which is currently being developed, is expected to be completed in the course of CY08.

20. **Country Systems.** The work on country systems—that is, on the ways in which the Bank responds to clients on the basis of their capabilities—has progressed. A status report was discussed with the Executive Directors on June 7, 2007.¹⁰ Executive Directors renewed their commitment to the Bank moving forward with greater reliance on country capabilities and to the Bank taking a leadership role in this regard. The idea of country-based pilots, rather than just project-based pilots, was also endorsed. Management will prepare a detailed methodology on assessing procurement capabilities, and will consult broadly on it. Management will also complete the evaluation of country-system pilots on social and environmental safeguards. It will report back to the Board in December 2007. If the Board agrees on a way forward, pilots on greater reliance on country capabilities will be launched early in 2008. Under these pilots, the countries' procurement and safeguard capabilities would be assessed for equivalence and for the extent to which they meet mutually agreed and verifiable standards. As bilateral and multilateral partners

¹⁰ See *Use of Country Systems in Bank-Supported Operations – Status Report* (R2007-0079), May 8, 2007; see also *Use of Country Systems in Bank-Supported Operations – Status Report – Supplemental Note* (R2007-0079/3), June 12, 2007.

would be involved in these assessments, it is expected that they would also rapidly rely on country capabilities for their own operations.

2. Loan Pricing

21. Borrowers have provided feedback that complexity in IBRD's loan pricing makes it difficult to compare its charges to other lenders, and that annual waiver decisions create uncertainty in the cost. Given the compression of spreads on emerging market debt, borrowers are looking to IBRD to provide funding at levels that are in line with other opportunities. To address these concerns, the World Bank Executive Board has approved on September 27, 2007 a significant simplification and a reduction in IBRD loan and guarantee pricing.¹¹ As a result, the all-in cost for new Fixed Spread Loans (FSLs) is approximately LIBOR +10 basis points and for Variable Spread Loans (VSLs) about LIBOR flat. The main features of the pricing reform include the following:

- ***Lower, uniform pricing.*** The overall cost of new IBRD loans has been reduced on average by 25 basis points returning the all-in cost of new borrowing back to 1998 levels. Because of the elimination of the commitment fee, the pricing for development policy loans (DPLs) and investment loans is now the same. Compared to the old pricing, on average the all-in cost savings for DPLs is about 17 basis points and for investment loans is approximately 32 basis points.
- ***Transparency.*** The commitment fee and waivers have been eliminated. The only remaining fee is a one-time, front-end fee of 25 basis points, equivalent on average to 4 basis points per annum during the life of the loan.
- ***Predictability.*** For new loans, the uncertainty of cost due to annual waiver approvals has been eliminated.
- ***Flexibility.*** All FSL-embedded options to manage currency, interest rate, roll over, and commodity price risks are preserved.
- ***Applicability.*** The new pricing is available for all new loans signed on or after May 16, 2007.

With the approved pricing reform, and the reduction to pre-'98 loan pricing levels, loan volumes are assumed to follow the corporate high lending case for the next three years and increase in line with inflation at about 3 percent per annum thereafter.

¹¹ See *Recommendations for Simplifying and Improving the Competitiveness of IBRD New Loan Pricing*, op. cit.; see also *Recommendations for Simplifying and Improving the Competitiveness of IBRD New Loan Pricing – Corrigendum*, op.cit.

3. Customized Financial Solutions

22. The IBRD's strategy calls for accelerated implementation of a flexible and responsive banking business providing customized financial solutions to borrowers. IBRD is committed to delivering tailored financial solutions appropriate to the particular needs, development stage, and institutional capacity of a country. Recognizing that MICs are a diverse group, IBRD allows countries to use flexibly their IBRD lending allocations to select from a range of financial services, including loans, risk management tools, and credit enhancement. As borrowers have become more sophisticated and financial markets have developed over time, IBRD's products have also evolved and its menu has broadened into new areas such as liability management, asset management, and treasury management services and/or advisory support.

23. IBRD is taking steps to ensure that its banking products continue to evolve to satisfy the diverse and changing needs of clients. It has streamlined internal review processes and is enhancing systems to enable a better response to demands for customized delivery of existing products or the introduction of new financial instruments. Several product enhancements have already been implemented (see Box 6), and similar proposals will be developed based on feedback from borrowers and staff about where the existing products have not been sufficiently flexible.

Box 6. Flexibility in Providing Local Currency Financing to Subsovereign Borrowers

The Bank was able to respond to Colombian subsovereign borrowers' requests to help reduce the interest rate and currency exposure on their existing IBRD loans by converting their IBRD obligations from floating US Dollars to fixed-rate Colombian pesos. Usually such conversions would be available as part of the flexibility built into the Bank's Fixed Spread Loans, or alternatively could be accomplished using currency and interest rate swaps through a Master Derivatives Agreement with the Bank. In this case, neither was possible since the terms of these older loan products did not incorporate the necessary risk management tools, and local laws did not allow the Government of Colombia—with which IBRD has a Master Derivatives Agreement—to intermeditate the swaps for the borrowers-of-record (a municipality and a province).

The Bank responded by agreeing to amend the existing loan agreements to include provisions for interest rate and currency conversions in accordance with procedures existing under the Fixed Spread Loans framework. As an additional benefit to the Government of Colombia, its contingent liability related to the guarantee of these loans was also converted into Colombian pesos, reducing its exposure to currency risks. In June 2007, based on the pilot case of Colombia and similar demand from other borrowers, the Board approved a general authorization to allow Management to include the risk management tools in the older generation of loans to assist MIC borrowers in managing their currency and interest rate risks.

24. Challenges in the delivery of customized financial services are often related to the capacity of clients to use and prudently manage derivative-based products, as well as of insufficient depths of knowledge of Bank staff in presenting potential options to clients. Outreach efforts to educate staff and borrowers about the available products and their risk management benefits are ongoing.

25. In particular, the Bank has been asked to consider ways to make financing vehicles more accessible to qualified borrowers. Indeed, this group of countries would share in the benefits of broader efforts to reduce the financial and nonfinancial costs of doing business

with the Bank and in having customized financial solutions. In addition, the Bank is financially more flexible (with respect to the lending envelope and the ratio between quick- and slow-disbursing operations) in CPSs for well-performing countries.¹² Currently, a proposal for lengthening loan maturities and grace periods (which currently are shorter for higher per capita MICs than for other MICs) is being discussed, as the original rationale for the distinction—related in part to constraints on IBRD’s capital—has ceased to apply. A permanent working group of Bank country directors for investment-grade countries is being established to promote continued dialogue on issues particular to this group of countries. Also under development is increasing the visibility of the MIC agenda in the Bank’s external communications.

4. Product Innovations

26. Countries are placing increasing emphasis on risk mitigation in managing public finances, going beyond traditional financial risks such as currency and interest rate exposure. They have appealed to the World Bank Group to provide instruments to help them manage exogenous shocks, such as natural catastrophes, commodity price volatility, or financial contagion. The IBRD already provides commodity swaps to link borrowers’ debt service to movements in key commodity prices.¹³ As described below, work has begun on instruments for dealing with other risks. Also, countries have indicated their interest in financial innovations that could help with the development of their capital markets.

27. ***Contingent Financing.*** Borrowers have called upon the Bank to provide contingent instruments to help fill liquidity gaps. The IBRD has reviewed its experience with the existing Deferred Drawdown Option (DDO) instrument and is developing proposals for refining the instrument to broaden the applications for its use (including for natural disasters), reduce and simplify pricing, and improve the balance between providing countries with ready access to liquidity over extended periods of time and ensuring that IBRD disburses funds prudently and in conformity with its policy framework. Proposals for product enhancements will be presented to the Board this autumn.

28. ***Market-based Instruments for Natural Disasters.*** Consistent with their greater appreciation for ex-ante risk management, IBRD members have asked the Bank to provide tools for managing risks of natural disasters, given that costs are becoming large relative to local fiscal resources and to capacity available through global reinsurance markets. Recognition is growing that it would be better to pre-fund losses through insurance and other risk transfer programs. However, primary insurance markets remain underdeveloped

¹² See *Enhancing World Bank Support to Middle Income Countries: Second Progress Memorandum*, op cit.

¹³ Since FY00, IBRD has made available commodity swaps that could help reduce exposure to volatility in key commodity prices. While there has been interest by governments to manage commodity price risk, there has been no demand for these products because of two factors: the absence of adequate asset-liability management frameworks, and political economy constraints by borrowers. Instead, many borrowers have set up funds to save portions of windfall gains as self insurance. The Bank is working with a few countries to help design and implement strategies and to improve capacity for the use of market instruments in the management of commodity price risk.

in many MICs and mechanisms for transferring risk to international markets, through reinsurers remain very weak.

29. The World Bank is responding to market incompleteness by developing a policy and operational framework to address natural disaster risk in client countries, including a supporting suite of instruments. These are designed to help governments to increase insurance penetration, efficiently aggregate risk at the country and subregional levels, build up domestic reserve funds, transfer risk to international markets (including through reinsurance), and create catastrophe insurance markets where they do not currently exist.

30. Examples of markets that the Bank has developed include the Turkish Catastrophe Insurance Pool, which has increased the number of registered properties with earthquake insurance from 600,000 to 2.6 million since inception; the Mongolian Livestock Index scheme (still in pilot stage), which covers herders against large scale death of livestock arising from drought and freeze and the Caribbean Catastrophe Risk Insurance Facility (see Box 7).

- The Bank and IFC are currently collaborating to establish by end-2007 a Global Index Reinsurance Facility—a combined specialist “index reinsurer” and multidonor trust fund that will develop markets in ACP (Africa, Caribbean, and Pacific) countries as well as provide parametric instruments to other sovereigns. There appears to be a growing interest in the donor community in providing funds to support the development of catastrophe risk management capabilities, including subsidizing the cost of risk transfer.
- The Bank is also exploring possibilities for speeding the opening of markets for the catastrophe funding needs of sovereigns, including through a multicountry catastrophe bond. Under this initiative, specific natural disaster risks of a geographically diversified group of countries would be pooled and the combined risk of the pool transferred to the market through a catastrophe bond or a collateralized debt-type structure. The global pooling of risk is expected to produce significant diversification benefits that could reduce insurance premiums. The collateralized debt-type structure would allow targeting of a wide investor base, which should produce additional cost savings and help reduce the premiums further.
- Also, as described above, progress is being made in developing a rapidly-disbursing catastrophe contingent debt instrument.
- Technical assistance has included setting up local risk pools and arranging reinsurance, setting up weather and index-based insurance pilots and supporting infrastructure, and advising on catastrophe bond issuance, local insurance sector capacity building, and regulatory and financial management upgrading. In parallel with the catastrophe funding work, the Global Facility for Disaster Reduction and Recovery has been established to support the overall risk management activities of client countries, including building mitigation and response capacity.

Box 7. The Caribbean Catastrophe Risk Insurance Facility (CCRIF)

The Facility, which commenced operations on June 1, 2007, is the first regional disaster insurance facility in the world. It allows regional governments to purchase coverage akin to business interruption insurance that provides them with an immediate cash payment after the occurrence of a major earthquake or the passing of a hurricane. Because of the speed at which a claim payment will be processed, the instrument is particularly useful to finance the immediate post-disaster recovery, giving the affected government time to mobilize additional resources for longer-term reconstruction activities.

The Facility is an independent legal entity acting as intermediary between the participating countries and international financial markets. The Facility is registered in the region and is under the supervision of the participating donor and client countries. All functions in the day-to-day operation of the Facility are subcontracted to specialized firms.

The IBRD assisted CCRIF in transferring a portion of its risk to the market by entering into a \$20 million one-year maturity catastrophe swap with CCRIF. IBRD hedged its risk by entering into a companion swap with a market counterpart. The swap between IBRD and CCRIF is the first transaction to enable emerging countries to use a derivative transaction to access the capital markets to insure against natural disasters. It is also the first time a diversified pool of emerging market countries' catastrophe risk is placed in the capital markets.

31. **Capital Market Development.** The Board of Executive Directors has approved the proposal to proceed with the Global Emerging Markets Currency Bond Fund (Gemloc Project.)¹⁴ The project proposes a strategic partnership with the private sector with the following perspectives: IBRD establishes and co-brands a fund of \$5 billion that will raise investment and enhance liquidity for local currency bonds in emerging markets; IFC establishes and co-brands a new bond index linked with investability rankings that will create a new benchmark and transparent targets for a strategic asset class; and the World Bank will provide technical assistance—financed through fees from the fund—to up to 40 countries for reforms that enhance countries' local market investability, translating into higher index weights and new long-term investment.

5. Mainstreaming Subsovereign Financing

32. Countries' increasing focus on management of broader balance sheet risks has also included those in relation to subsovereign entities. The Bank has taken steps to mainstream and scale up its joint IBRD-IFC work in this area.

33. **Subnational Department.** In November 2006, the former IFC Municipal Fund—created in 2003 as a pilot program for financing without guarantees local government projects—was transformed into a joint IBRD-IFC Subnational Department (SND), with its mandate extended to include nationally-owned utility enterprises. SND delivers business development, project processing, and technical assistance to clients through joint Bank-IFC teams, but books assets on IFC's balance sheet. The focus of its activities, while not exclusive, is on MICs at a relatively advanced stage of fiscal decentralization.

¹⁴ See *Global Emerging Markets Local Currency Bond Fund (Gemloc Project)* (R2007-0192 and IFC/R2007-0268), September 13, 2007.

- **Transactions.** As of June 2007, after eight months of operations, SND had obtained Board approval for four transactions for a total exposure of \$156 million and developed a pipeline of over 20 projects in all emerging regions that would represent an additional investment value of about \$500 million. This compares to an original estimate of about \$800 million over three years.
- **Technical assistance.** SND helped create, in July 2007, a multidonor technical assistance facility (a window within the Public-Private Infrastructure Advisory Facility) that helps subnational entities improve their institutional capacity and creditworthiness so they can access market-based financing on their own account and without sovereign guarantees. The objective of this new program is to help mobilize local capital for infrastructure investments and promote the development of local financial markets.

SND will continue to scale up investments in support of subnational infrastructure and expand its technical assistance support.

C. Knowledge Services

34. The Bank's global knowledge and its ability to link research on developing issues with policy advice based on worldwide experience is seen by MICs as one of its comparative advantages. Bringing expertise and innovation in the Bank's advice to MICs relies on the Bank's ability to formulate strategy that values, nurtures, and deploys the Bank's technical skills, deploys its research capabilities in a manner that it is useful to the Bank's work in MICs, and is inclusive and reflective of research work done in the MICs themselves. The IBRD strategy recommended actions in three interrelated areas: identify and eliminate impediments to the global delivery of expertise; further strengthen the links between the Bank's research work and its operational services; and, refine the business model for a timely response for business advice, including for fee-based services. The IEG evaluation confirmed these priorities, noting that the Bank's knowledge services are well regarded by its IBRD partners, but also that there is a need for the World Bank to become more agile in the delivery of its global knowledge and to strengthen the linkages between research and operational policy advice. Since the initiation of the IBRD strategy, Management has begun developing a strategy to address fully these recommendations, and some progress in identifying options has been made in all three areas. Nevertheless, more time is needed to work out the details and translate the recommended steps into actionable proposals.

35. One set of proposals being developed focuses on the organization of knowledge services in the Bank. An important objective of these proposals is to explore ways to adjust the Bank's organizational structure in a manner that maintains the country-based model but rebalances the role of technical expertise. Within that rebalancing, there is a need to increase responsibilities and recognition of staff who work in large MICs, providing appropriate incentives to ensure that the Bank's work is connected with local researchers and think tanks (whose expertise is not yet sufficiently utilized in the Bank's knowledge services). This could be complemented by concentrating additional resources in the offices of the Regional Chief Economists (in the Bank's Regions, these are the loci

that combine both technical expertise and cross-sectoral perspectives), and by making room in Network anchors for world leading experts (“gurus”) and cross-regional expertise. In this regard, consideration is being given to complement the work of staff in MICs with a program to bring global experts to the Bank. Under this program, leading international experts would be in residence at the Bank for fixed periods of time, helping cross-fertilize Bank and external perspectives, and providing stimulus to technical staff. Such a program would include researchers from MIC research institutions.

36. On the delivery of global expertise, several initiatives are already under way. One has been aimed at more closely linking the Bank’s research with its operational policy advice. The Research committee has recently been restructured to encourage the formulation of research proposals by the Regions and Networks and to more actively engage the Regions in the commissioning of research projects. Another step under way is to increase the treatment of issues of interest to MICs in the Bank’s journals, and expand accessibility to researchers in MICs. Steps are also being taken to ensure that lessons from industrialized countries are made available to MICs and other clients. The Poverty Reduction and Economic Management (PREM) Network is already preparing an OECD Digest to inform on reports and analyses of relevance to developing countries, and is planning more active engagement in OECD’s global forums, as well as developing proposals for a more active staff exchange program with the OECD and the IMF.

37. More progress has been made on fee-based knowledge services, which have evolved in two distinct but complementary directions in recent years: financial advisory services offered by the Treasury in three specific areas: (asset management, public debt management, and capital market access strategy and implementation), and, analytic and advisory services provided by the Regions.

38. A review of the fee-based services business model has been concluded. It indicates that: the volume of fee-based services provided or planned remains modest: 39 countries (almost half the potential market of 79 MICs) have been, or are, recipients of either Treasury-provided financial services or Regional Office-provided analytic and advisory services; and most services have been, or are currently being, delivered broadly in line with the existing policy governance framework—however, the framework is not easily accessible, user-friendly, or well understood.¹⁵

39. Several measures are planned to further fee-based knowledge services in a flexible manner, on a larger scale, and unbundled from lending (see Box 8). None of the emerging recommendations involves a significant change in operational policy, but they should increase the clarity and agility of the provision of such services.

¹⁵ OM/OP 8.40, *The Provision of Fee-Based Services*.

Box 8. Facilitating the Provision of Fee-Based Services

Mainstreaming fee-based services within Regional Offices—especially in those with a majority of MICs (that is, EAP, ECA, and LCR)—would add to the menu of Bank products and services routinely available through the CAS/CPS process.

Financing and cost-sharing of fee-based services: the present arrangements for cost recovery are far from clear. Guidelines would be issued that define appropriate costing for different services, and would provide clear templates for agreements, so that drafts can be prepared rapidly. These administrative aspects would be unified with those for other reimbursable services and with current proposals related to small trust funds.

Defining and accessing fee-based services: the existing governance framework (OM/OP 8.40) would be updated to include provision for: (i) project-related services, subject to appropriate safeguards mitigating risks of Bank liability and reputation; (ii) explicit mention of subnational entities, subject to associated legal due diligence, if necessary; and (iii) addition of Part I or OECD countries, subject to confirmation of explicit consistency with the Bank’s development and poverty mandates.

Assuring quality and accountability of fee-based services: similarly, OM/OP 8.40 would be updated to ensure: (i) full compliance of fee-based services with all applicable Bank operational policies (this is especially important with the potentially increased involvement in project-related services); and (ii) creation of central and/or regional databases to satisfy the Bank’s accountability and fiduciary obligations and also to facilitate periodic monitoring and evaluation of fee-based services.

D. World Bank Group Synergies

40. The private sector is central to MICs economic development, driving economic growth and job creation and reducing poverty. Therefore, to address MIC development issues effectively, it is increasingly important for the World Bank Group (IBRD, IFC and MIGA) to work more closely together to provide a seamless array of services and products, exploiting the comparative advantage of each organization. The IBRD strategy recommended the World Bank Group explore ways in which IBRD/IDA, IFC, and MIGA can strengthen their cooperation. This was to include greater progress in preparing World Bank Group CPSs, in having managers participate in major investment and strategy meetings, and in exploring single country management representing the World Bank Group or examining other ways of improving coordination at the country level.

41. Progress has been made in several important areas. First, at the strategy level, recent CPSs are more systematically reflecting close coordination between the Bank and IFC teams in the design of support programs and financing arrangements (see Box 9). Second, at the operations level, the Subnational Development Department was launched, as mentioned earlier; it brings together in an integrated manner the Bank’s expertise in institutional strengthening and IFC’s risk-assessment capacity. The operations approved in FY07 were booked on IFC’s balance sheet, and a shadow-booking process was put in place to account for Bank inputs and firm up staff incentives to develop business in this area. This practical arrangement ensures that the contributions of Bank and IFC staffs to subnational development operations are fully recognized. There are also an increasing number of collaborative arrangements between the Bank and IFC, including for

operations in education and with regard to knowledge services. A new example of IBRD and IFC collaboration is the Gemloc project (see para. 31).

Box 9. WBG Synergy at the Country Level

The Peru CPS demonstrates greater synergy among the work of different members of the World Bank Group, particularly between IBRD and IFC. The IBRD and the IFC have focused their collaboration on a few specific areas, such as linking urban property rights on the IBRD side and micro finance on the IFC side. The grouping of lending, analytic and advisory services and IFC investments within thematic clusters provides a useful way for the two branches of the World Bank Group to enhance the interaction between the public and the private sectors in Peru so as to achieve results. IFC's strategy will involve balancing its support among large companies and small- and medium-sized enterprises (SMEs), and between investment and technical assistance. The IFC will (i) work to reduce Peru's high informality with technical assistance; (ii) invest and develop projects which address bottlenecks to provision of basic services and physical infrastructure; (iii) invest in industries with strong competitive advantages, such as agribusiness and tourism; (iv) expand growth to new beneficiaries by providing access to SMEs, housing, and tertiary education finance and by building local government capacity to deliver services; and (v) support environmentally and socially sustainable growth (natural resources sector). In addition to IFC, MIGA has been very active in Peru's mining industry and its due diligence and monitoring efforts are to ensure compliance of the projects with the Extractive Industries Review principles. MIGA will participate in this effort, building on its experience in working with foreign mining companies to implement the good governance and transparency elements of the Extractive Industries Review principles and by collaborating with local governments to enact these principles.

42. At the level of the organization, three Bank Group senior management positions—Group Chief Financial Officer, Group General Counsel, and Group Chief Information Officer—have been established to help achieve broad synergies in managing the balance sheet, legal, and technological risks across the World Bank Group. Also, the merger of the Financial Sector Network and the Private Sector Development Network into the Finance and Private Sector Development (FPD) Network under a joint World Bank-IFC Vice Presidency has provided a platform for closer collaboration between the World Bank and the IFC. Following the merger, the recent World Bank Group Financial Sector Strategy that was endorsed by the Board in FY07 focused on the benefits of coordination between the Bank and IFC to meet client needs across the spectrum, from diagnostics and policy dialogue to detailed reform implementation—noting that the infeasibility of a clear division of labor between the two institutions reinforces the importance of good communication and coordination. FPD has also initiated joint WBG Regional strategy/work program reviews to facilitate closer coordination and collaboration. Several other initiatives under the IFC's program for advisory services (AS) have helped facilitate collaboration, such as opening up IFC information systems to relevant IBRD staff; ensuring that IFC staff consult with IBRD staff at planning stages of any AS program that involves government clients; encouraging the use of IBRD staff as peer reviewers; and encouraging inclusion of IBRD staff on IFC-led AS teams. In addition, MIGA's technical assistance work has been integrated into the Foreign Investment Advisory Service (FIAS), a unit of the FDP. These areas of progress have provided a platform for managers of the Bank, IFC, and MIGA to work together more closely. Management is also conducting a review of the practicality of joint World Bank Group country managers where circumstances warrant it, and is assessing the effectiveness of doing so.

E. International Cooperation and Partnership

43. Members expect the Bank to further enhance its collaboration with MDBs and other agencies providing support to MICs.¹⁶ They also encourage the Bank to develop, in consultation with partners, a menu of options for the blending of concessional donor support with MDB loans in sectors characterized by important public goods or affordability issues.

44. ***Collaboration among MDBs.*** There is a long track record of collaboration among MDBs, and recent steps have been taken to work together on strengthening country institutional capabilities in the fiduciary and safeguard areas (not only to facilitate more effective use of public resources, sustainable management of natural resources, and protection of the livelihoods of poor people, but also to build the foundation of capacity and confidence for the transition to the use of country systems). This work will contribute to reducing the burden on borrowers of complying with donors' disparate requirements, by providing the basis for donor harmonization and alignment with countries' own systems. For example, the Bank was instrumental in promoting the establishment of the MDB Financial Management Harmonization Technical Working Group, the Joint Venture on Public Financial Management under the auspices of OECD's Development Assistance Committee (DAC), and the Public Expenditure Financial Accountability (PEFA) partnership. It is now the norm for the Bank to conduct public financial management diagnostics jointly with other donors, including MDBs. Also, the MDBs' Heads of Procurement actively participated in the OECD-DAC Joint Venture on Procurement to develop a procurement benchmarking and performance measurement tool currently being tested with partner countries.¹⁷ Substantial steps toward harmonization among MDBs in this area include country-based reform initiatives led by the World Bank in partnership with the concerned regional MDB and aimed at implementing, among other activities, national procurement reforms to ensure good governance and local capacity as well as use of common documents and procedures for national competitive bidding. Such work encompasses, in particular, Country Procurement Assessment Reports that are jointly conducted by the Bank and the concerned regional MDB. Collaboration on country systems is being extended through the peer review of the Bank's methodology for reliance on country procurement systems in MDB-financed operations.

45. The Multilateral Financial Institutions–Working Group on Environment (MFI-WGE) has a membership of large, medium, and small multilateral financial institutions. It served as a reference group for the preparation of OP/BP 4.00 on piloting the use of

¹⁶ The strengthening of collaboration with the IMF in MICs is addressed in the Joint Management Action Plan on Bank-Fund Collaboration. See *Enhancing Collaboration – Joint Management Action Plan (Follow-Up to the Report of the External Review Committee on World Bank-IMF Collaboration)* (SecM2007-0117), September 25, 2007.

¹⁷ The MDBs' Heads of Procurement group overarching objective is the harmonization of MDB-funded public procurement policies and practices. Achievements over the last several years include significant progress toward the harmonization of procurement guidelines, the development of common master procurement documents, the introduction of similar Core Labor Standards conditions, cross-harmonization among various master procurement documents, e-procurement tools and guidance, and the adoption of new fraud and corruption definitions.

country systems for environmental and social safeguard policies. It will prepare a review of progress in addressing assessment issues consistent with the provisions of the Paris Declaration, including the use of country systems, as a contribution to the High-Level Forum on Aid Effectiveness to be held in 2008 in Ghana.

46. **Blending.** The Bank has experience with blending or combining IBRD loans with concessional funds from sources other than IDA. Management has distilled lessons from that experience (see Box 10) and is developing a proposal for a more structured approach to enhance engagement with donors, foundations, global programs, trust funds, and carbon finance, and to provide institutional support to staff.

Box 10. Lessons from Bank Experience with Blending and Combined Financing

The Bank has experience with blending across a wide range of actors. The following lessons have been identified.

- Blending should be considered in areas where there is donor and recipient country interest, although the most likely areas for successful operations in MICs would seem to be in areas related to the delivery of GPGs, and to the Millennium Development Goals (MDGs), if there are issues of affordability.
- There is need for a wide set of options in the menu of blending to accommodate different needs of donors and client countries. No single arrangement can capture all potential benefits and at the same time meet the varied priorities of different donors and MICs.
- There is need for clear eligibility criteria to avoid creating expectations for subsidized loans in cases without significant market failures or lack of affordability.
- There is need for better flow of information on resource mobilization efforts. Many past operations have been negotiated as one-off transactions and as a consequence have come with high transaction costs. As part of the framework under preparation for the Bank's role in GPGs—discussed in Section III A—Bank staff are proposing to conduct a systematic review of the use of trust funds linked to the GPGs, which could be better leveraged to complement IBRD funding for MICs. In other areas, such as support for MDGs, country-specific approaches are more likely to succeed.
- There is need for an institutional support mechanism to disseminate information and provide guidance and support to staff, both to prevent teams from “reinventing the wheel” and to identify opportunities in a more proactive and strategic manner.

47. The proposal for a more structured approach would likely include the following.

- **Bilateral donors.** Official donors currently provide significant grant and other concessional financing to MICs and some are interested in leveraging IBRD funds and nonofficial resources. Flexible arrangements could help provide mechanisms to tailor external assistance to country circumstances and achieve graduated levels of concessionality. To that end, the Bank should disseminate the menu of approaches agreed with the other MDBs; engage both at the institutional and country level to agree on possible areas of mutual interest; and seek donor-specific support, through directing a slice of existing commitments to trust funds for blending or through a transactions-based approach.

- **Foundations.** Future potential blending partnerships with foundations should identify the precise area of potential alignment, based on matching the foundations interests with a Bank program; engage first in high-level dialogues with foundations to agree early on a strategic direction of potential cooperation; and maintain close institutional and project-level contacts once a framework for cooperation has emerged.
- **Global programs.** Building on experience with the Global Environment Facility, the Bank could explore blending of IBRD funding with other global programs and trust funds providing investment funding for environmental and health GPGs. Such blending would catalyze additional financing, including where global benefits exceed national benefits (see para. 15).
- **Carbon finance.** The Bank could explore lending against expected carbon revenues, possibly as a component of overall Bank lending. Carbon credits generated by greenhouse gas emission reductions are likely to be a reliable source of income for projects in MICs, providing a bankable revenue stream and improving the financial viability of investments in low-carbon technologies, such as renewables, energy efficiency, and waste management. Few lenders are willing to lend against carbon revenues today, which may create an important opportunity for the World Bank Group to demonstrate the potential and create replicable models that commercial lenders and investment banks could eventually adopt.
- **Institutional support.** Staff would benefit from more systematic support to learn about blending examples and good practice, and receive guidance as to when IBRD blending may be suitable, what the possible options are, and what lessons have been learned. To that end, the Bank is considering the preparation of a review volume of the blending arrangements with possible standardized templates/best practices that can be easily used by other teams with similar operations. Greater institutionalized support to provide information, directions, and advice would facilitate identifying opportunities in a more proactive and strategic manner. This coordination effort could include a “service center” tasked with helping staff and others (such as donors and MDBs) who may want to tap into the possibilities. A clearinghouse mechanism could be set up to help answer requests and guide the process.

48. **Next Steps.** The Bank will re-engage with the other MDBs to discuss common principles for blending. An MDB working group will discuss technical issues in the autumn of 2007. A conference at the Vice Presidential level will be organized by early 2008. On the basis of this joint exercise, the Bank will then engage with the bilateral community and other agencies to develop options for expanding the use of this mechanism. Given the different and strong case-specific constraints that MDBs, clients, and donors face, the engagement should be tailored to match the particular goals of countries and donors and should aim to strengthen development effectiveness.

**ANNEX A. SUMMARY AND RECOMMENDATIONS OF THE
2006 PAPER TO THE DEVELOPMENT COMMITTEE**

ENTITLED

STRENGTHENING THE WORLD BANK'S ENGAGEMENT WITH IBRD PARTNER COUNTRIES

1. This paper discusses the World Bank's strategy for engagement with IBRD partner countries. These include 79 middle-income countries (MICs)—defined as those countries currently eligible for IBRD borrowing, and also all other members of the cooperative that make selective use of its services. MICs are extremely diverse and have different development needs. Collectively, they face the pressures and challenges of globalization. In parallel, the international community is experiencing a growing need for effective collaboration to address regional and global public goods issues. These developments are shifting the World Bank's role and its delivery mechanisms in fundamental ways.
2. This paper focuses on how IBRD can become more effective in delivering a flexible, high quality and cost-effective menu of services for all its clients to assist them in achieving development results; it does not attempt to classify clients. The paper seeks to refine and enhance IBRD's existing strategy and accelerate its implementation. The approach described in the paper builds upon existing work and lessons of experience, and addresses new opportunities and challenges facing the IBRD. The paper contains measures to improve the IBRD's effectiveness in partnering with MICs to achieve better development outcomes, and to pursue collective efforts to address regional and global concerns.
3. The mission of the World Bank is to reduce global poverty (see Box 1). The twin pillars of the Bank's strategic framework support: building the climate for investment, jobs and sustainable growth, and investing in and empowering poor people to participate in development. IBRD aims to reduce poverty in middle-income countries, including IBRD eligible creditworthy poorer countries. Middle-income countries, where 70 percent of the world's poor live, have made profound improvements in economic management and governance over the past two decades, and are rapidly increasing their demand for the strategic, intellectual and financial resources the Bank has to offer. The challenge facing the IBRD is to better manage and deliver its resources to best meet MICs' needs.

Box 1. Corporate Statement

The IBRD is a development cooperative which works with member countries to promote sustainable, equitable, and job-creating growth; to reduce poverty; and to address issues of regional and global concern consistent with the Bank's mandate. It helps members achieve results by delivering flexible, timely and tailored financial services, knowledge services, and strategic advice, while using its convening capacity as appropriate to further members' specific objectives. It seeks to enhance its impact by working closely with IFC and MIGA, capitalizing on MICs' own accumulated knowledge and development experiences, working closely with the IMF and other MDBs and collaborating with the development community.

4. The current strategy is anchored on the recognition that IBRD adds value in helping MICs achieve their own development objectives, most effectively by offering a package of lending, knowledge services and risk management products. The IBRD offers—in global

partnership with other development institutions—support for policies and programs that promote sustainable, equitable, and job-creating economic growth, raise living standards, and reduce poverty. Partnership with, and support for, MICs strengthens the Bank’s ability to support low-income countries. IBRD’s strategy also recognizes that MICs’ play an increasingly important role in the provision of global public goods such as clean energy, trade integration, environmental protection, international financial stability, and fighting the spread of communicable diseases. Finally, the strategy recognizes that as MICs develop they will eventually reach a stage of development when they will graduate from needing IBRD’s support.

5. Like any dynamic organization, the World Bank is adapting to new conditions and challenges, while relying on its core values and principles. Underlying the proposed approach is recognition of the significant evolution underway in IBRD partner countries. As in any cooperative, as members’ situations change, so does the nature of the services they expect the cooperative to provide. Lending remains important, and over the past three years efforts have succeeded in providing additional IBRD resources to clients. Today, IBRD members are also interested in rapid access to targeted technical expertise and to knowledge based on experience elsewhere, often but not always combined with finance, for strategically defined portfolios of development resources to support countries’ economic, social and environment goals and to address broader regional or global concerns. The IBRD seeks to meet these demands where it has a comparative advantage and the capacity to do so cost-effectively.

6. In this context, the proposed approach clarifies IBRD’s role in today’s world by:

- Restating IBRD’s value added proposition for members going beyond the financing role and looking at the universe of services provided as a package and as stand-alone services.
- Introducing the full menu of tools available to clients recognizing that MICs are a diverse group with different development needs and different preferences on how to engage with the World Bank Group (WBG). The proposed approach aims at assuring flexibility in products and product delivery mechanisms to allow the Bank and its partners to agree on the most appropriate combination of tools depending on the development stage, needs and institutional capacity of a country.
- Acknowledging MICs’ own contribution to the World Bank as repositories of extensive experience in what works and doesn’t in development; there is a major challenge in channeling this knowledge and experience for the benefit of countries that are at an earlier stage in tackling obstacles to growth and participation.

B. The Evolving World Context and Shareholders’ Demand

7. In recent years, MICs have made considerable progress in fostering economic growth and reducing poverty:

- While MICs continue to account for a majority of the world’s poor, they have grown by 5.8% on average over the past 4 years, the strongest growth in 3 decades.
- On average, MICs are better equipped to handle financial market shocks. Many have strengthened their government balance sheets by adopting more prudent fiscal policies, privatizing state owned enterprises, building up international reserves and reducing their foreign currency sovereign borrowing, and more than a few have

developed the infrastructure needed to deepen their domestic financial markets.

- A number of MICs have gained greater access to cross border flows of private capital. Net private capital flows to developing countries reached a record high of US\$483 billion in 2005.

8. Despite these favorable developments for MICs as a whole, there is wide dispersion within the group:

- MICs have an average per capita income of just US\$3.80 per day: 1.5 billion people live in countries that are eligible for IBRD support but have an average per capita income below the IDA cut-off (e.g. India, Indonesia and Pakistan).
- The record of growth and poverty alleviation is heavily influenced by China and India. If these two countries are excluded, the average growth rate in MICs over the past four years declines from 5.8% to 4.3%. On a regional basis, economic growth in MICs in Latin America and the Caribbean (3.1%), Sub-Saharan Africa (3.6%) and Middle East and North Africa (4.4%) has lagged behind that of East Asia and the Pacific (7.8%), South Asia (7.2%) and Europe and Central Asia (6.2%).
- Private capital flows, while being more widely disbursed than prior to the Asian crisis, are nevertheless largely concentrated in a very limited number of countries. Ten countries account for 70 percent of emerging market sovereign bond issues, and less than a dozen MICs can be regarded as established bond market borrowers able to access the market regularly at relatively stable spreads. Moreover, history suggests that there will continue to be periods when access to private finance for even the more creditworthy MICs will be much more difficult than it has been in recent years.

9. Increasingly, MICs are looking for more customized financial and advisory services from the IBRD, although the traditional bundled lending and knowledge management products remain important for many MICs, particularly those with credit ratings well below investment grade. In terms of evolving demand, four trends stand out:

- In FY05-06 lending to MIC clients in current US dollars terms returned to levels of \$13-14 billion per year, a level previously observed before the FY01 decline.
- MICs are increasingly drawing on the IBRD's flexible loan and hedging products to mitigate financial risks and are seeking customized financial advice to help manage their broader balance sheet risk. This includes products for expanding lending in local currency and to sub sovereigns and for managing commodity price volatility and catastrophic risk.
- The demand for the Bank's non-lending services is growing. More MICs are seeking unbundled IBRD's financial, knowledge and strategy services and access to the latter two on a stand alone basis.
- In addition, all shareholders are increasingly turning to the IBRD to use its knowledge, strategic advice, convening role, and financial capacity to address issues of global and regional concern, and to provide banking and administrative services to help operationalize these initiatives. Clearly defining IBRD's role on global public goods becomes even more important in the context of highly fragmented

international aid delivery mechanisms.

C. Addressing New Challenges and Opportunities

10. Over the last four years, building on previous MIC task forces' recommendations, the Bank has introduced numerous measures to increase its responsiveness to client demand. These include: overhauling its menu of financing and risk management products, broadening its freestanding delivery of knowledge services, offering treasury management services on the basis of cost recovery, introducing single-country technical partnerships and reducing the non-financial costs of doing business with the Bank.

11. Progress has been made but much more remains to be done. In order to meet the expectations of the MICs, the WBG needs to improve the delivery of integrated services across the business lines described below, successfully unbundling its services to meet individual client needs. The business segments approach presented below also help to improve and better evaluate IBRD's effectiveness in achieving development results, including tailoring support to diverse client needs. Finally, the approach makes it easier to define and address the challenges facing the institution.

12. The WBG operates the following business segments:

- Strategic policy advice to countries and on global and regional issues, with matching convening capacity, increasingly to help address global and regional public goods.
- Financial services, including a full menu of financing, credit enhancement and risk management tools to the sovereign and non-sovereign public sector.
- Knowledge services delivered at the country, sector and global level through a variety of delivery mechanisms: research, project cycle, analytical work, training, institutional capacity building and technical assistance.
- Loans, equity, structured finance and risk management products, and advisory services provided to pioneering enterprises in the private sector.

This paper focuses on the first three businesses which are central to the IBRD's role and discusses the fourth business (IFC and MIGA) in terms of its linkages with the first three.

D. Recommendations for Strengthening World Bank Engagement

13. Bank Management seeks Ministers' support for the enhanced partnership with IBRD partner countries described in this paper. Management will develop an updated action plan to address internal constraints to the delivery of this program and, prior to the 2007 Annual Meetings, will present a detailed overview to the Board on the implementation of the measures outlined below with separate reporting to the Board on several measures during the first semester of FY07. In developing these measures, a key objective will be to ensure that they facilitate the development of markets, and strengthen the role for the private sector as a key agent of income growth and job creation and as a deliverer of services.

14. Key services to be improved for MICs will cover five areas:

1. Strategy and Coordination Services

- At the country level, accelerate actions to produce higher-quality, more focused WBG Country Partnership Strategies, reflecting country-specific priorities and serving as platforms for more flexible assembly and delivery of the portfolios of expertise and financing - from whatever source - to implement them.
- Accelerate the Bank's responsiveness to increased demand for its engagement in global commons themes. Next steps include prioritizing strategic themes for World Bank engagement in global themes and developing a forward-looking menu of financing options to enhance support for high priority global undertakings.

2. Financial Services

- Accelerate ongoing actions to reduce the non-financial costs of doing business with the institution by streamlining internal Bank procedures and supporting the use of country systems where those systems meet mutually agreed and verifiable standards.
- Prepare options to simplify, improve the transparency and ensure the continuing competitiveness of IBRD loan pricing.
- Consider ways to make financing vehicles more accessible to qualified borrowers with strong fiscal and macroeconomic policies and effective development programs.
- Develop approaches to help catalyze market-based solutions to mitigate external shocks such as commodity price volatility and natural catastrophes.
- Mainstream IBRD participation in originating and administering public-sector financing at the sub-national level, with the understanding that, when such financing is done without a sovereign guarantee, it would be booked on the IFC balance sheet.

3. Knowledge Services

- Building on the Bank's comparative advantages, expand the menu of delivery mechanisms by developing and implementing a business model for a quick response window for timely policy advice and for the provision of fee-based expert services more flexibly and on a larger scale.
- Strengthen the links between the Bank's research work and the delivery of operational services in MICs, including stronger partnerships drawing on clients' own expertise and wider collaboration with local institutions.
- Identify and eliminate impediments to global delivery of expertise and improve the management of the Bank's pools of expertise to maintain quality and ensure cutting-edge skills.

4. World Bank Group Synergies

- Explore ways in which IBRD/IDA, IFC and MIGA can strengthen their cooperation, including piloting single country management representing the WBG or examining other ways of improving coordination at the country level. Greater progress will be made in preparing WBG Country Partnership Strategies, and in having managers participate in major investment and strategy meetings of the other parts of the Group.

5. International Cooperation and Partnerships.

15. Cutting across all business areas are opportunities to achieve stronger cooperation and partnerships to improve the impact of parallel support being given by other multilateral development banks (MDBs), other international agencies and funds, and bilateral agencies. Steps will be taken to:

- Enhance collaboration with MDBs and all other agencies providing support for MICs. Making this work in practice will require commitment from all development partners, both globally and at the country level, including, for example, commitment to pursuing the Paris Declaration agenda on alignment and harmonization in MICs and moving to greater use of country systems where appropriate in parallel with governance improvements. An update on MDB collaboration will be provided to the Executive Board by the 2007 Spring Meetings.
- Develop and implement, in consultation with partners, a menu of options for the blending of concessional donor support with MDB loans in sectors characterized by important public good or affordability issues, with an emphasis on transparency and a continuing shift towards performance-based subsidy allocation mechanisms.