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NOTE FROM THE PRESIDENT OF THE WORLD BANK

Attached for the information of Members of the Development Committee is a Note from the President of the World Bank, James D. Wolfensohn, for the Committee's September 27, 1999 meeting.

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President's Note to Members of the Development Committee

When we met in the Spring of this year, we tentatively welcomed what appeared to be a corner turned on the steep path out of the financial crises triggered in mid-1997. Since then, economic growth in some countries in East Asia has improved but growth in developing countries in general has been slower than we were expecting before the crisis. In addition, volatility continues to have a negative effect and serious questions of governance have been raised.

Sadly too, the past six months have been marked by conflict and by natural disasters, both of which have ripped people out of their homes and challenged our responsiveness. I particularly want to thank Bank staff for their extraordinary efforts to find ways to meet the needs of countries which have suffered in this way.

As we approach the close of the Twentieth Century and as we prepare to move forward into a new millennium, we face extraordinary challenges. My note to you lays out some of the groundwork that the Bank Group has been doing in preparation to face these challenges squarely, most particularly our core concern, poverty. I look forward to our discussions in the Development Committee of a number of these key issues.

1. Poverty reduction: the core agenda for development effectiveness

I believe we have made tremendous strides in placing poverty unambiguously at the center of our work. This is now widely recognized as the essential heart of the Bank Group's expertise and commitment. And we have made good progress in finding further concrete ways to ensure that the poverty reduction agenda underpins what we do.

At the country level, we have begun to sharpen the focus of our efforts to help countries with the design and implementation of effective poverty reduction strategies. In this regard, the Comprehensive Development Framework provides a potential framework for effective implementation, if governments are interested in pursuing this approach, as a number have been.

At the regional and global level, we and our partners are addressing a range of issues with strong impacts on poverty that transcend national boundaries and which cannot be effectively addressed at the country level alone. Later in this note I will address specific examples of severe indebtedness and commodity dependence.

The country-level approaches need, of course, to be responsive to the very different country circumstances. A large number of developing countries at the lower end of the income spectrum – the IDA-only countries – have been losing the fight against poverty these past two decades. In these countries, poverty reduction strategies must help build capacities to address the weaknesses in governance and in institutions that lie at the root of their poor performance. A number of developing countries which have made considerable progress in the fight against poverty – and, in the Asia region, mostly winning that fight – have suffered recent setbacks. These countries also still have very large numbers of people living on less than $2 a day and recovery does remain fragile. To them our assistance must be more selective. The focus must continue to be on capacity building but with an emphasis on creating the strong institutions of a market-based economy that help address remaining structural and social weaknesses.

Comprehensive Development Framework

In my Note to the Development Committee for the Spring 1999 meetings, I shared with Ministers the key elements of the Comprehensive Development Framework (CDF) proposal, which we see as a major tool for achieving greater development effectiveness. I stated then that the CDF was essentially a process rather than a blueprint to be applied uniformly. I emphasized that while it was work-in-progress, we were at that time engaged in discussions with thirteen countries to implement the principles of the proposed approach. All these countries have since become CDF pilots: Bolivia, Côte d'Ivoire, Dominican Republic, Eritrea, Ethiopia, Ghana, Jordan, the Kyrgyz Republic, Morocco, Romania, Uganda, Vietnam and West Bank and Gaza.

Over the last several months, the CDF has been discussed with a wide variety of audiences including Ministers and senior officials in developed and developing countries, academics, civil society, the private sector and, other stakeholders. The Bank has been seeking to engage its key partners at various levels in ongoing consultations. We have been part of a constructive debate on the CDF through workshops, conferences and other forums and in May and June an on-line dialogue attracted worldwide participation.

Overall, there has been wide acceptance of the CDF as an effective way of doing business for the Bank, its key partners and recipients. More specifically, the concept of the country assuming the lead in determining its development agenda, a position central to this approach, is widely accepted. Equally, it is recognized that the CDF helps to focus on the difficult task of forging stronger partnerships among the key players in support of the poverty reduction objectives of developing countries. Perhaps the most exciting product of the CDF process so far is the growing consensus within the development community around a "common view" for an approach to development that would enhance effectiveness. The Development Assistance Committee (DAC) is presently coordinating an exercise to identify the basic principles of this common view and build consensus around them. In the spirit of its objectives and underlying principles, I hope the CDF can be an integral part of the debate and the effort to build consensus.

Turning to the on-going CDF pilots, measurable progress is being made in several countries. This is especially so with respect to building partnerships among the key players and to holding national consultations in the course of which national strategies and priorities are identified and agreed upon while consensus building is promoted. This sort of holistic approach is emerging in several countries and greater weight is increasingly being given to the social, structural and institutional aspects of development. Key development agencies, including the UN system and other multilaterals, have designated a number of senior officials as focal points for closer liaison with the Bank on the CDF.

As we proceed, a number of challenges are beginning to emerge: building country ownership requires space, time and capacity; engaging civil society and stronger partnerships among the key players calls for mutual trust and confidence. We are seeing that the process of sharing experiences and learning should be intensified and we are realizing that, in some instances, existing business practices and procedures might be reviewed and modified to facilitate the implementation of the new approach.

Recognizing that the CDF is, at its core, about effective poverty reduction, we have been thinking about how we might strengthen the Bank's poverty reduction strategies by building on the central elements that emerge from the CDF way of working: its emphasis on outcomes, its longer term view of development and its insistence on partnerships as a means to a broadly shared, broadly owned country development strategy. A recent Board paper, *Building Poverty Reduction Strategies in Developing Countries* represents our current thinking on this, setting out an approach to sharpen the poverty focus of Bank country strategies. This issue is also taken up in the joint Bank Fund paper to the Development Committee entitled: *Heavily Indebted Poor Countries (HIPC Initiative): Strengthening the Link between Debt Relief and Poverty Reduction.*

The approach proposed in these two papers identifies three key elements in a country's poverty reduction strategy:

- A comprehensive understanding of poverty and its determinants: who the poor are, where they live, their sources of livelihood and the risks they face;
- Choosing public actions with the largest impact on the poor (actions that improve economic opportunities for the poor; improve capability and delivery of essential services, increase empowerment and participation of the poor in the development process, and that reduce the vulnerability of the poor to shocks); and
- A highly participatory and transparent process for the identification and monitoring of poverty outcomes.

The Bank for its part will support countries through effective country strategies that are informed by strengthened information, analysis and diagnostic work, and which draw on instruments better suited to the longer-term nature of the poverty problem. This effort is likely to find its immediate operational application in the HIPC and IDA-ESAF countries, given the importance Governors have attached to a strengthened poverty focus on the part of the Bank and the Fund in low-income countries.

HIPC Review

The 1999 review of the HIPC Initiative has truly been a remarkable process, mobilizing governments, NGOs, faith-based organizations, and the media in the active search for a much strengthened debt relief program for our poorest member countries. The result of this intensive consultation process was a mandate to change the HIPC framework, supported by ministers attending the Spring Meetings. Subsequently, the

Bank and the Fund continued their consultations and benefited from concrete proposals, including those put forward at the Cologne summit of the G7 in June. I am pleased these efforts have now been translated into an enhanced framework for the HIPC Initiative.

We have also been reviewing how to strengthen the link between debt relief and poverty reduction. To this end, we have had intensive debate with several interested parties, including a successful seminar hosted by UN ECA in Addis Ababa. What has emerged categorically from this debate is the need to integrate debt relief into an overall effort on poverty reduction and we have made concrete proposals on how to do this.

The enhanced HIPC framework is expected to more than double the amount of debt relief and to increase the number of countries likely to qualify for relief. We are, however, faced with a major challenge to secure its financing. There have been ongoing consultations with donor countries, including two meetings in Paris, on how this challenge could be met. As you know, I have repeatedly stated that almost all multilateral institutions, including the Bank, will need to rely on bilateral contributions to finance the extra cost of the enhanced framework.

Under this enhanced framework, The Bank is faced with a cost of over US$5 billion in net present value terms. To date, we have covered our share from internal resources, mainly IBRD net income and, to a lesser extent, IDA grants. The cumulative IBRD net income transfers of US$2 billion, that we intend to make to the HIPC Trust Fund, is well in excess of the cost of debt relief (US$0.7 billion) that would need to be delivered to HIPCs with a significant outstanding IBRD debt. While the IBRD net income transfers have helped cover the IDA debt relief under the current framework, it is clear that we will need your help in securing the financing of the additional cost to IDA under the enhanced framework. As we are continuing consultations with donors, the uncertainty about funding is the most difficult issue confronting us on the HIPC initiative and needs to be squarely addressed at the upcoming Development Committee meeting.

Meanwhile, the high visibility of the HIPC review process and the proposals to modify the framework have not slowed down implementation in various countries. Since the Spring Meetings, Guyana and Mozambique have reached their respective completion points, providing aggregate debt-service relief of US$4.1billion. Preliminary HIPC documents have also been discussed for Nicaragua and Tanzania, bringing to 14 the number of countries that have been considered under the Initiative to date. As soon as the enhanced framework for the HIPC Initiative, including its funding, has been endorsed by the Development and Interim Committees, we will intensify our efforts to bring to the Boards additional debt relief packages.

Strengthening the Social and Structural Framework in Developing Countries

Social and structural issues have always been at the core of the Bank's development work and its mandate of poverty reduction. One of our major contributions to the holistic CDF process can and surely must be in this area of our greatest expertise. Lessons drawn from the recent wave of financial crises underscore that, in addition to macroeconomic stability and policies for growth, good structural and social policies and their institutional underpinnings are of critical importance to enable countries to harness the benefits and avoid the pitfalls of integration with the international financial system.

Recent discussions about international financial architecture highlight three ways in which the Bank can contribute to developing good structural and social policies. One, we do this by supporting international standard-setting bodies in their development and dissemination of norms and best practices, along with methodologies for assessment and implementation. Two, we assist countries in deepening their understanding of key social and structural sources of vulnerability. And three, we contribute by assisting countries strengthen their capacity to benefit from globalization by achieving sustainable growth and poverty reduction. (see *Progress Report: The Bank's Role in Strengthening International Financial Architecture* prepared for this meeting of the Development Committee.)

The Bank is not a standard-setting body. However, its experience in social and structural policies and in supporting reforms in these areas, means we have much to contribute to international efforts to define norms and good practices. The Bank is supporting standard-setting bodies in some areas as well as catalyzing work in others where there are gaps such as insolvency regimes and the social dimensions of crises. The Bank has also expanded its work to assist countries assess the key social and structural roadblocks to poverty reduction. Social and Structural Reviews, piloted over the last year, provide a more systematic evaluation of country policies and vulnerabilities.

The lessons of the recent crises have led the Bank to sharpen its support for capacity building, both to reduce vulnerability to crises and to help countries deal with the longer-term goals of development. In addition to supporting country-level capacity building, we are also supporting global initiatives like the Global Forum on Corporate Governance with the OECD, the Symposium on Bankruptcy and its follow-up and a push for improvements in accounting and auditing practices at the global level. At the regional level, I am delighted to report that the African capacity building initiative known as PACT is taking shape. We are supporting a fund for this with $150 million over five years and our co-collaborators include UNDP, the IMF and the African Development Bank. Most important though is the fact that this is a wholly-owned African initiative developed by the African leadership to address capacity building in the public sector and in its interface with civil society and the private sector.

Good Practices on Social Dimensions of Crises

The social impact of the financial crises that began in East Asia in 1997 showed us all the need to pay greater attention to protection of the poor and of vulnerable groups during crises. As part of its work on crisis management and prevention, the World Bank prepared a note for Spring Meeting of the Development Committee on Principles and Good Practices in Social Policy. Since then this document has evolved to identify practical advice on good practices for social policy, especially in the context of preventing and managing the social dimensions of crises.

Three interlinked elements have emerged. They are the need to enhance the knowledge and understanding of good practice in addressing the social dimensions of crises; the need to organize knowledge so that it is accessible and useful; and the need to bring that knowledge into operations. The latest paper outlines the development of information on good practices and how it will be made available to countries and to Bank managers. The material is intended to assist decision makers in the process of setting priorities and designing programs for crisis prevention and management.

In considering crisis management, the paper provides a survey of macroeconomic policies, safety nets, education, health and labor markets, with additional focus on the role of information and institutions. In the immediate future we propose the establishment of specifically designed websites which will be instrumental in linking good practices to operations. In addition, discussions will be ongoing with the IMF, UN and other partners on good practices.

Commodity Risk Management Initiative

Managing risks in highly volatile commodity markets remains one of the major challenges of development, especially for the poorest countries. More than 50 developing countries (mostly in Africa) depend on three or fewer leading commodities for more than one half of their export earnings. In many of these countries, commodity production and trade affect the livelihood of millions of people, the government's fiscal revenue and public expenditure, as well as the country's trade balance, foreign reserve and creditworthiness. Inability to manage uncertainty makes it difficult for farmers to plan their crops, allocate resources, obtain credit for inputs, and even simply recover costs. It also weakens the ability of governments to maintain a conducive and stable environment for domestic business and to implement policies and programs to assist the poor. When looked at from this perspective, improved commodity risk management can make an important contribution to poverty reduction.

To confront this challenge, the Bank convened in January an International Task Force (ITF) on Commodity Risk Management in Developing Countries. Bringing together a broad representation of international organizations, producer organizations and private sector entities, our idea was to explore new, market-based approaches to help developing countries better manage their vulnerability to commodity price fluctuations. After extensive deliberations and consultations, the ITF has prepared a discussion paper summarizing its recommendations. The group reached consensus on the principles of a possible new market-based approach to bridge the gap between providers of risk management instruments and potential users in developing countries who lack access to these instruments. The discussion paper also suggests the creation of an international intermediary that would help bridge this gap. We will be consulting with the Bank Executive Directors and others as we seek to develop an agreed framework for action.

Countries Affected by Conflict

I am pleased to report good progress in advancing the difficult work of the post-conflict agenda. On a policy level, a draft Operational Policy on Development Assistance and Conflict will be widely circulated for contribution by the end of the year. It is heartening that there is now an increased interest in countries affected by conflict. In response we are producing a Quarterly Monitoring Report which keeps Executive

Directors and Senior Management informed about Bank involvement in these countries. Further, the Brookings Institution hosted two conferences this year where bilateral and multilateral relief and development agencies put their heads together to identify ways in which we could bridge the gaps in post-conflict transition and recovery. As a result we have begun cooperative work in Sierra Leone and the Great Lakes region of Africa.

Different regions within the Bank have been challenged to respond flexibly and with innovation to widespread conflict which has occurred this year. The Africa region gave technical presentations at peace talks for Sierra Leone and Burundi and maintains contact in Liberia and the Democratic Republic of Congo to be ready for full-scale re-engagement when circumstances permit. The region also launched its own Thematic Group on Conflict and Post-Conflict Management to deepen the expertise of staff.

As joint chairs, the Bank and the European Commission have been coordinating the international donor initiative in southeastern Europe. The Bank participated in the recent Stability Pact meeting aimed at forging closer regional and economic cooperation and co-chaired four emergency donor conferences, preparing emergency assistance packages for the six most-affected neighboring countries. We are making every effort to establish a Trust Fund for Kosovo using resources from Bank net income to provide selective financial assistance for reconstruction and economic re-start activities.

With prospects for a political settlement quite promising in the Middle East, donors are beginning to re-examine ways of improving aid mobilization and effectiveness in their work with the Palestinians. The Bank is assessing aid effectiveness and donor coordination structures in an effort to strengthen the basis for economic growth and poverty reduction.

Developing Countries and the International Trade Agenda

The international community has made impressive progress in reducing barriers to global trade through successive rounds of negotiations. Developing countries have increased their integration with the world economy substantially through tariff reductions and the elimination of quantitative restraints. But, as barriers to trade have come down, the urgency of defining and implementing effective strategies in low and middle income countries so that they may benefit fully from the opportunities for growth and poverty reduction offered by the global economy, has increased. At the same time, the multilateral trade agenda has expanded greatly to encompass institutional and regulatory issues previously considered outside the mainstream of trade policy. Trade policy and effective development have become increasingly intertwined.

The Bank has participated in this process with an active program of support to assist developing countries. Over a quarter of our investment lending during the past five years has been for trade-related activities such as ports, telecommunications, institutional strengthening, and private sector development. The majority of adjustment loans have also supported policy and institutional reform linked to international trade. Research and institution building efforts have been directed toward assisting developing countries to participate more fully in setting the agenda for future trade policy negotiations.

Now we are entering a new phase and I would like to take this opportunity to welcome Mike Moore as the new Director-General of the WTO. We welcome, too, the new round of negotiations that will commence in Seattle later this year. As we prepare for the meetings, I urge that we all focus on helping developing countries participate actively. We must ensure that developing countries benefit directly from the new trade round with improved and full access to the world economy and we must ensure that trade is an effective instrument for growth and poverty reduction.

2. Strengthening Bank Financial Capacity and Instruments

Lending Retrospective and Review of Options for New and Improved Instruments

World Bank lending rose to record levels over the FY98-99 period, reaching an all-time high of $29 billion in FY99. The surge was driven mainly by IBRD adjustment lending, reflecting in part the impact of the global financial crisis on large IBRD borrowers and their demand for quick-disbursing lending. This included support for social programs which accounted for over 25 percent of adjustment lending. However, robust lending to IDA borrowers also contributed to the strong outcome. Most importantly, quality remained strong as lending increased and virtually all indicators of project quality and performance improved over the course of FY99. As we look forward, IBRD lending is expected to decline from the record highs of FY98-99, but remain above the levels of the mid-1990s. IDA lending is expected to remain relatively stable.

Underpinning these strong results has been the Bank's increased responsiveness to client needs in the face of difficult global conditions. Guided by the goals of our Strategic Compact, we have made significant progress in expanding and refining the lending instrument toolkit to make it more relevant to the challenges our clients face today. Adaptable Program Loans and Learning and Innovation Loans have given the Bank much more flexibility in terms of response time, scale and continuity. More recently, we introduced Special Structural Adjustment Loans to help clients respond to financial crises, and Policy-Based Guarantees to help IBRD borrowers with strong economic and social programs improve their access to private foreign financing.

Increasingly we are getting to grips with the fact that for development assistance to be effective and sustained, financial considerations must go hand in hand with good policies. This thinking is fundamental to the CDF and we now recognize the need to give much more attention to lending instruments that allow us to scale up our development assistance, respond flexibly to systemic crises, and support systematic policy reform and sustained institution building over the medium term. To do this we are pursuing policy- and program-based lending though Sector Investment Programs, Adaptable Program Loans/Credits and Programmatic Structural Adjustment Loans/Credits. I believe that programmatic approaches will prove particularly useful when focused on fostering fundamental institutional changes to improve public sector reform and governance or on enhancing support for government programs aimed directly at poverty reduction. This will help us scale up our development impact and is high on the priority list for the Bank as we look beyond the work of the Strategic Compact and into the 21st Century.

Strengthening Financial Capacity of Bank Group

Since the last Development Committee meeting, the Board of Executive Directors and Management have studied carefully the financial condition of the Bank and its capacity to fulfill the expectations of shareholders. The Executive Directors also noted the Bank's strong AAA status and expressed their continued support for maintaining this rating in light of possible future demands. A separate note, prepared for consideration by the Committee, concludes that:

- The global financial crisis in FY98 resulted in a surge in Bank lending and a deterioration in the condition of the Bank's loan portfolio that together imposed strains on the Bank's financial capacity. At the end of FY98, the Bank took major steps to strengthen its finances though loan pricing and administrative expense management.
- The Bank's capital structure remains sound but its financial capacity may be reaching its limits, depending on future demands.
- Further discussion in the Bank Executive Board on the role of the Bank in a financial crisis and in poverty alleviation would be useful. These discussions will help answer questions about when and by how much the financial capacity of the Bank should be enhanced.

Internal Renewal

We recently submitted the fifth progress report on the Strategic Compact to the Board. The Compact will end in December 1999, and as we take stock during the final months of this program, I am struck by the advances that we - Executive Directors, staff and management - have collectively made in achieving our objectives. We are close to becoming the "new Bank" we envisaged when we launched the Strategic Compact. We have made great strides in placing our clients at the center of our work and have demonstrated our commitment to partnership with others to serve the needs of the poor. Social and structural concerns are now an integral part of our work program. We have also achieved much in changing the way we do our business with the result that the quality of the Bank's work has improved, translating into greater development effectiveness. Our responses to client needs are faster and nearly half our country directors are now posted in country offices, closer to clients and with a deepening understanding of their needs. We are better equipped to share cutting-edge knowledge with staff, clients and partners. When we launched the Strategic Compact over two years ago, I said: *"We are looking for a better Bank: a faster and flatter Bank; better-trained staff at lower cost; more efficient, more flexible and fully committed to excellence."* I believe we are well on the road to achieving what we set out to do.

3. Building Partnerships and International Institutional Arrangements

Building Partnerships

As much of this note has stressed, building stronger partnerships is at the heart of the CDF and the strategy of leveraging the Bank's impact on poverty reduction. The recent wave of financial crises has also highlighted the need for enhanced collaboration with a broad range of stakeholders in order to strengthen the international financial architecture. Hence, an important aspect of the CDF pilots and of our efforts to support reforms and institution building in our member countries, is to pursue new and more effective partnerships. We look to do this through the OECD DAC and with individual agencies. While this is a broad-based effort, we are giving special attention to our collaboration with the IMF in view of the complementary role of the two institutions. We are taking further steps to enhance our joint capacity to support poverty reduction and to assist countries integrate successfully with the international financial system. As set out in the joint HIPC Initiative paper, we are proposing to prepare with governments a tripartite Poverty Reduction Strategy Paper (PRSP) that can greatly improve the joint support from ESAF and IDA.

Similarly, the Bank and Fund continue to deepen their collaboration in both assessing progress and improving compliance with a wide range of standards and principles of best practice. Notable is the joint Financial Sector Assessment Program that examines key vulnerabilities and development challenges in the financial sector.

Review of Options for Strengthening the Development and Interim Committees

A range of possible improvements in the workings of the Development and Interim Committees are under consideration. One change is that in the Interim Committee, the Bank President has become a full participant. Some practical improvements are also being made in the functioning of the Development Committee. For example, the two managements made a suggestion, which the two Boards supported in August, to pursue a clear division of labor between the two committees on how HIPC would be addressed. It was envisaged that Ministers in the Development Committee would discuss the overall design of the Initiative, its critical connection to poverty reduction and general financing issues. Ministers in the Interim Committee would take up financing issues specific to the Fund. More recently there has been shareholder interest in experimenting instead with a joint meeting of the two committees on the HIPC matters scheduled for consideration by the Development Committee. As a result, the first-ever joint session of the Interim and Development Committees is likely to take place on September 26, 1999. The interest shown in exploring these new approaches illustrates the desire to find pragmatic ways to strengthen the work of the committees. We look forward to a review of the results of this year's experience, and will continue to work with the Fund and shareholders in developing further proposals for change.