

# **Enhancing World Bank Support to Middle Income Countries**

## **Management Action Plan: Progress Memorandum**

On March 11, 2004, the Executive Directors discussed at an informal meeting a Memorandum from the President entitled “Enhancing World Bank Support to Middle Income Countries” and the associated Management Action Plan (SecM2004-0071, dated February 26, 2004.) The action plan was revised in the light of the discussion, and a Revised Version was circulated to Executive Directors for information (SecM2004-71/1, dated April 20, 2004.) On April 25 and October 2, 2004, the Development Committee indicated an interest in reviewing Bank’s efforts to enhance its support for development in middle-income countries (MICs.) Ahead of discussions at the informal Board meeting on February 15, 2005, this memorandum briefly recapitulates the action plan and provides an update on the implementation of each of the key initiatives.

### **Action Plan**

The rationale for enhanced Bank support to MICs—defined as countries eligible for IBRD lending--derives from the importance of sustained growth and poverty reduction in these countries, which are home to over 70 percent of the developing world’s poor, for the achievement of the global development goals and the Millenium Development Goals (MDGs). The Bank is uniquely placed to help MICs in such key areas as institutional reform, infrastructure investment across the public-private spectrum, improved social service delivery, and coping with market volatility. Management therefore views enhanced support to the development efforts of MICs as part of the Bank’s commitment to the post-Monterrey global development agenda, complementing the institution’s support to low income countries and low income countries under stress.

The action plan focuses on five main areas:

- Strengthening staff ability to respond to the development needs of MICs. This includes initiatives to use countries’ own safeguard and fiduciary systems where they are equivalent to the Bank’s policy requirements; to further streamline policy conditionality in Bank operations; to make greater use of the inherent flexibility of the country assistance strategy (CAS) framework to customize support to country circumstances and respond quickly to newly emerging lending opportunities; and to realign particular investment lending instruments and disbursement mechanisms with the evolving needs of clients.
- Making better use of Bank resources and skills to provide timely, relevant, and high quality knowledge services.
- Strengthening support for risk management through better dissemination of existing IBRD products and development of new financial products.
- Exploiting Bank Group synergies, including in lending and technical and analytical support to sub-sovereigns and through financial intermediaries.

- Enhancing partnerships with bilateral donors and multilateral agencies in supporting the development efforts of MICs.

## **Implementation of the Action Plan**

The following provides an update on the implementation of the action plan, including progress made and activities being pursued. For most actions, separate documents have been or will be presented for discussion with Executive Directors in technical briefings and informal or formal Board meetings. Many of the actions involve changes in Bank practices. Any policy changes that arise will be brought to the Board following established procedures.

### ***1. Strengthening staff ability to respond to the lending needs of MICs***

Over the past 10 months, substantial progress has been made on most initiatives in this area, while critical actions are in train for others.

#### ***Use of country systems***

Use of country systems in Bank operations refers to use of the country's national, sub-national, or sectoral implementing institutions and applicable laws, regulations, rules and procedures for the activity being supported by the Bank. The Bank already uses country systems in financial management and national competitive bidding procurement, as permitted under existing policy, and such use will continue. Management's plans for extending the use of country systems to environmental and social safeguards and to international competitive bidding (ICB) procurement and international selection of consultants were laid out in meetings with the Board in 2004 (an informal Board meeting in May, a Technical Briefing in June, and a formal Board meeting in September). In September, the Board discussed a paper "Issues in Using Country Systems in Bank Operations" (R2004-0177), in which Management proposed to develop a pilot program to test the use of country safeguard systems where, in the Bank's judgment, they are equivalent to the Bank's policy framework applicable to the operation, and where relevant country implementation practices, capacity, and track record are satisfactory. Executive Directors endorsed this approach and advised that such pilots be governed by a formal policy approved by the Board.

The Issues Paper, which included key elements of a proposed policy framework for piloting the use of borrower systems to address environmental and social safeguard issues in Bank operations, was posted on the Bank's external website in October 2004. This was followed by face-to-face meetings with governments, bilateral and multilateral development partners, civil society organizations, and private sector representatives in all six Regions. Borrowers and development partners endorsed the approach to extending the use of country systems to environmental and social safeguards. Civil society organizations were more cautious, and emphasized that in pursuing this initiative, the Bank should not dilute its safeguard policies or its responsibility for due diligence. The Issues Paper has been revised to take account of the feedback received.

Going forward, the revised Issues Paper is scheduled for CODE discussion on February 16, 2005 and Board discussion on February 24, 2005. At the Board meeting, Management will seek formal approval of the draft policy OP/BP 4.00 (Piloting the Use of Borrower Systems to Address Environmental and Social Issues in Bank-Supported Projects) - and authorization to proceed with implementing a two-year program of pilot activities. The paper will be accompanied by a summary of the feedback received in consultations and the Bank's response. Subsequently, interim staff guidelines, currently under preparation, will be finalized and a monitoring and evaluation framework developed in cooperation with an international panel of experts.

A similar track is being followed with respect to the use of country systems in ICB procurement and the international selection of consultants. A paper "Increasing the Use of Country Systems in Procurement" (R2004-0206) was distributed to Executive Directors in November 2004 and will be discussed at an informal Board meeting in March 2005. The paper would subsequently be posted on the Bank's external website for consultations with stakeholders. A revised paper with a request for Board approval of the governance framework and authorization of the pilot program would be presented to the Board at the end of FY 05.

### *Use of Conditionality*

The Action Plan envisaged further streamlining of policy conditionality in Bank operations. The new OP/BP 8.60 "Development Policy Lending" (DPL), which the Board approved on August 9, 2004, focuses conditions on actions that are critical for the implementation and expected results of the program supported by the DPL. In September 2004, OPCS issued a staff guidance note "Disciplined Use of Conditionality in Investment and Development Policy Operations." This note states that sector policy reforms should be advanced through analytical work, regular policy dialogue, DPLs, and sector-wide approaches (SWAPs); that individual investment operations should not normally carry sector policy conditionality; and that a simple project should be considered when the policy and institutional frameworks do not support a major investment operation in the sector.

Further conditionality reform can be expected from the conditionality review requested by the Development Committee in its October 2004 meeting. Issues of particular importance for Bank support to MICs include a more operational approach to the results framework in these countries, the appropriate scope and content of conditionality, and the level for applying conditionality—to what extent conditionality could be moved to the CAS level or kept at the lending instrument level. Executive Directors discussed an approach paper entitled "Review of World Bank Conditionality: Issues Note" (CODE2005-0002) at the CODE meeting on January 19, 2005. Consultations have started with borrowers, partner institutions, and civil society organizations (CSOs), which will feed into a set of papers for discussion with Executive Directors, and suggested good practice principles. A Board paper summarizing and drawing the main conclusions will be discussed by the Board by the end of July 2005, which will serve as an input for a final document for consideration by the Development Committee at the Annual Meetings 2005.

### *CAS Flexibility*

The Action Plan encouraged staff to make better use of the existing CAS framework to customize support to country circumstances and to facilitate a more rapid response to lending demand. The Board has since welcomed a number of CASs or Country Partnership Strategies with these features such as the documents for Mexico, Kazakhstan, India, Slovakia, and El Salvador. A staff guidance note on CAS customization and financial flexibility was issued jointly by OPCS and SFR in January 2005. With the new good practice, Bank country management units will be better able to promptly respond to developments on the ground and emerging opportunities for increased volume of lending, as well as aligning the mix of fast and slow disbursing lending with the country's development finance needs. In the case of well-performing countries, principles of financial flexibility outlined in the note allow for increasing the CAS lending envelope and the share of fast disbursing lending operations during the implementation of the CAS program, as long as it is consistent with the single borrower exposure limit and credit constraints.

### *Investment Lending Instruments and Disbursement*

The action plan envisaged presenting to the Board proposals for updates to Bank policies OP/BP 13.20 (Supplemental Financing) and OP/BP 8.50 (Emergency Lending) to incorporate lessons learned from the use of these instruments and to make them more effective in responding to borrowers' needs. The Bank is also updating its disbursement policies and practices to clarify available flexibility and facilitate reliance on borrower systems where this is appropriate.

The updated OP/BP 13.20, which would be renamed "**Additional Financing**", would continue to permit the Bank to add funds to the original loan amount when such funds are needed to support original project activities in cases of a financing gap or a cost overrun. In addition, it would permit the Bank to provide additional financing to scale-up the activities under the original project when it has proven successful and when such scale would lead to enhanced results and development impact, and to support modified activities as part of project restructuring undertaken to address circumstances that emerged during project implementation.

The proposed revision was discussed at CODE on January 19 and was broadly supported. In response to questions from some CODE members, staff provided additional information and explanation on expected implementation and on measures to be put in place to mitigate some of potential risks that the proposed flexibility may pose. A revised paper, which incorporates some of the details provided orally, will be circulated to CODE and then to the Board for discussion on February.

Updated policies and procedures for **emergency lending** would address problems encountered with implementation of many emergency operations; recognize the important role of trust funds in mobilizing and delivering a coordinated emergency response; include among the objectives support to transitional safety nets and preservation of human capital;

clarify what constitutes an "emergency" that can trigger the Bank's emergency response; and allow for the provision of "contingent" support to countries that experience periodic emergencies for which they developed a satisfactory response system. Operational guidelines to staff on the preparation and implementation of emergency operations are being prepared in parallel with a Board package on the proposed policy update. The Board package would include a paper that would summarize experience to date, identify issues, and recommend specific policy revisions to address them, as well as drafts of the revised OP/BP 8.50. Management expects to finalize the Board package by the end of FY 05.

The Bank is pursuing two initiatives with respect to disbursement. One concerns the expanded use of **output-based disbursement**, where the Bank—consistent with existing policy--disburses against reports on outputs based on agreed standard costs, finances payments for competitively procured output-based contracts between the borrower and private providers, or supports the borrower's provision of conditional funding to eligible institutions (e.g., local governments) using performance targets as eligibility criteria. At present, output-based disbursement is rarely used in practice despite its potential for significantly reducing the cost of doing business with the Bank and for contributing to the objective of managing for results. Management has appointed a working group to explore obstacles to the greater use of output-based disbursement and propose solutions. A final report to Management is expected in February 2005.

The other initiative concerns the updating and consolidation of OP/BP 12.00 (Disbursement), OP/BP 12.20 (Special Accounts), and OP/BP 12.30 (Statements of Expenditure) into one OP/BP 12.00 to be renamed "**Disbursement Management.**" The updated policies and procedures will reflect eligibility reforms, align disbursement management with recent changes in fiduciary and other policies, and enable borrowers and staff to more flexibly manage advances, pool funds, and use interim financial reports to support disbursement, in keeping with assessed borrower capacity and the implementation needs of individual investment projects. At a Technical Briefing in November 2004, Management agreed to circulate the proposed OP/BP 12.00 and supporting documents to the Executive Directors and hold a second Technical Briefing. This is currently scheduled for March 15, 2005. Management expects to issue the new OP/BP 12.00 shortly thereafter.

## ***2. Making Better Use of Bank Resources and Skills to Provide Timely, Relevant, and High Quality Knowledge Services***

The action plan envisaged action on three main issues in this area: the provision of analytic and advisory (AAA) services to those MICs that have little or no borrowing from IBRD; the better alignment of regional, network anchor, DEC and WBI work in providing country knowledge services; and creating greater flexibility for responding to client demands and to operational needs for AAA services as the program for replenishing the stock of core diagnostic economic and sector work (ESW) products reaches conclusion.

A Bank-wide working group prepared a draft report on AAA for inactive borrowers. The final report and proposals for future Bank practice will be presented to Management in

March 2005. The working group also explored proposals for the better alignment of country knowledge services by the Regions, Network anchors, DEC, and WBI. However, further work has been delayed to await the outcome of the Bank's Organizational Effectiveness Task Force (OETF) with respect to recommendations for the strengthening of country client service delivery. In the course of FY05, the working group will present proposals consistent with approved OETF recommendations. With respect to creating room for the response to client demand and operational needs for AAA, OPCS issued a report "Improving the Bank's Analytic and Advisory Services" in September, 2004. The report placed the programming of core diagnostic work on a country-by-country basis.

### ***3. Strengthening Support for Risk Management***

#### ***Dissemination of Existing Products***

In line with the Action Plan, Treasury (TRE) has made major progress in improving the Bank's capacity to deliver financing and risk management products and solutions. In particular: (1) TRE bankers are providing advice to country teams and clients on the use of IBRD hedging products and financial services. So far, the work extends to 17 country teams, and the aim is to reach 25 clients with the greatest potential to benefit from a reinvigorated relationship with IBRD. (2) TRE and the EAP, ECA and LCR Regions have selected regional financial officers to provide day-to-day banking advice and rapid response to client requests in liaison with TRE. These officers work for the Region while spending six months in TRE becoming familiar with TRE banking resources and operations. (3) TRE is intensifying internal and external outreach. It delivers to clients presentations on IBRD products, updated to include new developments such as local currency financing and the increasingly portfolio-based approach to IBRD's banking relationship with its MIC clients.

#### ***Financial Products Development***

IBRD continues to develop products suitable for the complex risk management and financing needs of a number of MICs. In particular: (1) *Hedging products*. The President has approved for submission to the Audit Committee and the Board a paper seeking authority for IBRD to offer hedges on clients' non-IBRD sovereign liabilities. This will complete the range of financing and risk management tools offered by IBRD. (2) *Local currency financing*. The Finance Committee considered and approved extending local currency financing to IBRD clients on a case-by-case basis. The first two of these operations (both in Mexico) were approved by the Board in September. Eight more are in various stages of preparation. (3) *Hedging product implementation*. Four Master Derivatives Agreements (MDAs - the framework documentation for client execution of IBRD hedges) have been signed and five more are in active discussion or negotiation. This process would likely accelerate if/when the Board approves the above recommendation to offer hedges on clients' non-IBRD sovereign liabilities.

#### ***4. Exploiting Bank Group Synergies***

##### ***Support through Financial Intermediaries***

The Action Plan called for a Bank Group approach to providing support through financial intermediaries. The Financial Sector Board's (FSB) membership now includes IFC and MIGA. The FSB reviews all financing through financial intermediaries proposed by the Bank, IFC, and MIGA. A staff guidance note for Bank/IFC/MIGA operations with financial intermediaries is under preparation and is expected to be issued in March 2005.

The Bank Group has also established a Municipal Fund that provides lending to municipal development funds. This Fund has successfully closed two transactions in South Africa and Mexico, while one transaction in South Africa is under implementation. Two additional projects are expected to be presented to the Board within FY 05.

##### ***Sub-sovereign Lending***

The decentralization process in many of our client countries, particularly MICs, is resulting in the transfer of fiscal responsibility from the central government to sub-national authorities, including local governments, public service entities, and parastatals. While the Bank is playing an important role in supporting central governments' efforts to delegate fiscal responsibility, it is not equipped to help the sub-sovereign entities to effectively accept these responsibilities. At the same time, the central governments wish to avoid providing sovereign guarantees for sub-sovereign borrowing to reinforce the transfer of responsibilities. A Bank Group-wide Working Group, established in November 2004, is exploring options for a sub-national development vehicle that can engage directly with these sub-national entities in a financing and capacity building relationship without the sovereign guarantee requirement that currently constrains IBRD's activities in this area.

The vehicle under management consideration should draw upon the comparative advantages of the Bank and IFC to provide a comprehensive set of competencies to support sub-national economic development effectively. This vehicle should provide the seamless offering of WBG capabilities that is of such great importance to our work. A variety of organizational, legal, and financial issues are being analyzed.

The working group will submit a detailed proposal for senior management consideration in February 2005. Consultations with Executive Directors will commence thereafter, and a Board paper and discussion is planned for May 2005.

#### ***5. Strengthening Partnership on Middle-Income Countries with Bilateral and Multilateral Development Agencies***

Discussion on this objective began in earnest in June 2004 when Messrs. Zhang and Adams held discussions in Europe with bilateral partners. These discussions centered on three main subjects:

- The value to development agencies of providing support to MICs
- The role of agencies in supporting policy and institutional development, and meeting the financial needs of MICs
- The instrumentalities to make a partnership work in MICs, covering analytical and advisory services, technical assistance, and financial support.

Following the exchanges in June 2004, on October 1, 2004, a workshop with donors was held in Washington. This provided a first opportunity to discuss and exchange views and experiences between the Bank and bilateral partners on whether and how to support MIC development. The general conclusions of this workshop was a consensus on the need to support MIC development. It was fully recognized that this support was essential if MICs, particularly lower income MICs, were to achieve the MDGs and contribute to progress in other high priority global public goods areas. The discussion also focused on the important steps being taken by the Bank in the MIC Management Action Plan, and the receptivity to these actions by selected MICs where they were being put into effect. The discussion also focused on financial collaboration, including the possibility of blending donor resources and non-concessional multilateral lending to improve the incentives for MICs to accelerate their attention to global development priorities.

Since this first concerted discussion, subsequent working sessions have been held with a group of donors in Paris on December 7, 2004, and further consultations are being planned with additional development partners, including with the Regional Development Banks, and a representative sample of middle-income countries. For this purpose, an Issues Note is being prepared on what could constitute a “New Development Partnership” to support MIC development. Management expects that a broad consultation meeting will take place in mid-April, 2005, and that the Executive Directors will be briefed again on progress at the time of the Annual Meeting.

To recap, the main areas to be covered by the partnership are expected to include:

- Joint technical assistance facilities, and better linking of bilateral and multilateral assistance
- Scaling up the use of sector-wide approaches and similar policy support and pooling arrangements
- Increase use of blending approaches –donor grants with multilateral non-concessional lending; greater use of co-financing and parallel financing; use of trust funds, bilateral donor guarantees to unlock multilateral lending, etc. The Development Committee has requested that Management prepare a paper, for the forthcoming Spring Meetings of the Development Committee in 2005, on innovative financing mechanisms, as well as on blending aid with other flows, including Multilateral Development Bank lending.