

**ANNUAL REPORT ON
PORTFOLIO PERFORMANCE**

FISCAL YEAR 2002

**DECEMBER 12, 2002
(VOLUME I – MAIN REPORT)**



ACRONYMS AND ABBREVIATIONS

AAA	Analytical and Advisory Activities	LIL	Learning and Innovation Loan
ACS	Activity Completion Summary	M&E	Monitoring and Evaluation
AFR	Africa Region	MDG	Millennium Development Goals
AIDS	Acquired Immune Deficiency Syndrome	MIC	Middle Income Countries
ARPP	Annual Report on Portfolio Performance	MNA	Middle East and North Africa Region
ARDE	Annual Rpt. on Development Effectiveness	MP	Montreal Protocol
APL	Adaptable Program Loan	MTEP	Medium-Term Expenditure Program
BW	Business Warehouse	OED	Operations Evaluation Department
CAE	Country Assistance Evaluation	OPCS	Operations Policy and Country Services
CAS	Country Assistance Strategy	OPR	Operational Performance and Results
CDF	Comprehensive Development Framework	PAD	Project Appraisal Document
CEM	Country Economic Memorandum	PER	Public Expenditure Review
CFAA	Country Fin. Accountability Assessment	PIP	Portfolio Improvement Program
CODE	Committee on Development Effectiveness	PRSC	Poverty Reduction Support Credit
CPAR	Country Procurement Assessment Review	PREM	Pov. Reduction and Econ. Mgmt. Network
CPIA	Country Policy and Institutional Assessment	PSD	Private Sector Development
CPPR	Country Portfolio Performance Review	PSI	Private Sector Devt & Infrast Network
CRM	Corporate Resource Management Group	PSAL	Programmatic Structural Adjustment Loan
DEC	Development Economics	PSR	Project Status Report
DO	Development Objective	PTI	Poverty Targeted Interventions
EAP	East Asia and Pacific Region	QEA	Quality at Entry Assessment
ECA	Europe and Central Asia Region	QAG	Quality Assurance Group
EFT	Education Fast Track	QER	Quality Enhancement Program
ERL	Emergency Recovery Loan	QSA	Quality of Supervision Assessment
ESSD	Env. and Socially Sustainable Dev. Network	RVP	Regional Vice President
ESW	Economic and Sector Work	SAD	Sectoral Adjustment Loan
FIL	Financial Intermediary Loan	SAL	Structural Adjustment Loan
FSE	Finance Network	SAR	South Asia Region
GEF	Global Environment Facility	SB	Sector Board
HD	Human Development	SIL	Specific Investment Loan
HNP	Health Nutrition and Population	SSP	Sector Strategy Paper
IAD	Internal Auditing Department	SWAp	Sector Wide Approach
ICR	Implementation Completion Report	TAL	Technical Assistance Loan
IP	Implementation Progress	TF	Trust Fund
IRIS	Integrated Records and Information System	TTL	Task Team Leader
JSA	Joint Staff Assessment	WBI	World Bank Institute
LCR	Latin America and the Caribbean Region	WDR	World Development Report
LICUS	Low Income Countries Under Stress	WSS	Water Supply & Sanitation

ANNUAL REPORT ON PORTFOLIO PERFORMANCE FISCAL YEAR 2002

CONTENTS

PAGE NO.

EXECUTIVE SUMMARY	i
--------------------------------	----------

REPORT

I. Introduction	1
II. Portfolio Size and Composition	2
III. Portfolio Performance.....	13
IV. Economic and Sector Work.....	23
V. Millennium Goals and Results	28
VI. Recommendations	35

TEXT TABLES

Table 2.1 FY02 Portfolio by Lending Instrument	6
Table 2.2 Portfolio by Sector of Focus and Theme	10
Table 3.1 Trends in Portfolio Indicators.....	13
Table 3.2 Riskiness by Region and Network.....	17
Table 3.3 Riskiness by Sector and Theme.....	18
Table 3.4 Quality Indicators.....	18

FIGURES

Figure 2.1 Trends in Portfolio Size and Resource Transfer	2
Figure 2.2 Portfolio Distribution by Region, FY97 and FY02	8
Figure 2.3 Portfolio Distribution by Network, FY97 and FY02	11
Figure 3.1 Trends in Portfolio Status	14

BOXES

Box 2.1 Portfolio Dynamics	3
Box 2.2 Was there a September 11 Portfolio Effect?	5
Box 2.3 What is Programmatic Lending?	7
Box 2.4 Sectoral and Thematic Codes.....	9
Box 2.5 New Approaches to Lending	12
Box 3.1 Fine-Tuning Portfolio Management Indicators	16
Box 3.2 Riskiness in Crisis Adjustment Lending.....	17
Box 3.3 Status of FY01 ARPP Recommendations	21
Box 3.4 FY03 Portfolio Improvement Program	21
Box 3.5 Elements of Best Practice.....	22

Box 4.1	A Reformed Approach to ESW-AAA Assessment.....	25
Box 5.1	Strengthening Data for Policy-Making.....	29
Box 5.2	MDGs – A Pilot Country Assessment.....	30
Box 5.3	New Style CPPR: EAP and AFR.....	32
Box 5.4	MDGs and the CAS.....	33

ANNEXES

Annex 1: Guarantees.....	37
Annex 2: The Portfolio – An Overview Table	39
Annex 3: Basic Portfolio Definitions	40
Annex 4: Millennium Development Goals.....	42
Annex 5: FY03 PIP Countries and PIP Projects.....	43

Volume II : STATISTICAL APPENDIX

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EXECUTIVE SUMMARY

1. The Annual Review of Portfolio Performance (ARPP) provides the Board and Senior Management with a strategic overview of the effectiveness of the Bank's portfolio in delivering results to its clients. It assesses the portfolio's present status, examines issues and opportunities, and recommends measures to maintain portfolio quality, including enhancements to its measurement. As a special theme, this ARPP explores approaches to making the Millennium Development Goals (MDGs) operational in the context of the Bank's corporate commitment to reinforce attention to *Results*.

2. **Portfolio Size and Composition.** The portfolio of active Bank projects (\$102 billion), has decreased by 19 percent since FY96. A slight gain for IDA is more than offset by a 25 percent reduction in the IBRD component. This decrease was entirely in investment lending, in particular for the energy sector. Although investment loans still dominate the portfolio, their continuing decline has focused attention on the need to modernize the procedures and business practices that guide the delivery of key lending products. Portfolio composition shows a modest trend towards more diversity, with some shrinkage in the existing largest regions and networks (notably EAP and PSI). The new thematic coding shows that Finance & PSD and Environment & Natural Resources are the two largest themes, as they were in FY97. But there has been some growth in the share for the Social and Governance themes. Adjustment lending has grown, mainly driven by financial crises. It accounted for 40 percent of new lending in last five years. Much of this is fast-disbursing and hence not counted in the end-year portfolio. The old divide between investment and adjustment lending is starting to fade; programmatic instruments (still under 10 percent of the portfolio) – and reformed approaches to investment - can both contribute to a portfolio which is more strategic and country-driven.

3. **Portfolio Performance.** After five years of steady improvements, several portfolio risk indicators for FY02 returned to levels comparable to FY00. A similar pattern is shown by key quality indicators (projects-at-entry, supervision). The detailed analysis from these latter exercises points to a vulnerability arising from the limited experience of many new frontline staff and gaps in the support available from a stretched sector management. This is a cautionary signal, not a cause for alarm. After a period of sustained improvement, this result is not unexpected, and needs to be seen against the pre-FY96 context when about 30 percent of the portfolio was at-risk and operational quality was less than satisfactory for one in four projects. Two complementary messages emerge: first, the need to ensure the recent quality gains do not slip away; second, to deepen and broaden the internalization of a quality culture, shifting the focus to a higher level, that is to *Results* and the overall effectiveness of country programs. In the portfolio context specifically, these trends triggered a review of the current methodology for measuring riskiness, as well as the appropriate balance between calculated risk-taking in program design and implementation and judicious exercise of the Bank's fiduciary responsibilities.

4. The ARPP presents a fine-tuning of the approach to measuring riskiness. This responds in part to a conclusion that these key indicators of quality may have modestly overestimated portfolio improvements in the last four to five years. It will also help reinforce

Management's efforts to encourage more candid reporting, on which there appears to have been some progress. The ratings for *Realism* and *Net Disconnect* indicate that portfolio management can improve further. The modified system will strengthen the technical and predictive quality of leading indicators as an instrument for portfolio oversight, whilst bringing them into closer alignment with OED outcome data. In policy terms the overall conclusion is that portfolio riskiness continues to be at realistic levels, in the range 15-20 percent. This corresponds to an 80-85 percent *Satisfactory* rating in OED outcome terms, which leaves appropriate space for innovation and calculated risk-taking in the increasingly complex environment bearing on the Bank's portfolio.

5. **Economic and Sector Work.** ESW volume grew again in FY02, driven by increases in the number of policy notes and informal products. There is an increased coverage of the key Core Diagnostics products, but this program may need fine-tuning to better respond to country priorities. ESW is now moving towards parity with lending in terms of levels of resources and management attention within the Bank. Following the efforts of the past few years, ESW quality has now largely caught up with that of projects. There has been increased use of participatory approaches; this mode of implementation shows significant quality gains. A new approach to assessing ESW-AAA will be built around the quality of its integration into the CAS process.

6. **Millennium Goals and Results.** The Bank's focus on Poverty Reduction has now been enhanced by the commitment to support the Millennium Development Goals (MDGs). The new development paradigm, as recently endorsed by the Development Committee, is a *results*-based approach, built around MDG+ goals. The year saw a surge of activity across the Bank exploring the implications of operationalizing the MDGs. This will also involve engaging client-countries (including support to them in improving data systems), updating of country programs and strengthened partnerships. The next stage, now underway, is mainstreaming in Operations. Over a maybe 4-5 years transition, these new perspectives should be built into most individual CASs and PRSPs, including localization of the targets. A new generation of *results*-based CASs will serve as a key vehicle for institutionalizing this shift in perspectives. These will also provide for a new focus in developing Bank operations and structuring the portfolio. Quality assurance and evaluation will also need to embrace these same, more strategic, *results*-oriented approaches. Inter alia, it is proposed that the ARPP itself be broadened to cover **Results**. All this will be a demanding agenda that will need adequate resourcing as well as a rebalancing of incentives to staff.

KEY RECOMMENDATIONS

- *Updating Business Processes and Instruments to be more client-responsive*, providing for a more integrated, country-driven approach to the portfolio and an enhanced approach to both adjustment and investment lending.
- *Improving the balance between Risk and Innovation*, inter alia by reconfirming that portfolio riskiness levels in the range 15-20 percent are broadly appropriate in terms of providing incentives for innovation and calculated risk-taking.
- *Strengthening staff and management capacities*, notably by enhancing the skills and work environment in ways that will permit staff and managers to function more effectively in frontline operations.
- *Pushing the Measurement Frontier* by extending assessments to a more strategic and aggregate level, while ensuring adequate coverage at task level. Country and CAS will increasingly become the primary unit of account.
- *Deepening the Agenda* by ensuring that the MDGs, are well-integrated within the framework of the new *results*-based approach, recognizing the importance of country ownership.
- *Reporting on Results* should be more systemically incorporated into the portfolio, including expanding M & E at a more aggregate level. As part of corporate reporting, future ARPPs should cover new *results*-based approaches and indicators.

I. INTRODUCTION

OBJECTIVES AND APPROACH

1.1 The Annual Report on Portfolio Performance (ARPP) provides the Board and Senior Management with a strategic perspective on the Bank's portfolio—the primary vehicle for delivering results to our clients. The main objectives, as defined in the Approach Paper reviewed by CODE, are as follows:

- Assess the current status of the Bank's portfolio, and review management efforts and results in relation to the FY01 ARPP recommendations and the Bank's strategic priorities.
- Assess likely trends and challenges to the portfolio over the medium-term.
- Examine two special topics: the management of risk in the portfolio, and the progress the Bank is making in measuring the poverty orientation in the portfolio and in incorporating the Millennium Development Goals into Bank operations.
- Identify priority actions needed to broaden/deepen the gains in portfolio quality during the past few years.

1.2 The FY02 ARPP draws primarily from materials that are prepared as part of regular portfolio monitoring functions carried out by the Regions and Networks, supplemented by project/portfolio data in the Bank's management information systems. Consistent with past ARPPs, the report uses a five-year time frame (FY97-02) to examine medium-term trends in the portfolio. In preparing the ARPP, extensive consultations were held with managers and staff from around the Bank. An array of self-evaluative processes developed in the Bank over the past few years has also helped make the ARPP process more analytical and forward-looking.

STRUCTURE AND COVERAGE

1.3 The report is organized into five subsequent Chapters. Chapter II reviews the recent trends in size and composition of the lending portfolio. Chapter III reviews overall portfolio performance as well as revised approaches to riskiness measurement. Chapter IV reviews the Economic and Sector Work (ESW) portfolio. Chapter V examines the progress in incorporating the Millennium Development Goals into Bank operations, the poverty-orientation of the portfolio and approaches to incorporate a *results*-based approach into Bank operations. Recommendations are summarized in Chapter VI. A second volume contains a detailed set of supporting statistical material.

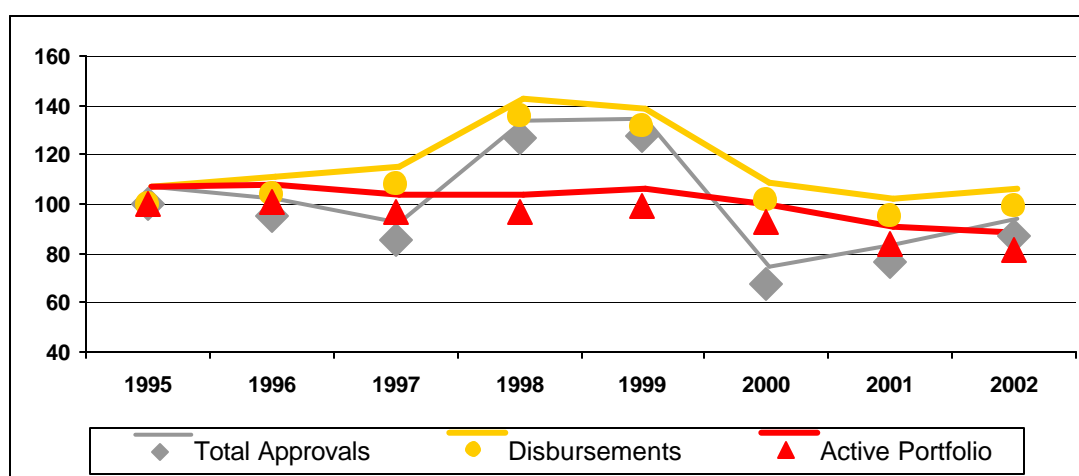
II. PORTFOLIO SIZE AND COMPOSITION

The size of the Bank project portfolio has decreased significantly since FY97, with the reduction centred on the IBRD component. Portfolio structure has been broadly stable; although, on a commitment basis, there is a trend towards a portfolio that is more diversified by region and sector. Regionally, EAP still has the largest share of commitments but also the largest proportionate decline; AFR still accounts for the largest number of projects in the portfolio. By Network, there has been a marked shift away from PSI (still the largest), whilst PREM shows the largest increase by number. The new product coding shows Financial/PSD and Environment/Natural Resources as the two largest themes. By lending instrument there has been a relative shift towards adjustment, but investment loans still dominate the portfolio. Programmatic approaches may start to blur the dividing line. Portfolio size will be significantly influenced by how well the Bank makes that shift, as well as the matching translation into new guidelines, processes and delivery capabilities.

PORTFOLIO SIZE

2.1 The Bank's lending portfolio (IBRD/IDA plus TFs) for FY02¹ consisted of 1,542 operations representing commitments of \$102 billion.² The latter figure represents a 4 percent drop in nominal terms from the previous year. However, the decline in the portfolio has been about 19 percent³ from a peak of \$126 billion in FY96. Over the last five years, the dominant factor has been a drop of just over 25 percent in IBRD net commitments, with the IDA component increasing modestly (Annex 2 provides an overview of the portfolio). In resource transfer terms, both new approvals and disbursements show a major peak in FY98-99, with approvals declining sharply in FY00 then recovering in FY01 and 02. Disbursements show a smoother trend following the peak due to crisis adjustment lending (Fig. 2.1).

FIGURE 2.1: TRENDS IN PORTFOLIO SIZE AND RESOURCE TRANSFER (FY95 = 100)



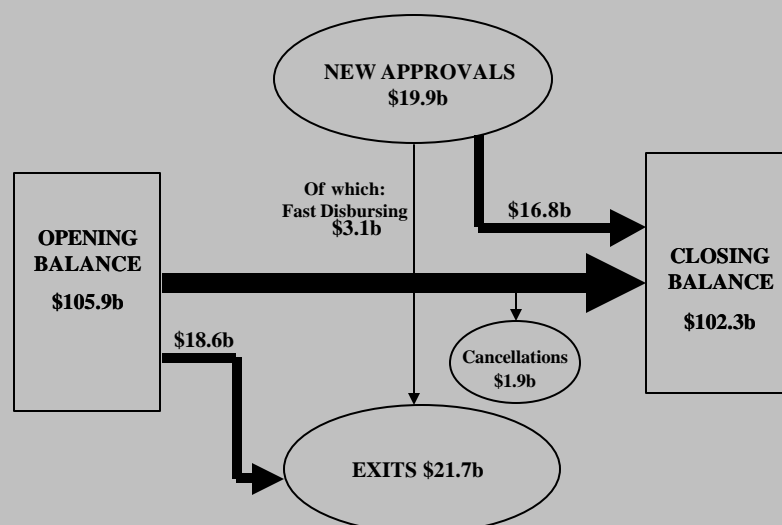
¹ Portfolio as used in this report refers to the end-fiscal year situation.

² The portfolio also includes 16 Guarantees, totaling \$1.6 billion still in force under the Guarantee Program. Their performance is reviewed separately in Annex 1.

³ Twenty-one percent in real terms.

BOX 2.1: PORTFOLIO DYNAMICS

Portfolio as formally defined in the ARPP is a **stock** concept. Lending by contrast is a **flow**. For the ARPP, the portfolio consists of the loans, credits and grants in approved and active status at the end of the fiscal year; it excludes operations which closed during the year. It is recorded as the sum of individual projects' net commitments. The graphic below illustrates those relationships for FY02 where fast disbursing loans, which are approved and closed during the same FY are not captured in the end-year portfolio, represented \$3.1 billion (16 percent) of total new approvals of \$19.9 billion.



Prior to FY00, the ARPP definition of portfolio included only IBRD and IDA loan operations. The introduction of SAP during FY00 was the occasion to broaden that definition to cover other loan and grant products for which the World Bank had substantive managerial accountability, usually under trust arrangements. This added in GEF (Global Environment Facility), Montreal Protocol, and Special Financing. The latter covers mainly programs for countries where normal loan arrangements are not applicable, including West Bank and Gaza, East Timor, Kosovo, Afghanistan and the Federal Republic of Yugoslavia. Currently, the ARPP definition of the portfolio does not include eight Rainforest projects (\$43 million) nor the 16 guarantees that are still in force.

Beginning in FY02, the terms for part of the IDA portfolio started to change. FY02 IDA approvals included \$150 million of **grants**, provided under the program of post-conflict grants begun in IDA12. Under the new IDA 13 agreement there is provision for a specific program of grants for regular project operations in selected countries/sectors. The next three fiscal years can be expected to see \$4-4.5 billion of such grants. These grants will be appropriately coded in SAP; they will be treated essentially as credits for portfolio purposes.

Coding and recording within the portfolio will become more complex with the expansion in **programmatic lending**. A SWAp, a sectorwide program, could embrace several activities from policy analysis/reforms (ESW) to a classic structural adjustment loan or an APL. Innovations such as the multi-country AIDS MAP could be recorded as one initial approval, but then transformed into maybe a dozen individual country credits or even a mix with new IDA grants. The Bank will need an agreed uniform approach to coding these new portfolio elements.

2.2 The pattern of entries and exits defines the portfolio. Roughly one-in-six projects are new to the portfolio each year. New entrants by numbers peaked in the crisis years of 1998/9 and are now in FY02 about 20 percent lower (254 projects, including 25 trust fund approvals). Exits, mainly projects approved in the mid 90s, have hovered around 280 for the last three years. It should be noted that the formal portfolio definition does not capture many important fast disbursing loans: principally single-tranche adjustment operations which typically open and close within the same fiscal year. There were sixteen such operations in FY02 totaling \$3.1 billion (Box 2.1).

2.3 The most striking change is the decline in the IBRD portfolio. Net commitments have fallen by a quarter since FY97, roughly equally from reduced numbers and smaller individual commitments. These reductions were all in investment lending. By Network, the reduction is overwhelmingly from PSI. At \$65.5 billion in FY02, IBRD commitments are at their lowest level in more than a decade (but still almost twice those for IDA). The volume of new IBRD lending in FY02 rose to \$11.5 billion from \$10.5 billion in FY01, substantially influenced by a few large adjustment loans, particularly for Turkey. However, these recent levels of new approvals are just over half the peak in the crisis FY98-99 period. For the third consecutive year, IBRD exits exceeded new approvals.

2.4 IDA net commitments in contrast have been essentially stable; for FY02 the portfolio showed a small increase to \$35 billion. New IDA lending rose for a third year to \$8.1 billion for FY02. Contributing to this increase was \$2.4 billion in adjustment lending. The FY02 increase was substantially influenced by growth in AFR, including a second \$500 million Multi-country HIV/AIDS Program (Box 2.5).

2.5 The portfolio of trust funds and other operations, continues to grow with new approvals of \$0.4 billion in FY02. There were 115 operations in this portion of the portfolio, with net commitments reaching \$2.0 billion in FY02. The Montreal Protocol portfolio now stands at \$800 million, now more comparable to the GEF portfolio in commitment terms. The GEF portfolio had \$1.01 billion in commitments, split 65:35 between free-standing projects and blended or partially blended projects. Special Financing programs, which are funded out of the Bank's net income, are now a significant component of the portfolio in terms of number of operations.

2.6 Looking back at the recent trend in portfolio size and the crisis-linked volatility in new approvals, it is clear that there continues to be a high level of uncertainty in making lending projections. For FY03-05 planning purposes, corporate and regional median projections assume an essentially flat profile to FY05. In a larger context, it might indeed be useful for OPCS/CRM to explore how to improve corporate level forecasting. This would be useful for Bank wide planning, budgeting and staffing. As Fig. 2.1 illustrates, the recent historical trend has been a slow reduction to the present \$100 billion level with the decline having been in the IBRD portfolio. However, a new crisis, a recovery in demand by IBRD clients in investment borrowing and/or a sustained growth of programmatic lending could push it upwards.

BOX 2.2: WAS THERE A SEPTEMBER 11 PORTFOLIO EFFECT?

September 11 affected the portfolio in the short term, but overall, the Bank coped well. There was a modest slowdown in new lending in the 2-3 months immediately following. This reflected the general disruption of work-patterns, most notably delays in travel critical to key stages – appraisal, negotiations, etc. - in project development as well as supervision. After that slowdown, as reflected in a smaller than usual share in new approvals in those months, there was a slow recovery. By end-year the level of new approvals was actually running above the trend rate of the previous three years. The decline in some quality indicators may reflect some residual effects from delays in supervision. The general weakness in the global economy that followed September 11th is still affecting the Bank portfolio as new circumstances, such as lower exports, declines in commodity prices, weakened travel and tourism, and the like, affect the detailed structure of new lending, as well as leading to some project restructuring. The growth in emergency-linked adjustment lending certainly has part of its roots in the post-Sept 11th generalized economic weakness. The major program to support the Afghanistan recovery was a very specific collateral outcome.

INSTRUMENTS

2.7 The Bank's lending portfolio is traditionally divided into either investment or adjustment, with the former very much dominant. Looking forward, the dividing line is becoming less clear, as programmatic approaches start to emerge. The shift to-date has been relatively slow. Year-to-year fluctuations are much higher for new adjustment lending, but there seems to have been a slow secular increase, with its share of the portfolio rising about four percent points since FY97. This increase was concentrated in IBRD borrowers. However, in portfolio terms, investment operations still accounts for 96⁴ percent of projects and 89 percent of commitments in FY02. Straddling these two groupings, programmatic lending (Box 2.3) is well under 10 percent of the portfolio by commitments.

2.8 *Specific investment loans* (SILs) are the most widely used instrument, representing about 72 percent of total commitments. The *APL*, now just over five percent of the portfolio and 18 percent of FY02 new investment lending, is steadily gaining in popularity. It has largely displaced use of the less flexible *Sector Investment and Maintenance* (SIM) loan. The *LIL*, the *APL*'s twin as a new instrument, has had a more difficult start. Its use has fallen by almost half in the last two years as its early promise of low-cost, speedy delivery, design flexibility and experimentation often failed to materialize. Two other investment instruments have significant profiles: in a world of endemic crises, use of the *Emergency Recovery Loan* has grown steadily, whilst the commitment value of *Technical Assistance Loans* (TALs) has declined about 15 percent since FY97, while remaining a significant vehicle for skills and knowledge transfers.

2.9 *Adjustment lending* has accounted for over 40 percent of total IDA/IBRD new lending volume over the last five years. A major driver here was its active but inevitably volatile role⁵ as a response to financial and other crises. However, because adjustment operations are

⁴ This portfolio basis of comparison exaggerates the importance of investment loans due to their longer lifespan. A comparison in resource transfer terms is better made using cumulative net disbursements.

⁵ A secondary role is that of a resource transfer mechanism to support long-term policy or institutional reform. This is the programmatic mode of adjustment lending (e.g., PRSC).

relatively fast-disbursing, in formal active portfolio terms they comprise just four percent of operations and 11 percent of commitments at end-FY02. Formally including seven different types of operations, this area is dominated by Structural (SAL) and Sectoral (SAD) adjustment loans. The important new PRSC instrument is a modest one percent of FY01-02 lending. The sharp increase in adjustment lending in FY02 was dominated by Turkey, with substantial operations also in Brazil, Argentina and Pakistan.

TABLE 2.1: FY02 PORTFOLIO BY LENDING INSTRUMENT

Investment		No.	\$B	Adjustment		No.	\$B
SIL	Specific Investment Loan	1,017	73.6	SAL	Structural Adjustment Lending	36	5.8
APL	Adaptable Program Loan	128	5.5	SAD	Sector Adjustment	20	3.9
TAL	Technical Assistance Loan	122	2.4	PSL	Programatic Structural Adj Loan	3	1.8
LIL	Learning and Innovation Loan	96	0.4	PRC	Poverty Reduction Support Credit	2	0.3
SIM	Sectoral Investment and Maintenance	52	4.0	ECO	Expanded Cofinancing Operation	0	0.0
ERL	Emergency Recovery Loan	45	3.3				
FIL	Financial Intermediary Loan	21	1.5				
		1,481	90.6			61	11.7
TOTAL INVESTMENT + ADJUSTMENT		1,542	102.3				

2.10 The optimal balance between investment and adjustment lending for any country is heavily influenced by macro-performance characteristics, such as fiscal and balance of payments situations, absorptive capacity and governance, as consolidated in the CAS process. However, the supply side is also a relevant factor in practice: the approach of many staff is still influenced by their often greater experience with investment lending which historically has defined many Bank practices. Borrowers are also sometimes not well-versed on the choices of instruments available. Another complicating factor is the high staff turnover in recent years. Over time the choices are seen to have become more complex as new instruments, responding to client needs, have been added to existing ones. Table 2.1 is a partial indication of that diversity. Both the Bank and its clients are now seeking to gain more value from this array of lending instruments. This is a particularly pressing challenge when at the same time the programmatic approach, often framed within a CDF/PRSP, is demanding greater cohesion across all lending, indeed also non-lending, activities and a multi-sectoral team approach. New instruments such as the PRSC and APL, as well as Sector-Wide Approaches (SWAp) are custom-designed to fit this new style, but may still need further adaptation to meet some important client needs, for example for budgetary support.

2.11 Work is now underway on proposals for Management on revised Bank operational policies for adjustment lending as well as a complementary re-examination of the effectiveness of present Bank investment lending. These two reform exercises are running in parallel, but the ultimate solutions will be integrated and complementary. The goal should be a system where the choice of instrument is driven by country needs and development effectiveness, not by preferences internal to the Bank. On the investment lending side, the main challenge is how best to rationalize the accumulation of several decades of procedures, processes and business practices, which can sometimes weaken the Bank's competitiveness. An early improvement may come through revisions to the rules on eligible expenditures. Procedural simplifications are another avenue being examined. As was spelt out in the *Cost of Doing Business* report, Bank clients increasingly practice a competitive approach in

selecting their lending partners. They want transparency, a set of rules and practices in project design and implementation that is more consistent amongst donors and less burdensome. Some of the solutions under consideration include: simplifying project-specific fiduciary and safeguard requirements while helping clients strengthen their national standards/capabilities; strengthening task manager skills as well as providing them scope for more discretionary judgments; and harmonizing donor policies and procedures.

2.12 In the adjustment domain, there are other distinct concerns⁶. An important tension in the past had been around the perceived array of performance conditions – in terms of their number, focus, complexity and the demands they can place on borrowers. The challenge looking forward is to build upon emerging good practices, including environmental, social and fiduciary considerations, supported by substantive, results-based M & E. As noted in Chapter V this needs a close integration of ESW-AAA activities and lending within a unified portfolio plan. As the Bank moves forward with Poverty Reduction and now the MDGs as key policy drivers, it will be critical to address these issues as part of the ongoing operational policy update, in a manner that is also consistent with country ownership.

BOX 2.3: WHAT IS PROGRAMMATIC LENDING?

Programmatic lending is an approach, rather than a new instrument. The emphasis is on a staged, iterative process, one where the Bank intervention serves to support a sequenced set of strategic, policy-driven goals, often linked to a MTEP and/or PRSP. It involves a linked series of loans. Amongst the instruments labeled *programmatic* are products from both the world of investment lending such as the APL, and that of adjustment – Poverty Reduction Support Credit (PRSC) and PSAL/PSAC. Programmatic project interventions (and ideally complementary ESW) need to be closely tied to a country strategy, and owned by client and the Bank alike. It is an approach that can serve many in the Bank's client spectrum: an APL can be a good choice for a longer-term sectoral intervention in a MIC, while the PRSC is a tailor-made instrument for the operationalisation of a PRSP. The overall scale of programmatic lending is still very modest – perhaps somewhat under 10 percent of the portfolio. Often a programmatic intervention is best built on a multi-donor base: here the SWAp (Sector-Wide Approach) is of growing importance. The programmatic approach creates new challenges for Bank policies and procedures which were written for the classic investment project, whereas many SWAps embody the need for a pooling of donor resources under a common harmonized implementation framework. Programmatic lending can be seen to represent a middle way in which the divide of investment vs. adjustment becomes instead a continuum driven by country needs and institutional capabilities.

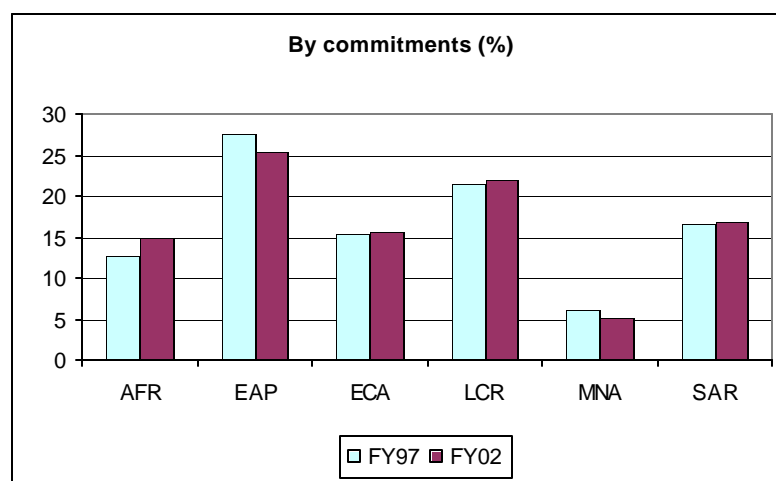
REGIONS AND COUNTRIES

2.13 The FY02 portfolio includes operations in close to 130 countries, with a heavy concentration in just five countries (China, India, Brazil, Turkey, Mexico, in order) which account for 45 percent of net commitments. In comparison, the 50 smallest borrowers account for only 6 percent. The concentration is less intense by numbers of projects; here, the top ten represent roughly 30 percent of the portfolio.

⁶ From *Adjustment Lending to Development Policy Support Lending*. OPCS.

2.14 Portfolio data inevitably lags, as well as smoothes, the trend in new lending. There was an overall decline in commitment terms concentrated in EAP, ECA and SAR; within these regions there were particularly large declines in several key countries: China, Indonesia, Russia, Hungary, Ukraine. Possible factors that account for this include: transition to IBRD status, portfolio management concerns, and country exposure. AFR has the largest number of projects in the portfolio among the six regions, accounting for 24 percent of the active portfolio in FY02; its share by value is significantly lower at 15 percent (Figure 2.2). After several years of contraction, the AFR portfolio has begun to stabilize and the outlook for future growth – as reflected in more active IDA lending – is promising. The AFR share of IDA lending is now just short of 50 per cent. The number of projects in the ECA portfolio, after a period of growth centered on its IDA countries, is now stabilizing; new lending grew in FY02 but mainly due to specific factors, especially adjustment lending to Turkey. EAP continues to have the largest share of commitments in the active portfolio, but both number and commitment values have fallen in the last year or so, in part due to substantial restructuring/ streamlining of key country portfolios (Indonesia, Philippines) and lending exposure limits to China. The MNA portfolio, which is moving towards a knowledge-sharing orientation, remains by a large margin the smallest in commitment terms; it continued to decline albeit slowly in FY02.

FIGURE 2.2: PORTFOLIO DISTRIBUTION BY REGION, FY97 AND FY02



2.15 Portfolio composition has consciously shifted over the last five years away from countries with weak policy and institutional environments⁷; in particular the share of the portfolio in low CPIA countries declined from 15 percent in FY97 to 7 percent in FY02 on a commitment basis. The share for strong performers grew more than fourfold to 18 percent. The LICUS Report has reminded us that caution on the project portfolio front in those countries may need to be balanced by an expansion in activities to support institutional development and capacity-building. Not unexpectedly the portfolio for such LICUS countries is very modest.

⁷ As measured by the Country Policy and Institutional Assessment (CPIA). Low CPIA countries are those with a rating of 3 or less on a scale of 1 to 6.

NETWORKS, SECTORS AND THEMES

2.16 For the first time this section reports on the new outcome-orientated data from the recoding of the Bank's portfolio completed in July, 2002. The traditional database – still the most reliable for historic comparisons - is a coding based on the structure of Bank administrative units, Networks and Sector Boards. The new coding structure has been retrofitted to the existing portfolio, although not (yet) fully integrated into the SAP/BW system. Box 2.4 provides some details on this major new database.

BOX 2.4: SECTORAL AND THEMATIC CODES

For years the basic Bank coding system was built around Bank administrative units, specifically which SB managed the activity. Starting this year there is a new approach driven by an outcomes perspective: which sectors of the economy are supported by Bank interventions? what in terms of Bank thematic goals and objectives are we achieving? The new system is based upon *economic sectors* and *themes* and covers most Bank operational products - projects, ESW, other AAA, research, client training. It was designed to improve monitoring, including budget monitoring, relative to corporate priorities, as well as to standardize reporting to management, shareholders and external stakeholders in a more cost effective manner. It permits some partial mapping to the MDGs. Each activity can be tagged against 10 *economic sectors* (57 sub-sectors) and 11 *themes* (68 sub-themes). Staff can classify a task against several sectors and themes on a percentage basis to reflect more accurately the multiple impacts of a single product, the only caveat is that the total cannot exceed 100 percent. However, as with all reporting systems, it will be very dependent upon the quality of the inputs: in essence how well do line and task managers define their own work from this new outcomes perspective, how well do they understand and how carefully will they use the definitions of the numerous sub-categories? This retrofitted data shows little difference between the new economic sectors and the traditional sector board based data in terms of portfolio size or composition. The fit of both *economic sectors* and *themes* with the actual Bank portfolio is uneven. For example there are five sub-sector codes for Health (6 percent of the portfolio), but seven sub-themes for the much smaller Law portfolio (1.8 percent).

2.17 Because the coding framework is so new, and because the data was retrofitted, conclusions need to be treated with caution. The portfolio composition by *sectors* of focus for period FY97 and FY02 shows there are no radical changes on a commitment basis but rather a steady shift over the five years out of Energy and into Transportation (the largest individual sector), Law and Public Administration, and Health and Social Services. The shares of other sectors remained fairly stable. The share of Health and Social Services grew fastest over the period (45 percent), and Energy declined the most (37 percent). Using this new data to isolate cross-sectoral projects, defined as those reporting activities in at least three sectors each absorbing at least 20 percent of the total project budget, these remain a modest 13 percent by value of all projects.

TABLE 2.2: PORTFOLIO BY SECTOR OF FOCUS AND THEME
(Commitments, % Shares)

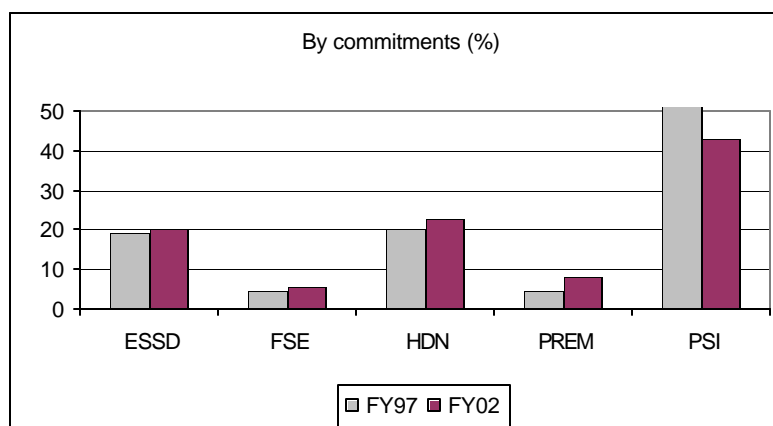
Sector	FY97	FY02	Theme	FY97	FY02
Agriculture	10	10	Econ. Mgmt.	2	1
Law & Public Admin.	13	15	Public Sector/ Gov.	7	8
ICT	2	2	Law	2	2
Education	9	9	Finance & PSD	25	19
Finance	5	5	Trade	3	3
Health & Social	9	13	Social Protection	5	6
Industry & Trade	6	5	Social Development	5	8
Energy	19	12	Human Dev.	10	11
Transportation	17	19	Urban	12	13
Water & Sanitation	10	10	Rural	13	14
			Environ & Nat. Res.	16	15

2.18 Reviewed against the eleven *themes*, portfolio composition shows a similar slow but steady shift to a stronger social/governance orientation over the FY97-FY02 period. Finance and PSD dropped the most (25 to 19 percent), with the largest declines within that theme occurring in Private Sector Infrastructure Services. The largest increase was in the Social Development theme as its share rose from 5 to 8 percent, with the bulk of the gains concentrated in one sub-theme, Civil Engagement, Participation and Community Development. Other themes showed only marginal shifts.

2.19 As noted, whether the pace of change in the past is reviewed by *economic sector* or *theme*, the result – a measured pace – does not change. To see what the implications are for moving towards the Bank’s strategic goals, projected commitments were reviewed under the FY03-07 lending pipeline. These results should be treated as indicative; they represent rather incomplete planning intentions which can be subject to large changes, particularly in the outer years. By *economic sector*, there is continuing growth in the share of Law and Public Administration, and now in Finance; there are indicators of substantial declines in Energy and Mining, Transport, and Industry and Trade. By *theme*, most shifts are modest; the only substantial movements indicated are for Economic Management and Public Sector Governance.

2.20 Using traditional definitions, by **Network**, the Private Sector and Infrastructure (PSI) portfolio of 543 projects (\$44 billion) remains the largest with a 43 percent portfolio share, but it has shrunk substantially over the past five years, confirming the trend shown in the new coding by *economic sector* of impact. No single Network grew to fill the gap but the largest increase is in PREM. This portfolio has nearly doubled since FY97, but still represents only eight percent of the portfolio.⁸

⁸ Including the fast-disbursing adjustment operations that is not recorded as ‘portfolio’ would raise the PREM share, but only by about 2 percentage points.

FIGURE 2.3: PORTFOLIO DISTRIBUTION BY NETWORK, FY97 AND FY02

2.21 Within the PSI Network, the largest decline (more than 50 percent) was in the Energy and Mining sector. Almost all the portfolio reduction was in IBRD countries. Explanatory factors are the greater availability of private funds to this sector, the perceived burden of Bank safeguards and fiduciary requirements, especially for larger IBRD borrowers with market access, and a de-emphasis by the Bank on lending to these sectors. The Human Development Network (HDN) portfolio is now the second largest. Its size has been roughly constant since FY97, with a small decline for Education and an increase for Social Protection. New lending in FY02, despite some positive pointers for the future, was still well below peak levels of FY98 and FY99. In FY02 there was an upturn for Education, HNP was flat and Social Protection declined sharply. Looking to the future the MDGs and new global health issue funds should create new incentives for HD lending. The newly launched Education Fast Track Initiative is another important innovation.

2.22 Many specific innovations are occurring in lending approaches. Two important examples, both supportive of a more programmatic approach to key developmental challenges, are outlined in Box 2.5.

BOX 2.5: NEW APPROACHES TO LENDING**A. EDUCATION FAST TRACK INITIATIVE**

There is a new sense of urgency about responding to the core goals of the MDGs. The 'Fast Track' initiative, with origins in the 1990 Jomtien Education For All Conference, is being introduced following the Monterrey Summit commitment to enhanced funding in support of the MDG goal of universal primary school completions. In essence it promises that funding will not be a defining constraint for those countries with credible programs of reform, and an implementable education sector strategy. Pointedly it recognizes that appropriate recurrent budget support may be more important than capital investment. Fast Track will emphasize country ownership, policy cohesion within a PRSP framework and a good track record of performance. As a multilateral initiative it will challenge the donor community, including the Bank, to truly work in partnership. SWAP-type instruments with their potential to pool resources may be key to success, even as they expose rigidities in our existing procedures.

B. MULTI-COUNTRY AIDS PROGRAM (MAP)

In tackling the spread of HIV/AIDS around the world, the Bank has introduced a new approach to managing the portfolio – using a single generic umbrella Board authorization, then providing for its customization to specific country circumstances. This created the first Horizontal APL, or thematic SWAp. The first phase was a \$500 million Multi Country AIDS Program (MAP) for Africa approved in September 2000. Some 12 country projects were approved within 15 months, much faster than originally anticipated. In December 2001, a \$500 million MAP II was approved. The central feature of the MAP was its multi-country nature, but it is also highly innovative in several other aspects. It takes a multi-sectoral approach to a unique socio-cultural health, HIV/AIDS, it complements the work of a global coalition, UNAIDS, and has a major component of community-based programming. This framework approach – not a blueprint – provides for intensive supervision, extensive learning between the countries involved, regular institutionalized processes for sharing best practices, and common M&E standards to facilitate feedback and learning. Encouragingly, for such a high risk approach, the first few QAG quality ratings for individual MAP country projects were largely positive, but cautioned that framework, not blueprint, should indeed be the style. A similar approach was used for a \$155 million IBRD loan for AIDS prevention in the Caribbean. The cost savings in project preparation compared to separate country-by-country approvals are being allocated to supervision, to enable more intensive follow-up, using the flexibility embodied in the APL concept.

2.23 Concluding comments: The portfolio is perhaps at a turning point in structural terms. The old divisions of investment and adjustment are becoming less meaningful in the context of greater integration in programming, more country-driven agendas and the growing focus on aggregate *Results*. The middle zone of a more programmatic approach is likely to expand in future. Portfolio size will be significantly influenced by how well the Bank makes that adjustment, as well as the matching translation into new guidelines, processes and delivery capabilities.

III. PORTFOLIO PERFORMANCE

Following five years of improvements, several portfolio riskiness and quality indicators have returned to FY00 levels. After a period of sustained gains, this is not unexpected, and needs to be seen in the context of the pre-FY96 period when about 30 percent of the portfolio was at risk and operational quality was less than satisfactory for one in four projects. For the future the Bank needs to ensure the gains of the last few years, including a strengthened quality culture, are maintained. Enhancements to the system for measuring portfolio riskiness are being introduced. This would see risk levels stabilizing in the range 15-20 percent, a rate judged appropriate in terms of balancing innovation and development impact with fiduciary responsibility.

OVERALL PERFORMANCE

3.1 There has been a sustained period of improvement in most quality indicators since FY96. However in FY02 several portfolio-wide risk indicators returned to levels comparable to FY00. The central indicator of *Projects at-risk* is 15 percent for FY02. *Realism* is lower than in the last two years, while *Proactivity* returned to its FY00 level. In terms of OED outcomes, 77 percent of the 265 projects exiting the portfolio in FY01, projects largely initiated in the late 90s, were rated *Satisfactory*. OED has now completed the assessment of nearly half of the 275 FY02 exiting projects. Based on the PSR ratings for the remaining exit cohort, the FY02 outcome rating is forecast at 80 percent, continuing the steady improvement since FY96. *Net Disconnect*, the difference between OED ratings and the final supervision rating for a project, has been fluctuating in the range 8-13 percent over the last five years. The estimate for FY02 is 10 percent. As another check on realism this indicator still remains high and compares to a target of around 5 percent. This array of indicators are summarized in Table 3.1.

TABLE 3.1: TRENDS IN PORTFOLIO INDICATORS

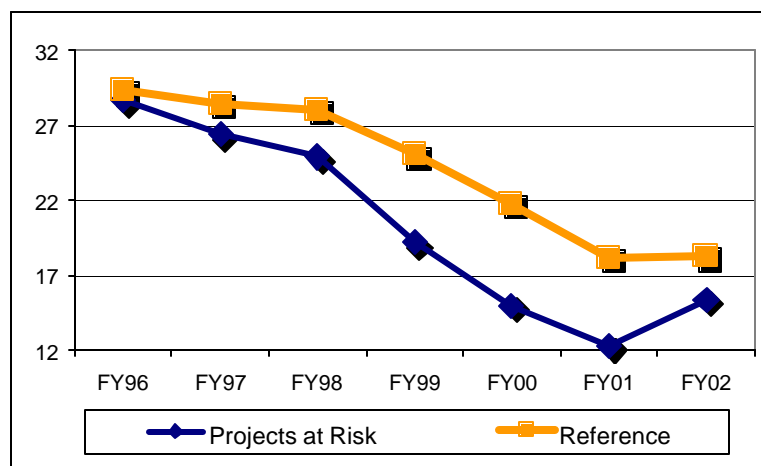
Portfolio (% by #)	FY97	FY00	FY01	FY02
Projects-at-risk	26	15	12	15
Commitments-at-risk	24	16	12	14
Realism	66	79	80	72
Proactivity	70	84	90	84
OED Satisfactory Outcomes	73	76	77	80*
Net Disconnect	11	9	13	10*

All above data is before refinements to 'flags'. * FY02 projected

3.2 These FY02 outcomes were reviewed to ascertain their causes and to assess their degree of seriousness. A core conclusion is that the overall riskiness of the portfolio remains commensurate with satisfactory OED outcomes in the 80-85 percent range. These results were also judged to be in part the result of more candid reporting. They are also in line with accumulating evidence indicating that portfolio improvements have been over-estimated in recent years. A second level of review sought to determine how robust the current risk indicators were. Figure 3.1 shows the divergence over time between the current *Projects at-*

Risk methodology and a *Reference* methodology developed as a cross-check on its robustness. The *Reference* methodology statistically adjusts the current methodology on the basis of the historic divergence (the ‘disconnect’) from OED outcome ratings; in essence it corrects for past under-recording of risk. Although the two measures are converging again in FY02, it was concluded that the current methodology needed some refinements to improve its predictive capacity. The results of this review reinforce the conclusion that there is no major secular deterioration in the portfolio. But the Bank will need to remain vigilant to ensure that the gains of the last five years are maintained.

FIGURE 3.1: TRENDS IN PORTFOLIO STATUS (% Riskiness)



3.3 Consequently, the overall judgment is that the shifts in the main portfolio indicators have to be seen as cautionary signals, but not causes of alarm. Maintaining the quality of the portfolio at its current levels is a satisfactory result. Moreover, Management and the Board have conveyed to staff messages that the Bank is in a risky business, that good development programming does involve taking calculated chances and making trade-offs, and that satisfactory outcomes in the 80-85 percent range remain appropriate. As flagged in the FY01 ARPP and discussed below, it is now estimated that riskiness, especially in recent years, may have been modestly but systemically under-estimated. A factor here is the impact of task team optimism, an otherwise welcome positive mindset, that emerging problems will dissipate with time and supervisory effort. The FY02 upturn in the riskiness ratings is most probably associated with a positive phenomenon: more candid reporting by line staff and their immediate managers, responding to signals over the last year or two from senior management as well as to communications about the need to rectify deficiencies in the quality of reporting. They also reflect the fact that the Bank has captured the lion's share of the quality gains it can expect under the present assessment system, which focuses on individual products and internal quality. The gains on that front now need to be consolidated and maintained, at the same time as the quality assurance perspective shifts to support the Bank's broader, more strategic, goals and the *Results* agenda. This shift would also be consistent with the stronger client-focus of recent years.

3.4 These results are thus not unexpected overall, and need to be seen in the context of the pre-FY96 period when about 30 percent of the portfolio was at-risk and OED outcomes were running at about 70 percent *Satisfactory*. They are also consistent with the changing structure of the portfolio discussed in Chapter 2. The Bank's operating environment is growing more complicated. Both crisis-driven adjustment lending and the implementation of 'soft' sector investment lending under such as CDD and SWAp modes is intrinsically more demanding. There are also new complexities in terms of country choices: for example uncertainties in some larger borrowers, and the greater engagement with conflict-related countries.

RISK METHODOLOGY: SOME REVISIONS

3.5 The vulnerabilities in project quality exposed by the Wapenhans report led indirectly to the introduction of the *Projects-at-Risk* (PAR) methodology in 1996, which has now become a key instrument for portfolio oversight. The approach took the task team's self-assessment of quality and applied a series of leading indicators for riskiness, the so-called 'flags' (see Annex 2. Definitions). Two other quality indicators formed part of the 1996 portfolio assessment package: *Realism* and *Proactivity*. This system, working as designed, should track in a predictive mode the independent estimates of portfolio outcomes prepared by OED on projects exiting the portfolio. However, with staff and management adapting over time to the mechanics of the system, the methodology has lost some of its heuristic value as an early warning device for portfolio management. In particular, the current methodology is now⁹ judged to have over estimated the absolute level of portfolio improvement, but not the strong upward trend.

3.6 The existing portfolio risk methodology has now been fine-tuned to restore its value as an instrument for portfolio oversight and management. The 'flags' system has been refined to better capture potential problem projects. This revised methodology tracks OED ratings much more closely. Box 3.1 summarizes these changes.

⁹ Since the long-established OED system is evaluating projects which are typically 5-6 years old it is only in the last year or two has there been enough overlap to make solid judgments on the relationship with QAG's *real-time* quality indicators. An important indicator from the data is that there is a high correlation between these OED **at-exit** ratings and the QAG quality-**at-entry** ratings.

BOX 3.1: FINE-TUNING PORTFOLIO MANAGEMENT INDICATORS

THE PROJECTS AT-RISK SYSTEM

- Riskiness here relates to a specific risk, that of not meeting a project's self-defined Development Objectives (DO). It is not about some generalized uncertainties. The system is built around a list of twelve 'flags', each a distinct leading (early warning) indicator of potential riskiness. If a project shows three or more risk 'flags' it is judged a *potentia* problem project.
- *Projects at-risk* (PAR) combines the self-assessed *actual* problem projects with the *potentia* problem projects as identified by the flag system.

FINE-TUNING THE METHODOLOGY

The intent is to bring about a better alignment between at-risk status and final OED outcome ratings. This involves broadening the threshold indicators that can trigger some key 'flags'. The existing twelve 'flags' system is to be maintained, but with the following three changes:

- a renamed Country Environment flag will now also include in/post-conflict countries
- a renamed Country Record flag will capture countries with weak ratings in any recent OED Country Assistance Evaluation.
- the Critical Risks flag can now be triggered by a wider range of factors

REALISM AND PROACTIVITY

Realism measures the divergence between riskiness as assessed by task teams and then as adjusted by the 'flag' system. *Proactivity* in practical terms measures whether corrective action has been initiated on self-identified problem projects in the last twelve months. These indicators will remain as before. Consistent with present judgments about an appropriate target for riskiness, a new *Realism* target of 70 percent will replace the present 80 percent. A reference series has also been created. The *Proactivity* index is not being changed, but the target will now be 80 percent instead of 90 percent.

3.7 This fine-tuning has the effect of shifting the at-risk rating curve closer to that for OED outcomes. For FY02 this adjustment changes the riskiness rating to 19 percent overall. The Reference methodology produced a comparable result.

DETAILED PORTFOLIO PERFORMANCE

3.8 Two detailed aspects merit attention in this ARPP: the special features of adjustment lending and the perspective relative to the new sectoral/thematic codes. More broadly, amongst Regions, Africa and MNA remain the two with the riskiest portfolios. IBRD and IDA lending remain about equal in terms of riskiness.

3.9 Instruments. Reflecting in large part the country crisis-driven nature of most adjustment lending, the riskiness rating of the FY02 adjustment portfolio rose to 23 percent (compared to 15 percent for investment lending). While significantly higher than in FY01, it is comparable with FY97. As a consequence the PREM Network shows the sharpest increase in riskiness. An important factor in this FY02 increase was one very large adjustment operation to Turkey.

BOX 3.2: RISKINESS IN CRISIS ADJUSTMENT LENDING

The increased level of risk reflects the continuing reality of difficult global and regional economic conditions, including in several large borrowers. In some cases macroeconomic vulnerability and contagion effects, led to a deterioration while adjustment operations were ongoing. Overall crisis-related lending has increased, with the Bank joining international assistance packages, often in partnership with the IMF. There has been an increase in the riskiness of the adjustment lending portfolio, reflecting the crisis context and often sensitive country circumstances, rather than poor preparation or supervision. Moreover, the counterfactual, no response to the crisis, can be equally risky and is usually politically or economically unsustainable.

3.10 Regions and Networks. Table 3.2 shows results under the fine-tuned risk methodology for the Region and Network portfolios. AFR and MNA are the two riskiest for both FY97 and FY02; this is true under both the original and the fine-tuned methodology. Among the Networks, PREM and FSE are the two riskiest portfolios in FY02. As the methodology shifts to the fine-tuned basis, the largest increases in riskiness occurs in quite distinct areas: amongst Regions in LCR and amongst Networks in PREM and FSE.

TABLE 3.2: RISKINESS BY REGION AND NETWORK

Region	% Projects at Risk		Network	% Projects at Risk	
	FY97	FY02		FY97	FY02
AFR	40	25	ESSD	24	16
EAP	15	13	FSE	32	16
ECA	23	19	HDN	25	21
LCR	21	17	PREM	25	24
MNA	35	23	PSI	28	18
SAR	21	10			
BANK	26	19	BANK	26	19

3.11 Economic Sectors and Themes. Table 3.3 applies the revised risk methodology to the new coding system. Measured by the number of projects at risk, it shows that Health and Other Social Sectors, and Energy are the riskiest *sectors*. The fastest growing and now second largest *economic sector* (Law and Public Administration) is the third riskiest. Among *themes*, Urban became the riskiest theme in FY02, followed by Finance & PSD and Human Development. Because this *economic sector* and *theme* data is new and was retrofitted, it needs to be treated with some caution.

TABLE 3.3: RISKINESS, BY SECTOR AND THEME

Economic Sector	% Projects at Risk		Theme	% Projects at Risk	
	FY97	FY02		FY97	FY02
Agriculture	27	16	Econ. Mgmt.	27*	19*
Law & Public Admin.	25	20	Public Sector/ Gov.	28	18
ICT	14*	22*	Law	26*	16*
Education	22	18	Finance & PSD	28	21
Finance	30	18	Trade	21	19
Health & Social	26	24	Social Protection	18	19
Industry & Trade	29	16	Social Development	27	18
Energy	28	24	Human Dev.	26	21
Transportation	23	15	Urban	30	23
Water & Sanitation	33	17	Rural	27	18
			Environ & Nat. Res.	24	13
Total Sectors	26	19	Total Theme	26	19

* these Sectors and Themes not statistically significant because the portfolios are small.

PORTFOLIO MANAGEMENT

3.12 Quality indicators derived from QAG panel reviews¹⁰ (projects-at-entry, supervision, ESW) show a broadly similar trend as riskiness (Table 3.4). There has been a substantial advance in quality over the five year period since FY97, with the last 2-3 years showing somewhat fluctuating results, although the FY02 data is only partial. Again, as for the risk indicators, the easy gains have been made, and the overall focus in future is to maintain the broad gains, whilst also shifting the assessment perspective to specialized facets or more strategic relationships, including *Results*. All three assessments show that the quality culture is now broadly internalized in the Bank compared to five years ago, but that it remains vulnerable to continuing pressures from the push to book commitments. Against this perspective, quality is broadly stabilized in the range 85-90 percent *Satisfactory*. A Bankwide target has been set at 90+ percent.

TABLE 3.4: QUALITY INDICATORS

Quality (% <i>Satisfactory or better</i>)	FY97	FY00	FY01	FY02 ^{/b}
Projects-at-entry (QEA)	82 ^{/a}	89 ^{/a}	94	86
Supervision (QSA)	63	92	n.a.	89
ESW	72 ^{/c}	86	91	94

^{/a} calendar year basis; ^{/b} preliminary results; ^{/c} 1st exercise was FY98

3.13 At the level of the individual project and task team, there continue to be major concerns with both the initial clarity of development objectives and the subsequent quality of monitoring - exercised through the supervision process and the PSR. In QEA5 a large percentage of operations were rated uncertain to meet their development objectives. The

¹⁰ These assessments are reported in detailed to CODE via the annual QAG Synthesis Report. ESW quality is discussed in Chapter 4.

quality of PSRs has been criticized in past ARPPs, as well as many individual QAG task assessments. Problems with updating PSRs and the timely delivery of ICRs have been noted for several years. The PSR instrument is often seen as not very user-friendly, and more basically its effectiveness is diminished since it is not much used as an active management tool. The PSR is also a key, but seriously under-performing, vehicle for M & E. At the management level the performance of sector managers and country directors is noted by QAG panelists as a source of concern. Their span of responsibilities can be so diverse that they are spread too thin, with adverse effects on timeliness and attention to portfolio management and support of operational staff. This makes it more difficult for example to spot deteriorating performance at the early 'curable' stage or better still by timely intervention with task teams on a preventive basis. Finally, the rapid turnover of frontline staff, including new faces amongst sector management, while representing an influx of welcome new ideas, technical expertise, outside experience and creative energy into the operational complex, has meant a loss of institutional experience with some consequent increase of the Bank's vulnerability on the quality front.

3.14 The recent QEA5 exercise retains the overall finding of earlier exercises that quality at-entry is a key determinant of project success. Some 86 percent of FY02 operations were rated *Satisfactory* by QAG panels, a decline from QEA4 (94 percent). Overall while the FY01 quality assessments may have shown some upwards bias, the FY02 assessment exercise is judged to have had marginally tougher benchmarking. As in QEA4, quality ratings were somewhat better for IBRD operations than for IDA. The most significant deterioration was in the quality of implementation arrangements which critically affects the chances of operations achieving their development objectives. Monitoring and evaluation (M&E) arrangements, risk assessment and quality enhancement arrangements are other areas identified as in need of significant improvement. In contrast, fiduciary, environmental and social development aspects were seen as well-planned. More generally the assessments detected a sense that there was some return to a lending culture, which unduly focuses staff and management attention on new projects. To maintain the gains of recent years, recommendations include: revisions making the PAD format more user-friendly and *results-oriented*; assistance to task teams to ensure development objectives are better spelt out; developing corrective measures to improve M&E; making better use of ex-ante QER panels and similar mechanisms to upgrade quality enhancement; and ensuring that policies and procedural standards for emergency and CDD operations are applied.

3.15 Supervision and the quality of Bank performance in implementation have also been regularly assessed. Following major gains in supervision quality between FY97 and FY00, there was an assessment exercise focused on risky projects (QSR) in FY01. A new regular Quality of Supervision Assessment (QSA5) was carried out in FY02. QSR suggested that the Bank does not pay sufficient attention to the risky segment of the portfolio, and that it is often difficult to remedy project deficiencies during implementation. When these results were extrapolated to the FY01 portfolio, QSR shows that about 19 percent of projects were failing to achieve their development objectives, compared to 12 percent as captured by the *Projects at-risk* system and only 6 percent as self-assessed in PSRs. The report suggested that one important adverse influence is the lack of incentives for seasoned managers and staff to work on risky projects, a variant of the LICUS problem. Preliminary data from the QSA5

exercise finds some deterioration in overall supervision quality. Three areas of particular concern are noted: first, an increase in the lack of realism in rating project risk; second, a continuing weakness in defining development objectives and M&E arrangements; and third, a failure to address implementation questions thoroughly, including weak follow-up by managers.

3.16 Taken together the FY02 quality exercises flag two general concerns. The first is the reduced experience, as opposed to technical competence, of staff responsible for portfolio management and supervision, following the higher levels of turnover in recent years, and of the new cohort of Sector Managers. As a consequence, training, mentoring and management guidance will be very important for several years. The second is the persistent finding that M&E arrangements are frequently deficient. This will require attention, notably at the more aggregate level as the Bank moves towards a *Results* orientation. All these areas will need to be addressed with renewed vigor as part of the effort to maintain the gains in portfolio quality.

OTHER MANAGEMENT INDICATORS

3.17 Other management indicators also support the need for continued attention to quality. As noted earlier, Net Disconnect at nine percent remains high and compares to a target of around five percent. This is of concern at a time when Regions and Networks have strengthened portfolio management in the last few years. Factors contributing to a high disconnect include poorly defined development objectives, weak monitoring, over-optimism in rating risk by the TTL, and gaps in management attention. For sustained improvements there needs to be a still stronger focus on timely and realistic rating in PSRs and ICRs by line managers and staff.

3.18 PSR and ICR bunching remain a problem area. Some 40 percent of FY02 PSRs were updated in one month, June. The ultimate issue seems to be one of incentives, not least the active use of PSRs by managers in their portfolio management and monitoring. For ICRs, Regions should encourage line management and staff to accelerate their preparation. Part of a longer-term solution is a more conscious management of Closing Dates so that the work load is spread more evenly across the year.

3.19 Performance on the management of Closing Dates, Long Term Problem Projects and effectiveness delays is now broadly satisfactory. But in the case of Closing Dates, about half of the projects due to close require extensions beyond 12 months. Management and staff need to be more realistic both at appraisal and in tackling problem projects.

STRENGTHENING PORTFOLIO MANAGEMENT

3.20 The status of the recommendations made in the FY01 ARPP, as well as some important management responses are summarized in Box 3.3.

BOX 3.3: STATUS OF FY01 ARPP RECOMMENDATIONS	
Recommendation	Actions and Results
Emphasize Sustainability and sharpen Development Objectives (DO) in project documents	Regions have strengthened their focus on governance reform, budget management. Enhanced support and training to task teams in defining DOs and monitorable indicators.
Strengthen mechanisms to monitor Networks role in improving quality	QAG piloted assessments with two Sector Boards (Rural and Transport). This is now to be mainstreamed across the Networks in FY03.
Continue strengthening ESW management and integration into portfolio.	Regions are increasingly managing and monitoring ESW tasks as they do for projects, explicitly within the CAS. ESW-AAA definitions clarified.
Replace the PTI as lead poverty indicator with an improved set of indicators	PTI has been dropped. New approach to assessing poverty focus piloted in QEA5.
Review and refine portfolio monitoring indicators and <i>at-risk</i> flag system	Indicators revised, and new system introduced in November, 2002 (see Box 3.1)

3.21 An additional tool to create incentives for strengthened portfolio management is the Portfolio Improvement Program, outlined in Box 3.4. This identifies areas of the current portfolio which are more vulnerable, then urges a special review of the actions that might reduce the riskiness of these parts of the portfolio.

BOX 3.4: FY03 PORTFOLIO IMPROVEMENT PROGRAM (PIP)

The PIP, as detailed in Annex 5, identifies countries, sectors and large projects that contribute disproportionately to the overall riskiness of the Bank's portfolio. The number of PIP countries increased to fourteen in FY03 from ten in FY02. Twelve large projects are included in the FY03 PIP compared to sixteen in FY02; four are carryovers. The FY03 PIP portfolio constitutes about one-quarter of the total portfolio and about two-thirds of the portfolio 'at-risk'.

The individual amelioration plans submitted in response place primary emphasis on using the Country Portfolio Performance Review (CPPR) to turn the portfolio around with closer follow-up of agreed Action Plans. They show a particular focus on strengthening fiduciary processes and procurement. There is less attention on revisiting development objectives or monitoring and evaluation. Most plans raised the need to take account of the prevailing macroeconomic and fiscal situations in-country as solutions are developed.

3.22 Beyond these specific actions, senior management is encouraging more candid reporting of risk by line managers and staff. All Regions now have in place their own active quality support teams, as well as tools which allow them to systematically assess country and sectoral portfolios (e.g., enhanced CPPRs). Quality-at-Entry Reviews (QER) are being more widely used; they have been mainstreamed in most Regions, with Networks now shifting

their resources more into producing guidelines and other support tools. Regions are increasingly decentralizing responsibility for portfolio management, procurement and individual project supervision to country offices. They are carrying out special assessments of portfolios at-risk, as well as creating new incentives for seasoned staff to work on risky projects and more demanding countries (e.g. LICUS), including appropriate attention in the annual Performance Evaluations and in staff recognition programs. Partly in response to the QSR observation that intrinsically more difficult projects were perversely often receiving less support (budget, more experienced TTLs, management attention etc.) than the less risky, it has been decided that there should be incremental funding for supervision of more risky projects.

3.23 Some specific examples of recent best practice in portfolio management are noted in Box 3.5.

BOX 3.5: ELEMENTS OF BEST PRACTICE

EAP has undertaken three Rapid Assessment Client Reports to provide quick feedback from borrowers on portfolio management and supervision. LCR incorporated Trust Funds into its regular portfolio reviews in FY02. ECA screens all new projects for the quality of their Development Objectives and has begun to do the same for particular (risky) portfolios. In FY03, together with the Networks, it will focus on working with governments to strengthen sectoral-project links. ECA, AFR and MNA are expanding training of operational staff, and AFR includes borrower institutions in that training. AFR is promoting the use of risk management action plans for high-risk country portfolios. MNA has initiated a project readiness filter system which is shared with client countries.

SAR is focusing more on project ratings, including how well they reflect performance on the ground and relate to initial indicators. Most Regions are building strong operational support functions in Country Offices. The gains can be quite striking: the regional procurement hub in New Delhi helped to halve the average time for procurement in Nepal to move from bid invitation to contract award.

The PREM Network and the Social Development Sector have collaborated to undertake reviews of policy-based lending in twelve countries to determine their poverty content and social impact. They are also working together on sourcebooks for empowerment and social analysis as well as a poverty and social impact users guide.

3.24 **Concluding comments:** Provided that there remains a consistent management message on quality and riskiness the Bank should be able to deliver satisfactory outcomes on a sustained basis. As an institution dealing with difficult development challenges, the Bank must take calculated risks and create incentives to operational staff for innovation. An approach built around a goal of lowering riskiness further could become a strategy of safe mediocrity, which would undermine the Bank's role in promoting innovative approaches to development. This year's ARPP thus proposes that the Board re-affirm the existing Bank-wide target of 75 percent satisfactory outcomes, with scope for variation for individual regions and sectors. Consistent with this target, in order to help ensure that quality is maintained at a satisfactory level, this report recommends Bankwide targets for *Realism* of 70+ percent and for *Proactivity* of 80+ percent.

IV. ECONOMIC AND SECTOR WORK

Consistent with the spirit of the Knowledge Bank, ESW is coming to play an increasingly active role in the portfolio. Volume is up again, driven by increases in numbers of Policy Notes and informal products. There is also greater volume and improved coverage for Core Diagnostics. Quality gains have stabilized, with particular strength shown by participatory processes. A reformed assessment process would focus on the overall ESW-AAA portfolio in the CAS context.

4.1 ESW is now integrated into the ARPP under an expanded concept of the Bank portfolio. The relatively short (12-18 month) life-cycle of most individual ESW tasks is deceptive. The implications are cumulative and systemic. Developmentally the effectiveness of ESW depends upon its integration forwards into the lending program and vertically into the CAS/PRSP and the broader policy dialogue. The role of ESW in total operational activities grew substantially in FY02, after several years of very limited growth. In direct Bank budget terms, in FY02 ESW absorbed \$86 million (FY01 \$48 million), compared to \$114 million for new lending. In terms of overall numbers, Regional ESW products deliveries in FY02 totaled 423, compared to 324 in FY01, an increase of 30 percent. Within this total, delivery of regular Reports was essentially unchanged between the two fiscal years. The growth was concentrated in the sub-category Other ESW Products; this group, some 189 tasks, dominated by often time-dependent Policy Notes, almost doubled in size in FY02.

4.2 A new SAP category has been created for **Network** ESW. Whilst so far not subjected to quality assessment, these products which are managed **and financed** directly from SB anchor resources, are quite substantial. The latest FY03 Budget document reports they numbered 109 tasks in FY02, rising in FY03 to being maybe 40 percent of Regional ESW activity. It will be important to capture this activity for monitoring and quality assurance purposes.

4.3 There is a marked variability in the size of country ESW programs, with some nine countries having ESW programs of over \$1 million in FY02. Over the past two years, the top ten countries absorbed 35 percent of funding. There is also a significant country-to-country variance. Using a concept of ESW-intensity¹¹ the Bankwide ratio is now 14 percent, up from 11 percent two years earlier. The ESW-intensity for IDA countries at 12 percent is somewhat smaller than that for IBRD. There is a very wide variation between countries; in FY02 the intensity ranged from 3-5 percent to around 30-40 percent at the other extreme. Between regions the FY02 intensity varied between a low of 10 percent for countries in AFR to a high of 19 percent in SAR. Given the concerns raised by the LICUS task force that there should be a reinforced effort to provide ESW (for its capacity-building role, etc.), it is worth noting that for this group their ESW-intensity is essentially comparable with IDA countries at 13 percent.

¹¹ This indicator is defined as percentage of Bank administrative budgets spent on ESW relative to total Country Services. It is calculated strictly for country programs, excluding regional level spending.

4.4 The size of ESW tasks varies from \$5,000 to over \$1 million.¹² Unit costs have fallen across all product types for the third year in a row, to an average of \$148,000 per product in FY02. Formal reports cost an average \$183,000 (of which Core Diagnostics cost slightly more at \$192,000 on average), whilst Other Products averaged \$103,000. Policy Notes, often seen as a light ‘just-in-time’ product, in practice this year cost an average \$101,000.

4.5 In terms of Network affiliation, ESW is traditionally dominated by PREM, which was responsible for 185 of 423 tasks in FY02 or roughly half by delivery costs. PREM is the main supplier of Core Diagnostic products. HDN and PSI are the next most active Networks for ESW. The three Networks also show above trend growth in FY02 over FY01. Using interim data with the new thematic codes, Public Sector Governance led with 26 percent of FY02 deliveries by number, followed by Finance and PSD, Human Development and Economic Management, all in range 12-14 percent.

4.6 Over the last two years, responding to perceived gaps in the availability of core elements of basic country analytical work, a special priority has been attached to a key subset of ESW products, the Core Diagnostics.¹³ FY02 saw a rapid growth in these activities – reflecting the new quasi-mandatory status of these items. Deliveries nearly doubled to 84/234 formal reports. The program of Core Diagnostics is now growing in line with the recommended five year rule for coverage. At end-FY02 OPCS estimated that coverage was about 40-50 percent, with the best coverage for PERs and the worst for CFAAs. As a concomitant, these Core Diagnostics are taking up an increasing share of total ESW resources; they now represent 28 percent of FY02 delivery costs (BW basis). The goal of the program of Core Diagnostics was to ensure that there was a basic coverage in all countries of the key knowledge products for good macro-policy. Looking forward the pattern of coverage should be managed to avoid crowding-out of other analytic priorities by being fine-tuned to respond to country-specifics, including size and the new focus on the MDGs. Country ownership, the engagement of the client, is key to the effective internalization of the policy advice embodied in each Core Diagnostics program.

ESW MANAGEMENT AND QUALITY

4.7 The last few years has seen a major effort to strengthen the management and quality of ESW and bring it to par with the project portfolio. QAG has carried out annual quality assessments for ESW since 1998. The ESW Synthesis reports have explored a number of important systemic quality challenges from the critical importance of quality-at-entry to the necessity for broader ownership and participation, as well as operationally key factors such as managerial engagement and weaknesses in the peer review process. OPCS has spearheaded two phases of reform under the generic heading of *Fixing ESW*. The first phase in FY01 focused on improvements in the ESW recording and monitoring systems; a second

¹² The largest was \$1.1 million, with three more exceeding \$800k.

¹³ Core Diagnostics include the Poverty Assessment, Country Economic Memorandum (CEM), Development Policy Review, Public Expenditure Review (PER), Country Financial Accountability Assessment (CFAA), and the Country Procurement Assessment Review (CPAR)

phase, in FY02, focused more on the strategic role of ESW, including the introduction of Core Diagnostics work for each country on a regular basis.

4.8 Strategic Content and Coverage. The heightened attention to ESW has been reinforced by the growing appreciation of the importance of an appropriate policy regime to overall development effectiveness. The products and dialogue generated by an effective ESW program provide a strategic contribution to policy development. This perspective has guided the stronger focus on Core Diagnostics and much clearer expectations that ESW would be a fully programmed element within the CAS. Similar messages emerge from recent QAG Syntheses, along with the finding that effective client participation was correlated with higher quality, notably *Likely Impact*.

4.9 The recent QAG pilot assessment of country ESW-AAA programs in three countries provided some practical insights on the strategic role of ESW. Each country pilot looked at the total ESW program and also the other major AAA components (e.g. non-lending TA), framed against the goals of the full CAS cycle. An early and consistent message was that good ESW could not exist in isolation; its strength lay not just in its internal (technical) quality but also on how well it was integrated into broader priorities emerging from policy dialogue and the lending portfolio. This pilot provides some important insights on the management of ESW/AAA. In the context of generally satisfactory outcomes, there are some important weaknesses in terms of the cohesion and sustainability of the programs. Sometimes there was a lack of cohesion between individual tasks, sometimes between the individual task and the strategic priorities of the CAS and/or lending portfolio. The pilots raised questions about appropriate selectivity, as well as the need for better planning and resourcing of individual tasks to permit a sustained engagement. They pinpointed the importance of ownership of key ESW tasks by the clients. They noted continuing issues in terms of the quality of recording ESW/AAA activities, as well as the budgetary allocations, both administrative budget and trust fund.

BOX 4.1: A REFORMED APPROACH TO ESW-AAA ASSESSMENT

Recognizing the changing role of ESW, QAG initiated a comprehensive review of the approach to assessing ESW quality in Spring 2002. The review, whose major conclusions were supported by Management, proposed several important changes that could enhance ESW assessments. The key conclusion, encouraged by the early positive indications from the Country AAA pilots (see above), was to take a more programmatic perspective and consequently move to a more aggregate level of assessment and accountability. Specifically it recommended that from FY04 onwards all ESW reviews would shift from the present individual task basis to one examining a multi-year ESW-AAA country program, and its effectiveness within the framework of the CAS/PRSP. Another important conclusion was that assessments should focus more on measuring *Likely Impact*, including the important role played by interaction with the clients.

4.10 **Quality of ESW.** The more intense focus on a sound analytical basis for both policy dialogue and project interventions has reinforced the concern for ESW quality. The QAG task level ESW assessments that began with FY98 tasks had initially shown disappointing levels of quality, well behind the comparable figures for projects, with a *Satisfactory or better* rating for FY98+99 of only 73 percent by numbers. However, the quality level moved up rapidly in FY00 to 86 percent, then reached 91 percent FY01. Preliminary¹⁴ data from the latest year (FY02) show a closely comparable rating, but also an encouraging higher share for *Highly Satisfactory* products. The overall stabilization of ESW quality over the last three years is fully in line with the Bankwide quality target set at 90 percent *Satisfactory*.

4.11 These assessments are also piloting perspectives on new dimensions of ESW. A first baseline ESW assessment of Fiduciary products (CFAA and CPAR), which are an important part of the Core Diagnostic package, noted scope for substantial improvement, in particular a need for better integration with the wider CAS perspective. There are early results from these conclusions in the form of upgraded guidelines, with a more strategic emphasis, as well as some important piloting of joint fiduciary products – CFAA/CPAR/PER combined and also the FSAPs. The FY02 assessment will now look on a pilot basis at the quality of informal tasks, those usually without any report but often focused around an event such as a workshop.

4.12 The QAG assessments covers four core quality dimensions. Relevance is now rated in the mid-90 percent range, with indicators for Internal Quality, Dialogue and Likely Impact averaging in the upper-80s. The quality of Bank Processes – including the engagement of managers at critical stages in guiding and supporting ESW as well as the resources (budgets, skills, etc) made available - is also assessed; this facet has lagged behind other indicators at around 70 percent *Satisfactory*. The most sensitive dimension, especially with a new focus on *Results*, is Likely Impact which, after falling last year against a raised quality bar, seems to have recovered in FY02 with an 83 percent rating.

4.13 **Participation and partnership.** In keeping with the CDF/Partnership principles, there has been a significant increase in use of participatory approaches to ESW, to an estimated 40 percent in FY01. This applied both to Bank clients and to donor partners.. The indications from the QAG ratings is that this approach is paying off in terms of ESW quality which is significantly higher for this sub-group, notably in the ratings for Likely Impact and Relevance. This extra impact is arising without the feared increases in total costs or time to complete tasks.

4.14 There are a growing number of partnerships with donors in the form of joint analytical work in the field. There is also a complementary multilateral process. The Bank has promoted two joint donor workshops which have been held to foster cooperation on ESW. Participants are now working towards harmonized guidelines and common toolkits. An important tool is the creation of a joint website, covering guidelines, programs of ESW, and case-studies/reference versions of specific tasks. Separately, cooperation with the IMF

¹⁴ This Synthesis Report is being finalized for CODE distribution in early 2003.

on ESW has been intensified with a formal agreement that the Bank supports the IMF with structural, sectoral and social reviews, and the IMF supports the Bank with its analysis of macro and fiscal issues. Many aspects of that collaboration is now focused within the joint efforts to support PRSPs and assess their quality via the JSAs.

4.15 **Timing.** As noted above, the quantity and variety of ESW output increased substantially in FY02. Average delivery time for formal reports rose a little to 14.2 months, with a high percentage of tasks substantially delayed compared with the originally planned delivery date. Policy Notes were delivered somewhat faster than formal reports, on average in 10.6 months. ESW delivery is also subject to a severe bunching problem; in FY02 some 37 percent of products were delivered in the last month of the fiscal year. Multi-year budgeting and a more strategic approach to ESW/AAA programming within the CAS is seen by many as a partial solution.

4.16 **Recording and Monitoring Systems.** These tools continue to slowly improve. FY02 saw the introduction of important clarifications to the core definitions, but they are still not fully effective. For example, the Network Anchor ESW products identified in the Budget document for FY02 were not captured in SAP as ESW, hence not subject to QAG sampling for quality. The level of detail in the SAP and BW still remains uneven. Staff are seemingly not yet as conscientious in updating SAP for ESW tasks as they are for projects. As the Bank moves towards a *Results* culture for ESW-AAA, it will become more important that the Activity Completion Summary (ACS), an evaluation document prepared by the staff, be completed in a more thorough manner and be better utilized by line management. Moreover, some important milestones may need updating to reflect the impact of a more participatory approach.

4.17 **Concluding comments:** ESW is now moving towards parity with Lending in terms of the focus of resources and managerial commitment in the Bank. This needs to be better reflected in the attention given to monitoring and reporting upon these activities, but even more important is to reinforce the encouraging trend to give ESW (and the associated Other AAA activities such as Non-lending TA and support for PRSPs) a full role in the CAS process. Finally, the new emphasis on *Results* will place new demands ... and higher expectations on the effectiveness of ESW.

V. MILLENNIUM GOALS AND RESULTS

The Bank's focus on Poverty Reduction has now been joined by a commitment to the Millennium Development Goals (MDGs). The new development paradigm, as recently endorsed by the Development Committee, is a results-based approach, built around MDG+ goals. The year saw a surge of activity across the Bank exploring the implications, including the need to smoothly harmonize these overlapping agendas. Many demand strong partnerships; most require active engagement of client-countries. This MDG orientation will need to be built into individual CASs and PRSPs, including localization of the goals. A new generation of results-based CASs will serve as a key vehicle for institutionalizing this shift in perspectives, including a more strategic approach to operations and the portfolio. The transformation will place new demands on Bank operations, including posing new challenges in measuring effectiveness.

MAINSTREAMING THE MDGs

5.1 The last few years have seen a renewed focus on Poverty Reduction. More recently, the Bank has made a major commitment to the Millennium Development Goals (MDGs). These are seen appropriately as complementary, with the MDGs offering a broadly endorsed frame of reference and a set of results indicators that reinforces the Poverty Reduction agenda. Indeed the first MDG is Poverty Reduction (Annex 4). Together they provide the foundation for a new *results*-based development paradigm for the Bank. The working premise for IDA countries is that the MDGs (embracing as they do Poverty Reduction) will be integrated within an enhanced PRSP. This should be seen not as an increment but rather as an enrichment of a product and a process that is increasingly well-rooted in the development thinking and agendas of many borrowers. PRSPs would be recalibrated to internalize and 'localize' the MDGs at the country level. In middle-income countries, under the concept of MDG+, there will often emerge an extended agenda in which the core MDGs are complemented by other key development goals in a national development strategy.

5.2 The MDGs will set the tone (rather than the specifics) of individual country programs. As such their role is to help mould priorities within the development agenda, but it will be critical that there also be an effective bridge to operations, serving to guide future project selection and policy objectives within the portfolio. The natural unit of account in an MDG framework will typically be the country program. However, the individual project or analytical task will remain an active part of the equation as the 'brick and mortar' vehicle that serves to demonstrate effective operational responses or refine specific policy perspectives.

5.3 In this process of operationalisation the Bank faces three broad challenges. Data and information for policy-making and program design is the first issue: what do the MDGs mean in a country and time-specific context? There are major ongoing exercises in DEC and key Networks on how to better define the baselines for the MDGs, including at the client/country level which is key to localization of relevant MDG goals. The Bank already has some 200 projects with a focus on building statistical capacity and systems. Given the importance of the CPIA, some of its components might be reviewed to see if there is scope to better capture sensitivity to the MDGs.

BOX 5.1: STRENGTHENING DATA FOR POLICY-MAKING

It will be difficult to make or measure progress in meeting the MDGs without a major effort to build the datasets in developing countries. Yet numbers – reliable, robust and current statistics – have been historically one of the weakest points in the institutional framework of most Bank clients. Spurred first by the PRSP, there has begun a multi-donor effort at capacity-building, much coordinated through the PARIS 21 process. Within the Bank, DEC is working with Regions on a range of specific exercises under the chapeau of the STAT CAP program as well as via a trust fund for statistical capacity-building. However many see the greater challenge to lie on the demand side – politicians and civil servants must first feel a need to know these numbers about the basic well-being of their populations.

5.4 A second element is to ensure effective coordination and operational follow-up on the MDG agenda. Management has now established an Implementation Follow-Up (IFU) action plan to pull together the work initiated by a few key units such as DEC and the PREM and HD anchors. An MD-led Steering Group launched in October is now implementing an approach designed to ensure clearer staff and managerial awareness, develop a Bank response that takes into account country realities and limitations in Bank capacity, and then to execute an action program that links the key actors and actions across the Networks and Regional Units. Monitoring will be built into strengthened Unit Compacts and the budgetary cycle, with appropriate reporting to the Board. Mainstreaming will not be easy; it will take management attention and some time for effective implementation. Best practices will need to be adapted from the current creative efforts in different parts of the Bank. Co-ordination is also an issue at the partnership level. The Bank, with the IMF, is developing monitoring systems for support to the MDGs agenda by the main stakeholders. The Bank will also need to maintain a close working partnership with UNDP, which is playing a central role at both the global¹⁵ and the country levels.

5.5 A third dimension is to review what changes might be needed in operational policies and practices to reflect the new focus on MDGs, for example through enhanced CAS guidelines. Regions are exploring how the MDGs, suitably adapted to country perspectives and situations, can serve as a frame of reference for the CAS, as well as future lending and AAA. Recent assessments indicate that overall PRSPs have made better progress in spelling out quantified goals than their CAS counterparts, but that these are often based on over-optimistic frameworks and seen as weak in the area of realistic and monitorable goals. A broader approach will be needed for many MICs whose CASs are typically less poverty-oriented. An early challenge is to build a stronger sensitivity to these goals into Bank analytical work; this is key to building the understanding of the cross-sectoral linkages that drive the *results* equations as well as to defining a viable set of intermediate indicators. A major focus will be strengthening M&E processes. Under the MDGs, these will now need to be designed to operate at both the project and the national/sectoral levels. All this will likely

¹⁵ The next UN Human Development Report will be centred on the MDGs. The UNDP team and the Bank team working on the WDR 2004 on *Making Services Work for Poor People* are coordinating their analysis and other preparatory work.

have significant budgetary implications. This is an area of still limited Bank capacity and often not well-integrated into operations. Given the even more difficult capacity-building challenges for Bank clients, M & E enhancements for the Bank should be well-integrated with client country efforts. An early step should be country-specific action plans that could be built into the preparation cycle for future *results*-based CASs.

5.6 MDG-related indicators are being integrated into QAG's regular assessment frameworks for individual projects and ESW. The initial approach is built around a self-assessment by the team leader of standard development objectives, three of which broadly map into the MDGs. Preliminary results from the recently completed QEA5 found that 38 percent of FY02 operations sampled showed at least one MDG-linked objective rated by the team leader as a high priority. Poverty Reduction was present as a stated objective for 64 percent of the QEA5 sample; however, QAG panels judged this was likely to be successful in only 72 percent of these cases. Human Development was identified as a goal by 32 percent of task teams, with a QAG panel judgment of likely success of 69 percent. Environmental Sustainability was a focus in 29 percent of cases, with a 100 percent rating for likely success. The next cycle of QAG assessments will include supplementary questions that seek more explicit indications of the quality of task team sensitivity to broader MDG objectives. A basic concern emerging from the QAG exercise is that project development objectives, whether MDG-linked or not, are typically too numerous and poorly specified, with few measurable benchmarks for success.

BOX 5.2: MDGs – A PILOT COUNTRY ASSESSMENT

As we move to internalize the MDGs we need to shift to specifics – what is the situation at the country level. To understand what this involves a Bank team has assembled case-studies for six distinct countries ranging from Argentina to Yemen. The studies examine the practical challenge of mobilizing an accelerated response to the MDGs. At the country level, early conclusions point to the need for: basic statistics and the capacity to gather them; a results-based approach to policy-making, including working M&E systems; a focus on service delivery for effective impact, especially in health and education; more attention to the vulnerable or marginalized. The studies also offer some cautionary thoughts: MDGs are not a (donor-led) alternative to national goals, but are complementary; the MDGs need to be adapted, sometimes 'stretched' to country-specific situations, especially in MICs.

5.7 A wide range of issues confront Bank managers and staff in translating the new focus on the MDGs into operational reality. In an already overloaded and often over-constrained operational environment, the MDG focus brings new accountability to CDs and other managers, as well as many complex technical programming challenges. These will need appropriate resource allocations and maybe a relaxation of other competing demands. While some of the tensions over the matrix approach have diminished, they have not vanished. The IFU action plan is intended to ensure that these tensions are managed proactively, especially on the elements of the MDG+ agenda which are identified as needing attention at the institutional level. The MDGs will further test the matrix effectiveness, especially given the consistent message that cross-sectoral approaches, including at the analytical level, can be often key to an effective response.

5.8 It has to be recognized that the Bank is only at the early stages of the internal institutional learning curve. The Corporate commitment is very explicit, but frontline staff need to be better engaged. New incentives are not yet in place. At this early stage, front-line staff feel some uncertainty as to how to reflect the MDGs in country dialogue and operations: are they an add-on, a basic rethinking of priorities, or do they serve to deepen and systematize the Bank's longstanding Poverty Reduction agenda? It will be important over the coming months for managers to exercise leadership in this area, and to mainstream the commitment to MDG+ alignment in the regular programming and budgeting process.

5.9 **Poverty-focus.** Last year the ARPP examined approaches to better measure the poverty-focus of the portfolio. This can be done at various levels. The ARPP noted that Country Programs, Sector Strategy Papers (SSPs) and individual operations, all needed to do a better job of incorporating poverty reduction goals and measuring performance. Some recent indicators are discussed below.

5.10 The latest CAS Retrospective using Poverty Board criteria found that the level of *Satisfactory or better* for treatment of poverty issues was only 61 percent in its cohort of 28 FY00/01 CASs. Areas showing improvement included poverty diagnosis, alignment with national poverty reduction strategies and participation. More recent analysis by the Bank's Poverty Reduction Group of CASs for FY01/02 showed some decline in focus on poverty reduction in these same areas, although the sample was somewhat dominated by MICs, with several planned PRSP-linked CASs having been delayed. The PREM report noted that some MIC CASs have weaker linkages to poverty, reflecting their broader development strategies.

5.11 For SSPs, the OPCS Stocktaking exercise of last year, which looked back at the first nine SSPs, found adequate attention to poverty reduction in eight of them. The next generation of SSPs are expected to have a more refined perspective on performance relative to the MDGs, including a recognition that many results chains are indirect (e.g. improved rural feeder roads can be key to allowing young girls to have safe access to primary education). The new Poverty Board Progress Report suggests that SSPs continue to make progress, but that more work is needed on benchmarks and monitorable indicators.

5.12 A third perspective emerges from assessments of individual products. On the ESW side the rating in the last QAG assessment (FY01) for 'poverty *sensitivity*' was significantly improved on the previous year at 83 percent *Satisfactory*. More substantively following an analysis and recommendations in last year's ARPP, a major exercise has just been completed to pilot a new approach to assessing the poverty *focus*¹⁶ of the portfolio in this year's QAG assessment of projects-at-entry (QEA5). This model was built around a three-level typology developed by RDV for the poverty-focus in project design: *focused*, *inclusive* and *enabling*. The approach also evaluated the linkage to the available poverty diagnosis and strategy, as well as the extent to which the operation makes a serious efforts to include the poor (via monitoring and evaluation arrangements, targeting mechanisms). The QAG sample rated

¹⁶ Neither approach measures the actual poverty reduction **impact** or **outcome**. However the implicit hypothesis is that good **sensitivity** or **focus** is a prerequisite for *likely* impact.

some 75 percent as *Satisfactory* on poverty-focus. The quality of poverty strategies in these projects was substantially better than that of design and more specifically of their often still weak M & E frameworks. In validating the exercise with PREM, it was agreed that some refinements could make the approach more robust; specifically, there needed to be further benchmarking, including improved formulation of key questions and a reformatting of the project typology. A joint review is planned ahead of the next QEA cycle.

RESULTS AND THE ARPP

5.13 Two years ago the ARPP explored ‘a Portfolio in Transition’, looking at the changing context in which the Bank was delivering its mandate. A more holistic approach was needed, and is now emerging, supported by efforts towards stronger partnerships and greater client ownership. Enhancements to the Country Portfolio Performance Review (Box 5.3) are helping to achieve a real integration of country strategy and portfolio management.

BOX 5.3: NEW STYLE CPPR: EAP AND AFR

EAP is mainstreaming a more integrated CPPR that moves beyond a cataloguing of important project specific issues to a more programmatic perspective, embracing development effectiveness, partnerships and knowledge-sharing. Their approach has now evolved to engage core partner-donors as well as a diverse range of country stakeholders, including the use of Client Surveys. The CPPR is being treated as an ongoing process, not a static document.

The most recent example is Mongolia which builds upon an approach already used for the Philippines, Thailand and Indonesia. Government was very much the driver. The process had strong support from the Asian Development Bank and Government of Japan as partners. The scope extended beyond the current project portfolio to topics such as ESW, fiduciary issues and harmonization. The early lessons are very positive. While even better suited to decentralized operations, the Mongolia CPPR process was judged very effective and has led to a series of quarterly follow-up meetings.

The emerging AFR model is also participatory. The CPPR is used in CAS design as well as to ensure alignment with PRSP objectives and to foster programmatic approaches. Some examples include: the Uganda CPPR focused on a more programmatic approach; that for Malawi was led by the Government and covered issues such as civil service incentives and capacity-building for M&E; the Lesotho CPPR included a ‘Public Day’ with civil society participants. In several AFR post-conflict situations, CPPRs facilitated portfolio restructuring.

5.14 There has been a rapid evolution in the last 2-3 years. The international community - both governments and public interest groups - has become increasingly focused upon *results* as the core driver of development co-operation. The Bank’s own perspective has also evolved. There is more confidence in the quality of individual building blocks such as projects and analytical work. Attention is now being refocused at the country and sectoral levels, on issues of development effectiveness, ownership and sustainable results. Also, national governments, in an era of more demanding populations and more open societies, need measurable outcomes to demonstrate *success*.

5.15 The Development Committee has now endorsed an approach that emphasizes *results*. This will need to combine efforts by countries to realize their national priorities with those of their development partners. Where the Bank is a major partner, these goals and intermediate targets would be translated into the framework of a *results*-based CAS. CRM is exploring how a *results* frame might be integrated into Unit Compacts. It is envisaged that future SSPs will also become an important vehicle for monitoring and evaluating Bank performance relative to key thematic or sectoral goals, again notably those embedded in the MDGs.

5.16 To build such a system cannot be an overnight achievement. It is well recognized that beyond the complexities of defining a set of realizable development goals, many, if not most, Bank clients, will have to make extensive efforts to build up national capacities to create a more comprehensive and robust set of indicators. Even within the more immediately manageable arena of the Bank's own operations there will need to be a steady evolution¹⁷, rather than any immediate transformation. The Networks and their external partners will need to define meaningful sets of intermediate indicators. As this ARPP illustrates, the Bank portfolio is a complex and diverse array of over \$100 billion of ongoing projects. It will take several years and significant incremental resources to create a *results*-based Bank portfolio. The same reality needs to be recognized for the reconfigured CAS/PRSPs which will be central to the new approach; realistically there will be a significant transition (maybe 4-5 years or longer), including substantial piloting, before all CASs coming to the Board would be routinely *results*-based.

BOX 5.4: MDGs AND THE CAS

We are already seeing early front-runners in the piloting of more *results*-based CASs. The Board recently endorsed the Vietnam CAS which was prepared in close collaboration with the client. This illustrates well the possibilities, indeed necessity of customizing the MDGs to the specifics, in policy and development terms, of the country. It was built upon, and in fact was delayed until the national poverty strategy document was completed. The annex contains a focused array of performance goals, linked to these 'localized' MDGs -- with in most cases quite explicit time-bound goals. The Bank, exercising selectivity via the CAS, committed itself to support a subset of these goals. The challenge -- looking forward -- will be for such CASs to quantify the Bank's **own** engagement with explicit measurable performance indicators.

5.17 This internal transformation will be constrained by the pace at which client governments (and the Bank's other development partners) also shift their approaches to be more *results*-focused. At steady state, the Bank portfolio would be directly supportive of a subset of the larger country-driven *results* framework. Some form of logical framework could help set out the relationship between these country goals and the specific Bank portfolio activity, also providing the monitorable performance indicators. While this will often involve defining some numerical targets, more importantly the process will be about understanding and then operationalizing specific *results*-equations. The qualitative will be as

¹⁷ A key issue for those in an overburdened operational frontline is what other accountability or regulatory dimensions might be simplified or dropped. For example, OPCS has begun to act on implementation simplification, and QAG is starting to use 'lighter' assessment samples.

important as the quantitative. Modeling techniques such as used for the Education Fast Track program can help clarify these relationships. Training programs will have to build in a results perspective. The more strategically-styled CPPR could be an important tool for the regions; sector board anchors and thematic groups will have a key role in disseminating best practices.

5.18 In parallel there will need to be a shift in Bank expectations and de facto staff incentives. The quality culture that now pervades much of Bank operations only emerged slowly over the course of four to five years. The focus of management on measurement of quality, mainly through OED and QAG assessments, reinforced the message for staff that this was indeed an institutional priority. Management will now need to create comparable incentives around *Results*, as the new quality priority, one with a higher level of aggregation and a focus further along the input-output-outcome continuum. As one element, given the positive experience using quality assessments for individual projects/ESW, it is being proposed that there be a comparable quality assessment framework for country strategies, one with an emphasis on the learning dimension and early dissemination of best practices. This approach would involve a self-assessment by the country team, followed by a peer-review assessment by QAG. The more strategic, longer-term OED CAE would remain as now on a sample basis.

5.19 As another part of that new framework, the recent Development Committee paper on *Results* proposed that the ARPP take on an expanded mandate to help in monitoring this transformation and reporting progress to the Board. This effort will need to be carefully coordinated with the work of OPCS and SRM. The scope of that reporting will necessarily also evolve over time. The next ARPP, re-titled as Operational Performance and *Results* (OPR), would provide a status report on how the Bank is managing the transition. For example, it will explore how the CAS process is being revamped, how differently (and with what problems) the next generation of projects and AAA are being designed to fit into a *results*-based approach, what is happening with the development of the related support systems for staff and managers covering training, new procedures/guidelines, etc. Separately QAG has started to revamp its traditional assessment products to enhance the indicators on results-orientation. It will report on lessons learned from piloting any new CAS Assessments with their *Results* focus. The OPR could report on the ongoing work in individual Networks, DEC and SRM, including data collection and the development of intermediate performance indicators with Bank clients. In subsequent years, the OPR will consolidate reporting on the effectiveness and likely impact of CASs and the portfolio proper in delivering a *results*-based agenda for Bank operations. This can only happen when the new reporting/assessment systems start to function at a broader, more representative level.

5.20 **Concluding comments:** The new focus on MDGs builds naturally upon the Bank's existing overarching goal of Poverty Reduction. The commitment to *Results* will define the Bank's approach to implementation of this enhanced set of development goals. The commitments are each intrinsically demanding, especially when country-ownership and the need to foster partnership are taken into account. The full transition, which inevitably will take several years, will be made substantially easier if accompanied by the right incentives, as well as resources, for managers and staff.

VI. RECOMMENDATIONS

1. ***Updating Business Processes and Instruments to be more client-responsive.*** Bank business practices and instruments need to be updated to better support an integrated, country-driven approach to the portfolio. This process should cover both traditional lending instruments and programmatic approaches. [paras 2.10-2.12, 3.14, 4.6]

□ *Specific actions [OPCS]:*

- improve client-responsiveness and simplify business processes for investment lending
- introduce updated adjustment lending guidance, with a focus on programmatic approaches
- introduce more user-friendly and *results*-oriented PSR and PAD
- ensure Core Diagnostic ESW does not crowd-out other important analytic priorities

2. ***Improving the balance between Risk and Innovation.*** Management and the Board should reconfirm that current targets and actual levels of portfolio riskiness are broadly appropriate in terms of providing incentives for innovation and calculated risk-taking, *inter alia* to reinforce increased candor in reporting. [para 3.24]

□ *Specific actions:*

- confirm appropriateness of the existing 80-85 percent target for portfolio outcomes [Board/ Management]
- use revised Bankwide targets for *Realism* (70+ percent) and *Proactivity* (80+ percent) [QAG]

3. ***Strengthening staff and management capacities.*** Management should ensure that frontline operations have the capacities to respond effectively to the challenge of delivering products in an MDG+ framed *Results* context [paras 3.14-3.16]

□ *Specific actions [OPCS/HR/ Networks/Regions]:*

- explore nature of impediments for sectoral management in delivering effective quality support to frontline staff; strengthen training and support mechanisms
- improve managerial support (including mentoring) and training for staff new to Bank operations

4. ***Pushing the Measurement Frontier.*** The quality assessment agenda should be extended to a more strategic and aggregate level, while protecting quality gains at the task level. Country and the CAS should become the primary units of account, in an increasingly participatory approach. [paras 5.13 - 5.18, boxes 4.1, 5.3]

□ *Specific actions:*

- pilot a self-assessment instrument and a peer review process for *results*-based CAS [OPCS/QAG]
- mainstream Country AAA assessments [QAG]

5. ***Deepening the Agenda.*** Management should ensure that within the framework of implementing the new *results*-based Bank approach, the Millennium Development Goals and Poverty Reduction, are managed in an integrated manner. Cross-sectoral approaches should be emphasized, along with the importance of country ownership. [paras 5.4-5.8, 5.16-5.18]

□ *Specific actions:*

- support to clients for statistical, information and policy-making capacity-building [DEC/Regions]
- use country coordination mechanisms, notably an enhanced PRSP and a new *Results*-based CAS to appropriately internalize and align MDG and Poverty Reduction agendas, [Regions]; Sector Boards to ensure that MDGs are well reflected in analytical work.

6. ***Reporting on Results.*** The portfolio should more systemically incorporate a *Results* focus, with appropriate M & E components. Given the large existing portfolio, this transition can only be incremental. [paras 5.13-5.19]

□ *Specific actions:*

- SRM to enhance corporate reporting formats for Budget and key strategic documents to cover *results*;
- ARPPs to report on *results*-based approaches and indicators [QAG];
- build MDG/*Results* perspectives into OED/QAG assessments; work on further enhancements to measuring poverty-focus of Bank operations [PREM/ RDV/ QAG/ SDV]

ANNEX 1**GUARANTEES**

1. So far, 20 guarantees for 19 projects (nine partial credit, nine partial risk and two policy-based guarantees) have been approved by the Board. Of these, seven guarantees were issued on a stand-alone basis and 13 guarantees are associated with Bank project loans. Sixteen guarantees, with exposure of US\$1.58 billion¹⁸ equivalent, remain in force. In FY02, the Bank did not make payments under any of the guarantees. However early in FY03 there has been a default by Argentina.¹⁹

2. In December 2001, the Board approved a partial risk guarantee to support the Bujagali Hydropower project in Uganda in an amount of US\$ 115 million. The guarantee will support the construction of a 200 MW power plant on a Build-Own-Operate-Transfer basis and associated distribution systems. Financial closure for this project is still pending.

3. During FY02, product innovation and diversification of the guarantee instruments continued. Deployment of the guarantee instrument was expanded to multiple sectors and applications including privatizations, infrastructure guarantee facilities, and the water sector. The Bank continued to provide substantial project finance advisory services to client countries for a number of transactions, ranging from Small Enterprise Development in Comoros to a Mortgage Insurance Scheme in Latvia.

PROJECT PERFORMANCE

4. The performance of the guarantee portfolio is regarded as overall satisfactory. Some examples of projects covered by this program include: Haripur Power project in Bangladesh (the recipient of the second IDA partial risk guarantee) and Uch Power project in Pakistan. (this suffered delays from the failure of WAPDA and OGDCL to meet deadlines and is currently undergoing financial restructuring). The Bank is considering a request from the Government of Philippines to transfer a NAPOCOR (the national power corporation) bond issue to PSALM (the successor entity). The Azito Power project in Cote d'Ivoire continued to perform satisfactorily during FY02 in spite of the country's "in-arrears and non-accrual" status with the Bank for part of this period.

5. Supervision of guarantees requires different treatment from loans since guarantees need to be supervised until they are released, canceled or have reached the end of their term (loans are supervised during disbursement period only). A template for the supervision of completed guarantee transactions, similar to the Project Supervision Report (PSR) used for lending projects, was prepared and an electronic version is currently being implemented in

¹⁸ As of July 31, 2002.

¹⁹ Consequent to default by Argentina to the holders of series "D" zero coupon notes (covered under IBRD guarantee No. B-1150), IBRD made a payment of US \$250 million on the due date (October 15, 2002) to the note holders.

SAP. Lenders, whose debt the Bank guarantees, have been playing a key role in supervision of these private projects. Stand-alone guarantees are monitored regularly based on progress reports received from the lenders and/or borrowers. In addition, specific areas needing Bank attention, such as government performance of its contractual obligations and compliance with stipulated sectoral and financial covenants, are monitored as part of the Bank's regular supervision missions. Wherever guarantees are provided along with loans, loan supervision includes two critical parameters that are monitored to ensure the success of these guarantees: (i) project performance, to ascertain to what extent projects supported by guarantees meet their expected financial and technical objectives; and (ii) monitoring of government performance vis-à-vis their contractual obligations outlined in the project documentation and covered by the guarantee.

ANNEX 2

THE PORTFOLIO – AN OVERVIEW TABLE

Fiscal Year	1995	1996	1997	1998	1999	2000	2001	2002
Net Commitments (\$m)								
Opening Balance ^{a/}	123,653	125,079	125,691	121,394	120,768	124,784	117,285	105,946
Approvals in FY	22,522	21,352	19,147	28,594	28,952	15,494	17,501	19,939
IBRD	16,853	14,488	14,525	21,086	22,138	10,919	10,487	11,452
IDA	5,669	6,864	4,622	7,508	6,813	4,358	6,764	8,068
TF						217	251	420
Cancellations in FY ^{b/}	3,062	2,641	3,274	2,542	2,680	3,566	4,652	1,881
IBRD	2,507	2,373	2,895	1,902	2,460	3,387	4,418	1,552
IDA	555	268	379	640	220	179	232	316
TF						0	2	13
Exits	18,033	18,196	19,746	26,570	22,896	19,410	24,323	21,682
IBRD	13,046	14,749	14,534	20,906	17,722	13,607	18,715	14,882
IDA	4,987	3,447	5,212	5,664	5,174	5,722	5,498	6,671
TF ^{a/}	na	na	na	na	na	82	110	129
PORTFOLIO: end-year balance	125,079	125,691	121,394	120,768	123,799	117,285	105,946	102,341
<i>Real ^{c/}</i>	<i>125,456</i>	<i>128,782</i>	<i>126,584</i>	<i>126,857</i>	<i>129,633</i>	<i>121,538</i>	<i>108,108</i>	<i>102,341</i>
Number of Projects								
Opening Balance	1,497	1,496	1,525	1,532	1,540	1,625	1,590	1,561
Approvals in FY	243	256	241	286	275	243	256	254
IBRD	135	129	141	151	130	97	91	96
IDA	108	127	100	135	145	126	134	133
TF						20	31	25
Exits	244	227	234	277	272	281	284	275
IBRD	126	130	129	137	140	126	142	133
IDA	118	97	105	140	132	139	133	125
TF						16	9	17
End-Year Balance ^{d/}	1,496	1,525	1,532	1,540	1,544	1,590	1,561	1,542

a/ Trust Fund data is not available in SAP/BW prior to FY00. The opening balance for FY00 has been adjusted to take this into account.

b/ Cancellations represent partial reduction in a project budget but not project closure ("Exit"). They therefore reduce commitments dollars but not the number of projects in the portfolio.

c/ FY02 prices, based upon OECD-DAC deflator for IBRD/IDA lending commitments.

d/ End balance may not exactly equal Opening balance plus Approvals minus Cancellations and Exits due to synchronization differences in the SAP/BW databases used.

ANNEX 3

BASIC PORTFOLIO DEFINITIONS

DEFINITIONS

1. The active portfolio covered by the FY02 ARPP includes all loans approved through FY02 and excludes those that were completely cancelled and/or closed during the fiscal year. Starting in FY00, the definition of the active portfolio was expanded to include GEF, Montreal Protocol and Special Financing operations. Due to data limitations, portfolio figures prior to FY00 relate to IBRD and IDA only.

2. Some important terms – listed in alphabetical order - used in this ARPP relating to the portfolio include:

Actual Problem Project: a project for which Development Objectives or Implementation Progress are self-reported as Unsatisfactory or worse on the latest Project Status Report.

Commitment at-risk: The commitment value of a project that is judged at-risk of not meeting its self-defined development objectives. Such projects can be both *actual* and *potential* problem projects.

CPIA: The Country Policy and Institutional Assessment (CPIA) is an annual exercise through which Bank staff assess in a comparative framework the quality of each borrower's policies and institutions in key development areas relevant to effective economic growth and poverty reduction.

Development Objectives (DO): The self-rating of a project on the likelihood of attaining the development objectives agreed with the borrower.

Implementation Progress (IP): The self-rating of a project in terms of implementation performance in relation to the benchmarks agreed with the borrower.

Net Commitments: Total commitments, net of cancellations, for projects in the active portfolio.

Net Disconnect: The difference between the percentage of projects rated as unsatisfactory by OED and the percentage self-rated by the regions in the final PSR as unsatisfactory for achieving their development objectives.

PIP Country or Sector: Countries or sectors designated for intensive monitoring and supervision due to poor quality of the portfolio.

Potential Problem Projects: Projects which are self-rated as Satisfactory on IP and DO, but which exhibit selected risk factors ('flags') historically associated with unsatisfactory outcomes. See para 4 below.

Proactivity Index: The proportion of projects rated as actual problem projects twelve months earlier that have been upgraded, restructured, suspended, closed, partially or fully canceled or are located in a *post-conflict* country with a Board-approved transition strategy.

Projects at-risk: This term for all projects judged to be ‘at-risk’ of not meeting their development objectives combines **Actual Problem Projects** and **Potential Problem Projects**.

Realism Index: The ratio of **Actual Problem Projects** to total **Projects at-risk**.

MEASURING PORTFOLIO PERFORMANCE

3. Experience shows that the project IP and DO ratings which are made by the responsible task manager have tended to be over-optimistic, when compared to the Operations Evaluation Department outcome rating that projects are given upon completion. To help close that gap the Bank uses the QAG/ARPP concept of **Projects at-risk** to serve as the basic predictive indicator of portfolio performance.

4. **Potential Problem Projects** are identified by some 12 criteria or warning “flags” that take into account not only various aspects of actual implementation experience, but also other relevant factors such as economic management and past portfolio performance in the country. Potential problem projects are defined as those exhibiting 3 or more risk “flags”. These flags cover weaknesses relating to legal covenants, safeguards, financial performance, monitoring and evaluation requirements, financial management, procurement, project management, critical risks, effectiveness delays, disbursement delays, country record and country environment. A so-called *golden* flag can be used by the Regions to override the at-risk rating where they are aware of special circumstances that may have falsely triggered a regular ‘flag’.

5. The **at-risk** rating provides a more comprehensive picture of the current state of the portfolio than DO/IP ratings alone, because it expands upon the task managers’ judgments on IP/DO. The concept is useful in providing an early warning of potential failures and their causes.

6. Although there is now an established high correlation between **at-risk** status and final OED rating, the concept is not perfect. Some operations that get flagged as “risky” are subsequently evaluated as Satisfactory, and others that are evaluated by OED as Unsatisfactory were not captured by the system.

DATA SOURCES

7. Data for the statistical tables in the ARPP is taken mainly from the latest available Project Status Reports (PSR). This data was “frozen” on July 5, 2002. The main data sources were the SAP and Business Warehouse.

ANNEX 4**MILLENNIUM DEVELOPMENT GOALS****Goals and targets**

Goal 1	Eradicate extreme poverty and hunger <ul style="list-style-type: none"> • halve, between 1990 and 2015, the proportion of people whose income is less than \$1 a day • halve, between 1990 and 2015, the proportion of people who suffer from hunger
Goal 2	Achieve universal primary education <ul style="list-style-type: none"> • ensure that, by 2015, children everywhere, boys and girls alike, will be able to complete a full course of primary schooling
Goal 3	Promote gender equality and empower women <ul style="list-style-type: none"> • eliminate gender disparity in primary and secondary education preferably by 2005 and in all levels of education no later than 2015
Goal 4	Reduce child mortality <ul style="list-style-type: none"> • reduce by two-thirds, between 1990 and 2015, the under-five mortality rate
Goal 5	Improve maternal health <ul style="list-style-type: none"> • reduce by three-quarters, between 1990 and 2015, the maternal mortality ratio
Goal 6	Combat HIV/AIDS, malaria, and other diseases <ul style="list-style-type: none"> • have halted by 2015 and begun to reverse the spread of HIV/AIDS • have halted by 2015 and begun to reverse the incidence of malaria and other major diseases
Goal 7	Ensure environmental sustainability <ul style="list-style-type: none"> • integrate the principles of sustainable development into country policies and program and reverse the loss of environmental resources • halve, by 2015, the proportion of people without sustainable access to safe drinking water • have achieved, by 2020, a significant improvement in the lives of at least 100 million slum dwellers
Goal 8	Develop a global partnership for development <ul style="list-style-type: none"> • develop further an open, rule-based, predictable, nondiscriminatory trading and financial system • address the special needs of the least developed countries (includes tariff-and quota-free access for exports, enhanced HIPC cancellation of official bilateral debt, and more generous ODA for countries committed to poverty reduction) • address the special needs of landlocked countries and small island developing states • deal comprehensively with the debt problems of developing countries • develop strategies for decent and productive work for youth ; provide access to affordable, essential drugs; make available the benefits of new technologies

ANNEX 5

FY03 PIP COUNTRIES

<i>Region</i>	<i>Country</i>	<i>No. of Projs</i>	<i>Commit \$M</i>	<i>% Proj At Risk</i>	<i>% Commit at Risk</i>
AFR	Cameroon	9	434	56	82
AFR	Cote d' Ivoire	12	758	42	45
AFR	Kenya	13	712	38	61
AFR	Madagascar	17	750	76	87
AFR	Mali	14	546	29	42
AFR	Nigeria	9	682	78	65
EAP	Indonesia	47	3579	30	39
ECA	Russia	29	2519	45	40
ECA	Uzbekistán	8	287	38	30
LCR	Argentina	38	4009	34	38
LCR	Ecuador	13	405	8	37
LCR	Venezuela	10	368	30	15
MNA	Egypt	18	1012	28	34
MNA	Lebanon	13	518	46	37

FY03 PIP PROJECTS

<i>Region</i>	<i>Country</i>	<i>Project</i>	<i>Network</i>	<i>US\$M</i>
AFR	Cameroon	SAC III	PREM	217.4
AFR	Cote d'Ivoire	Transport Sector Adj	PSI	238.8
EAP	Indonesia	Kecamatan Devt. Fund	PREM	273.2
EAP	Indonesia	Kecamatan Devt. Fund II	HDN	320.2
ECA	Turkey	ERL	PREM	759.6
ECA	Turkey	Priv Soc Support	HDN	250.0
LCR	Argentina	B.A. Urban Transport	PSI	200.0
LCR	Argentina	SEGBA V / Yacyreta	PSI	266.0
LCR	Argentina	AR Cordoba PRL5	PREM	303.0
LCR	Argentina	Provincial Roads	PSI	300.0
LCR	México	Disaster Management (ERL)	ESSD	404.1
SAR	India	Orissa Power Sector	PSI	290.0