DEVELOPMENT COMMITTEE
(Joint Ministerial Committee
of the
Boards of Governors of the Bank and the Fund
On the
Transfer of Real Resources to Developing Countries)

DC/2000-19

September 8, 2000

SUPPORTING COUNTRY DEVELOPMENT: WORLD BANK ROLE AND INSTRUMENTS IN LOW- AND MIDDLE-INCOME COUNTRIES

Attached for the September 25, 2000 Development Committee meeting is an issues paper prepared by World Bank staff on Supporting Country Development: World Bank Role and Instruments in Low- and Middle-Income Countries as background to item 1.B of the Provisional Agenda.

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DEVELOPMENT COMMITTEE MEETING
SEPTEMBER 25, 2000

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CONTENTS

ACRONYMS

CAS	Country Assistance Strategy
CDF	Comprehensive Development Framework
CEM	Country Economic Memorandum
CPIA	Country Policy and Institutional Assessment
ESW	Economic and Sector Work
EU	European Union
HIPC	Highly Indebted Poor Country
IFI	International Financial Institutions
JSA	Joint Staff Assessment of the PRSP
PRSC	Poverty Reduction Support Credit
PRGF	Poverty Reduction and Growth Facility
PRSP	Poverty Reduction Strategy Paper
SSR	Social and Structural Review

SUPPORTING COUNTRY DEVELOPMENT: WORLD BANK ROLE AND INSTRUMENTS IN LOW- AND MIDDLE-INCOME COUNTRIES

I. INTRODUCTION

1. The global landscape for development has changed dramatically in recent years, with the rapid and interactive growth of world trade, capital flows, and communications. For many people living in developing countries, these changes will translate into opportunities for faster progress toward higher standards of living, in part the result of private sector development and finance. However, for too many others, the age-old misery of grinding poverty and deprivation remains—poor health, limited access to clean water and sanitation, food and physical insecurity—punctuated by the modern horrors of AIDS, ethnic conflicts, and environmental disasters. Both the new opportunities and the new challenges raise questions about the role and scope of public policy in development—at the national level, but also at the global, regional and local levels. In turn they have opened up a debate about the role and instruments of the Bank and other international financial institutions (IFIs), which is reflected both in this paper for the Development Committee on the Bank's role in country programs and in the companion paper on the Bank's role in the provision of global public goods.[1]

2. ***Changing Paradigm.*** The debate comes at a time when profound changes also have occurred in the paradigm for development assistance. Poverty reduction is now universally recognized as the central objective of development assistance programs, and country performance in reducing poverty has become the key determinant of aid allocations. In line with the increased focus on impact, the Bank has been paying much greater attention to operational quality, country performance, and results on the ground—all judged in terms of poverty reduction. But more work is needed. The operational modalities for the new paradigm are not yet fully in place, neither within the Bank nor in the broader development community. Nor has there been a clear consensus about the appropriate division of labor among the IFIs—both between the Bank and the Fund on the one hand, and between the Bank and the regional development banks on the other—and between the IFIs and the private sector, an issue that mostly affects the middle-income countries. Hence, there is scope for further streamlining the development assistance system to enhance its development effectiveness, and its cost-effectiveness in a highly constrained resource environment. Getting this right will be an important contribution to the design of the new development architecture.

3. ***Shareholder Discussions.*** The debate has been reflected in meetings of the Development Committee, G-7 and G-8 heads of government, G-7 finance ministers, G-24 ministers, and other fora.[2] Most recently, at the Bank-Fund Spring Meetings, shareholders expressed the need for further discussion of the Bank Group's future role in supporting country development programs,

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1 See *Poverty Reduction and Global Public Goods: Issues for the World Bank in Supporting Global Collective Action* (DC/2000-16), September 6, 2000.

2 See, for example, Communiqués of the Intergovernmental G-24 on International Monetary Affairs (DC/2000-11), and the Statement of G-7 Finance Ministers and Central Bank Governors, Washington, D.C., April 15, 2000.

in the broader context of IFI reform. The discussion of this paper at the September 25, 2000, Development Committee meeting in Prague may be the first of several on this topic, since work and thinking on some of these issues by the Bank and its Executive Board are still at an early stage. And there will be need for much discussion with clients and partners. To facilitate Development Committee deliberations, this paper describes the Bank's current approach to supporting country development programs—the Bank's core business—and sets out options for strengthening its impact, building on recent changes within the Bank and taking into account the roles and responsibilities of other IFIs, particularly the IMF. It outlines further work that is under way within the Bank to improve selectivity, delivery, and impact. The final section sets out issues on which Ministerial guidance is sought to help steer the future directions of this work.

II. SUPPORTING COUNTRY DEVELOPMENT

4. Today's World Bank Group is very different from the institution that first opened its doors at the end of World War II. In those early days, the Bank was small, with a single lending window—IBRD—focused very much on the reconstruction of war-torn Europe. As the immediate postwar reconstruction needs subsided, the Bank's focus shifted to financing infrastructure projects in Europe, Latin America, and Asia, in line with then-current thinking about development gaps and constraints. Over the years, as more was learned about the necessary conditions for successful development and poverty reduction, the paradigm for development assistance changed—to focus less on bricks and mortar, and more on policies and institutions, country ownership of the development process, the role of the private sector, partnerships, knowledge, and learning. The Bank's approach and instruments evolved along with this paradigm. Starting in the early 1990s, it began to use the Country Assistance Strategy (CAS) to place individual lending operations in the context of the country's own strategy and the Bank's overall program of activities. In the late 1990s, Mr. Wolfensohn articulated the Comprehensive Development Framework (CDF) as a country-led and country-owned development program to which the Bank and its partners would contribute.[3] In many respects, the CDF caps a 50+ year progression. The process of incorporating these principles into the Bank's operational practices is a continuing one—and this paper discusses further steps in that direction.

5. ***Country Programs: Key Elements.*** Given the diversity of country development challenges, there cannot be a one-size-fits-all approach to Bank support. Instead, the Bank customizes its support to country conditions, working with clients and partners through an interactive process, with the objective of reaching a shared view about the priorities for action and for development assistance. In its simplest form, this process can be described in terms of its four pillars—vision, diagnosis, programming, and results.

- ***Vision.*** The most important lesson the development community has learned over the last 50 years is that development cannot be done *to* a country; if development is to be successful, the *country* must do it. The foundation of the Bank's work has to be a country-led and country-owned policy framework covering the range of structural, social, environmental, institutional, and macroeconomic policies that make for successful development; country commitment is essential. The associated program to

[3] The Annex provides definitions of CAS, CDF, PRSP, and many of the other terms used in this paper.

implement the policy framework may be articulated through a CDF, a Poverty Reduction Strategy Paper (PRSP), or a home-grown country-led process.

- ***Diagnosis.*** The Bank's assessment of the country's policies, institutions, and private sector strength provides the basis for determining both how best, and by how much, the Bank should support the country's efforts. Indeed, while the country must "own" its vision and program, the Bank must "own" and be accountable to shareholders for its diagnosis and the programs it supports. In most cases, the country's vision, priorities, and analysis and the Bank's diagnosis are mutually interactive, supporting and complementing each other. Due diligence and other diagnostic economic and sector work (ESW), prepared and shared with clients and partners, provides key inputs that the country can use in developing its vision and its own diagnosis, which, in turn, influences the composition of the ESW program. But while a shared diagnosis is desirable, it is not always attainable: sometimes it is best to agree to disagree. Straight talk about differences is the heart of the policy dialogue.

- ***Programming.*** The Bank's diagnosis in turn provides the basis for its country business strategy, in which—as a committed long-term partner—it aims to help the country carry out its vision for growth and poverty reduction. Within this strategy—set out in a CAS document—the Bank's program of lending and nonlending assistance reflects country priorities, need, performance, and institutional capacity. The specifics of the program take into account the Bank's track record, its comparative advantage, the actual and potential contributions of other partners, and, where relevant, Bank efforts in the provision of global public goods. Bank, IFC, and MIGA staff increasingly work together in the context of Bank Group CASs.

- ***Results.*** At the end of the day, it is results on the ground that matter. This means that governments must set clear targets, monitor and evaluate performance against those targets, and use the results to shape current and future programs. This principle is enshrined in the CDF and PRSP, which include country performance benchmarks and outcomes as central elements. But judging Bank performance is also essential; thus, work to strengthen the monitoring and evaluation of the Bank's contribution to poverty reduction and other country development objectives is very much a part of efforts to improve the CAS process.

6. ***The Program Approach.*** The country program cycle has replaced the project cycle as the Bank's most important business model, just as the country has replaced the project as the critical unit of account in development. And as the focus further shifts to results measured in terms of poverty reduction, clients and country directors are finding CAS-based lending—sectorwide approaches, programmatic adjustment lending, and so on—to be a cost-effective vehicle for supporting the policy dialogue on the social and structural agenda and for partnering with other agencies. To be sure, individual investment projects are still important; they provide opportunities to test approaches, learn lessons, and provide intensive poverty-focused support—for example, for community-driven development. And in poor performers, small one-off projects continue to have a role, allowing the Bank to maintain a project supervision presence, however limited, complementing intensive policy dialogue supported by nonlending services. But in all cases, projects must be selected and judged strategically in the context of the overall CAS program and on the basis of their contribution to the bottom-line objective—the promotion

of sustainable growth and poverty reduction. On this view, a high economic rate of return is not enough. The critical performance tests for projects—as well as for all other Bank-supported activities—are sustained policy and institutional impact, the twin drivers of sustainable growth and poverty reduction.[4]

III. Applying the Program Approach in Practice

7. The Bank today has over 100 active country clients with vastly different characteristics and needs. Countries range from very small states to huge federal systems, from desperately poor countries to middle-income countries in transition and emerging market economies. The development challenges facing these countries vary enormously, and the program approach must be applied and implemented in a way that is appropriate to individual country conditions. This customization takes place in the context of the CAS process. But it is also worthwhile to look across country types for patterns and shared problems, as a basis for considering the menus of lending and nonlending interventions that the Bank can offer countries in different situations.

- *Small states* face major constraints because of their size. They are particularly vulnerable to natural disasters and trade swings; they face major challenges, but also opportunities, from globalization; and they need to surmount diseconomies of scale in the public and private sector. For many, regional integration is a priority. For all, donor coordination and harmonization of donor policies and procedures is essential.

- At the opposite end of the spectrum, *large federal systems* face major challenges in managing subnational programs, decentralization, and diversity. They share common issues around revenue raising and sharing, and reconciling national standards with local autonomy and capacity building. Often the poor are concentrated geographically, and subnational entities are responsible for the delivery of key social services, notably health and education. Action to promote fiscal sustainability and to improve the quality of public expenditures at the state and local level is therefore a priority for poverty reduction in many such countries.

- The *poorest countries* face major challenges of improving health (including combating AIDS), promoting education, and building institutional capacity. Research shows that in the presence of good policies, resource transfers from donors can be very effective in fueling growth and poverty reduction. Conversely, helping very poor countries is complicated when performance problems limit the scope for effective use of resource transfers.

- In *post-conflict countries* the challenges center on the restoration of order and central and local government capacity and the demobilization and reintegration of former combatants. A key requirement is for all development partners to work closely with the government to help develop a national recovery plan, around which assistance for rebuilding infrastructure and restoring essential services can be provided.

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4 See David Dollar and Lant Pritchett, *Assessing Aid: What Works, What Doesn't, and Why*, World Bank Policy Research Report (New York: Oxford University Press for the World Bank, 1998); see also *1998 Annual Review of Development Effectiveness*, Operations Evaluation Department (Washington, D.C.: World Bank, 1999), available at http://www.worldbank.org/html/oed.

- *Transition economies* continue to face major adjustment needs in building the institutions of a market economy, reversing the substantial rise in poverty accompanying the transition process, and dealing with the environmental legacy of the past. In Europe, several countries have advanced to the extent that Bank Group assistance can focus on helping them meet the requirements of EU accession. But others still need support for basic policy and institutional reforms, and for reversing the adverse poverty trends and environmental threats they face.

- Although *emerging market economies* have some access to private capital flows, their access is limited and often volatile, requiring careful management if they are to achieve sustained growth and reduce poverty. Many need support for complex structural and social reforms, especially to strengthen the investment climate and to deal with remaining—often very large—pockets of poverty. Preventing crises and mitigating the social impact of crises are priorities.

8. ***Cross-Country and Global Issues.*** Despite this broad spectrum of development challenges, these countries have much in common—from high levels of poverty to gaps in economic and social development. Hence there is much scope for learning and for sharing the lessons of experience, with the Bank's global perspective helping countries to adapt the lessons learned to their unique circumstances and needs. This perspective also underpins the Bank's role in global public goods—working both at the international level to help ensure that action plans are designed and financed with local priorities and constraints in mind, and at the local level to help ensure that country programs reflect agreed international commitments.

9. ***Low- and Middle-Income Countries.*** As is clear from the above, countries do not fall neatly into low- and middle-income groups; rather, they lie along a continuum in terms of per capita incomes, incidence of poverty, and development. They also lie along a continuum in terms of availability of concessional funds, public debt burdens, and access to private capital markets. Within the Bank, these differences translate into the fact that most low-income countries are eligible for IDA concessional assistance, and most middle-income countries are not. Conversely, most middle-income countries are eligible for IBRD funding, and most low-income countries are not, although there are "blend" countries that are eligible for both IDA and IBRD funding. For simplicity, the discussion that follows uses the IDA and IBRD designations.

A. IDA-Eligible Countries

10. The task of reducing poverty is particularly challenging for the 78 IDA-eligible countries.[5] Not only is the incidence of poverty highest in these countries, but the institutional and capacity constraints are most binding, the economic environment is least attractive to private investment, and the access to resources is most limited. IDA-eligible countries are home to about 70 percent of all people living on less than $1 a day—and about 60 percent of those living on less than $2 a day. They typically receive concessional assistance from multiple donors, but

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[5] The list of 78 countries includes 16 "blend" countries that are eligible for both IBRD and IDA resources. With a few exceptions, IDA-eligible countries are those with per capita incomes below $885 per year in terms of 1998 GNP per capita. One exception is China, with a per capita income of $780 per year, which graduated from IDA, effective July 1, 1999. The other exceptions are 13 IDA-eligible small-island economies with per capita incomes exceeding $885.

little by way of private market financing. Heavily indebted poor countries, or HIPCs, represent more than half of all IDA-eligible countries.

11. ***Bank Group Role.*** The Bank Group's agenda in the low-income countries focuses on promoting sustainable growth and reducing poverty by providing support for improving policies; strengthening institutional capacity; building critical social infrastructure; improving governance, particularly in areas such as financial accountability; and increasingly, also, helping countries to implement the global public goods agenda. IDA support, both lending and nonlending, targets sound economic and social programs—such as for girls' education, AIDS prevention, and environmental protection—where the government and the Bank believe it will be most effective, and commensurate with donor willingness to provide concerted support. To help improve these countries' receptivity to and attractiveness for sound investments, IDA, IFC, and MIGA work together, paying special attention to the investment climate for private sector development, with IFC frontier lending and investments often playing an important catalytic role. The Bank works closely with the IMF in these countries, with the Bank leading the dialogue on the social and most structural issues and the Fund leading the dialogue on the macroeconomic and related issues. The Bank also works closely with the regional development banks, bilateral donors, and others, increasingly in the context of country-led development partnerships, helping countries build the capacity to lead the donor coordination effort. The Bank has a significant role in promoting the harmonization of operational policies and procedures among development partners, an effort aimed at reducing the transaction costs of aid programs to poor countries.

12. ***Program Approach in IDA-Eligible Countries.*** The Bank has made significant changes in the way it helps its poorest members. Working closely together, the Bank and the Fund developed the Debt Initiative for Highly Indebted Poor Countries (HIPC Initiative) to help poor countries reduce their debt and free up resources for poverty reduction. Countries receiving debt reduction under the HIPC Initiative are required to prepare Poverty Reduction Strategy Papers (PRSPs) in consultation with civil society.[6] PRSPs also are required for accessing the IMF's Poverty Reduction and Growth Facility (PRGF), and, effective July 1, 2002, they will underpin almost all IDA CASs discussed by the Board. For PRSP countries, the Bank's diagnosis is reflected in the Bank-Fund Joint Staff Assessment (JSA), which evaluates the adequacy of the PRSP as a basis for Bank (and Fund) assistance. The CAS articulates the IDA business strategy, including the program of lending and nonlending instruments to be used in supporting the country vision set out in the PRSP, and the benchmarks for judging both results on the ground and Bank performance. The program is selective, taking into account the Bank's track record in the country, its comparative advantage vis-à-vis other partners, and the available resources as determined by the performance-based IDA allocation process—with special attention to such cross-cutting issues as gender, governance, financial sector reform, the environment, and the Bank's global agenda. IFC's and MIGA's programs also emphasize improving the business environment to encourage both foreign and domestic investment. For poorly performing countries, the volume of IDA financial support is very limited, consisting mainly of technical assistance and small projects with very direct benefits targeted to the poor, in keeping with IDA's policy of performance-based allocations. For countries emerging from conflict, IDA

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[6] In general, a PRSP is required when a country reaches its decision point under the HIPC Initiative. However, during a transition period, countries may present a simpler Interim PRSP. See *Heavily Indebted Poor Countries (HIPC) Initiative and Poverty Reduction Strategy Papers (PRSPs): Reports on Progress in Implementation* (DC/2000-18), September 8, 2000.

provides exceptional levels of support during the first few years of the post-conflict recovery phase, guided by a Transitional Support Strategy.

13. ***Instruments.*** As we develop the program approach, the CAS will increasingly focus on how the Bank can best support the country's social and structural agenda spelled out in the PRSP. IDA's main financial vehicle for such support could be a poverty reduction support credit (PRSC), complementing the Fund's support for macroeconomic stability and related reforms via the PRGF. The PRSC could be structured as a series of annual programmatic structural adjustment credits supporting the government's overall poverty reduction strategy, but linked to a few carefully selected priority actions and performance benchmarks, building on such due diligence economic and sector work as a Poverty Assessment, a Public Expenditure Review, and/or a Social and Structural Review. The PRSC would be governed by the Bank's operational policies on adjustment lending, including those setting out fiduciary requirements and other safeguards. The CAS program could also include other vehicles, as appropriate, for deepening support in key areas of the broader strategy: investment lending, IDA guarantees, and/or adjustment credits for discrete topics, such as financial sector reform, privatization, subnational reform, or civil service reform. The key point is that the impact of the Bank's program, taken together with the programs of other partners, should be a coherent package adding up to more than the sum of individual projects; likewise, the benchmarks for judging Bank performance must go beyond individual projects.

B. IBRD-Eligible Countries

14. Broadly speaking, IBRD-eligible countries have greater public and private sector capacity, more resources, and better prospects than IDA-eligible countries. But they nevertheless also have much poverty and many policy and institutional gaps that impede economic performance. IBRD-only countries are home to about 30 percent of all people living on less than $1 a day and about 40 percent of those living on less than $2 a day.[7] Their policy and institutional gaps range from weak regulatory frameworks for power, telecommunications, and environmental protection to unsustainable social security systems for protecting vulnerable populations. In these countries, the key to sustainable growth and poverty reduction is to enhance the role of the private sector and improve the investment climate through a strengthened policy and regulatory framework, while at the same time establishing efficient and equitable social expenditure and protection programs geared to building human capital, providing equal opportunity, and protecting vulnerable groups.

15. ***Bank Group Role.*** The Bank Group's job in such countries is to add value that private markets cannot—or will not. This entails using lending and nonlending services to help them correct weaknesses in their structural and social policies and institutions, promote efficient social programs, improve environmental policies, demonstrate that reforms have opened viable new opportunities for the private sector, reduce vulnerability to the adverse effects of capital market volatility and other external shocks, sustain reforms and social spending during crises, and implement the internationally agreed global public goods agenda. Because many IBRD-eligible countries have some access to international capital markets, some observers have concluded that

7 Including blend countries eligible for both IBRD and IDA borrowing—such as India, Indonesia, and Pakistan—these shares increase to 87 percent of those living on less than $1 a day, and 88 percent of those living on less than $2 a day.

the Bank Group no longer has a financial role in helping them. However, for most IBRD borrowers, capital market access is limited in magnitudes and maturities, and often volatile; in such a setting, there is special value in continued access to Bank Group financing, which offers long maturities and affordable terms linked to support for the policy and institutional reforms that underpin sustainable development and attract private sector finance. Because the Bank has a long-term financial relationship with borrowers, it engages in regular due diligence, including economic and sector work that informs both clients and the Bank about risks and policy options for mitigating them.

16. ***Program Approach in IBRD-Eligible Countries.*** The basic program approach set out above—vision, diagnosis, programming, and results—applies equally to the Bank's work with IBRD- and IDA-eligible countries. Nevertheless, in IBRD-eligible borrowers, the rationale for Bank Group involvement must reflect the relatively larger role of the private sector and the relatively smaller role of the Bank. This places a premium on identifying the particular interventions through which the Bank Group can leverage important policy reforms on the one hand and financial flows on the other. The CAS thus needs to set out the justification for Bank Group involvement very clearly. It should demonstrate both that Bank Group financial support does not crowd out private sector activities—and in fact crowds them in through policy and institutional reforms—and that Bank Group activities synergistically support private sector development, with IBRD focused on the enabling environment and IFC and MIGA on catalyzing market development and private investment. In view of the Bank Group's financial structure, the program of financial support—loans, guarantees, and IFC investments—must reflect a consideration of the borrower's creditworthiness and the overall financial capacity of the different parts of the Bank Group to increased exposure, taking into account both country-specific risks and overall portfolio effects.

17. ***Instruments.*** There has been much work in recent years on instruments for IBRD borrowers, but more work on modalities, safeguards, and constraints is needed in several areas. First, just as IDA-eligible countries could benefit from a PRSC, IBRD borrowers could realize major developmental benefits from CAS-based programmatic adjustment lending, synchronized with their budget and policy cycles for greatest impact. Such approaches are likely to be increasingly used to support medium-term structural and social reform programs, underpinned by appropriate economic and sector work. Second, providing this and other kinds of long-term finance may not, however, leave much financial room for the Bank to respond to country requests for countercyclical financial support for social and structural programs in the face of capital market volatility, or for contingent lending, in which some clients have recently expressed interest. The Bank introduced special structural adjustment loans in 1998 to help countries in crisis to mitigate adverse social impacts and implement remedial structural measures. Those loans were designed with shorter maturities and much higher prices than regular Bank loans, and their availability was limited by the Bank's risk-bearing capacity. Indeed, IBRD's financial structure is not well suited to sustain sharp spikes in disbursements of long-term loans, especially when crisis-driven demand is correlated among borrowers and with deterioration in the creditworthiness of the Bank's existing portfolio. Third, other IBRD clients are seeking increased economic and sector work even as they are limiting their borrowing, raising questions about cost recovery, Bank Group resource allocation mechanisms, and equity among borrowing shareholders. Finally, against this background and recognizing that borrowers

have alternative sources of financing and other services, there is a need to review the direct and indirect costs of our products.

IV. ENSURING STRATEGIC SELECTIVITY, DELIVERY, AND IMPACT

18. Taking the program approach to country assistance further, and implementing it systematically, adds up to a large agenda for the Bank. To keep it manageable—and to ensure coherence with approaches being pursued elsewhere—appropriate partnership arrangements, and division of labor with other IFIs, are essential. We believe that a sharpened focus on the social and structural agenda, supported by a more systematic approach to diagnostic economic and sector work, will provide a better basis for collaboration and complementarities with the IMF and its focus on macroeconomic policies. But we also need to do more with the regional development banks and other partners to delineate respective areas of institutional comparative advantage, utilize each other's diagnostic work, and pursue the scope for harmonizing operational policies and procedures. The overall aim is to migrate to a more disciplined, strategically selective, and systematic approach for the Bank Group's work, within a coherent and cost-effective framework for development assistance.

19. ***Bank Group Strategy for Low-Income Countries.*** Though much work has already been done to clarify the business model for the low-income countries, more work is needed in four areas. First, each of the elements of the business model will be more effective, and the Bank will have a greater development impact, if the linkages are applied more systematically than in the past. Thus, we will be looking for greater coherence across the PRSP, CAS, and lending and nonlending instruments, including in many cases the presentation to the Board of a PRSP and PRSC along with the CAS. For the approach to be successful, the Bank will need to ensure that for each country there is adequate economic and sector work to underpin a solid diagnosis, and that appropriate fiduciary and other safeguards are in place. We also need to better align the annual Country Policy and Institutional Assessment exercise with the IDA12 priorities, link CAS triggers and scenarios more closely to them, and make them more transparent to clients. Second, further work is needed on lending and nonlending instruments. For lending, the issues are the scope for multicountry instruments to finance regional public goods, an issue for many small states; and the use of the PRSC at the subnational level, an issue for large federal states. For nonlending, the main issues are the coverage and periodicity of essential due diligence economic and sector work—especially to underpin the PRSC—and the modalities for working with clients and partners to fill identified gaps and to promote capacity building. Third, we will continue to promote country-led aid coordination and development partnerships—working closely with UNDP—within CAS programs for CDF pilots and other countries, and to emphasize the work on harmonizing operational policies and procedures with the regional development banks and—through the OECD DAC—with bilateral donor agencies. Finally, work is under way, in collaboration with the Bank's independent Operations Evaluation Department, on monitoring and evaluating country programs, and especially on the methodology for assessing Bank performance as a basis for ensuring management accountability.

20. ***Bank Group Strategy for Middle-Income Countries.*** The previous section outlined the importance of continued Bank Group involvement in middle-income countries and emerging market economies and suggested ways to address their varying assistance needs. But this discussion is simply the beginning—an entry point into a deeper consideration of how the Bank

Group carries out these roles. A newly established Task Force on the World Bank Group Strategy for Middle-Income Countries will explore additional ways that the Bank Group can help countries at different stages of development and reform address poverty and cope with capital market volatility, and ways that it can strengthen nonlending services and knowledge dissemination as a core line of business. Reflecting the broader context of ongoing debates within the development community, and work being undertaken by others, the task force will consider the modalities of conditionality and ways to maximize the development effectiveness of assistance, the scope for providing more financial support at times of capital market dislocation, and the cost of doing business with the Bank—including the direct and indirect costs to clients of obtaining lending and nonlending services and the implications for pricing. It will, of course, be essential to ensure that the business model is consistent with the underlying financial structures of the Bank, IFC, and MIGA. The task force expects to complete its work by end-December, with its findings and Management's recommendations considered by the Executive Directors in the new year.

21. ***Country Program Approach.*** The Bank's work program also includes several operational stocktaking exercises, meant to inform the Bank's business strategy and policy development. First, the work on *Fixing ESW: Where Are We?* has developed a framework for assessing the adequacy of diagnostic economic and sector work to underpin the program approach. In so doing, it has unearthed major quality and coverage gaps that we are taking steps to fill. One such step is to launch a dialogue with bilateral and multilateral partners to explore the scope for working together, harmonizing approaches, and pooling findings, especially for Public Expenditure Reviews and other core due diligence products. Second, the ongoing *Adjustment Lending Retrospective and Strategy* exercise draws lessons from recent developments in adjustment lending—including the work under way on the fiduciary framework—for the design and implementation of the proposed PRSC facility and developmental applications of programmatic adjustment loans to middle-income countries. It examines the record of adjustment lending on poverty reduction, environmental and social development, and governance, as an input into the upcoming review of Bank policy. It will seek the guidance of the Executive Board on the overall framework for adjustment lending, including the appropriateness of changing the name to "development support lending" to signal the new approach to adjustment lending and its focus on the social and structural policy and institutional reforms needed for sustainable growth and poverty reduction. Third, the upcoming *Stocktaking on Sector Strategy Papers* considers how the Bank can be more strategically selective in determining the menus it offers in its country programs. We look to the IMF for expertise and country support in macroeconomic and related policy areas; but how should what the Bank offers in the social and structural areas be guided by a systematic division of labor with the regional development banks and other partners? The country program approach implies that the Bank should remain capable of evaluating a country's entire range of structural and social policies—and indeed part of the Bank's comparative advantage is its unique ability as a global development institution to carry out this kind of integrative analysis. But this does not imply that we must maintain a uniform depth of expertise across all sectors and cross-cutting areas, especially where other IFIs have the underlying comparative advantage. This is an important topic for further work with partners.

V. Issues for Ministers

22. Much of what is set out above is work in progress, providing an opportunity for upstream discussion and engagement on critical questions early in the process of evolving the Bank's new approaches to supporting country development. In this context, Ministers may wish to focus on the issues highlighted in this section.

A. IDA-Eligible Countries

23. For the low-income countries, the key developmental priorities for Bank Group support remain the social and structural basics—capacity building, governance, efficient and equitable public expenditures, and an investment climate that is hospitable to efficient private sector development—all geared to promoting sustainable growth and poverty reduction. The enhanced HIPC Initiative and the PRSP process—supported and complemented by PRGF and IDA resources as well as the efforts and financial assistance of other multilateral and bilateral donors—support this agenda, which is in line with the CDF principles. Effective July 1, 2002, almost all IDA CASs/Progress Reports submitted to the Board will be based on a PRSP. In the transition period, the timing of CASs/Progress Reports relative to PRSPs/Interim PRSPs will need to be decided on a case-by-case basis, but to the extent possible, CASs will be timed to coincide with, or to follow soon after, PRSPs/Interim PRSPs. The paper indicates that the CAS will give special attention to the PRSP's social and structural agenda, supporting it through a program of poverty reduction support credits in almost all cases where there is an adjustment lending relationship with the country and/or an IMF PRGF. ***Do Ministers think that a July 1, 2002, cut-off date for mainstreaming the PRSP link to the CAS process is appropriate? Do they agree that a PRSC lending vehicle could be a useful component of the PRSP framework, complementing the PRGF in supporting the country's poverty reduction strategy? Do they support the idea that, with appropriate safeguards, the PRSC could become the main financial vehicle of the CAS in countries accessing the PRGF, complemented by individual credits determined on the basis of the Bank's comparative advantage?***

B. IBRD-Eligible Countries

24. The paper argues that the Bank Group has a continuing role to play in the middle-income countries—all with a view to reducing poverty in these countries—focused on attracting and retaining private sector capital, promoting high-quality social spending, and helping countries to manage in the face of volatile capital markets. The specific modalities for Bank Group support—such as the design and use of lending and nonlending instruments, the use of financial instruments for leveraging private finance, the Bank's role in helping countries manage their crisis response, the coverage and financing of due diligence and other diagnostic economic and sector work, the cost of doing business with the Bank, pricing, and related issues—are to be analyzed in the context of the Task Force on the Bank Group Strategy in Middle-Income Countries. ***Do Ministers agree with the paper's assessment of a continuing Bank Group role in middle-income countries? Do Ministers support the agenda proposed in paragraph 20 for the Task Force on the Bank Group Strategy in Middle-Income Countries? What guidance do they have for the task force and the Executive Board as this work goes forward?***

C. Country Program Approach

25. The paper sets out an iterative four-step programmatic approach to Bank support for country development that starts with the country's vision and agenda, applies diagnostic tools to determine the appropriate level and mix of Bank Group support, and uses the results obtained to guide future strategy and implementation. This approach does not replace investment lending, but it emphasizes the importance of setting such support in the context of a sound overall program of structural, social, and macroeconomic policy—with the Bank focusing its support and diagnostic work on the structural and social elements. ***Do Ministers agree with the priority attached to further work on the country program approach, including (a) strengthening diagnostic economic and sector work in partnership with others—including the IMF, the regional development banks, and bilateral donors; (b) refining the operational modalities for CAS-based programmatic adjustment lending to provide overall support for key aspects of the government's development program; and (c) advancing partnerships, the division of labor on sectoral and cross-cutting issues, and work on the harmonization of operational policies and procedures with bilateral donor agencies and the multilateral development banks, all with a view to enhancing institutional selectivity and the cost-effectiveness of development assistance?***

DEFINITIONS

Country Assistance Strategy (CAS) is the central tool for reviewing and guiding the Bank's country programs and the vehicle for judging the impact of its work. It summarizes the development context for the Bank's assistance in a client country and sets out the level and composition of the Bank's lending and nonlending activities. Its objective is to identify the key areas where Bank assistance can have the largest impact on poverty reduction.

Comprehensive Development Framework (CDF), introduced on a pilot basis in January 1999, emphasizes the following principles of development assistance: country ownership; partnership with all donors and stakeholders; long-term comprehensive approach to development (treating social, structural, and institutional issues equally with macroeconomic issues); and focus on development outcomes and results, particularly poverty reduction.

Country Policy and Institutional Assessment (CPIA), an annual Bank exercise, rates the quality of each borrower's policies and institutions in areas relevant to economic growth, poverty reduction, and effective aid use. The CPIA consists of 20 criteria covering economic management, structural policies, policies for social inclusion/equity, and public sector management and institutions. It underpins IDA's performance-based allocations.

Economic and Sector Work (ESW) is the Bank's primary country-based knowledge instrument—analytic and advisory work serving the needs of the Bank, member countries, and the international community. The Bank performs three types of country-based ESW: due diligence, other diagnostic, and customized. Due diligence ESW may include the following:

- ***Public Expenditure Reviews (PERs)*** examine the equity and effectiveness of public spending in the context of sector priorities and the country's macroeconomic framework. Their scope has broadened to include both spending patterns and the institutions of public expenditure management.
- ***Poverty Assessments (PAs)*** provide a thorough analysis of poverty profiles and the determinants of poverty in its income and non-income dimensions. PAs evaluate the effects of economic and social policies on the poor.
- ***Social and Structural Reviews (SSRs)*** examine the social and structural policies that affect economic development, analyze priority areas and transaction costs, develop performance indicators, and identify knowledge gaps. SSRs normally are based on existing ESW products, but may also include fresh analysis in key areas not covered elsewhere.
- ***Fiduciary Assessments*** evaluate public financial accountability mechanisms and underpin dialogue with clients on steps to strengthen accountability.

Joint Staff Assessment (JSA), prepared by staff of the Bank and the Fund, accompanies the PRSP when it is presented to the Bank and Fund Boards of Directors. The JSA establishes whether the government's program as set out in the PRSP provides a sound basis for Bank and Fund concessional assistance to the country. It bridges the government's expressed development goals and plans and the Bank's business strategy, and the IMF's support via the PRGF.

Poverty Reduction and Growth Facility (PRGF) is the IMF's concessional facility for low-income countries (previously known as the Enhanced Structural Adjustment Facility). It is intended that PRGF-supported programs will in time be based on country-owned poverty reduction strategies adopted in a participatory process involving civil society and development partners, and articulated in a PRSP. This is intended to ensure that each PRGF-supported program is consistent with a comprehensive framework for macroeconomic, structural, and social policies to foster growth and reduce poverty.

Poverty Reduction Support Credit (PRSC) is envisioned as a programmatic structural adjustment credit with a strong poverty focus, which would support the overall poverty reduction strategy and program policy reforms in PRSP countries. The PRSP and the JSA would provide the medium-term framework for the structural and social reform program supported by the PRSC. The PRSC would typically accompany the PRSP for countries with an adjustment lending relationship with the Bank and/or a Fund PRGF, and would consist of a series of annual credits over the PRSP timeframe (typically three years).

Poverty Reduction Strategy Paper (PRSP) summarizes a country's strategy for reducing poverty. It is prepared through a participatory process by the government, with support from the Bank, the Fund, and other partners. The PRSP includes a diagnosis of poverty, a discussion of linkages between policy action and poverty reduction outcomes, and a system to monitor progress in reducing poverty. The PRSP forms the basis for World Bank (IDA) and IMF concessional assistance to low-income countries—including debt relief under the HIPC Initiative.

Sector Strategy Papers (SSPs) are Network products that review the Bank's operational experience within a sector or thematic area, identify priorities for the Bank at the global level, and set out an implementation plan for pursuing the priorities. They define indicators that can serve as a basis for assessing country and Bank performance, and for identifying priority country programs for Bank involvement.