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

Attached for the September 18, 2006, Development Committee Meeting is a paper entitled "Strengthening the World Bank's Engagement with IBRD Partner Countries," prepared by the staff of the World Bank. This item will be considered under Item II of the Provisional Agenda.

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ABBREVIATIONS AND ACRONYMS

| | |
|------|--|
| EU | European Union |
| HIPC | Heavily Indebted Poor Country (initiative) |
| IBRD | International Bank for Reconstruction and Development |
| IDA | International Development Association |
| IFC | International Finance Corporation |
| IMF | International Monetary Fund |
| MDB | Multilateral Development Bank |
| MDG | Millennium Development Goal |
| MIC | Middle-Income Country |
| MIGA | Multilateral Investment Guarantee Agency |
| OECD | Organization for Economic Co-operation and Development |
| WBG | World Bank Group |

STRENGTHENING THE WORLD BANK'S ENGAGEMENT WITH IBRD PARTNER COUNTRIES

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STRENGTHENING THE WORLD BANK'S ENGAGEMENT WITH IBRD PARTNER COUNTRIES

SUMMARY AND RECOMMENDATIONS

1. This paper discusses the World Bank's strategy for engagement with IBRD partner countries. These include 79 middle-income countries (MICs)—defined as those countries currently eligible for IBRD borrowing, and also all other members of the cooperative that make selective use of its services. MICs are extremely diverse and have different development needs. Collectively, they face the pressures and challenges of globalization. In parallel, the international community is experiencing a growing need for effective collaboration to address regional and global public goods issues. These developments are shifting the World Bank's role and its delivery mechanisms in fundamental ways.

2. This paper focuses on how IBRD can become more effective in delivering a flexible, high quality and cost-effective menu of services for all its clients to assist them in achieving development results; it does not attempt to classify clients. The paper seeks to refine and enhance IBRD's existing strategy and accelerate its implementation. The approach described in the paper builds upon existing work and lessons of experience, and addresses new opportunities and challenges facing the IBRD. The paper contains measures to improve the IBRD's effectiveness in partnering with MICs to achieve better development outcomes, and to pursue collective efforts to address regional and global concerns.

3. The mission of the World Bank is to reduce global poverty (see Box 1). The twin pillars of the Bank's strategic framework support: building the climate for investment, jobs and sustainable growth, and investing in and empowering poor people to participate in development. IBRD aims to reduce poverty in middle-income countries, including IBRD eligible creditworthy poorer countries. Middle-income countries, where 70 percent of the world's poor live, have made profound improvements in economic management and governance over the past two decades, and are rapidly increasing their demand for the strategic, intellectual and financial resources the Bank has to offer. The challenge facing the IBRD is to better manage and deliver its resources to best meet MICs' needs.

Box 1. Corporate Statement

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

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

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

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

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

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

B. The Evolving World Context and Shareholders’ Demand

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

- While MICs continue to account for a majority of the world’s poor, they have grown by 5.8% on average over the past 4 years, the strongest growth in 3 decades.

- On average, MICs are better equipped to handle financial market shocks. Many have strengthened their government balance sheets by adopting more prudent fiscal policies, privatizing state owned enterprises, building up international reserves and reducing their foreign currency sovereign borrowing, and more than a few have developed the infrastructure needed to deepen their domestic financial markets.
- A number of MICs have gained greater access to cross border flows of private capital. Net private capital flows to developing countries reached a record high of US\$483 billion in 2005.

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

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

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

- In FY05-06 lending to MIC clients in current US dollars terms returned to levels of \$13-14 billion per year, a level previously observed before the FY01 decline.
- MICs are increasingly drawing on the IBRD's flexible loan and hedging products to mitigate financial risks and are seeking customized financial advice to help manage their broader balance sheet risk. This includes products for expanding lending in local currency and to sub sovereigns and for managing commodity price volatility and catastrophic risk.

- The demand for the Bank’s non-lending services is growing. More MICs are seeking unbundled IBRD’s financial, knowledge and strategy services and access to the latter two on a stand alone basis.
- In addition, all shareholders are increasingly turning to the IBRD to use its knowledge, strategic advice, convening role, and financial capacity to address issues of global and regional concern, and to provide banking and administrative services to help operationalize these initiatives. Clearly defining IBRD’s role on global public goods becomes even more important in the context of highly fragmented international aid delivery mechanisms.

C. Addressing New Challenges and Opportunities

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

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

12. The WBG operates the following business segments:

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

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

D. Recommendations for Strengthening World Bank Engagement

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

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

1. Strategy and Coordination Services

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

2. Financial Services

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

3. Knowledge Services

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

4. World Bank Group Synergies

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

5. International Cooperation and Partnerships.

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

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

E. Issues for Discussion

16. Governors are asked to give guidance on the following:

- What do Governors see as the key rationale and value-added for the IBRD in MICs?
- Do Governors agree that the proposed Corporate Statement captures this consensus?
- Do Governors agree with the proposed improvements and further work identified to meet this evolving role?
- How else should the IBRD adapt to ensure it meets all its shareholders' wishes in its support for MICs? In particular, what are the circumstances under which Governors endorse the IBRD placing greater reliance on country systems?
- Do Governors support existing IBRD graduation policy, or are there any changes they would like to see in the eligibility of countries for different forms of IBRD support?

STRENGTHENING THE WORLD BANK'S ENGAGEMENT WITH IBRD PARTNER COUNTRIES

I. INTRODUCTION

1. As the world economic and financial systems have become more complex, so have the needs of 79 middle-income countries (MICs) and their demands for services provided by the World Bank Group (WBG).¹ MIC clients are looking for high-quality and cost-effective services, which can be chosen as part of a package of lending and other services, the normal pattern to date or as individual self-standing services. Most often it is the package of services that provides the greatest value to clients. However, for some, the value of IBRD rests primarily in access to low-cost financing, while for others, sector expertise or strategic policy advice and convening power is what matters most. In addition, the international community, including the MICs, increasingly looks to the WBG to develop, implement and facilitate knowledge sharing about strategies to address important issues of global priority such as addressing climate change, natural disasters, avian flu, HIV/AIDS, global financial stability and trade integration. And shareholders call on the WBG for trustee services to effectively deploy funds they make available for these and other development-related purposes. IBRD's value to its shareholders, including those MICs with access to market financing, lies in its ability to customize the delivery of its services while, when needed, mobilizing its global convening capacity.

2. This paper proposes an expanded Bank² strategy for using its strengths to improve its ability to respond to new and changing client needs. The challenge for the WBG in MICs is to enhance and accelerate implementation of its strategy for engagement with MIC clients to enable it to become a more effective partner in helping them achieve development results and respond more effectively to the increasingly complex challenges that they face. This paper builds on the work done by previous Bank task forces which have addressed the question of how to enhance WBG support for MICs, and it seeks to accelerate implementation of the existing recommendations of the Management Action Plan, as well as broaden the scope of actions for future engagement in MICs.³

3. ***Structure of the Paper.*** At its last meeting the Development Committee asked the Bank to refine and enhance its engagement strategy with this group of countries. This paper responds to that request, and seeks the Committee's guidance on key emerging issues. Section II describes the MICs and trends in the global economy and financial system that affect them, and it sets out what MIC clients and other shareholders say about services the IBRD provides and changes they would like to see. Section III discusses the implications for the IBRD's services. Section IV examines opportunities for better exploitation of synergies within the WBG and the scope for strengthening WBG cooperation with other development partners to improve quality of overall

¹ For WBG purposes, this paper addresses primarily the relationship with IBRD borrowers ranging from upper-middle-income countries and emerging market countries to lower-middle-income countries, including IBRD/IDA blend countries (see Annex A).

² The term "Bank" is used to refer to IBRD and IDA, while WBG refers to IBRD/IDA/IFC/and MIGA.

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

support to MICs. At previous meetings, the Development Committee has also called for further work on blending arrangements, and Section V reports progress on this issue. Section VI concludes and outlines next steps.

II. THE WORLD BANK GROUP'S EVOLVING ROLE AND OPPORTUNITIES

4. This paper defines MICs as the group of 79 countries that are eligible to borrow from the IBRD.⁴ On this definition, MICs are an extremely diverse group of countries, ranging from upper-middle-income countries, such as Argentina or Malaysia, to lower-middle-income countries with many characteristics of low-income countries, such as Guatemala or Philippines, and from emerging market countries with relatively good market access, such as Mexico or the Slovak Republic, to countries with little or no access to global financial markets, such as Gabon and Ukraine (see Annex A). The eligible group includes 14 countries with gross national income per capita above the cut-off for initiating consultations on IBRD graduation; the Bank's policy on and approach to graduation is set out in Box 2.

Box 2. Graduation from IBRD Lending

The term "graduation" means the formal determination that a country has attained a level of development that renders it ineligible to borrow from the Bank. Graduation is a clear indication of country success: the first country to graduate was France in 1947, and by the 1970s a number of OECD countries that had borrowed from the Bank in the 1950s and 1960s also graduated. It is grounded in the IBRD's Articles of Agreement, which include as one of the statutory conditions for lending that IBRD be satisfied that, in the prevailing market conditions, the member country would be otherwise unable to obtain the loan under reasonable conditions (Article III, Section 4 (ii); see also, Article 1 (ii)). The rationale for excluding a country from Bank lending is based on the principle that IBRD financing supplements private investment when private capital is not available on reasonable terms.

In 1982, in order to codify Bank procedures for graduation, the Executive Directors approved a graduation policy which they reformulated two years later. The reformulated graduation policy requires that the Bank review a country's borrowing eligibility if the country's per capita income exceeds a certain level. This level, which has been revised over time, is presently set at \$6055. Reaching this level is a starting point for graduation review and does not exclude countries from Bank lending. Consistent with the policy, among other issues, the review examines the country's overall economic situation and its capacity to sustain a long term development progress with particular reference to two factors: (i) access to external capital markets on reasonable terms, and (ii) the extent of progress in establishing key institutions for economic and social development.

The policy gives the Bank flexibility in making these assessments and, while the decision on graduating a country rests with the Bank, the 1984 reformulation emphasized that the relationship between the Bank and its clients was one where graduation should take place as a "natural outcome" of the evolving relationship between the Bank and its members. Recent graduates include Slovenia in 2004 and the Czech Republic in 2005. The flexibility implicit in the policy has been clearly demonstrated in the few cases, notably Korea in the late 1990's, where countries which have graduated from IBRD lending have obtained new financing because of the deterioration in their economic circumstances.

⁴ This definition differs from the one commonly used by the OECD's Development Assistance Committee, which depends only on average per capita incomes. The definition excludes eleven low middle-income countries that only borrow from IDA and includes five low-income countries with access to both IBRD and IDA financing.

A. MICs—A Snapshot

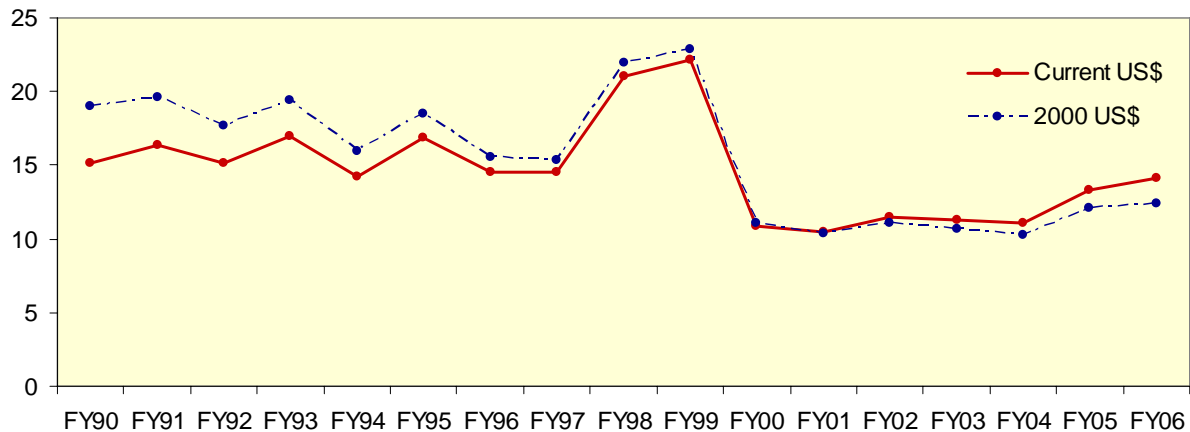
5. The MICs as a group have performed well economically in recent years, but continue to face deep development challenges:

- MICs account for two-thirds of the world's population and are home to more than 70 percent of the developing world's poor people, those living on less than US\$2 per day.
- MICs account for 80 percent of the developing world's population in 2005, with an average per capita income of just US\$3.80 per day: 1.5 billion people live in countries that are eligible for IBRD support but have an average per capita income below the IDA cut-off (e.g. India, Indonesia and Pakistan).
- The record of growth and poverty alleviation in MICs is heavily influenced by China and India. If these two countries are excluded, the average growth rate in MICs over the past four years declines from 5.8% to 4.3%. On a regional basis, economic growth in MICs in Latin America and the Caribbean (3.1%), Sub-Saharan Africa (3.6%) and Middle East and North Africa (4.4%) has lagged behind that of East Asia and the Pacific (7.8%), South Asia (7.2%) and Europe and Central Asia (6.2%).
- Most MICs continue to face major challenges in reaching the Millennium Development Goals (MDGs).
- MICs also include 18 Small States of varying income, which face particular challenges due to lack of economies of scale, erosion of trade preferences and special vulnerabilities to natural disasters.
- Many of MICs' challenges are structural in nature, requiring strengthening of public institutions and actions to improve the business environment and competitiveness; and many of these countries also need to address large income inequalities and implement social agendas.⁵

6. **Lending trends.** Figure 1 depicts commitments to IBRD countries in current and constant US dollars. In current dollars it shows year-to-year fluctuations around a fairly stable trend in the FY90-97 period, a sharp upswing in FY98-99—reflecting IBRD's response to the global financial crisis—followed by an even sharper downswing and fluctuations around a much lower trend in FY00-04. In FY05-06 lending to IBRD countries in current US dollars terms returned to levels of \$13-14 billion per year, a level previously observed before the FY01 decline. For commitments in constant US dollars, Figure 1 shows a declining trend already in the early and mid- 1990s, despite the advent of new borrowers in Europe and Central Asia in that period as well as the increases post FY04.

⁵ Sixty-two percent of MICs rank in the lowest three quintiles on the UN's Human Development Index. In MICs for which information is available, 48 percent have GINI coefficients above 0.4, a marker that indicates that income distribution is highly unequal (see Annex A).

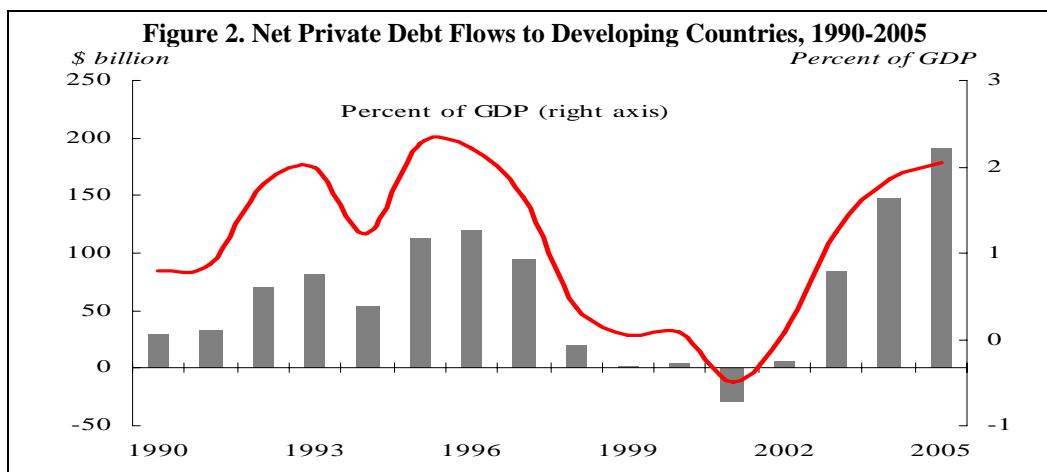
Figure 1. IBRD Commitments, FY90-06^{1/}
(US\$billion)

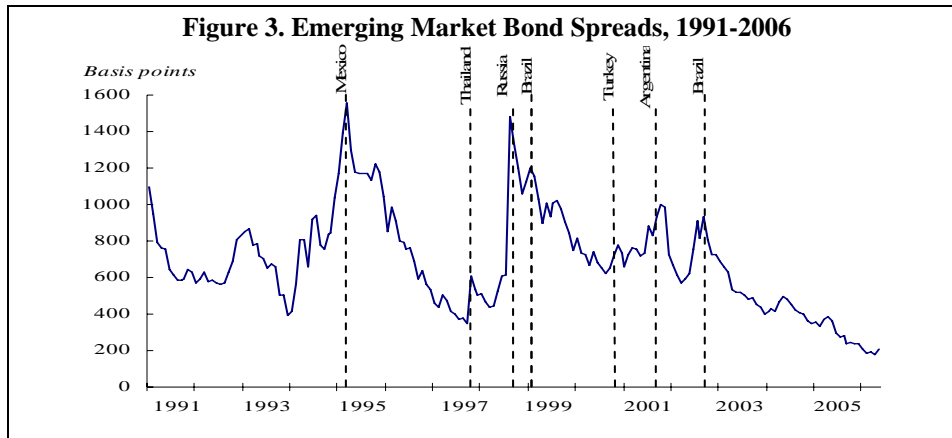


^{1/} Excludes Guarantees

7. **Project Performance in MICs.** The Bank has achieved a high rate of successful performance in MICs, as measured by the Bank’s Quality Assurance Group (QAG) and the Independent Evaluation Group (IEG). QAG reports 93 percent overall satisfactory performance for the Bank’s work in MICs across all indicators—quality-at-entry, supervision-and analytical and advisory services. Regarding the portfolio of 756 projects in MICs, QAG reports nine percent at risk. In addition, IEG’s outcomes rating for 826 projects in MICs, that closed during the FY01-05 period, stands at 80 percent satisfactory. This contrasts favorably with the outcomes rating by IEG for non-MICs, which stands at 73 percent satisfactory for 550 projects during the same period.

8. **Economic and Financial Environment.** In recent years, the global economic and financial environment has been highly supportive for many emerging market economies. Net private capital flows to developing countries reached an all-time high of US\$483 billion in 2005—substantially above the previous peak of US\$295 billion in 1997 and more than triple the low of US\$154 billion in 2001. Net private debt flows are also at an all-time high (see Figure 1), and spreads on emerging market bonds reached a record low in February 2006 (see Figure 2).





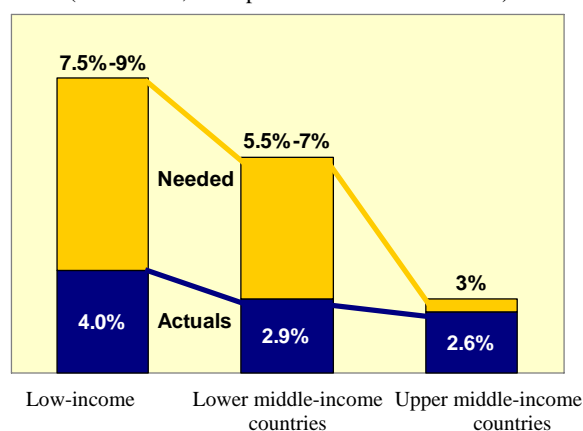
9. ***Uneven Access to Private Finance.*** Despite this supportive environment, MICs’ access to private capital has been uneven: 10 countries account for 70 percent of emerging market sovereign bond issuance, and less than a dozen MICs can be regarded as established bond market borrowers able to achieve regular access and relatively stable spreads. Current market conditions in part reflect improved policies and financial soundness in MICs themselves. Conditions also reflect strong growth, low interest rates and abundant liquidity in high-income countries, conditions that are already beginning to change. For those MICs without stable access to bond markets, commercial bank lending provides the main source of private capital: from 2002 to 2005, 80 percent of commercial bank loans were made to borrowers that had no credit rating or that were below investment grade—that is, without significant access to bond markets.

10. Today many MICs continue to have very limited or no market access and most of the other countries face the prospect of loss of access or rapid withdrawal of banking flows when conditions become less favorable, making them particularly vulnerable to exogenous shocks. History suggests that stability of the world’s financial system cannot be taken for granted and can quickly reverse the recent favorable access by some MICs. Supporting MIC governments in strengthening markets through policy reforms remains a critical pillar of WBG strategy for helping enhance their access to private finance over the long term. History also suggests that there will continue to be periods when access to private finance for even the more creditworthy MICs will be much more difficult than it has been in recent years. This volatility is a key reason why even upper MICs continue to be interested in a relationship with IBRD.

11. ***Disappointing Infrastructure Financing.*** Infrastructure remains seriously underfinanced in most developing countries including MICs (see Figure 4). The relative contribution of the public and private sector to the financing of MIC infrastructure has been an important issue over the last decade. Although MICs capture about half of all private financing going to infrastructure, these flows have never reached a level at which private participation in infrastructure could replace public financing. Since the late 1990s, commitments by private investors to invest in infrastructure in MICs have been on a downward trend in amounts and numbers of projects, and it is projected that in the coming years the public sector will need to draw on internal and external resources to finance around 65 percent of all infrastructure outside the telecommunications sector. In response, the Bank has been reengaging in investment lending for public infrastructure, including support for public-private partnerships. New IBRD commitments in the sector have increased by more than 40 percent between FY03 and FY06 and

are on course to grow further. The mix of public-private participation and detailed arrangements depend to a significant degree on the specific infrastructure sector in which the investment is to be made and on the expected profitability of that investment. In general, however, a greater private sector role in infrastructure is unlikely if cost recovery-based pricing for services is not possible or a reliable subsidy cannot be established. Addressing the pricing subsidy issue remains challenging in many MICs, and it remains key to mobilizing the kind of investments needed in either the public or the private sectors, to address the gap in infrastructure services (see Box 3).

Figure 4. Infrastructure Expenditure: Actual (1990s) vs. Needed (2005-10)
Annual Expenditures as % of GDP
(investment, and operations and maintenance)



Source: Global Monitoring Report 2004.

Box 3. Infrastructure Services

The challenge of sustaining and extending infrastructure services in MICs is immense. In order to have a significant impact, IBRD projects will have to provide replicable sector models for efficient service delivery and leveraging financing from a variety of sources. Output-based support provides a tool of growing utility to accomplish both of these goals. The Paraguay Rural Water Supply and Sanitation Project and the Peru Rural Electrification Project extend access to households under output-based approaches reducing costs to the government by nearly 50 percent. These projects use competitive selection of private companies to build and operate water networks and extend access to electricity, respectively. Private companies were offered a subsidy per connection and were selected on the basis of the lowest proposed connection charge to users. Under the previous public sector model, government subsidies in both countries were more than double the cost. The approach has been replicated in IBRD projects across infrastructure sectors.

B. The Demand Dimension

12. Against this background, MICs have stressed that the Bank continues to play an important role in supporting their still large but differentiated development needs. There is also consensus among MICs that income per capita alone is not a good measure of their development or their need for support. There is urgency, however, to accelerate reforms to address the constraints that impede the quality and effectiveness of the Bank's financial and knowledge services. At the same time, non-borrowing-country shareholders are increasingly looking to the Bank to develop and implement strategies to help MICs respond to important global priorities, such as climate change, catastrophe risk management, financial instability, trade integration and communicable diseases. The MICs are also looking to the Bank for support in enhancing their voice in setting the global agenda on these issues and in linking them to local needs. This section addresses these demands in greater detail.

1. Views from MICs

13. A series of regional consultations were organized jointly with the multilateral development banks (MDBs) to seek views from senior government officials from MICs on the

evolving role of the Bank and other MDBs and how this could be enhanced. Some common themes emerged from these consultations, but there were also differences in needs and in demand for Bank's services.⁶

14. **Strategy.** Most MICs continue to value support from the WBG and other MDBs (see Box 4). They see the WBG and other MDBs as the most important source of support in addressing their policy and institutional development challenges. Even the European MICs, which are getting European Union Structural Funds and have limited need for MDB financing, look to the Bank to help them design and implement parts of their policy agendas and increase absorptive capacity as they prepare for EU membership.⁷

Box 4. Why is China a Client of the World Bank Group?

The Government of China values the WBG's work in China for the ideas, innovations, and knowledge that it brings. It sees the WBG as a neutral objective partner that can be trusted to act in China's best interest in learning from international experience. WBG activities build on a long-term partnership based on a shared commitment, and pragmatic cooperation that aims to develop and implement sustainable solutions tailored to pressing development problems. Though modest in scale, WBG activities often have large impacts, helping to scale-up policy and institutional reform, technological innovation and improved project management. The WBG has contributed to a stronger focus on high-quality poverty analysis; financial sector reform, including interest rate reform and IFC issuance of a local currency denominated "Panda" bond; and greater awareness of resource scarcity and environmental challenges and how to manage them.

China remains interested in new IBRD borrowing because it values the nonfinancial services that IBRD provides as part of its loan package and that are not readily available from the private sector. IBRD typically makes a commitment to remain involved until the issues are resolved, at a cost that is limited to the loan charges. Similarly, Chinese private companies work with IFC because they value the services IFC delivers with financing. As a trusted partner, IFC plays a unique role in piloting initiatives that lead to further economic opening and adoption of international norms. MIGA helps China by complementing existing insurance capacity and thus helping attract foreign direct investment. It also provides mediation support to clients when investment disputes occur.

15. **Financial Services.** Some MICs no longer see the need for significant routine financial support from IBRD on the basis of the strength of their external and fiscal positions. But other MICs would like continued and even expanded development financing from the MDBs given their large investment needs, including for public infrastructure and social services. These MICs see official finance as critical to implementing policy and institutional reforms and making the investments in human and physical capital that are necessary to crowd in private finance. Many MICs also want IBRD financing to remain available as a backstop if private market access should diminish. Other MICs have large pockets of poverty or significant gaps in meeting MDGs, and would like MDBs to mobilize blended loans on concessional terms to accelerate progress towards these goals.

16. MICs have highlighted the importance of MDB support for their debt management strategies aimed at improving debt quality and reducing the overall cost of debt and are increasingly making use of the Bank's new debt management and hedging facilities. At the same time, they have asked for the MDBs' increased attention to (a) local currency financing; (b) non-

⁶ A consultation with Middle-East MICs is planned during the Bank/Fund Annual Meetings.

⁷ The Bank's assistance programs for Bulgaria, Romania, and Turkey are shaped around their priority of preparing for EU accession.

recourse financing for the private sector; (c) financial instruments appropriate for sectors with weak or delayed financial returns on investment, such as MDB loans blended with grant finance (discussed in Section V of this paper); (d) subnational lending when requested by the national authorities; (e) refinancing instruments to help improve debt management; (f) preapproved loans that become effective when resources are drawn (which help better address countries' immediate liquidity needs in the aftermath of natural disasters), and (g) indexed loans and other products with insurance and risk pooling features. They have also stressed the need for modifications in current lending terms to enhance transparency and simplicity.

- ***Business costs.*** MICs are concerned with what they see as extremely high costs to them of the MDB lending procedures: the nonfinancial costs of doing business with the institutions. MDB procedures are seen as a major source of implementation delays, and of additional costs to the borrowers. MICs are looking for faster and simpler pre- and post-loan approval processing. For the social sectors and areas of special global interest or where the returns on investment take a long time to materialize, MICs would like MDBs to take the lead in mobilizing blended loans that reduce loan spreads. They value the Bank's convening role and ability to catalyze support from other development partners, and would like this role to be expanded.
- ***Loan costs.*** MICs would like to see lower MDB loan charges. They view costs and pricing differences between MDBs as creating distortions; commitment and up-front fees are particularly unwelcome.
- ***Harmonization and use of country systems.*** MICs strongly support MDBs' attempts to harmonize their safeguard, procurement, and financial management procedures and align them with country systems, in line with the Paris Declaration on aid effectiveness. But they are disappointed by progress in this respect—with MDBs using different methodologies, guidelines and procedures, and all appearing reluctant to move quickly toward using country systems. Many MICs have laws establishing country systems and procedures that have been enacted through democratic processes and consensus, and they see MDBs' desire to bypass these laws and use their own systems as a source of delays, paralysis and higher costs, as well as an impediment to capacity building and, thus, as likely to lead ultimately to disengagement.

17. ***Knowledge Services.*** MICs value the analytic and advisory work provided by the IBRD and other MDBs particularly in cutting-edge and second generation issues (see Box 5). But they warn against unnecessary duplication of assessments across agencies. Some also see scope for stand-alone fee-based services. Many MICs emphasized the importance of MDB support for policy development, for which there were no alternative sources of advice. They suggested that MDBs need to strengthen their skills and better train their staff to take into account differing country conditions, and that they should help strengthen—and use—MICs' own consulting services capacity. They would welcome enhanced efforts to support exchanges of experience among MIC experts, including the secondment of experts between MICs.

Box 5. Second-Generation Issues: Latin American and Caribbean MICs

Brazil continues to seek the Bank's advisory services, but places priority on "how to" advice drawing on best international practice on complex issues in areas where its own experience is nascent. Such issues include how to plan, finance and regulate infrastructure investment in an environment of limited fiscal space; how to go beyond an access orientation in health and education and build the human capital needed to transform Brazil into a high-income country; how to address with the nexus of environment, infrastructure, agriculture and human capital in complex ecosystems; and how to reduce entrenched and persistent poverty in its northeast. The Bank's long-standing partnership with Brazil in the northeast has included both knowledge and finance. Multisectoral solutions involve increased access to infrastructure, market-friendly land reform, microfinance and productive projects to grow incomes; support for community associations to build social capital; adoption of sustainable development plans; and improvements in the efficiency of public expenditures. The Bank has developed an instrument for local currency financing that the federal government and, with the necessary support from the national authorities, the local government could use to access Bank financing in Reais and reduce vulnerability to currency shocks.

Jamaica sought the Bank's support for its plan to combat inner city crime and violence and reverse the downward spiral of relocation of business and industrial activities, rising unemployment, and deterioration of coverage and quality of basic services that triggers further crime and violence. The Inner City Basic Services for the Poor Project, which aims to improve the quality of life of over 60,000 poor urban dwellers, draws on the Bank's knowledge of crime and violence prevention programs in South Africa and Brazil; incorporates best practice in impact evaluation, building on Bank operations in Indonesia, Swaziland and Tanzania; and adapts a performance-based microfinance innovation that Chile successfully tested in the *Fondo de Solidaridad y Inversion Social*.

18. **Private Sector Development.** MICs stressed the need for stronger support from MDBs for improving the business environment; the importance of MDB funding mechanisms for the private sector and of public-private partnerships in infrastructure financing as a mechanism to promote private investment; and a need to enhance the private sector's awareness of products offered by the MDBs (see Box 6).

Box 6. Strategies of IFC and MIGA in MICs

In MICs, particular attention is required to ensure that the WBG provides substantial value added to the private sector. This often means focusing on frontier regions of a country or playing a significant role in enhancing the environmental, social or corporate governance performance of projects. It is also important to focus on catalytic activities with large demonstration and systematic development impacts, for example, helping create a viable mortgage market, or projects that reach out to small and medium enterprises.

IFC's strategy has five priorities that apply to both middle-income and frontier countries:^a a) strengthening the focus in frontier markets (and for middle-income countries frontier regions within countries); b) building long-term partnerships with emerging global players in developing countries (including promotion of south-south investments); c) differentiating through sustainability competencies; d) addressing constraints to private sector growth in infrastructure, health and education; and e) continuing to emphasize local financial markets' development through institution building and by using innovative financial products.

MIGA's strategy engages in MICs in five ways: a) Marketing South-South Investment; b) supporting foreign investment in sub-national entities; c) providing technical assistance for investment promotion and providing guarantees; d) providing online services promoting investment opportunities into new markets; and e) facilitating trust fund resources to help new companies meet and maintain environmental and social safeguard standards.

IFC and MIGA recognize the potential for innovation and learning in middle-income countries, where companies are often sufficiently sophisticated to pioneer innovative approaches that can become models for investments in other parts of the country and in other regions.

a. According to IFC, "frontier countries are low-income (WB income category) or highest risk countries (Institutional Investor rating of 30 or less)." See IFC Strategic Directions: Implementation Update and FY07-FY09 Outlook (IFC/R2006-0077).

2. Views of other Bank Shareholders

19. The Bank has been holding extensive consultations with bilateral donor agencies and the European Commission (EC) to explore ways to enhance collaboration in support of MICs. It is clear from these discussions that bilateral agencies and the EC are pursuing a number of often overlapping aims in providing support for development in MICs. Political, strategic and (to a declining extent) historic factors are the driving force; expanding EU aid to “neighborhood” countries falls into this category, as does much current support to countries in the Middle East. Donors seeking to focus their aid on poverty reduction want to address continuing substantial regions/pockets of poverty in MICs. And all donors are concerned to support MICs in contributing to global public goods, for example, in combating communicable diseases such as avian flu and malaria, reducing global carbon emissions or increasing global financial stability. While donors’ views on MDB engagement in MICs differ, they converge around five points:

- They agree there is a sound rationale for MDB engagement with MICs, but would like to see greater clarity about graduation policy, and they are concerned to ensure that MDB engagement adds value in relation to private sector financing.
- They would like to see more cost recovery for MDB services to MICs, and while sympathetic to bringing down financing costs, they look at this issue also in the perspective of other needs.
- They are concerned about the cost-effectiveness of the whole system of international financial institutions and look for opportunities to secure efficient divisions of labor.
- They recognize the need for progress in implementing the Paris Declaration agenda, including use of country systems in MICs where appropriate, but they also recognize that their own concerns and those of civil society in their countries has presented a challenge to this effort.
- They are pressing for strong WBG engagement in the analysis and delivery of global public goods, particularly in relation to climate change, catastrophe risk management, disease, trade integration and financial stability, but they are also concerned that the Bank may become overextended.

20. **Donors and MDBs.** Many bilateral donors are reviewing their engagement with MICs, often looking beyond the activities of aid agencies to the activities of the whole government and reviewing the role of the MDBs of which they are members. In general, they look for MDB engagement with MICs for the same reasons that they themselves are involved. Moreover, a number of major donors are focusing more of their aid on low-income countries and concentrating their residual aid to MICs in fewer countries, including “anchor” countries that produce positive spillovers. This process, too, is leading them, as MDB shareholders, to look to MDBs to step up support to MICs in areas they see as important.

3. MICs' Contribution to the World Bank

21. IBRD is a cooperative. Its MIC members are owners as well as clients. As owners they participate in management of its affairs and the growth of its capital. As clients they can obtain financing and access to expertise and other services, and as creditworthy borrowers of nonconcessional funds they contribute to the financial health of the Bank.⁸ Indeed, they increasingly see their relationship with the Bank as a partnership rather than a client relationship; reflecting this, over the past 18 months they have agreed on a large number of Country Partnership Strategies with the Bank. Many MICs are also increasingly contributing to development in other countries through the growing financial integration among developing countries—South-South flows of foreign direct investment, bank lending, workers' remittances and even development assistance. A number of MICs are long-standing contributors to IDA,⁹ and some are also partners in arrears clearance and debt reduction exercises that benefit some of the world's poorest countries.

22. MICs prominently contribute to global knowledge about development: for example, the lessons of Chile's pioneering pension reform have been adapted to pension reform in other MICs; and the success of Brazil, Chile and Mexico in developing effective conditional cash transfer programs is helping to revolutionize traditional social protection schemes in other countries (see Box 7). MICs' experience as they address such second-generation development challenges generates valuable knowledge that both they and the Bank share with the Bank's other member countries. And finally, some MICs are playing an increasingly important role in the governance of the global economy, contributing both to developing the global policy agenda on issues such as trade and climate change and delivery of global public goods, including combating infectious diseases, reducing green-house gas emissions and preserving biodiversity. Commensurate with their growing contributions in these areas, they seek a greater voice in the MDBs and in setting the global programs priorities.

Box 7. Conditional Cash Transfer Programs: A MIC Contribution to Innovative Poverty Reduction

Among the most effective programs in Latin America for reducing poverty and promoting social inclusion are the conditional cash transfer programs that Brazil, Mexico and Chile have pioneered. Going beyond traditional social assistance policies, these programs help reduce current poverty and inequality by providing cash transfers to extremely poor families but also serve to break the intergenerational transmission of poverty by conditioning these transfers on the beneficiaries' making investments in their human capital and that of their children. Conditions typically include school attendance, vaccinations, improved nutrition and prenatal visits and, for adults, participation in programs to enhance employability.

The programs have produced impressive results. In Mexico, for example, a 20 percent increase in the enrolment of girls in secondary school and a 10 percent increase in boys' enrolment, and a 12 percent lower incidence of illness in children one to five years old in the program. In Brazil, the program covers over 9 million families (about 36 million people) and will reach universal coverage of the poor (an estimated 11.2 million families).

The Bank has facilitated regular knowledge sharing among Brazil, Chile and Mexico, and is supporting or planning support for similar programs in Argentina, Colombia, Dominican Republic, Ecuador, El Salvador and Jamaica. The Bank has also actively promoted broader international exchanges on conditional cash transfer programs, through conferences in Mexico, Brazil and, most recently, Turkey—one of the first countries outside of Latin America to adapt the model to its own needs.

⁸ MICs' interest payments on IBRD loans are a major source of the Bank's income. These payments help underpin the IBRD's ability to make transfers to IDA and the HIPC Trust Fund, thereby benefiting other Bank constituencies.

⁹ Countries such as Brazil have made significant and growing contributions. While the contribution of Part II donors to IDA is still under 3 percent, it reinforces the active cooperative structure of the Bank.

4. Conclusion

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

- MICs are increasingly drawing on the IBRD's flexible loan and hedging products to mitigate financial risks, and are seeking customized financial advice to help manage their broader balance sheet risk. This includes products for expanding lending in local currency and to sub sovereigns and for managing commodity price volatility and catastrophic risk.
- The demand for the Bank's non-lending services is growing. More MICs are seeking unbundled IBRD's financial, knowledge, and strategy services, and access the latter two on a stand alone basis.
- In addition, all shareholders are increasingly turning to the IBRD to use its knowledge, strategic advice, convening capacities and financial services to address issues of global and regional concern and to provide banking and administrative services to help operationalize these initiatives. Clearly defining IBRD's role on global commons issues becomes even more important in the context of a fragmented development aid system.

24. Evidence seems clear that there will continue to be substantial demand for IBRD services to support effective development in MICs—particularly if these services can be simplified, expedited and better tailored to individual country needs. Continuing to reduce the costs of doing business is central. It also seems clear that the relative importance of IBRD's nonlending services on complex development issues will continue to grow, and there will be a corresponding need to ensure that the IBRD is well placed to respond effectively to that demand.

III. IBRD TODAY: CHALLENGES AND STRATEGIC PRIORITIES

25. Over the last four years, building on previous MIC task forces' recommendations, the Bank has introduced several measures to increase its responsiveness to client demand. These include: overhauling its menu of financing and risk management products, broadening its freestanding delivery of knowledge services, offering treasury management services on the basis of cost recovery, introducing single-country technical partnerships and reducing the non-financial costs of doing business with the Bank. Much more remains to be done, however, if the WBG is to meet the evolving demands of the MICs. This requires improving the delivery of integrated services across IBRD's three business segments described below, staying abreast of international best practices with respect to cutting edge development issues and, where appropriate, unbundling its services to meet individual client needs. This approach should help improve and better evaluate IBRD's effectiveness in achieving development results, including tailoring support to diverse client needs. The approach also helps define and address key challenges facing the institution. This section deals with the main challenges and considers the strategic priorities for IBRD in its three business segments.

26. **Business Segments.** IBRD's three primary business segments are (a) strategic policy advice and coordination services at the country and global levels, including in the provision of global public goods; (b) financial services, including banking services to sovereign and sub-sovereigns and asset management; and (c) knowledge services, deployed through research activities and mobilization of expert services. As reflected in the distribution of administrative expenses, the knowledge segment is the largest at about 60%, the financial service is the second largest at about 25% and the strategic country and global services is somewhat smaller at 15%.

27. In each segment, the IBRD has several product lines:

- **Strategy and coordination services—country and global:** policy dialogue, expertise and advice on designing and implementing strategies and assembling resources (funds and expertise) to achieve growth and poverty reduction in countries and to address matters of global, regional and sector significance.
- **Financial services:** loans, hedging products, guarantees, asset management services, and treasury management services. Loans are not available on a free-standing basis, but the other service segments are available on top of the financing itself and on a free-standing basis. As noted above, financial services accounts for roughly 25% of administrative expenses. However, its revenues on loans and investments net of borrowing costs supply substantially all of the income necessary to operate the other two segments and support transfers to IDA and other purposes as directed by shareholders.
- **Knowledge services:** research and expert services delivered by sector experts at the country, sector and global level through a number of delivery mechanisms: project cycle work, analytic work, training, institutional capacity building, technical assistance and other advisory engagements.

28. **Product Delivery and Customization.** The challenge for the IBRD is to continue becoming more flexible and responsive in delivering both the traditional integrated loan package and other services in each individual business line in a cost-effective manner, assisting clients in achieving development results. Although, at present, most net income comes from lending, it is possible that in the future a modest but increasing share could come from fees associated with stand-alone advisory services. The focus of this paper is on how IBRD can become more effective in delivering a flexible, high quality and cost-effective menu of services for all clients to assist them in achieving development results; it does not attempt to classify MIC clients.

29. **Integrated Development Solutions.** Most MICs continue to prefer addressing their development challenges through an integrated package of services from IBRD that combines strategic support, financing and knowledge (see Box 8). Successful delivery of the integrated package requires: competitive financing terms, relevant and often cutting-edge expertise, ability to deliver in timely fashion, good local knowledge and strong presence, strong project management and supervision, and sufficient credibility to coordinate with other donors. Going forward, IBRD integrated package of services will be more valuable to all its shareholders if each component business performs at the highest standard.

Box 8. Support to Countries' EU Accession Process: An Integrated Package

In early 2005, *Romania* asked the Bank for urgent support for critical reforms to strengthen the efficiency, autonomy, integrity and accountability of the judicial system, and to step up anticorruption efforts. These reforms were necessary to fulfill EU requirements in time for Romania's planned 2007 accession. The Government needed strategic advice, world-class technical expertise and capital investments to move ahead with the reforms. Leveraging analytic and diagnostic work undertaken since 2002 as well as the experience of a series of programmatic development policy loans, the Bank responded with a \$130 million loan prepared in only 10 months.

The Bank's \$1 billion loan to assist the countries of the *Energy Community of South East Europe* to realize the potential gains from increased energy trade illustrates the Bank's capacity to respond to MICs' need for support on frontier, second-generation issues. The project objective of supporting and facilitating increased regional energy trade also supports the wider goal of deeper regional integration between these countries and with the EU. The Bank supported the countries' dialogue with the EU and helped them to establish the regulatory institutions and develop the technical market management functions they needed to meet the conditions for EU accession.

The Bank is helping to prioritize reforms in support of *Turkey's* accession through a programmatic series of Country Economic Memoranda and through technical assistance. The Bank is also helping economic convergence primarily through programmatic development policy loans to help improve the investment climate, generate more and better jobs, and reform the public sector, including the social security system. It is able to share with Turkey the accession experience of former candidate countries through World Bank Institute workshops, study tours for Government officials, and so on. Finally, the Bank is supporting institution building to meet EU requirements through investment lending and technical assistance in various sectors, as well as assisting the country in improving its capacity to absorb EU funds through fiduciary work and project preparation.

A. Strategy and Coordination Services

30. **Overview.** IBRD has had long experience in helping countries frame their development strategies, set priorities, and integrate the knowledge and financing needed to implement them. In this respect, IBRD expertise remains essential to many MICs and to the international community. The Bank's global knowledge allows it to offer development solutions that have been tested elsewhere, and the Bank's convening capacity allows it to act as an effective and objective broker, for example in facilitating regional cooperative approaches. On the strength of the earnings in its financial services business, IBRD provides its development resource management services free of charge to most of its clients and to the international community at large.

31. In the past decade there has also been a strong growth of global partnerships promoting collective action and knowledge sharing on key global development issues. The Bank has increasingly responded to calls from the international community to act as a leader in convening or managing global or regional initiatives related to the MDGs or the provision of global public goods. One important area for action has been in helping to promote global financial stability: MICs have a strong interest in their own stability but also can contribute to a stronger global financial system. Another area relates to the fast pace of development and industrialization in a number of MICs, which is placing severe pressure on the global commons—forests, river systems and the public health implications of burgeoning urban populations—that can affect many people beyond the borders of one particular country. There is a globally shared responsibility to tackle these problems, and there is a strong case for seeking to integrate MICs fully in the process of setting the global public goods agenda and to develop new mechanisms through which IBRD can provide assistance.

1. At the Country Level

32. **Bank Contribution.** The core of the Bank's business in this area is helping countries to develop strategies for achieving their development goals and to identify and assemble the portfolios of assistance (expertise and financing) for implementing those strategies. This is achieved through formal country strategy documents, on-going policy dialogue, specific economic and sector work, and organization of Consultative Donor Group Meetings.

33. **Challenges.** If the Bank is to better deliver country-level strategy services, with an emphasis on achieving the results the country wants and addressing the difficult issues that are central to that vision, it will need to (a) ensure recognition of this role as separate from the delivery of country financial and knowledge services; (b) make faster progress in implementing a partnership approach in MICs to fully realize the promise of the new Country Partnership Strategies (see Box 9); and (c) take a number of actions to increase the flexibility and effectiveness of the other Bank services and better exploit synergies across the WBG (discussed in Section IV). More effective Country Partnership Strategies can also better integrate country and global priorities. This approach will require more flexibility from the Bank than in the past: continuing to develop flexible lending envelopes, consistent with prudent exposure management, accelerating efforts to move to using country systems where standards are mutually agreed and verifiable, and to develop new financial products that help insure against exogenous shocks and market volatility.

Box 9. Country Partnership Strategy: Kazakhstan

The Bank's Country Partnership Strategy (CPS) with Kazakhstan opens a new path in IBRD-client relations. It is designed to remain in force until such time as it is no longer relevant. It identifies areas of priority interest to the Government in which the Bank can add value through knowledge transfers, without prejudging what vehicle might best convey the knowledge. The backbone of this relationship is the Joint Economic Research Program. Following initial research efforts and a preparation of a paper, *Getting Competitive, Staying Competitive*, the jointly owned mechanism has focused on strategy formulation and implementation through multiple outputs: quick notes, workshops, training and capacity building. As a reflection of the program's relevance, value and credibility, it has nearly doubled from \$1 million to \$1.9 million, with the Government financing 50 percent. Modest lending (two to three projects annually) has followed to support implementation of strategic advice. This lending enjoys strong Government ownership, as the Government evidenced by providing \$2 million for project preparation.

2. In Global Programs

34. **Bank Contribution.** The Bank is increasingly being asked by shareholders to convene and manage global or regional initiatives that respond to the achievement of the MDGs and the provision of global public goods. Examples of the latter include the global response to Avian Influenza (where the Bank is working with the UN and international technical agencies and a range of other partners), the Education for All Fast Track Initiative (the Bank hosts the global secretariat and manages the FTI Catalytic Fund) and promoting trade integration.

35. The Bank is a strong partner in providing these services with technical expertise, global development knowledge and experience. As knowledge broker it provides insights and analysis on global issues and their implications for developing countries and for policymaking at the international level. With its expertise in organizing and financing global programs it can provide practical advice on their design and management. With its presence at the country level, the Bank is

well placed to link global issues and programs with country-level implementation, fostering dialogue between developed and developing countries, capturing the “double dividend” of local development benefits and global public benefits and furthering attempts to harmonize aid efforts. The Bank is involved in a broad range of global programs in different sectors, such as health, environment, infrastructure, microfinance and others. While these are primarily grant programs, they are relevant to MICs, especially in helping them contribute to the supply of global public goods, such as reducing greenhouse gases and increasing agricultural technology, as well as addressing the second generation development issues that arise from rapid economic growth, such as urbanization, energy supply, infrastructure development and pollution management (Box 10).

Box 10. Global Programs—Selected Experience in MICs

Reducing Carbon Emissions. The Bank has played a pioneering role in the development of the carbon market, first by launching the *Prototype Carbon Fund* (PCF) in 1999 to understand and test the processes and procedures for creating a market, and more recently by launching a series of Carbon Funds, to enhance confidence in the nascent carbon market, reduce entry risks, expand learning-by-doing to various countries and economic sectors and address market failures. Fifty six Emission Reductions Purchase Agreements (ERPAs) have been signed to date, and 44 of these for \$1.173 billion are for projects in 21 MICs.

Addressing Urban Strategies. The *Cities Alliance* (CA) provides matching grants for city development strategies and slum upgrading and has provided a significant share of its funding to MICs, *almost half of core funds in FY05 and FY06* (or about \$20 million in total). Relatively small amounts of CA grants can have enormous impact because of the enhanced capacity of the national partners to implement activities and integrate learning into their national and local development policies and programs. This also allows the CA to maximize learning from its investments. Brazil, China, Philippines and South Africa have participated in the program.

Building Infrastructure Partnerships. The *Public-Private Infrastructure Advisory Facility* (PPIAF) was launched in July 1999, at the joint initiative of the governments of Japan and the United Kingdom, working closely with the World Bank. *PPIAF has directed 36.4 percent of its total commitments of \$110.2 million towards activities in MICs.* Such support to MICs is important in supporting nascent institutional capacity and developing innovative approaches for public private partnerships in infrastructure that often provide useful lessons for other lower income countries around the world.

36. The Bank’s “global business” is directly linked to its role in intermediating and managing specialized donor funding. The Bank currently holds about \$10 billion in trust, for a wide range of purposes and on a spectrum of trustee services that range from a simple fiscal agency to a more intensive program administration role and direct delivery of services. Some donor-funded programs are targeting global public goods, and the Bank itself also contributes grant funding to global and regional partnership programs through the Development Grant Facility, which has provided about \$180 million per year over the last decade.

37. **Challenges.** The Bank faces challenges in this work. As the trustee of donor funds there is a heightened risk that the services provided are driven by the nature or timing of donor requests and are not necessarily congruent with the Bank’s standards of operational and financial viability, its corporate priorities, or the priorities of partner countries. The rapid growth of the Bank’s trust fund portfolio and the associated administrative costs give rise to questions of efficiency and effectiveness of growing aid resources increasingly dedicated to specialized purposes without a sufficient global debate on priorities and implementation strategies to provide global public goods. Proliferation and limited effectiveness are real risks. The voices of MICs are critical to the strategic choices that must be made and to the delivery of global public goods that should also produce the necessary local

development benefits. As shareholders of the Bank they have an interest in ensuring that the Bank fully meets its fiduciary obligations (e.g. when managing trust funds) in supporting local priorities.

38. **Strategic Priorities.** In meeting these challenges, a task for the WBG, and especially IBRD, is to develop financing and other mechanisms that will help MICs address such global and systemic issues. Next steps will include:

- Prioritizing strategic themes for World Bank engagement in global themes. A key criterion for prioritization is the opportunity to achieve the “double dividend” of local development and global public benefits.
- A discussion among Bank shareholders on the Bank’s diverse roles in the provision of global public goods as a source of research and policy analysis, as a source of finance, and as a trustee of donor funds, with the aim of increasing coherence between global priorities, local development priorities, and the instruments to deliver on agreed objectives. This may lead, among other things, to consideration of reforms in trust fund instruments to make them more flexible in support of global programs, and more efficient in their governance and decision-making. Management intends to prepare a Board paper on these issues during the first semester of FY07.
- Developing a forward-looking menu of financing options to enhance support for high priority global undertakings, and a systematic review of ways in which the IBRD’s financial capacity can be more strategically used to support global public purposes with direct benefits to MICs, as well as to the wider development community. This will include consideration of innovative ways to enhance financial support for high-priority global public goods (e.g., International Financing Facility for Immunization), which can catalyze other forms of global financing or provide financing assurances which accelerate investment and market development.
- Further consideration of blending or combining of IBRD loans with concessional forms of financing provided by donors, as discussed further in Section V below.

39. On each issue, a degree of international consensus would be needed on the content and structure of any related new transfers and subsidies.

B. Financial Services

40. **Overview.** The WBG provides financial services for its members through four legally distinct entities that, taken together, provide a full menu of financing, credit enhancement and risk management tools to the sovereign and nonsovereign public sector and to private business in developing countries. For IBRD borrowers, the value of IBRD’s financial services business remains simple and compelling: IBRD runs a banking business that provides many of its clients with financing on favorable terms; at the same time, the earnings on that business enable it to provide broader access to other business services as well as fund contributions to IDA and other agreed priorities.

41. IBRD's banking loan assets, at about \$100 billion, are dwarfed by those of many commercial banks and are comparable to those of the major regional development banks taken together. The spread earned on these loans, combined with the earnings on shareholders' equity cover the costs of the knowledge and strategic services businesses, administration and corporate overhead, and the annual transfers that IBRD's owners choose to make to IDA, HIPC and other development-related entities and activities.

42. **Bank Contribution.** The nature of the financial services that the IBRD is asked to provide has evolved greatly over the past 20 years, well beyond the sovereign, public sector project lending that dominated its relationship with its emerging market members in the early years. This evolution has reflected a number of key factors:

- Recognition that macroeconomic and sectoral policy change can be more important than specific investments and that IBRD lending can both encourage and support those changes.
- Adoption of more effective public-sector financial and debt management—a development actively encouraged and supported by the Bank and the IMF, especially in the aftermath of the Asian and Russian financial crises of 1997-98.
- Increasing emphasis on risk mitigation in managing public finances. This goes beyond traditional financial risks such as currency and interest rate exposure; IBRD members today seek tools to help manage the risk of macroeconomic contagion (such as standby credit lines and GDP-linked financing), natural disasters (such as products with insurance features) and changes in commodity prices (see Box 11).
- Devolution—to local government, public utilities and other nonsovereign public bodies—of responsibility for development-related investments and an insistence on their financing these investments without resorting to sovereign credit.
- Increasing emphasis on local currency financing, at both the sovereign and subnational levels. While closely related to the overall emphasis on risk mitigation, this development is also part of authorities' efforts to accelerate development of domestic capital markets.

Box 11. Comprehensive Disaster Risk Management and Catastrophe Risk Transfer

The Bank emphasizes comprehensive approaches and strategies for-disaster risk management which include mitigation and risk transfer (disaster insurance). Hazard Risk Management activities increasingly include components for contingent risk financing and catastrophe risk transfer to the global reinsurance market to ensure that countries have adequate financial resources if disaster strikes. The **Colombia** Disaster Vulnerability Reduction Project and the **Turkey** Marmara Earthquake Emergency Reconstruction Loan include large contingent loan facilities. The Turkish Catastrophe Insurance Pool (TCIP) set up with the technical and financial assistance of the Bank in 2000, helped the Turkish government to considerably reduce its fiscal exposure to the risk of natural disasters and enabled over 2.6 million Turkish families to receive access to affordably priced catastrophe insurance coverage. A similar Bank supported program is on the way in **Romania** to enable the country to reduce its catastrophe exposure to the risk of quake and flood. The **Argentina** Flood Management Project is financing infrastructure investments to mitigate the risk of floods. In the **Eastern Caribbean**, the Bank is aiding governments to strengthen institutional capacity, including developing and enforcing building codes and introducing effective airport security.

43. The WBG has responded to members' evolving priorities in a number of ways: stepping up the relative proportion of its financing delivered as policy support lending; overhauling the terms of its financing; introducing a LIBOR benchmark for floating-rate loans (thus making the resulting exposure hedgeable using market-standard instruments); giving borrowers a choice of currency (including local currency) and interest rate payment conventions, as well as embedded options that could link debt service to extraneous variables such as commodity prices; and making available to borrowers tools and practitioner support to manage interest rate, currency and commodity risks in their overall portfolios, without linking those tools directly to IBRD loans.

44. **Strategic Priorities.** Nevertheless, borrowers want the IBRD to be an even more flexible, responsive and user-friendly cooperative financial services provider. Many of the more creditworthy of IBRD's emerging market members have borrowed in the commercial markets without having exhausted their credit lines with IBRD and other multilateral financiers, even when commercial terms (interest rate, maturity, embedded options for risk management, etc.) have been substantially inferior to those offered by IBRD. In short, members have been willing to access more expensive sources of funds in preference to borrowing from the IBRD. The reasons that MICs make this choice are diverse and can be as simple as wanting to establish a name as an issuer in commercial markets, or to signal the markets that the country is no longer "dependent" on an "aid agency." However, these actions also clearly reflect dissatisfaction with the perceived nonfinancial costs of doing business with the IBRD. The key areas of Bank focus for improving its work with MICs are set out below.

1. Nonfinancial Transactions Costs

45. The Bank has taken a range of actions to reduce non-financial costs.¹⁰ It has

- Simplified processes and procedures for investment lending and adopted a policy for additional financing. As a result, the Bank has reduced average processing times from 18 months to 15 months and is on course to reduce it still further, and it is meeting strong demand for additional lending designed to scale up successful projects (see Box 12).

Box 12. Simple & Repeater and Additional Finance Projects in MICs

MICs have benefited from simplified procedures and more agile operational products that have generated efficiencies for Borrowers and the Bank alike. Simple and repeater projects require fewer and shorter reviews, and they have maintained their standards of quality. They have resulted in budget savings amounting to 36 percent of the costs of standard investment loans. Since FY04 over 100 such projects were approved, and in FY06 alone there were 47 operations. Half of all these projects were in IBRD clients such as Brazil, China, Grenada, India, Jamaica, Kazakhstan, Macedonia, Namibia, Pakistan, Papua New Guinea, Peru, Tunisia, Turkey and the Slovak Republic.

Another successful innovation has been additional finance operations, which save on processing time by building on ongoing projects that justify scale-up or address cost overruns, financing gaps, emergencies or additional components. Since the existing reporting and monitoring systems remain unchanged, significant cost savings can be achieved. To date, 14 additional financing loans have been approved, and IBRD borrowers such as Brazil and Pakistan, have benefited from this innovation.

¹⁰ See *Enhancing World Bank Support to Middle Income Countries, Second Progress Memorandum* (SecM2005-0560), December 1, 2005.

- Increased financial and program flexibility in Country Assistance Strategies to allow for a rapid response to changes in client demands; most strategies in MICs are now prepared as Country Partnership Strategies with indicative lending programs.
- Streamlined the use of conditionality in development policy operations and disciplined it in investment lending operations. As a rule, investment operations no longer carry sector policy conditionality; instead, support for necessary policy and institutional reforms is provided through policy dialogue, economic and sector work, development policy lending and lending in the context of sectorwide approaches.
- Offered most potential clients for its banking services advice on the use of IBRD loan and hedging products to improve the country's debt profile, lower its debt service and mitigate its exposure to risks; and expanded the use of currency and exchange rate hedges to clients' non-IBRD debt.
- Engaged bilateral donors and regional development banks in discussion over a new partnership framework for enhancing support to MICs (see Section IV).

46. Much remains to be done. Agreed changes in Bank policies, including for investment lending in general and for infrastructure in particular, and for streamlining conditionality, have to be implemented fully and consistently in country operations. In addition, greater use of borrowers' own safeguard and procurement systems remains to be achieved. The Board has approved a pilot program for the use of country safeguard systems, but implementation has generally not progressed beyond the assessment of equivalence of policies and acceptability of country implementation in four MICs. There have been extensive consultations with Executive Directors and external parties on a draft proposal for the use of country procurement systems. A new proposal is being developed in order to reach agreement with the Board on a pilot approach that ensures adoption of mutually agreed and verifiable standards. Management will be assessing progress and reporting to the Board on the pilot program for the use of country safeguard systems in October 2006; at that time it will put forward to the Board specific proposals to enhance the effectiveness of using country systems, as may be called for in the light of experience. Similarly, a proposal for reforming emergency investment lending (Operational Policy 8.50) needs to be presented for Board approval. Progress also needs to be achieved in creating quick-disbursing financing vehicles for countries with strong records on policy and institutional performance. Progress in these key areas will be achieved only with a broader level of support and agreement from shareholders.

47. Despite the unfinished business, the Bank's response to MICs' demands for changes in its financial services has probably been a factor in the strong lending recovery since FY04. Between FY01-03 and FY06, IBRD development policy lending has remained steady and investment lending has increased by nearly 60 percent across a broad front of sectors and regions. Specifically, in FY05 lending to MICs increased by over \$2 billion and in FY06 a further increase of \$800 million was recorded (see Annex B).

2. Simple, Transparent and Competitive Pricing

48. A second factor in MICs' deciding not to borrow from IBRD is the difficulty they have in evaluating the true price of IBRD financing, so as to compare it clearly with other financing

opportunities. The average price of an IBRD loan averages about LIBOR+ [40] basis points, with variations dependent on product and loan type. However, to reach this conclusion, borrowers have to take into account the spread-equivalent cost of a front-end fee, a commitment fee and the potential that IBRD will at some point decide to suspend a waiver. In contrast, the pricing of a bond-market financing typically is presented to the borrower as a fixed spread to LIBOR or the applicable government-issue (in the case of fixed-rate borrowing) and a front-end charge for the costs of management, underwriting and distribution. Because the IBRD pricing structure has a front-end fee and a commitment fee, both with partial waivers, the spread-equivalent total charge is not obvious.

49. Management is working to simplify and improve the transparency and ensure the continuing competitiveness of IBRD pricing. During FY06, the Board approved Management's proposal to both reduce and simplify charges for the currency pool and dollar pool legacy products. The Board has also fully waived the front-end fee for FY07. In addition, Management will carry out a review of price competitiveness and alternatives that would simplify the pricing structure and will present this to the Board during FY07.

3. Tools to Mitigate the Risks of External Shocks

50. Government finance managers in MICs are acutely aware that they remain relatively highly exposed to uncertainties other than interest rates and currency risk, which have traditionally dominated thinking in the field: commodity price movements and natural catastrophes are examples. To facilitate management of these risks, borrowers have expressed interest in financial products, like the IBRD's existing Deferred Draw Down Option (DDO), that could be used in the case of adverse events (such as a natural catastrophe, a downturn in economic growth, or adverse changes in commodity prices or terms of trade), and the creation of a Bank-supported global facility to provide competitively-priced catastrophe insurance for member countries (see Box 13). The Bank already offers commodity swaps to link borrowers' debt service requirements to movements in key commodity prices and is reviewing other possible mechanisms to help clients better manage nonfinancial risks while ensuring prudent management of the Bank's own risks.

Box 13. Growing Interest in Catastrophe Insurance

The growing frequency and severity of natural disasters has increased interest on the part of MICs in utilizing the financial capacity of the global reinsurance and capital markets to fund their immediate liquidity needs in the aftermath of natural disasters and supplement the financial resources available from MDBs and donors. For instance, realizing that its funding needs in the aftermath of a large earthquake in Mexico City may be well in excess of those accumulated in FONDEN (a national disaster fund), the government of Mexico has recently adopted, with Bank advice, an innovative risk financing strategy. The strategy involves a risk transfer from FONDEN to the international reinsurance and capital markets through a reinsurance contract and issuance of a catastrophe bond. The financial protection obtained by Mexico entitles it to a US\$450 million insurance indemnity in case of a large quake within the perimeter of Mexico City.

In response to similar concerns, the Bank has been exploring the feasibility of working with the private sector on market-based solutions. For example, establishing the Caribbean Catastrophic Risk Insurance Facility (CCRIF), which would allow small island states to pool risks and access reinsurance where most efficient, to cover part of their financial exposure to disaster risk. It would allow for the payment of claims based on the occurrence of a hurricane of certain magnitude (rather than on assessment of hurricane related losses). An optimal combination of risk pooling and use of third-party donor capital (in financing the risk capital of the facility) could help lower the cost of coverage and retain or lay off risk depending on which is most efficient. In this instance, the Bank's role has been to provide extensive advisory support and help with coordination of donor funding.

4. Local Currency Lending

51. Most IBRD clients find it impossible or very costly to access the financial tools for mitigating the risks associated with foreign currency-denominated borrowings. Lack of an investment-grade credit rating makes them ineligible for an array of financial instruments—such as short-dated futures, forwards and options, and longer-dated currency and interest rate swaps—available in the capital markets. To help IBRD clients protect themselves from exchange rate volatility and better manage their overall sovereign debt, the IBRD offers local currency products. In addition to mitigating the effects of exchange rate volatility on the government's own finances, local currency products could be used to enhance the financial viability of individual projects, e.g., on-lending and infrastructure, as local currency financing eliminates the potential currency mismatch between a project's revenues and its debt service.

52. The IBRD offers clients two approaches for accessing its local currency products: the inclusion of a currency conversion option in a fixed spread loan (FSL), or a currency swap with the IBRD, under the provisions of a Master Derivatives Agreement (MDA), which swaps foreign currency loan proceeds and future debt service obligations into the local currency, without the need to post collateral to the Bank. In the case of currency conversion with FSLs, withdrawals can be converted into local currency at the time of disbursement, resulting in a synthetic local currency loan. However, unlike financing in major currencies offered by the IBRD, the use of local currency loans requires the availability of a liquid swap market in the local currency. This is required for IBRD to hedge the currency risk it faces in making loans to borrowers.

53. The IBRD has extended some loans with sovereign guarantees in local currencies; however, in practice it is unusual for the Bank to fund at a rate below the rate at which the sovereign can fund in its own currency. As a result, IBRD local currency loans are generally not attractive to sovereign governments (see Box 14). The picture is more promising, however, with respect to local currency lending to sub-sovereign governments, subject to the requisite interest and support of national authorities. At the subnational level, the Bank can be price-competitive and the knowledge and advice that is bundled with the finance can further increase the package's value to the subsovereign clients. For financing private investments through IFC, the situation is also more promising—the WBG can fund in local currency at rates that leave sufficient room to provide on-lending at rates that are attractive to the private sector. Through the IFC-based Municipal Development Fund, the WBG has made a limited move toward subnational lending without a sovereign guarantee.

5. Subnational Development Financing

54. In 2003, to address members' interest in subnational financing, the WBG established the IFC Municipal Fund, which offers financial support to subnational entities without sovereign guarantees. The WBG now proposes to scale up this business in a three-year Subnational Development Program (SND), continuing to book this nonsovereign financing on the IFC balance sheet while fully integrating Bank staff into the process and engaging MIGA guarantees and staff support, where appropriate. Most of the financing provided in the program would be in local currency, priced to reflect risk. It is estimated that loans and guarantees worth about US\$800 million could be made over the three-year program life. This program will also involve extensive technical and advisory services (including technical assistance grants) to members to

help build the institutional capacity at the subnational level to encourage fiscal responsibility, efficient and transparent implementation and the evolution of local credit markets. On the basis of the experience with the 3 year program, the SND proposal calls for the WBG to review options for a larger scale-up, including options under which the IBRD will share the risk.

Box 14. Attractiveness of Local Currency Lending—The Mexico and Egypt Experiences

To date, four IBRD operations in local currency have been approved (three to Mexico and one to Egypt). Since the Mexico operations were approved, other countries have shown interest in local currency financing. As structured, the instrument could also provide local currency financing in Brazil or Colombia, subject to agreement by the national authorities, which could prove valuable to state and municipal governments. Further, the IBRD is in discussions with a number of sub-sovereign borrowers (which do not have access to currency hedging instruments) on the possible conversion of their IBRD loans into local currency.

Mexican authorities have highlighted their appreciation for the IBRD's "innovative and flexible financial products" suggesting that increasingly it will be the quality as much as the quantity of financial services that keep MICs like Mexico and other MICs borrowing from the Bank. In some of these projects, the Bank has offered financial engineering with derivatives such that multi-tranche, hard-currency loans are disbursed and repaid in local currency. Through a swap, the exchange-rate risk is transferred to international markets. This innovative and flexible way of financing is a win-win proposition to all partners — the Bank, the country and the markets— anchoring a partnership spirit, creating the appropriate incentives for the promotion of local markets and increasing the resources available to finance development towards common goals such as poverty-reduction and human development.

The Egypt Mortgage Finance Project enables banks and non-bank lenders in the primary market to begin offering long-term market-based mortgage loans for residential housing. The Egyptian Company for Mortgage Refinancing (ECMR), legally incorporated as a joint stock company during project preparation with the assistance of the Bank, will receive the proceeds of a Bank local currency loan as a line of credit. The line of credit will support the initial, start-up phase of the ECMR's operations as a second-tier, wholesale, market-based liquidity facility focused on refinancing longer-term residential mortgage loans originated by lenders in the primary market. As it matures, the ECMR is expected to begin issuing bonds or other securities in the capital market to help fund its operations on a market-sustainable basis. The Bank loan is structured as a fixed-spread loan funded by Egypt's national currency paid-in capital (NCPIC) in Egyptian pounds. The lending charge in the local currency term will be determined using market currency swap quotes. Should the tenor of swap quotes that the Bank is able to obtain from the market be shorter than the maturity of the loan funded by NCPIC, the Bank will extend such swap rate to the end of the loan maturity.

C. Knowledge Services

55. The WBG has accumulated a substantial store of global knowledge and experience on factors that affect sustainable economic growth and development. This is the Bank's largest business line, absorbing about 60 percent of administrative expenditures. Within the knowledge services, there are two primary product lines: research and expert services.

1. Research, Data, and Prospects Work

56. Bank research provides a range of high-quality and relevant knowledge services:

- research to evaluate the positive and negative effects of policies and analyze the impacts of programs; multi-country and comparative studies that provide insights beyond those of single-country work; and research on global issues;

- collection, analysis, and dissemination of development data and statistics—which make possible an informed discussion about policies, programs and results—and assistance to countries in building their own statistical capacity (see Box 15);

Box 15. Bank’s Data and Statistical Capacity Support

MICs need reliable official statistics for informed policy making and program management and to measure and monitor results. For instance, good quality statistical data are needed for developing policy and managing service provision related to education, health and labor. Credible economic and financial data that meet international quality standards are needed for macroeconomic management and for participation in global financial markets. The Bank supports MICs by disseminating relevant and comparable data in publications and databases, which reach a global audience and inform development discussion and debate. The Bank also helps client countries improve their capacity to produce good quality statistics, and works in partnership with other agencies to improve international statistical standards. Grants have also been provided to several other countries through a multi-donor trust fund, to improve specific aspects of statistical capacity and to formulate comprehensive strategies for statistical development. The Bank also hosts the global office of the International Comparison Project, which is a large-scale effort in 107 countries to collect and compare price data between countries.

- cross-country and global projections and monitoring of emerging trends—for example, examining how global events and risks (such as higher interest rates, global imbalances, or avian flu) affect borrowers (see Box 16).

Box 16. Work on Avian Influenza

Growing global concern regarding the current avian flu outbreaks and possible future impact of a pandemic has led to various initiatives within the WBG. On the operational side, the Bank has taken the lead in mobilizing global resources to assist countries in dealing with surveillance and response to outbreaks, including setting up a multi-country facility to provide financial support to countries. Bank analysts have undertaken assessments of the impact of the current bird-to-bird outbreak on the poultry sector in affected developing countries, drawing on structural and household data and assumptions about severity of flu in different contexts. Modeling work is also ongoing to provide indicative estimates of the order of magnitude and linkages among various possible factors or "shocks" that might emerge from a possible pandemic—for example, the impact on world trade, air travel, higher transport costs, etc. Research is underway on policies to address social and economic impacts, including both epidemiological models and analysis of compensation schemes. Bank staff has also participated actively in global and regional meetings on the issue.

57. **Challenges.** While these kinds of research can be valuable to MICs, the challenge from their perspective is to strengthen the links between operations and research—links that are robust in such areas as education and trade, but require more work in others. Management will take steps in this area in the context of the updated Management Action Plan (see Section VI).

2. Expert Services

58. IBRD provides advice to its country clients through a variety of delivery mechanisms: project cycle services in designing, implementing and supervising projects, technical assistance, analytical work, training, and other ad-hoc engagements such as impact evaluations, providing technical expertise in project management itself, “certification” of best practices, etc. These expert services are also engaged on regional and global themes.

59. **Bank Contribution.** IBRD's comparative advantage is in combining technical and policy skills to provide global technical knowledge, particularly in areas of public policy. It has a wide array of in-house expertise and access to external expertise in different areas; it is seen as an impartial broker with broad development experience that can provide objective advice, and it has the convening capacity to gather funds and world experts and to match policymakers with counterparts from other countries.

60. **Challenges.** The two key challenges relate to skills and delivery mechanisms. A critical challenge is to foster an environment for staff to develop deeper skills and broader global knowledge in their topical area. MICs are often looking for cutting-edge and broad-based solutions that cut across sectors—for example, infrastructure projects that incorporate environmental elements and target poor people; conditional cash transfers that rely on poverty analysis and household surveys and work to build local government institutions; or disaster mitigation projects requiring planning in infrastructure and public finance. When MICs seek policy advice in fields where the Bank has relatively little in-house expertise, the Bank needs to engage other organizations, including the private sector. The Bank needs to balance many considerations in responding to the rapidly changing policy agenda at the global and regional level: it needs to be able to identify emerging issues, respond initially, and mobilize and coordinate newly engaged experts as needed; be flexible in bringing in expertise from outside the Bank; and, above all, be selective about the areas in which it chooses to offer advice and retain or invest in expertise.

61. In terms of delivery mechanisms, it is important to develop new and efficient ways of responding to the needs of emerging markets and other MICs that are facing next-generation issues, but that do not necessarily need IBRD finance or Bank-supported projects. The Bank is able to provide fee-based services outside the lending context,¹¹ particularly in the technical assistance implementation and institutional capacity building phase. In certain MICs, partially or totally fee-based delivery of timely advice is becoming increasingly important (see Box 17).

62. **Strategic Priorities.** Management will:

- Identify and eliminate impediments to global delivery of expertise and improve the management of the Bank's pools of expertise to maintain quality and ensure cutting-edge skills.
- Make greater use of MICs' own accumulated knowledge and development experiences, e.g., by expanding partnerships with local institutions, such as research institutes and academia.
- Expand the menu of delivery mechanisms by developing and institutionalizing the business model for: (a) a quick response window for timely policy advice and (b) the provision of fee-based expert services more systematically and on a larger scale. Management is working to develop a range of options for a new conducive framework covering such stand-alone advisory services, including potential funding arrangements, governance, accountability, and benchmarking.

¹¹ See Operational Policy 8.40, Technical Assistance, October 1994, and the Operational Memorandum - The Provision of Fee-Based Services, May 1998.

Box 17. Fee-Based Analytic and Advisory Services

The **Russian Federation** has engaged the Bank on a fee-for-service basis to act as an independent investment consultant and provide project implementation support to the Government of St. Petersburg for its Western High Speed Diameter Project, which will be the first concession for toll roads in Russia. Under the reimbursable technical assistance agreement, the Bank will conduct a detailed review of project feasibility to secure financing and, subsequently, assist the Government of St. Petersburg during the transaction process, including its prequalification and public competitive bidding phases.

Chile and Mexico have sought fee-based services from the Bank for advice on issues such as options for costing and managing public contingent liabilities for infrastructure finance, evaluating the efficiency and effectiveness of government spending programs and ministerial restructuring and modernization.

The Bank's reimbursable technical assistance **GCC Technical Cooperation Program** began 30 years ago, initially focusing on assisting the six member countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates) in the areas of economic planning and industrial and infrastructure development. Support includes technical and advisory services and studies, the full range of project support from identification and design through implementation and evaluation, communications and outreach activities structured to share international experience and build consensus on best practice solutions and, lastly, capacity building and training.

Algeria and Egypt have entered into reimbursable technical assistance (RTA) programs with the Bank. The first RTA agreement with Algeria for \$580,000, signed in August 2005 with the Ministry of Water Resources is now well underway, covering the preparation of management contracts in water supply for three large cities. A second RTA for \$530,000 was signed in April 2006 for the establishment of the Caisse Nationale d'Equipelement et de Développement (CNED). The Bank has also launched two new programs of RTA in Egypt, one of which is a \$591,000 RTA agreement for the Bank to provide technical assistance to the Ministry of Finance in support of the pension reform program. The RTA will be provided over an eighteen month period and will support policy analysis, legal work, institution building and a public awareness campaign. Egypt also signed a \$588,000 RTA agreement for the Bank to support postal sector reform, media convergence and telecommunication policy, ICT development and e-signature, and ICT regulation.

The **Government of South Africa** requested that the Bank carry out an investment climate assessment and paid \$250,000 towards its cost. The assessment was carried out jointly by the Bank, the government and civil society organizations. The Government has taken full ownership of the exercise and has presented the findings in Parliament and to the media.

The **World Bank Treasury** has offered governments financial and advisory services to help them develop the framework, tools and capacity that will allow them to establish a prudent debt management strategy and implement it efficiently. This work has two stages: first, when a country expresses a desire for Bank assistance to improve the quality of its public debt management, the Treasury team performs a "needs assessment," free of charge. This assessment is in sufficient detail to serve as a platform for the authorities to begin specifying an action plan, and to take a decision on whether and to what degree to engage the Bank team in follow-up activities. The second stage comprises in-depth advisory services, provided on a cost-recovery basis. Clients can pay for the services in two ways. The first is through a straight hourly or fixed fee for the professionals engaged, plus travel costs. These costs may be recovered through direct payments from clients or other donors or internally within the Bank (e.g., analytic and advisory services, loan preparation and/or supervision). A second approach is for the client to engage Treasury to provide direct financial services, such as asset management or operations services, using a fee schedule that also covers provision of capacity-building and advisory services. Treasury currently has 22 fee-paying clients for its capacity-building businesses.

IV. WORLD BANK GROUP SYNERGIES

63. MICs expect the private sector to be central to their development, driving growth and job creation, as well as reducing poverty. Enabling the private sector requires the combined efforts of governments and private actors. Thus it is increasingly important for the IBRD, the WBG's public sector arm, to work closely with IFC and MIGA, its private sector affiliates, in supporting MICs' development.

64. **Focus on Cooperation.** WBG support for private sector development focuses on two tasks. Governments need to ensure a sound investment and regulatory environment that includes good governance and provides physical and social infrastructure. There is a growing role for governments and the private sector to work together in public-private partnerships in infrastructure and delivery of public services. While IBRD concentrates on the first task and IFC/MIGA on the second, the WBG must work together to enhance the effectiveness of the overall support to MICs' development.¹² IFC's and MIGA's knowledge of foreign investors is already informing IBRD support for improving the private sector environment, and is increasingly an essential component of WBG country partnership strategies (see Box 18). Over time, greater integration of WBG country support will translate into more effective WBG cooperation at the project and global program levels. Enhanced WBG cooperation is one of the key strategic goals of IBRD, IFC and MIGA, and efforts are underway to monitor the levels of cooperation. This cooperation will be also important for implementing the Subnational Development Program.

Box 18. WBG Coordination at the Country Level

In areas such as urban infrastructure, transport projects and cultural heritage projects, the Bank is looking to work with governments to establish appropriate regulatory environments, facilitate privatization or finance certain government activities, while IFC will support private sector participation. In addition, the Bank and IFC are cooperating in subnational finance.

Russian Federation. Joint IFC-World Bank support for infrastructure investment finance in the Russian Federation Chuvash Republic illustrates the kind of synergies that can be achieved with close collaboration. This subnational Municipal Fund activity, prepared by a joint IFC-Bank team, involves an IFC local currency partial credit guarantee of a RUR 1.0 billion (US \$35 million equivalent) bond issue that allowed the Chuvash Republic fund to finance local investments in water supply, road construction and housing. This operation leverages the Bank's prior involvement with the Chuvash government in projects in the water and other sectors, as well as its support for fiscal reform to strengthen the Republic's creditworthiness and bond issuance capacity.

China. In China, the WBG is working to improve information flows on private sector activities by including Bank staff in IFC's business development efforts, inviting IFC staff to participate in certain Bank projects, and expanding coordination on business environment work. The three institutions recently collaborated extensively on the China Country Partnership Strategy for 2006-2010. IFC representatives were part of the team during all consultations in China with central government agencies, provincial authorities, private sector representatives and civil society.

¹² Three key WBG positions (Chief Financial Officer, General Counsel and Information Officer) have been established to bring a group wide oversight responsibility to key management roles and steps are being taken to systematize IFC input into Country Assistance Strategy discussions and increase the participation of Bank managers in IFC's strategy process.

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

V. INTERNATIONAL COOPERATION AND PARTNERSHIPS

66. WBG support for MICs should also be seen in the broader context of parallel support being given by other MDBs (including the European Investment Bank), by a variety of global and regional funds, often offering grant terms or concessional finance, and by bilateral donors, who typically provide technical assistance, advice and other support on grant terms.

67. *Context.* Average annual IBRD lending in MICs over the last three years has been at about the same level as average total nonconcessional lending by other MDBs and of around half the level of total bilateral aid to this group of countries. If the IBRD, through its engagement in MICs, can help improve the effectiveness and development impact of support from other sources, the gains will be as great as those from improving the quality of IBRD support alone. Other MDBs are facing many of the same issues as the IBRD and are beginning to address them as they seek to refocus and enhance their support for MICs. MDB Heads met in February 2006 and agreed on a work program to achieve greater harmonization and coherence of MDB efforts, so as to achieve greater impact in terms of results and effectiveness at the country level.

1. Benefits of Stronger Collaboration

68. The World Bank and the regional development banks have been working for a number of years to enhance their collaboration at the global and country levels. Although borrowers can benefit from being able to choose among financing institutions, even larger benefits can often come if the MDBs work together and exploit their respective comparative advantages in providing support at the country level.

69. *Multilaterals and Bilaterals.* All MDBs face the challenge of strengthening their collaboration with bilateral agencies, which, unlike MDBs, provide grant finance and technical cooperation without any linked lending operations. There are risks to be avoided, for example, when bilateral or regional agencies provide financing on inappropriately soft terms and in ways that can crowd out potentially higher-quality policy and project support from MDBs. There are also large opportunities for exploiting better the synergies between the different types of support given by MDBs and bilateral agencies. This is partly a matter of differences in instruments: blending or combining bilateral grant finance or technical assistance with MDB lending can sometimes greatly enhance the effectiveness of both. And it is partly a matter of differences in policy focus: bilaterals can sometimes supply a critical political dimension. For example, the political dimension and policy framework provided by the EU for applicant and potential applicant countries has provided a powerful driver for economic reform. It is important to recognize that MDBs, including for example the European Investment Bank, have different

mandates and the success of their collaboration will often depend on the specific areas of collaboration.

70. **Other Partners.** Cooperation with the IMF and the Organisation for Economic Co-operation and Development (OECD) also helps underpin the support that the Bank provides to MICs. The Bank has a well-established program of collaboration with the IMF in areas of particular relevance to MICs, including work on financial sector assessments and reporting on standards and codes. The ongoing review of Bank-Fund collaboration is examining ways to further improve the effectiveness of this collaboration. Collaboration with the OECD is of growing importance to MICs, given the OECD's expertise and interest in such areas as governance and anticorruption, climate change, investment, employment and migration, corporate governance and trade and agricultural policies. The Bank also works with other partners on a number of cross-cutting topics, such as migration (International Organization for Migration), gender (United Nations Development Fund for Women), aid for trade (World Trade Organization) and health services delivery (Global Fund to Fight Aids, TB and Malaria).

2. Enhancing Cooperation

71. The MDBs have been working together for some years to improve their collaboration (see Box 19). The IBRD has signed memoranda of understanding on cooperation with all the regional development banks and, for some Regions, with the European Investment Bank. However, such memoranda by themselves do not deliver action. More explicit and accountable cooperation frameworks at the country level would be useful. Where MICs have coherent development strategies and budget processes, it should be possible to integrate MDB assistance strategies in support them; where they do not, MDBs may be able to encourage MICs to create such frameworks. Cooperation among MDBs, bilateral agencies, and global and regional funds in supporting MICs has been even less systematic. The Paris Declaration should provide a framework for enhanced collaboration between countries and all development partners.

Box 19. Multilateral Development Banks' Partnership in MICs

The Presidents of MDBs have taken stock of progress on the MIC support agenda and agreed to move ahead on three fronts: hold joint consultations with MICs (which have been held and provide a basis for the MIC demand diagnosis of this paper); explore the possibilities for blending bilateral grant and multilateral lending resources; and greater efforts to build on ongoing joint analytical work, technical assistance, advisory and operational work. Indeed, already eight joint Country Financial and Accountability Assessments have been completed between the Bank and the Inter-American Development Bank in common MIC clients.

A strengthened MDBs partnership for MICs fulfills a number of unmet needs. Support from MDBs should be coordinated to resolve issues of duplication and to allow MDBs to undertake operations on a greater scale with the possibility of achieving greater impact. Partnership presupposes a need for competition about ideas on appropriate policies, which will allow for consensus on reforms and programs that could otherwise be more difficult to attain. A partnership implies that one institution can take a lead role in a specific country, given its expertise, capacity and knowledge. It reflects the willingness of key partners to follow that lead. This can only become possible through increased communication and a continuous flow of information between partners.

72. ***Strengthened Collaboration.*** Three practical steps could strengthen collaboration among agencies providing support for MICs:

- First, recognizing the need for commitment by all parties to improve cooperation (particularly bilateral agencies and global funds). Common guidance to all agencies from governments represented at the Development Committee will be a key to achieving this.
- Second, providing leadership at the country level. Bank country directors for MICs should seek opportunities for fruitful collaboration with other development partners—particularly in active pursuit of the Paris Declaration agenda on alignment and harmonization, including greater capacity support for and reliance on country systems where those systems meet mutually agreed and verifiable standards—and it is to be hoped that other agencies and development banks and funds will be ready to reciprocate.
- Third, enhancing the effectiveness and leverage of the financial support provided to MICs through greater and more systematic use of well-designed blending (and guarantee) mechanisms.

3. Blended or Combined Financing

73. In many MICs, while MDBs would be ready to provide additional lending for projects and programs related to the MDGs and global public goods, governments are reluctant to borrow on nonconcessional terms for projects and programs that generate little revenue. Concessional forms of finance could help unlock demand for the financing of such projects and programs. In some cases donor guarantees could be used to have the same effect. Blending bilateral grant resources and MDB loans could augment the volume of financing available, better tailor concessionality to needs, with the degree of concessionality calibrated to achieve maximum impact, and improve development effectiveness. Deploying part of the current donors' concessional financing to MICs into blending arrangements could relax specific donor constraints and raise development effectiveness, since the same amount of bilateral grant financing would support more or larger country programs without changes in donors' priorities. Moreover, given the modest share of total donor aid to MICs that is currently directed to projects related to the MDGs or global public goods, blending that increases the effectiveness of assistance in these areas also may attract a larger share of the total resources that donors allocate to MICs, without impinging on donor resources for low-income countries.

74. ***Blending and Guarantee Arrangements.*** Agencies differ in the extent to which they are required to attribute specific outcomes to their aid, apply their own safeguard, fiduciary, and disbursement procedures, or ensure selection of specific countries, sectors or population groups. Thus, in each case the development partners would need to establish blending (and guarantee) arrangements that are suitable to the particular circumstances. No single arrangement can capture all potential benefits and at the same time meet donor needs. A menu of financing options for blending and guarantee arrangements (see Box 20) could be structured to provide different types of arrangements appropriate to the country and program circumstances, and donors could choose from among these options. Project or program specific arrangements could

use grants or concessional funds to finance or subsidize specific elements of a project or program otherwise financed by loans—typically, elements that would be financially unviable.

Box 20. Blending: Menu of Financing Options

- **Parallel financing of projects or programs expands their scope and extends benefits to the poor.** By reducing the average cost of financing, parallel financing provides an incentive for governments to embark on larger MDG- or global public goods-related efforts.
- **Pooled financing of programs produces the same benefits as parallel financing,** but avoids the issues of separate financing streams and diverse safeguard, fiduciary, and disbursement requirements and also reduces uncertainty about future resource flows. The funds are deposited into a common bank account and channelled through the national treasury as an integrated part of the government’s annual budget
- **Buy-downs can be used to tailor financing terms to a target level of concessionality.** Buy-downs lower the debt service cost for MICs that are willing to borrow only at more concessional rates to expand the MDG or global public goods agenda. In an often-cited example, DfID grants were blended with IBRD financing in support of a tuberculosis program in China, effectively reducing the loan interest rate and partially repaying principal.
- **A single-donor debt service trust fund arrangement.** The donor contributes to an MDB-administered dedicated trust fund from which a part of the debt service is made as agreed between the MDB and the donor. While the financial impact is the same as in a direct buy-down, multiple financing streams are replaced by a prepayment mechanism (a trust fund), allowing the borrower to deal with the financial flows of only one agency.
- **Donor guarantees of MDB exposure.** Donor guarantees for MDB lending to MICs would enable the MDBs to respond to lending demand from creditworthy countries that are willing to borrow on nonconcessional terms for activities related to the MDGs and global public goods but have reached the institution’s exposure limits.
- **Multidonor trust fund.** A multidonor trust fund administered by an MDB would address the mismatch between aid allocations to single MICs and their relative needs for concessional support for that purpose. The trust fund would assume part of the MDB debt service and/or contribute concessional funds to the pooled financing of MDG- and global public goods-related projects or programs.
- **Combining buy-downs of IBRD debt service with donor guarantees.** Debt service buy-downs alone would not provide a solution for noncreditworthy gap countries, as they would not resolve the underlying creditworthiness limitation arising from their lack of capacity to carry nonconcessional debt. A guarantee could be used to transfer the credit risk of the borrower to a highly creditworthy donor, addressing the MDB’s financial constraint on lending to such a country.

75. **Ongoing Work.** Blending, or combined financing, is potentially an important mechanism to support global public goods and accelerate progress on poverty and social goals, and the Bank has been working with the other MDBs on a joint paper on blending mechanisms. On the basis of this joint exercise, the Bank will engage with the bilateral community and other agencies to develop options for significantly expanding the use of this mechanism to provide enhanced support to meet shared development goals in the MICs.

76. **Blending and Carbon Finance.** Carbon finance and IBRD lending can be blended to mobilize increasing amounts of financing for infrastructure, energy and natural resource management projects in MICs, primarily in the public sector. The Bank’s experience suggests that carbon finance can serve as a catalyst for beneficial investments that would not otherwise take place. The Bank as trustee of carbon funds agrees to purchase greenhouse gas emission reductions through Emission Reduction Purchase Agreements (ERPA), which are long-term contracts that provide hard currency revenue streams based on fixed prices and signed with creditworthy buyers. As such, ERPAs can provide credit guarantees. The Bank has experience with several types of situations where carbon finance provides credit guarantees. The Bank as a lender and carbon buyer can use the future receivables under the ERPA to offset the debt service

under an IBRD loan agreement with a borrower. The carbon payments can be used to amortize the loan (i.e. principal only), offset the interest payment (i.e. loans may be structured as a “grant” facility), or repay the loan’s annual debt service (i.e. principal plus interest) (see Box 21).

Box 21. Carbon Finance and IBRD—Experience

In the *Brazil Plantar* project, the Emission Reduction Purchase Agreement (ERPA) was monetized by allowing Rabobank to extend a loan of a sufficiently long tenor to the project entity. The loan amortization was scheduled so as to mirror the annual ERPA payments, which were assigned directly to the lender. In the *Brazil Nova Gerar Landfill* project, the ERPA served to finance the lease of equipment from a technology provider to the project entity. The ERPA payments are made directly to the technology provider’s account. In the *Ecuador Abanico hydro project*, the ERPA provided an off-take agreement similar to a power purchase agreement allowing the borrower to reach the minimum secured sales required by the lender, the Inter-American Development Bank (IDB). The ERPA was structured so that the proceeds accrue directly to a debt reserve account at IDB, which was also able to reduce the interest rate by 100 base points as a consequence.

77. *A challenge.* If resources are made available for this purpose, it is important to ensure that the programs that are being subsidized are clearly defined and targeted, with the subsidies being allocated as much as possible on a performance basis, avoiding distortions that can occur when subsidized public service providers operate alongside non-subsidized private sector service providers. This has the dual advantage of enhancing transparency around the use of grant resources and potentially greater engagement by private actors in delivering critical services to the target groups or projects. Development agencies differ in the extent to which they are compelled to attribute specific results to the assistance they provide, the oversight they lend and the way they select priorities, so the Bank will need to work with partners to identify those options for blending or combining instruments that meet the above criteria.

VI. CONCLUSION

78. This paper has discussed IBRD’s continuing role as a cooperative institution that offers strategy advice, knowledge and financial resources for its members. It described ways in which the IBRD can improve the quality and cost-effectiveness with which it delivers these resources, with the objective of making the IBRD a more effective partner for its members in their individual pursuit of national development goals and collective efforts to address issues of regional and global concern.

79. *Evolution in MICs.* The paper recognizes that members’ situations have evolved significantly. Many MICs have modernized their fiscal administration, establishing sound development-related investment budgets and implementation mechanisms, and addressed fundamental issues of access to health, education, and basic infrastructure services. In the financial arena, countries are focusing more on mitigating risks than obtaining funding alone. While in many instances countries continue to prefer the IBRD bundle of financial—lending or banking or both— and knowledge services, in other cases countries prefer access to IBRD services on a stand-alone basis. Some are interested in using IBRD expertise, while others are interested in IBRD’s convening role. Other shareholders and providers of development support have relied on the Bank to manage or oversee global initiatives. These have grown in number,

scope and complexity, and seek to use IBRD's strategic and convening capacity, knowledge base, and administrative infrastructure to ensure that resources are effectively deployed.

80. ***Delivery of IBRD Services.*** In the light of the changing context, the paper examined the way IBRD services are being delivered. It puts forward a fresh perspective on how IBRD should support MICs, and outlines a series of proposals for action, and for consideration by Executive Directors and Ministers. These proposals are introduced in the Executive Summary, and dealt with in greater depth in the paper itself.

81. ***Going Forward.*** Following discussion by the Development Committee, Management will develop an updated Action Plan to accelerate implementation of recommended actions, including further development of proposals which Executive Directors and the Development Committee agree are needed. Any changes in Bank policy will be subject to usual consideration by the Board. As part of the Action Plan, Management will also develop a set of success measures it will use to assess progress in implementing this enhanced strategy.

ANNEX A. IBRD ELIGIBLE COUNTRIES

| Country | GNI per capita | HDI | Percent living on <\$2/day | Gini index | Government Efficiency | Country Credit Rating | Level of Indebtedness | HIV/AIDS Infections (thousands) | CO ₂ Emissions: metric tons (thousands) |
|---|----------------|---------|----------------------------|------------|-----------------------|-----------------------|-----------------------|---------------------------------|--|
| IBRD-only Countries | | | | | | | | | |
| a) Lower Middle Income Countries | | | | | | | | | |
| Algeria | 2730 | (3) 103 | (2) 15.1 | (1) 35.3 | (3) 60 | (3) 68 | L | (1) 31.9 | (3) 92097 |
| Belarus | 2750 | (2) 67 | (1) 2 | (1) 30.4 | .. | .. | L | .. | (3) 59959 |
| Brazil | 3460 | (2) 63 | (2) 22.4 | (2) 59.1 | (4) 71 | (3) 62 | S | (4) 1269.9 | (4) 313757 |
| Bulgaria | 3450 | (2) 55 | (2) 16.2 | (1) 31.9 | (5) 107 | (3) 56 | S | (1) 7.8 | (3) 41921 |
| China | 1740 | (3) 85 | (4) 46.7 | (2) 44.7 | (2) 29 | (2) 37 | L | (4) 1300.0 | (5) 3513103 |
| Colombia | 2290 | (2) 69 | (2) 22.6 | (2) 57.6 | (4) 74 | (3) 65 | M | (3) 309.6 | (3) 57375 |
| Dominican Rep. | 2470 | (3) 95 | (1) 2 | (2) 47.4 | (5) 113 | (4) 92 | L | (3) 146.9 | (3) 21544 |
| Ecuador | 2590 | (3) 82 | (4) 40.8 | (2) 43.7 | (3) 55 | (4) 84 | S | (2) 38.6 | (3) 24834 |
| Egypt, Arab Rep. | 1250 | (4) 119 | (4) 43.9 | (1) 34.4 | (3) 53 | (3) 64 | L | (2) 71.3 | (4) 143697 |
| El Salvador | 2450 | (3) 104 | (4) 58 | (2) 53.2 | (2) 38 | (3) 62 | M | (2) 46.5 | (2) 6231 |
| Fiji | 3140 | (3) 92 | .. | .. | .. | .. | L | (1) 0.8 | (2) 1353 |
| Guatemala | 2330 | (4) 117 | (3) 37.4 | (2) 48.3 | (5) 103 | (4) 72 | L | (3) 132.0 | (3) 10302 |
| Iran, Islamic Rep. | 2770 | (3) 99 | (1) 7.3 | (2) 43.0 | .. | .. | L | (2) 68.2 | (4) 360223 |
| Iraq | .. | .. | .. | .. | .. | .. | .. | (2) 27.3 | (3) 79471 |
| Jamaica | 3370 | (3) 98 | (2) 13.3 | (1) 37.9 | (5) 97 | (4) 80 | M | (2) 31.5 | (3) 10809 |
| Jordan | 2470 | (3) 90 | (1) 7.4 | (1) 36.4 | (2) 34 | (3) 70 | S | (1) 5.4 | (3) 16728 |
| Kazakhstan | 2930 | (2) 80 | (1) 8.5 | (1) 31.3 | (3) 55 | (3) 57 | S | (2) 29.7 | (4) 147921 |
| Macedonia, FYR | 2790 | (2) 59 | (1) 4 | (1) 28.2 | (5) 105 | (4) 81 | L | (1) 2.0 | (3) 10258 |
| Marshall Islands | 2980 | .. | .. | .. | .. | .. | .. | .. | .. |
| Micronesia, Fed. States | 1910 | .. | .. | .. | .. | .. | .. | .. | .. |
| Morocco | 1730 | (4) 124 | (2) 14.3 | (1) 39.5 | (3) 56 | (3) 58 | L | (2) 30.6 | (3) 43663 |
| Namibia | 2990 | (4) 125 | (4) 55.8 | (2) 70.7 | (4) 73 | (3) 66 | .. | (3) 423.0 | (2) 2152 |
| Paraguay | 1280 | (3) 88 | (3) 30.3 | (2) 56.8 | (5) 117 | (4) 85 | M | (2) 29.4 | (2) 4122 |
| Peru | 2710 | (3) 79 | (3) 37.7 | (2) 49.8 | (5) 106 | (3) 67 | S | (3) 135.8 | (3) 25489 |
| Philippines | 1250 | (3) 84 | (4) 46.4 | (2) 46.1 | (4) 90 | (4) 71 | M | (2) 80.2 | (3) 73779 |
| Romania | 3830 | (2) 64 | (2) 20.5 | (1) 30.3 | (4) 85 | (3) 61 | L | (2) 21.9 | (3) 86745 |
| Suriname | 2540 | (3) 86 | .. | .. | .. | .. | .. | (1) 7.5 | (2) 2254 |
| Swaziland | 2280 | (5) 147 | .. | .. | .. | .. | L | (3) 401.5 | (1) 970 |
| Syrian Arab Rep. | 1380 | (4) 106 | .. | .. | .. | .. | S | (2) 18.1 | (3) 49097 |
| Thailand | 2750 | (3) 73 | (3) 32.5 | (2) 43.2 | (2) 27 | (2) 42 | L | (4) 947.2 | (4) 231927 |
| Tunisia | 2890 | (3) 89 | (1) 6.6 | (1) 39.8 | (1) 4 | (3) 52 | M | (1) 9.9 | (3) 22067 |
| Turkmenistan | .. | (3) 97 | (4) 44 | (2) 40.8 | .. | .. | M | (1) 4.7 | (3) 42136 |
| Ukraine | 1520 | (3) 78 | (4) 45.7 | (1) 29.0 | (4) 92 | (4) 76 | L | (4) 665.1 | (4) 306807 |
| b) Upper Middle Income Countries | | | | | | | | | |
| Antigua and Barbuda | 10920 | (2) 60 | .. | .. | .. | .. | .. | .. | (1) 372 |
| Argentina | 4470 | (1) 34 | (2) 14.3 | (2) 52.2 | (5) 94 | (5) 107 | S | (3) 266.0 | (4) 133322 |
| Belize | 3500 | (3) 91 | .. | .. | .. | .. | S | (1) 6.2 | (1) 790 |
| Botswana | 5190 | (4) 131 | (4) 50.1 | (2) 63.0 | (2) 35 | (2) 43 | L | (4) 660.8 | (2) 4100 |
| Chile | 5870 | (2) 37 | (1) 9.6 | (2) 57.1 | (2) 40 | (2) 32 | M | (2) 47.9 | (3) 57320 |
| Costa Rica | 4820 | (2) 47 | (1) 9.5 | (2) 46.5 | (4) 83 | (3) 60 | L | (2) 25.1 | (2) 5834 |
| Croatia | 8070 | (2) 45 | (1) 2 | (1) 29.0 | (4) 87 | (3) 55 | S | (1) 4.5 | (3) 21118 |
| Equatorial Guinea | .. | (4) 121 | .. | .. | .. | .. | L | .. | (1) 169 |
| Estonia | 9100 | (2) 38 | (1) 5.2 | (1) 37.2 | (3) 64 | (2) 38 | S | (2) 14.8 | (3) 15943 |
| Gabon | 5010 | (4) 123 | .. | .. | .. | .. | S | (3) 108.6 | (2) 3459 |
| Hungary | 10050 | (1) 35 | (1) 7.3 | (1) 24.4 | (4) 80 | (2) 40 | M | (2) 10.2 | (3) 56647 |
| Korea, Republic of | 15810 | (1) 28 | (1) 2 | (1) 31.6 | (2) 39 | (2) 28 | .. | (2) 47.5 | (4) 446190 |
| Latvia | 6760 | (2) 48 | (1) 8.3 | (1) 32.4 | (4) 78 | (3) 48 | S | (2) 14.0 | (2) 6306 |
| Lebanon | 5510 | (3) 81 | .. | .. | .. | .. | S | (1) 3.5 | (3) 16392 |
| Libya | 5530 | (2) 58 | .. | .. | .. | .. | .. | (2) 16.9 | (3) 50418 |
| Lithuania | 7210 | (2) 39 | (2) 13.7 | (1) 31.9 | (4) 86 | (2) 46 | M | (1) 3.5 | (3) 12565 |
| Malaysia | 4960 | (2) 61 | (1) 9.3 | (2) 49.2 | (1) 5 | (2) 35 | M | (2) 97.7 | (4) 151630 |
| Mauritius | 5260 | (2) 65 | .. | .. | (2) 46 | (3) 51 | M | .. | (2) 3114 |
| Mexico | 7150 | (2) 53 | (3) 26.3 | (2) 54.6 | (3) 68 | (2) 45 | L | (3) 313.0 | (4) 383671 |
| Palau | 7410 | .. | .. | .. | .. | .. | .. | .. | (1) 234 |
| Panama | 4630 | (2) 56 | (2) 17.6 | (2) 56.4 | (3) 65 | (3) 59 | S | (2) 28.1 | (2) 6255 |
| Poland | 7110 | (2) 36 | (1) 2 | (1) 31.6 | (4) 72 | (2) 39 | M | (2) 38.6 | (4) 296398 |
| Russian Federation | 4460 | (2) 62 | (2) 23.8 | (2) 45.6 | (5) 109 | (3) 54 | M | (4) 1590.8 | (5) 1432913 |
| Saint Kitts and Nevis | 8200 | (2) 49 | .. | .. | .. | .. | S | .. | (1) 114 |
| Seychelles | 8290 | (2) 51 | .. | .. | .. | .. | S | .. | (1) 535 |
| Slovak Republic | 8130 | (2) 42 | (1) 2.4 | (1) 25.8 | (3) 67 | (2) 41 | M | (1) 5.4 | (3) 36841 |
| South Africa | 4960 | (4) 120 | (2) 23.8 | (2) 59.3 | (1) 21 | (3) 49 | L | (5) 10087.7 | (4) 345382 |
| Trinidad and Tobago | 10440 | (2) 57 | .. | .. | (4) 84 | (3) 50 | L | (2) 41.5 | (3) 41217 |
| Turkey | 4740 | (3) 94 | (2) 10.3 | (1) 40.0 | (4) 77 | (3) 69 | S | .. | (4) 207996 |
| Uruguay | 4360 | (2) 46 | (1) 3.9 | (2) 44.6 | (3) 69 | (4) 77 | S | (2) 10.2 | (2) 4082 |
| Venezuela | 4810 | (3) 75 | (3) 32 | (2) 49.1 | (5) 116 | (4) 74 | M | (3) 180.7 | (4) 108163 |

| Country | GNI per capita | HDI | Percent living on <\$2/day | Gini index | Government Efficiency | Country Credit Rating | Level of Indebtedness | HIV/AIDS Infections (thousands) | CO ₂ Emissions: metric tons (thousands) |
|---------------------------------|----------------|---------|----------------------------|------------|-----------------------|-----------------------|-----------------------|---------------------------------|--|
| IBRD/IDA Blend Countries | | | | | | | | | |
| Albania | 2570 | (3) 72 | (2) 11.8 | (1) 28.2 | (5) 99 | (5) 96 | L | .. | (2) 2588 |
| Azerbaijan | 1240 | (3) 101 | (1) 9.1 | (1) 36.5 | (3) 63 | (4) 78 | L | (1) 8.3 | (3) 27998 |
| Bolivia | 1010 | (4) 113 | (3) 34.3 | (2) 44.7 | (5) 104 | (4) 87 | M | (1) 8.8 | (3) 10075 |
| Bosnia and Herzegovina | 2550 | (2) 68 | .. | (1) 26.2 | (5) 112 | (4) 89 | L | (1) 3.9 | (3) 18629 |
| Dominica | 3790 | (2) 70 | .. | .. | .. | .. | S | .. | (1) 120 |
| Grenada | 3920 | (2) 66 | .. | .. | .. | .. | S | .. | (1) 230 |
| India | 730 | (4) 127 | (5) 79.9 | (1) 32.5 | (3) 50 | (3) 53 | L | (5) 9637.2 | (5) 1220926 |
| Indonesia | 1270 | (4) 110 | (4) 52.4 | (1) 34.3 | (2) 44 | (4) 75 | S | (3) 217.4 | (4) 306491 |
| Pakistan | 690 | (4) 135 | (5) 65.6 | (1) 33.0 | (3) 61 | (4) 82 | M | (3) 151.8 | (4) 108677 |
| Papua New Guinea | 660 | (4) 137 | .. | (2) 50.9 | .. | .. | M | (2) 33.9 | (2) 2482 |
| Saint Lucia | 4800 | (3) 76 | .. | .. | .. | .. | M | .. | (1) 378 |
| Saint Vincent and the Gren | 3590 | (3) 87 | .. | .. | .. | .. | M | .. | (1) 184 |
| Serbia and Montenegro | 3280 | .. | .. | .. | (5) 100 | (5) 98 | S | (2) 21.0 | (3) 46637 |
| Uzbekistan | 520 | (4) 111 | (5) 77.5 | (1) 26.8 | .. | .. | M | (2) 25.8 | (4) 122330 |
| Zimbabwe | 340 | (5) 145 | (5) 64.2 | (2) 56.8 | (5) 111 | (5) 117 | S | (5) 3164.3 | (3) 12452 |

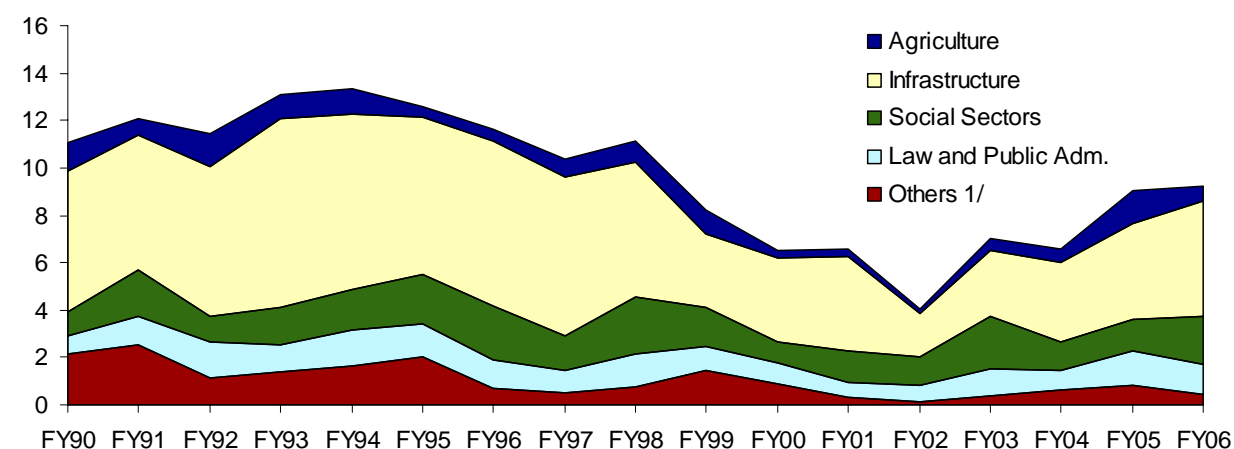
Sources:

- Income classification based on Global Development Finance 2006 Report, Table A. 30: Classification of countries by region and level of income.
- World Bank lending eligibility based on OP 3.10 - Annex D July 2006.
- GNI per capita data was obtained from the World Bank's OP 3.10 - Annex D July 2006.
- HDI data was obtained from UNDP's Human Development Indicators 2005 statistics. Countries are ranked from 1 to 5 based on their ranking within the index out of a total of 177 countries, where (1) = countries ranked between 1 and 35, (2) = countries between 36 and 70, (3) = countries between 71 and 105, (4) = countries between 106 and 140, and (5) = countries between 141 and 177.
- Percent living on less than \$2/day data was obtained from the World Bank's World Development Report 2005: A Better Investment Climate for Everyone, from Table 2: Poverty and income distribution data. Countries are ranked from 1 to 5 where (1) = countries ranked between 1 and 10, (2) = countries between 10.1 and 25, (3) = countries between 25.1 and 40, (4) = countries between 40.1 and 60, and (5) = countries between 60.1 and 100.
- Gini index data was obtained from the World Bank's World Development Report 2005: A Better Investment Climate for Everyone, from Table 2: Poverty and income distribution data. Countries are ranked where (1) = countries with a Gini index score of 0-40, and (2) = countries with a Gini index score of 40-100.
- Government efficiency data was obtained from the World Economic Forum's Global Competitiveness Report 2005-2006: Policies Underpinning Rising Prosperity. Countries are ranked from 1 to 5 based on their ranking out of 117 countries within index 6.18: Government effectiveness in reducing poverty and inequality. (1) = countries ranked between 1 and 23, (2) = countries between 24 and 47, (3) = countries between 48 and 70, (4) = countries between 71 and 93, and (5) = countries between 94 and 117.
- Country credit rating data was obtained from the World Economic Forum's Global Competitiveness Report 2005-2006: Policies Underpinning Rising Prosperity. Countries are ranked from 1 to 5 based on their ranking out of 117 countries within index 2.21: Country credit rating, 2005. (1) = countries ranked between 1 and 23, (2) = countries between 24 and 47, (3) = countries between 48 and 70, (4) = countries between 71 and 93, and (5) = countries between 94 and 117.
- Level of indebtedness data was obtained from the World Bank's Global Development Finance 2005: Mobilizing Finance and Managing Vulnerability, Analysis and Statistical Appendix, Table A. 50: Classification of countries by level of external indebtedness. L = Less indebted, M = Moderately indebted, and S = Severely indebted.
- HIV/AIDS infections data was obtained from the United Nations Statistics Division; Millennium Indicators: "HIV prevalence rate, aged 15-49, percent (UNAIDS estimates)" and from the United Nations Statistics Division; Common Database: "Population total, estimates and projections (UN Population Division) [2003 data]". Countries are ranked from 1 to 5 where (1) = countries with 0 - 10; (2) = countries with 10.1 - 100; (3) = countries with 100.1 - 500; (4) = countries with 500.1 - 2000; and (5) = countries with 2000 or more.
- CO₂ Emissions data was obtained from the United Nations Statistics Division; Millennium Indicators: "Carbon dioxide emissions (CO₂), thousand metric tons of CO₂ (CDIAC)". Countries are ranked from 1 to 5 where (1) = countries with 0 - 1000; (2) = countries with 1001 - 10,000; (3) = countries with 10,001 - 100,000; (4) = countries with 100,001 - 1,000,000; and (5) = countries with 1,000,001 or more.

ANNEX B. LENDING TRENDS BY INSTRUMENT, SECTORS, AND REGIONS

1. **Sectors.** Figure 1 reveals the important contribution of infrastructure to the overall decline in investment lending during FY90-02, and its significant role in the recovery of investment lending since then. It also shows that lending to other sectors (except social sectors) experienced a similar decline. Investment lending for agriculture and law and administration has increased since FY02. The sector breakdown of development policy lending (Figure 2) shows the continued importance of law and administration. Policy-based lending to the social sectors increased in the early 2000s but has since declined, with the financial sector, trade, and industry receiving greater focus in IBRD countries during the past two years.

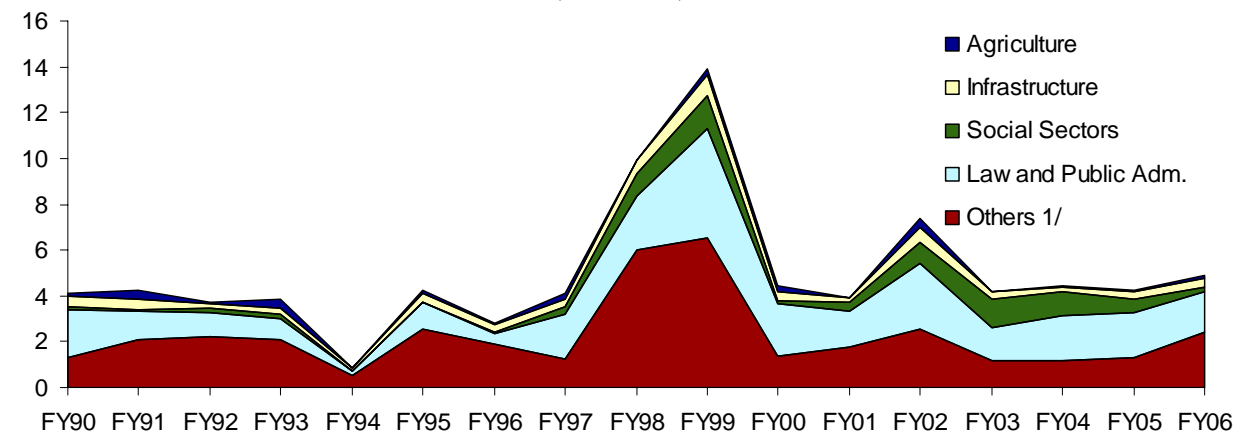
Figure 1. IBRD Investment Lending by Key Sectors, FY90-06^{2/}
(US\$billion)



1/ Includes: Finance and Industry and Trade

2/ Excludes Guarantees

Figure 2. IBRD Policy-based Lending by Key Sectors, FY90-06^{2/}
(US\$billion)

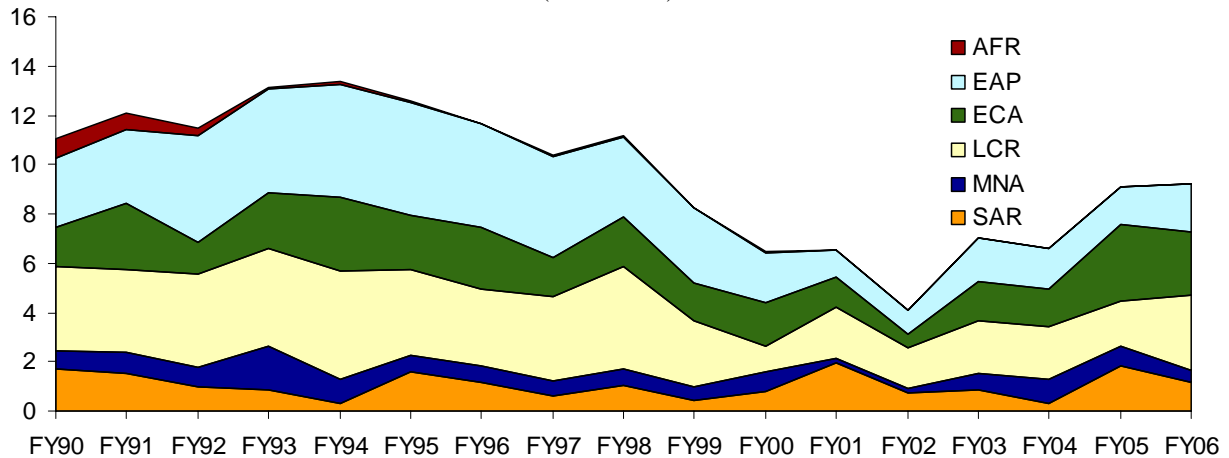


1/ Includes: Finance and Industry and Trade

2/ Excludes Guarantees

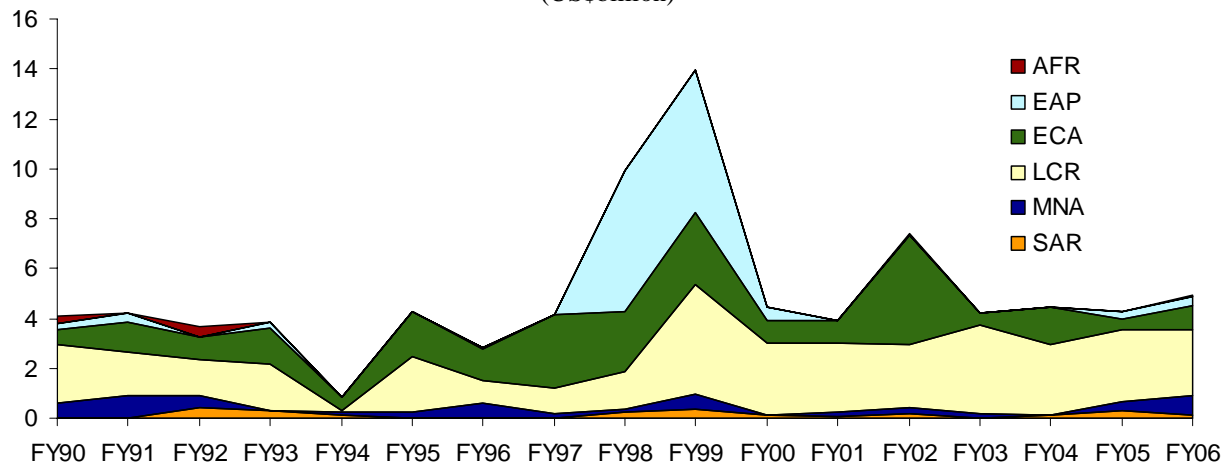
2. **Regions.** The decline in investment lending since the mid-1990s occurred in all regions other than South Asia (Figure 3). It was particularly marked in East Asia. The recent recovery in investment lending has been driven by the EAP, ECA, and LCR regions. The breakdown of development policy lending by region (Figure 4) shows a growing concentration in the LCR region until FY04, with emerging interest in MNA and, to a smaller extent, EAP during FY05-06.

Figure 3. IBRD Investment Lending by Region, FY90-06^{1/}
(US\$billion)



1/ Excludes Guarantees

Figure 4. IBRD Policy-based Lending by Region, FY90-06^{1/}
(US\$billion)



1/ Excludes Guarantees