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

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IMPLEMENTING THE STRATEGIC COMPACT: FIFTH PROGRESS REPORT

Attached for the information of the Development Committee is the Executive Summary of the Fifth Semi-Annual Progress Report on the Strategic Compact. This responds to the Committee's request in its April 29, 1997 communique (para. 13) that it receive periodic reports on progress achieved in implementation of the Strategic Compact.

The full report was discussed by the World Bank Board of Executive Directors on Tuesday, September 14, 1999. The Executive Directors generally endorsed the report with a broad consensus on the achievements to date as well as on what remains to be done. The Board commended management and staff on progress, including improvements in CAS's, client interaction, response capacity, quality of supervision, and a sharper focus on poverty. The Board noted that several challenges remain, including clarifying lines of accountability and responsibility under matrix management, reducing staff stress, focusing on strategic selectivity and consolidating and building on the progress to date.

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EXECUTIVE SUMMARY

Overview

1. The Strategic Compact approved by the Board on March 31, 1997, provided additional funding of $250 million over a 30-month period to launch an ambitious program to renew the Bank's effectiveness in fighting poverty. Now after two full years of operation, the Compact's initiatives are being integrated into our normal business and helping the Bank to better carry out its mission of poverty reduction.

2. The *Fourth Progress Report on Implementing the Strategic Compact (R99-48)* discussed our performance to mid-FY99 and how we were responding rapidly and flexibly to satisfy client demands. The report also pointed to the need for further improvements in the quality of our products and active management of budget pressures.

3. This *Fifth Progress Report* notes our strengthened focus on poverty reduction through high quality and increased services and the significant progress made in FY99 in taking social and structural issues into account. It discusses the quality improvement programs for lending and ESW products that were launched during the second semester of FY99 and measures taken to improve budget monitoring. It highlights the new challenges facing us as we approach the final months of the two and a half year Compact period ending in December 1999.

Performance

4. The Bank has continued to perform at the high level attained in FY98 with greater client orientation, better quality and increased client services, and a healthier net income. These were achieved in an environment of greater uncertainty brought on by the global financial crisis, which began six months after the Compact was approved. Its aftershocks continue to affect a large number of countries. A summary of Bank performance indicators can be found in Table 1.

5. As our clients tell us, the Bank has become more *client-oriented*, and is now widely recognized by those who appreciate the "new" Bank as having a better understanding of their needs, and clear channels of communication with them. These changes have been achieved through:

- Clearer and higher quality CASs delivered by empowered country directors;
- HR Reforms which are focusing on renewing skills and creating a "one-staff" culture; and,
- Knowledge Management, supported by the Networks and WBI, which is beginning to help us to share best practice and cutting-edge expertise among staff and with our clients.

6. Reinforcing our shift towards greater client-orientation is the *location of work* initiative which is helping us move closer to our clients by devolving decision-making authority to country

offices. By end-FY99, country offices were further strengthened. We now have 24 of 51 country directors and 20% of Regional staff (excluding all ACS staff) in country offices compared to 22 and 18%, respectively, at end-FY98. Clients have responded positively to the shift in decision making authority to country offices, and feel that communication with the Bank has been enhanced and project implementation has improved.

7. Our emphasis on *quality* in the Strategic Compact is paying dividends as higher quality is contributing to a greater impact on development effectiveness. The quality gains made during the past year were achieved in the context of high service levels. For example:

- The quality of CASs improved on several dimensions - in particular, the coverage of governance and corruption, self-evaluation, and the use of participatory approaches in CAS preparation;

- Quality at Entry[1] for FY99 was 86% and, although falling short of our target of 90%, compared favorably with 82% achieved in FY98;

- Quality of Supervision[2] improved from 76% in FY98 to 82% in FY99, but fell short of our target of 85%; and,

- both the realism[3] and proactivity[4] indices increased substantially from 68% and 72%, respectively, in FY98 to 74% and 83% in FY99, reflecting the greater attention given to portfolio implementation issues.

8. The Bank continued to provide a *high level of service* to clients in FY99. Disbursements totaled $24.2 billion, close to FY98's record of $24.9 billion. IBRD/IDA lending set new records at $29.0 billion with adjustment lending reaching new highs as we responded to the needs of clients affected by the financial crisis. Lending for the social sectors increased by 40% during the first two years of the Compact, compared to the prior two years. Advisory services and technical assistance also increased by 15%. The HIPC initiative made great strides with a total of $6.8 billion of debt relief provided or committed to date.

9. When the Strategic Compact was launched, projected net income for IBRD showed a declining trend. This has improved largely due to actions taken over the past year to address the Bank's structural financial issues. Moreover, the FY99 IBRD net income of $1.5 billion exceeded projections by about 60% due primarily to a one-time capital gain on the liquid investment portfolio, the cutback in the annual waivers of interest charges, and the lower than budgeted administrative expenses. Current projections for the medium term anticipate a rising

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[1] Quality at entry is the percentage of projects, approved during the calendar year, with satisfactory or better overall likelihood of achieving their development objectives as assessed by QAG.

[2] Quality of Supervision is the percentage of projects under implementation with satisfactory ratings on supervision as assessed by QAG.

[3] Realism index is the percentage of actual problem projects to the total of actual and potential problem projects.

[4] Proactivity index is the percentage of projects rated as problem projects 12 months earlier which have since been upgraded, closed, suspended, or partially cancelled.

net income trend and stable return on assets. However, the very rapid growth in loans and the earlier deterioration in loan portfolio credit quality have prompted the Bank, at the request of the Development Committee, to take another look at potential options for enhancing IBRD's financial resilience.

Challenges

10. The Bank has achieved much during the past two years and the investments made under the Compact have in many ways enabled it to do so together with the tremendous effort and dedication of staff. Yet in going forward, we face several challenges: i) further improving quality; ii) addressing staff concerns; iii) increasing budget flexibility; iv) realizing the savings potential from the new SAP system; and, v) strengthening our skills base.

11. Attaining further *improvements in quality* beyond the levels already achieved remains a challenge. For example, Quality of Lending, as reflected by Quality at Entry, improved again in FY99 (86%), but did not reach our stretch target of 90%. Similarly, Quality of Supervision increased again in FY99 (82%), but short of our target of 85%. The Quality of ESW[5], undertaken for the first time to assess FY98 outputs, showed that at 73%, quality of these products were less than we had expected. Consequently, quality issues are receiving close management attention and action plans are being implemented for both lending and ESW to keep us moving on an upward path.

12. In the recent 1999 Staff Survey, feedback has been positive in some areas with staff generally feeling that the internal changes are for the better and the Bank is now more focused on its mission. Staff have also identified *areas of concern* to them:

- stress and its impact on personal and family life;
- effectiveness of matrix management and coordination across the Bank group;
- trust among staff and senior management; and,
- career development decisions and opportunities.

13. These serious concerns are being addressed in the context of on-going work as well as through specific follow-up to the staff survey. Among the steps already taken in tackling staff stress is through lower levels of overprogramming. Emphasis on reducing overprogramming has already resulted in a lower level by end-FY99. We will continue to monitor for further progress in FY00.

14. Increasing *budget flexibility* is critical to enabling the Bank to redeploy resources during the course of the year to where they are needed most. This requires a larger staffing headroom and/or more movements of resources within the matrix and across units. The recently introduced SAP system will enhance transparency of resource use across the Bank and facilitate redeployments. Strengthened budget monitoring and forecasting will also reduce the unexpected

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[5] Quality of ESW is the percentage of ESW products completed during the year with satisfactory ratings as assessed by QAG.

swings in budget utilization as observed and reported at end-FY99 (*FY99 World Bank Budget Outcome and Carryover* [SEC M99-545]).

15. In FY99, the enormous task of laying the groundwork for "going live" with SAP was completed and the system came on-stream in July 1999. The experiences of other institutions have shown that in the initial months following the launch, there is a temporary drop in performance as staff begin to learn and adapt to the new system. The immediate challenge for us is to proactively monitor and manage this dip. The longer-term challenge is to ensure that we *realize the savings* promised by the new system. This is likely to require further streamlining and simplification of our processes.

16. As we enter the new millennium, we need to position ourselves to take on more global responsibilities as our shareholders increasingly expect of us, and help growing numbers of clients confronting post-conflict issues and financial crises. To do this, we must also continue *strengthening our skills base,* to ensure that we will continue to provide top-quality expertise to our clients.

Going Forward

17. The Compact has helped us strengthen our focus on poverty reduction and increasingly mainstream social and structural concerns into our normal business. Poverty reduction will continue to be the yardstick by which we determine our future work program and evaluate our performance. Moving beyond the Compact, we need to step up our efforts through greater partnering, and take a holistic approach along the lines of the *Comprehensive Development Framework* focusing particularly on issues of capacity-building, especially in the areas of good governance, anti-corruption, effective legal and judicial systems, well-organized and supervised financial systems, and social safety nets.

18. In spite of the progress made over the past two years, our commitment to the Bank's mission, our best efforts to serve our clients, and the efforts of our partners in development, worldwide poverty trends are worsening. We will fall short of our ambitious goals if the current trends continue. Our greatest challenge remains to win the fight against poverty and for this to happen we need to make substantial progress in accomplishing results on the ground. We are looking to the approach being developed under the CDF as the way forward.

Table 1: Bank Performance Indicators – FY97-99

	FY97	FY98	FY99		FY00	FY01
				Plan/	Plan/	Plan/
	Actual	Actual	Actual	Target	Target m/	Target m/
Development Effectiveness a/						
Lending Services						
Quality at Entry b/	76%	82%	86%	90%	90%	100%
IDA concentration (3-year averages) c/	45%	44%	39%	n.a.	n.a.	33%
Portfolio management:						
% projects rated satisfactory by OED d/	71%	80%	n.a.	n.a.	n.a.	n.a.
Realism index e/	66%	68%	74%	75%	75%	75%
Disbursements - Investment and Adjustment Loans ($b)	20.0	24.9	24.2	26.9	n.a.	n.a.
Disbursement ratio f/	20%	20%	20%	n.a.	n.a.	n.a.
Quality of Supervision g/	63%	76%	82%	85%	93%	100%
Nonlending Services:						
Quality of ESW h/	n.a.	73%	n.a.	80%	90%	100%
Responsiveness to Clients a/						
Lending services:						
Commitments ($ billions)	19.1	28.6	29.0	28.0-30.7	25.6-29.3	25.0-27.5
(No. of Operations, incl. West Bank and Gaza)	244	288	279	267-305	280-300	280-300
Appraisal to Board - % of Projects meeting 5-month standard	41%	52%	57%	73%	73%	80%
Portfolio management:						
No. of Projects under Supervision i/	1,778	1,830	1,823	1,842	n.a.	n.a.
Pro-activity index j/	70%	72%	83%	80%	90%	90%
Productivity a/						
Average Lending Completion Cost ($'000) i/	305	330	269	297	320	309
Supervision Effort per Project ($'000)	60	62	64	59	67	65
Average ESW Completion Cost	139	105	91	112	115	109
IBRD Net Income ($ millions) k/	**1,285**	**1,243**	**1,518**	**950**	**1,430**	**1,674**
of which: Allocable Net Income ($ millions)	**1,173**	**1,061**	**1,263**	**700**	**1,255**	**1,502**
IBRD Financial Performance Indicator (ROA %)	**1.04**	**0.98**	**1.04**	**0.69**	**0.94**	**1.05**
Equals						
Net Interest Margin (a+b)	**1.62**	**1.47**	**1.62**	**1.36**	**1.63**	**1.57**
(a) Net Interest Spread on Average Earning Assets	0.28	0.20	0.42	0.15	0.53	0.51
Return on Investments and Loans	6.42	6.30	6.38	6.49	6.45	6.29
Cost of Borrowings Outstanding	(6.14)	(6.10)	(5.96)	(6.34)	(5.92)	(5.78)
(b) Contribution from Equity	1.34	1.27	1.20	1.21	1.10	1.06
Plus						
Net Income from Pension and Other Post-retirement Plan	0.05	0.32	0.18	0.18	0.12	0.11
Commitment Charges and Net Other Income	0.09	0.08	0.10	0.10	0.10	0.10
Minus						
Administrative Expenses l/	0.67	0.69	0.69	0.74	0.63	0.56
Loan Loss Provisions	0.05	0.20	0.17	0.21	0.28	0.17

a/ *FY00 Plan/Target are from "World Bank Programs and Budgets for FY00", R99-111. FY01 Plan/Target are from "Strategic Directions for FY00-02", R99-47.*

b/ *Percentage of projects likely to achieve their development objectives as defined by QAG. FY99 = CY98. CY99 available in May 2000.*

c/ *Percentage of IDA commitments to countries in the two lowest policy performance quintiles.*

d/ *FY99 results available end September 1999.*

e/ *Percentage of actual problem projects to the total of actual and potential problem projects.*

f/ *Disbursements as a percentage of undisbursed balances for investment lending at the beginning of the fiscal year.*

g/ *Percentage of projects under implementation with satisfactory ratings on supervision, per QAG's annual review.*

h/ *Percentage of ESW products completed during the year with satisfactory ratings, per QAG's annual review. The FY99 review is due in October 1999.*

i/ *Includes West Bank and Gaza.*

j/ *Percentage of projects rated as problem projects twelve months earlier which have since been upgraded, restructured, closed, suspended or partially cancelled.*

k/ *FY00 includes an estimated income of $175 million from SRP. FY01 includes an estimated $172 million income from SRP.*

l/ *Administrative Expenses for IBRD projected at $961 million and $898 million for FY00 and FY01 respectively.*

m/ *Figures for Net Income are projections from "Allocation of FY99 Net Income, Transfer from Surplus, and Waivers of Loan Charges for FY99". R99-143.*