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EXECUTIVE SUMMARY

The Bank and our constituency office have seen considerable change over the past year. Over FY04 the Bank renewed several important policies with the aim of making itself a more attractive, cost-effective and relevant development-partner, and thus scaling-up its lending. We support these reforms and urge their consistent and accelerated implementation.

Constituency Office

During FY04 we continued to represent the interests of our constituency members at the Board and with Bank staff, and to assist constituency members in their relations with the Bank. We have increased our focus on communication with our members, in particular reporting developments at the Bank.

In Board discussions we have continued to emphasise the role of economic growth in reducing poverty. Consistent with this, we have supported the Bank’s efforts to improve the investment climate in developing countries and to promote trade liberalisation. During FY04 we also focussed on reducing the financial and compliance costs to developing countries of doing business with the Bank, both for the direct benefit of developing countries and to ensure that the Bank remains an attractive development-partner. To this end, we have sought restraint in the Bank’s own budget - the costs of which are passed on to developing countries, including our constituency members - and improved budget processes, which are necessary to achieve to this outcome.

Bank Policy Issues

On current trends, most developing countries will not meet most Millennium Development Goals. The poverty goal is likely to be achieved at the global level, but Africa will fall well short. For the human-development goals, the risks are much more pervasive across the regions. In response to these trends and to the challenge of reducing the financial and compliance costs to developing countries of doing business with the Bank, over FY04 the Bank renewed several important policies with the aim of making itself a more attractive, cost-effective and relevant development-partner, and thus scaling-up its lending.

- The Bank’s share of lending to middle-income countries has been declining in recent years. The Bank has proposed several ways of increasing the value of its services and reducing the financial and compliance costs of its lending to middle-income countries.

- Over FY04 the Bank progressed its long-term agenda of modernising its lending instruments in order to reduce compliance costs and improve the quality of lending. It is replacing the several variants of adjustment loans with one loan
instrument - "development policy lending" - and modernising investment loans to provide simpler, faster and more useful investment-lending.

- The Bank and the IMF are working on options to enhance the voice of developing countries in their decision-making. Some of the options raise fundamental issues of Bank structure. The 2004 Annual Meetings will provide an opportunity for Governors to debate this issue, give guidance and set the future agenda.

- Bank lending for infrastructure has been declining over the last decade. The Bank is aiming to reverse this trend by its Infrastructure Action Plan, under which it will more actively lend to both public and private sectors, explore engagement at the sub-national level, and expand analytic work to identify infrastructure bottlenecks.

- A lengthy and controversial review of the Bank Group's role in extractive industries concluded with a Board decision that the Bank should continue to engage in this sector and should increase its focus on the governance, environmental and social aspects of extractive-industry projects.

**IDA and HIPC Policy Issues**

At the IDA 13 mid-term review in November 2003, IDA Deputies agreed that developing countries had broadly met, and in some cases exceeded, the results targets set during the IDA 13 replenishment. The IDA 14 replenishment is now underway. The Bank is seeking a 30 percent increase in the replenishment, compared with the IDA 13 replenishment. Key issues in the negotiations are the allocation and use of grants, refinements to the performance-based allocation system, and the cost and financing of HIPC debt-relief.

Our office has continued to emphasise that the quality of countries' policies and institutions ("country performance") should be the main criterion for IDA resource allocation. We have supported efforts to refine the IDA allocation formula, in particular to reduce the large shifts in allocations that small changes in governance ratings can produce.

Disclosure of Country Performance and Institutional Assessment (CPIA) ratings of individual countries has been a controversial issue. In September 2004 the Board agreed to disclose the ratings, starting with the 2005 ratings. We also supported disclosure.

Another important development in FY04 was initial work on developing a framework for preventing the debt of developing countries reaching unsustainable levels. The Bank and the IMF, in consultation with other creditors, are exploring alternatives to debt financing for countries whose debt is approaching an unsustainable level.
Development Results

Bank assistance since 1999 had moderately-satisfactory or better outcomes at the country level in about 70 percent of cases. Of the individual projects that closed in FY02 (the latest full-year cohort of evaluated projects), 79 percent had satisfactory or better outcomes. This improved on both FY00 and FY01 cohorts and was the third year in a row in which project outcomes exceeded the corporate target of 75 percent satisfactory. Regionally, East-Asia Pacific has the highest and Africa the lowest proportion of satisfactory or better outcomes.

IBRD Finances

IBRD loans outstanding at the end of FY04 were $110 billion, compared with $116 billion at the end of FY03 and $122 billion at the end of FY02. This is about the same level as at the end of FY96, immediately before the Asian crisis. FY04 is the third year in a row of negative net disbursements, driven mainly by a high level of prepayments. New commitments fell from $11.5 billion in FY02 and $11.2 billion in FY03 to $11.0 billion in FY04. A major influence on the decline in IBRD lending is that its loans are becoming less competitive for middle-income countries, as the compliance costs of doing business with the Bank increasingly outweigh the price advantage of its loans.

IBRD net income fell to $1.6 billion in FY04 from $3.0 billion in FY03 and $2.0 billion in FY02, largely due to the fall in international interest-rates. The net income results in both years mask a weaker underlying position, as income in both years was boosted by large reductions in loan-loss provisions due to prepayments. Nonetheless, at the end of FY04 IBRD is in a strong capital position, with a 29 percent equity-to-loans ratio.

The Board set aside $400 million of FY04 net income for future IDA and HIPC transfers. As a result, IBRD will have a greater capacity to maintain or even increase transfers to IDA and HIPC if shareholders so desire. The main result of the decline in net income from FY03 to FY04 is to lower the allocation to reserves more than would otherwise have been the case.

IDA Finances

IDA credits outstanding were $116 billion at the end of FY04, compared with $107 billion at the end of FY03. In FY04 IDA committed a record $9 billion in development assistance, of which $1.7 billion was in the form of grants.

IDA grants and the HIPC initiative add to the risks around IDA's future finances. Grants, unlike credits, do not generate future refinances to IDA. Therefore to maintain the existing level of development assistance, donors will need to increase their contributions in future replenishments. A compromise was reached under IDA13 whereby donors would compensate IDA for the service charges forgone on grants and would consider compensation for foregone principal-reflows as they fall due. HIPC currently reduces IDA reflows by about $600 million annually, a cost to IDA largely met by transfers from
IBRD net income. In FY05 the IBRD Board will consider funding from IBRD for later years.

**FY05 IBRD/IDA Budget**

The FY05 operating budget for IBRD/IDA is $2.0 billion - a 7 percent increase above FY04.

In FY04 we continued to call for a budget process that better controls costs. We are concerned that key cost-drivers, notably staff-cost increases, are treated as exogenous, and, more generally, that complex, fragmented budget processes reduce transparency and disguise from management and the Board the costs to developing countries resulting from the Bank's increasing budget. Management has responded to these concerns by undertaking to initiate reviews with the potential to improve cost-control. Given the Bank's recent history of budget increases and slow progress in internal reform, we will continue to stress these issues and monitor progress.

**International Finance Corporation**

IFC generated a record profit of $982 million in FY04, compared with then-record profit of $528 million in FY03. The FY04 result represents a return on net worth of about 14 percent. The quality of IFC's portfolio improved in FY04 for both equity investments and loans, to levels which are somewhat better than before FY02, when the Argentine crisis struck IFC. IFC's commitments in FY04 were $4.8 billion (23 percent higher than in FY03) and disbursements were $3.2 billion (7 percent higher than in FY03).

IFC continues to implement and plan internal reforms to add value in new ways, to manage a growing organisation, and to improve financial and developmental performance. Its overall business strategy, however, remains largely unchanged.

Our office supported IFC's business strategy and its FY05 budget. However, we called for better information on the results of increased expenditures and for a longer-term perspective on both strategy and budget. We also sought to better understand the constraints on IFC's growth.

**Multilateral Investment Guarantee Agency (MIGA)**

The outcome of MIGA's financial operations in FY04 was mixed. The Agency issued $1.1 billion in guarantees covering 54 contracts in support of 34 projects - a 21 percent decrease compared with FY03 in terms of guarantee amount, although gross and net exposure slightly increased.

MIGA's portfolio diversification has been disappointing, especially with regard to investors. Our office has advocated a diverse portfolio among regions, sectors and investors, and a proactive marketing strategy. We called for particular attention to the East Asia Pacific region, where MIGA activity in FY04 has been limited.
Constituency Issues

Australia: Australia and the Bank continue to collaborate on a range of issues, particularly developments in East Asia and the Pacific. The Bank’s regional office in Sydney, headed by Country Director Xian Zhu, has played a key role in collaboration between the Bank and the Australian Government in Pacific Island countries. Over the past year Australia provided $A129 million to IDA, and trust-fund contributions of $A61 million. World Bank President James Wolfensohn visited Australia in February 2004.


Cambodia: The Bank has continued its work in Cambodia despite the delay in forming a new government following the July 2003 general election. The formation of a new government in mid-July 2004 provided the Bank with the opportunity to engage with Cambodia more intensively. Early in 2005 the Bank will launch a new Country Assistance Strategy for 2005-2008.

Over FY04 the Board approved two new IDA projects and three IFC projects in Cambodia. The Bank also issued two analytic papers, one on improving fiscal management and the other on Cambodia’s competitiveness. It is also working with other
stakeholders to support the government in organising a high-level conference, scheduled for December 2004, to discuss Cambodia’s growth strategy in the era of free trade.

Korea: Relations between Korea and the Bank continued to strengthen during FY04 through Korea’s active involvement in the Bank’s financial and non-financial activities. Korea contributed $13 million to Bank activities over FY03 and FY04. Korea’s support for Bank activities is evolving towards a focus on global and regional programmes, such as GEF, HIPC and ASEM. Good progress is also being made in knowledge partnerships, under which Korea is sharing her development experience with developing countries.

Mongolia: In May 2004 the Board approved the Bank’s 2005-2008 Country Assistance Strategy (CAS) for Mongolia. The new CAS focuses on three objectives: consolidating the transition to a free-market economy, reducing vulnerabilities, and aligning policies and resources with development results.

In FY04 the Board approved one IDA credit, two IFC loans and a MIGA guarantee in Mongolia. The Bank also continued an active analytic programme, with two major reports issued in FY04. A Country Assistance Evaluation, issued in May 2004, reviewed the Bank’s activities in Mongolia over the past decade.

Executive Director John Austin visiting the construction of the National Legal Center, financed by the World Bank, in Ulaanbaatar, Mongolia, in May 2004

New Zealand: New Zealand has advanced development of its multilateral engagement strategy, due to be completed in early 2005. The strategy emphasises regional cooperation and assistance. Government agencies continue to engage closely with the Bank’s regional office in Sydney and with other donors to the Pacific.
During FY04 New Zealand strengthened its cooperation with IFC through new contributions to the Mekong Private Sector Development Facility and the Corporate Citizenship Fund. New Zealand also continued to engage with the Pacific Enterprise Development Facility and the Foreign Investment and Advisory Service in the Pacific.

**Pacific Island Members:** FY04 saw the beginning of a new phase of Bank engagement with the Pacific. A Country Assistance Evaluation of the past decade of Bank assistance to the Pacific Islands is being completed, and a new Pacific Strategy is being developed. Over the past six months the Bank has consulted government, civil society and the private sector on a discussion paper about the new strategy. The new strategy, expected to be completed by the end of FY05, will seek to find niches where the Bank’s comparative strengths can best be used. It will be an important document in shaping the Bank’s engagement in the Pacific over the next several years: we encourage our Pacific members to take advantage of this opportunity to influence the direction of that engagement.

Five Executive Directors, including our constituency Director John Austin, visited Samoa in February 2004. The Executive Directors visited Bank projects and held discussions with the Government, business leaders, NGOs and donors.

![Photo](image)

*Executive Director John Austin (left of photograph) during the February 2004 visit of Executive Directors to Samoa.*

**Papua New Guinea:** The World Bank and the Government of Papua New Guinea have continued to implement the recommendations of the Bank’s Public Expenditure Review
and Rationalization report. Other major donors also support this work, which is a good example of donor coherence. There has also been good progress on the Gas Development and Utilization Technical Assistance Project. In August 2003 the Bank suspended the Forestry and Conservation Project and associated GEF grant, and has been in dialogue with the Government to resolve outstanding issues.
CONSTITUENCY OFFICE

Office Developments

During FY04 the constituency office continued to represent the interests of our members at the Board and with Bank staff, and to assist constituency members in their relations with the Bank. For example, we have liaised closely with Bank staff involved in developing the new Pacific Strategy, encouraged them to make appropriate contact with Pacific Island states and facilitated that contact.

An additional Senior Advisor position was created in each Executive Director’s office at the end of 2002. In June 2004 we filled the position with Tom Hall, who had served as a Senior Advisor under Neil Hyden, the previous Executive Director, and was thus already familiar with the work of the Bank and our office. He will help advance office priorities, in particular our work on voice for developing countries, through improved communications, and development and implementation of an operational plan for the office. The appointment was made on a temporary basis until the constituency agrees on longer-term arrangements.

Our office is increasing its focus on communication with its members, in particular reporting developments at the Bank. To this end, we have initiated a newsletter, with a new issue to be distributed about every two months to all constituency members. It will discuss policy issues and office activities that are of direct concern to our members, particularly developing-country members of the constituency. We welcome feedback on the newsletter.

In July 2004 a dedicated website for our office came on line (accessible at http://www.worldbank.org/eds09). The website provides information about office staff, contact information, links with the Bank’s websites (where they exist) for individual constituency countries, development news relating to constituency members, a projects database, and publications and analytic work relating to constituency members.

In FY04 the Bank initiated an annual secondment programme for officials from developing countries. Each year’s group of secondee will work at the Bank for six months. In our constituency three candidates (from Cambodia, Mongolia and Samoa) have been nominated by their respective authorities. A Selection Committee will decide in early FY05 whether to appoint them as secondee. Secondee will work at the Bank for six months and receive training to increase their knowledge of Bank procedures, products and operations. On return to their countries, the secondee officials are expected to be the key contacts of their countries with the Bank and our office.

Policy Priorities

In our work within the Bank, we have focused on the following policy issues, which are particularly important for our constituency’s developing members.

- lowering the costs of doing business with the Bank. Our work here has been on two broad fronts. One concerns the Bank’s budget, the cost of which is ultimately recovered from borrowers through loan charges. We have advocated reform of budget processes and reduced budget-growth. The other concerns the financial and compliance costs on
developing countries of Bank requirements (such as safeguard standards) associated with its lending. The Bank should take into account the balance of benefits and costs, and the perspectives of developing countries, when it make decisions about and implements policies that impose requirements on developing countries.

In both of these broad areas, Bank management is aware of the need for improvement and is considering or implementing various initiatives. The speed and depth of change, however, varies across the initiatives. We have pressed for more consistent, and in some cases more urgent, reform and for concrete results. This will continue to be central to our agenda in FY05.

- improving governance and the business climate in developing countries. We have encouraged the Bank to focus on this issue in its policy research, in its outreach to developing countries, and in its lending programmes. This area has become a major focus of Bank work, including global outreach through its flagship publications Doing Business (see page 30) and the World Development Report, the 2005 edition of which is about improving the investment climate in developing countries.

- supporting Bank research and advocacy to reduce trade barriers for developing countries, especially in agriculture. We have encouraged the Bank to continue to pursue this work and disseminate it widely.

- supporting the implementation of the Low Income Countries under Stress initiative. As the Bank has implemented this initiative, we have stressed that non-African LICUS countries should receive due focus.

- encouraging the Bank to better understand the development process. We have encouraged the Bank to better understand – both from formal policy research and its own on-the-ground experience - which policy reforms work, which don’t, and how successes can be scaled up, and to disseminate its analysis widely.

- refining the use of performance and governance measures to allocate IDA resources. We have encouraged the Bank to think systematically about the impact of its allocation formula, in particular the governance factor, on the finances available to individual borrowing-countries (including Cambodia and Mongolia in our constituency), regional allocations, and how the Bank can engage and retain influence in countries with small allocations of aid.

We have also been working with the two other Executive Directors representing IDA borrowing countries in the East Asia and Pacific region to support the region’s Borrower Representatives in the 14th IDA replenishment discussions. The Executive Directors’ offices organised a consultation-meeting between East Asia-Pacific borrowing countries and Borrower Representatives in the margins of the Asian Development Bank’s Annual Meetings in Jeju, Korea, in May 2004. The consultation-meeting provided useful input to the July 2004 meeting of IDA Deputies in Hanoi. The Executive Directors’ offices also provided the Borrower Representatives with a briefing for each of the IDA Replenishment Meetings.
BANK POLICY ISSUES

The challenges facing the Bank are not new. There is, however, an increasing urgency to dealing with them as it becomes increasingly clear that most developing countries will not meet most Millennium Development Goals. The poverty goal is likely to be achieved at the global level, but Africa will fall well short. For the human-development goals, the risks are much more pervasive across the regions. In response to these trends and to the challenge of reducing the financial and compliance costs to developing countries of doing business with the Bank, over FY04 the Bank renewed several important policies with the aim of making itself a more attractive, cost-effective and relevant development-partner, and thus scaling-up its lending. Our office has supported the strategic directions embodied in the policy changes discussed in the following pages. The speed and depth of change, however, varies across the initiatives. We have pressed for more consistent, and in some cases more urgent, reform and for concrete results.

The Bank and Middle-Income Countries

The World Bank’s share of lending to middle-income countries has been declining in recent years. To remedy this, over the past year the World Bank has examined ways to enhance its support for these countries. A paper on enhancing support to middle-income countries was discussed by the Board in March 2004 and at the 2004 Spring Meeting of the Development Committee.

The Bank has proposed several ways to increase the value of its services and reduce the financial and compliance costs of its lending to middle-income countries. We support these efforts, which include building on the Bank’s agenda for modernising and simplifying lending to reduce the costs of investment projects, and repeating or scaling up successful activities. In well-performing countries, the Bank will support not only new reforms (as it currently does), but also the implementation of existing programmes.

The Bank is also trialing an initiative to reduce compliance costs for middle-income countries by relying on national systems where the Bank assesses such systems to be adequate. The Bank is already relying on countries’ own financial-management systems, and is looking to broaden this to environmental and other safeguards. The first example of this new approach was the Mexico Decentralized Infrastructure Reform and Development Project, which the Board approved in June 2004. We were disappointed that this first example of using country systems was rushed through the Board without adequate examination of the principles behind it and has probably increased implementation costs for Mexico.

Developments in Lending Instruments

Over FY04 the Bank progressed its ongoing agenda of modernising its lending instruments in order to reduce compliance costs and improve the quality of lending. We supported these developments.

The Bank is replacing the several variants of adjustment loans (e.g., sectoral adjustment loans and structural adjustment loans) with one loan instrument – “development policy lending".
Poverty Reduction Support Credits (PRSCs) are being retained as a name for loans that support PRSP reforms, but they have the same terms and conditions as development policy loans. Development policy loans will incorporate current understandings of good development practice, for example country ownership, a focus on institutions and structural reforms, fewer conditions, requirements for consultation, good analytic-underpinnings, a results focus, good monitoring and evaluation, and consistent treatment of poverty, social, environmental and fiduciary aspects. Most development policy lending will be in the form of series of loans over a three to five year period. The new lending instrument came into effect on 1 September 2004.

The Bank is also modernising investment loans (loans for specific projects) to provide simpler, faster and more useful investment-lending. In April 2004 the Board agreed to expand the types of expenditures which can be financed with the Bank’s investment loans. Before this, for example, the Bank could not finance local costs, recurrent expenditures or land. Under the new policy, the Bank may finance all expenditures borrowers need to incur to implement their development goals, with the exception of a “negative list” of specified expenditures, such as military expenditures and luxury items. The Bank is also implementing quicker processing of simple, repeater and restructured projects. Further changes to investment lending are expected in FY05.

**Trade**

In FY04 the Bank continued to contribute to global research on the effects of trade liberalisation and to present its findings to a global audience in such flagship publications as *Global Economic Prospects 2004* and *Global Monitoring Report 2004*. The Bank’s research focused on the benefits of liberalisation for developing countries, in particular the importance to developing countries of developed countries lowering their agricultural trade barriers. The Bank’s efforts have helped sustain pressure for progress in the Doha round of multilateral trade negotiations – which have the potential to bring greater benefits to developing countries than bilateral or regional trade-liberalisation.

Recent and forthcoming Bank work also highlights the importance of developing countries building their capacity to trade through reducing “behind the border” barriers to trade. These barriers include the logistic problems arising from poor transport-systems, poor hygiene that hinders food exports, and time-consuming or corrupt bureaucratic and customs processes, which raise costs or cause spoilage and unreliable contract-performance.

Analysis by the Bank’s trade specialists has also identified the fastest-growing areas of agricultural trade, namely non-traditional goods with low levels of protection, such as fresh fruits and vegetables, seafood and flowers. Since they are perishable, overcoming “behind the border” barriers to trade is particularly important for these products. Trade in such goods has grown because of recent technological advances and cost reductions in refrigeration, air transport and communications.
The following graphs illustrate the gains to poor countries from trade liberalisation.\(^1\)

**Increase in real income in 2015 relative to baseline**

![Bar chart showing gains to high-income and developing countries.]

- **Static Gains**
- **Dynamic Gains**

High-income countries vs. Developing countries

**Source:** Global Monitoring Report 2004

The Bank's research also points out the growing role of the developing world in global trade-flows, the high protection developing countries often impose against each other, and the potential for gains from "South-South" trade liberalisation.

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\(^1\) The graphs compare the status quo with the following scenario: elimination of agricultural export subsidies and domestic support, a tariff ceiling of 10% on agricultural products and 5% for manufacturing in OECD countries, and a tariff ceiling of 15% for agricultural products and 10% for manufacturing in developing countries.
Bank programmes help members overcome these challenges by building their trade capacity. About 35 trade-related lending operations are being prepared for some 25 countries, although only four are in the East Asia-Pacific region. Within this constituency, Cambodia has undertaken a Trade Diagnostic Study and incorporated its recommendations into its National Poverty Reduction Strategy.

We strongly support the Bank’s work on trade.

**Voice of Developing Countries**

The 2002 Monterrey Consensus asked the Bank and Fund to enhance the voice and participation of developing and transition countries in their decision-making – a call also made by the Development Committee in 2002, 2003 and (at the Spring Meetings) 2004.

The Bank is working on options to achieve progress. It has prepared several papers for discussion in various fora, including a paper to be considered by the Development Committee at the October 2004 Annual Meetings. The paper for the Development Committee defines a framework within which the issue of voice can be considered. Ideally, the framework will include the relationship between the Bank and the Fund, the range of options, differentiation among groups of countries or regions, and the management of the process going forward.

There is a consensus among shareholders of support for some of the less-significant options, such as an increase in basic votes. Other options, such as a selective capital increase, need further development. Some further options, however, involve fundamental changes to Bank structure, and so are (unsurprisingly) controversial and lack broad support. Progress requires political will on the part of shareholders for fundamental change, or acceptance that only less-significant options should be adopted. The 2004 Annual Meetings will provide an opportunity for Governors to debate the issue, give guidance and set the future agenda.

**Revitalising Support for Infrastructure**

Provision of infrastructure is a key factor in economic growth and poverty reduction. Unmet needs remain enormous. Bank lending for infrastructure, however, declined by 50 percent from 1993 to 2002. The Bank is aiming to reverse this trend by its Infrastructure Action Plan, launched in July 2003. The Action Plan signals a greater willingness to lend to both public and private sectors, explore engagement at the sub-national level and expand analytic work to identify infrastructure bottlenecks.

Over the past year the Bank has made progress in implementing the Action Plan, and East Asia has been at the forefront of this re-engagement. The Bank has been cooperating with the Asian Development Bank and the Government of Japan on a major study of infrastructure in East Asia and has developed a significant regional pipeline of infrastructure-related lending.

**Extractive Industries Review**

Over the last four years the World Bank has been reviewing its role in extractive industries (the oil, gas and mining sectors). The review included reports from the Bank’s independent
evaluators (the Operations Evaluation Department and other evaluation units), along with an external review by Dr Emil Salim, former State Minister for Population and Environment, Indonesia. These reports were completed in July and November 2003, respectively. The review, and the Salim report in particular, has attracted considerable interest among governments, NGOs and commercial organisations in the sector.

The Bank’s evaluation units concluded that well-governed extractive industries can increase economic growth and reduce poverty. Accordingly, they recommended that the Bank should continue to selectively engage in extractive industries, even if countries have imperfect governance; sequence its involvement so that initial engagement seeks to achieve minimum governance-standards (including “tell what you pay” transparency of payments to governments) and greater engagement parallels improved governance; increase its focus on governance, environmental and social aspects of extractive-industry projects; and, generally, judge whether to engage in the sector on the basis of a qualitative assessment of the balance among economic, governance, environmental and social considerations, with strengthened attention to the latter three criteria.

The Salim report made recommendations on broadly the same issues. However, its recommendations were put in absolute terms. For example, the Bank should not engage in an extractive-industry project unless governance is already at a high standard and all local groups benefit. Dr Salim also recommended phasing out Bank Group investments in oil and coal production by 2008. If the Bank Group adopted these recommendations, it is likely that its involvement in extractive industries would significantly reduce or possibly end.

Bank management and the Board concurred with the approach and recommendations of the evaluation units.

Our office supported management’s approach and most of its recommendations. We argued that the challenge of the Bank’s involvement in extractive industries is ensuring that governance and policies are initially sufficient, and (with the Bank’s input) steadily improving. That is, the Bank should help national policies to improve, rather than reduce its investment in extractive industries. We were concerned that the process Dr Salim followed focussed excessively on input from NGOs and provided too little opportunity for governments – particularly those of developing countries – to voice their perspectives on the issues under debate. This was contrary to the aim of increasing the voice of developing countries in Bank decision-making.

Low Income Countries under Stress ( LICUS )

This constituency continues to support the LICUS initiative. LICUS countries are the most difficult environments for achieving results from international aid because of their combination of weak policies, institutions, governance and, often, a lack of civil and political liberties. Over FY04 the Bank developed re-engagement strategies for a number of LICUS countries. These involve trials of a range of innovative approaches, including promoting internal demand among citizens for positive change, developing country-capacity to implement change, supporting a limited number of simple and politically-feasible entry-level reforms and piloting new mechanisms for social-services delivery.
In January 2004 the Board approved a $25 million LICUS Trust Fund to support this work. The Trust Fund, administered by IDA, will focus mainly on LICUS countries which are in arrears to the Bank and hence ineligible for new IDA lending. IDA has made allocations from the Trust Fund to support work in Liberia and the Central African Republic. The Trust Fund is currently scheduled to operate until the end of FY07.

Both the LICUS initiative and the Bank’s work on middle-income countries demonstrate that the Bank is increasingly differentiating its products and approaches to better meet the needs of its range of clients.

**Trust Fund Reforms**

Trust fund reforms have continued over FY04. The Board agreed to phase out trust funds that impose nationality restrictions on procurement. The last year in which these trust funds will accept new contributions is FY05; the deadline for disbursements from them is 30 June 2007.

The Board also agreed to various measures to improve access by a wider range of consultants to Bank work financed by trust funds. They include implementing a new e-procurement system, which lists consulting opportunities on a real-time basis, and expanding outreach efforts to more countries. The outreach includes missions to donor countries and broader country-coverage (including Australia and New Zealand) of Private Sector Liaison Officers Networks, which link the Bank and private-sector firms that may want to do business with the Bank. Management agreed to do more to promote diversity within its consultant pool, and to monitor and report progress.

Staff programmes financed by trust funds have developed in *ad hoc* ways in recent years. The Board has agreed to rationalise these programmes. This will result in more-consistent terms and conditions on which different countries sponsor their nationals on the Bank’s staff.
IDA AND HIPC POLICY ISSUES

IDA Replenishment

The mid-term review of the 13th replenishment of IDA took place in November 2003. At the meeting, Deputies and Borrower Representatives agreed that developing countries had broadly met, and in some cases exceeded, the results targets set during the IDA 13 replenishment. They reiterated the importance of economic growth for poverty reduction, underlined the centrality of country-led development and acknowledged the challenges ahead in achieving harmonisation.

Deputies and Borrower Representatives supported IDA’s performance-based allocation system (see page 10) and work to refine it. They called for the on-going Bank and Fund work on debt vulnerability to advance and encouraged IDA to develop a menu of instruments to support debt-vulnerable countries.

The 14th IDA replenishment is now underway. Deputies and Borrower Representatives have met twice, and will meet a third time in Washington following the 2004 Annual Meetings. The East Asia and Pacific region is represented by Vongsey Vissoth, Deputy Secretary General of the Ministry of Economy and Finance in Cambodia, and by Marwanto Harjowiryono, Director of the Bureau of International Cooperation in the Ministry of Finance in Indonesia. The offices of the three Executive Directors who represent East Asia and Pacific IDA borrowing countries are working together to support the region’s Borrower Representatives (see page 2).

The Bank is seeking a 30 percent increase in the 14th replenishment, compared with the 13th replenishment. This will be further discussed. The allocation and use of grants continues to be debated, but there is general agreement that IDA should allocate grants mainly on the basis of debt vulnerability. This is likely to change the access to grants by countries in our constituency.

IDA Results Measurement

Managing for development results is an important element of the global development agenda and of the Bank’s strategic objectives. Managing for results enables countries and the Bank to make better decisions, taking into account the lessons from experience.

IDA Deputies responded to this imperative during the IDA 13 replenishment by adopting a system to monitor development results. The system monitors results at two levels: IDA’s own effectiveness, as measured by the results of selected pieces of analytic work that underpin IDA’s dialogue with governments; and country-outcome indicators that capture the performance of all development partners, including IDA and country governments, in achieving a set of 17 development goals critical for growth and poverty reduction. Three specific areas were agreed as the focus of measuring project outcomes: primary school completion-rates, measles immunisation-rates, and the time and cost of business start-up.

Lessons from the IDA13 phase of results measurement are informing development of proposals for a revised system for the IDA 14 period. Under the new system the list of country-outcome indicators would focus on those that are most relevant to IDA and most-easily measurable in
IDA countries. It would also introduce a mechanism to track selected outcome-indicators in health, education, water and transport, where IDA has an active portfolio.

Allocation of IDA Resources

We have continued to take a close interest in the allocation of IDA resources. A consensus has grown in recent years that the quality of a country's policies and institutions is critical to achieving economic growth and reducing poverty. In response to this the World Bank has improved its measurement of policies and institutions and refined its allocation system to more closely align allocation of resources with the quality of policies and institutions.

The Bank calculates country allocations each year for a rolling period of three years. Every IDA-eligible country gets a basic allocation of SDR 3 million, which particularly benefits small states. The bulk of IDA's resources, however, are allocated on the basis of a combination of the following factors: the quality of a country's policies and institutions; the quality of implementation of a country's portfolio of Bank lending operations; population; and per capita income. The use of the criteria relating to policies, institutions and portfolio implementation is called the performance-based allocation system.

IDA summarises the quality of policies and institutions in a single number - the Country Policy and Institutional Assessment (CPIA) rating. It also summarises the overall quality of a country's policies, institutions and portfolio performance in another number - the Country Performance (CP) rating. The CP and CPIA ratings are on a scale of 1 to 5 and are reviewed annually.

The effective weight of governance in the per capita allocation formula is currently 67 percent, which is much higher than its weighting in allocation formulae used by the regional banks. As a result, small changes in governance ratings produce large year-to-year shifts in allocations. Further, since the overall volume of IDA lending is constrained, if many countries improve their governance scores, then those whose scores remain unchanged or improve less than others receive smaller allocations.

IDA regularly updates the performance-based allocation system to reflect the factors which current research suggests contribute to aid effectiveness. The current system, agreed during the IDA 13 replenishment, is being discussed during the IDA 14 replenishment. Options will be examined for modifying the governance factor to reduce the large shifts in allocations that it can produce.

We continue to emphasise that performance should be the primary criterion for allocating resources. As noted earlier in this report, we have encouraged the Bank to think systematically about the impact of its allocation formula, in particular the governance factor, on the finances available to individual borrowing-countries (including Cambodia and Mongolia in our constituency), regional allocations, and how the Bank can engage and retain influence in countries with small allocations of aid.

A diminishing proportion of IDA resources are being allocated under the performance-based allocation system. For example, part of the IDA replenishment pool is being diverted into special programmes, such as those for post-conflict countries or regional initiatives. A smaller
pool of funding allocated under the performance-based allocation system is likely to result in less funding being available for East-Asia Pacific countries, however good their performance. The impact of such special programmes on resources available to countries under the performance-based allocation system needs to be carefully considered.

**Disclosure of Country Performance (CP) and CPIA Ratings**

IDA ranks countries by CP rating and by CPIA rating (see previous section), and groups each country into five ratings-categories. Since FY00 it has disclosed which of the five CP and CPIA groupings each IDA country belongs to (for example, Uganda is currently in the top fifth of IDA countries by CP rating and Angola is in the bottom fifth by CPIA ranking).

IDA Deputies discussed disclosure of the ratings of individual IDA countries as part of the IDA 13 negotiations. They concluded that the system would benefit from open scrutiny and asked management to report on whether the system is ready for disclosure. Management discussed disclosure with the Board and IDA countries and strengthened the underlying CPIA methodology and processes.

In early 2004 Management convened an independent panel to review the CPIA methodology and ratings. The Panel concluded that the CPIA criteria focus on the right issues and produce robust results. However, it found unnecessary overlap among some of the criteria and made some recommendations to improve methodology and process. The Panel supported disclosure of the CPIA ratings of individual countries. Management is implementing most of the Panel’s recommendations, following discussion with the Board.

In September FY05 the Board approved a management proposal that the individual CP and CPIA ratings for all IDA countries should be disclosed, starting with the 2005 ratings. The resulting greater transparency will probably lead to greater international scrutiny of the IDA system and of individual countries’ policies and institutions.

**Heavily-Indebted Poor Countries (HIPC) Initiative**

In FY04 the Bank continued to provide debt relief to the world’s poorest and most heavily-indebted countries. Of the 27 countries currently in the HIPC initiative, 11 have now reached completion point, which allows them to receive the full amount of debt relief promised at decision point. Guyana, Nicaragua and Senegal reached completion point in FY04.

There is a deadline, currently the end of 2004, for countries to meet the eligibility conditions for entering the HIPC initiative. At a July 2004 informal meeting of the Board held to discuss the deadline, Board members expressed concern at the lack of alternative debt-relief mechanisms for highly-indebted countries which do not enter HIPC before the current deadline. Most Executive Directors supported some form of extension. At the 2004 Annual Meetings in October 2004, the Development Committee will consider whether to extend the deadline.

A 2002 review by the Bank’s independent evaluation unit (the Operations Evaluation Department) found that in some cases the provision of bilateral debt-relief to countries in HIPC initiative appears to have reduced aid flows to non-HIPC poor countries. This is of concern to
our constituency, since the better-performing countries of the Asia-Pacific region would be disadvantaged if HIPC resource flows – which are directed mainly to Africa – reduced aid-flows to non-HIPC countries. It is therefore important that the international community honours its commitment to provide HIPC assistance in addition to existing aid-flows.

**Debt Sustainability**

While the HIPC initiative assists countries whose debts have reached unsustainable levels, it does not address the accumulation of debt before it reaches unsustainable levels. In early 2004 the Bank and Fund took initial steps towards developing a new approach intended to prevent the debt of developing countries reaching unsustainable levels.

The debt-sustainability framework aims, first, to better identify how much debt a country can afford. This will vary according to a country’s economic circumstances and policy and institutional performance. Secondly, the Bank and Fund, in consultation with other creditors, are exploring alternatives to debt financing for countries whose debt is approaching an unsustainable level.

Although the Bank is still developing technical aspects of the framework, as part of the IDA14 negotiations the Bank has proposed an initial approach to operationalising the principles of the framework. It has completed provisional debt-sustainability assessments for IDA countries and established interim lending-thresholds, pending completion of more-detailed assessments. Information on debt sustainability is likely to be a key factor in the allocation of grants under IDA14. Some countries in the Asia-Pacific region have debt close to unsustainable levels according to this framework, and may therefore qualify for additional grant-assistance under IDA 14.

Questions to be resolved under the debt-sustainability framework include whether donors will meet the cost of a higher volume of grants, and whether other assistance provided to countries receiving a higher proportion of grant funding will be reduced, to take into account the greater benefit to them of grants compared with loans.
DEVELOPMENT RESULTS

The 2003 Annual Review of Development Effectiveness (ARDE), written by the Bank’s independent evaluators (the Operations Evaluation Department), evaluated the outcomes\(^2\) of Bank activities at the country and project levels and reported in-depth on the effectiveness of the Bank’s support for policy reform.

Bank assistance since 1999 had moderately-satisfactory or better outcomes at the country level in about 70 percent of cases evaluated. Improving country-policies, satisfactory country-level outcomes of Bank assistance, and good development-outcomes tend to be associated with each other.

Of the individual Bank projects that closed in FY02 (the latest full-year cohort of evaluated projects), 79 percent had satisfactory or better outcomes. This improved on both FY00 and FY01 cohorts and was the third year in a row in which project outcomes exceeded the corporate target of 75 percent satisfactory. Regionally, East-Asia Pacific had the highest and Africa the lowest proportion of satisfactory or better outcomes. Eighty-four percent of the FY02 project cohort is likely or highly likely to be resilient to future risks and 51 percent had substantial institutional impact – both representing modest improvements over the FY01 cohort. Evaluation of part of the FY03 cohort suggests that 72–74 percent of the full FY03 cohort will have satisfactory or better outcomes, although confirmation of this awaits the evaluation of the full cohort. It is unclear whether this represents a trend departure from improvements in results in recent years.

The ARDE’s review of the Bank’s support for policy reform found that two-thirds of developing countries improved their economic and social policies over 1999-2003. The recent environment for policy reform may have been unusually favourable, since many countries are emerging from crisis and/or are advancing with policy transition from central planning. Countries that improved their policies during this period grew at about twice the rate of countries that did not. Bank lending was concentrated in countries that have relatively good policies. While the Bank has been reasonably successful in the aggregate in associating its support with opportunities for policy reform, outcomes have been worse where there is no track-record to guide engagement, for example in its early work in countries in Central and Eastern Europe.

The ARDE found that the Bank is poor at enforcing lending-conditions. More generally, imposed conditionality has proven ineffective as a means of encouraging policy reform. Rather, country ownership of high-quality reform programmes is necessary to economic growth and poverty reduction. The ARDE (and other studies) also found that the Bank too often promotes generic policy-prescriptions, with too little attention to alternative perspectives or the circumstances of individual countries.

\(^2\) "Outcomes" are rated taking into account three criteria: relevance of an activity’s objectives in relation to country and Bank priorities, achievement of objectives, and efficiency in achieving the objectives.
IBRD FINANCES

Trends in the Lending Portfolio

The global economic environment over the last twelve months has been largely positive for IBRD countries. With low interest rates and good growth in most regions, many of the fast-growing middle-income economies were increasingly able to access capital markets for sovereign borrowing and to attract private-investment flows. India, Thailand, Korea and China have all been able to refinance old IBRD loans at lower cost. Eight countries from the Europe and Central Asia region joined the European Union in 2004: their ability to access structural funds from the European Union is also likely to lower their demand for Bank financing.

This economic environment, while good for development, has reduced both the volume and profitability of IBRD’s lending portfolio. Low international interest-rates make non-Bank financing more attractive for middle-income countries, as the compliance costs of doing business with the Bank increasingly outweigh the price advantage of its loans. The Bank’s strategy to increase lending to middle-income countries is discussed on page 3.

IBRD loans outstanding at the end of FY04 were $110 billion, compared with $116 billion at the end of FY03 and $122 billion at the end of FY02. This is about the same level as at the end of FY96, immediately before the Asian financial crisis. FY04 is the third year in a row of negative net disbursements, driven mainly by a high level of prepayments ($4.6 billion in FY04). New commitments fell from $11.5 billion in FY02 and $11.2 billion in FY03 to $11.0 billion in FY04.

Although interest rates are expected to increase over the next few years, we are concerned at the lack of growth in the IBRD loan portfolio. Unless this is reversed in the medium term, IBRD’s net income will decline, particularly if the administrative budget continues to increase. The Bank is responding to these concerns by reviews with potential to improve cost-control (see page
19) and by the various policy developments discussed elsewhere in this report that aim to make the Bank a more attractive lender, particularly to middle-income countries.

In FY04 investment and adjustment lending accounted for 60 percent and 40 percent, respectively, of the new IBRD commitments - a proportion similar to FY03. In FY03, the last year for which figures are available, about one quarter of new lending commitments (covering both IBRD and IDA) supported recovery from emergencies, both natural and man-made. These loans need to be developed and delivered rapidly, often in difficult circumstances. Nonetheless, there is a need for greater rigour in defining their content, particularly when they include medium-term objectives. The Bank is revising guidance to staff to address these concerns.

**Net Income Results**

IBRD net income fell to $1.6 billion in FY04, from $3.0 billion in FY03 and $2.0 billion in FY02. Loan income fell by $1.3 billion (offset somewhat by a $0.8 billion drop in interest expenses); investment income fell by $110 million; and administrative costs increased by around $115 million. The net income results in FY03 and FY04 mask a weaker underlying position, as income in both years was boosted by large reductions in loan-loss provisions due to prepayments ($1.3 billion in FY03 and $0.7 billion in FY04). IBRD forecasts net income of $0.7 billion in FY05 and $1.1 billion in FY06.

The following table shows IBRD profitability over recent years.

<table>
<thead>
<tr>
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<th>FY99</th>
<th>FY00</th>
<th>FY01</th>
<th>FY02</th>
<th>FY03</th>
<th>FY04</th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on equity</td>
<td>5.3%</td>
<td>6.3%</td>
<td>4.0%</td>
<td>6.8%</td>
<td>10.2%</td>
<td>5.3%</td>
</tr>
<tr>
<td>Return on equity, excluding movement in provisions</td>
<td>6.3%</td>
<td>6.6%</td>
<td>6.7%</td>
<td>6.8%</td>
<td>5.8%</td>
<td>3.2%</td>
</tr>
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The fall in international interest-rates largely explains the decline in net income in FY04: a drop of one percentage point reduces net income by about $350 million. Low international interest-rates also reduce the interest-rate margin on Bank loans.

**Net Income Allocation**

The Board set aside $400 million of FY04 net income for future IDA and HIPC transfers. As a result, IBRD will have a greater capacity to maintain or even increase transfers to IDA and HIPC if shareholders so desire. The Board also allocated net income for the Bank's FY05 contribution to IDA ($300 million) and HIPC ($240 million), completing IBRD's commitments under IDA13. An additional $50 million was allocated to the debt-reduction facility for IBRD countries; $5 million to the non-earmarked surplus account; and the remaining $680 million to reserves. The main result of the decline in net income from FY03 to FY04 is to lower the allocation to reserves more than would otherwise have been the case.

As well as maintaining existing fee-waivers, shareholders agreed to waive 50 percent of the front-end fee on IBRD loans in FY05. The waiver represents a return to the cost structure that was in place prior to the Asian crisis, and brings IBRD fees in line with similar lending products from other MDBs.
Capital Adequacy

At the end of FY04 IBRD is in a strong capital position. The equity-to-loans ratio stands at 29 percent, compared with an average over the last five years of 23 percent. This is mainly due to the smaller loan-portfolio and the large contributions to reserves the Bank made in FY03 and FY04. With the quality of the loan portfolio remaining sound, the Bank’s ability to withstand a large credit-shock has significantly improved.

Analytic and Advisory Assistance (AAA)

In FY03 the Bank delivered 1029 AAA products at a cost of $141 million. This represents an approximate doubling of the number of products over the past three years. While the quality of economic and sector work, representing about two-thirds of AAA spending, has improved over the past five years, the Bank does not systematically monitor the other components of AAA (non-lending technical assistance such as stand-alone advisory work to strengthen local capacity). The Bank is undertaking further work to improve the quality of the broader AAA programme. Our office is concerned that the Bank is doing too little AAA work in small states and LICUS countries. Since AAA is a basic part of the Bank’s engagement, we have encouraged the Bank to increase AAA in these countries.
IDA FINANCES

IDA is a separate financial entity from the IBRD. Unlike IBRD, IDA does not have a base of shareholders’ capital from which it can finance its operations. Donor and IBRD contributions, negotiated in three-yearly replenishments, are added to internal resources (principal repayments, service charges and commitment fees) finance the cost of IDA’s grants and concessional lending.

Trends in the Lending Portfolio

IDA credits outstanding at the end of FY04 were $116 billion, compared with $107 billion at the end of FY03 and $96 billion at the end of FY02. In FY04 IDA committed a record $9 billion in development assistance, of which $1.7 billion was in the form of grants. New IDA commitments in FY04 were again concentrated mainly in the African region, although South Asia also received a large increase. Lending to East Asia and the Pacific, while a small proportion of total lending, increased from $0.5 billion in FY03 to $0.9 billion in FY04. Activities in post-conflict countries continued to rise, including continuing activities in Afghanistan.

IDA Regional Lending Trends

Investment lending made up 81 percent of FY04 commitments, an increase from 75 percent in FY03. Adjustment loans made up the balance of IDA lending.

In FY04 IDA received $1.4 billion in principal repayments, $882 million in service charges and commitment fees, and $54 million from liquid investments. Internal resources financed around one-third of IDA’s $6.9 billion gross disbursements in FY04. Donor contributions financed most of the remainder.
Impact of Grants and HIPC on IDA Finances

IDA grants and the HIPC initiative add to the risks around IDA’s future finances.

Under IDA13 IDA began providing some of its assistance in the form of grants rather than credits. Although credits are concessional (they are effectively about two-thirds grants), they do generate refloows to IDA. Since grants do not generate any refloows, to the extent that they replace credits IDA’s capacity to contribute internal resources to future replenishments will be diminished. Therefore, to maintain the existing level of development assistance, donors will need to increase their contributions in future replenishments.

Some donors, concerned at the prospect of diminishing future IDA resources, have called for additional contributions from donors to compensate IDA upfront for the cost of the refloows forgone when grants replace credits. A compromise was reached under IDA13 whereby donors would compensate IDA upfront for the service charges forgone on grants and would consider compensation for foregone principal-refloows as they fall due.

Current modelling shows that if grants remain at around 20 percent of disbursements, then donors’ contributions to each replenishment would need to increase by 3 percent (in real terms) to maintain a constant replenishment pool (in real terms). If grants were to increase to 50 percent of disbursements, donor contributions would need to increase by 6 percent (in real terms) to do this. These increases would be additional to any other increases in donor contributions to enhance IDA resources.

Debt-relief under HIPC currently reduces refloows to IDA by about $600 million annually. If new countries enter the initiative or if more countries receive topping-up relief at completion point, the cost to IDA would increase. Transfers from IBRD net income have financed most of the cost of relief of IDA debt, with donors meeting the balance of costs. However, the IBRD Board has thus far only agreed to provide this funding until FY05. In FY05 it will consider funding for later years. Our office will support IBRD continuing to make a contribution to HIPC debt-relief. To the extent (if at all) that future payments from IBRD or donors do not offset the costs of HIPC to IDA, IDA’s ability to maintain or increase the volume of its assistance to developing countries would be compromised.

IDA Accounting Policies

The Bank’s external auditors consider that IDA’s special purpose financial statements are not appropriate for current reporting purposes (given the wide audience), and have requested that IDA change its accounting policies to conform to generally accepted accounting principles (GAAP). The Board expects to decide in FY05 on the timing of change to conform to GAAP.
FY05 IBRD/IDA ADMINISTRATIVE BUDGET

In June 2004 the Board approved the IBRD/IDA administrative budget for FY05. The FY05 operating budget is $2.0 billion - a 7 percent increase above FY04.

Bank management prepares a combined administrative budget for IBRD/IDA. The costs of administering the IDA portfolio are separately identified and recovered from IDA borrowers through loan charges. As a result of an increasing administrative budget and an increasing share of costs allocated to IDA, the costs allocated to IDA now exceed the revenue from the service charges on IDA loans. Therefore in FY04 and FY05 the Bank imposed an additional commitment fee on undisbursed IDA balances. This fee will be about $0.5 million each for Cambodia and Mongolia. If such charges are necessary, we need to be sure they pay for outputs of high value to our constituency members.

In FY04 our office continued to call for a budget process that better controls costs. We are concerned that the Bank’s budget process treats key cost-drivers, notably staff-cost increases, as exogenous and therefore not subject to Board scrutiny as part of the budget process. Of the total IBRD/IDA budget increase of $130 million in FY05, the Board scrutinised only $15 million as part of the budget process. We also remain concerned, more generally, that complex, fragmented budget-processes reduce transparency and disguise from management and the Board the costs to developing countries resulting from the Bank’s increasing budget.

In April 2004 management took a step forward by presenting an inaugural Medium-Term Strategy and Finance Paper, covering FY05 to FY07. The paper linked trends in the World Bank’s revenues and expenditures with an assessment of the strength of the Bank’s financial position, a discussion of strategic priorities and an analysis of possible budget trade-offs. While a worthwhile improvement, this document needs to be accompanied by further reforms, including better integration of staff-cost increases into the budget process.

Since reform of budget processes and of the methodology of setting staff remuneration was inadequate, we abstained again on management’s proposal for increases in staff remuneration for FY05. Board members are increasingly concerned about the Bank’s budget and budget processes: a majority want the Bank to aim for zero budget growth (in real terms) in future years. Only with changes in budget processes, however, is this likely to be achieved.

Management has responded to these concerns by undertaking to initiate reviews with the potential to improve cost-control. It has agreed to review the methodology of calculating staff compensation and to improve aspects of the budget process, including introducing more flexibility and accountability for achieving specific performance-goals. It has also established a Task Force on Enhancing Organisational Effectiveness, which is looking at improving the productivity of the Bank. Given the Bank’s recent history of budget increases and slow progress in internal reform, we will continue to stress these issues and monitor progress.
INTERNATIONAL FINANCE CORPORATION (IFC)

IFC’s Operational Results

IFC generated a record profit of $982 million in FY04, compared with the then-record profit of $528 million in FY03. The FY04 result represents a return on net worth of 14 percent. The main sources of the FY04 profit were capital gains from sales of equity investments ($381 million), dividends ($207 million) and reduced provisioning for losses ($177 million). The proximate reasons for the high FY04 profit were buoyant equity-markets and an improving world economy, although IFC’s good selection of investments and portfolio-management were preconditions for reaping gains from these external factors. The FY04 profit is unlikely to be repeated: IFC is forecasting a base-case profit in FY05 of $390 million. The lower profit-forecast, compared with FY04, is based on lower estimated equity-income and a normal level of estimated provisioning for losses.

IFC’s commitments in FY04 were $4.8 billion (23 percent higher than in FY03) and disbursements were $3.2 billion (7 percent higher than in FY03), in both cases exceeding initial forecasts by about 30 percent. After strong volume-growth in the last two years, IFC is forecasting broadly-similar levels of disbursements and commitments in FY05 as in FY04, with a similar regional distribution. The quality of IFC’s portfolio improved in FY04 (measured by riskiness and provisioning for losses) for both equity investments and loans, to levels which are somewhat better than before FY02, when the Argentine crisis struck IFC.

IFC’s independent evaluation unit (the Operations Evaluation Group) evaluates the commercial and developmental results of IFC’s individual projects ex post. The most recent information available derives from evaluations conducted in 1998-2002 of a sample of projects the Board approved in 1995-1997. Of this sample 49 percent were successful financially, 58 percent were successful developmentally, and 41 percent were successful by both criteria. The “win-win” rates of the cohorts of one and two years earlier were 42 percent and 48 percent, respectively. IFC believes that the evaluated results of projects will improve as various reforms within IFC in the late 1990s and early 2000s begin to be reflected in investment evaluations.

IFC’s Direction

IFC continues to implement and plan internal reforms to add value in new ways, to manage a growing organisation, and to improve financial and developmental performance. The following are the major developments of FY04.

• Profit Target: Consistent with the recommendation of the World Bank Group’s private-sector strategy (and our own view expressed at the Board), IFC has agreed with the Board a long-term profit target. The target is 6 percent return on equity. This is based on the 8 percent average return of large international banks, lowered by 2 percent to account for IFC’s non-commercial activities, such as uncompensated advisory work and work on non-commercial small projects. Setting a profit target is a significant and positive development that should clarify trade-offs among commercial and non-commercial activities.
• **Incentives for Staff:** IFC has strengthened its measurement of individual and corporate performance. This includes development of a staff Performance Awards Programme to reward superior performance. The Operations Evaluation Group had recommended such a programme to better link incentives with results on the ground.

• **Growth in Value-Adding Activities:** IFC has developed a package of additional activities in priority areas. These activities aim to strengthen focus on frontier markets; to increase ‘sustainability activities’ (such as corporate governance and capacity to review the environmental and social sustainability of investments); to increase IFC’s business in private-sector education in Africa and in infrastructure and financial markets; to better manage risk; and to continue decentralisation. The additional cost of these initiatives will be $15 million in FY05, a budget increase of 5 percent. IFC presented these initiatives to the Board in FY04 as an alternative to a flat budget, which it also set out for Board consideration. The Board approved the proposed expenditure increases.

• **Review of Safeguards and Disclosure Policies:** IFC has initiated a review of its safeguards (for example, environmental, resettlement and forced-labour safeguards) and disclosure policies. IFC’s safeguards mitigate the risks of projects it finances and provide a basis for its leadership on sustainability issues. It intends to use current safeguards as a baseline for minimum standards. IFC is also reviewing its disclosure policies, in response to increased expectations of transparency of publicly-owned institutions. Both of these reviews also respond to calls from the Extractive Industries Review (see page 7) for higher standards in these areas. The Board will consider the revised policies in FY05.

• **Technical Assistance and Advisory Fund:** IFC has established a technical Assistance and Advisory Fund to pay for technical assistance and advisory work, such as support for small and medium-sized enterprises, environmental and social initiatives, investment-climate work and capacity-building. The Fund will be financed by an annual replenishment from IFC’s profit. The replenishment will equal a percentage of profit above $150 million, the percentage increasing the higher IFC’s profit. The Fund aims to provide a more sustainable, transparent and streamlined source of finance for IFC’s technical assistance and advisory activities.

These initiatives aim to better implement IFC’s business strategy, which remains largely unchanged. The strategy entails IFC focusing on frontier and high-impact sectors and augmenting its core financing activities with value-adding services.

**Office Perspectives on IFC**

Our office supported IFC’s business strategy and its proposed budget, including the 5 percent increase in expenditure. We cautioned, however, that IFC should not use the Technical Assistance and Advisory Fund to pay for increased routine administrative expenditure.

We called for better information on the results of increased expenditures and for a longer-term perspective on both strategy and budget – IFC continued to present a one-year budget for FY05 despite Board requests (including from ourselves) for three-year budget forecasts. We also
sought to better understand the constraints on IFC’s growth, including the implications of continuing high growth-rates for IFC’s financial ratios, in particular IFC’s capital adequacy.

IFC should be clearer about its role in the health and education sectors. It needs to demonstrate that its involvement adds value and does not divert resources from the poor to those who can pay.
MULTILATERAL INVESTMENT GUARANTEE AGENCY (MIGA)

The outcome of MIGA’s financial operations in FY04 was mixed. The Agency issued $1.1 billion in guarantees covering 54 contracts in support of 34 projects. This represented a 21 percent decrease compared with FY03 in terms of guarantee amount, although gross and net exposure slightly increased. MIGA generated $88 million of net income, compared with $59 million in FY03. This increase was mainly due to a $62 million release of provisions for claims.

MIGA’s portfolio diversification has been disappointing, especially with regard to investors. The share of gross exposure to the Latin America and Caribbean region declined to 34 percent in FY04 (43 percent in FY03), while exposure to Europe and Central Asia (ECA) increased for the second consecutive year, from 25 percent in FY03 to 36 percent in FY04. The increase was due largely to investment activities by two European banks. The increasing importance of MIGA’s ECA portfolio is greater when measured by the number of projects for which MIGA issued guarantees: by this measure ECA received three-quarters of all MIGA guarantees in FY04.

This office has advocated a diverse portfolio among regions, sectors and investors, and a proactive marketing strategy. We called for particular attention to the East Asia Pacific region. In FY04 MIGA issued guarantees to only three projects in this region.

The Board approved MIGA’s proposal for voting-power parity between MIGA’s developed and developing member countries, whereby the voting parity of the two categories is automatically maintained when there are changes in membership.

MIGA provides technical assistance and facilitation to encourage foreign direct investment in developing countries. In FY04 it worked with the Pacific Island Forum and the Commonwealth Secretariat to establish country websites for Pacific Island states, aimed at potential foreign investors in Pacific Island economies.
CONSTITUENCY ISSUES

Australia

Australia and the Bank continue to collaborate on a range of issues, particularly developments in East Asia and the Pacific. The Bank’s regional office in Sydney, headed by Country Director Xian Zhu, has played a key role in collaboration between the Bank and the Australian Government in Pacific Island countries.

The World Bank President, James Wolfensohn, visited Australia in February 2004, accompanied by Alternate Executive Director Terry O’Brien. He visited Sydney, Canberra and Melbourne and met with Prime Minister John Howard, Treasurer Peter Costello and Foreign Minister Alexander Downer. He also held meetings with senior Treasury, Department of Foreign Affairs and Trade, and AusAID officials. In addition, the New South Wales and Victorian Premiers each hosted a lunch in his honour. The visit also provided an opportunity for Mr Wolfensohn to spend time in the Bank’s Sydney office and discuss its programmes in the Pacific.

The Bank Vice President for East Asia and the Pacific, Jemal-ud-Din Kassum, visited Australia in March 2004 to participate in a major policy-roundtable on Asia and the Pacific, organised by the Global Foundation and jointly sponsored by the Bank, the Government of Australia and the Government of New South Wales. The roundtable was attended by 120 Ministers, senior policymakers and other leaders from government, business, academia and civil society from around the region. Mr Kassum also visited Canberra for discussions with Federal Government agencies and participated in two inter-agency roundtables. He attended a Regional Cooperation Meeting in Sydney with Joseph Eichenberger, Vice President of the Asian Development Bank, and Bruce Davis, Director General of AusAID.

Over the past year Australia provided $A129 million to IDA, and trust-fund and co-financing contributions of $A61 million, including contributions for Afghanistan, East Timor, Iraq, Papua New Guinea and the South Pacific.

The Australian Trade Commission and New Zealand Trade and Enterprise are working with the World Bank to appoint Private Sector Liaison Officers (PSLOs). PSLOs, which other countries are already using successfully, will link the Bank with private-sector firms in Australia and New Zealand that may want to do business with the Bank. In FY04, Australian companies won more than 50 prior review contracts funded by the World Bank, valued in total at around $23 million.

Cambodia

The Bank has continued its work in Cambodia despite the delay in forming a new government following the July 2003 general election. The formation of a new government in mid-July 2004 provided the Bank with the opportunity to engage with Cambodia more intensively. In December 2004 the Bank will join with the government to organise a Consultative Group meeting. Early in 2005 the Bank will launch a new Country Assistance Strategy (CAS) for 2005-2008. Working in partnership with the ADB and DFID, the Bank is designing the new
CAS to help the government to implement its National Poverty Reduction Strategy, which the Bank and Fund Boards endorsed in February 2003.

The Board approved two new IDA projects in the second half of 2003. These were for the Provincial and Rural Infrastructure Project, amounting to $20 million, and for the Rural Electrification and Transmission Project (RETP), amounting to $46 million, including a GEF grant of $5.75 million. The RETP, jointly developed and financed with the ADB (which lent an additional $55 million), finances energy supply in rural areas. The GEF grant supports a renewable-energy component of the project.

The IFC approved three private-sector projects in the first half of 2004. These were a $6 million loan to Acleda Bank, a $5 million loan to Canadia Bank and a $10 million loan to Société Concessionaire de l’Aéroport.

For FY05 IDA plans to finance the Basic Education ($24 million), Trade and Competitiveness ($10 million) and Land Allocation for Social Development ($10 million) projects. More projects, such as Higher Education, Community Capacity Building, PRSC1 and Public Financial Management, are planned for FY06.

The Bank completed two major analytic papers on Cambodia in FY04. As part of its Integrated Fiduciary Assessment and Public Expenditure Review, the Bank issued *Enhancing Service Delivery through Improved Resource Allocation and Institutional Reform* in September 2003. Jointly written with the ADB, this paper focuses on improving fiscal management. The paper *Seizing the Global Opportunity: Investment Climate Assessment and Reform Strategy for Cambodia*, issued in July 2004, focuses on Cambodia's competitiveness. It aims to help Cambodia take advantage of its accession to the World Trade Organisation and overcome the negative effects on its garment exports from the expiry of quota access to the United States at the end of 2004. The Bank is also working with other stakeholders to support the government in organising a high-level conference, scheduled for December 2004, to discuss Cambodia's growth strategy in the era of free trade.

In October 2003 Cambodia hosted the second six-nation Regional Conference on Poverty Reduction Strategies, co-sponsored by ADB, IMF, UNDP and WB. Taking the opportunity to join this Conference, World Bank Vice-President Jemal Kasum consulted with government authorities, donors, the private sector and civil society about Bank activities in Cambodia.

**Korea**

Relations between Korea and the Bank continued to strengthen during FY04 through Korea’s active involvement in the Bank’s financial and non-financial activities. As Korea’s economy has advanced, it has repositioned its relationship with the international community, including the World Bank, as an active partner in assisting developing countries. Korea contributed $13 million to Bank activities over FY03 and FY04. This included $0.5 million for the ASEM Trust Fund, $2.6 million for GEF, $5 million for HIPC, $0.4 million for WBI, $4 million for the Afghanistan Reconstruction Fund and $0.4 million for the Consultants Trust Fund. Korea's support for Bank activities is evolving towards a focus on global and regional programmes, in which Korea has little direct bilateral interest. Korea expects that its involvement in global
issues will expand, consistent with its enhanced efforts towards international partnerships.

In addition to the government's contribution, Korea Exim Bank (a Korean state-owned bank) has begun to engage with the Bank as a co-financer. It is about to sign a loan agreement with the government of Sri Lanka for the World Bank's e-Sri Lanka project and is in the process of positively reviewing financing for two other projects.

Good progress is also being made in knowledge partnership. Korea signed a Memorandum of Understanding for Knowledge Partnership with the Bank in FY01 and FY03, with the aim of sharing her development experience with developing countries. Under this partnership, in FY03 the Korean Development Institute, a leading research institute of Korea, set up an office in Seoul and in FY04 undertook joint research programmes and held seminars and conferences aimed at government officials from developing countries. As a founding member of the Development Gateway Foundation, Korea has also established an information-technology training centre in Seoul and provides support to developing countries for the development of information and communication technologies. During FY04 the centre delivered ten training courses attended by over 100 government officials, researchers and private-sector business people from 40 countries.

Mongolia


In May 2004 the Board approved the Bank's 2005-2008 Country Assistance Strategy (CAS) for Mongolia. The new CAS focuses on three objectives: consolidating the transition to a free-market economy, reducing vulnerabilities, and aligning policies and resources with development results.

In April 2004 IDA approved an $18 million credit for the Second Ulaanbaatar Services Improvement Project. In June 2004 IFC provided two loans, a $5 million loan to the Trade and Development Bank of Mongolia and a $3 million loan to the Agricultural Bank of Mongolia. The IFC investments support the development of Mongolia's financial markets and the privatisation of the banking system, and promote foreign direct investment. In July 2004 MIGA provided its first guarantee in Mongolia. The guarantee was provided to Gerald Metals Inc. and Banca Commerciale Lugano to cover equity investment and future retained earnings in the Trade and Development Bank. In FY05 IDA plans to finance the PRSC1 ($12 million) and the Index-based Livestock Insurance scheme ($5 million). Other projects, such as Second Private Sector Development Project, PRSC2 and Social Sector Project, are scheduled for FY06.

The Bank continues an active programme of analytic work in Mongolia. A Country Procurement Assessment Report, issued in September 2003, reviewed procurement in all sectors and proposed an action plan to improve efficiency and transparency. A Country Assistance Evaluation (CAE), written by the Bank's independent evaluation unit (the Operations Evaluation Department) and issued in May 2004, reviewed the Bank's activities in Mongolia over the past decade. The review highlighted many successes in the Bank's assistance and the good progress
on the part of the government in moving towards a free-market economy. The CAE concluded with recommendations to guide future Bank assistance to Mongolia.

To maintain regular consultation with our Mongolia authorities the Alternate Executive Director, Terry O’Brien, participated in the Consultative Group meeting in Tokyo in November 2003, and the Executive Director, John Austin, visited Mongolia in May 2004.

New Zealand

In August 2003 John Austin began his term as Executive Director from New Zealand. This appointment has provided opportunities for New Zealand to strengthen its engagement with the Bank in FY04.

New Zealand has advanced development of its multilateral engagement strategy, due to be completed in early 2005. This strategy will provide an overarching framework to guide New Zealand’s engagement with multilaterals.

New Zealand’s aid strategy emphasises regional cooperation and assistance. Accordingly, it has closed its Consultant Trust Fund with the World Bank and the New Zealand IFC Technical Assistance Trust Fund, and redirected the resources to align with this strategy. New Zealand supports the Bank’s reform of trust funds, including the decision that trust funds should not impose nationality restrictions on procurement.

During FY04 New Zealand strengthened its cooperation with IFC through new contributions to the Mekong Private Sector Development Facility and the Corporate Citizenship Fund. New Zealand also continued to engage with the Pacific Enterprise Development Facility and the Foreign Investment and Advisory Service in the Pacific.

New Zealand participated in the IDA 14 replenishment negotiations. In particular, it was interested in advancing work on debt sustainability, which has major implications for IDA lending policies. It supports the efforts being made to ensure that debts incurred through development-lending remain at sustainable levels.

New Zealand also participated in two major international conferences sponsored by the World Bank: the roundtable on Managing for Development Results held in Marrakesh in February 2004 and the Conference on Scaling Up Poverty Reduction held in Shanghai in June 2004. Officials from New Zealand worked with the Bank at donor harmonisation meetings in Sydney in February 2004, at the Forum Economic Ministers Meeting in Rotorua in June 2004, and at other consultations on donors’ Pacific Strategies. The Government welcomed the March 2004 visit to New Zealand by Jemal-ud-din Kassum, the Bank Vice President for East Asia and the Pacific.

New Zealand sees opportunities to further improve donor cooperation in the Pacific and looks forward to the completion of the review of the Bank’s Pacific programme. It is important that lessons from past experience inform the Bank’s forward strategy. New Zealand continues to believe that the Bank has valuable knowledge and experience to bring to the Pacific, especially technical assistance. The Pacific Forum’s Pacific Plan provides an opportunity for the Bank to
engage more actively with the Forum Secretariat and Pacific Island governments in support of regional cooperation.

To progress these initiatives, government agencies continue to engage closely with the Bank’s regional office in Sydney and with other donors to the Pacific.

**Pacific Island Member Countries**

The Pacific Island countries in our constituency are some of the Bank's smallest member-states. Their size and geography bring a unique set of challenges. They are also a diverse group of countries. For example, the Republic of the Marshall Islands, Palau and the Federated States of Micronesia, with their relatively high Gross National Income (GNI) per capita, are eligible to borrow only from the IBRD, whereas Kiribati, Samoa, the Solomon Islands and Vanuatu are eligible to borrow from IDA.

FY04 saw the beginning of a new phase of World Bank engagement with the Pacific. The Bank’s independent evaluation unit, the Operations Evaluation Department, is completing a review of the past decade of Bank assistance to the Pacific Islands, and the Bank is developing a new Pacific Strategy. Over the past six months the Bank has consulted government, civil society and the private sector on a discussion paper about the new strategy. In addition, early ideas were discussed at the donors meeting that preceded the Forum Economic Minister’s Meeting in New Zealand in June 2004. Further discussions will take place in Washington following the 2004 Annual Meetings. The Pacific Strategy is expected to be completed by the end of FY05.

Experience globally has shown that the World Bank's development activities are most effective where they are embedded in countries' own development programmes and based on strong analytical work and countries' own perceptions of their needs, and where countries have good policies and institutions that function well. As a relatively small donor in the Pacific - the World Bank provided 2 percent of total aid to the Pacific between 1992 and 2002 - the Bank’s programmes will need to take account of the region’s major donors. The Bank is working closely with the Asian Development Bank, Australia, New Zealand and Pacific Island institutions to strengthen donor coordination. The new strategy will seek to find niches where the Bank’s comparative strengths can best be used. The new Pacific Strategy will be an important document in shaping the Bank's engagement in the Pacific over the next several years: we encourage our Pacific members to take advantage of this opportunity to influence the direction of that engagement.

As part of its strategy work, the Bank is reviewing human development in the Pacific Islands. This will involve the production of six papers, starting with a review of current human-development outcomes in the Pacific, followed by an examination of resource availability, expenditure patterns, health, education and issues of risk, and finally the strategy paper itself.

The Bank is also planning a study of remittances and migration in the Pacific. Recent work in this area has demonstrated that remittances now exceed both aid and foreign direct investment as a source of finance for developing countries globally.
Five World Bank Executive Directors including our constituency’s Executive Director John Austin visited Samoa and the World Bank Sydney office in February 2004. The Executive Directors visited Bank projects and discussed economic reform, drivers of economic growth, education, infrastructure and donor co-ordination with the Government, business leaders, NGOs and donors. As a result of the visit, participating Board members have a better understanding of the constraints and development challenges the Pacific Islands face.

The table below sets out the Bank’s projects that have been approved and those being prepared for Kiribati, Palau, Samoa, Solomon Islands and Vanuatu. Fiji and Tonga, while not part of our constituency, are included in order to provide a broader view of the Bank’s work in the region. The Bank does not currently have any projects in the pipeline for the Marshall Islands or the Federated States of Micronesia, although the development of the new Pacific Strategy may highlight areas where additional projects may bring benefits.

### PACIFIC ISLANDS - ONGOING AND PLANNED BANK ACTIVITIES

<table>
<thead>
<tr>
<th>Approved Projects</th>
<th>Fiscal Year</th>
<th>Amount ($m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Solomon Islands Health Development</td>
<td>2000</td>
<td>4.0</td>
</tr>
<tr>
<td>Samoa Health Sector Management</td>
<td>2001</td>
<td>5.0</td>
</tr>
<tr>
<td>Tonga Cyclone Emergency Recovery</td>
<td>2002</td>
<td>5.9</td>
</tr>
<tr>
<td>Samoa Telecoms and Post Project</td>
<td>2003</td>
<td>4.5</td>
</tr>
<tr>
<td>Tonga Health Sector Management</td>
<td>2004</td>
<td>10.9</td>
</tr>
<tr>
<td>Samoa Infrastructure Asset Mgmt-2</td>
<td>2004</td>
<td>12.8</td>
</tr>
<tr>
<td>Samoa Infrastructure Emergency Recovery Grant</td>
<td>2004</td>
<td>2.4</td>
</tr>
</tbody>
</table>

**Under Preparation**

<table>
<thead>
<tr>
<th>Project</th>
<th>Fiscal Year</th>
<th>Amount ($m)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tonga Education</td>
<td>2005</td>
<td>4.0</td>
</tr>
<tr>
<td>Kiribati Adaptation Pilot (GEF)</td>
<td>2005</td>
<td>to be determined</td>
</tr>
</tbody>
</table>

### 2. Non-lending Operations (Analytical and Advisory Activities)

**Under Preparation**

**Regional**

Labour Mobility Study
Pacific Strategy, 2005-2008
Public Utilities reform TA
Regulatory and Institutional Reform for Private Sector Development (World Bank, in collaboration with FIAS)
Risk Management and Adaptation Study

**Country-Specific**

Fiji Microfinance TA
Palau Oil and Gas TA
Solomon Islands Economic Report
Solomon Islands Energy Regulation and Reform
The Bank has reactivated its programme with the Solomon Islands, following clearance of arrears in August 2003 and the success of the Regional Assistance Mission to the Solomon Islands. It reviewed a suspended health project and agreed to restart it. In addition, it is developing or implementing a range of grant-funded activities for the Solomon Islands.

An important piece of analytical work the Bank produced in FY04 was Doing Business in 2005: Pacific Island Indicators. This database is a part of the Bank’s broader Doing Business in 2005 report, which collects information on the costs of doing business in different countries around the world. The data for the Pacific show that most Pacific Island states have considerable room to improve their business climate in areas such as the cost and time to start a business, enforce a contract or recover assets in the event of bankruptcy. There is, however, a wide range of experience even among Pacific states. Similar to world-wide experience, poorer countries in the Pacific tend to regulate both more heavily and less effectively.

Reducing the costs of doing business is an important area of policy reform and potential Bank assistance in the Pacific. The Bank is financing trials to try to reduce the costs of doing business in Fiji, Samoa and Tonga. The subject of the 2005 edition of the Bank’s flagship World Development Report is improving the investment climate for growth and poverty reduction. This complements, on a broader canvass, the findings of Pacific Island Indicators.

Papua New Guinea

The World Bank and the Government of Papua New Guinea have continued to implement the recommendations of the Bank’s Public Expenditure Review and Rationalization (PERR) report. The Bank’s PERR team visited PNG several times to review progress and assist with implementation. This work is being carried out jointly with the Asian Development Bank and Australia, and provides a good example of donor coherence in an important area of assistance. There has also been good progress on the Gas Development and Utilization Technical Assistance Project. In August 2003 the Bank suspended the Forestry and Conservation Project and associated GEF grant, and has been in dialogue with the Government to resolve outstanding issues.
ANNEX A. CONSTITUENCY OFFICE

1. CONSTITUENCY OFFICE OBJECTIVES

The Office will promote the interests of the member countries of the Constituency in the policies and operations of the World Bank Group (WBG) by:

(a) Advocating policies and practices to improve the effectiveness and efficiency of the WBG in pursuing its mandate for poverty alleviation and sustainable development while maintaining its financial integrity;

(b) Ensuring that the WBG takes full account of the concerns of the Constituency in its policies and activities;

(c) Maximising the WBG's interest and active engagement in Cambodia, Korea, Mongolia, Papua New Guinea and the Pacific Islands;

(d) Encouraging the WBG to promote a free trading environment for developed and developing countries;

(e) Keeping Constituency authorities informed of the policies and activities of the WBG, including its partnership and research activities;

(f) Increasing understanding and support in member countries for the WBG’s policies and activities;

(g) Assisting in the co-ordination of co-financing agreements between the WBG and the development assistance programs of Australia, Korea and New Zealand;

(h) Facilitating contacts between businesses in Constituency countries and the WBG, including in obtaining consultancy and procurement contracts.
2. 2003-2004 CONSTITUENCY OFFICE - STAFF

EXECUTIVE DIRECTOR

Mr. John Austin  New Zealand  Elected: August 1, 2003

ALTERNATE EXECUTIVE DIRECTOR

Mr. Terry O'Brien  Australia  Appointed: July 23, 2003

SENIOR ADVISORS

Mr. Dong Soo Chin  Korea  Appointed: July 23, 2003
Mr. Tom Hall  New Zealand  Appointed: June 7, 2004

ADVISORS

Ms. Angela Barnes  New Zealand  Appointed: July 1, 2003
Mr. Jeff Barton  Marshall Islands  Appointed: November 25, 2002
Mr. Yoon-Kyung Kim  Korea  Appointed: February 3, 2003
Mr. Tola May  Cambodia  Appointed: November 22, 2002
Ms. Julia Newton-Howes  Australia  Appointed: July 28, 2003

OFFICE SUPPORT STAFF

Mrs. Yolanda Cunnane  Senior Executive Assistant
Mrs. Hille Blackshaw  Staff Assistant
Mrs. Elena Chanchu  Staff Assistant
Ms. Annie Lugassy  Retired September 2003
3. **CONSTITUENCY OFFICE TRAVEL: JULY 1, 2003 - JUNE 30, 2004**

1. **John Austin, Executive Director**

   Sept.  25-October 1, 2003  Asian Development Bank, Manila, Philippines
   February 2-21, 2004  EDs' Group Travel, Samoa; CWA Australia & New Zealand
   April 28-29, 2004  ECOSOC, United Nations, New York
   May 11-June 14, 2004  CWA, Korea, Mongolia, China, Philippines, Australia & New Zealand

2. **Terry O'Brien, Alternate Executive Director**

   September 7-10, 2003  DC Deputies Meeting, London, England
   November 16-22, 2003  Mongolia - Consultative Group Meeting, Tokyo, Japan
   February 6-15, 2004  Australia, Accompanying Mr. Wolfensohn

3. **Dong-Soo Chin, Senior Advisor**

   July 31-August 8, 2003  CWA, Seoul, Korea
   February 21-28, 2004  CWA, Seoul, Korea
   April 28 & 29, 2004  CWA, New York

4. **Angela Barnes, Advisor**

   February 16-21, 2004  IDA14 Negotiations, Paris, France

5. **Yoon-Kyung Kim Advisor**

   May 11-20, 2004  Accompanied Executive Director, Seoul, Korea

6. **Julia Newton-Howes, Advisor**

   February 16-21  IDA14 Negotiations, Paris, France

CWA: Consultations with Authorities
ANNEX B: CONSTITUENCY STATEMENTS

1. THE HON. PETER COSTELLO, MP TREASURER, AUSTRALIA
Development Committee Meeting, September 22, 2003  Dubai, UAE

The past year has seen regional and civil conflicts, economic uncertainties and slow world economic growth. These circumstances have impacted directly on our constituency members. In such times, when the global economic climate is less helpful to raising national living standards, there are particular rewards for having pro-growth domestic policies and institutions. In this constituency, we have witnessed a range of economic performance: on the one hand some countries with sound policies sustained strong economic performances; while on the other hand, several countries have experienced fiscal slippages and deteriorating social conditions, leading to a worsening climate for domestic saving, investment and the conduct of business, and declines in their citizens' real living standards.

These meetings help us take stock of global and comparative national and regional performance in the conquest of poverty and in broadening the opportunities for education, good health and employment which our citizens rightly expect. How can the World Bank help its members implement and sustain the policies that will ensure progress towards these objectives?

Supporting sound policies with adequate and appropriate financing

First, we should learn lessons from the global successes that show us that good policies produce superior economic and social outcomes for the poor.

The fastest progress against poverty has occurred in developing countries with good business climates, reasonably good governance and institutions, inclusive social policies and fast growth in trade. Export revenues in developing countries rose from less than 15 per cent of their GDP in 1990 to almost 25 per cent by 2000. Exports of manufactures by developing countries have grown particularly strongly, and have become increasingly important in global trade. Real GDP per capita is forecast to continue to grow faster in developing countries than in high-income countries through to 2015.

The absolute number in extreme poverty has continued to fall. By 2015, the global population will be over a billion higher, almost all of that increase born into developing countries. But notwithstanding that population growth, the number living on less than $2 a day is forecast to fall to about 2.1 billion from just over 2.7 billion in 2000.

The fastest progress against poverty has occurred in Asia, which has had relatively low inflows of official development assistance (ODA) per person. Among the 18 populous low-income countries which the World Bank uses as illustrations of economies with relatively good policies and the capacity to productively deploy more ODA, some of the strongest GDP growth per capita through the 1990s occurred in economies with the lowest ODA (both per capita and as a share of GDP).³

This underscores that a sound domestic business climate, effective governance, the ability to mobilize domestic resources, and inclusive social policies are the key paths to sustainable growth in living standards, rather than ODA.

More effective aid, well-directed to the developing countries with the policies and institutions to make best use of it, would doubtless assist even faster progress. But at any level of aid, good domestic policies and institutions will ensure the highest payoff.

In this constituency, we grapple with the challenges of raising living standards in a number of small, geographically isolated economies. Such economies are disadvantaged by small domestic markets, high transport costs to neighbouring countries and global markets, limited market access, and consequently limited opportunities to generate the specialization, productivity and gains from trade that are the key to sustainable, self-reliant improvement in living standards.

For such countries, the World Bank can play a positive role by helping with technical assistance to build understanding and support for the institutions, values and policies that generate economic growth. Given the small scale of the economies concerned, this may not require large projects costing millions, but certainly will benefit from intensive programs to deploy the lessons learnt in other countries.

We encourage the Bank's work on how best to assist Low Income Countries Under Stress (LICUS), the lessons from which will benefit the many developing countries seeking to improve their performance, and also donors seeking to improve the efficacy of their aid. Already, we are struck by the finding that aid to the post-conflict economies which form a large proportion of the LICUS cases, tends to peak very soon after the cessation of conflict, rather than being sustained in the medium-term over which it can most effectively be used.

Enhancing voice and participation of developing and transition countries

The World Bank has made important practical progress in enhancing the voice of developing and transition countries in the Bank’s operations, through improved country ‘ownership’ of key processes (such as Poverty Reduction Strategy Papers and subsequent Country Assistance Strategies) that form the framework for Bank lending. It has also increased its staff’s awareness of country views through decentralization. Decisions to better resource the Executive Directors’ offices of some large developing country constituencies also carry the potential to help them improve their voice on the Executive Board of the Bank.

While these measures are important, they are not widely understood in those non-government circles which question the legitimacy of Bank decision-making processes, and we should do more to explain their potential. Moreover, their ultimate success will depend on the use that is made of them in years to come by developing countries. We have made progress over the last year, but more could be done in the future. Developing countries could significantly raise their voting power within the International Development Association by fully taking up their available subscription votes. We support the further development of options for officials from developing countries to take up development opportunities on Bank staff. Other options could build developing countries' capacity for independent research into Bank issues, and the Bank could continue to increase the diversity of its staff, while maintaining professional standards.

Much could also be achieved within and among existing constituencies. As illustrated in this thirteen-country constituency of developed and developing economies, internal arrangements to consult, to share experiences, to build expertise and to reflect changing economic weights in changing representation patterns can strengthen ‘voice’ in a practical sense.

Given this experience, our constituency members believe that ‘voice’ would also be significantly enhanced in an environment that builds greater understanding of the historical, political and cultural backgrounds which influence each member’s view of issues that come before the Board. That
environment also helps gain a better appreciation of the policy priorities and implementation issues facing each member. This is something that single member constituencies or constituencies consisting solely of developed or developing countries are perhaps less able to appreciate.

In other constituencies where numbers may be considered too large, there may be opportunities to reconfigure existing country groupings into smaller ‘mixed’ constituencies of developed and developing countries, in cooperation with those smaller or single-member European constituencies that often express concerns about ‘voice’, and are themselves over-represented in the Bank from the viewpoint of relative economic weight. Members may be prepared in future to consider more radical re-weightings of quotas and voting power in the IMF and the World Bank, but the issues raised by this course go to fairness of voice for countries beyond the ranks of the developing and transition members. This is exemplified in the experience of fast-growing but relatively under-represented economies such as Korea. Once again, progress would only be possible if some of those developed countries now enjoying over-representation were prepared to relinquish it.

**Trade**

Engagement in trade has proven a powerful poverty-buster. Not only does the specialization that trade produces create employment, raise productivity and increase income, but also it encourages the adoption of modern business practices and helps build commercial institutions.

That is why Australia and New Zealand, in this constituency, have lowered their trade barriers: multilaterally in successive GATT and WTO rounds; bilaterally in their Closer Economic Relations treaty; and unilaterally in their respective abolition of all duties on imports from least developed countries.

We should use the Bank’s timely and forceful analytical work in *Global Economic Prospects 2004* to help restore momentum to the Doha round of trade negotiations after the disappointing failure to make progress at the Fifth WTO Ministerial Conference in Cancun, despite groundwork on a number of issues.

A good outcome from the Doha round would yield strong development benefits, fairly distributed among nations, and in particular to the benefit of the poorer developing countries. Poorer countries are presently most damaged by developed countries’ agricultural subsidies and protectionism, and by significant trade barriers against simply transformed manufactures. (These barriers are often also applied by developing countries themselves.) Trade liberalization would accelerate progress against extreme poverty by 2015, with Bank estimates that extreme poverty would be cut by a further 140 million people. This is probably a larger prize in the battle against poverty than can be won by any other feasible international policies at our disposal.

At Cancun, developing countries judged rich countries had not made meaningful concessions on faster agricultural reform, and had underestimated the implementation problems developing countries faced on some of the commitments initiated at Singapore. This is one clear example where developing countries have begun to exercise the ‘voice’ that the consensus rules of the WTO have given them. Rich countries may not agree with the message, but the developing world is entitled to assert its interest.

We need to redouble our efforts to bring about a pro-development outcome from the Doha round. This will require more movement by all countries, and especially by those rich countries that most heavily subsidize agricultural exports. The rich countries profess concern with eradicating extreme poverty,

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*Defined relative to the $2 a day poverty line. See Trade and Development After Cancun: Information Note, prepared by the World Bank*
meeting the Millennium Development Goals, mobilizing developing countries’ domestic resources, engaging the private sector in development and achieving sustainable debt burdens on the heavily indebted poor countries. But without better market access for developing countries through a successful Doha outcome, those concerns will all ring hollow.

We should not underestimate the gains that can arise from investments that strengthen trading capacity such as improving customs and logistics systems, and from unilateral or regional actions to reduce trade barriers. We are heartened by the Bank’s stepped-up trade assistance program to facilitate strengthened trading capacity, which can also assist in the transitional adjustments that liberalizing countries may have to make (for example, a decline in revenue from tariffs). Countries which have recently joined the WTO (such as Cambodia in this constituency) may particularly benefit from such assistance.

One of the consequences of strong growth in developing countries’ trade in recent years, particularly in the trade in manufactures, is that remaining barriers to south-south trade have assumed significance, and offer their own options for trade liberalization.

**Achieving the Millenium Development Goals (MDGs)**

Progress towards the MDGs, while promising at a global level, has been uneven both by region and by goal. Uneven progress is only to be expected, and is in part a corollary of country ownership of goals set in national Poverty Reduction Strategy Papers: individual countries may choose national goals that are not aligned either in time frame or in priority with those implicit in the global MDGs.

Where some countries have chosen less ambitious targets, the stronger performance of other countries may both encourage higher goals in future, and illustrate the better policies and institutions necessary to achieve them.

We support the Bank’s work to develop, in effective cooperation with the IMF, improved measures for tracking progress towards the MDGs, but caution that these measures should not be over-elaborated at the cost of timeliness or policy utility.

**Progress in Poverty Reduction Strategy Papers (PRSPs)**

We strongly endorse further development of PRSPs. They are a key means of improving the clarity of member countries’ planning of their social and development priorities, engaging civil society in that process, and increasing country ‘ownership’ of the resultant development strategy.

But the process can become unwieldy in its complexity, slow to adjust to any shocks which invalidate projections in the strategy, and undesirably distant from the national operational requirements of expenditure decisions and budget processes.

We encourage a focus on practicality and operational utility in the further development of these valuable tools, so that developing countries’ practical needs of the process take precedence over excessively elaborate international standardization of the PRSPs.

**Heavily Indebted Poor Countries (HIPC) and debt sustainability**

It is gratifying to see the mounting number of HIPCs that have reached or passed the decision point for significant relief of their heavy debt burdens.

We share concerns that some or these countries may face debt sustainability problems (measured in terms of the ratios of their debt service payments to their export earnings) even after completion of the HIPC process.
From an anti-poverty perspective, the fundamental problem in such cases is the inability to generate sufficient growth to reduce the debt service ratio by raising exports. A poor country without the capacity and market access to expand its exports is likely to remain very poor, even if its entire debt were to be completely forgiven. In such cases, we should be more focused on the trade liberalization and development tasks most likely to initiate the export and income growth that will deliver debt sustainability as a by-product of defeating poverty.

**Infrastructure Action Plan**

While the role of the private sector in cost-effective provision of infrastructure is important, it seems likely that the very marked reduction in Bank lending on public infrastructure provision during the 1990s went too far. We believe there is a role for the Bank in both encouraging private sector participation, and judicious lending to well-performing public utilities, whose development has been integrated into PRSPs and Country Assistance Strategies. There is growing international recognition of the importance of infrastructure to both economic growth and poverty reduction.

Accordingly, we endorse the Bank’s renewed focus on infrastructure lending in its Infrastructure Action Plan. However this approach should not become volume-driven. The policy framework for infrastructure and the efficiency of its regulation of remain central to the success of activities in this sector. The Infrastructure Action Plan does not directly address the issue of quality and sustainability of investments. Many past investments have suffered from maintenance problems and lacked sustainability. The Bank should continue to focus on policy and institutional issues to ensure better outcomes from lending.
2. THE HON. PETER COSTELLO, MP TREASURER, AUSTRALIA  
Development Committee Meeting, April 25, 2004, Washington, DC

A. Global Growth and Poverty

It is gratifying to see not only some strengthening in global growth since we last met, but also the strong growth now evident for many developing countries and predicted out to the 2006 forecast horizon. Over that period, developing countries’ real GDP growth is forecast to continue at about twice the rate of developed countries’ growth. Most developing regions are sharing in this growth, which considerably outpaces their population growth. Unfortunately, growth in Sub-Saharan Africa remains too weak in per capita terms to make significant progress against poverty.

Growth in some of the developing countries in this constituency also remains subdued, but we have been heartened to see the World Bank’s intensified activity to understand the constituency’s challenges. There have been recent visits by President Wolfensohn, senior Bank management, and a sub-group of Executive Directors; a recent regional workshop to pool insights into the best path forward, and novel attempts to increase coordination among aid donors to meet recipient’s priority needs, involving the World Bank and the Asian Development Bank and the Governments of Papua New Guinea and Australia.

While many developing countries face challenges in meeting some of the Millennium Development Goals (MDGs), new World Bank work confirms earlier estimates that from 1981 to 2001, the proportion of people living in extreme poverty fell from 40 per cent to 21 per cent, and the number fell by about 400 million, notwithstanding global population growth of 1.6 billion over that time. This represents unprecedented progress over the last two decades towards and beyond the overarching MDG, that of reducing income poverty.

The Global Monitoring Report 2004 shows that this strengthened growth and progress against poverty is due in part to improved macroeconomic and structural policies in most regions, although the vital areas of quality of governance and public administration continue to lag, and in some countries and regions, to go backwards.

With better macroeconomic and structural policies, average developing country credit ratings have risen. The average spread on emerging market bonds has fallen more than 200 basis points since the end of 2002. Low global interest rates have helped developing countries’ investment and growth, and reduced their debt-servicing burden, from 18 per cent of exports in 1997 to 15 per cent in 2003. But developing countries will need to continue to monitor their indebtedness closely, particularly in the face of a probable increase in global interest rates in years to come from historically low levels.

Global threats to continued progress remain. Large current account deficits in the US draw in much of the world’s savings, and structural rigidities restrain growth in Western Europe and Japan. Such factors hold back global growth and raise the risks of disorderly corrections, and we urge accelerated national progress in these areas of reform.

Terrorism also regrettably remains a threat to economic confidence. The Bank and Fund have a role to play to reduce this threat, as embodied in the recent decision for more effective organization and resourcing of measures to counter money laundering and the financing of terrorism.

B. ‘Global Monitoring Report 2004’: Progress towards the Millennium Development Goals (MDGs)

The joint work of the IMF and the World Bank to produce the Global Monitoring Report usefully adds to our understanding of development successes and failures. Work by the Bank on the quality of
governance, regulation and business climate, and on barriers to trade, highlights the reforms that are needed by both developed and developing countries to raise living standards. We commend the Bank on this work and urge its continuation and refinement.

Global goals and national commitments
Interpreting the MDGs as guides to national policy requires a common sense approach. The MDGs were endorsed by governments as global goals, not national goals. While they can only be met by national actions, the way some goals are expressed prevents their ready direct application in all national circumstances. For example, goals such as reducing infant mortality by two-thirds or maternal mortality by three-quarters may be more or less feasible depending on an individual country’s starting point. For relatively good performers close to the ‘frontiers’ of best practice, the cost of further large reductions in their mortality rates might be prohibitive, whereas even larger improvements might be achievable in countries with weaker starting points.

The MDGs should serve as encouraging broad external benchmarks of what is feasible, but countries must have the right to ‘own’ their development priorities and shape them to their needs, resources and starting points. Moreover, the MDGs also remind us that the interconnections among economic and social goals are important. For example, the Global Monitoring Report suggests that gender equity is vital to improving educational outcomes, and that improving educational outcomes is vital to improving maternal and infant health, halting the spread of infectious diseases, improving economic growth, and thus conquering income poverty.

The consistent shortfall in progress towards the MDGs in Sub-Saharan Africa is suggestive of deep seated problems of instability and weak governance. As an example of both problems and progress, the case of Uganda is illustrative: progress towards the goal of universal primary education was being hindered not only by constrained budgeted spending on education, but also by teacher absenteeism which ran at 25 per cent and diversion to other uses of as much as 87 per cent of non-wage resources intended for schools. Yet in just five years, the diversion of non-wage resources was cut by more than three-quarters through improvements in transparency and public involvement.

It is hoped that initiatives such as the African Peer Review Mechanism of the New Partnership for Africa’s Development can help improve governance more widely. Better governance would provide the foundation of a better business climate, a better use of existing resources, and a more productive environment for seeking higher levels of future aid that could assist progress once necessary underlying conditions are in place.

Investment, remittances, trade and aid
Net foreign investment inflows to developing countries were running in 2002 at about $150 billion a year, and remittances to developing countries were over $90 billion a year. Official development assistance (ODA) was almost $60 billion a year in 2002, though the latest estimates suggest it rose again in 2003 to almost $70 billion.

World trade growth continues at more than twice global GDP growth. Developing countries’ international trade (imports plus exports) is equivalent to about half their gross national income. Yet trade barriers among developing countries themselves as well as the particularly harmful barriers by some OECD economies that bear on developing countries’ exports – subtract some $350 billion a year from developing countries’ potential income, and about $150 billion from developed countries’ potential income.

To put it differently, for every $4 the private sector and individuals transfer to the developing world in investment and remittances, developed countries’ governments add about $1 in aid, while all
governments’ trade barriers subtract over $5 of potential income. Those numbers suggest a focus for our efforts: improving the business climate in developing countries to attract private capital flows, and lowering trade barriers everywhere, can do more to generate self-sustaining economic development and reduce debt than any feasible increase in aid volumes.

In our view, well designed and effective ODA (particularly in improving governance and supporting human capital) is best seen as playing an important complementary role to trade and investment.

**Business climate and governance**

Good governance and robust, transparent and honest legal and economic institutions are the foundations of wealth production. They are also the foundations that allow performance-based aid to be deployed effectively.

The *Global Monitoring Report 2004* deploys strong new evidence from the World Bank’s ‘Doing Business’ database to confirm that heavy regulation tends to be associated with corruption, high proportions of business conducted inefficiently in the informal sector, and low growth. Corruption is a regressive tax that hits hardest at the weakest and the poorest. In addition, corruption in developing countries destroys the support for aid in developed countries.

The Bank, the Fund, the regional development banks and bilateral donors all have valuable contributions to make towards strengthening governance and institutions in developing countries. Over the last year, Australia has taken innovative measures in cooperation with local authorities and the international financial institutions in both the Solomon Islands and Papua New Guinea to help strengthen the rule of law and the quality of governance.

But domestic reformers in developing countries themselves have the greatest role to play, and here the Bank can help the reform process with the dissemination and transparent comparison and benchmarking of countries’ performance in improving governance. The Country Policy and Institutional Assessment (CPIA) ratings and the ‘Doing Business’ database have particular potential, and we encourage their further dissemination and use to enable comparisons of who is moving in the right direction, and who is failing in these basic building blocks for economic growth.

**Trade liberalization**

We congratulate the Bank on its continued analytical work on the costs of trade restrictions, export and production subsidies. In addition, the Bank’s technical assistance and project lending help strengthen trade capacity, and help lower the ‘behind the border’ impediments in logistics and customs that often prevent developing countries from making the most of their market access.

For developed countries, the Bank’s work on trade restrictiveness confirms the damaging heights of trade protection, export and production subsidies in agriculture and the way tariff escalation often works to discourage more processed imports from developing countries. Both factors explain why the dynamic estimates of gains from plausible multilateral trade liberalization yield more than twice the income gains to developing countries ($350 billion) than to high-income countries ($150 billion).

For developing countries, declining simple average tariffs provide heartening indication of progress in reducing trade barriers over the last decade. Nevertheless, new trade restrictiveness indexes suggest that developing countries still have trade barriers more than twice as high as those in OECD economies, and that barriers against other developing countries are often as high as, or higher than, barriers against developed country exports. This is a powerful reminder that the potential for gains from multilateral trade liberalization in a successful Doha Round lie in ‘South-South’ trade as well as between developed and developing countries.
More and better quality aid

We strongly support continued movement to performance-based allocation of multilateral aid, including grants and loans from the International Development Association, although we recognize there are some shortcomings in the current system. In particular, for smaller countries the system can be inflexible and lead to significant fluctuations in allocation as a result of only small changes in governance ratings. We look forward to further work on fine-tuning the allocation system. In addition, we consider there should be full transparency as to the indicators (based on the CPIA ratings) that drive that allocation. Following the recent examination of CPIA methodology by an expert panel, we urge the prompt publication of full details of countries' CPIA scores. But a corollary of performance-based aid is a well-developed program of technical assistance and capacity building for those countries that can not benefit from performance-based aid because they are recovering from conflict or they have weak policies and governance or they are highly indebted. Bilateral aid will also have to play a role in dealing with these difficult cases.

Useful World Bank involvement outside the performance-based framework is outlined in the ideas for Low Income Countries Under Stress (LICUS). However, such ideas are at this point under-developed in practical terms and under-resourced in implementation. The creation of a three-year, $25 million LICUS trust fund is only a very tentative first step. The modesty of this initiative is indicated by the fact that the first call on that fund, on behalf of Liberia, has already accounted for 16 per cent of its resources. Well-designed aid to LICUS and post-conflict countries can be vital, and we urge increased priority on developing LICUS programs, especially in the context of tailoring assistance that will be compatible with the estimates of long-term debt sustainability for low-income countries as further discussed below.

In this context, we do not share the Global Monitoring Report's implication that the recent increase in ODA is in some sense devalued by the amounts devoted to debt forgiveness, technical assistance and aid administration. We do not share the assumption that only cash transfers for program support amount to high-quality aid. Indeed, given the scope of problems in LICUS countries and countries that face debt sustainability problems, we may need to see more technical assistance in such cases.

The Global Monitoring Report introduces an interesting new measure of the 'selectivity' of aid allocation in poverty reduction, with 'selectivity' implying that a certain level of aid, provided to better performing but poorer countries will lead to greater reductions in poverty than if it were allocated evenly to all countries or more were given to countries with poor policies. But 'selectivity' in this sense measures only two dimensions of aid. The form in which aid is given is also important, as are the reasons (other than poverty alleviation) that sometimes inform aid decisions. For example, responses to humanitarian crises or conflicts, or aid to a LICUS country, may be measured as less 'selective' aid, but nonetheless meet a real need.

Efficiency and co-ordination of the International Financial Institutions

The partnership among developed and developing countries and the international financial institutions demands a strong performance from all three to improve progress towards the MDGs. Against that aspiration, it is clear the chapter in the Global Monitoring Report 2004 on efficiency and coordination of the international financial institutions is the weakest in an otherwise impressive analysis.

In future work, we would appreciate a clear identification of the conclusions the Bank draws for its own prioritization and the efficiency with which it applies its existing resources.

C. 'Long-Term Debt Sustainability in Low-Income Countries'

Foreign debt sustainability is a function both of the cost of debt repayments, and of the opportunity to export in order to meet those repayments. Consequently, the trade liberalization imperatives outlined above are central to debt sustainability as well as to economic development. One of the best ways for
developed countries to address the issue of debt sustainability would be to review trade barriers and subsidies that impede developing countries' earning opportunities. We welcome the joint Fund-Bank work on a forward-looking methodology to study debt sustainability for low-income countries. Although this work is still in its early stages, already some useful general guidance is apparent.

First, the quality of policies and institutions in a low-income country is an important determinant of its vulnerability to debt crises: countries with weak institutions and policies as revealed by the CPIA ratings, are vulnerable to debt crises at lower levels of debt than countries with stronger CPIA ratings. That is another reason why the details of CPIA ratings should be released now, even though the rating system will doubtless be improved further by additional testing and study, including external research.

Second, at any given level of institutional and policy quality, countries that are particularly prone to exogenous shocks such as export price fluctuations or climatic disruption to agricultural output have less capacity to service foreign debt. Again, the evidence on economic volatility would be a valuable addition to governments' and markets' capacity to judge debt sustainability.

Third, debt sustainability will always remain a matter of judgment and depend on the circumstances of each country. Judgments and country circumstances will always differ, and there is unlikely to be any single, definitive indicator of sustainable debt. We wish to see the debt sustainability analysis developed cooperatively by the borrowing country, the Fund and the Bank together (and used for example in Article IV examinations and Country Assistance Strategies), but the process should not remain solely an official or confidential one. All market participants deserve timely access to the information yielded by debt sustainability analysis, and we advocate public dissemination of the insights from this process as soon as possible.

While the debt sustainability analysis is forward looking, we also need to apply its insights to the tail-end of the HIPC processes.

An old aphorism notes that when one wants to get out of a hole, one should first stop digging. Yet in the last few years for some HIPCs, the international financial institutions have deepened the hole of excessive debt by lending more funds (albeit at concessional rates) even as countries already exceeded the HIPC exit point target ratio of 150 per cent of the present value of external debt to exports. More debt is never the solution to unsustainable indebtedness. Forgiveness of debt that was widely perceived to be unsustainable, even as it was contracted, worsens moral hazard and makes a mockery of performance-based aid allocation. The process favours that subset of HIPCs that benefit, but is unfair to the similarly poor, but less indebted developing countries, including some in this constituency. The HIPC sunset clause will come into effect at end-2004. The question of what to do about heavily indebted countries that have yet to enter the HIPC process will become important. There are strong grounds for maintaining encouragement for as many HIPCs as possible to progress their reforms sufficiently to take advantage of the HIPC concessions.

Most of those HIPC countries that have not yet reached decision point have suffered conflict and instability, and debt sustainability analysis may show their ultimately sustainable debt levels to be below current HIPC benchmarks. We will need more detailed analysis of specific country circumstances as we proceed to operationalize the new debt sustainability analysis framework.

'Voice' in the governance of the World Bank
Addressing representation and governance issues at the IMF and the World Bank is critical to the on-going credibility of the institutions. The representation of the fastest growing economies of the world, in particular those in East Asia, has not kept pace with their importance in the world economy and this
continues to create tensions at the institutions. An adjustment to quota shares at the IMF, followed by a change in the capital subscription shares of the IBRD, is needed to improve the credibility of the institutions.

One approach to these goals that might command support would be to establish a review of the role, functioning and operation of the Boards. The structure and composition of the Boards could then be subsequently reviewed.

D. Conclusions

We believe the Global Monitoring Report 2004 embodies some useful new insights into the causes of persistent poverty such as poor business climate, weak governance and persistent trade barriers. With the new tools deployed in the report, we hope to see sharpened diagnoses of what countries need to do to lay the foundations for poverty-busting growth, sharpened performance-based allocations of aid, and diagnoses of debt sustainability. We also look forward to the World Bank's efforts to assist LICUS countries.
### ANNEX C - CONSTITUENCY VOTING POWER - PERCENTAGE OF TOTAL & NUMBER OF VOTES
June 30, 2004

<table>
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<tr>
<th>MEMBER</th>
<th>IBRD</th>
<th>#</th>
<th>IDA</th>
<th>#</th>
<th>IFC</th>
<th>#</th>
<th>MIGA</th>
<th>#</th>
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<td>1.30</td>
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<td>.00</td>
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<td>.10</td>
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### CONSTITUENCY MEMBERSHIP

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<td>X</td>
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<tr>
<td>Palau</td>
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<td>X</td>
<td>X</td>
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<tr>
<td>Papua New Guinea</td>
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<td>X</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Samoa</td>
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<td>X</td>
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<td>X</td>
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CONSTITUENCY VOTING RECORD  JULY 1 2003 – JUNE 30, 2004

During this period the Bank’s Group Board of Governors voted on the following resolutions:

**IBRD Governors’ Resolutions, July 2003 – June 2004**

551. Direct Remuneration of Executive Directors and their Alternates  
      August 8, 2003

552. Financial Statements, Accountants’ Report and Administrative Budget  
      September 24, 2003

553. Allocation of FY03 Net Income  
      September 24, 2003

554. Forthcoming Annual Meetings of the Board of Governors  
      - Change of 2004 Annual Meeting Dates  
      September 24, 2003

555. Resolution of Appreciation  
      September 24, 2003

556. Transfer from the Surplus to Replenish Trust Fund for West Bank and Gaza  
      February 4, 2004

557. Transfer from Surplus to Low-Income Countries under Stress Implementation Fund  
      March 24, 2004

**IDA Governors’ Resolutions, July 2003– June 2004**

205. Financial Statements, Accountants Report and Administrative Budget  
      September 24, 2003

206. Resolution of Appreciation  
      September 24, 2003

**IFC Governors’ Resolutions, July 2003- June 2004**

237. Financial Statements, Accountants Report and Administrative Budget  
      September 24, 2003

238. Membership of Bhutan  
      September 24, 2003

239. Resolution of Appreciation  
      September 24, 2003

**MIGA Governors’ Resolutions, July 2003-June 2004**

66. Financial Statements, Accountants Report  
    September 24, 2003

67. Resolution of Appreciation  
    September 24, 2003
## ANNEX D  CONSTITUENCY PROJECTS JULY 1, 2003 - JUNE 30, 2004

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<thead>
<tr>
<th>DATE</th>
<th>$ Million</th>
<th>FROM</th>
<th>PROJECT DESCRIPTION</th>
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<tbody>
<tr>
<td><strong>CAMBODIA</strong></td>
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<tr>
<td>September 2003</td>
<td>20.0</td>
<td>IDA</td>
<td><strong>Provincial and Rural Infrastructure Project (PRIP):</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>The credit of $20 million to the Kingdom of Cambodia will finance:</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• a road rehabilitation and maintenance program;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• capacity building and training program;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• development of improved public policies and strategies.</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>The development objective of this project is to provide sustainable access to</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>markets and essential services for four remote and the poorest provinces of Cambodia.</td>
</tr>
<tr>
<td>December 2003</td>
<td>45.75</td>
<td>IDA/GEF</td>
<td><strong>Rural Electrification and Transmission Project:</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>The project will be financed with a development credit of $40 million and a Global</td>
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<tr>
<td></td>
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<td></td>
<td>Environment Facility (GEF) Trust Fund grant in the amount of $5.75 million. The</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>project aims to:</td>
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<td></td>
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<td>• improve power sector efficiency and reliability as well as reduce electricity</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>supply costs;</td>
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<td></td>
<td>• expand rural electricity supplies and thus contribute to improvement in standards</td>
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<td></td>
<td></td>
<td>of living, and foster economic growth;</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• strengthen electricity institutions, the regulatory framework and create “enabling</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>environment” for sector commercialization and privatization.</td>
</tr>
<tr>
<td></td>
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<td></td>
<td>Overall, the project target is to provide electricity to about 100,000 new</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>customers.</td>
</tr>
<tr>
<td>January 2004</td>
<td>10.0</td>
<td>IFC</td>
<td><strong>Investment in Société Concessionaire de L’Aéroport:</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>The loan of up to $10 million will help finance infrastructure expansion and</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>modernization at Cambodia’s two international airports. The current project seeks</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>to facilitate the expansion of the tourism sector in Cambodia.</td>
</tr>
<tr>
<td>April 2004</td>
<td>6.0</td>
<td>IFC</td>
<td><strong>Investment in Acleda Bank, Plc:</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>The investment by IFC in the Acleda Bank Plc. is in the form of a credit line of up</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>to $6 million which will be used to support the Bank’s expansion program, to an</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>additional 28 rural districts. In addition, the investment will finance the Bank’s</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>pilot for “fixed asset financing” program.</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>81.75</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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*September 2003 Economic Report*

**Cambodia: The Integrated Fiduciary Assessment and Public Expenditure Review:**

A joint document of the World Bank and the Asian Development Bank assesses the public expenditure policy and management of the Government of Cambodia. Principal findings:

- to ensure fiscal sustainability domestic resource mobilization must be improved;
- high level of fiduciary risk to public funds exists in light of weaknesses in the public expenditure and financial management system;
- to meet the poverty reduction targets, the Government must improve the effectiveness of public spending;
- to address the serious problems afflicting the civil service, comprehensive civil service reform must be initiated.
<table>
<thead>
<tr>
<th>DATE</th>
<th>$ Million</th>
<th>FROM</th>
<th>PROJECT DESCRIPTION</th>
</tr>
</thead>
</table>
| MONGOLIA   |           |       | **Mongolia: Second Ulaanbaatar Services Improvement Project:** The credit of $18 million to Mongolia will finance construction of water supply facilities to serve the urban poor. The project has four objectives:  
- to improve water supply in the ger areas;  
- to strengthen the primary network system in selected city areas;  
- to replace selected obsolete high energy consuming electrical equipment;  
- to support further improvements in selected operational and commercial aspects of USAG. |
| April 2004 | 18.0      | IDA   | **Investment in Agricultural Bank of Mongolia:** The investment by IFC is in the form of a loan of up to $1.8 million and an equity of up $1.2 million, to support expansion and institutional strengthening of Agbank, following its privatization. |
| June 2004  | 3.0       | IFC   | **Investment in Trade & Development Bank of Mongolia:** The IFC investment in Mongolia’s Trade & Development Bank is in the form of an equity of $1.5 million and a subordinated loan of $3.5 million. |
| June 2004  | 5.0       | IFC   | **Total:** 26.0                                                                     |

September 2003

**Mongolia: Poverty Reduction Strategy Paper (PRSP):**
Prepared by the Government of Mongolia, the paper reviews poverty in the country and defines a comprehensive poverty reduction strategy. A joint IDA/IMF staff assessment of the PRSP indicates that the government’s development agenda provides an adequate framework for the Bank assistance.

February 2004  CODE Meeting

**Mongolia: Country Assistance Evaluation (CAE):**
The report, prepared by the Operations Evaluation Department (OED) of the World Bank Group in March 2002, reviews the Bank’s experience in Mongolia over the past decade, assesses the performance of Bank assistance, and develops recommendations for use in the design and implementation of future country assistance strategies. OED rated the outcome of Bank assistance as partially satisfactory, institutional development as modest, and sustainability as unlikely. The evaluation recommended that future Bank assistance should remain selective and focus on improving fiscal management and the private sector environment. The report was discussed at a meeting of the Informal Subcommittee of the CODE. The Subcommittee identified a number of areas it believed required more focus:  
- better understanding of how the WBI, WB, and IFC could build synergies to promote faster private sector growth and enhance capacity efforts;  
- more analysis on the impact of the Asia crisis on country and Bank performance;  
- income distribution issue requires more focus and concrete proposals for what could be done about reducing the country’s vulnerability to external shocks were requested.
<table>
<thead>
<tr>
<th>DATE</th>
<th>$ Million</th>
<th>FROM</th>
<th>PROJECT DESCRIPTION</th>
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</thead>
<tbody>
<tr>
<td>April 29, 2004</td>
<td></td>
<td></td>
<td><strong>Mongolia: Country Assistance Strategy (CAS)</strong></td>
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<tr>
<td></td>
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<td></td>
<td>The World Bank Group’s CAS for Mongolia reviews the country challenges in achieving the objectives of its Economic Growth Support and Poverty Reduction Strategy (EGSPRS), and proposes that the WB assistance to Mongolia focuses on the following objectives:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• consolidating the economic transition through institutional reforms that improve public sector and market efficiency;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• addressing growing equity concerns and reducing rural and urban vulnerabilities;</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• aligning policies and resources around results.</td>
</tr>
</tbody>
</table>

**SAMOA**

<table>
<thead>
<tr>
<th>DATE</th>
<th>$ Million</th>
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<tbody>
<tr>
<td>April 2004</td>
<td>4.47</td>
<td>IDA</td>
<td><strong>April 29, 2004</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td><strong>Samoa: Cyclone Emergency Recovery Project:</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>The financing to the Independent State of Samoa for a Cyclone Emergency Recovery Project includes an IDA grant of $2.39 and IDA credit of $2.08, amounting to the total of $4.47 million. The objective of the project is to assist the government of Samoa to recover from the damage caused by Cyclone Heta.</td>
</tr>
</tbody>
</table>
### CONSTITUENCY:-WORLD BANK GROUP FINANCED PROJECTS TO 30 JUNE 2004

<table>
<thead>
<tr>
<th>State</th>
<th>2000</th>
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<th>2002</th>
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<td></td>
<td>No of Loans</td>
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<td>No of Loans</td>
<td>Total $ M</td>
<td>No of Loans</td>
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<tr>
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<tr>
<td>Papua New Guinea</td>
<td>1</td>
<td>25</td>
<td>4</td>
<td>141</td>
<td>1</td>
<td>40</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>3</td>
<td>2,073</td>
<td>4</td>
<td>141</td>
<td>1</td>
<td>40</td>
</tr>
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<td><strong>IDA</strong></td>
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<tr>
<td>Cambodia</td>
<td></td>
<td></td>
<td>3</td>
<td>63</td>
<td>3</td>
<td>47</td>
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<tr>
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<td>3</td>
<td>69</td>
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<tr>
<td>Samoa(^5)</td>
<td></td>
<td></td>
<td>1</td>
<td>5</td>
<td>1</td>
<td>4.5</td>
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<tr>
<td>Solomon Islands</td>
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<tr>
<td>Vanuatu</td>
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<td>4</td>
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<tr>
<td><strong>Total</strong></td>
<td>8</td>
<td>141</td>
<td>6</td>
<td>75.5</td>
<td>4</td>
<td>65.75</td>
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<tr>
<td><strong>IFC</strong></td>
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<tr>
<td>Cambodia</td>
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<td>1</td>
<td>3</td>
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<tr>
<td>Korea, Rep. Of</td>
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<td>68</td>
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</tr>
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<tr>
<td>Pacific Islands</td>
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<tr>
<td><strong>Total</strong></td>
<td>1</td>
<td>68</td>
<td>1</td>
<td>50</td>
<td>3</td>
<td>73</td>
</tr>
</tbody>
</table>

Grand Total: IBRD IDA/ITF and IFC = $2.77 billion   All figures rounded

\(^5\) Samoa also received an IDA Grant in the amount of $2.39m
ORGANIZATION CHART OF THE MULTILATERAL INVESTMENT GUARANTEE AGENCY

May 2004

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