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JDW Chron File

June 1995-December 1996

The World Bank
Washington, D.C. 20433

GAUTAM S. KAJI
Managing Director
Operations, Policies & Programs

Tel.: (202) 458-1384
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FACSIMILE TRANSMITTAL FORM

DATE: August 21, 1997

No. of Pages: 7
(including this page)

TO: Mr. James D. Wolfensohn, President

FAX #: Through Ms. Deana Canlas

MESSAGE:

Jim,

You may be interested in seeing the attached from Bloomberg on Camdessus' press conference. Please note his warning to Brazil.

All the best,

2/7

BN IMF's Camdessus Says Worst of Thai Economic Crisis Is Past
Aug 21 1997 10:54

Washington, Aug. 21 (Bloomberg) -- The worst of Thailand's economic crisis, which has pummeled the Thai baht in recent weeks, is past, the managing director of the International Monetary Fund, Michel Camdessus, said today.

``I strongly believe that, yes, we have seen the worst of the crisis provided this program is implemented with perseverance which should match the boldness of the measures which have been adopted,'' Camdessus said at a news conference.

``I have no reason to doubt it and, as a matter of fact, I have been reassured by the reaction of the markets today.''

Moreover, Camdessus said he doesn't expect a comparable economic crisis in other emerging market economies in the near future. ``If action in Thailand was too late, the action in the other countries is timely and strong enough, so I can tell you that I don't expect a new banking crisis,'' he said.

``Thailand's problems could have been corrected at much less cost to the economy and to the economies of neighboring countries if they have been addressed in a more timely manner,'' Camdessus said.

Camdessus said the ability of the IMF to put together a

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$16.7 billion rescue package for Thailand ``if anything shows the safety net is working, and working well.''

He defended the IMF's role in the crisis, and its oversight of the Thai economy, saying the organization had repeatedly warned Thai authorities the country faced economic problems.

The IMF yesterday approved a $3.9 billion loan for Thailand, its portion of the $16.7 billion international bailout package for the troubled Southeast Asian country.

Thailand's economy, the world's fastest-growing between 1985 and 1995, is suffering from the slowest growth since the 1960s, a depreciated currency and the closure of 58 failing financial institutions.

India, Brazil

Camdessus was asked specifically about India and Brazil. While India has some problems in its ``fiscal domaine,'' Camdessus said, ``the risk of a major accident for India is not presently with us.''

Brazil, he said, is one of many countries with current account deficits that are too high, even if those countries enjoy a steady flow of foreign financing. While the continued flow of foreign investment into emerging markets ``is reassuring,'' that

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shouldn't lull governments or international financial institutions into complacency, he said.

Brazil, in particular, should ``strengthen its current account position,'' Camdessus said.

The Thai bailout package will bolster Thailand's foreign currency reserves, which were severely depleted when the government tried to fight off speculators' attacks on its currency. The country's net foreign reserves shriveled to as low as $6.6 billion from almost $40 billion last October.

Bank of Thailand Gov. Chaiyawat Wibulswasdi told a news conference reserves at the end of July totaled $30 billion. The government owes $23.4 billion of that on foreign-currency contracts used to support the baht and due by August 1998.

Thailand's foreign-exchange contracts will be paid when they come due, and the central bank will receive baht for the contracts, he said. Thailand stands to lose at least 25 percent of the value of those transactions, because that's how much the baht has fallen since the contracts were made.

Reserves Depleted

In a best-case scenario, Thailand's current foreign-exchange reserves are worth about $23 billion. Economists expect

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the currency to drop even further by the time the contracts come due 12 months from now.

``They're clearly out a lot of money on this,'' said John Seel, an economist at Bear Stearns Asia Ltd. in Hong Kong. ``That's a lot of swap contracts.''

Thailand needed the IMF package to help pay its $89 billion of foreign debts, about $40 billion of which is due within a year. More than $30 billion of the total is owed to Japanese banks.

Under the terms of the agreement, Thailand must keep its foreign-exchange reserves at about $23 billion this year and $25 billion next year.

The disclosures are part of the government's agreement with the IMF to reveal more information about Thailand's finances.

The goal, the IMF said, is to ``achieve an orderly adjustment of the domestic economy to the sharp, forced reduction in the current account deficit to about 5 percent of GDP (gross domestic product) in 1997 and 3 percent of GDP in 1998.''

The first $1.6 billion of the IMF loan will be available immediately, with $810 million more coming after Nov. 30 if economic performance targets are met, the IMF said. Further disbursements will be made quarterly ``subject to the attainment of performance targets and program reviews.''

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Defense

The decline in reserves stems from Thailand's failed defense of its currency, which came under pressure this year as traders bet it was overvalued. One of the world's widest current-account deficits and a slowing economy made the baht -- pegged mainly to the strengthening U.S. dollar -- a fat target.

The central bank tried to prop up the currency by buying forward contracts, committing it to buy baht at a specified time and price. The central bank finally threw in the towel July 2, prompting Malaysia, the Philippines and Indonesia to scrap their currencies' peg to the dollar.

Since Thailand devalued the baht it dropped almost 25 percent to 32.2 against the dollar.

Chaiyawat said the baht may continue to weaken, suggesting interest rates will remain high and slow an economic turnaround. Economic growth will be about 2.5 percent this year, compared to rates near 10 percent from 1986 to 1995. ``We have to accept there will be pressure on the baht,'' he said.

In addition to the IMF loan package, the Bank for International Settlements has agreed to provide a $1 billion bridge loan to help prop up Thailand until the bulk of the

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international funds arrive.

The U.S., which is not participating in the international loan package, will contribute to the BIS bridge loan, Treasury Secretary Robert Rubin said.

``The US is prepared to participate in a short term multi-lateral bridging facility, if needed and under appropriate conditions, to provide liquidity in support of Thailand's program,'' Rubin said in a statement.

The BIS loan, which would help cover a balance of payments shortfall, would be short term, repaid by the funds from the international aid package. The U.S. would contribute an ``appropriate fraction'' of that, Treasury officials said, probably around $250 million.

--Michael McKee in Washington (202) 624-1895 and James Hertling in Hong Kong, with Lee Miller in Bangkok/tre

Story illustration: To chart the performance of the Thai economy, type: ECST <Go>. To graph the baht's performance against the dollar, type THB <Crncy> GIP, GPC.

News by category:
NI IMF International Monetary Fund

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SDW file.

THE WORLD BANK

Managing Director, Operations

R. Wolfenson

Jim:

The last I heard from his colleagues in LAC (with whom he keeps in touch) is that defensive aspects of his back is felt — he was even suggesting Feb-3!

GAUTAM S. KAJI

THE WORLD BANK GROUP

Int 2855

ROUTING SLIP	DATE: January 15, 1997

NAME	ROOM. NO.
Mr. Gautam Kaji	D 10-065

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	FOR ACTION		NOTE AND FILE
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	FOR SIGNATURE		PREPARE REPLY
	NOTE AND CIRCULATE		NOTE AND RETURN

RE: PAKISTAN Weekly Breifing Note - December 20, 1997
Prepared by Ms. Antoinette Sayeh, SA1CO

REMARKS:

Gautam:

For your ease of reading, following is a "translation" of JDW's remarks on the attached weekly briefing note for Pakistan:

"Where does this leave Burki? Do we still expect him back as I hope?"

Best regards.

FROM	ROOM NO.	EXTENSION
Atsuko Horiguchi	E 1229	84256

DAIX INT 2955

THE WORLD BANK GROUP

ROUTING SLIP	DATE: December 20, 1996

NAME	ROOM. NO.
Mr. Wolfensohn	
cc: Messrs./Mmes. Kaji, Koch-Weser, Frank, Einhorn (EXC); Wood, Williamson (SASVP); Iida (MIGEX);	
Lindbaek (CEXVP); Bruno (DECVP); Nishimizu (SA1DR); Wilton (FPICR)	
Yap (SA1CO); S. Ahmed (SA1PK).	

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RE:
PAKISTAN -- Briefing Note -- STRICTLY CONFIDENTIAL

REMARKS:

Attached please find this week's briefing note on Pakistan.

FROM	ROOM NO.	EXTENSION
Antoinette Sayeh, SA1CO	T 8-114	34719

President Has Seen

→ Kaji: Where does this leave Bombi? Do we still expect him back on 1 Jan?

1/3

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Pakistan Weekly Brief
December 20, 1996

STRICTLY CONFIDENTIAL

Key Financial Indicators

- The free market exchange rate appreciated for most of the week. However, a slight depreciation on December 19 (to Rs 42.00/US$) raised the premium over the official rate to 4.2% (from below 4% the previous day), the first increase in more than a week.

- The downturn in the stock market continued, with the KSE-100 index losing another 2.6% of its value, ending the week below 1400, which is considered to be a psychological barrier. The index fell by almost 1% on December 18 alone, on news that purchases under the IMF Stand-by Arrangement were being split into two tranches (see below).

- At about US$ 650 million (2.6 weeks of imports) on December 18, the level of official foreign exchange reserves are almost US$ 100 million lower than a week ago. The reserve loss is due to debt service payments and net withdrawals from foreign currency deposits of US$ 50 million (on December 18).

Political Highlights

- In a possible political setback for the interim Government, the Law Minister resigned on December 18, in protest against proposed amendments in the accountability ordinance (apparently favored by President Leghari), and the Chief Justice's reported interference in the appointment of the Law Secretary. The Federal Minister for Education also resigned from the interim cabinet to contest the general elections.

- Former Prime Minister Bhutto's husband, Asif Ali Zardari, was ordered released by the Sindh High Court , but was subsequently re-arrested on December 18 for his alleged involvement in the murder of Murtaza Bhutto (Ms. Bhutto's brother) last September.

- Senators from all parties (except Nawaz Sharif's Pakistan Muslim League) staged a walkout from the Senate on December 15 to protest steps by the interim Government to reduce public sector employment.

- Two separate strikes paralyzed Karachi on December 14. One by a religious party was against the induction of a minister in the Sindh government. The other by the Karachi Transport Association was to protest the increase in petroleum prices. At least eight people were reportedly injured.

Economic Highlights

- The interim Government has informed the two Swiss pre-shipment inspection companies, SGS and COTECNA, of the termination of their contracts with effect from March 3, 1997. The Government had been concerned about the cost-effectiveness of their services (in relation to yields from customs revenues), and governance-related problems in awarding the contracts. The Central Board of Revenues had also been pressing for the abolition of pre-shipment inspection for some time, reportedly in an attempt by customs officials to retain discretionary powers in assessment of import duties.

- The National Bank of Pakistan, one of the two largest state-owned commercial banks, announced plans to lay off all staff appointed after April 1995 in contravention of established recruitment policy (affecting about 5,000 employees).

IMF Board Approval of Second Review of SBA

- On December 18 the IMF Executive Board approved the second review of the Stand-by Arrangement, allowing Pakistan an immediate purchase of SDR 53.58 million. The next drawing of SDR 53.58 million by January 15, 1997 is contingent on fulfillment of the end-December performance criteria and elimination of the concessional 5% General Sales Tax rate (a revenue-raising measure agreed to by the Delegation that visited Washington last week). Pakistan had initially expected to draw the full amount of 107.16 million immediately following the Board meeting, but a decision was made to split it to ensure implementation of agreed measures.

- Discussion at the meeting was dominated by skepticism on the part of many Executive Directors about the Government's commitment to reform and the credibility of the program, given Pakistan's poor track record. A number of Executive Directors explained their approval as merely "giving the authorities the benefit of the doubt".

Prepared by: Antoinette Sayeh, SA1CO.
Approved by: Mieko Nishimizu, SA1DR.

THE WORLD BANK GROUP

ROUTING SLIP	DATE: October 31, 1996

NAME	ROOM. NO.
Mr. James D. Wolfensohn, EXC	E12-27
THROUGH: Mr. Gautam Kaji, EXC	D10-065
CC: Mr. Caio K. Koch-Weser	D10-093

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RE: Bosnia: Note for your discussions with U.S. officials on Bosnia

REMARKS:

1. As you requested, we have prepared bullet points for your phone calls/discussions with the U.S. officials on Bosnia.

2. The letters to Messrs. Sklar and Bildt are being prepared. We would like to incorporate the results of your interventions in those letters.

FROM	ROOM NO.	EXTENSION
Johannes F. Linn, ECAVP	H12-071	80602

Brief for Discussions with US on Bank's Role in Bosnia Reconstruction

The Bank (and EC) has recently been criticized in a charge led by Dick Sklar and Carl Bildt that we have not delivered on either reconstruction assistance or coordination of the reconstruction effort.

The Bank has done well by all standards in delivering support for reconstruction; we have met the targets we set.

The Bank:

1. Set up a $150 million special fund in February, prior to Bosnia's membership, and within three months approved five operations fully committing these resources.

2. Approved an arrears resolution package in March so that Bosnia could become a member in April. Also approved an exceptionally high per capita IDA allocation and a total of $400 million for three years.

3. Pledged $310-350 million at Donors' Conferences for 1996. $326 million (for 13 operations) is now committed (Annex 1); we are likely to commit somewhat more than $350 million by end-year, including three new projects ready for negotiations.

4. Explicitly supported the Federation-building efforts of the U.S. and other G7 countries through a Transition Assistance Credit (TAC; a one-tranche $90 million operation).

5. Has achieved sound implementation progress: During the first 10 months, about $160 million[1] has been disbursed of the Bank's own resources, including $90 million for the TAC (in all, about 50% of total commitments). In addition, a further $90 million has been contracted. The Bank has also disbursed $32 million from Bank-administered trust funds. Some of the key physical accomplishments with our support: two road bridges between Sarajevo and Mostar have been rebuilt; three principal power plants are being repaired; thousands of apartments are being rehabilitated; heating is being restored to tens of thousands of Sarajevo dwellings; some 1,000 tractors have been imported; and essential social supplements are being made to 400,000 citizens monthly.

   A comparison with the two other major donors, the EC and the U.S., is shown in Annex 2.

The Bank has succeeded, with the EC, in coordinating reconstruction under difficult circumstances.

The Bank, with the EC:

---

[1]/ Bank disbursements include initial deposits to special accounts that are used as advances for future payments to contractors. Per our operational procedures, these deposits are calibrated for three to four months of anticipated expenses; in practice special accounts have been replenished by about one-third every month. The amount of advances that has not been used to pay contractors could therefore currently be estimated at about $20 million.

1. Prepared a 3-4 year reconstruction program as a framework for donor support and received the endorsement of the donor community for this program at a first Donors' Conference held Dec. 21-22, 1995, one week after the Peace Agreement was signed.

2. Co-chaired two successful Donors' Conferences to raise $1.8 billion for the 1996 financing needs of the reconstruction program. To date, $1.9 billion has been pledged and close to $1.7 billion has been firmly committed. (Note: these amounts include $120 million committed for peace implementation; firm commitments for reconstruction proper plus balance of payments support amount to $1.57 billion.) Regarding implementation of the overall program, some $700 million has been disbursed (including the TAC and the advances of the Bank and other donors, most notably the U.S.). Contracts signed (including the $700 million disbursed) total some $1 billion (about 60% of the firm commitments). Annex 3 provides donor-by-donor information on pledges, commitments and implementation.

3. Set up and maintained a donor information database to monitor implementation, and reported back to the donor community on progress achieved. The database is now being broadened to better capture physical progress, as suggested by Sklar. Success of this effort depends critically on donors' willingness to provide very detailed information.

4. Helped to set up sector task forces in the field which are actively coordinating the reconstruction efforts in many sectors (good examples: agriculture, transport). These task forces were weak initially given limited donor presence in Sarajevo; by now they are becoming viable vehicles for donor coordination. The sector task forces are discussing these days the sector strategy papers that have been prepared by the Bank for the next donors' conference.

Most donors want to maintain visibility and set their own priorities. Coordination has not been easy and has clear limits. Under these difficult circumstances, we have had more success than could have been expected.

Recommendation:

In light of the facts above, the criticisms which have been raised are unfounded. It is particularly important to redress this message within the U.S. government, where we have previously had excellent collaboration and support.

We recommend that you send the message to the U.S. (and then to others, including Carl Bildt and his supporters) that:

(a) the World Bank has delivered, on both the reconstruction assistance and donor coordination fronts;

(b) the Bank is at the disposal of the international community to continue its coordination role, however, we are not asking for it. We will be ready to cede the role to the U.S., the Office of the High Representative, or whoever the donor community considers most appropriate; and

(c) the role of coordination -- which includes preparing the reconstruction program, monitoring and reporting to the donor community and arranging for cofinancing, among other tasks -- is not an easy one. It is not immediately evident that there are other actors in a position to assume these responsibilities.

AHorvai/MSheehan
October 31, 1996
m:\bosnia\us.jdw

Background Note on Dick Sklar's Views:

1. His philosophy: quick results on the ground (which is fine) and do not deal with the government ("they are all corrupt"). His strong-arm tactics can yield results; for example he got more than $20 million for an important power project by walking over USAID bureaucracy. But he has a very short-term agenda.

2. He is not at all happy with the U.S. agencies' performance in Bosnia; he is a major critic of USAID. Therefore, comparing the Bank's performance with that of the U.S. is not likely to be productive.

3. Beyond his general criticism of the Bank (too slow and bureaucratic), he recently made three specific points:

(i) The Bank overstates implementation progress by using the disbursement figure as a main indicator of progress; according to him this figure is meaningless since it includes advances (both the World Bank's special account deposits and advances made by USAID). He would prefer to look only at progress on physical implementation.

Our position: Disbursement, as a financial indicator, is a reasonably good proxy for implementation progress, given current lack of data on physical progress. We have also reported on the value of signed contracts, an equally important indicator. Our definition of disbursement, including special account-type advances, is widely used in international practice. As soon as we have better information from donors on physical progress (a detailed contract monitoring system is currently under preparation, in fact with help from Sklar), we will also use that.

(ii) The Bank has accepted to finance payroll taxes on local labor which increase the cost of contracts and provide "uncontrollable" revenues to the "corrupt government".

Our position: Payroll levies, in Bosnia as all other countries, are a legitimate component of the gross cost of labor that finances government pension, health and unemployment programs; we agree that their rate is too high and will address this in the next adjustment credit. We are also working on the development of viable budgets at all levels of government, and will examine the use of such taxes in the pension and unemployment funds in that context. Any specific "wrongdoing" by the government will be followed up as appropriate; but we cannot react to general allegations. So far, no specific corruption case has been made, and the one quoted in the *Washington Post* turned out to be completely unfounded.

(iii) The Bank has been slow in landmine clearing.

Our position: We are not happy with the slow progress either. The main issue has been employment of foreign companies to jump-start the program in the absence of local capacity, which the government has strongly resisted. They have recently modified their position and

have agreed with employing foreign supervisors for local companies to ensure adequate safety and effectiveness. Works have started (in October) on four sites and further progress is expected. To our knowledge, no actual mine clearing has taken place under the U.S., EC or UN programs. We, IFOR and the Norwegians are the only ones undertaking actual mine clearing.

4. Finally, Sklar's views do not necessarily represent the views of the State Department or the Treasury. However, we have recently noticed that our friends in both Departments no longer take his comments lightly -- probably in anticipation of some important role he might play after the elections.

WORLD BANK-SUPPORTED PROJECTS
Financing Plans and World Bank Disbursements
(as of October 30, 1996)
(US$ million)

Project	Project Cost	WB Grant/Credit	Other Donors	Financing Gap	WB Amount Disbursed [1]
Emergency Recovery	160.0	45.0	82.0	33.0	23.8
Emergency Farm Reconstruction	50.4	20.0	19.7	10.7	6.4
Emergency Water Supply	70.0	20.0	50.0	0.0	5.3
Emergency Transport Reconstruction	163.0	35.0	112.7	15.3	8.6
Emergency War Victims	30.0	10.0	12.7	7.3	1.0
Emergency Education Reconstruction	32.8	10.0	7.3	15.5	4.2
Emergency District Heating	38.1	20.0	14.0	4.1	5.8
Emergency Landmine Clearance	67.0	7.5	42.2	17.3	0.6
Emergency Housing Repair	50.0	15.0	35.0	0.0	4.9
Emergency Power Rehabilitation	196.4	35.6	116.4	44.4	7.5
Demobilization Support and Reintegration	20.0	7.5	0.4	12.1	0.9
Public Works and Employment	45.0	10.0	4.0	31.0	1.4
Transition Assistance Credit	110.0	90.0	20.0	0.0	90.0
TOTAL	**1,032.7**	**325.6**	**516.4**	**190.7**	**160.4**

[1] Includes any amounts withdrawn or paid out from the Credit/Grant accounts for (i) payments to suppliers/contractors, (ii) the initial deposits for and replenishments of special accounts, and (iii) balance of payments support.

Bosnia and Herzegovina
Implementation Status of the World Bank, U.S. and EC Programs
As of October 30, 1996
(US$ million)

	Procurement Contracts Signed But Not Yet Disbursed	Disbursed	Total
World Bank	**89.5**	**160.4**[1]	**249.9**
U.S.	98.2	123.4[2]	221.6
Peace Implementation	*39.4*	*35.9*	*75.3*
Reconstruction	***58.8***	***87.5***	***146.3***
EC	68.3	85.7[3]	154.0
Peace Implementation	*1.5*	*13.2*	*14.7*
Reconstruction	***66.8***	***72.5***	***139.3***

[1] Includes an estimated $20 million of yet unused advance payment.

[2] Includes an estimated $35 million of yet unused advance payment.

[3] Somewhat under-estimated since EC reports disbursement only when EC monitors verify the delivery of goods.

PRIORITY RECONSTRUCTION PROGRAM IN BOSNIA AND HERZEGOVINA

October 1996

Pledges, Commitments, Amounts Under Implementation and Disbursed by Donor[1]
in US$ million

DONOR	TOTAL PLEDGES	TOTAL COMMITMENTS[2]	UNDER IMPLEMENTATION[3]	DISBURSED[4]
ALBANIA	0.02	0.02	--	--
AUSTRALIA	1.13	1.13	1.13	1.13
AUSTRIA	11.50	22.95	22.58	11.56
BELGIUM	7.57	7.48	--	--
BRUNEI	2.00	18.70	18.70	16.70
BULGARIA	0.01	--	--	--
CANADA[5]	25.44	29.61	11.72	11.72
CROATIA	0.50	0.50	--	--
CZECH REPUBLIC	6.00	6.00	5.50	0.04
DENMARK	5.10	3.76	3.76	3.66
EGYPT	1.00	1.00	0.60	0.60
ESTONIA	0.07	--	--	--
F.R. YUGOSLAVIA	10.00	10.00	--	--
FINLAND	5.00	9.09	3.06	3.06
FRANCE	9.29	13.19	11.65	10.94
FYR MACEDONIA	0.10	0.10	--	--
GERMANY	39.25	38.70	35.67	28.41
GREECE	7.00	7.00	7.00	--
HUNGARY	1.00	1.00	1.00	1.00
ICELAND[5]	1.60	1.60	0.15	--
INDONESIA	2.10	2.10	--	--
IRELAND	6.00	4.51	3.33	3.33
ITALY[5, 6]	63.65	70.70	7.51	7.51
JAPAN[5]	136.70	95.70	43.60	36.60
KUWAIT	35.00	35.00	--	--

1/ Information on commitments and status of implementation not available for the following countries: Bulgaria, Croatia, Latvia, Portugal, and Russia.

2/ **Total commitments** include both firm and indicative commitments. A ***firm commitment*** is a pledge which has been: (i) approved by a national legislative body or multilateral Board; and (ii) allocated to a specific sectoral program or project. An ***indicative commitment*** is a pledge which has either legislative approval but is not yet allocated to a specific sectoral program project; or, a pledge which has been allocated in principle to a particular program or project, however, is pending legislative approval. The total of indicative commitments amounts to $175 million.

3/ **Under implementation** includes (i) amounts disbursed; (ii) procurement contracts signed but not yet disbursed, and (iii) contracts under tender.

4/ **Disbursed funds** are those transferred to an account in the name of a Bosnian agency, or a disbursement agency (foreign or local) in Bosnia, and include expenditures made against works, goods and service contracts, for balance of payments, and advanced for the purpose of payment of contractors. In-kind assistance is considered disbursed once provided.

5/ Donors who have placed grant funds to Bosnia and Herzegovina in a Trust Fund with the World Bank include: Canada $3.6 million; Iceland $150,000; Italy $20 million (a further $16 million has been committed); Japan $9 million (a further $41 million has been indicated but not yet committed); Luxembourg $520,000; The Netherlands $75 million; Norway $4 million; Sweden $1 million; and Switzerland $5.8 million. Funds have been disbursed into accounts with the World Bank unless noted as committed or indicated. These funds are considered to be under implementation or disbursed once actual works contracts are underway or payments made.

6/ Donors who contributed to resolution of arrears with IBRD are as follows: Italy $15 million; the Netherlands $6.5 million; Norway $1.5 million; and Switzerland $2 million. These amounts are additional to the total reconstruction pledges shown.

DONOR	TOTAL PLEDGES	TOTAL COMMITMENTS[2]	UNDER IMPLEMENTATION[3]	DISBURSED[4]
LATVIA	0.09	--	--	--
LITHUANIA	0.07	0.08	--	--
LUXEMBOURG[5]	3.23	2.87	2.63	2.63
MALAYSIA	12.00	12.00	12.00	--
NETHERLANDS[5,6]	100.02	103.00	66.56	55.58
NORWAY[5,6]	40.76	42.40	37.67	37.67
POLAND	2.90	2.90	--	--
PORTUGAL	1.00	--	--	--
QATAR	5.00	5.00	2.00	2.00
REPUBLIC OF KOREA	1.00	1.00	1.00	1.00
ROMANIA	0.21	0.21	0.21	--
RUSSIA	50.00	--	--	--
SAN MARINO	0.14	0.23	--	--
SAUDI ARABIA	50.00	42.00	20.00	5.00
SLOVAKIA	1.50	1.50	1.50	--
SLOVENIA	2.89	3.19	3.19	1.53
SPAIN	17.50	17.76	4.65	4.65
SWEDEN[5]	30.40	31.30	19.88	18.67
SWITZERLAND[5,6]	33.50	27.60	26.15	12.01
TURKEY	26.50	11.50	2.20	--
UNITED KINGDOM	39.70	38.93	38.93	34.21
UNITED STATES	281.70	296.96	232.20	123.36
CE SOC. DEV. FUND[7]	5.00	5.00	--	--
EBRD[8]	80.21	87.21	--	--
EUROPEAN COMMISSION	367.10	385.88	185.97	85.70
IsDB	15.00	19.00	6.00	6.00
ICRC[9]	1.50	1.50	1.50	1.50
IFAD	7.30	7.30	7.30	6.82
OIC	3.00	3.00	3.00	3.00
SOROS FOUNDATION	5.00	5.00	--	--
UNDP[9]	2.00	0.64	0.64	0.31
WHO[9]	1.18	1.18	1.18	1.18
WORLD BANK	330.00	325.60	293.00	160.40
TOTALS	**1,894.43**	**1,861.58[10]**	**1,146.32**	**699.48**

m:\bosnia\donorlst\newtable.amt

7/ As of October 15, 1996 the CE Social Development Fund reduced its pledge from $10 million (made in December 1995) to $5 million.

8/ As of August 15, 1996, the EBRD had reduced its pledge from $100 million (made in April 1996) to about $80 million.

ICRC, UNDP and WHO implement various programs on behalf of bilateral donors, in addition to carrying out programs funded by pledges made at Donors' Conferences in December 1995 and April 1996.

10/ Uncommitted pledges totaling $120 million are not included. Total commitments plus uncommitted pledges add to more than the 1996 pledged amount, since several donors have committed funds over and above their 1996 pledges in order to continue ongoing activities. Because these funds have not yet been formally pledged, they have not been shown as part of total 1996 pledges.

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: October 31, 1996

TO: Mr. James D. Wolfensohn, EXC

THROUGH: Mr. Gautam S. Kaji, EXC

FROM: Johannes F. Linn, ECAVP

EXTENSION: 80602

SUBJECT: **BOSNIA and HERZEGOVINA -- Proposed Essential Hospital Services, Industry Re-Start and Local Initiatives Projects**

As we have reported to you, the above three projects were to have been presented to the Board on November 21, 1996. After reviewing the situation on the ground in Bosnia, I have suggested that this presentation be postponed for about two to three weeks.

We expect that a new government will be formed in the coming weeks. We consider the new administration's firm commitment to these projects essential to their successful implementation. The additional time would allow us to negotiate these projects with the new government prior to presenting them to the Board.

This slight change in schedule would not have any major impact on the implementation of our Bosnia program.

Distribution:

Messrs./Mmes. Koch-Weser [o/r] (EXC); Linn (ECAVP); Severino, Wallich [o/r], Sheehan, Horvai (EC2DR); Apitz (EC2ET); O'Sullivan (EC2BA)

The World Bank
M:\BOSNIA\BD-JL.DOC
October 31, 1996 1:41 PM

Chron 61C

THE WORLD BANK GROUP

ROUTING SLIP	DATE: October 30, 1996

NAME	ROOM. NO.
Mr. J. D. Wolfensohn, EXC	E 12-27

	URGENT		PER YOUR REQUEST
	FOR COMMENT		PER OUR CONVERSATION
	FOR ACTION		NOTE AND FILE
✓	FOR APPROVAL/CLEARANCE		FOR INFORMATION
✓	FOR SIGNATURE		PREPARE REPLY
	NOTE AND CIRCULATE		NOTE AND RETURN

RE: ARGENTINA - Second Yacyretá Hydroelectric Project
(Lns. 2854-AR and 3520-AR)
Management Response to the Request for Inspection

REMARKS:

I have cleared the package.

FROM	ROOM NO.	EXTENSION
Gautam Kaji, EXC	EX 11 150	81384

10|29

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: October 29, 1996

TO: Mr. Gautam Kaji, EXC

FROM: Shahid Javed Burki, LACVP

EXTENSION: 82332

SUBJECT: **ARGENTINA - Second Yacyretá Hydroelectric Project**
(Lns. 2854-AR and 3520-AR)
Management Response to the Request for Inspection

1. Attached is the Management Response to the Request for Inspection registered by the Inspection Panel on October 1, 1996, and a covering memorandum to the Chairman of the Panel. It incorporates the comments and observations made by LEGLA in their memoranda of October 10 and 28 on this subject.

2. We are in a strong position to respond to all the claims and allegations made in the Request. While the project has been delayed and has encountered multiple problems in implementation, we do not agree with the allegation that the Bank has failed to follow its own procedures and policies and therefore caused the problems and resulting consequences for the local population.

cc: Messrs./Ms. Koch-Weser (o/r) (EXC); Alexander (OPRDR); Ody (LACVP); Ecevit (LATSO); Nankani (LA1DR); Augusto, Hagerstrom (LA1C2); Faiz, de Franco, Jadrijevic (LA1IU); Oliver (LA1ER); Collell, Molnar (LEGLA)

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: October 30, 1996

TO: Mr. Richard E. Bissell, Chairman, The Inspection Panel

FROM: James D. Wolfensohn

EXTENSION: 81384

SUBJECT: **ARGENTINA - Second Yacyretá Hydroelectric Project**
(Lns. 2854-AR and 3520-AR)
Management Response to the Request for Inspection

1. On October 1, 1996, the Inspection Panel registered a Request for Inspection concerning the above-referenced project, the implementation of which is currently supported by two Bank loans. The attached Response has been prepared in close coordination with the Inter-American Development Bank, and addresses all of the issues raised in the Request. In our response, we provide supporting evidence and details to demonstrate that the Bank has not been remise in complying with our policies for such operations. In particular, the response highlights the thoroughness of the Environmental Assessment in identifying environmental risk and mitigation measures.

2. The crux of the matter is that not everything has gone, nor will go, perfectly well and there are still large uncertainties in completing the operation. This has to do with the planned privatization and the need to complete a very substantial resettlement component prior to filling the reservoir to the next levels -- 78 meters above sea level (masl) and 83 masl. For the works done to date and the filling to the 76 masl level, while there have been delays, there is little evidence of harm having been done to the affected parties. The next major hurdle is a decision to be taken on privatization: that will determine what happens next. In our response, we stress that the Bank has adequate safeguards to ensure that all resettlement and environmental mitigation measures are implemented before raising the reservoir above the elevation 76 masl, regardless of who operates the Yacyretá complex.

cc: Messrs./Mmes.: Kaji, Koch-Weser (o/r) (EXC); Shihata, Rigo (LEGVP); Alexander (OPRDR); Burki, Ody (LACVP); Ecevit (LATSO); Nankani (LA1DR); Augusto, Hagerstrom (LA1C2); Faiz, de Franco (o/r), Klockner, Jadrijevic (LA1IU); Oliver (LA1ER); Collell, Molnar (LEGLA)

A.Tate
M:\ENERGY\PANEL\YACYRETA\BISELMEM.DOC
October 30, 1996 6:41 PM

(JDW) Chron GK

THE WORLD BANK

Managing Director

October 28, 1996

Mr. James D. Wolfensohn

Jim,

Attached is the response to Peter Nicholl's comments on the CODE discussion.

Attachment

GAUTAM S. KAJI

The World Bank
Washington, D.C. 20433
U.S.A

JAMES D. WOLFENSOHN
President

October 28, 1996

Mr. Peter W. Nicholl

Dear Peter,

Thank you for your very thoughtful and constructive comments on the public sector management (PSM) paper which was discussed by CODE early in September. Your comments served us well in challenging our thinking in the PSM field as well as in the context of our internal renewal program. I agree with you that we need to shift from an input orientation to an outcome and output focus and that our goals and purpose must be given a clear operational context. These principles are the cornerstones of our internal renewal process.

I have asked the PSM Unit in PSP to respond to your detailed comments. Their response is attached. Please feel free to talk directly with the Unit (Mike Stevens, ext. 37493) or contact me personally if you consider that there are broader ramifications that we should discuss.

Sincerely yours,

James D. Wolfensohn

Attachment

CODE - PUBLIC SECTOR MANAGEMENT PAPER

RESPONSE TO STATEMENT OF MR. PETER W. NICHOLL (EDS09)

1. We welcome the comments since we share a common perspective – the importance of public sector management (PSM) to the Bank's operations and to development effectiveness generally. We agree completely with the comment in the first paragraph that "it is not meaningful to consider public sector management in isolation from other related topics, such as private sector development and regulatory reform." We try to reflect a similar view by supplementing the focus on the enabling environment for the private sector with a recognition of the importance of an enabling environment for the public sector. Without the latter, a country will not achieve the former. An enabling environment for the public sector is one which is conducive to performance in areas such as the provision of classic public goods, regulation, the delivery of social services and policy making and implementation generally. For many of our borrowers, the environment within the public sector is disabling.

2. We have followed closely many aspects of the successful public management reforms of New Zealand, first with the corporatization and eventual privatization of departments and agencies providing commercial services, and second, with the reform of core government itself. The political dynamics, the reform principles and the processes and organizational forms adopted have been of great interest to many Bank staff, and especially its public management specialists.

3. While the particular processes and organizational structures the public management reforms in New Zealand have taken may not be readily transferable (New Zealand is a small, unitary state, with a long tradition of good public administration, a skilled population and a high degree of social consensus), we agree that the basic principles underpinning the New Zealand experience provide many valuable lessons for any country. As you know, earlier this year, the PSM Unit in PSP engaged as a visiting scholar a former senior New Zealand public servant, Rob Laking. His task was to research the principles of public management reform in New Zealand and other reforming OECD countries, as the first of a two-part study of the transferability of (or "lessons to be learned from") New Public Management. His report, "Good Practice in Public Sector Management: Issues for the World Bank," has been shared with the EDs office.

4. At the organizational level, it is important that public sector departments and agencies should have a clear goal and purpose. However, we would argue that the key to the New Zealand's reform (and other successful public management reforms in OECD countries) is broader than the statement implies, and includes the aggregate processes of government budgeting, financial management and cabinet decision making that reconcile policy commitments with resources, and, in turn, force organizational clarity. While a well functioning organization is part of a well-functioning government, public sector

management is as much about the systems which achieve this across a government as it is with what happens within specific organizations. We think of this as the institutional setting within which organizations have to operate. This is illustrated in the attached slide which we use in presentations both inside and outside the Bank (note, in particular, the reference to both "clear purpose" and "well specified tasks").

5. The New Zealand model, as the Statement describes, makes a distinction between the responsibilities of departments and agencies (the production of outputs) and the responsibilities of ministers (the achievement of outcomes). We have had a long standing concern that the New Zealand model draws too sharp a distinction between output and outcomes. In a well performing government, which need not operate on an explicit contract basis, the emphasis of public officials will be on both outputs and outcomes.

6. Even "simple" PSM projects may be technically complex because of the linkages between the various systems of public management. Too many projects in the past have been approved without adequate consideration of the preconditions or the accompanying institutional change necessary for their success. On one hand this has reflected a focus on solutions rather than problems. On the other hand, it has been associated with a tendency to see PSM projects as an "add-on" to make other projects work better. Having said that, we agree that technical complexity at the project level is less important as a factor in project success than is the complexity of the public sector environment.

7. The comment referred to on page 3, para 2 of the Statement can, indeed, be read as a criticism of past Bank advice. In our reviews of past Bank projects, we have on several occasions come across situations where a task manager, specialist staff, or a consultant has advocated budgetary reform without the prior analysis that would determine whether the particular technical solution would fit. Indeed, there is a risk that this could happen with the New Zealand reforms. Advisors will focus on the particular technical solution - the most likely candidate being output budgeting - without understanding either the underpinning institutional setting or the quite radical changes in that institutional setting.

8. There was certainly no intention of suggesting that decentralization was an end in itself. In fact, it has been a concern that many countries and their advisors have begun from that position. The result is that many of those countries are today encountering difficulties, particularly with their intergovernmental finances. We have been critical of the view, implicit or otherwise, that the issue was about decentralization v. centralization. It seems to us that we are really talking about a spectrum and that the balance between centralized and decentralized approaches will vary among, for example, countries, issues and structures.

9. How closely the reward system for public officials should be tailored to individual performance continues to be the subject of vigorous debate. While staff should have their

performance monitored, a tight link with individual pay may not be achievable or desirable. Performance management does not necessarily entail performance pay.

10. The reference to the Bank's non-lending work is to current research in PRDPE on the impact of institutions on budgetary outcomes. We see this as important work, and separately we are sending you a recent working paper. The thesis is that budgetary systems can be assessed for performance at three levels: (i) the capacity to set and achieve fiscal targets; (ii) the allocation of resources according to strategic priorities, and (iii) the extent to which program and projects achieve technical efficiency. This work is important to shifting attention to the institutional framework for resource allocation. We believe it also provides a very sound framework for confronting performance issues in the public sector more generally.

11. We hope to be able to continue this important dialogue and look forward to working with you and other Board members in drawing applicable lessons from world-wide experience.

WELL PERFORMING PUBLIC SECTOR ORGANIZATIONS

REQUIRE:

- **Government-wide systems and processes which are results oriented:**
  - **Policy Making**
  - **Budgeting**
  - **Personnel Management**
- **Strong coordinating mechanisms**
- **Organizations which have:**
  - **A clear purpose**
  - **Well specified tasks**
  - **Authority to perform**
  - **Accountability for the use of the authority provided**

Chron GIC

THE WORLD BANK GROUP

ROUTING SLIP	DATE: October 28, 1996

NAME	ROOM. NO.
Mr. James D. Wolfensohn	
Through: Mr. Caio Koch-Weser, EXC	

	URGENT		PER YOUR REQUEST
	FOR COMMENT		PER OUR CONVERSATION
	FOR ACTION		NOTE AND FILE
	FOR APPROVAL/CLEARANCE		FOR INFORMATION
✓	FOR SIGNATURE		PREPARE REPLY
	NOTE AND CIRCULATE		NOTE AND RETURN

RE: Invitation to the Third Economic Conference for the Middle East and North Africa (MENA) on 12-14 November 1996 in Cairo.

REMARKS:

Please see attached for your signature.

FROM	ROOM NO.	EXTENSION
Mr. Daniel Ritchie, Acting Vice President, MNA	H4- 049	81312

The World Bank
Washington, D.C. 20433
U.S.A.

JAMES D. WOLFENSOHN
President

October 29, 1996

His Excellency Amre Moussa
Minister of Foreign Affairs
Cairo
Arab Republic of Egypt

Your Excellency,

Thank you for your invitation to participate in the Third Economic Conference for the Middle East and North Africa (MENA II), to be held in Cairo from November 12 to 14, 1996.

While I will not be able to attend personally, due to other commitments, I have asked Mr. Kemal Derviş, Vice President of the Middle East and North Africa Region, to represent the World Bank on my behalf.

The Cairo conference comes at a critical time for the region. The momentum generated by the Casablanca and Amman conferences toward regional economic collaboration must be restored, if the aspirations of the people of the region for durable peace and prosperity are to be realized. You may count on the World Bank to continue to be an active partner in this effort.

With best wishes for a successful conference.

Sincerely yours,

James D. Wolfensohn

cc: Mr. Khalid M. Al-Saad, Executive Director

bcc: Messrs./Mmes. Koch-Weser (EXC); Derviş (o/r), Page, Bouhabib (o/r) (MNA); Ritchie (MN1DR); Sud (o/r) (MN2DR); Kanaan, Van Gelder (MN2CO); Correspondence Unit, File

EXC Ref: 12728
D. Ritchie
m:\kd\egyptjdw

No.: EXC-12728

CORRESPONDENCE MANAGEMENT FOR THE PRESIDENT'S OFFICE

CHORUS

External Correspondence Profile

High Priority

URGENT

FOR ACTION: Kemal Dervis **STATUS: Open**

VPU: MNA Room #: H7065 Telephone: —	Log Date:	10/21/96
	Logged in by:	Amy J. Morrow
	Response Date:	

CORRESPONDENCE DESCRIPTION:

From:	Amre Moussa
Organization:	Minister of Foreign Affairs
To:	Mr. Wolfensohn
Dated:	10/09/96
Topic:	Invitation to the Third Economic Conference for the Middle East and North Africa (MENA) on 12-14 November 1996 in Cairo.

ACTION INSTRUCTIONS: *Due Date:* 10/31/96

1. PLEASE PREPARE A RESPONSE FOR MR. WOLFENSOHN'S SIGNATURE.

   Follow the macro for the President's letter or use the sample layout in the correspondence guidelines for the formatting of the letter.

- Only ONE original is needed, printed on the appropriate stationary (available from the Front office of each VPU). If an item requires an urgent signature, please bring this to our attention;
- Include the bcc distribution pages. Please note that cc's (for Executive Directors and other parties the recipient should be aware of having received a copy) should be included on the original signed letter;
- Attach copies of relevant incoming correspondence;
- If you would like our office to handle the dispatch of the original, please include an envelope with your division's code marked clearly on the envelope. If no envelope is attached, the letter will be returned by special messenger as soon as it is signed. If a letter is to be couriered, please attach both an envelope and the courier request sheet;
- You will receive one copy of the signed original by special messenger on the same day the item has been dispatched. VP Units are responsible for the distribution of copies of the letter both internally and outside the Bank.

If the action instruction is incorrect, or an item of correspondence has been overtaken by events, please send a brief E-Mail to the "Correspondence Unit" All-in-One Account, quoting the EXC reference number.

Thank you.

SPECIAL INSTRUCTIONS:

JDW cannot attend, rerouted from A. Tsatsakis

INFORMATION COPIES:

Please return to:
Correspondence Unit, Room E1247 (Ext. 82441)

12728 AT

EMBASSY OF THE ARAB REPUBLIC OF EGYPT
3521 INTERNATIONAL COURT, N.W.
WASHINGTON, D.C. 20008
TELEPHONE: (202)895-5400 * FAX: (202)244-4319/5131

No. 170/96

The Embassy of the Arab Republic of Egypt presents its compliments to the World Bank and has the honour to enclose an invitation to Mr. James Wolfensohn, President of The World Bank, to participate in the Third Economic Conference for the Middle East and North Africa (MENA III) which will be hosted by Egypt in Cairo from November 12 to 14, 1996.

The Embassy of the Arab Republic of Egypt avails itself of this opportunity to renew to The World Bank the assurances of its highest consideration.

14 October 1996
Washington, D.C.

MINISTER OF FOREIGN AFFAIRS

October 9, 1996

Your Excellency,

On behalf of the Government of Egypt, it gives me great pleasure to invite you to participate in the Third Economic Conference for the Middle East and North Africa, MENA III, which will be hosted by Egypt in Cairo between 12 - 14 November 1996.

The third in its series after Casablanca and Amman, the Conference is taking place during a critical and important juncture in the Peace Process of the Middle East which started with the Madrid Peace Conference in 1991. A phase where the people of the region can lay the foundation for a just, comprehensive and durable peace on the basis of fulfilling their obligations and the principles of the peace process which we all accepted as the basis to settle the Arab-Israeli conflict and to achieve peace with its three pillars i.e. political settlement, arms control and regional security, and economic development.

The Cairo Conference is being held under the overall theme entitled "Building for the Future: Creating an Investor Friendly Environment" in order to encourage national, regional and international capital to participate in developing the Middle East so that our people can hope for a better future.

In organizing the Conference, Egypt is mindful of the lessons learned from the previous conferences in Casablanca and Amman and is working to ensure that the Cairo Conference provides for

MINISTER OF FOREIGN AFFAIRS

dialogue and interaction among government representatives, businessmen and enterprises. The Conference will also deliberate on different issues of economic cooperation such as: Transport, Energy, Trade, Tourism, Industry, Environment... etc. with the aim of preparing the grounds to accelerate the development path in the region and attract foreign investment.

Your personal participation in the Conference would be highly appreciated.

Best wishes until we meet in Cairo.

Sincerely,

Amre Moussa

Mr. James Wolfensohn
President of the World Bank

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director, Operations

August 30, 1996

Mr. James D. Wolfensohn, President

Jim,

Welcome back to Washington! I do hope that your stay in Jackson Hole gave you a chance to unwind a bit and get the much needed rest.

Since we are getting together for lunch on Tuesday, I thought it would be most useful if I were to brief you verbally first and, as required, provide you any written input thereafter, instead of writing you a detailed note covering a score of major and minor issues.

You have a VPs meeting on Tuesday morning. During your absence, I adhered to your regular schedule of VPs meetings, though, as you may imagine, attendance was quite sparse. We should have a reasonably full house on Tuesday. The Board meeting is in the afternoon, and, on the Bank side there is nothing on the agenda other than a number of streamlined procedures projects. The IFC has one item on enhancing IFC's development effectiveness. Papers are being sent to you at your home. I understand Jannik would be available to chair the meeting on IFC should you so wish.

Catch up with you on Tuesday.

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director, Operations

CONFIDENTIAL

August 29, 1996

DECLASSIFIED
MAY 17 2017
WBG ARCHIVES

Mr. James D. Wolfensohn

RE: Borrower Accountability

Jim,

You will have seen the exchange between Jules and myself. I am sorry to inflict this on you but I don't have much choice. I have serious reservations about Jules Muis' memo of August 21st to you. While I am certain that we can do better, I am not convinced that Jules' memo either correctly diagnoses the problem or contains the right corrective actions.

We need to debate this further. We have to keep the issues raised by Jules in perspective and view them in the context of our larger development agenda. Already, the documentation reviews associated with World Bank disbursements are more stringent than other banking institutions. To date, the multiple layers of audits required by the Bank under each investment operations have not revealed any major mis-use of Bank funds. This is an enviable record under very challenging circumstances. In many ways, the problems encountered in the timeliness and quality of audit reports are a proxy for deeply seated development problems facing our borrowers. Sound financial management indeed is one of our development goals. This ought to be the focus of the debate and not mixed with the issue of the Bank's fiduciary responsibilities.

The memo itself is based on a misleading interpretation of data on audit compliance. While the fundamental issues of improving borrower accountability have to be addressed, the memo is unnecessarily alarmist in the way it presents the problem and lacks understanding of Bank policies and standards in some of the proposed solutions. It understates what we are already doing, and several of the solutions are not feasible, being based on a misunderstanding of the relative roles of the borrower and the Bank. In addition, the memo is surprisingly silent on Controller's Departments own accountability.

My basic concerns with the memo are outlined below.

Statement of the Problem

Jules' diagnosis hinges on the timeliness of project audits. Jules himself acknowledges that the Bank ultimately receives most audit reports due. Records indicate

that the vast majority -- 95 percent --of the reports are received within 12 months of the due date (and not two to three years later as noted in Jules' memo), with the bulk of the outstanding reports relating either to borrowers in non-accrual status or countries suffering from conflict in which operations have effectively ceased. Over 95 percent of the audits, including those received late, are clean. Any qualifications are rarely related to the use of Bank funds and, as indicated in the memo, are usually not material.

The primary argument is that $15.4 billion in disbursements was in "non-compliance". This is an attention catching number often repeated to you but it far exaggerates the problem. There are difficulties with: a) the completeness of data in the Audit Report Compliance system (ARCS) at any given point; and b) the methodology for interpreting these data, including using June 30th as the cut-off date. Jules' analysis, further, attempts to combine together, in a simplistic manner, three very different issues related to overdue audits, statement of expenditures (SOEs) and qualified audit reports.

To illustrate our differences with the analysis, we have recalculated the *Summary Exposure* figure in Jules' memo, using more reasonable assumptions based on historical experience on the receipt of audit reports and projected disbursements for the first quarter of FY 97. As indicated below, these assumptions reduce dramatically the amount of disbursements associated with delayed and/or qualified audits from $ 15.4 billion to $ 7.5 billion. This drop simply reflects the reality of the time it takes to submit and process audit reports by moving from a June 30th cut-off date to September 30th. Two other adjustments are made: first, to drop the amount associated with qualified audits and, second, to take into account the fact that, while an audit may be overdue, disbursements (except for SOEs) were done with full supporting documentation. With these adjustments, exposure falls to $ 2.5 billion. This is, in effect, the amount of disbursements under SOEs for which audits are overdue. The reasoning behind these different assumptions is explained below.

Bank Disbursements Linked to Audit Reports

		Summary Exposure ($ billion)
Disbursements related to projects with overdue audits:		
as of July 7, 1996 (figure from memo)		15.4
as of September 30, 1996 (estimated figure) *		7.5
Further Adjustments		
less: qualified audits	-0.9	6.6
less: disbursements with full documentation	-4.1	2.5

* Based on historical performance and projected disbursements for Q1 FY 97

Overdue Audits

It is misleading to derive estimates of non-compliance by borrowers in FY 96 by using data in the system as of July 7, 1996. A very large number of audits are due from the borrowers on June 30th each year. When the borrowers send an audit report to the Bank, it takes a number of weeks for the report to arrive at headquarters and be reviewed and logged into the system. This is especially true in July. It is not realistic to expect all of these reports to be recorded in the central system within a few days of the borrower deadline.

To underline this point, please note that the ARCS system shows that the overdue reports have dropped by one fourth between July 8 and August 26: some 800 additional audit reports have been recorded in the system in the intervening six weeks. In dollar terms it is worth noting, for example, that for East Asia the amount drops to less than $200 million compared to $4 billion mentioned by Jules. As staff return from summer leave and work through the backlog of reports already in the Bank, most of the reports regarded as overdue as of July 8th are likely to be found to have been received.

My own view is that it would only be reasonable to provide a three month period for submission by the borrowers and our internal processing of the reports before declaring "non-compliance". That would mean that a good point to assess compliance would be September 30th, since most audits are due on June 30th.[1] This is consistent with our past experience, which shows that the majority of overdue reports--some 75 percent-- are entered in the ARCS system within three months of the due date.

As illustrated above, the amount of disbursements associated with the delay of audits shrinks significantly when we take into account the need for such submission and processing time by using the September 30th date.

Statement of Expenditures (SOEs)

The use of SOEs was expanded by the Bank a few years ago in recognition of increased Bank lending to social sectors, which typically involves small transactions that can not be processed cost-effectively in Washington. The current system was proposed by the Loan Department and has yielded the desired results of accelerating disbursements and reducing Bank costs. Borrowers also gain considerably from this and do not have to provide the Bank copious documentation for relatively small expenditures. This initiative foreshadowed recent Bank efforts to provide more responsive client services.

Documentation justifying the disbursement under SOEs is retained by the borrowers and Bank policy requires ex-post reviews of 5% or more of those transactions,

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[1] As noted in Annex A, audit reports are typically due six months after the close of the borrower's fiscal year which is frequently December 31st but could also be March 31st or June 30th, for example.

either by regional staff or by Controllers. This review by staff is intended to act as a safe guard in addition to the specific audit of these disbursements by the external auditors. A sample approach is perfectly acceptable practice and it was never expected, as implied in Jules' memo, that 100 percent of SOE transactions have to be reviewed by staff.

Jules correctly points out that the ex-post review even on a sample basis is not being done systematically. Based on feedback from task managers and anecdotal evidence we know that most task managers do not see this as a priority. Nevertheless, some of the Regions, particularly those with large resident missions such as Jakarta and Delhi, do carry such reviews regularly albeit on small samples. This is an area of vulnerability but there are offsetting factors.

First, much of the Bank's disbursements are subject to prior review of the procurement process and/or require full supporting documentation at the time of disbursement. According to the most recent Annual Financial Report issued by the Controller's, IBRD/IDA disbursements during the last four fiscal years (FY93 through FY96) aggregate to $71.5 billion. Of this, investment operations account for $52 billion. Audits are no doubt important, but the fact is that out of the $52 billion disbursed for investment operations, $35 billion was disbursed after a review of full documentation (prior review of contracts and shipping of documents or invoices in respect of all expenditures before effecting disbursement). Thus, timely audit reports assume importance mainly in the case of disbursements against SOEs.

Second, while task managers may not be carrying out ex-post reviews of individual transactions, it is unfair to imply from that that they are completely in the dark as to how the monies are being used. Staff regularly monitor budgets and corresponding workplans, agree to ex-ante allocation of funds and review actual expenditures against plan. Such provisions are usually part of the project legal agreements. For smaller, more frequent expenditures that would be disbursed under SOEs--it must be remembered that SOEs can only be used for certain kinds of expenditures--staff would typically agree ex-ante to unit prices and the number of units to be acquired, services to be performed or persons to be trained, etc. While it is clear that such ex-ante agreement and monitoring of actual expenditures are not substitutes for ex-post reviews of individual transactions, regular supervision does provide the basis for identifying anomalous situations, highlighting unjustified levels of expenditure, if not specific items, and monitoring the overall use of SOEs.

Qualified Audits

I agree with Jules that the Bank must treat this issue seriously and take corrective actions wherever feasible. Yet, we should keep in mind that the total amount of related disbursements is relatively small ($906 million). Moreover, as Jules' notes in his memo, the qualifications tend not to affect project funds and are usually not material. In addition, ineligible expenditures, if identified as part of a qualification, are recovered.

It seems to me that, on balance, this is an area which does not pose a grave risk to the Bank.

Interpretation of Bank Policies and Accountabilities

I also take issue with the way in which some key Bank policies and the relative responsibilities and accountabilities of our borrowers and, within the Bank, of operations and Controller's staff have been interpreted. I give two examples.

- One of the major recommendations is that the Bank, in effect, take over all audit work related to Bank operations and negotiate directly with one or more of the six international auditing and accounting firms under global "framework agreements". This proposal ignores the fact that, while the Bank requires its borrowers to arrange and submit audits, the responsibility for doing so is clearly the borrowers and must remain so. The borrowers pay for the audits. Moreover, this recommendation assumes that the "big" six international auditing firms are the only firms that are qualified for such a task. As a development institution that promotes competition and encourages local institutions, it will be highly inappropriate for us to take such a position.

- Throughout the memo, the impression is given that Controller's has no accountability for reviewing documentation against which disbursements are made or for the audit of SOEs. In reality, all of the disbursement applications are processed by Controller's. As noted earlier, the bulk of the Bank's disbursements are made against full documentation. Staff in Controller's, together with the task managers, are responsible for ensuring that the documentation is complete and that the disbursement request is valid. In the case of SOEs, operations staff and Controller's jointly determine what type of expenditures are eligible for SOE disbursements and the contract limits and, in addition to the operations staff's responsibility for spot ex-post reviews, Controller's has the authority for and Loan Administration staff do undertake selective audits in the field. Moreover, several of the areas recommended for improvement--eg, standard terms of reference for project audits--are within Controller's domain and action on these issues can be taken directly.

Remedial Actions

I agree with Jules that we need to tighten our managerial processes and strengthen staff skills in addition to enhancing capacity among our borrowers. We can always do more but it is only fair to point out that the situation is not as bleak was Jules' memo would have you believe.

For many years, the Regions have been trying to help borrowers. There are a substantial number of projects, in addition to IDF grants, which provide support for countries to improve their financial systems; many structural adjustment operations

involve improvements to public sector budgeting, accounting and auditing processes and technical assistance projects provide needed investment and training in these systems. In total, we have some 300 on-going projects which explicitly include assistance to improve financial management in a variety of agencies and countries.

We have also taken steps internally. Each Region has a senior adviser on accounting and auditing. Diagnostic reviews of financial management are being done in selected countries, as Jules points out. In addition, the decision of the OVPs in late June to establish and adhere to tighter business standards for the time taken to review and follow up on audit reports is designed to both emphasize the importance of audits and expedite corrective actions. The recent reissue of the staff instructions on audit requirements already tightens by three months the "grace" period on receiving audits before the Bank can take remedial action to suspend disbursements. I am also instructing the regions to take firm and decisive actions whenever we receive qualified audit reports.

Beyond these steps, it is clear that we need to take a more fundamental look at both the justification of our current audit requirements and the way we handle SOEs, so as to minimize the Bank's risk exposure and to be cost-effective and client responsive. In reviewing our policies, we need to re-think why we are requesting four different levels of audits and sometimes require a dozen or more audits every year under the same project--at great cost to our borrowers. For example, does the requirement to have separate audits of special accounts add any value when we also review the full documentation that accompany the related requests for reimbursement?

We should also agree within the management team that we will allow about three months' of "grace period" for internal Bank review and processing of audit reports submitted by the borrowers before treating an audit report as in non-compliance; this will be consistent with the above mentioned business standards.

In addition, we need to discuss how Controller's can better assist operations staff in undertaking a more systematic ex-post reviews of the SOE accounts to complement steps the Regions are taking to adhere to Bank policy, e.g. contracting of auditors to do this work on behalf of the Bank.

My final observation is that I was most interested to read Exhibit III of Jules' memo which is the back-to-office report by Mr. Michael Ruddy, who was Director of the Accounting Department until December 1995, and who visited India, China and Indonesia–which represent 25% of the Bank's portfolio–to examine the reporting and auditing arrangements in these countries on how they fit into the Bank's own system of risk management. Mr. Ruddy's conclusions are that:

> "in these three countries, there are comprehensive management control system in place, including auditing systems. It was also clear that all three governments are making a significant effort to respond to Bank accounting and auditing requirements..... After looking into the government auditing

procedures in these countries, I came away with a substantial level of comfort on questions of: exposure or overall risk management, adequacy of audit work and the level of interest on the part of these governments to meet Bank requirements".

As you can see, the report by someone who was Controller's own senior manager and who had responsibility for advising us on Bank policies related to borrowers' accountability does not support Jules' assessment. I also find it curious that I should be seeing this important document for the first time now–almost five months after Mr. Ruddy's report was written. It was not discussed with the Country Departments concerned, nor did Jules refer to it during the last three months of discussion, not even when he and I met on August 20.

Gautam S. Kaji

Messrs/Ms. Sandström, Einhorn, Koch-Weser, Muis

a:/wd/jdwba/ma

The World Bank
Washington, D.C. 20433
U.S.A.

JULES W. MUIS
Vice President and Controller

CONFIDENTIAL
August 21, 1996

Mr. James D. Wolfensohn

DECLASSIFIED
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WBG ARCHIVES

Re: Borrower Accountability

Jim,

1. I refer to your request to prepare a memorandum on the borrower accountability landscape and tentative remedial action proposals. Subsequently, Sven requested to prepare a memo jointly with Gautam to present you a joint view.

2. Controller's prepared a first draft dated August 14 (Exhibit II).

3. Gautam responded to this draft on August 15, per Exhibit I, which I subsequently discussed with him on August 20.

4. On the eve of my vacation, I am faced with the question whether there is a reasonable prospect of a joint position paper in the very near future. Although I am hopeful that we can make more headway than ever before with Operations in terms of corrective action, I still think the outcome to be too uncertain and the time too long to let you wait for a briefing at least from Controller's perspective. Hence, the enclosures, for your optional reading.

5. I have discussed with Gautam the unadulterated expression of his view that the Controller's draft of August 14 paints (for the first time) a 'dollarized' picture which serves to be too sensational. Based on the explicit assumptions of the draft paper, we have properly pictured the volatility of non-compliance in dollar terms over time -- recognizing that the cut-off date is of particular significance. This cut-off date, i.e., July 1, has been the traditional cut-off date used by operations for many years. The Bank used to take stock also at a December 31 but that was dropped some years ago on request by the regions because it proved too laborious in terms of value for money.

6. Although the OPR Information System that is supposed to keep track of non-compliance needs quite some upgrading, I can comfortably confirm that my initial "seat off the pants" guesstimate for July, i.e., close to $15 billion non or substandard compliance with our own standards, is about right. Although we may get some (false) comfort from the fact that the amount drops over the subsequent months to about half, this cyclical but structural non-compliance with our own standards signifies reputational and prudential exposure in a system that is already poor at entry, i.e., borrower financial project management level.

7. Of that a hard core of around $5 billion, the bulk, represents annualized disbursements on a SOE bases, meaning disbursements where the task manager is supposed to check the underlying evidence, but does not do it and/or mostly does not have the management skills for it. We will be proposing fundamental procedural changes to Operations to remedy that.

8. Another core problem area is audit reports overdue for more than a year but against which we keep disbursing ($410 million disbursement in FY96 on top of $0.5 billion "overdue"). I have asked my Department to prepare a listing of the relevant projects and ask the regions explicit explanation of the situation and why we should continue disbursing.

9. Finally, we have the qualified opinions Controller's will insist to review these, as a matter of course to assure proper follow-up.

10. We will propose other system changes, some fundamental, some procedural (see Exhibit II and III) within the context of LACI, including limiting some of the Institution's onerous audit requirements, subject to proper quality at entry.

11. The Bank cannot afford taking the same picture year after year again of the same unsatisfactory situation without either changing the goal posts, or enforcing its own standards. It is my prediction that alternative calculations will not change the borrower accountability problems as reported by Controller's this year and, year after year again, i.e., (a) weakness at entry (financial project management level), (b) weaknesses at exit (audit timeliness, audit quality, follow-up on qualifications), (c) weaknesses in process (skills), (d) weaknesses in the SOE product (no review, skill problem), and (e) weaknesses in enforcement (reluctancy in disbursement deferral upon violation of rules).

12. Controller's has a monitoring/reporting function/authority as regards borrower accountability; prime authority to do something about it rests with Operations; we could, and will be, more proactive on the subject than before.

13. Although senior operational management may play down the nature and scope of the problems, the annual non-compliance reports by middle management at regional level are very self-incriminating. This internal inconsistency between appraisal and action is a major reputational exposure of the Bank, unless it acts one way, or another, or changes its standards.

14. I hope that, upon my return from my vacation, progress has been made in our discussions with Operations on a joint solution. Ad interim, I thought it important to give you a head start on the issues of substance as this was promised to you by last week.

15. As for the dynamics of the disbursement process, in particular the weak links in the decision/validation chain, the crucial junctures and responsible units, please find enclosed a color-coded story line, per Exhibit IV. We'll be pleased to explain it to you.

cc: Messrs. Kaji, Sandström, Raghavan, Joscelyne, Choudhury, Andersen
Ms. Einhorn

The World Bank
Washington, D.C. 20433
U.S.A.

EXHIBIT I

GAUTAM S. KAJI
Managing Director, Operations

August 15, 1996

Mr. Jules Muis, Vice President & Controller

Jules,

RE: An Overview of Borrower Accountability

I refer to your note of August 14 and the attached draft joint memorandum to the President, which I received today.

I regret I am unable to sign it. In my opinion the draft memo and the underlying analysis, by acts of commission and omission, paints a picture (the much heralded $15 billion!) which by confusing multiple elements, taking a snap shot on a cut-off date which produces the worst possible slant and not providing the full background and facts, serves to create a sensational and alarmist document. While fully respecting your specific functions in the Bank, I do believe all of us have a responsibility as officers and professionals to present a balanced and considered assessment to the President.

All this is not to say that I disagree with the thrust of all your recommendations. There are areas where we need to exercise greater care and follow through. We also need to pay much greater attention to financial management capabilities in our borrowing countries from a broader development perspective. But all such responses should be considered against the backdrop of careful analysis and understanding of multiple objectives being pursued.

Since your cover note makes it clear that the draft for joint signature is sent to me on a take it or leave it basis, you are welcome to send your memorandum to the President if you wish. I will then convey my views to the President separately. I will do so with much regret as it is contrary to the values and management culture Jim is keen to establish. On the other hand, if you wish to seriously discuss the issues, I will be pleased to meet with you on Tuesday, August 20.

Gautam

EXHIBIT II

The World Bank
Washington, D.C. 20433
U.S.A.

JULES W. MUIS
Vice President and Controller

August 14, 1996

Mr. G. Kaji

Gautam,

Enclosed please find the proposed joint memorandum for Jim on the borrower accountability landscape, and tentative remedial action proposals. These are penetrating and will need further study as to how to implement.

My experience in and out of the Bank with joint papers on positions is not very good. On a number of topics -- i.e., MOV, pensions costs and cost savings opportunities, IDA's financial policies and management oversight, outsourcing, salary scales -- where I have shown restrain in communicating directly with the President, I ended up in the quicksand of bureaucratic deliberations. One day this will catch up with Controller's and its reputation. I am not asking you to agree with all or everything in this proposed text -- the style is "Mouse" but as a matter of fact I have the impression we've come a long way to seeing this issue the same way -- but I hope you realize that I have my own responsibility in letting Jim know if and when I foresee (ongoing) structural problems.

Thanks for accepting such a brief "reading period" and I trust we will put this issue to rest in the coming couple of years: there is no quick fix!

Encls.

cc: Messrs./Mmes. Einhorn, Sandström, Joscelyne, Bassinette

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

PROPOSED
DRAFT

DATE: August 14, 1996

TO: Mr. James D. Wolfensohn

FROM: Jules W. Muis, CTRVP and Gautam S. Kaji, Managing Director

EXTENSION: 81674 and 81384

SUBJECT: **An Overview of Borrower Accountability**

1. This memorandum responds to your request for a summary of the current situation with respect to borrower accountability, i.e., the dollar amount of disbursements unvetted, in terms of unaudited or unsupported Statements of Expenditure (SOEs) as well as audit reports qualified or not yet received; analyzes the underlying reasons for it; and offers our recommendations for what structural actions the Bank should take to correct the situation.

I. THE PROBLEM

2. The World Bank does not seriously enforce the financial covenants in its loan agreements. As a result, as of July 8, 1996, approximately $15 billion in disbursements was in non-compliance with the Bank's own rules -- measured in terms of disbursements against projects with overdue audits, qualified audit opinions, and SOE documentation not reviewed, or inadequately reviewed, by the Task Manager.

3. This figure of $15 billion approximates the ceiling of the Bank's current exposure due to formal non-compliance with its own financial covenants. There are a number of assumptions underpinning it which, if changed, would move this figure up or down. (See Annex A.) One such variable is the timing of the snapshot, to which the number of overdue audits in particular is sensitive. This reflects the variation in due dates, in turn a function of fiscal year-ends of projects, which vary from borrower to borrower (with some degree of homogeneity within certain Regions). We have used the traditional cut-off date of June 30. Given the aging of disbursements in non-compliance, it is reasonable to assume that the $15 billion will come down dramatically within the next six months. And ultimately, non-compliance typically diminishes to less than 5% within two to three years following disbursement. However, unless the Bank changes its ways, the cycle will repeat itself in the course of the next 12 months. And in any event, the dollar figure for non-compliance is too big to be tolerated.

4. Over the years, the exception has gradually become the *de facto* rule. This lack of enforcement is due to an unwillingness to look at borrowers' non-compliance with the prudential provisions of the Bank's loan covenants as sufficient reason for suspending disbursements. This view has in turn led to inadequate resource allocation in the Regions for staffing and training to ensure borrower accountability, resulting in the current severe

shortage of skills among Bank staff with this responsibility. Equally lacking is sufficient specialized support from which they can seek professional advice within the Bank. This is not intended as criticism of the existing accounting and auditing specialists in the Regions; on the contrary, we believe they are doing excellent work and under extremely difficult conditions, in that they are seriously overstretched and current incentives for operational staff do not value borrower accountability. Our assessment of the current situation is corroborated by the results of the recent Control Self-Assessment with senior Task Managers from across the Bank.

II. SUMMARY OF RECOMMENDED ACTIONS

5. We recommend the following actions:

(a) First and foremost, the Bank's operational management -- at all levels -- needs to demonstrate leadership and commitment to the Bank's making sound project financial management a key development objective, and recognize it as one of the primary contributors to development impact at the project level, as well as a key accountability tool.

(b) The Bank should be serious about enforcing its own rules:

- by following its own stated policy of requiring that the borrower establish proper financial management, accounting, and internal control systems, acceptable to the Bank and formally reviewed by the external auditor for the project, prior to project implementation; and

- by enforcing its own financial covenants regarding the receipt of timely and reliable audits acceptable to the Bank.

(c) For those audits performed by the private sector under Bank-financed projects, the Bank should negotiate audit framework agreements with international accounting firms -- effectively franchising the audit work by region or country cluster -- to allow for a much more focused and cost effective value added per audit, beyond *ex post* accountability; and the Bank should examine from a structural standpoint how audits are awarded to the public sector (Auditors General) versus private firms.

(d) For each borrower country and over a period of time, the Bank should carry out a diagnostic review of institutional capacity to sustain financial accountability, to be fed into the governance and transparency aspects of the Country Assistance Strategy, and to form a basis of discussion and action at Consultative Group and Round Table meetings with borrowers and donors.

(e) Each Region should have a senior level financial accounting and auditing capacity to assume a leadership role and to serve as the Regional focal point on all aspects of borrower accountability.

(f) Controller's needs to complete its Loan Administration Change Initiative (LACI). Not to prejudice its outcome, recommendations here are still tentative, but this much is clear: the loan administration function needs to evolve from transaction processing to an integral part of the various phases of the project cycle, with key responsibilities for portfolio financial management (e.g., mandated review by Controller's of audit opinions that are not "clean").

(g) A major change in the Bank's skills base in financial management and accounting and auditing is required, in Controller's as well as in the Regions.

6. It is important that all of the above actions be pursued and ultimately implemented. Any one without the others will most certainly fail. Given the paradigm shift required, a transitional period is needed. Some of the recommendations could be implemented in selected Regions or for certain groups of borrower countries. Disbursement rates would, in all probability, decrease initially but over the medium term rally to current levels or, more likely, better. However, the pace of a transitional phase should not compromise achievement of the overriding goal of making financial management a development objective and ensuring that the Bank enforces its own borrower accountability policies and, by so doing, nurtures a more enabling environment for development. Proper execution of the Bank's fiduciary responsibilities cannot be cost-free. But it is reasonable to expect that over the medium term, many of these upfront expenses will have proven to be a high-yield investment in significantly strengthening both the Bank's and its borrowers' efficiency and effectiveness.

III. PROJECT FINANCIAL MANAGEMENT: A DEVELOPMENT OBJECTIVE

7. If the Bank is to strengthen its effectiveness as a development institution, it must make a paradigm shift, and make sound project financial management a key development objective. To do otherwise is a disservice to our borrowers in terms of promoting good governance, as well as to all of our shareholders in terms of our fiduciary responsibilities.

A. Current Situation

8. The Bank, in fulfilling its responsibility for the accountability of its funds, has traditionally relied on (i) its procurement procedures; (ii) the receipt of properly approved supporting documentation as evidence of the eligibility for disbursement against expenditures for goods, works, and services; (iii) the physical observation by its staff of the implementation and achievements of project components; and (iv) its requirement for an independent audit of all projects to ensure that proceeds of loans and credits have been used for the purposes intended.

9. Disbursements against SOEs have risen significantly (SOEs now account for 50% of all disbursements) due to (i) increased lending in the social sectors, where disbursements are of individually smaller amounts and relate to a much greater number of

documents, and (ii) an increasing threshold for prior-review of procurement contracts, for which disbursements are generally made under SOE procedures. The move to SOEs has signaled the increasing importance and need for Task Managers to review SOE documentation in the field -- a Bank requirement as part of supervision missions. This need is not being met, however, as it is widely recognized in the Regions that Task Managers do not have the time, expertise, or motivation and incentives to carry out this type of review.

10. A review of financial compliance by the borrower and the Bank as of July 8, 1996 showed a non-compliance equal to about $15.3 billion (based on the assumptions discussed in Annex A). Of this amount, $8.9 billion is disbursements against documentation, and $6.4 billion is disbursements against Statement of Expenditure (SOE) procedures. Broken out by the three types of noncompliance, of the total figure of $15.3 billion, $11.8 billion relates to non-compliance by the borrower in terms of timely submission of audited financial statements (only 41% of audits for projects disbursing in 1995 were received by the Bank on time, with "on time" defined as six to nine months after the end of the financial year of the project entity); $0.9 billion relates to qualifications with respect to audit reports received; and $2.6 billion in terms of SOE documentation not reviewed by Task Managers in the field, as is required. The aging of those disbursements in non-compliance is as follows: $5.3 billion relating to 1996 disbursements through end-June, $9.6 billion relating to 1995 disbursements, and $0.4 billion relating to disbursements for earlier years. (See page 1 of Annex A.)

11. A summary of these amounts by region, together with the assumptions used, is shown on page 2 of Annex A. The SAS Region shows a relatively superior performance (20% of audits for SAS projects disbursing in 1995 were overdue), with poor performances from the LAC, ECA and MNA Regions (each with more than 70% overdue for projects disbursing in 1995). It should be noted, however, that until recently, SAS has benefited from having more time to comply -- a nine month grace period after the project's fiscal year-end, as opposed to the six months more common in other Regions.

12. The primary impact caused by the late submission of audit reports is the reduced usefulness of these reports, both for providing financial management information for project implementation, and for the Task Manager to monitor the project. Also, it is highly likely that when an audit report is overdue, the quality of the eventual audit suffers because key project managers have changed, records have become more difficult to find, and consequently the audit becomes more form than substance. Over the past three years, the records show that about 96% of all audit reports are eventually received, leaving 4% unaccounted for. Those unaccounted for relate in part to problem projects in nonaccrual and/or war-torn countries (e.g., Somalia, Yugoslavia), with some relating to projects closed for which the audit reports were not further pursued.

13. Non-compliance as shown in Annex A also includes about $900 million relating to 1995 disbursements for which the audit reports received had qualified, adverse or disclaimer audit opinions. In most cases, these qualifications were not subject to professional review and follow-up to ascertain the impact of the qualifications on project

financing and whether the Bank's funds were being used efficiently and for the purposes intended. Furthermore, Bank studies have shown that the receipt of most "clean" (unqualified) audit reports does not provide sufficient evidence of financial accountability for the use of project funds. Terms of reference for the auditors are not harmonized and clear. Furthermore, audit reports are frequently not substantively reviewed by the Bank, as those Operational staff charged with this responsibility are usually unskilled to carry out these reviews.

14. We observe that audit costs are abnormally high, triggered by the poor quality of the accounting records, inadequate borrower capacity to judge value per audit. Auditors frequently, therefore, carry out a significant amount of the accounting work themselves and after the fact, and they often lack of a clear understanding of the project, Bank procedures (e.g., SOEs and Special Accounts), and the financial structure of Bank-assisted projects. In many cases, Bank staff have not properly defined the scope of the audit engagement, which has added to confusion and cost. Based on discussions with Bank staff in the Regions, we estimate that total audit costs (including government as well as private auditors) for the Bank's approximately 1,800 ongoing projects amount to $55 million per annum. It is regrettable that the high amount of funds spent on audits provides only limited benefits for the projects and the borrower, as audits are typically viewed as merely a compliance control mechanism rather than as a transparent feature of accountability and integrity.

B. Underlying Reasons

15. A Control Self-Assessment (CSA) which Controller's held recently with 42 senior Task Managers with wide regional representation confirmed a substantive lack of financial management skills and capacity in the Regions. While the Task Managers agreed that good project financial management contributes significantly to good project management, they also acknowledged that this was not the norm among Bank-assisted projects and among borrowers in general. They also readily acknowledged that they simply did not have the financial management skills themselves to fulfill effectively their mandate to appraise and monitor borrowers' accountability and to take appropriate steps when this was lacking. These views have been corroborated by the draft findings and recommendations of the sub-group on Accounting, Financial Management and Auditing, which formed a part of the Working Group on Core Services Needed by Task Managers (created at the request of the Operations MDs' office).

C. Recommended Actions

(i) Meaning What We Say

16. First and foremost, the Bank's operational management -- at all levels -- needs to demonstrate leadership and commitment to the Bank's making sound financial management a key development objective, and recognize it as one of the primary contributors to development impact at the project level, as well as a key accountability tool. To give project financial management strategic priority, management needs to

ensure that the new OP/BP 10.02 and the associated financial covenants in the Bank's loan agreements are seriously enforced, even if this causes (short-term) delays in lending and/or disbursements. Any such delays would probably be short-term only, in that over the medium to longer term, strengthened project financial management should, in fact, facilitate lending and disbursements.

17. More specifically, the Bank should follow its own stated policy of requiring that the borrower establish a proper financial management, accounting, and internal control systems, acceptable to the Bank and formally reviewed by the external auditor for the project, prior to project implementation.. Without proper financial reporting and accounting systems in place *ex ante*, subsequent project audits (also required by the Bank) are meaningless (inasmuch as there is nothing meaningful to audit), there is no public or private sector accountability, hence a country cannot survive economically, and the Bank therefore compromises its own development effectiveness. If, however, the Bank is serious about enforcing its own requirement that project financial management systems be in place prior to project implementation, then it is far more likely that the borrower will be able to produce timely and reliable audits for the Bank's -- and, more to the point, its own -- review. The external auditor for the project should play a key role, by reviewing the financial management system in place prior to project implementation -- the system that will generate the information that the external auditor will subsequently be auditing.

18. The Bank should nonetheless also be serious about enforcing its own financial covenants regarding the receipt of timely audits acceptable to the Bank. Per its current policy, the Bank may -- at the discretion of the Regional Vice President -- suspend disbursements for a given loan if an audit is nine months overdue or if the audit reveals major deficiencies in internal controls, including insufficient evidence that funds have been used for expenditures eligible under the loan agreement. The reality is that this sanction is rarely enforced. The recent report from the Bank's Inspection Panel with respect to the PLANOFORO project in Brazil is an example of a project which had inadequate project financial management arrangements and audits outstanding for more than three years, with no consultation with Controller's regarding the waiving of the financial covenants. Experience shows that overdue audits are most often a symptom of inadequate financial accountability, which in turn is detrimental to development effectiveness.

19. The benefits -- to the borrower as well as to the Bank -- from timely and reliable accounting and auditing include:

(a) providing the comfort needed by both the borrower and the Bank (and donors where relevant) that project funds have been used efficiently and for the purposes intended;

(b) providing information needed to manage the project by those responsible for implementation, and needed by both the government oversight department and by the Task Managers to monitor project progress, to compare actual achievements against plan for both cost and other key performance indicators, thereby providing the opportunity for speedy remedial action where needed;

(c) improving the efficiency of project monitoring by the Bank, by facilitating the identification of project problems in a timely manner, thereby enabling the Task Managers to focus on priority issues during supervision missions and to monitor project progress even before going on mission;

(d) setting an example to the government for good financial management, demonstrating the benefits therefrom and acting as an example for wider adoption (as is currently the case with the Bank's procurement guidelines);

(e) serving as a deterrent to fraud and corruption; and

(f) allowing the Bank to simplify and streamline a number of its control procedures (e.g., Task Managers' review of SOEs, disbursement procedures, and the extent of audits required).

(ii) Audit Framework Agreements

20. Each Bank loan generates, on average, 2.5 audits per year, for which the costs are borne by the borrower. Approximately 50% of audits for Bank-financed activities are performed by the public sector (Auditors General) and 50% by private auditing firms. Of the latter, most are local affiliates of the "Big Six" international accounting firms. Last March, Controller's sponsored a forum with representatives of these firms to discuss issues of common concern related to these audits. The auditing firms' shared frustration regarding lack of coordination on the Bank's side, as well as among cofinancing donors, was apparent. Likewise, the Bank expressed its frustration with the lack of coordination within a given international firm vis à vis the Bank as a principal co-user of the hundreds of audits performed in connection with Bank-financed projects over the course of a year. It was agreed that both sides of the table should consult internally and propose how a more consolidated approach might be put in place.

21. The Bank should seize this opportunity to rationalize its dealings with the international accounting firms in connection with audits conducted for its borrowers. We propose that for those audits performed by the private sector, the Bank negotiate audit framework agreements with these firms -- effectively franchising this audit work by region or country cluster -- to allow for a much more focused and cost effective value added per audit, beyond *ex post* accountability. In addition, the Bank should examine from a structural standpoint how audits are awarded to the public sector (Auditors General) versus private firms. Each firm would have one international partner responsible for managing that firm's relationship with the Bank and the relevant borrower governments. Such an arrangement would significantly reduce, if not eliminate, the fragmentation and lack of coordination that exist today, and would provide better quality assurance in auditors' services to the Bank and its borrowers. Terms of reference could be more standardized, with audit framework agreements drafted by Bank staff with professional expertise in accounting and auditing, rather than left to the discretion of individual Task Managers not skilled in these areas. The quality of audits would improve ("quality in,

quality out" as opposed to "garbage in, garbage out") and at the same time, audit fees for our borrowers would be reduced significantly, in light of better guidance to the auditors by knowledgeable Bank staff -- with the result that the cost of introducing good financial management would be more than offset by the savings on audit costs within a short period of time.

22. In light of the international accounting firms' frustrations with the inconsistencies among audit terms of reference for different donors under a given project, the Bank should also consider including other donors in audit framework agreements. Initially, the Bank should pursue this idea with the other multilateral development banks (MDBs), and Controller's has included it in the agenda for the upcoming (September) MDB Controllers' Forum. At a later stage, it could be discussed with bilateral donors as well.

(iii) Diagnostic Country Reviews

23. To reiterate from the Financial Reporting and Auditing Task Force (FRAT) Report, as well as from recent internal audit reports on financial accounting, reporting and auditing in lending operations in the LAC and MNA Regions: We propose that for each borrower country and over a period of time, the Bank carry out a diagnostic review of institutional capacity to sustain financial accountability. The Bank should begin with those countries where we know of serious accountability issues, and also where project implementation problems are widespread, to avoid having to resolve the problem of poor financial management on a project-by-project basis when many of these problems may be of a similar nature. Therefore, a most urgent task would be to monitor the quality of the financial management and reporting information currently provided to the Bank for ongoing projects, and to assess their general level of accountability. Some Country Portfolio Performance Review (CPPR) activities have looked at this cross-sectoral issue, but usually superficially. And most Private Sector Assessments have ignored analysis of the financial accounting and reporting basis of the country.

24. Diagnostic reviews -- such as those performed in Moldova, South Africa, Angola, Mozambique and Peru -- allow both Bank and borrower staff to be fully informed as to the levels of efficiency of financial accountability likely to be available in a given country. They identify what changes to institute and/or professional services to upgrade, possibly under a subsequent Institutional Development Fund (IDF) grant or lending operation, either free-standing or as a project component. Such diagnostic reviews have already led to lending operations in several countries as well as IDF grants in others, to strengthen the accounting and auditing profession. As such, these diagnostic reviews of institutional capacity to sustain financial accountability should feed into the governance and transparency aspects of the Country Assistance Strategy (CAS) and form a basis of discussion and action with the borrower and donors at Consultative Group and Round Table meetings.

25. Our concern about the degree of efficiency of the financial services in a country relates to the performance of both the public and the private sectors. Supported by an adequate legal framework, a strong accounting and auditing profession is important for a

program of privatization and for attracting private investors. The types of relevant technical assistance that could be financed under an IDF grant (as already done in several African and Asian countries) or a Bank loan (also as already done in a handful of countries) would support: (i) drafting of new or revised legislation; (ii) design or modification of accounting, financial reporting and auditing systems in the public sector; (iii) development of accounting standards and guidelines; (iv) design of new or modified educational programs; and (v) training of trainers.

(iv) Efficiency Gains

26. A byproduct of *ex ante* financial management systems and the receipt of timely, reliable audits is the opportunity to streamline the disbursement process itself. That is, with proper internal controls in place, the Bank could afford to make larger disbursements and fewer per project. This would be more cost effective for both the Bank and its borrowers from an administrative and transaction processing standpoint. Over the longer term, these savings -- together with (i) those generated by the efficiency gains accruing to the Bank and its borrowers described in para. 19 above, and (ii) those derived from lower aggregate audit fees under the audit framework agreements proposed in paras. 21-22 above -- would more than offset the additional costs associated with introducing good financial management and serious enforcement of the Bank's current financial covenants.

IV. ORGANIZATIONAL IMPLICATIONS FOR THE WORLD BANK

27. The above recommended actions have several organizational implications for the Bank. Some pertain to the Regions, some pertain to the loan administration function performed by the Loan Department in Controller's, and others pertain to how the Regions and Controller's interface on borrower accountability issues.

A. The Regions

28. Concurring with the views expressed by Task Managers, we believe that the promotion of good financial management in project work requires senior level financial accounting and auditing capacity in each Region, to assume a leadership role and to serve as the Regional focal point on all aspects of borrower accountability. This function would coordinate and manage the diagnostic reviews proposed above, advise on technical assistance projects and project components that may emerge as a result of these reviews, review incoming audits, assist with the design of project financial management systems as part of project preparation and appraisal, and generally provide support and advice to Task Managers on borrower accountability issues.

29. Each Task Team needs -- and should have -- the support of staff assigned to provide advice and assistance in all aspects of financial management. Some Country Departments already have them in place. The support at the departmental level would vary from being a direct assignment in the department to that of being provided through a shared staff located in a Technical Department, an Operations Support Family, or their equivalent.

B. Controller's

30. As part of LACI (launched in April 1996), Controller's is considering possibilities for how to better integrate the loan disbursement and repayment process into the various phases of the project cycle, to ensure that this function is client responsive and cost effective, while maintaining the Bank's financial integrity. (See Annex B for a schematic description of the current loan disbursement and repayment process, and its inherent control weaknesses.) Preliminary conclusions that have emerged thus far from the information gathering phase of LACI are:

(a) the focus of the disbursement/repayment function must shift from transaction processing to project controllership and financial portfolio management;

(b) the Bank's borrowers need better integration of the various aspects (i.e., technical, financial, disbursement, audit) of project review and monitoring by Bank staff; and

(c) senior management in the Regions and in Controller's must jointly define the competencies, skills and organization structures (including skills gaps and training needs) required to maximize the Bank's effectiveness in ensuring project financial management systems are in place.

C. Interface Between the Regions and Controller's

31. From the borrower's standpoint, there needs to be a seamless integration of the respective roles of the Regions and Controller's. In line with the above preliminary LACI conclusions, Controller's is considering options for offering better support to Task Managers on borrower accountability issues. Specialized support from within the Bank would release the Task Managers from duties they currently try to carry out, frequently without the required competence.

32. The Regions and Controller's would need to collaborate closely in negotiating the proposed audit framework agreements and the audit terms of reference governed by them. Bank operational policy should be changed such that any audit reports sent to the Bank with qualified, adverse, or disclaimer opinions should automatically be sent by the Task Manager to Controller's for review, to determine whether the audit is satisfactory to the Bank. Current operational policy details appropriate consequences if it is not satisfactory.

V. SKILLS IMPLICATIONS

33. The above organizational implications in turn call for a paradigm shift in the skills base in Controller's as well as the Regions. As recommended above, the Bank will need to ensure that each Region is staffed with a nucleus of professional accountants and financial management specialists. In addition, the Loan Department plans to undertake a major retooling initiative, to develop the skills of current LOA staff in project finance and

financial management, or to recruit staff with those skills where training is impractical -- with the goal of shifting the loan administration function away from transaction processing to portfolio financial management and controllership.

VI. TRANSITIONAL PHASE

34. The recommended actions outlined above are ambitious, and will take time to implement. We should therefore envision a transitional phase, during which some of the recommendations could be implemented in selected Regions or for certain groups of borrower countries. Disbursement rates would likely initially decrease, but over the medium term rally to current levels or, more likely, better. The pace of this transition should not compromise achievement of the overriding goal of making financial management a development objective and ensuring that the Bank enforces its own borrower accountability policies and, by so doing, nurtures a more enabling environment for development. Proper execution of the Bank's fiduciary responsibilities cannot be cost-free. But it is reasonable to expect that over the medium term, many of these upfront expenses will have proven to be a high-yield investment in significantly strengthening both the Bank's and its borrowers' efficiency and effectiveness.

Annex A: Summary of Bank's Exposure as of July 8, 1996
Annex B: Schematic Overview of Loan Disbursement and Repayment Process

cc: Messrs./Mmes. Koch-Weser, Einhorn, Sandström, Joscelyne, Picciotto, Choudhury, Raghavan, Andersen, Russell, Morris, Willams

Summary Exposure
July 8, 1996

	US$ million			
	Total	Against Documents	SOEs	Not Allocated
Derived by (a) applying percentage of audit reports received (41% of those due) to disbursements in the period January - December 1995 relating to audit reports received ($6 billion) and (b) applying the percentage of audit reports received (15%) to the above, which had qualified, adverse or disclaimer audit opinions.	906			906
Derived by applying 59% of total disbursements for investment projects, being percentage of audit reports outstanding at July 8, 1996:				
- Disbursement in period January - December 1995 ($14.7 bn)	8,696	5,465	3,231	
	9,602			
- Disbursement in period January - June 1996 ($4.6 bn)	* 2,697	2,697		
Actual disbursement in period January - June 1996 - 100%	* 2,653		2,653	
	5,350			
Actual disbursements in FY94 and FY95 - for which audit reports were still outstanding at July 8, 1996.	402	310	92	
Total Exposure	15,354	8,472	5,976	906

* Included in disbursements for January - June 1996 is about $590 million relating to projects with audit reports outstanding for more than 12 months.

SUMMARY EXPOSURE AS AT JULY 8, 1996 (US $ MILLION)

DESCRIPTION	TOTAL	%	AFR	%	EAP	%	ECA	%	LAC	%	MNA	%	SAS	%
Disbursed Jan -Dec 1995 for which no audit reports received at July 7, 1996	8696	(59)	1068	(58)	2584	(64)	1161	(73)	2611	(72)	777	(72)	495	(20)
OF WHICH														
Against documents	5465	(59)	782	(58)	1863	(66)	952	(72)	1019	(72)	526	(71)	323	(22)
SOE Procedures	3231	(57)	286	(60)	721	(63)	209	(77)	1592	(73)	251	(78)	172	(17)
Disbursed Jan - June 1996 for which reports for Jan - Dec 95 and earlier periods were not received at July, 1996														
Against documents	* 2697	(59)	422	(58)	819	(66)	558	(72)	476	(72)	240	(71)	182	(22)
Disbursed 1993/1994 for which no audit reports received at July 7, 1996	402		77		15		0		134		31		145	
OF WHICH														
Against documents	310		65		12		0		80		31		122	
SOE Procedures	92		12		3		0		54		0		23	
Disbursed Jan - June 1996 which were were not reviewed by TMs, as required														
SOE Procedures	2653		212		643		130		1016		172		480	
SUBTOTAL	14448		1779		4061		1849		4237		1220		1302	
OF WHICH														
Against Documents	8472		1269		2694		1510		1575		797		627	
SOE Procedures	5976		510		1367		339		2662		423		675	
Audit reports received FY96 Qualified, Adverse, Disclaimer opinions	906	(15)	128	(16)	172	(13)	73	(19)	265	(26)	46	(19)	222	(13)
TOTAL EXPOSURE	15354		1907		4233		1922		4502		1266		1524	

* Includes $ 595M relating to projects with overdue audits of 12 months or more. ( ) percentages based on reports received applied to disbursements during the period.

BANK EXPOSURE DUE TO AUDIT NON-COMPLIANCE
as of July 8, 1996

ASSUMPTIONS

1. Quality of ARCS data: The status of audit reports due and received has been obtained from the Audit Review Compliance System (ARCS). The ARCS changes on an ongoing basis as new entries are made, always providing an up-to-date snapshot except when the system is frozen for data review. It provides, with respect to each Bank FY, information such as reports due, received, status of audit reports received, etc. The current review resulting in the figures in the "Summary of Bank Exposure" table is based on a snapshot which was frozen on July 8, 1996 with respect to reports due for FY96. The ARCS, which ACTCO inherited and reviews, is managed by OPRIS, with the Regions responsible for managing their own inputs and for making adjustments where necessary. Historically, the Regions have not paid sufficient attention to the ARCS, have exercised poor control over inputs and adjustments, and have usually waited until annual reviews are institutionally mandated. The ARCS also suffers from some system weaknesses and is not user friendly. It is currently being reviewed for overhaul and conversion to a PC-based system. We believe, however, that the information used for the review is sufficiently reliable to provide a reasonable picture. The table does not include the impact of about 100 audit reports for which due dates and audits received or overdue have yet to be entered into the ARCS. Once these are entered, it is expected that they may increase marginally the percentage of non-compliance (now 59%). ACTCO has requested the Regions to obtain and input the necessary information as soon as possible.

2. Percentage of audits as proxy for percentage of disbursements: The amounts shown in the "Summary of Bank Exposure" table were arrived at by applying the percentages of the number of audit reports to actual dollar disbursement information obtained from LOA (e.g., 59% of audit reports for 1995 disbursements were overdue at the review date; this was applied to the dollar amount disbursed in 1995 to arrive at the value of such overdue). The exception to this approach was the project-by-project review carried out for those reports which were overdue by more than 12 months. While the table shows $402 million disbursed in FY94 and FY95, with respect to projects overdue at the review date for more than 12 months, it is worth noting that another $590 million was disbursed against them in FY96.

3. Sensitivity to timing of snapshot: Due dates for the submission of audit reports to the Bank vary, but are most often six months after the end of the projects' fiscal year. Many, particularly in the SAS region, have due dates nine months after the end of the fiscal year. (OP/BP 10.02 seeks to have all projects using a six months due date [grace period] for submission of reports). Financial year-ends also vary -- typically December 31, March 31 or June 30 of each year. For the purposes of this review, we have used December as the year-end, and six months as the grace period, because it is the most often used and we feel it provides the closest to an average picture. For example, SAS currently

compares favorably with other regions, as most of its projects have March year-ends and December due dates (a review at June 30 allowing a period of 15 months before it shows non-compliance); compared to LAC projects, which usually have December year-ends and six months grace period (a review at June 30 showing non-compliance immediately after the grace period of six months). How the Regions fare in a comparison with each other is therefore influenced by the date of the review. A more in-depth review may show for each Region the truer picture of delays with respect to the grace period allowed, but such a review at this time would be faulted by the current poor management of the ARCS, including data entry dates well after the Bank's actual receipt of audit reports. It should be noted that the 59% non-compliance figure for 1996 disbursements would be even higher if we had included those reports received but after their due dates.

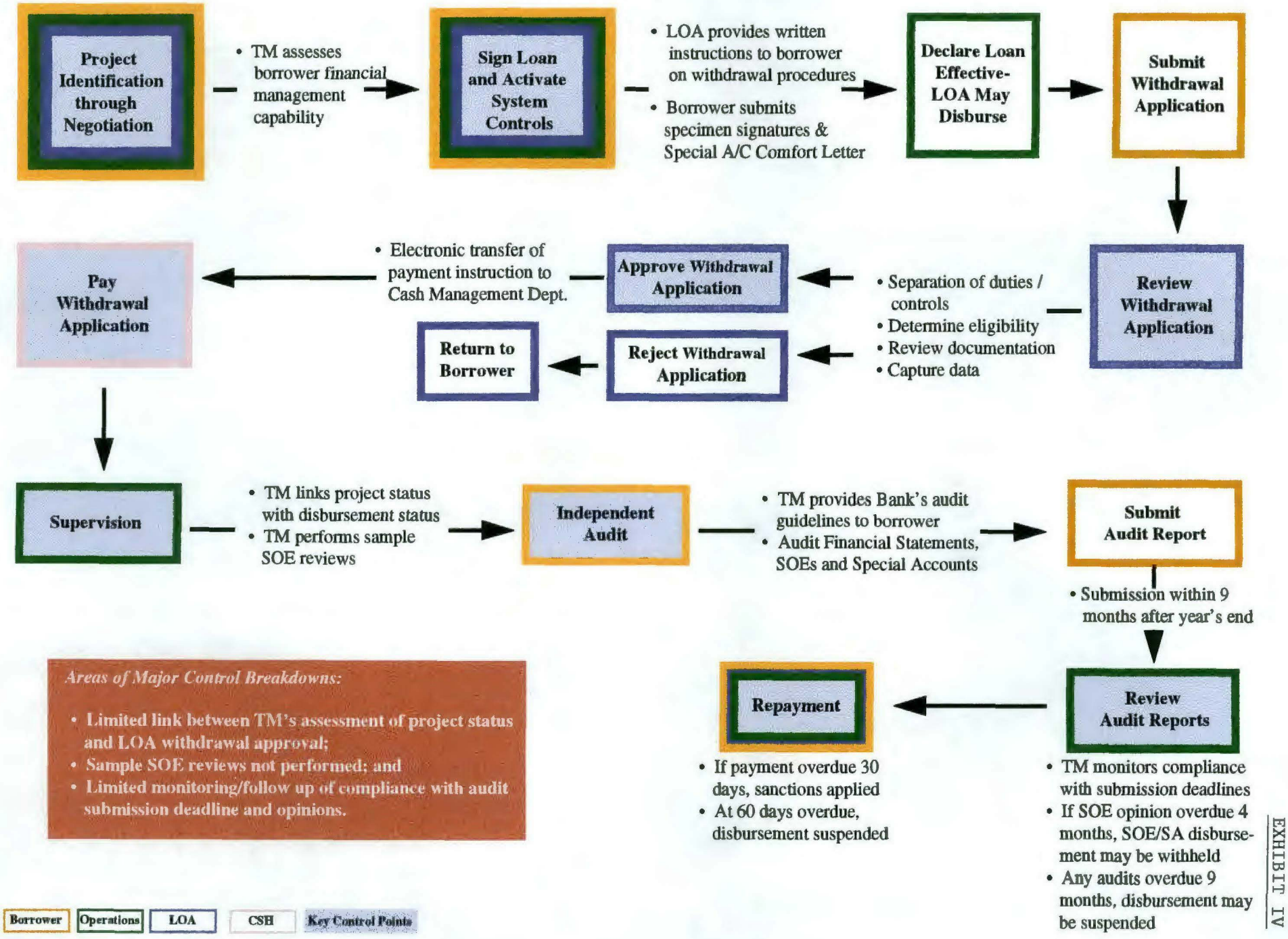
4. Qualified audits: The table shows $906 million relating to 1996 disbursements for which the audit reports received had qualified, adverse or disclaimer audit opinions. (This dollar figure is derived from the percentage of such reports received.) If the same percentage (15%) were applied to the disbursements of the entire year (including reports not received), the amount exposed would increase considerably to $2.2 billion. Instead, the lower amount has been used in the table, as experience shows that many of the audit qualifications are not material and do not relate to the use of funds. Many qualifications are with respect to immaterial amounts and insignificant regulations that have no impact on project funds and relate more to comments expected in a management letter instead of in the audit report. However, about 50% of all audits are carried out by government auditors, who tend to be more reluctant than private auditors to give audit qualifications. When LOA is informed by the Region that an audit qualification identifies ineligible disbursements, the amount is always recovered or covered by substitute expenditures.

5. Disbursement against SOEs: The table includes SOE disbursements during the six months period January to June 1996 in the amount of $2.6 billion. The SOEs for these disbursements should have been reviewed by Task Managers as a normal part of their project monitoring, but it is almost never done. No recognition is made in the table of the Task Managers' lack of review in the year to December 1995, since we assume that the audit would have covered this period. We should note, however, that the Task Managers' review should consist not merely of checking documents but, more importantly, identifying expenditures ineligible for financing under the project. This safeguard has also been missing for earlier years, even though audits may have been received.

6. Special Accounts beyond project closing dates: The table does not include $29 million in Special Account balances for projects which are more than six months beyond their closing dates.

7. Adjustment loans: The table does not include any reference to disbursements under adjustment loans ($4.6 billion in FY96) even though by their nature, these funds are not effectively monitored by the Bank to ascertain their ultimate use.

Loan Disbursement & Repayment Process (as designed) — Investment Lending



Annex B
EXHIBIT IV

Loan Disbursement & Repayment Process

Investment Lending Control Points

Control Point

Project Identification through Negotiation

Assess borrower financial management capability

Review status of financial reporting / audit on existing loans

Assess borrower capacity to satisfy Bank SA/SOE control requirements

Satisfied? No

Develop remedial action plan to ensure correction of deficiencies by loan effectiveness

Sanction

If overdue audits, condition negotiations / board present. on compliance

Yes

Determine level of accountability to be delegated to borrower

High Threshold = Low Level

Low Level

High Level

High Level

Procurement Prior Review - *a Bank monitoring procedure requiring Bank review of all steps in the procurement process before contract is signed*

- Set thresholds that result in the review of contracts for about 80% of the total value of Bank-financed contracts

Full Documentation - *a disbursement procedure for reimbursing the borrower or paying suppliers based on expenditure documentation*

- Normally required for expenditures for goods, works and services under contracts above procurement prior review threshold
- Exceptionally required for other expenditures if borrower fin. management capability is weak

SOE - *a disbursement procedure for reimbursing the borrower based on a description of expenditures incurred*

- Set types / levels of expenditure eligible for SOE - e.g., force a/c works, incremental operating costs, local training programs and all expenditures for goods, works, and services under contracts below the procurement prior review threshold

Special Account - *a dedicated borrower a/c to which loan funds are advanced*

- Set authorized allocation amount commensurate with project needs
- Set initial authorized allocation limitation to take into account lower needs at project start-up
- Assess soundness of SA holding bank

Include standard financial & auditing covenants in legal agreement:

- Maintenance of project records and accounts
- Audit of project records and accounts
  - include SA in audit
  - separate audit opinion on SOE
- Submission of audit reports to Bank as specified in loan agreement (up to 9 months after year end)
- Enable Bank to review SOE records at borrower site

Indicates areas of control breakdowns

Borrower | Operations | LOA | CSH | Key Control Points

Loan Disbursement & Repayment Process

Investment Lending Control Points

Control Point

Sign Loan and Activate System Controls

Sign Loan

LOA provides written instructions to borrower on withdrawal procedures including min withdrawal threshold

LOA establishes loan characteristics in LAS (Loan Administration System)

Borrower submits specimen signatures

If Special Account, borrower submits SA comfort letter -- *a letter from SA holding bank stating that funds will not be set off, attached, or seized.*

Sanction
Withhold SA advance until comfort letter received.

Indicates areas of control breakdowns

Borrower | Operations | LOA | CSH | Key Control Points

Loan Disbursement & Repayment Process

Investment Lending Control Points

Control Point

Review Withdrawal Application

- *35,000 applications per year of which 95% are Investment Lending*

Risk of human error

Log application into LAS within 24hrs. of receipt - done by staff independent of processing function

Capture details of expenditures such as:

- *currency & amount approved*
- *disbursement category*
- *SOE or full documentation*
- *expenditure type*
- *source of supply*
- *contract details*

Determine application/expenditure eligibility :

- *Appropriate application form*
- *Signed by authorized signatory*
- *Check that application is not a duplicate*
- *Sufficiency of funds*
- *Application amount above min threshold*
- *Compliance with disb. conditions*
- *Payment instructions appropriate*
- *Correct disbursement % applied*
- *Correct arithmetic, calculations*
- *No suspension of disb. in effect*
- *Application Summary Sheets match submitted documentation (for full doc only)*

- *Expenditures consistent with project description (accurate determination cannot be made due to limited project knowledge of LOA staff)*
- *Goods/services from eligible countries*
- *TM procurement clearance received if contract subject to Bank prior review*
- *Expenditures incurred during period of eligibility*
- *Amount excludes taxes*
- *Check that expenditures not duplicates*

If SOE, info. provided may be insufficient to verify these items

Determine if submitted documentation is satisfactory

Special Commitment

Request for Issuance

- Application Form 1931
- Copy of L/C
- Contract if greater than procurement prior review threshold

Request for Payment

- Negotiating Bank performs document review
- Negotiating Bank sends payment request to Bank

SOE

- Application Form 1903
- Tables detailing expenditures - *"Statements of Expenditure"*
- Detailed information required if foreign supply > $100,000
  - *Name/address of supplier*
  - *Contract number and date*
  - *Description of goods*
  - *Contract amount*
  - *Amount and date paid*
- Summary information required if local supply or foreign supply < $100,000
  - *type of expenditure*
  - *country of supply*
  - *amount claimed*

SA

- SA bank statement
- Borrower SA reconciliation

Full Documentation

- Application Form 1903
- Tables detailing expenditures - *"Summary Sheets"*
- Contract
- If Goods - supplier invoice and bill of lading
- If Works - contractor statement of work performed
- If Services - consultant invoice
- If Reimbursement- evidence of payment

Indicates point of contract breakdown

Borrower | Operations | LOA | CSH | Key Control Points

Loan Disbursement & Repayment Process

Investment Lending Control Points

Control Point

Supervision

Obtain adequate financial reports to monitor borrower financial management and accounting system

Sanction

- If loan agreement requires submission of such reports, disbursements may be suspended

Link project implementation status with disbursement status

Perform sample review of procurement post-review contracts

- Depending on project, review 1 in 4 to 1 in 20 contracts

Perform Sample SOE Reviews

- Inform borrowers, government, and independent auditors of findings
- Summarize SOE findings in annex to Form 590 and specify timing of next review. Copy annex to Disbursement Officer

- LOA supplements TM SOE review - *(less than 1% of total SOE applications)*

Monitor Special Account Status including:
- misuse of funds
- receipt of monthly SA bank statements
- receipt of monthly SA replenishment applications

Sanction

- If SA inactive for 6 months: send notice requiring refund in 90 days unless account becomes active

Sanction

- If failure to meet SA obligations continues for 12 months: suspend disbursements or condition board presentation / SA advance of new loans

- *AFR has conditioned board presentation / advance in several cases*

Indicates areas of control breakdowns

Borrower | Operations | LOA | CSH | Key Control Points

Loan Disbursement & Repayment Process

Investment Lending Control Points

Control Point

Repayment

Send billing statement to borrower 6 weeks before due date

Payment received?

Yes → Apply Payment

No

At 5 and 15 days overdue,
LOA reminds borrower of overdue payment

At 30 days,
CD director reminds borrower of overdue repayment

Sanction
- Condition board presentation and loan signing on repayment

At 35 days,
LOA notifies borrower of loss of eligibility for waiver of interest charge

At 45 days,
RVP warns borrower of impending suspension of disbursement

- *If RVP decides to delay notice, must advise MD, CTRVP, FPIVP, and LEGVP*

At 53 days,
CD director informs cofinanciers of impending suspension

At 60 days,

Sanction
RVP sends notice of suspension of disbursement and informs Board

- *RVP recommends any delays to MD and advises CTRVP, FPIVP, and LEGVP*

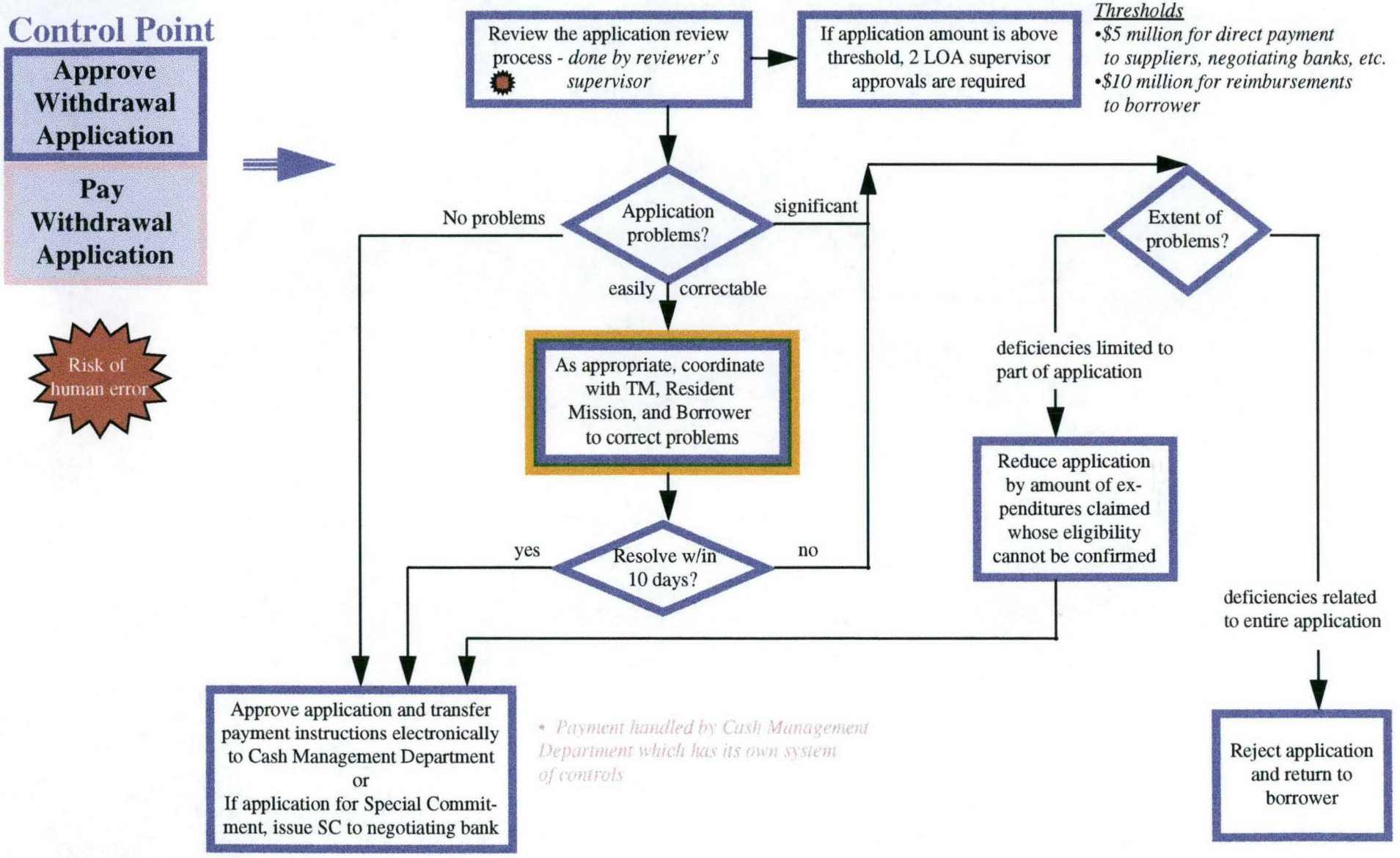
After at least 30 days of continuous suspension,
RVP approves cancellation of loan balances

Indicates areas of control breakdowns

Borrower | Operations | LOA | CSH | Key Control Points

Loan Disbursement & Repayment Process

Investment Lending Control Points



Loan Disbursement & Repayment Process

Investment Lending Control Points

Control Point

Audit

Select auditor by start of project activities

Review auditor's independence, qualifications, experience, and TOR and agree to auditor

- *Improving trend begun last year*

Monitor compliance with report submission deadlines

Receive reports?

Yes

No

- *41% of reports due in FY 96 received on time*

- *Limited report review by qualified staff*

Audit reports acceptable?

Yes

No

Inform borrower & request revised submission

- *Limited problem identification due to poor report quality*

Report identifies project financial accountability problems?

Yes

No

Identify remedial actions, e.g., tech. assistance or special audit arrangements

- *Limited follow-up due to limited Bank report review*

- *Limited ineligible expenditure identification due to poor report quality*

Disburse-ment of ineligible expenditures?

Yes

No

Request borrower to submit substitute expenditure documentation or refund amount disbursed

- *Limited link between Operation's audit status monitoring and LOA's withdrawal application approval*

Closing date on loan not extended, condition negotiation or board presentation of new loans

W/in 30 days send warning notice of requirement for submission w/in 90 days

Sanctions

If 90 day deadline passes, discontinue SOE disbursement and withhold SA replenishment

If audit compliance is not achieved within 9 months, RVP may suspend disbursement

Provide ongoing updates to Audit Reports Compliance System (ARCS)

- *For most projects update is only performed when the annual Bank-wide review is carried out*

Indicates areas of control breakdowns

Borrower | Operations | LOA | CSH | Key Control Points

THE WORLD BANK/INTERNATIONAL FINANCE CORPORATION

EXHIBIT III

OFFICE MEMORANDUM

DATE: March 25, 1996
TO: Mr. Fayezul Choudhury, ACTDR and Mr. V.S. Raghavan, LOADR
FROM: Michael E. Ruddy MER
EXTENSION: 81664
SUBJECT: Financial Reporting and Auditing of Bank Projects and Their Adequacy for Risk Management

1. The purpose of the study is to look at how well, in the countries with best practices (India, China and Indonesia), the reporting and auditing requirements of the Bank promote financial control, project implementation and project management on the borrower side, and how well the products of these requirements fit into the Bank's own system of risk management. These countries were selected because they represent about 25% of the Bank's portfolio and because, in the opinion of the Loan Department staff, they represent best practices worldwide with respect to borrower compliance with Bank reporting and auditing covenants. This study does not look at the broader issue of environmental controls over the use of government funds.

2. In order to ground the study and focus on concrete processes, practices and problems, 15 projects were selected (5 in each country) to use as a basis for dialogue on what is being done today by borrowers and by Bank staff to carry out agreements and responsibilities for accounts and audits. Bank task managers for these projects were interviewed at headquarters and in the field to determine how specific requirements were defined in a project (how the accounts, financial statement and audit TOR were defined) and how task managers carried out their responsibilities with respect to reviewing audit reports and Special Account operations. On the borrower side, these same 15 projects were the basis for a dialogue with four separate constituencies in the governments (the Ministry of Finance office responsible for Bank operations, the government line agency at the central level responsible for implementing Bank projects, the central audit agency and the project entity at the implementation level) to see what role they played in defining these projects' financial statements, audit requirements and how they used the audit reports produced.

3. The interviews with task managers showed that there is a significant gap between what is expected of task managers and what they can in fact do. For the most part, they do not have the time, the skills or the interest to deal effectively with issues of accounting and auditing. These findings do not differ from other studies on this subject. They confirm that task managers are not, as a general rule, able to carry out a number of responsibilities assigned to them. This is particularly true of the SOE monitoring function that should be done as part of regular supervision.

4. On the borrower side it is clear that in the three countries visited there are comprehensive management control systems in place, including auditing systems. There are primarily government systems of management (budget systems, transaction processing, budget accounting and cash disbursement systems) which are strong on the control side, but weak on the project management side. It was also clear that all three governments are making a significant effort to respond to Bank accounting and auditing requirements. China has some 3,000 auditors working on 170 Bank projects for seven months a year. In all cases the independence of the audit agencies is not an issue nor is the credibility of the audit work being done, given the compliance nature of audit TORs agreed to by the Bank.

5. After looking into the government auditing procedure in these countries, I came away with a substantial level of comfort on questions of: exposure and overall risk management; adequacy of audit work; and the level of interest on the part of these governments to meet Bank requirements. I also came away from the experience with some questions on : how well the Bank has been able to articulate what it wants in the way of audits and what it wants to get from these audits; how fully Bank staff understand the complexity and linkages between management systems and financial control systems in various project structures; why we have fragmented the process of requirements and standard setting across operations when this could be done so much more professionally from the center; and how do we expect to move forward in the areas of accounts and audits when the people given the principle responsibility (task managers) do not have the time, the skills, the resources or the interest in this work.

6. Against this backdrop of findings the report makes four major recommendations:

- Drop formal audit requirements for Special Accounts. These audits duplicate what is done by the disbursement officers when a Special Account is replenished, and they add little value to the process of risk management. The loss of these audits would not alter the risk profile for the Bank (page 9 of the report);

- Place responsibility for Statement of Expenditure audits with the Loan Department, and relieve task managers of this burden.. How SOE accounts are set up, what kind of reporting is appropriate, what is audited and how should be the business of the Loan Department (pages 9 and 10 of the report);

- Differentiate borrower accountability requirements for revenue projects executed by separate legal entities from projects implemented by government agencies (non revenue projects). Revenue projects are prepared by Bank staff who are fully conversant with the financial and accounting aspects of operations in these entities. These staff are, therefore, in the best position to manage financial covenants and all other aspects of borrower accountability for these kinds of projects. In the case of non revenue projects executed through line agencies of the government, the responsibility for setting minimum standards and for monitoring compliance should be with Controllers (pages 10 and 11 of the report); and

- Some experimentation with alternative audit compliance approaches is in order -- the use of periodic instead of annual audits (start up year, mid term and completion); introducing performance audit to replace financial audits in some countries to improve the value of the reports and audit input; waive project account audit where the Region has developed alternative ways of assessing risk; and develop formal technical assistance training programs for government audit agencies to up grade the quality and content of audit work, not just for the Bank but for the countries as well (pages 12 and 13 of the report).

Attachment

cc: Messrs./Mmes. Muis, CTRVP; Andersen, ACTCO; Hwang, LOAEL; John, LOAAS; Perera, LOAAS; Russell, ACTCO; Sengamalay; LOAAF

EXHIBIT IV

(PLEASE REFER TO ANNEX B
OF EXHIBIT II)

The World Bank
Washington, D.C. 20433
U.S.A

GAUTAM S. KAJI
Managing Director
Operations

August 27, 1996

Mr. James D. Wolfensohn

RE: Interim Trust Fund

Jim:

As you know the resolution establishing the Interim Fund delegates approval authority to the President in consultation with a Committee of Executive Directors representing contributors and borrowers.

We have some credits which now need to be approved and hence we need to agree on the specific procedures. Please see the attached draft which has been agreed with Shihata and Zhang. I had discussed the concept briefly with Sven. All of us are in agreement and I want to check with you whether you had any concerns. The procedures proposed would essentially mirror the "streamlined procedure" we have today, except that it's the President who approves, and not the Board.

Gautam

The World Bank
Washington, D.C. 20433
U.S.A.

JAMES D. WOLFENSOHN
President

August 27, 1996

Memorandum to the Executive Directors

Procedures for Consultation and Approval of Credits Funded out of the Resources of the Interim Trust Fund

1. The Resolution of the Board of Governors of IDA (Resolution No. 184 adopted on June 26, 1996) establishing the Interim Trust Fund (the Resolution) provides in Section 5 (c) that:

> "Each Interim Fund Credit will be approved by the President of the Association after consultation with a committee of Executive Directors representing the Interim Fund contributors and eligible borrowers of the Association or the IBRD."

2. The "Report of the Executive Directors of IDA on the Interim Trust Fund for FY97" (IDA/R96-64), dated April 16, 1996, states that the Deputies agreed that a separate approval procedure should be established for operations financed by the Interim Fund. They recommended that operations be approved by the President of IDA after consultation with a committee composed of Executive Directors representing the contributors and eligible IDA and IBRD borrowers (the Committee). The Report further states that the Committee "would agree on appropriate procedures for reviewing and commenting on draft project documents, which would be similar to those prepared for IDA-financed projects."

3. In view of the foregoing, and in order to give effect to the provisions of Section 5 (c) of the Resolution, the following procedures are proposed for adoption by the Committee:

(a) In all cases other than those referred to in sub-paragraph (b) below, the concerned Managing Director would circulate the documents for the operation consisting of a Memorandum from the Managing Director together with a staff appraisal report (the Documents) to the members of the Committee for their comments. Questions and comments would be referred to the staff specified in the covering memorandum from the Vice President and Secretary within fifteen working days of circulation in the case of adjustment operations and within thirteen working days thereof in the case of other operations. The Managing Director, after the expiry of

the period specified for receipt of comments made by the members of the Committee, would submit the proposed operation to the President for approval noting the comments received from the members of the Committee and, when applicable, the measures taken in response to such comments. The President would issue his approval after reviewing the submissions by the Managing Director. However, in the event that the comments received from the members of the Committee raise significant issues on which the views of the Executive Directors cannot be reconciled, the President intends to convene a meeting of the Committee to consider such issues prior to issuing his decision on the proposed operation.

(b) Where the proposed operation raises new policy issues, or otherwise covers a complex or controversial project, the Managing Director concerned would circulate the Documents for the operation to the members of the Committee for their review and discussion in a meeting to be chaired by the President or a Managing Director acting for him on a date which shall not be less than fifteen working days for adjustment operations and thirteen working days for other operations after the date of circulation of the Documents by the Vice President and Secretary. The President would decide on the operation after such review and discussion by the Committee taking into consideration the outcome of such discussion.

4. **Recommendation:**

I recommend that the Committee of Executive Directors referred to in Section 5 (c) of the Resolution adopt the procedures described in paragraph (3) of this memorandum.

Gautam S. Kaji
Acting President

THE WORLD BANK GROUP

ROUTING SLIP	DATE: August 23, 1996

OFFICE OF THE MANAGING DIRECTOR OPERATIONS

NAME	ROOM. NO.
Mr. James D. Wolfensohn	
By fax 307-733 9110	

	To Handle		Note and File
	Appropriate Disposition		Prepare Reply
	Approval		Per Our Conversation
	Information		Recommendations

RE: JORDAN

REMARKS:

Jim,

Attached is a current report on the Jordan situation and issues that might come up when you see the Governor of the Central Bank of Jordan. Please see the para marked on page 2.

Gautam

FROM:	EXTENSION:
Gautam S. Kaji	81384

Attachment w/ blc –

THE WORLD BANK GROUP

ROUTING SLIP	DATE: August 23, 1996

OFFICE OF THE MANAGING DIRECTOR OPERATIONS

NAME	ROOM. NO.
Mr. James D. Wolfensohn, President	
By FEDEX	

	To Handle		Note and File
	Appropriate Disposition		Prepare Reply
	Approval		Per Our Conversation
	Information		Recommendations

RE: Pakistan - Contingency Plan

REMARKS:

Jim,

Please find attached our current reading of the situation and the contingency plan. I would like to discuss with you next week how we come to closure on a "go/no go" on the Pakistan part of your South Asia trip.

FROM:	EXTENSION:
Gautam S. Kaji	81384

Attachment w/ GK
in Pakistan Folder on shared

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director, Operations

Tel.: (202) 458-1384
Fax.: (202) 522 3399
Facsimile Transmittal Form

DATE: August 22, 1996

No. of Pages: __8____
(including this page)

TO: Mr. James D. Wolfensohn, President

FAX #: 307-733 9110

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CONFIDENTIAL

Jim,

Attached are the two notes on Pakistan that I spoke to you about.

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

CONFIDENTIAL

DECLASSIFIED
MAY 17 2017
WBG ARCHIVES

DATE: August 21, 1996

TO: Mr. Gautam Kaji, Acting President
Mr. Caio Koch-Weser, EXC
Mr. D. Joseph Wood, SASVP
Ms. Mieko Nishimizu, SA1DR

FROM: Shahid Javed Burki, LA Shahid Javed Burki.

EXTENSION: 82332

SUBJECT: **Visit to Pakistan**

My just concluded two-week home leave turned out to be a working vacation. Given Pakistan's current economic, political and social situation, I don't think I could have avoided the meetings sought by senior policy makers or the media attention that inevitably accompanied these deliberations. There was only one regrettable episode that occurred during my stay: a headline carried by one of the English language newspapers (*The Nation*, August 16, 1996) that the World Bank was taking a serious view of corruption in Pakistan. The story that followed the headline was reasonably accurate, given the standard of journalism in the country. The story grew out of a long conversation with a few journalists. I was asked about the World Bank's view on corruption. I said that the Bank's view was articulated by Mr. Wolfensohn in a recent *Financial Times* write-up. We regarded corruption as a highly corrosive phenomenon. It results in a severe misallocation of resources, people invariably lose confidence in corrupt states. What was the Bank doing about it, I was asked. I said that the macro-economic policies we advocated reduce the opportunities for rent creation and, therefore, the incidence of corruption. I said that we had a highly effective system of procurement in place which ensured transparency and competition. Countries would do well to adopt similar systems of government. Those who had moved in that direction - as China had done - had benefitted a great deal.

Let me now return to the main point of this note: impressions gleaned from the conversations I had with the country's senior policy makers and my own analysis of the situation in the country. I had two meetings with President Farooq Leghari and spent a total of nearly five hours with him. I met General Jehangir Karamer, Chief of Army Staff, for more than an hour and had extended conversations with V.A. Jafarey, Shahid Hasan Khan, Iqbal Haider Zaidi, Special Assistant to the Prime Minister, and Moeen Afzal. I also met with Sartaj Aziz, Mahbubul Haq and a group of businessmen and had a three hours long "open dialogue" with a group of academics on the subject of the reforms I thought needed to be launched immediately and those that needed to be implemented over the medium and long term. A transcript of this presentation was prepared and is likely to be published in *Dawn*.

I avoided meetings with politicans. Both leaders of the opposition—Nawaz Sharif and Imran Khan—wanted to get together with me but since I had not met with Benazir Bhutto, I thought it would be imprudent to meet with them.

I return from Pakistan with the following impressions:

- One, the present government has lost all credibility with the people. At the same time Islamabad has little confidence in the opposition. People expect some action some time soon from the Islamabad establishment.

- Two, the economy is moving towards a serious crisis. (In all my discussions I very deliberately avoided using the world "crisis"; preferring to talk about problems and difficulties. Jafarey told me that he very much appreciated that.) There are five pressure points building up: increased budgetary deficits, with almost panic spending by the government to buy political support; inflation, with a serious erosion in real incomes; possible bank failures; flight of capital; serious industrial recession accompanied by a sharp increase in unemployment. There is enough going wrong with the economy to produce a Mexico-like situation.

- Three, breakdown of law and order, which now engulfs most large cities. Only Islamabad has been spared.

- Social restiveness, which may bring people to the streets as they have done in the past.

Those who understand the economy—Jafarey, Shahid Hasan, Moeen Afzal—share some of these perceptions. Jafarey said to me that he will have a crisis of unprecedented proportions if the does not reach agreement with the Fund by end-September.

As to the Bank's role in the near term. Jafarey believes that he needs the Bank (and, of course, the Fund) to come to the aid of the government. He is puzzled by the Fund's displeasure: "I have implemented each one of their proposals in the FY97 budget," he complained. Some other senior officials want the Bank to send a strong signal to the government on the need for action on the budget, credit expansion, resolution of the banking crisis, corruption, poor governance. A number of people worry that, in spite of earnest efforts by the Bank, the Social Action Program funds are being used for political purposes. Some others are extremely concerned that the government may be preparing to scuttle the energy policy since it has reduced the opportunity for graft and favoring friends.

I am not prone to exaggeration. I am also not given to pessimism. But I thought I should share some of my thoughts with you upon my return from Pakistan.

I would appreciate it if this note is not circulated beyond the four addressees, unless you want to share it with Jim Wolfensohn.

[redacted]kistan News.....S.Shahid Husain - Where do
[redacted]Lines Updated On:Wednesday, August 21, 1996

WHERE DO WE GO NOW?
[Syed Shahid Husain, Dawn, August 10, 1996]

1. Changes in economic policy in Pakistan generally emerge from crises when there are few options and little flexibility. In the last few years, debt service has been allowed to balloon, public employment has expanded through numerous political appointments and Commitments have been made for large defense purchases without adequate consideration of tradeoffs. So, in making the budget, the government tied its own hands. The sole option was to "round up the usual suspects", those who already pay taxes, and tax them more. The goose that lay the golden egg may, therefore, be killed. If businesses pay all the taxes, they might as well close shop. However, if these taxes are not collected, workers and the middle classes will pay because the value of their earnings will be eroded by added inflation.

2. The dilemma regarding the banking system is no less serious. Mismanagement and cynical looting have reduced the public financial institutions to empty shells. Thirty to forty percent of their loans may be uncollectable. If nothing is done, as is the current policy, the entire monetary and banking system will be jeopardized. If the government cleanses their balance sheets, the fiscal cost will be huge. In the absence of a [redacted]aconian reduction of public expenditure, people, at large, will bear the c[redacted] through additional taxes and inflation.

3. The State Bank has given exchange rate guarantee on nine billion dollars of deposits and short term debt. With each rupee appreciation of the dollar, the State Bank loses nine billion rupees! Foreign banks bring dollars, get exchange rate guarantees and lend not at dollar interest rates but rupee interest rates. What a deal! The government, strapped for cash, has no option. The handling of the foreign exchange situation is day to day. At all cost a run on the dollar deposits must be prevented. So, there is panic if the Governor State Bank is purported to resign or if the IMF refuses to send a mission. Yet, the mere reappointment of the governor and the announcement of an I.M.F. mission are like putting a thumb in a crumbling dike. The organic makeup of the problem does not change; the day of reckoning may just be postponed.

4. The question is not whether an economic crisis can be avoided. Pakistan is in a deep economic crisis. The government has no social purpose left and is totally preoccupied by day to day survival. The question now is whether a financial crash can be avoided. I recently spent some time in Paidstart and met a large number of thinking people in government, business and politics. Except for a handful in government, I did not meet anyone who thought that the situation could be salvaged with the current policies. This consensus is shared in bilateral and multilateral lending agencies. A high official in an international agency described the current policies as tax and misspend. According to him, while taxes on t[redacted]e who pay have been raised to absurd limits, projects in Islamabad and P[redacted]-- convention Center, Bhutto Memorial and Pakistan Memorial--

[redacted]ting tens of billion rupees are going ahead as if there is no scarcity of [redacted]urces. Another international financial institution is so concerned that it has constituted an internal watch committee to monitor Pakistan's financial situation

5. 1t would be easy to throw up one's hands and say that Pakistan is ungovernable. However, there have been important instances of economic and social reconstruction in the wake of economic breakdown in a number of developing countries- Indonesia after Soekarno, Chile after Allende, Peru after Garcia and Argentina after the Perons and military dictators. There are also cases where crises are never resolved and, ultimately, the state as the principal instrument for an organized society ceases to exist, e.g.. Somalia, and Rwanda. In Chile and Indonesia, military governments, aided by technocrats and with the support of the middle classes, restructured the economies and laid the foundations of vigorous growth. Chile now has a thriving democracy and and one of the most vigorous economies in the world. In Argentina and Peru, deep structural adjustments took place under democratic regimes which came to power after total economic breakdown and hyperinfiation. In each case economic breakdown helped to solidify a national consensus for change and the accompanying sacrifices by important sections of the population. In Indonesia, Argentina and Peru external support was critical to facilitating the transition and easing the pain of adjustment. In these countries there was a solid political backing for economic policy makers. However, none of these faced the geo-political situation that Pakistan does.

[redacted] Getting back to Pakistan. It is conceivable that the [redacted]ent setup continues, the financial situation continues to deteriorate and, after a financial breakdown, a solid national consensus develops for a fundamental political and economic restructuring. But the underlying economic structure is so weak that, after a total economic breakdown, reconstruction may be close to impossible and our national unity and security may be jeopardized. Because of Pakistan's heavy dependence on external finance, foreigners are an integral part of our domestic political scene. Their price in concessions on strategic issues will be heavier the greater the burden of adjustment and the deeper our begging bowl. Time is of the essence. The balancing elements in our governmental structure, led by the President, now have the responsibility for a concerted effort to educate the people on the depth of our national crisis and what needs to be done to resolve it. At a minimum, any future government must have the mandate, the capacity and the tenure to plan and implement significant economic and political reform.

7. Whatever the political sequence, we need a national debate on the key elements of political and economic reform. Let me suggest a few issues for such a debate:

8. Political reform: Constitutional reform, by itself, does not change political behavior. However, the feudal stranglehold on our political system can not be eased nor the political power structure broadened without a census and an electoral reform. A census must be held before another election and the constituencies reapportioned so that the [redacted]nding urban population can have the representation it now lacks in [redacted]iament. Simultaneously, we must, as a nation, focus on the urban

problem. The problem of large cities must be considered as a political, as well as management issue. A fair measure of self government for large cities is essential.

9. An electoral reform is essential to rectify the current situation in which electoral expenses are so high that only moneyed people can contest elections. Perhaps it is time to think of a complete ban on private financing of elections and limited public financing of electoral campaigns. With our experience of political corruption a strict code of conduct for elected representatives and an independent tribunal to enforce it may not be out of order.

10. Governmental reform: Our fiscal problem cannot be solved without a drastic reduction of the size of the central and provincial governments. There should be a comprehensive review of each governmental organization and the justification for its existence. What remains should be strengthened through competitive recruitment, substantially improved training, administrative processes and salaries. The induction of party people in government, without competition, should be barred by law. Political handouts to legislators, now a major source of political corruption and misuse of resources, should be abolished. The responsibility and accountability of provincial governments in education and health should be made specific through agreements between central and provincial governments on targets to be achieved as conditions for the transfer of tax finds. The management of commercial activities is one of the biggest sources of corruption in Pakistan. These should be privatised.

11. Tax reform: A modern, progressive state can not function without a tax system which ensures adequate public revenues, equity and economic efficiency. Our multiple taxes and exemptions and an outdated and corrupt collection machinery ensure the opposite. A tax reform should reduce the number of taxes and eliminate exemptions, particularly of agricultural incomes. However, a tax reform makes no sense without an overhaul of the tax collection machinery. Over five years, there should be a concerted effort to improve recruitment through competition,training, information systems and, above all, salaries. Having tax collectors who are not paid a living wage is a sure prescription for massive revenue leakages.

12. Banking system: The biggest single source of political corruption in Pakistan is the nationalized financial system. During a recent meeting with the Governor State Bank, I found him in despair over the threat the banking system posed to the nation's financial stability- the bad loans of public financial institutions are one hundred and twenty billion rupees, fully one third of their total assets! An indication of the current state of economic management- rather, mismanagement- is that the governor has not had a detailed and formal review of the state of the banking system with the Prime Minister and the Cabinet.

13. We need quickly a strategy to restore a minimum of viability to the balance sheets of public financial institutions. Government will have to play a part and bear pan of the cost. With a minimum of restructuring, the public financial institutions should be privatised. Any major restructuring should be left to the new owners. Simultaneously, the

State Bank should be substantially fortified. Its independence should be enhanced. Its board of directors should be strengthened, comprised entirely of persons from the private sector. Its capacity to formulate monetary policy and for research should be built up. The Banking Council should be abolished.

14. Foreign trade and exchange management: While world trade and export from Developing Countries have been increasing rapidly, Pakistan's exports have been stagnant, except when cotton production is good and price high. There has been no diversification of Pakistan's exports and, under the present policies the prospects are poor. The exchange rate and import duties represent a massive discrimination against their development and diversification. Far from joining the ranks of Asian Tigers, the current economic regime will relegate us to the status of an Asian alley cat.

15. We should significantly reduce import duties, with no more than two or three slabs. Simultaneously, the exchange rate should be floated. The loss in revenue should be compensated through the substitution of excise taxes for import duties. Along with the rehabilitation of the banking sector and general deregulation, we may, thus, gradually move towards export led growth.

16. The current policy of providing exchange guarantees on dollar deposits should be phased out. True, a government in crisis does not have many options. To begin with, there should be no new contracts for exchange rate guarantees. Overtime, the stock of such contracts should be reduced. As the exchange rate is floated, government should meet its foreign exchange needs by buying in the free market. A market for foreign exchange has existed for a long time and floating the currency, by itself, should not lead to increased instability. The critical issue is whether the government can control its fiscal deficit. For, in its absence, nothing works.

17. Education reform: Economic research has established that investment in basic education in developing countries has higher returns than almost any other investment. Pakistan has badly lagged in this area. A substantial pan of resources saved from administrative reform and mobilized from tax reform should be channeled to basic education and improving its quality. All restrictions on private education should be lifted. Over a period of five years we should aim to have in primary schools all children of primary school age.

18. Relations with external lenders: Pakistan's dependence on external funds is heavy. Without reform, this dependence will continue indefinitely, although with little developmental impact. If concerted reform is undertaken, the role of external funds should be to facilitate a transition to an open and liberal economy, with a smaller and, yet, stronger public sector, focusing heavily on education, health and infrastructure. During any transition, our debt service and imports must be maintained and, domestically, the adverse social consequences of a change in the structure of the economy must be alleviated. Any future government should approach the World Bank the I.M.F. and bilateral lenders individually and through the consortium to support such a

program. External official resources would be pooled in support of
d economic reform and money disbursed as Pakistan reaches agreed
kers. A small escrow account should be established with the I.M.F. to
help with unforeseen liquidity crises.

19. This is a tall order. None of this may ever happen. And, who knows, our country may miraculously overcome its difficulties without a trauma. In the meantime, it will be a good idea if Dawn sponsors a debate on the issues I raise here. And, please, let us focus on the issues and not on the supposed motives or right to speak of people like me.

End

Record Removal Notice

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File Title	Barcode No.
James D. Wolfensohn - Chronological File - June 1995 through December 1996	1477082

Document Date	Document Type	
August 20, 1996; July 26, 1996	Notes	

Correspondents / Participants
To: Mr. Wolfensohn
From: Gautam S. Kaji

Subject / Title
Notes from an outside source: Update on South Africa

Exception(s)
Information Provided by Member Countries or Third Parties in Confidence

Additional Comments

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Withdrawn by	Date
Shiri Alon	May 18, 2017

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director, Operations

Tel.: (202) 458-1384
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Facsimile Transmittal Form

DATE: August 19, 1996

No. of Pages: 4
(including this page)

TO: **Mr. James D. Wolfensohn, President**

FAX #: 307-733 9110

Jim,

Attached for your approval is the staff announcement on Russ Cheetham. We plan to distribute this Friday morning. Also, please find an Oxford Analytica write-up on the set up of the new Russian Government which might be of interest, in case you have note seen that.

I will call you later in the morning to brief you on a number of queries you had raised.

OADB today.

Index

I.RUSSIA: New Government

ENT: Prime Minister Viktor Chernomyrdin unveiled his new government yesterday.

SIGNIFICANCE: The shape of the new cabinet presages continuity in economic, foreign and security policies.

ANALYSIS: The new government is slightly slimmer than its predecessor, with the number of federal departments cut from 89 to 66. There will be three first deputy premiers:

-- Aleksei Bolshakov, who retains that rank from the previous cabinet, is to take charge of industrial policy, formerly overseen by Vladimir Kadannikov;

-- Viktor Ilyushin, who has served for a decade as President Boris Yeltsin's chief aide, is to be responsible for social policy; and

-- Vladimir Potanin, president of Oncksimbank and the man credited with having first floated the idea of the shares-for-loans scheme last year, has been given overall responsibility for economic policy.

The deputy premiers include Vladimir Babichev, the government's chief-of-staff; Oleg Davydov, who remains in charge of foreign economic relations; Aleksandr Livshits, hitherto Yeltsin's economic adviser, who now also becomes finance minister; Aleksandr Zaveryukha, who remains the government's agriculture overlord; Oleg Lobov, who has been demoted from first deputy premier, possibly owing to his reputed hardline approach to the Chechen conflict; Vitalii Ignatenko (information); and Valerii Serov.

ere is continuity in other major positions: Economics Minister Yevgenii Yasin, Foreign Minister Yevgenii makov, Interior Minister Anatolii Kulikov and Defence Minister Igor Rodionov remain in post, as do Nationalities Minister Vyacheslav Mikhailov and Justice Minister Valentin Kovalev.

The most prominent victim of the reshuffle is Kadannikov, who failed to make much of a mark after being appointed first deputy premier in January (see OADB, February 1, 1996, I). The conjunction of Kadannikov's removal and Potanin's appointment is symbolically significant: Kadannikov was formerly head of the industrial giant AvtoVAZ, whereas Potanin is chief of one of Russia's most dynamic new commercial banks. Potanin is also the first minister to have substantial experience of work in the Russian financial sector.

Prime Minister Viktor Chernomyrdin and Yeltsin have chosen not to broaden the government's political base by recruiting faction is not represented. Chernomyrdin said that opposition representatives could fill some of the remaining government vacancies, which include one deputy premiership and seven ministries. However, by unveiling his cabinet before making such an offer, Chernomyrdin has indicated that any opposition cooperation with the government is to be on the latter's terms.

Policy. This suggests that Yeltsin and Chernomyrdin are sufficiently confident to govern without making a deal with the opposition. This reduces the likelihood of either policy drift or a retreat from reformist economic policies. Considerable attention will be paid to the social aspects of for putting Ilyushin, one of Yeltsin's closest associates, in charge of social policy. However, the social emphasis is not new, and it is unlikely to lead to reckless overspending.

Kadannikov's removal and Potanin's appointment appear to represent a victory for the government's economic reformers, although Potanin's policy views are not as well known as his business record. Livshits is generally thought to be a more committed liberal than his predecessor as finance minister, Vladimir Panskov, who has become the egoat for the government's revenue problems (see OADB, July 23, 1996, II). However, some of Livshits' tements as Yeltsin's adviser to be a spokesman for industrialists demanding 'support for production', even if this meant compromising stabilisation and reducing pressures for enterprise restructuring.

There is further encouragement for market reformers:

-- the central bank remains in the hands of people with solid reformist credentials, including Chairman Sergei Dubinin and First Deputy Chairman Sergei Aleksashenko;

-- former first deputy premier Anatolii Chubais, now Yeltsin's chief-of-staff, would not stand idly by if economic policy were to shift in an anti-reform direction;

-- a large number of reformers in low-profile but important posts at deputy and first deputy minister level (eg Sergei Vasiliev and Yakov Urinson) are likely to remain in place; and

-- Yasin has recently adopted a higher profile and may play a greater role in the new government.

One remaining question is how Potanin, Livshits and Ilyushin experience.

Power. Politically, the distribution of top cabinet posts is finely balanced. Potanin is reputedly close to Chubais, while Ilyushin's function would appear to be at least partly to operate as the president's man in the cabinet. Babichev is close to Chernomyrdin. Bolshakov, the government's senior 'industrialist' (apart from Chernomyrdin), is to stand in for the premier when the latter is away. Bolshakov does not seem to have been very influential hitherto. This would suggest that he was designated for this role not because he is a powerful presence within the cabinet, but because he is not a threat to Chernomyrdin, or an obvious ally of one of the premier's rivals.

Chubais appears to have built up a strong position in the presidential administration. He has recruited a number of deputies who are close to him politically, and, in some cases, have worked under him before. Moreover, under a presidential directive published in 'Rossiiskie vesti' yesterday, Chubais now has the authority in most instances to determine whether or not draft presidential decrees are ready to be signed; only decrees including direct instructions from Yeltsin are to circumvent this procedure. This power is likely to be especially important as long as Yeltsin is in poor health.

[redacted]shin's departure from the president's office appears to further strengthen Chubais' position. As Ilyushin does not seem to have lost the president's favour, it is difficult to see why he would have wished to leave a Kremlin post in which he functioned as Yeltsin's 'gatekeeper'. It has been suggested that, in addition to acting as Yeltsin's eyes and ears in the new government, Ilyushin hopes to use his new job to position himself for the eventual presidential succession. As a Kremlin aide, he had no opportunity to establish an independent political identity, and relatively little scope for building alliances with other politicians. Ilyushin may now be able to establish a political position which helps him to secure a key post in any new political dispensation.

Security Council chief Aleksandr Lebed appears to be little affected by the cabinet reshuffle, although his position vis-a- vis Chubais and Chernomyrdin has suffered by their apparent success in consolidating their positions. Lebed could find himself isolated if reports of a rift between him and Rodionov

-- whose appointment as defence minister Lebed publicly backed -- are true. Rodionov is reported to be resisting pressure to purge the officers in the defence ministry. Although Rodionov has been a Lebed ally, he must be seen as an independent figure (see OADB, July 22, 1996, I).

The interactions among the major figures running the government, the Security Council apparatus and the presidential administration will depend to a great extent on Yeltsin's health. The better Yeltsin's health, the more likely he is to manage their rivalries, exploiting them to ensure his own control over the executive. However, the spats of recent weeks over such issues as Chechnya highlight the potential for contradictory statements and in-fighting when he is unwell. This is likely to intensify as the succession approaches.

CONCLUSION: The new government may be somewhat more liberal than its predecessors as regards economic [redacted]es, but not dramatically so. Its ability to function effectively will depend largely on how well political rivalries [redacted]in the executive branch are kept in check. This in turn will relate closely to Yeltsin's state of health.

Keywords: EE, Russia, politics, economy, government, opposition, party

The World Bank
Washington, D.C. 20433
U.S.A

JAMES D. WOLFENSOHN
President

August 23, 1996

STAFF ANNOUNCEMENT

Russell J. Cheetham, Vice President for the East Asia and Pacific Region, has informed me of his decision to retire on October 1, 1996, after twenty-seven years of distinguished service with the Bank.

Russ joined as an Economist in 1969 and held a number of senior positions in Operations, spanning East Asia and the Pacific, South Asia, Eastern Europe, and the former Soviet Union. Throughout his career, Russ set and met the highest standards of professional excellence. He is recognized internally and externally as a strong and decisive leader, with clear strategic direction, policy sense and focus on implementation. During his assignment as Director of the Resident Mission in Indonesia in the early 1980's, Russ developed close and trusting relationships with the highest officials. As Director of Europe and Central Asia, Country Department III, he developed the Bank's operational strategy for Russia and other countries of the former Soviet Union and led the design of substantive work programs.

With his promotion to Vice President in 1994, Russ took on an active role in the Bank-wide change efforts. He led one of the initial task forces that shaped the agenda for institutional change, and strengthened management processes in his Region.

Russ will be missed by the many friends, colleagues and clients who have worked with him and have benefited from his balanced judgement and wise counsel, and I will certainly miss his insights into the Region he knows so well. He has made many critically important contributions to development over the years, and has been instrumental in strengthening the Bank as an institution.

On behalf of myself and the senior management team, I would like to thank Russ for everything he has done for our member countries and for the Bank. We wish him and his wife Fay every happiness in Seattle and good luck in his new endeavors.

James D. Wolfensohn

Int-2105
JB

The World Bank
Washington, D.C. 20433
U.S.A.

Chron GK

GAUTAM S. KAJI
Managing Director, Operations

August 14, 1996

Mr. James D. Wolfensohn, President

Jim:

RE: Video - Investing in People

AUG 13 3 52

I am trying not to let the Bank intrude too much upon you, but I did think you might enjoy seeing the attached video "Investing in People", produced by the East Asia and Pacific Region. The production had two main goals: one was to show audiences in part I and part II countries that development in general, and participation in particular can be highly beneficial. The other was to inspire communities in our client countries to take the initiative to improve the quality of their lives.

This production cost the Bank less than $200,000 (Compared to Bank Economic Reports which can cost between $300,000 and $500,000). The video is being produced in eleven languages and is being marketed globally. The attached status report will give you an indication of the interest it has generated. I think you will find it worthwhile to spend a half hour or so viewing the video. We need to use this tool much more actively and more broadly in the Bank.

Attachments

A L - I N - 1 N O T E

DATE: 31-Jul-1996 04:43pm

TO: RUSSELL CHEETHAM (RUSSELL CHEETHAM @A1@WBWASH)

FROM: Graham Barrett, EXTRO (GRAHAM BARRETT)

EXT.: 80344

SUBJECT: Movie dissemination progress report

Russ ---

Here is a breakdown on the dissemination campaign for "Investing in People" so you can gauge what we are getting for our money. Preliminary efforts have yielded good results, with initial audiences expected to run into tens of millions, perhaps hundreds of millions, of viewers.

- The film is to be shown on BBC World's "Earth Reports" series in the fall, reaching an estimated three million of the satellite service's viewers and picking up numerous others with repeats. The series will also be screened in a number of other countries, including Canada with VisionTV, Spain with Televisio Espanola and India with Doordeshan, adding an estimated 10 million viewers.

- The big international German service Deutsche Welle is to screen it in German, Spanish and English to an estimated several million viewers.

- Deutsche Welle's French equivalent is to use an abbreviated version.

- China's national television channel CCTV has agreed to screen it, with many millions of viewers. For extra impact, Li Li, our external affairs officer in Beijing, is marketing it to provincial channels.

- The Television Trust for the Environment is distributing the film to broadcasters in many developing countries as well as to NGOs, governments and universities.

- The film has been adapted for a program in the British-made series "People and the Planet", which is being distributed to channels internationally. An associated magazine of the same name will contain a well-illustrated cover article on our three projects.

- Our marketing effort at the recent Cannes MIP television buyers' show has produced expressions of interest from a number of outlets, including Korea's Dong-A TV and Yongshap TV.

- The Cebu segment of the movie has been singled out for inclusion in an environmental series entitled "Islands", being made by our co-producers North-South Productions for screening on the Discovery Channel, SBS Television in Australia, and Channel 4 in the UK.

- Copies of the film have been, or are being, distributed for general use to numerous individual organizations with an interest in East Asian development

such as the Asia Society, AusAid and Human Rights Watch / Asia. A long list of academic and research institutions is being developed for this purpose, with each receiving a pamphlet and order form.

- The movie is being made available to major distribution houses in the US and Europe such as Filmmakers' Library, Cinema Guild and Film Council for inclusion in the listings to which hundreds of television channels subscribe.

- In addition, with assistance from our film and video unit in EXT, direct pitches will be made to a long list of broadcasters, distributors and resource centers in the US for this and a some other markets.

- For the US general market, Blockbuster Videos is considering our proposal to acquire copies for the "educational" or "documentary" shelves in their many outlets.

- Sub-titled versions in 10 languages, including the major languages of our region, are now complete and being checked for accuracy. With the help of our resident missions and film distribution agents in East Asia, we will work to achieve one of our primary goals, which is to place the movie on the national television channels of all the countries of our region.

- With the help of Francis Colaco and the Singapore Foreign Ministry, Singapore has already screened it in honor of Mr Wolfensohn's recent visit.

- Another primary goal, to make the movie widely available in our borrowing countries as an inspiration to communities, is being piloted in Jakarta, where the Video Resource Center, an NGO, is distributing it to groups, societies and universities. As each language version becomes available, so we will be looking to our resident missions to help identify appropriate means of achieving this kind of dissemination.

--- Graham.

CC:	Nicholas Hope	(NICHOLAS HOPE)
CC:	Marianne Haug	(MARIANNE HAUG)
CC:	Harold W. Messenger	(HAROLD W. MESSENGER)
CC:	JAVAD KHALILZADEH-SHIRAZI	(JAVAD KHALILZADEH-SHIRAZI)
CC:	Michael Walton	(MICHAEL WALTON)
CC:	Robert Voight	(ROBERT VOIGHT)
CC:	Harinder Kohli	(HARINDER KOHLI)
CC:	FRANCIS X. COLACO	(FRANCIS X. COLACO @A1@WBWASH)
CC:	Helen Vazquez	(HELEN VAZQUEZ)

Chron 8/6

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director, Operations

August 14, 1996

Mr. James D. Wolfensohn, President

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CC:	Helen Vazquez	(HELEN VAZQUEZ)

Chron
GK

THE WORLD BANK

[redacted]aging Director, Operations

August 8, 1996

Mr. James D. Wolfensohn

RE: Armeane Choksi's announcement

Jim:

Attached is the announcement for Armeane Choksi. I think it would be appropriate if it went out under your signature.

Gautam

[redacted]

GAUTAM S. KAJI

Sven. Gautam –
If Jim wants to sign this, we can change signature block. She can fax this to him after your review.

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: August 7, 1996

CONFIDENTIAL

TO: Mr. Gautam Kaji

THROUGH: Mr. Sven Sandström

FROM: Dorothy Hamachi Berry

EXTENSION: 39001

SUBJECT: **Staff Announcement - Choksi**

DECLASSIFIED
MAY 17 2017
WBG ARCHIVES

Attached is an announcement to all staff in connection with Armeane Choksi's departure from the Bank. Armeane has cleared the announcement.

I would be grateful for your approval or comments. The final version will be posted in the All-in-One and distributed desk-to-desk on August 15.

Thank you.

Attachment

The World Bank
Washington, D.C. 20433
U.S.A

JAMES D. WOLFENSOHN
President

August 15, 1996

STAFF ANNOUNCEMENT

Having completed over twenty-two years of distinguished service in the Bank, Armeane Choksi, Vice President, Human Capital Development, has indicated that he will be leaving the Bank on November 18, 1996 to pursue a second career in the private sector.

Armeane leaves the Bank with an outstanding record of achievement and leadership. He joined in 1974 as a Young Professional in the Development Economics Department, and held a number of senior positions in the East Asia and Pacific Country Programs Department, the Country Policy Department, and the Latin America and the Caribbean Region. During these years, Armeane gained broad recognition for his dedication to development, the effectiveness of his dialogue with member countries and his attention to portfolio quality.

He was promoted to his current position in 1993, where he spearheaded our efforts to bring analytical rigor to the issues facing the public and the private sectors in the area of human capital development and forged new initiatives to provide operational support and disseminate best practices. He launched a major outreach program to establish partnerships with external stakeholders in areas of critical importance to the Bank. He also led an ambitious, collaborative effort to develop a new vision and statement of purpose for the Bank, and managed and coordinated the preparations for the 50th Anniversary of the Bretton Woods Institutions.

Armeane will be missed by the many friends, colleagues and clients who respect him for his contributions to development over the years. On behalf of the senior management team, I wish him well as he embarks on his second career, and I express my personal regrets that he will not be here to assist us in the years ahead.

James D. Wolfensohn

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THE WORLD BANK

6/28/76

Managing Director, Operations

W. Wolfensohn

Jim:

I really do commend this for your reading.

It will give you a flavor of what can be achieved and some confidence that we have embarked on the right path.

GAUTAM S. KAJI

THE WORLD BANK

6/28/76

Managing Director, Operations

Mr. Wolfensohn

Jim:

This is a great piece of work — Thank you

I really do commend this for your reading.

7/11

It will give you a flavor of what can be achieved and some confidence that we have embarked on the right path.

Gautam

GAUTAM S. KAJI

6/28

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: June 28, 1996

TO: Messrs. Gautam Kaji and Caio Koch-Weser, EXC

FROM: Callisto Madavo and Jean-Louis Sarbib, AFRVP

TENSION: 82856/34946

SUBJECT: **AFR Experience with Fast-Track Projects**

1. The attached memorandum from Mahmood Ayub will be of interest to you. It reviews our experience with a sizable pilot (covering about 20% of our projects during FY96). The Region was able to cut down the processing time of these "fast-track" projects by up to about 50%, while still maintaining quality and a high degree of Borrower participation.

2. We plan to apply the lessons learned from this exercise more generally to our new projects. This should facilitate our achieving within a year or so the service standards, approved by you on June 12 for our main operational products.

Attachments

CC: Messrs./Mmes. Lomax, Salop (EXC); Garg, Sierra (EXCQA); Shihata (LEG); Picciotto (DGO); Alexander (OPR); Okonjo-Iweala (ICD); Cheetham (EAP); Wood (SAS); Linn (ECA); Dervis (MNA); Burki (LAC), Rischard (FPD); AFR RMT

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: June 27, 1996

TO: Messrs. Callisto Madavo and Jean-Louis Sarbib, AFRVP

FROM: Mahmood A. Ayub, AFRSA MAA

TENSION: 33155

SUBJECT: **Striving for Greater Efficiency: Africa Region's Experience with Fast-Track Projects**

1. Among the service standards approved recently by the MDs for our main operational products, two relate to the processing time of Bank loans/credits: elapsed time of 5 months from Appraisal Departure to Board, and of 4 months from Board to Effectiveness. The comparable baseline figures in FY95 for Africa Region were 10.3 months and 7.4 months, respectively.

2. On the face of it, achievement of these standards within a year appears a daunting challenge. However, the Region has demonstrated through the "fast-track" projects pilot during this fiscal year -- a year marked by significant additional activity related to the Renewal Program -- that the new standards are not insurmountable.

Background

3. A few words about the "fast-track" pilot. In May 1995, the SOA's Office selected a dozen projects (over 20% of all projects planned for presentation to the Board in FY96) for rapid processing. The projects are listed in the attached table. The logic of the exercise was that, until procedures were streamlined Bank-wide, further streamlining of Regional procedures would be "tinkering at the margin", and that we could achieve significant speed-up of processing without changes in Operational Procedures. Four criteria were employed to select fast-track projects:

* Strong Borrower commitment to the project;
* Significant up-front work already done (ESW, preparatory work);
* Simple project design;
* Seasoned task manager.

4. It is interesting to note that the initial reaction of many managers to this pilot was rather negative. Most commonly expressed reactions were:

* We run a tight ship and there is no scope for making big gains across the board;
* Quality will suffer;
* Most factors determining speed are outside our control;
* Staff don't like working under pressure.

The Results

5. Of the 12 projects selected for this pilot, 9 have already gone to the Board, with an average elapsed time between Appraisal Departure and Board of only 5.8 months (compared to the Regional average for FY95 of 10.3 months). For projects that have already become effective, the elapsed time between Board and Effectiveness has averaged 4 months (compared to the Regional average for FY95 of 7.4 months).

6. Speed did not necessarily detract from quality. The *Malawi Primary Education Project* and the *Madagascar Social Fund II* were highly praised by reviewers and very well received by the Board members. Similarly the ECON III Report, recently prepared by OPR and OED, on the quality of economic analysis of projects identified the *Côte d'Ivoire Railways Rehabilitation Project* as a best practice example of quantitative sensitivity and risk analysis.

7. Similarly, rapid processing did not preclude significant stakeholder participation and beneficiary consultation. It just meant that the participation activities had to be planned and executed well by the Bank and the Borrower. Indeed five of the projects with very short elapsed time of preparation were also the ones that included significant participation by the Borrower and other stakeholders: *Malawi Primary Education; Uganda Private Sector Competitiveness; Madagascar Agriculture Extension* and *Capacity Building; Congo Privatization and Capacity Building and Madagascar Social Fund II.* For example, the *Uganda Private Sector Competitiveness Project* -- which took only a year from identification to effectiveness -- involved heavy stakeholder participation. A project design workshop with 80 participants from the private and public sectors as well as the donor community was held early in the preparation process. The Borrower set up a Private Sector Task Force (comprising five private and four public sector representatives) which worked closely with the IDA project team. The Task Force visited Washington, D.C. for pre-appraisal and met with over 20 task managers from all parts of the Bank Group who had experience with similar issues in other countries.

Critical Success Factors

8. There was no surprise in the main factors facilitating the preparation of these projects; OED has identified many of these as elements of successful project at entry. They include Borrower commitment; simplicity of project design; solid prior economic, sector and project work; seasoned task team leaders; well-knit project teams; and an X-factor referred to here as the "Hawthorne Effect".

9. **(i) Borrower Commitment and Ownership**: This was a critical factor in facilitating project preparation. Strong borrower commitment in the *Lesotho Road*

Rehabilitation Project meant that agreement on the policy and institutional framework was reached in a short time. In the *Congo Privatization and Capacity Building Project* early involvement and commitment of the Minister of Finance was an important facilitating factor. Strong borrower commitment and ownership was also an important factor in the *Malawi Primary Education Project*, the *Madagascar Social Fund II Project, Madagascar Agriculture Extension Project* and the *Tanzania National Agricultural Extension Project.*

10. **(ii) Simple Project Design, Getting Away from Blue-Printing**: Although not all projects ended up that way, an important selection criterion was simplicity of design. A good example is the *Malawi Primary Education* Project which responded to an education crisis caused by a 68% increase in enrollment in the 1994/95 school year resulting from the new government's policy of eliminating all fees and associated cost of primary education. To avoid a serious decline in the quality of education, the project focused on the most urgently needed activities: construction of new classrooms and related infrastructure; provision of teaching and learning materials, and training of newly recruited teachers. The few project conditions were well-focused and fully discussed with the government. A project preparation facility was used to test out innovations in design and building the capacity of the Ministry. In the case of the *Ghana Public Enterprise and Privatization Project*, a decision was taken early on in project processing not to fine-tune the design excessively. Acknowledging the unrealism of designing with certainty a privatization program over a five year period, detailed plans were prepared for only the first two years. Agreement was reached with the government to prepare detailed plans for the remaining years at the time of the Mid-Term Review.

11. **(iii) Prior Economic, Sector or Project Work**: This greatly facilitated project processing, particularly for projects with elements of the broad sector (SIP) approach. In the case of the *Ghana Public Enterprise and Privatization Project*, this technical assistance (TA) project was a follow-on from a previous TA project. Much of the policy agenda for the privatization component had already been dealt with in the previously approved adjustment operation (PSAC). The existing agreement on policy, and continuity from the previous TA project made this ideal as a fast-track operation. Similarly in the *Madagascar Agricultural Extension Project* and the *Malawi Primary Education Project* sound upstream preparatory work had already been done. In the case of the *Côte d'Ivoire Railway Rehabilitation Project*, significant familiarity with the project had been developed in the 2-year process leading to the concessioning of the rail transport activity in Côte d'Ivoire and Burkina Faso to a private operator. In the case of the *Tanzania National Agricultural Extension Project*, the supervision of the ongoing phase I national extension project laid a solid foundation for this project.

12. **(iv) Experienced Task Team Leaders**: The experience has confirmed the importance of having *seasoned task team leaders* who can make judgments

where they can and cannot effect short cuts in standard procedures without jeopardizing the quality of the final product. Where, as in the case of the *Côte d'Ivoire Railway Rehabilitation Project*, the whole project team was very familiar with both the project and its environment, it is even better.

13. **(v) Well-knit Core Team**: A strength of these operations was the setting up of well-knit core teams, including relevant team members from outside the Region (Legal, Disbursements) at the very early stage of project preparation. In each case, the team agreed, in a meeting chaired by the SOA, on the overall objectives, responsibilities and time-table of the project, together with the steps that would be skipped from regular processing. Support from all relevant units and reviewers was exemplary. Perhaps the only unit from which support was mixed was the Legal Department. In the case of the *Ghana Public Enterprise and Privatization Project*, the support and clearance from Legal Department was outstanding, as was the case with the *Madagascar Agricultural Extension Project*, where negotiations, attended by the lawyer, were carried out expeditiously in the field. On the other hand, the sequential nature of clearances, including at late date, in the case of the *Uganda Private Sector Project*, the *Lesotho Road Rehabilitation Project* and the *Côte d'Ivoire Railway Project* (change of lawyers at a critical point in processing) delayed the projects.

14. **(vi) The "Hawthorne Effect"**: The very label "fast track" was helpful in signaling reviewers to act expeditiously. The project and the time-table were somehow taken more seriously by everybody involved. The sense of urgency, of a challenge, and of success near and clear developed a new "esprit". According to the task manager for the *Guinea National Agricultural Services Project*, "the fact that these projects were followed closely by the Regional Front Office led to the Hawthorne effect: the stimulation to output or accomplishment that results from the mere fact of being under concerned observation". The task manager for the *Congo Privatization and Capacity Building Project* noted: "the 'fast track' label in and of itself greatly reduced the time spent for reviews and clearances without compromising project quality. In fact, I was pleasantly surprised that reviews and clearances were obtained within record time".

Negative Factors

15. Two main factors led to delays in some projects compared to their earlier time-tables: over-optimism in establishing project processing schedules that over-estimated the borrower's capacity to prepare projects; and, in a few cases, budgetary constraints to prepare projects.

16. **(i) Under-Estimating Project Complexity and Risks**: In the case of the Les*otho Road Rehabilitation Project* -- a broad sector investment project (SIP) -- there was an under-estimation of project complexity and of the Borrower's capacity

to process legal and institutional changes which were Board or Effectiveness Conditions. Even in the case of the otherwise speedily prepared *Ghana Public Enterprise and Privatization Project*, the small delay compared to earlier schedule came about mainly because of problems related to the implementation of the new privatization policies and procedures, which delayed the release of the tranche of the previously approved adjustment operation and hence this project. In the case of the *Guinea Agricultural Services Project*, a SIP-like project, the deteriorating country economic situation forced the departmental management to ask for more progress on the reorganization of the MOA, and the downsizing of the proposed investment program. Delays due to Borrower inaction were particularly pronounced in the case of the *Côte d'Ivoire Railway Rehabilitation Project* where the elapsed time between appraisal and Board was affected by:

* delay in effectiveness of the concession agreement, a condition of negotiations (resulting in a 2-month delay);
* delay in start of negotiations at the request of the Ivorian authorities;
* delay in Board presentation due to the country's payment arrears.

17. Effectiveness of the Côte d'Ivoire project took six months after Board, even though there were no conditions of substance. In retrospect, the main problem has been that the patrimony corporations through which the money had been channeled at the Government's request "seem to revel in their capacity to block the private operator -- rather than have as their main objective to get the rail transport activity moving again".

18. Probably the worst example of under-estimating project complexity and risk was the *Madagascar Public Sector Capacity Building Project*. With the proposed SAC delayed, this project was supposed to act as the instrument for continued dialogue on a wide range of substantive issues (civil service reform, decentralization, judicial reform, etc.) dealing with several ministries. Even in the most stable political environment, this would have been a daunting agenda. In the politically unstable environment of Madagascar (tensions between the President and the Prime Minister, leading to a national referendum on who selects the Prime Minister and two changes of government) this was a virtually impossible challenge.

19. The question arises: Why did the other two fast-track projects for Madagascar go through comfortably to the Board while this one languished? The explanation is that the other two projects were (i) follow-up operations; (ii) dealt with single entities; and (iii) served clear constituencies -- farmers and the poor. This project, on the other hand, dealt with (i) issues very close to the center of political maneuvering; and (ii) several ministries. Clearly the task team significantly under-estimated the risks involved in the project.

20. By contrast, the *Malawi Primary Education Project* recognized the weak implementation capacity of the government and opted for the use of the private sector for implementation. Similarly in the case of the *Congo Privatization and Capacity Building Project*, the fast-track procedure was very effective in allowing the Bank to support a government determined to exploit a window of opportunity to introduce key reforms.

21. **Administrative Budget Constraints**: Three of the task managers indicated that because of the low level of resources allocated for project preparation, a great deal of the task managers' time was wasted in arguing for more resources for travel and subsistence or in seeking trust funds and consultants, many of whom were not too familiar with Bank procedures and policies.

Conclusion

22. It can be argued that what made the processing of these projects easy was their simple design, significant up-front work and full Borrower commitment to the project. But these are precisely the pre-requisites that we need to ensure if we are to meet our service standards, and, more importantly, respond to our clients' concern that we are too slow in delivering our products. All incentives and signals for "Christmas tree" projects and over-designing should be removed.

23. The review also confirmed that speed of processing and quality of project are not mutually exclusive. It is too early to know the results on the ground, but if the speed of effectiveness is an indicator of successful project outcome (and OPR studies indicate that this is the case), the probability of success is high. There will always be projects which by their nature will take longer to prepare: it is not surprising that the two projects with the longest elapsed time between Appraisal and Board (the *Guinea and Lesotho projects*) were broad sector investment projects (SIPs). However, it is also important to note that the average elapsed time of 5.8 months includes these two projects.

24. Finally, we should ensure that the lessons learned from this exercise are applied in our future operations, not only in terms of process simplification but also managerial behavior, project design, task team leader selection, etc.

Attachment

CC: Messrs./Mmes. S. Weissman, M. Pulgar-Vidal, B. Mitchell, C. Trapman, D. Ba, Q. Khan, S. Migliorisi, P. Ngomba, E. Hubert, L. Morrell, B. Becq, F. Schorosch, P. Bermingham

STATUS OF FAST TRACK OPERATIONS

(updated 6/3/96)

Dpt	ID	Project	Project Cost	Ln/Cr Amount	Appraisal Date	Board Date		Appraisal to Board	Task Manager
			(US$ mn)	(US$ mn)				(# of mos.)	
FY96									
AF3	1563	Madagascar Agricultural Extension	39.0	25.2	1/7/95	5/23/95	A	4.5	C. Trapman
AF3	568	Congo Privatization & Capacity Bldg	12.0	9.0	5/26/95	9/5/95	A	3.4	D. Ba
AF3	35669	Madagascar Social Fund II	45.0	40.0	6/15/95	9/14/95	A	3.0	Q. Khan
AF4	40115	Cote d'Ivoire Railway Rehab.	48.0	20.0	4/18/95	11/28/95	A	7.5	B. Mitchell
AF2	35634	Uganda Private Sector Investment	20.2	12.3	6/30/95	12/14/95	A	5.6	S. Migliorisi
AF1	42305	Malawi Primary Education	25.2	22.5	9/20/95	1/25/96	A	4.2	M. Wodajo
AF5	1081	Guinea Agricultural Services II	90.5	35.0	6/28/95	4/2/96	A	9.3	F. Schorosch
AF1	1403	Lesotho Road Rehab. & Maintenance	126.0	40.0	6/30/95	5/9/96	A	10.5	B. Becq
AF4	42516	Ghana Public Enterprise & Privatization	30.0	20.6	2/17/96	6/11/96	A	3.8	Bermingham
			435.9	**224.6**					
slipped to FY97									
AF2	2753	Tanzania Agric. Extension	34.4	31.1	9/25/95	7/11/96		9.8	E. Quisumbing
AF3	40019	Madagascar Capacity Bldg.	14.9	13.8	6/6/95	9/3/96		13.1	P. Demangel
AF1	46	Angola Urban Water & Sanitation	109.0	70.0	4/9/96	2/25/97		11.2	L. Morrell
			158.3	**114.9**					

THE WORLD BANK

Managing Director, Operations

6/28

A. Wolfensohn

Jim

Pakistan update

GAUTAM S. KAJI

THE WORLD BANK GROUP

ROUTING SLIP	DATE: June 28, 1996

NAME	ROOM. NO.
Mr. Kaji (EXC)	
cc: Messrs./Mmes. Wood (SASVP); Nishimizu (SA1DR); Ali (SA1AN);	
Lindbaek (CEXVP); Iida (MIGEX); Frank (EXC);	
S. Ahmed (SA1PK)	

	URGENT		PER YOUR REQUEST
	FOR COMMENT		PER OUR CONVERSATION
	FOR ACTION		NOTE AND FILE
	FOR APPROVAL/CLEARANCE	✓	FOR INFORMATION
	FOR SIGNATURE		PREPARE REPLY
	NOTE AND CIRCULATE		NOTE AND RETURN

RE:
PAKISTAN -- Briefing Note -- STRICTLY CONFIDENTIAL

REMARKS:

Attached please find today's briefing note on Pakistan for Mr. Wolfensohn.

FROM	ROOM NO.	EXTENSION
Christopher Hall, Acting Chief, SA1CO	T 8-107	3-4418

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Pakistan Update
June 28, 1996

STRICTLY CONFIDENTIAL

Daily Events

- Markets were closed today. However, we have more information regarding the sharp rise in official reserves on June 26 from $1319 million to $1601 million (7.5 weeks of imports): $150 million came from a floating rate note (terms: 4.5 years, 3-month US$ LIBOR plus 2% for the first 18 months); $90 million in short-term borrowing; and $42 million inflows into foreign currency deposits.

- An explosive device blew up last night near a bus terminal between Islamabad and Rawalpindi. Local press reports suggest that seven persons died and 60 were injured. Security forces are investigating.

Preparation of Contingency Plans

(1) Analysis of Potential Foreign Exchange Crisis

- As noted yesterday, part of the demand for foreign exchange in the coming months is debt service to the World Bank Group. FY97 debt service to IBRD and IDA totals $558 million. During July to September 1996, Pakistan owes IBRD/IDA $139 million. Pakistan now represents 3% of IBRD's total portfolio (debt outstanding and disbursed (DOD) from IBRD is $2.9 billion; IDA DOD is $3.3 billion).

- For IFC, total A-Loan DOD is $370 million, B-Loans $179 million, and equity and quasi-equity $157 million, giving a total DOD of $706 million . Without the B-Loans this is 6.8% of IFC's portfolio. Pakistan's B-Loans represent 4% of total B-Loans. Debt service for A Loans is about $70 million during FY97. During July to September 1996, debt service on A Loans is about $16 million. Data on B Loans are still being assembled by IFC. However, debt servicing is likely to be lower than for the A Loans as most B Loans are still disbursing.

(2) Analysis of Banking System Vulnerability and Potential Responses

- There are two IBRD partial risk guarantees for power projects in Pakistan: for Hub and Uch at $240 million and $75 million, respectively. Under Hub, a few political events and changes of law could trigger the guarantee now, but for all practical purposes foreign exchange rationing in the near term would not result in calling the

guarantee. Given the timing of debt service payments, which start a year or so from now, lack of foreign exchange will only be relevant after January 1998. For Uch, the relevant period is even later than that as the project is only beginning.

- For the remainder of the private power program, the GOP has guaranteed the availability of foreign exchange for servicing debt of $2.8 billion. As interest is being capitalized, debt service for these loans is reportedly less than $20 million in 1997. Hence for all practical purposes government guarantees would likely not be called even if there are foreign exchange shortages in the near term. Rationing of foreign exchange would only be relevant beginning in 1998 when debt service due jumps to $410 million.

- Furthermore, the government -- through the state-owned oil company (PSO) -- is responsible for supplying fuel oil to the new private power plants. If PSO fails to provide that supply, it is liable to pay damages -- in foreign currency -- of $370 million in 1997 rising to $1.1 billion by 2001. Our best assessment at this time is that this situation would not come to pass: PSO would likely first cut off fuel oil supply to WAPDA, the government's power utility, before incurring these damage payments to the private producers.

(3) Collaborative Work with the IMF

- Gautam Kaji and Michael Bruno will meet with Stan Fischer today at 4:30 p.m. to compare notes on our assessment of risks and possible responses.

prepared by Chris Hall and Shahrokh Fardoust, SA1CO
approved by Ridwan Ali , Acting Director SA1DR

The World Bank
Washington, D.C. 20433
U.S.A

GAUTAM S. KAJI
Managing Director
Operations

June 28, 1996

James D. Wolfensohn:

Re: Business Standards and Process Simplification

Jim:

Josie has passed on your question to me. As regards client surveys, we have formed a small group which will include Mark Malloch-Brown and others (who have had a role in designing the ad hoc surveys conducted to date) to design an approach and thereafter develop a vehicle. Once we have done that, we will come to the Executive Committee, because there is a need to harmonize the surveys with those that IFC and MIGA have been carrying out.

Our discussion with the Operational Vice Presidents was very productive. As you will see from the attached notes that Caio and I have sent out to all operational staff today, that the Process Simplification and Standards have been introduced in all Regions with effect from July 1. We will take stock at the end of this calendar year to monitor progress.

The World Bank
Washington, D.C. 20433
U.S.A

GAUTAM S. KAJI
Managing Director
Operations

CAIO KOCH-WESER
Managing Director
Operations

June 27, 1996

Note to All Staff, Operations

GETTING RESULTS ON THE GROUND: AN UPDATE

As the fiscal year draws to a close, we wanted to thank and say congratulations to everyone in Operations on a job well done. It has been a busy and eventful year. Thanks to your hard work and dedication, we can all feel proud of the end-year results. In our recent visits to projects in the field--in Bosnia, Bulgaria, Kenya, Jamaica, the Philippines, Tanzania, and Turkey--we have been impressed with the work you are doing and with the progress we are making on the ground, where it counts.

In our March 15 note **"Getting Results On The Ground",** sent shortly after we had taken up our new assignments, we had outlined ongoing work in a number of areas related to improving client focus and responsiveness, the quality of our services, and how to free up more "space" for you to focus on results rather than process. The purpose of this note is to give you an update on how far, together, we have come in these areas.

(i) Responding to Clients

New CAS: To help enhance client focus in all our operational work, first, you have made considerable progress in making the CAS much more strategic and the centerpiece of our operational work: designed in closer consultation with our clients and partners, with tailor-made programs to address country needs, linked to the performance of our existing portfolio, and focused on the country compact and monitorable objectives.

Country Management: A second area of enhanced client focus is the experimentation in evolving new approaches to country management. New country directors positions have been introduced in Africa, Gaza, and Mexico to focus country directors on one or a few countries so they can get closer to the clients and develop more strategic as well as demand-driven programs, and to free them from the plethora of managerial tasks which currently over-burden them.

Focus on Field Offices: A third area where we are making progress is the location of work. The Mexico Department is moving to the field--to be closer to our clients. The West Bank and Gaza and Sri Lanka country managers are already resident in the countries. More generally, our resident missions throughout are taking on added responsibility to ensure better, more cost effective, and faster services to our clients. We have also made some progress in integrating our excellent local staff. Next year, we will be preoccupied by the question of how to further strengthen our field presence, including by assigning more responsibilities to the local staff.

New Business Standards: Finally, we are beginning to set a faster pace of operational response. To strengthen this further, effective July 1, a new set of "business standards" will be established in Operations (see Attachment). Their introduction demonstrates our determination to be as responsive to our clients as possible, and to measure our performance. These standards will also help us to define a bottom line in judging the effectiveness of our internal processes and, at the same time, help us to gauge client satisfaction. We view their introduction as a substantial step forward in helping us to take our performance to a higher level. These standards are to be met by all regions within 12 months.

(ii) Improving Quality

Portfolio Quality: We also notice steady progress in the drive to improve the quality of our portfolio. We are pleased to note that each Region now has an action plan in place at the project, sector and country level. We have raised country portfolio reviews to a higher level of attention with our clients--including, on occasion, Mr. Wolfensohn himself taking up issues with a country's leadership. Also, to support your portfolio management efforts, we have endeavored during our own missions to visit projects under implementation and discuss portfolio issues. Please do let us know when Mr. Wolfensohn's or our involvement would help resolve outstanding issues.

While still early days, the ongoing review of the overall performance of our portfolio under implementation suggests a modest improvement over last year. We are hopeful that the upcoming OED review of recently completed projects will show a drop in the "unsuccessful" rate. And, we are on track to eliminate the ICR backlog by end-FY97. All this is very promising, but there is still a long way to go.

Other specific steps taken to improve portfolio quality include:

- *Actions are underway to improve quality-at-entry--improving economic analysis of new operations, enhancing stakeholder participation, and defining performance indicators--and as of July 1 all operations will be expected to meet the agreed standards in these areas;*

- *The Quality Assurance Group (QAG) is now up and running, and its recent workshops have focused on what we can learn together and how it can best support the task teams to apply lessons of experience elsewhere;*

Non-lending Services: The Regions are introducing mechanisms for self-evaluating the quality and testing methods to measure the impact on non-lending services. This is timely given their increasing importance in our CAS and their potential value, including exposing our clients to relevant experiences in other countries and informing public debate.

Professional Excellence: The overall quality of our work will be further enhanced by the ongoing exercise to establish "networks" aimed at ensuring our professional expertise, building cross-sectoral and cross-country linkages, and leveraging our global knowledge base. Above all, the networks should help to restore the Bank's professional edge.

(iii) Freeing Up Space

In our March 15 note, we made a commitment to take steps to reduce bureaucratic burdens and free up "space" so that you could focus more on the client and on results, rather than internal process. Our emphasis, therefore, has been on delegating as much responsibility as possible to the department level, minimizing the time spent on repetitious and sequential reviews, and reducing paperwork. As of July 1, a new set of **simplified business processes** will come into effect which include:

- *Department directors having the authority to approve and authorize Board submission (after guidance from the RVP, MD and/or OC at the concept stage) for some 80 percent of investment and non-lending products;*
- *Front-loading of Bank-wide reviews, including senior management involvement;*
- *Only two mandatory reviews for all major operational products; and*
- *Much more selective involvement of the OC and RLC in overall operational decisions; and elimination of duplication between them.*

We are sharing with you, separately, new Bank-wide guidelines for streamlined procedures for portfolio management, investment lending operations, and non-lending services. In addition to these steps, there is now the real prospect of simplified project documentation--which the Executive Directors have agreed to test on a pilot basis.

* * * *

As you can see from the above, we have made much progress over the past six months in our central objective of helping you deliver high-quality services to our clients. Thanks to your efforts we are off to a good start. We have also laid the foundation for further progress in FY97. In the coming year, we will continue to look for additional ways of getting inward looking processes out of your way and in helping you to improve the strategic and professional quality of all Bank products.

As always, your feedback will be essential in continuing the process of change and reform. We appreciate the feedback we have received in our meetings with staff over the period; we intend to continue this mode of interaction with you--to keep us in touch and to help us to identify opportunities for reaching a higher plane of development effectiveness.

We wish you and your families a safe and enjoyable summer.

Gautam S. Kaji

Caio Koch-Weser

Attachment

SERVICE STANDARDS FOR MAIN OPERATIONAL PRODUCTS

Product and Indicator	Bank-wide Benchmarks a/	
	90% cases within	80% cases within
Portfolio Management		
Send letter to Govt. & Issue SPN report after return of mission (incl. final Form 590 in system)	10 working days b/	
Form 590 update frequency	At least twice a year (100%)	
Time in problem project status c/	12 months (100%)	
Cancellation due to lack of Effectiveness		12 months after Board
Comments on bidding docs and evaluation reports d/:		
(a) under mandatory review limits	7 working days b/	
(b) subject to RPA review	10 working days b/ (eg. 3 wds additional for RPA)	
(c) subject to OPRC review	17 working days b/ (eg. 10 wds additional for OPRC)	
Reply to procurement complaints:		
(a) Within clearance authority of RPA	5 working days b/	
(b) Within clearance authority of OPRPR	10 working days b/	
Processing of withdrawal applications:		
(a) Approval	5 working days	
(b) Disbursement	5 working days	
Comments on Audit Reports:		
(a) Acknowledgment of non-qualified reports		15 working days
(b) Review of and response to qualified reports		45 working days
Lending		
Elapsed time from:		
(a) Appraisal Departure - Board		5 months
(b) Board - Effectiveness		4 months
(c) Implementation period (new entrants)		
Adjustment operations		2 years
Investment operations		5 years
Non-Lending Services		
Elapsed time main mission departure - delivery to client:		
Major Economic and Sector Reports		5 months e/
Length of reports:		
(a) Regular reports		25 pages
(b) "Reference" reports		40 pages
Other		
Return phone calls	24 hours	
Reply to: (a) letters; (b) faxes/telexes	10 working days; 5 working days	

Note:

a/ The proposed benchmarks are of two types: service standards to be met or beat in at least 90% of cases effective immediately; and those to be met by at least 80% of cases in each region by the end of FY97.

b/ If more time is required to resolve issues/reach decisions, an acknowledgment should be sent outlining the timeframe within which a substantive reply can be expected.

c/ A project should not remain in problem status without corrective actions agreed and acted upon by the Borrower.

d/ Mandatory RPA review of contracts for goods > $7.5M ($5M in AFR) and for works >$15M ($10M in AFR). OPRC reviews contracts for goods and works >$25M and for consultants >$10M.

e/ Up to four weeks more where translation of documents is necessary.

The World Bank
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GAUTAM S. KAJI
Managing Director
Operations

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June 27, 1996

Jim,

PAKISTAN

1. Attached are briefing notes on Pakistan. They summarize the current situation, the risks, and issues for the Bank.

2. In brief, here is the situation on the ground:

- The financial situation is highly vulnerable; net reserves are negative to the tune of over $7 billion. This means that in a crunch, a moratorium on meeting foreign exchange liabilities will be inevitable.
- This vulnerability notwithstanding, the markets are not showing particular jitters at the moment; this probably reflects the fact that indeed Pakistan has long pursued a strategy of sailing close to the wind and premature cries of "wolf" have been heard all too often in the past. The situation is simmering, but in our judgement unlikely to reach a boiling point, without a major political event such as an assassination or act of terrorism. Such acts cannot be ruled out in Pakistan.
- Indeed, it is the domestic political vulnerabilities that are by far the most worrying; and these are closely intertwined with the financial situation. Many of the holders of foreign currency deposits are resident Pakistanis; in the event of a moratorium, they will not be able to withdraw their funds — with possible explosive domestic political implications. Hence, a crisis could quickly snowball, and a military intervention cannot be ruled out.
- We are keeping a very close watch on the situation — monitoring it daily — and will come back to you immediately if something breaks.

3. In the meantime, we are looking more closely into our plans for dealing with a crisis should it erupt.

- We have communicated our concerns at the highest levels in Pakistan, and have offered our help in their preparation of emergency plans.
- We are in continuous contact with the IMF on this — both Management and staff. Michael Bruno and I will be meeting with Stanley Fisher tomorrow,

both to convey our worries, which seem greater than the Fund's, and to iron out a joint position.

- We are also discussing with IFC and MIGA, to make sure that we have a joint position on seniority of creditors in the event of a moratorium.
- Internally, we are looking across units to make sure that we are prepared on the financial sector, which is likely to take the direct hit in the event of a crisis.

4. Finally, I should stress that we have been very circumspect on all this; we do not want our concerns to trigger the very crisis we are worried about.

Attachments

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Pakistan Brief
June 27, 1996

STRICTLY CONFIDENTIAL

Daily Events

- FY96/97 budget approved by Parliament with reportedly a number of small modifications. However, we expect further changes to be made as a result of ongoing meetings with the business community. (Details in attached note from ResRep.)

- Gross reserves increased today from $1.3 to $1.6 billion. We think much of this increase is due to receipt of a 54-month floating rate bond issued through Citibank and some short-term borrowing.

- The Karachi stock market index (KSE-100) recovered from 1707 to 1717. The free market rupee/US dollar exchange rate remained stable at 37.85, with the premium over the official exchange rate at 7.8% compared to 9% two weeks ago.

Preparation of Contingency Plans

(1) Analysis of Potential Foreign Exchange Crisis

- Potential Demand for Foreign Exchange.

  Drawing on detailed work done by the Fund mission just back from Islamabad, we estimate that trade and contractual payments will create a net demand for foreign exchange of $400 to $500 million in the July-September quarter. The Fund staff projections assume this will be financed without further reserve drawdown, by FDI, portfolio investments and some commercial borrowing. We are skeptical about these inflows, although some will occur in association with implementation of power sector projects.

  We also see a high risk of net reductions in foreign currency deposits (FCDs). (Fund projections assume no change.) Analysis of the composition of those deposits indicates to us that about $5 to $6 billion of the $8 billion FCDs are neither used as collateral for domestic borrowing nor held by friendly governments in the Gulf Region. Of this total, something on the order of $3 to $4 billion is estimated (by us and the Fund) to fall due within the next three months, though they could be rolled over as has been the case in the past.

- A portion of the net demand for foreign exchange is due to debt service scheduled for the Bank Group and B loan participants. Details on these amounts are being assembled and will be reported tomorrow. Once we have these, we will raise any questions that need to be addressed concerning the assertion of seniority for payments to the Bank Group and/or its co-financing partners.

(2) Analysis of Banking System Vulnerability and Potential Responses

- A team is being formed included Marilou Uy and Joe Pernia (SAS), David Scott (FSD) and Roy Karaoglan (IFC) to develop an assessment of the risks in the banking system and to evaluate alternative responses. A progress report will be available over the next several days.

- A worst case scenario being developed assumes a loss of confidence leading to a loss of reserves of around $ 400 million mainly due to FCD withdrawals, triggering a substantial increase in interest rates, a devaluation and imposition of capital controls (e.g., freezing of FCDs).

- Alternative responses will include various options, including whole or partial privatization of Habib and other public banks.

(3) Collaborative Work with the IMF

- Gautam Kaji will see Stan Fischer tomorrow to compare notes on our assessment of risks and possible responses.

- The Country Department in the Fund (Paul Chabrier) intends to field a mission in early August to try to complete the second review of the Stand-by. Chabrier has already relayed his disappointment with the budget to the authorities via the Fund's Res. Rep.

- Irrespective of the outcome of the Stand-by discussions, we have agreed with the Fund to work over the next few weeks to develop a more fundamental reform package that could be discussed with key sources of external finance (e.g. the Japanese) as a prelude to a high level exchange with the Pakistan authorities either before or at the Annual Meetings.

prepared by Shahrokh Fardoust and Chris Hall, SA1CO
approved by Joe Wood, SASVP

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A1L - I N - 1 N O T E

DATE: 27-Jun-1996 07:02

TO: RIDWAN ALI (RIDWAN ALI@A1@WBHQB)

FROM: Sadiq Ahmed, SA1PK (SADIQ AHMED@A1@PAKSTN)

EXT.: 200

SUBJECT: Pakistan Budget Update: Strictly Confidential

Ridwan:

Below is an update on the new Budget. I am also taking this opportunity to give a flavour of the debate currently underway in the country on the new Budget, market reaction to the budget so far, and some comments on the downside risks.

A. Parliamentary Approval of the Budget:

The FY96/97 Budget was approved by the Parliament yesterday with a number of relatively small modifications. However, some further changes in the Budget will be required to accomodate agreements between the Government and the FPCCI reached last night. The main agreement which will have significant revenue implications is the reduction in the sales tax rate for six exportable items from the proposed 18% to 10%. These items are: cotton textiles, garments, leather and leather goods, surgical items, sports goods, and carpets. Although a firm estimate of revenue loss from this change is not available, this could result in a shortfall of about Rs. 3-4 billion over the draft budget proposal of Rs. 41 billion of measures.

To compensate for this and the likely shortfall of revenues from their targeted level due to implementation difficulties, my information suggests that the Ministry of Finance (MOF) has kept in reserve the possibility of expenditure cut-backs of Rs. 8-10 billion. A part of this will probably come from reduction of PSDP, which has been budgeted at about Rs.105 billion, some Rs. 18 billion higher than what is likely to be achieved in this fiscal year. Although we are rightly concerned about the continuing squeeze on PSDP as a source of fiscal adjustment, our latest PSDP review suggests that there is scope for some cutbacks in a number of doubtful programs. I understand that the tactics being adopted by the MOF is to keep this expenditure reduction option up their sleeves for negotiation when the Standby discussion with the IMF is resumed later in July. The rationale for this strategy is that expenditures can always be cut without Parliament's approval, but getting revenue measures approved is a difficult challenge.

B. Political Economy of the Budget:

As indicated in my previous communications, the opposition to the budget has been pervasive and across the board (including from a large part of the bureaucracy and segments of the PPP). Some of the resentment has already been manifested in the form of strikes and agitation. A number of other such activities are planned for July by opposition as well as by groups of civil society. In this very difficult environment, I must give credit to Jafarey and the PM for holding the fort and providing only relatively small concessions so far (i.e. agreement with FPCCI as noted above). Also, the PM is reported to be unhappy with the Punjab government for failing to implement a tax on agricultural incomes. As a result, my sources in the Punjab government inform me that deliberations are still underway to see if the tax on farm incomes could be introduced this year. If Punjab indeed complies with this, then all four provinces will have introduced some form of agricultural income tax. Please note though that, even in the best of circumstances, actual revenue yield is likely to be small in the first few years.

I have had discussions with a range of people, including politicians, civil servants, business, household, donors, and NGOs to understand better the opposition to the budget. The list of concerns are as follows:

o Budget is too deflationary and will kill economic activity, especially manufacturing and export. One of the strongest proponent of this hypothesis is Senator Sartaj Aziz, but it is also widely shared by private sector and local economists.

o Budget is inequitable because it comes down too heavily on those who comply, while a large segment (particularly landlords) get away without paying their due share.

o Implementation of the tax measures will lead to further corruption, given the weak tax administration.

o Heavy reliance on indirect taxes will lead to higher inflation.

o Government expenditures are excessive; so fiscal correction should happen through reduction in spending, especially non-core PSDP.

o Why get so much bogged down with an arbitrary figure of budget deficit of 4% of GDP? Instead why not focus on structural reforms, especially in the trade area, and let the budget deficit be in the 5% range?

o Budget is dictated by the IMF and World Bank and has

no relevance to the needs of the people.

I think the concerns on the adverse effects of the budget on economic activity and equity are genuine and need a bit more thinking and analysis by the Bank to better inform our fiscal policy dialogue with GOP.

C. Market Reaction to the Budget:

So far the reaction has been rather muted. On the positive side, there has been an exchange rate correction as rumors of an impending devaluation associated with the Budget did not materialize. For example, the free market rate fell from a peak of Rs 38.3/US$ on June 11 to Rs. 37.8/US$ currently. Foreign exchange reserves have been stable at around US$ 1.3 billion over the past two weeks or so. Stock markets have shown some small movements, but have not shown any signs of instability. For example, the KSE index has hovered around 1700 over the last two weeks. The UBL situation also seems to have stabilised (at least temporarily) and I am not aware of any further reports of deposit outflow. Overall, my sense is that the financial situation is stable although very tight.

Background Note for Pakistan Brainstorming
June 25, 1996

Short-term concerns.

- Credibility. As seen last year, without a strong macroeconomic framework in place, Pakistan's balance of payments could deteriorate quickly and result in a foreign exchange crisis and banking difficulties. So far, domestic reaction to the FY97 budget package announced two weeks ago, which proposes to reduce the budget deficit from 5.6% of GDP to 4%, has been negative. The stock market has dropped 2% in reaction to tax measures underpinning the GOP's budget. Yesterday clashes between Islamic radical protesters and police resulted in several deaths and injuries in Rawalpindi. Further protests are planned, and most businesses have gone along with the strike called by the main opposition group. The government may not have the ability to pass the budget in the National Assembly and is likely to have difficulty implementing it even if it does pass.
- External sector. The 1995/96 current account deficit is estimated at 6% of GDP (up from the targeted 4.6%), which is too high. Imports have grown due to requirements of energy investments and to relatively strong domestic demand. Export growth has been sluggish due to lack of a functioning duty drawback scheme, but likely mostly due to erosion of external competitiveness. The real effective exchange rate has appreciated by 5% since the October 1995 devaluation. Now the premium between the market and official exchange rates has reached 8% as compared to 6% in recent months and 3-4% in the past.
- Reserves / Foreign Currency Deposits. Yet while devaluation is needed, the authorities are very concerned about the substantial costs the government would incur. To prop reserves, the GOP has been encouraging additional foreign currency deposits (FCDs) through higher interest rates and has been borrowing short-term. Total short-term liabilities now total $9 billion, with FCDs at $7.7 billion (as compared to total reserves of $1.375 billion or 6.5-7 weeks of imports), of which a substantial amount will mature over the next 6 months. As the State Bank requires 100% surrender of the FCDs but then provides full foreign exchange cover, a devaluation of the rupee in excess of 4.75% (which is the State Bank's fee for the cover) will have significant quasi-fiscal and monetary costs.
- Financial sector. In this regard we are concerned about the fragility of the financial sector. While the foreign exchange cover for FCDs needs to be eliminated to mitigate short-term quasi-fiscal costs, taking that action, or increasing the State Bank's fee rapidly, might actually precipitate both banking and foreign exchange crises. In addition, privatization is necessary to improve bank governance and improve the banks' loan portfolios (non-performing loans are now about 40% of outstanding advances). Sound privatization now, however, will be difficult since the government does not have the resources to "clean up" the balance sheets of the two major banks (Habib and UBL). If confidence in these banks deteriorates further, good private bankers may be difficult to attract without a major bank restructuring.
- Operational concerns. IBRD DOD to Pakistan totals $4.3 billion, representing 3% of the IBRD portfolio. There are two outstanding partial risk guarantees to Pakistan: the Hub and Uch guarantees are for $250 and $75 million, respectively. IDA DOD to Pakistan totals $4.2 billion. MIGA's portfolio stands at $160 million (7.5% of the total portfolio). Total commitments now held by IFC are $592 million.
- Possible actions. In addition to voicing our concerns, which Mieko Nishimizu has done through a detailed letter to the government on the health of the financial sector and most recently in her meeting with the prime minister last week, there is little the World Bank can do of a preventive nature. Nonetheless, there are three immediate operational actions we are planning:
    - providing assistance to the State Bank on foreign exchange management, with a view to reducing dependence on FCDs in a phased manner;

- assisting the State Bank to improve its risk analysis of banks and early warning systems; and
- supporting bank restructuring/privatization, beginning with a workshop planned for next month on cleaning up banks' portfolios and improving bank supervision.

Longer-term development issues.

Although Pakistan is making progress in some areas (e.g., enterprise privatization, private energy investments), shorter-term problems are arresting movement on longer-term development issues. In addition, without greater fiscal space, the authorities will not have the resources to address the longer term challenges. The primary longer term challenges are:

- Public finances. In addition to the level of resource mobilization, greater attention needs to be paid to equity issues. As it now stands, the proposed FY97 budget relies in large part for new revenues on GST tax rate increases, which fall too heavily on the poor, rather than on broadening the tax base. Implementing the agricultural income tax in all provinces and raising the rate and yield of the agricultural wealth tax are needed. A new National Finance Commission Award needs to be finalized which will strengthen fiscal responsibility at the provincial level as well as strengthen autonomy and fiscal responsibility at provincial level.
- Trade policies. The new budget maintains the maximum import tariff at 65%, rather than continuing its reduction to 50-55% as previously planned, and retains the 10% regulatory duty introduced last fall. The program of tariff reductions needs to be continued in order to limit distortions and thus improve incentives for economic diversification and boost exports. While some exemptions and concessions are being reduced, phasing out all exemptions and concessions would also promote a more neutral and equitable tax structure.
- Financial sector. Full privatization of all state owned banks is an important long term structural reform. But while prudent privatization requires that the state-owned banks be solvent prior to sale, as noted above the fiscal cost of such restructuring is a potential issue. Prudential regulations and the State Bank's supervisory capacity need to be strengthened. Interest rate policies need to be rationalized to avoid disintermediation, and concessional and directed lending needs to be eliminated.
- Sustainability of government services. While progress has been made in expanding social services in Pakistan, there is now a need to broaden the focus to include improving quality and cost-effectiveness and ensuring financial sustainability. The second Social Action Program, now being developed, will be directed toward this issue. More needs to be done in agriculture where growth and diversification away from cotton requires greater liberalized input and output markets, decentralization of irrigation management and user charges for water to promote equity, and improved land markets and agricultural services.
- Power policies. Work is still required to fully put in place effective regulatory frameworks for privatized and new private investors in energy and infrastructure. Electricity tariff cross-subsidies need to be reduced (prices for industrial users are too high while agricultural and consumer users pay too little), and domestic petroleum and related product price adjustments in accordance to changes in border prices need to be continued.

THE WORLD BANK GROUP
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FACSIMILE COVER SHEET AND MESSAGE

DATE: June 25, 1996 **NO. OF PAGES:** 3 (including cover sheet) **MESSAGE NO.:**

TO: **Mr. Gautam Kaji** **FAX NO.:** **522-3399**
Title: Managing Director
Organization: World Bank
City/Country: Washington DC}

FROM: **Lorene Yap** **FAX NO.:**
Title: Chief Telephone:
Dept/Div: SA1CO Dept./Div. No.:
Room No.:

SUBJECT:

MESSAGE:

Attached is a brief for our 11:00 meeting on Pakistan.

Transmission authorized by: authorization

If you experience any problem in receiving this transmission, inform the sender at the telephone or fax no. listed above.

JUN 25 '96 09:45AM

Background Note for Pakistan Brainstorming
June 25, 1996

A number of concerns have arisen over the near-term situation in Pakistan. The following briefly summarizes some of these concerns.

- Credibility. As seen last year, without a strong macroeconomic framework in place, Pakistan's BOP could deteriorate quickly. So far, domestic reaction to the FY97 budget has been negative. The stock market has dropped 2% in reaction to the budget, and there have been clashes between Islamic radical protesters and police resulting in deaths and injuries. Most businesses are going along with the strike called by the opposition. The government may not be able to pass the budget, or may have difficulty implementing it even if it does pass.
- External sector. The current account deficit at 6% of GDP is too high. Imports are growing strongly, but export growth has been sluggish. The real effective exchange rate has appreciated by 5% since the October 1995 devaluation, and further devaluation is required. Now the premium between the market and official exchange rates has reached 8% as compared to 6% in recent months and 3-4% in the past.
- Reserves / Foreign Currency Deposits. There will be substantial costs to devaluation. The GOP has been encouraging foreign currency deposits (FCDs) and has been borrowing short-term. Total short-term liabilities now total $9 billion, with FCDs at $7.7 billion (as compared to total reserves of $1.375 billion or 6.5-7 weeks of imports). A devaluation of the rupee will have significant quasi-fiscal and monetary costs as the State Bank provides full foreign exchange cover for the FCDs.
- Financial sector. Pakistan's financial sector is fragile. While the foreign exchange cover for FCDs needs to be eliminated, taking that action might actually precipitate both banking and foreign exchange crises.
- Bank Group exposure. IBRD DOD to Pakistan totals $4.3 billion, representing 3% of the IBRD portfolio. There are two outstanding partial risk guarantees to Pakistan: the Hub and Uch guarantees are for $250 and $75 million, respectively. IDA DOD to Pakistan totals $4.2 billion. MIGA's portfolio stands at $160 million (7.5% of the total portfolio). Total commitments now held by IFC are $592 million.
- Possible actions. Our advice to the government is that the best short-term action would be to deal with the fundamentals. We have recently written a detailed letter to the government on the health of the financial sector, and Mieko Nishimizu expressed our concerns in her meeting with the prime minister last week. In addition, we are planning the following:
    - providing assistance to the State Bank on:
        - crisis management -- to give the State Bank an understanding of how other countries dealt with crises
        - foreign exchange management, with a view to reducing dependence on FCDs in a phased manner
        - installation of an early warning system
        - banking supervision
        - privatization of the banking system, including cleaning up banks' portfolios and improving bank supervision.
- Worst case scenario. We see there could be a run on FCDs of about $500 million -- in addition to a run on the private commercial banks, which could spill-over to other commercial banks. This crisis might also affect the Bank's guarantees. In addition, there would be balance of payments financing requirement for the quarter of an additional $400 million (including about $250 million multilateral debt service falling due in 3rd quarter of 1996).
- In the short run and provided there is a good macro program in place, we could use FSDIP to provide fast-disbursing support of $150 million (first tranche). In addition, there would be an IMF Stand-by

JUN 25 '96 09:46AM

tranche release of about $50 million, and private inflows of $450 million. The remainder could be financed by a reserve drawdowns and/or possible help from friendly Middle Eastern countries. In the longer term, if more is needed the Bank could provide an export development loan with $200-250 million disbursements in the first tranche (including cofinancing). There would also need to be additional IMF financing and rescheduling of bilateral debt.

- I N - 1 N O T E

DATE: 18-Jun-1996 09:49am

TO: Gautam S. Kaji (GAUTAM KAJI)

FROM: D. Joseph Wood, SASVP (JOE WOOD)

EXT.: 81429

SUBJECT: **Pakistan**

The attached summary of Mieko's meeting with Benazir Bhutto is interesting. It appears that Mieko was able to deliver the key messages on macro vulnerability without provoking a strong adverse reaction. In fact, the PM urged MIeko to continue the dialogue on her next visit.

Meanwhile, the Fund has decided against sending a joint letter until after the next Fund mission in August. Their goal is to avoid getting into short-term stabilization issues until the staff have analyzed the budget in detail and evaluated the first steps toward implementation. While this is understandable, I remain worried that the budget alone will not suffice to convince the markets that Pakistan is now on the road to resolving its external imbalance.

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1 - I N - 1 N O T E

DATE: 18-Jun-1996 04:05am EST

TO: ASIA ISC FILES (ASIA ISC FILES@A1@WBHQB)

FROM: Sadiq Ahmed, SA1PK (SADIQ AHMED@A1@PAKSTN)

EXT.: 200

SUBJECT: **Mieko Nishimizu's Meeting With Prime Minister Benazir Bhutto: Confidential**

Mieko Nishimizu and I met Prime Minister Benazir Bhutto on Sunday, June 16 at her Parliamentary office in Islamabad. Other GOP officials present were: Ms. Shahnaz Wazir Ali (PM's special assistant for social sector) and Messrs V.A. Jafarey (Advisor Finance), Shahid Hasan Khan (PM's special assistant for economic sectors), Javad Talat (Secretary EAD), Mian Tayyab (Secretary Finance) and Ashfaq Mahmood (Secretary Water and Power).

The meeting lasted for an hour and occurred in a warm, cordial, and informal atmosphere and in the form of a dialogue. The PM was very gracious, attentive and liberal in the use of her time, despite frequent reminders by her aides about her next engagement. Following the meeting, Mr. Talat commented that this was the best meeting he had attended with the PM.

A summary of the discussion follows.

A. Issues Raised by The PM

SAP: The PM started by thanking Mieko for her letter of Apri 17, 1996 summarizing Mieko's impressions of progress with Pakistan's social sector program (SAP) based on her immersion visit in February-March, 1996. The PM reiterated her strong commitment to SAP. She noted that despite progress many challenges remained, especially ensuring better quality and financial sustainability. These aspects will need to be emphasized in SAPP2. She said that she has instructed GOP officials to be vigilant and to visit schools to ensure that there are no ghost teachers, that books are available, and that school facilities are actually being used. She went on to recount a pleasant experience with a surprise visit to a school in Lahore and agreed with Mieko that surprise visits are the best ones. The PM endorsed the positive role of community participation in the social sector and the need to encourage this further. She thanked the Bank for assistance on the SAP and looked forward to continued support on SAP implementation.

Power sector: The PM pointed out that electricity prices

have been raised substantially over the past few years. She then went on to explain the present difficulties being faced by GOP on power pricing due to the interplay of private power agreements and WAPDA's inefficiencies. She said that GOP was taking a number of steps to reduce WAPDA's inefficiencies, while also moving ahead with privatization of electricity distribution and corporatization of WAPDA. She hoped that the Bank would take note of these changes and support GOP in developing an appropriate power pricing strategy during this transition period.

Other operational issues: She inquired about progress with resolving the issues related to the Karachi Water Supply Project and the proposed National Drainage Project.

B. Mieko's Response and Issues Raised

SAP: Mieko complimented the PM for her strong leadership in promoting the SAP. She noted that SAP was already having a noticeable impact. For example, more and more girls are attending school in Pakistan now. She agreed fully with the PM's view that SAPP2 should focus on ensuring better quality and financial sustainability. She appreciated the PM's interest in strengthening community participation and emphasized the important role of NGOs and private sector. Mieko also noted the need to avoid expansion of SAP to other activities (e.g. agriculture). The PM agreed and clarified that GOP is working on a plan to ensure the implementation of agriculture income taxes (a provincial subject), with a provision that the bulk of these resources will be spent on improving irrigation, drainage and other agriculture services. This is a separate exercise and not part of SAP.

Power sector: Mieko responded that she is fully aware of the transition issues in the power sector and reassured the PM that the Bank team is working closely with Ashfaq Mahmood to develop a proper approach to electricity pricing during this transition phase. She complimented the PM for GOP's energy policy for private investment, which is a model for other countries. She also complimented the PM for placing emphasis on putting strong managers in key public agencies and enterprises, such as WAPDA, to run them on professional basis. The PM expressed her appreciation for this support.

Other portfolio issues: GOP officials explained that these issues are being discussed with the Bank. Mieko, however, emphasized the need to build consensus and ownership before moving ahead with the proposed reform of the irrigation sector envisaged under the National Drainage Project. She observed that the reform will alter the course of the nation for the next 100 years, and investing sufficient time for such consultations now will give high returns.

Macroeconomic issues: Mieko stated that the Bank has not

yet completed its analysis of the new 1996/97 GOP Budget. She regrets, therefore, that she cannot share its views. Having seen various measures, however, she noted that the real challenge lies in its implementation to ensure outcome as planned on both revenue mobilization and expenditure control. She advised the PM that credible macro policy implementation deserves her utmost personal focus. In this context, she drew the PM's attention to three macroeconomic issues that seem to have become Pakistan's "Achilles' Heels":

o Exports are not growing as rapidly as necessary to meet Pakistan's BOP requirements;

o fiscal deficits remain large and are being financed by short-term borrowings. As a result, short-term foreign exchange liabilities have reached US$8.9 billions as compared with official reserves of a little over US$1.0 billion.

o The financial sector is very fragile due to the large volume of non-performing loans.

As a result of the large uncovered short-term foreign exchange liabilities, Pakistan's BOP is very vulnerable to any kind of shock. This in turn could lead to a banking crisis, given the fragile health of the financial sector. Mieko further explained that her contacts with international market watchers indicate that they have full knowledge of these risks and are closely watching Pakistan's macroeconomic management. They also perceive that there is a lack of adequate coordination in the management of fiscal, monetary and exchange rate policies in Pakistan. Unfortunately, Pakistan's credibility in international financial markets is weak in view of the country's past record. In this environment, there is an urgent need for strong teamwork in macroeconomic management. In particular, the PM's strong leadership in coalescing all policy instruments at GOP's disposal to promote exports, as if on a war footing, would be greatly beneficial.

The PM noted these points with great concern and agreed that the downside risks are worrisome. She requested Bank technical assistance to support the implementation of tax reforms in the new Budget. She also requested that the Resident Mission give briefing to her on the state of the economy on a monthly basis. In closing, she thanked Mieko for her inputs and invited her to visit again. She asked Mieko to convey her warm greetings to Mr. Wolfensohn and noted that she looks forward to welcoming him in Pakistan.

CC: JOE WOOD (JOE WOOD@A1@WBHQB)
CC: ROBERT S. DRYSDALE (ROBERT S. DRYSDALE@A1@WBHQB)
CC: RUI COUTINHO (RUI COUTINHO@A1@WBHQB)

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- I N - 1 N O T E

DATE: 20-Jun-1996 08:32am

TO: Gautam S. Kaji (GAUTAM KAJI)

FROM: D. Joseph Wood, SASVP (JOE WOOD)

EXT.: 81429

SUBJECT: **Pakistan Budget**

The attached note supplements what you have probably already read in press reports or Oxford Analytica.

I would underscore two of the points made in the attachment. First, the underestimate of the cost to the budget of further exchange rate adjustment (and potential increases in domestic interest rates) is potentially very serious. Second, the scope available to Pakistan to take corrective action is now severely constrained. They have already built into the budget more revenues than they can likely achieve, and the expenditure side remains dominated by non-development expenditures, particularly on defense and interest.

It looks to me that the budget has been designed to limit direct increases in prices to the consumers (e.g. wheat subsidy; inaction on petrol), although much of the sales tax increase will presumably be passed on to the consumer.

CC: Rui Coutinho (RUI COUTINHO)

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World Bank/IFC/MIGA
OFFICE MEMORANDUM

DATE: June 19, 1996 08:23pm EST

TO: D. Joseph Wood (JOE WOOD)

FROM: Shahrokh Fardoust, SA1CO (SHAHROKH FARDOUST)

EXT.: 33049

SUBJECT: **Pakistan -- FY97 Budget: A Quick Analysis**
CONFIDENTIAL [Pls. Keep the Distribution Restricted]

1. This note, which is prepared jointly with Antoinette Sayeh, is based on our quick analysis of the budget, on a summary we have received from Bill Byrd, and the discussions we have had with the IMF staff. The resident mission is preparing a more detailed analysis.

Summary Assessment

2. The budget as presented to the National Assembly (June 13) broadly conforms to the agreements reached between the Government and the recent IMF mission. In particular, the targeted budget deficit is 4% of GDP and the revenue effort includes a significant broadening of the tax base for the General Sales Tax (GST) as well as a reduction in the scope or elimination of some of the tax and import tariff exemptions and concessions. However, the deficit reduction package relies much more on revenue increases -- and less on expenditure control -- making it potentially more difficult to implement and less credible. Moreover, according to the budget, trade policy reform has been postponed.

3. The budget suffers from two major weaknesses, which also represent deviations from the agreed budget with the Fund: i) structurally weak on the expenditure side; and ii) over-dependence on tax rate increases, which could well result in political problems for the Government and jeopardize full implementation of the budget.

4. Given the high likelihood of a significant devaluation of the rupee (which has only partially been reflected in the budget), there will be important changes in the structure of the budget and the size of the government's borrowing requirements -- especially if one takes account of the quasi-fiscal costs that would be brought about by the effect of a significant devaluation of the rupee on the central bank's balance sheet.

Revenues

5. Revenues will approach 18.6% of GDP and tax measures total close to Rs 40 billion (compared to 18.2% and Rs 31.3 billion,

respectively, agreed with the Fund). The GST accounts for more than 60% of the tax package (more than double that envisaged by the Fund), relying on both base broadening (yield of Rs 12.3 billion) and increases in rates (yield of Rs 13.5 billion). The latter was not envisaged in the Fund agreement. The budget does not include the recommended new excise on gasoline (about Rs 2.5 billion), nor the Rs 5 billion expected from increasing retail petroleum prices.

6. However, all of the agreed structural measures are included in the budget, i.e. generalization of the GST to the import and manufacturing stages; removal of some exemptions and concessions from customs duties and income tax; and an increase in the rate of agricultural wealth tax per Productivity Index Unit (PIU) to Rs 400, with reduction of exemptions in the tax base. As expected, the abolition of the 10% regulatory duty (introduced in October 1995) and reduction of the 65% maximum tariff have been postponed, although the budget includes downward adjustments in some tariff rates on raw materials and capital goods.

7. The GST will be extended to the import and manufacturing stage with three non-zero rates of 5%, 18% (raised from 15%), and 23% (raised from 20%). Rather than further broadening coverage of the GST to raise additional revenues (i.e. by removing exemptions for sugar and edible oil and reducing the scope coverage of the 5% rate), the Government has opted instead for rate increases.

8. However, the expected GST yields may prove overly optimistic due to delays in putting in place the administrative infrastructure for collecting it, and the strong resistance expected from the business community -- where anger is already building up over postponement of the abolition of the regulatory duty -- and the opposition groups. Tactically, the Government may be counting on subsequent introduction of a new excise on gas and on an increase in retail petroleum prices to make up for shortfalls in GST revenue.

Expenditures

9. The expenditure package envisages an overall increase of Rs 1 billion compared to the baseline estimated by the Fund mission, rather than the Rs 9 billion reduction agreed. However, structural measures on the expenditure side include slightly reducing defense spending as a share of GDP compared to this year's expected outturn (from 5.3% to 5.2% of GDP) and increasing the overall spending on SAP to 2.5% of GDP. Budgetary development expenditures, at Rs 104.8 billion (4.1% of GDP), are higher than agreed with the Fund. But, according to the recently completed Bank report on the FY97 Public Sector Development Program (PSDP), the budgetary allocation for the "core investment program", at Rs 38.8 billion, falls short of the recommended level by about Rs 6 billion.

10. There appears to be an underestimation of domestic interest payments by some Rs 4.5 billion. This may reflect the unrealistic expectation that domestic interest rates can be kept at current levels, despite the programmed substantial tightening of monetary policy. On the other hand, subsidies are budgeted at more than double the 1995/96 allocation, reflecting mainly the sharp increase of international prices of wheat (a major import item) and the Government's concern about its adverse impact on the population. (The wheat subsidy is budgeted to rise to Rs 5.4 billion compared to Rs 10 million in 1995/96.) The Government has also not been able to reduce some grants significantly (including to Pakistan Railways) and has expanded others. For example, the Pakistan "Bait-ul-Mal" (which is an inadequately targeted social safety net program and includes a food subsidy scheme and an individual financial assistance program) has been more than tripled to Rs 1 billion.

11. Finally, it should be noted that the direct grant from the Federal Government to the provinces on account of SAP, which was budgeted at Rs 7 billion in 1995/96, has been eliminated in this budget. The provincial governments are expected to fill the financing gap by allocating 25% of the additional tax revenues accruing to them from the announced measures (through the revenue sharing arrangement) to the SAP. The Bank does not have a problem with this as long as SAP expenditures remain fully funded.

Summary Table for 1996/97 Fiscal Operations
(billion of Rs)

	IMF May Mission		Budget, 6/96
	no measure	measure	measure
Total Revenues	428.2	31.3	40.8
Tax Revenues	336.5	31.3	40.8
GST	55.7	10.4a/	25.8
Customs	97.1	7.1	7.6
Excise duty	55.0	7.0	2.9
Surcharges	28.9	5.0	0 b/
Inc.,prof.,prop.	85.7	0.8	2.5
Others	14.1	1.0	1.0
Impr.tax adm.	0	0	1.0
Non-tax Revenues	77.6	0	0
Use of Pr.Proceeds	14.0	0	0
Total Expenditures	569.4	- 9.0	+1.0
Current	471.7	-9.0	-6.0
Federal	351.9	-9.0	-6.0
Defence	134.3	-2.9	-2.9
Interest payment	146.1	0	-4.8 c/
Subsidies	3.5	0	+4.7
Grants to Ent. & local govt.	14.8	-4.4	-0.8
Other	53.4 d/	-1.7	0
Provinces	119.6	0	-2.2 e/
Development	97.7	0	7.0
Fiscal Deficit (narrow)	-141.2	- 101.0	- 101.2

a/ Includes Rs 1.1 billion from effect of extension of customs base on GST revenues.
b/ While there are no new measures on surcharges, the budget estimates of gas surcharge revenue are Rs 2.6 billion lower than the Fund's.
c/ Mainly under-estimation of interest payments on domestic debt.
d/ Includes general administration, law and order, economic services, social services, and the residual "unallocable" category; the Fund measure pertains to the latter category.
e/ This is not reflected in the budget, but provincial current expenditures will have to decline by Rs 2.2 billion over the Fund's baseline estimate in order to facilitate funding of the National Drainage Program.

Sources: IMF Mission Tables (May 23, 1996); RMP's Preliminary Note on 1996/97 Federal Budget (June 13, 1996); Federal Budget in Brief, 1996/97.

CC:	Robert S. Drysdale	(ROBERT S. DRYSDALE)
CC:	Rui Coutinho	(RUI COUTINHO)
CC:	Ridwan Ali (cleared w/)	(RIDWAN ALI)
CC:	Lorene Yap	(LORENE YAP)
CC:	John Wall	(JOHN WALL)
CC:	Mieko Nishimizu (o/r)	(MIEKO NISHIMIZU)
CC:	Marilou Uy	(MARILOU UY)
CC:	Per Ljung	(PER LJUNG)
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THE WORLD BANK

Managing Director, Operations

Jim:

The attached is a much better statement on why we could not receive prepayment penalties. I recommend you sign it. I had already told Bobby that you would be replying a little late as you wanted to fully understand our policy and rationale

6/13

GAUTAM S. KAJI

THE WORLD BANK/IFC/MIGA

Office Memorandum

DATE: June 13, 1996

TO: Mr. James D. Wolfensohn

FROM: Gary L. Perlin, TREVP

EXT.: 89111

SUBJECT: **PHILIPPINES: Request for Waiver of Prepayment Penalty**

Jim:

You asked Gautam about the proposed response to Secretary de Ocampo regarding his request for a waiver of the prepayment penalty on a package of fixed-rate loans. Your specific questions were: (1) **is it fair?** and (2) **does it make sense?**

Is it fair? The Bank has not waived the prepayment penalty for any borrower selectively prepaying its higher-yielding loans since the premium was formulated and approved by the Board in 1988. Indonesia paid a premium of $6.5 million earlier this year to prepay a package of loans ($244 million @ 11.42%) similar to those which Philippines intends to prepay (about $250 million @ 10.37%), for which the indicative penalty is $5.9 million. Russ Cheetham and I agree that this fact alone would make it *unfair* to waive the penalty for Philippines.

Does it make sense? I presume that your question relates not to our practice of charging prepayment penalties for above market-rate loans, but to the rather complex formulation included in IBRD loan contracts. The penalty is not calculated in reference to market rates (as is typically the case in yield maintenance agreements), and is applied only when the borrower is selectively prepaying higher-yielding loans *and* their overall book is not substantially in excess of the average IBRD loan rate. This makes sense in view of the cooperative nature of the Bank, where prepayment by one country adversely affects all others.

A simpler draft is attached which reflects the above. It also points out that refinancing would still make sense after paying the premium. If Philippines can refinance the loans, then the penalty should not stand in their way. As for the competition, ADB tells me that they routinely waive penalties for those countries who will continue to borrow; given their more limited range of clients, they might not have a choice. I believe it is better to compete by aligning our instruments and practices as closely as possible to those in the market.

Attachment

cc: Messrs./Mmes. Kaji, Cheetham, Shivakumar, Haug, Cox, Opper, Nayak, Ramboyong, Bhargava

The World Bank
Washington, D.C. 20433
U.S.A.

JAMES D. WOLFENSOHN
President

June 13, 1996

Hon. Roberto F. de Ocampo
Secretary
Department of Finance
Central Bank, Roxas Boulevard
Manila, Philippines

Dear Secretary de Ocampo:

Thank you for your letter dated May 20, 1996, advising me of your intention to prepay some of your outstanding obligations to the Bank and reiterating your request for a waiver of the prepayment premium.

I am afraid the substance of my response cannot differ from that contained in the letter to you from Mr. Shivakumar dated May 17, 1996. The reason is that -- to be fair to all its borrowing members -- the Bank applies without exception the policy set by our Executive Directors in 1988 regarding prepayment premiums with respect to loans carrying rates above the average rate of a country's loans. Since premiums are calculated with reference to Bank lending rates rather than to prevailing market benchmarks, however, it is still possible that the present value of savings which would be generated by refinancing higher-cost Bank loans would outweigh the premium. We believe this to be the case with the package of loans you propose to repay.

You are no doubt aware that I have proposed to the Board for their consideration later this month a substantial set of modifications to the terms of Bank loans. This includes choice of currency and interest rate bases for all loans approved after July 1, 1996, and options to convert outstanding currency pool loans soon thereafter. If borrowers choose, their loan terms can closely track market benchmarks. While this does not address the treatment of the loans you intend to prepay, it should greatly help in the future management of your liabilities.

I am truly sorry -- but extend my best wishes,

Sincerely yours,

James D. Wolfensohn

cl.w./ & cc: Messrs./Mmes: Haug (Actg. VP, EAP); Perlin (TREVP); Nayak (FPIFP); Ramboyong (LOALA).

bcc: Messrs./Mmes.: Kaji (EXC); Cheetham o/r (EAPVP); Shivakumar (Actg. Director, EA1); Cox, Dhar, Khan (EA1CO); Bhargava (EA1PL)
Asia Information Center

EXC Ref: 09052

THE WORLD BANK GROUP

ROUTING SLIP	DATE: June 7, 1996

NAME	ROOM. NO.
Mr. James D. Wolfensohn	
cc: Ms. Rachel Lomax (3 copies)	

	URGENT		PER YOUR REQUEST
	FOR COMMENT		PER OUR CONVERSATION
	FOR ACTION		NOTE AND FILE
	FOR APPROVAL/CLEARANCE	✠	FOR INFORMATION
	FOR SIGNATURE		PREPARE REPLY
	NOTE AND CIRCULATE		NOTE AND RETURN

RE:
Briefing - Country Audits of Project Procurement and Execution

REMARKS:

FROM	ROOM NO.	EXTENSION
Gautam S. Kaji	D10-065	81384

BRIEFING FOR MR. WOLFENSOHN

COUNTRY AUDITS OF PROJECT PROCUREMENT AND EXECUTION

June 7, 1996
Myrna Alexander, OPR

COUNTRY AUDITS OF PROJECT PROCUREMENT AND EXECUTION

Introduction

As part of a more concerted effort to address issues of corruption in the context of Bank-financed operations, we propose to engage an independent party to conduct audits of procurement activities in ongoing projects.

Purpose

These audits are intended to:

- act as a wake-up call for the Bank's management, staff and borrowers
- create a deterrent for those involved in procurement decision-making and oversight
- stimulate corrective actions.

Target Countries and Projects

The countries to be audited are being selected from the list of major borrowers (those with at least $ 1 billion in outstanding commitments and/or at least 20 active projects--see attached list). The intention is to cover all regions--with one or two countries audited in each region.

To start, we have selected three countries--**Poland, Pakistan and Kenya.** For each country, we have selected at random a number of projects to be audited. The list is attached. The auditors will select the contracts to be examined.

Approach

The approach being taken is patterned after a similar exercise which was done on national procurement under Bank-financed projects in Indonesia. The audits will:

- be a surprise to staff and borrowers
- cover all aspects and types of procurement, including those matters under the Bank's responsibility
- focus on a sample of about 15 percent of the ongoing projects in the selected countries
- include price comparisons and physical inspections of completed works/equipment.

Work Program

The auditor's work has been divided into three phases, as set out in the terms of reference (see attached). Most of the work will be done in the field, at the level of the project implementation agency.

Timing

Each country audit is expected to take about three months, followed by report preparation. The three audits being done first will be staggered: we expect the initial audit findings for Kenya and Poland to be ready by mid-September and the audit findings for Pakistan by early-November (see attached schedule).

The Auditor

We have selected the company *Societe Generale de Surveillance* (SGS) to undertake the first three audits. This is a Swiss company with an excellent reputation for such audits; it did the audit in Indonesia; and it has an active business in pre-shipment inspection. It was selected on a sole-source basis.

Costs

We will complete negotiation of the contract with SGS this week. The work for the three audits is estimated to cost about $ 845,000.

Future Developments

Depending on how successful the first three audits are, we expect to continue the program and cover at least three other countries in FY 97. Based on these experiences, we may decide to make such audits a regular feature of the Bank's internal audit program.

Element of Surprise

Thus far, (i) the fact that the audits will take place; (ii) the selection of the countries and the projects to be audited; and (iii) the work plan are know to only central staff in charge of procurement and related legal matters and staff of SGS.

Senior managers and staff involved in the projects to be audited will be informed at the start of the auditors work about June 17th. You could make a more general announcement at that point. We are presently working with Mark Malloch Brown on the announcement.

Country Notification

The Bank has the right of access to information and to inspect projects sites, without restriction. Therefore, there is no substantive objection that a country could make to the conduct of the audit.

Nevertheless, we should expect some country resistance and questions from staff. This may be in the form of delays in gaining access to procurement documents which could slow down the work of the auditors.

Moreover, the actual selection of the countries may give the appearance of *a priori suspicion of corruption.* That was not one of the criteria for selecting the countries. However, in the case of Kenya, there are allegations of corruption generally in the country and specifically in one of the projects.

We will need to allay these country concerns and to reiterate that the audit is a new process of accountability that the Bank has adopted in order to assure itself of the integrity and effectiveness of our procurement processes.

This will be done by communications from the Managing Directors to the respective borrowers and Executive Directors about one week prior to the start of the field work in the respective countries.

M.Alexander
June 7, 1996

Attachments

1. *List of FY95 Large Borrowers*
2. *List of Projects Selected for Country Audits*
3. *Auditors' Terms of Reference*
4. *List of Possible Questions*
5. *Auditors' Work Program*

FY95

LARGE BORROWERS*

	No. of Projects	Commitments (US$m)
China	107	17,208
India	92	16,185
Mexico	41	10,190
Brazil	65	7,791
Pakistan	47	5,200
Russia	19	4,616
Argentina	23	4,392
Turkey	27	3,390
Poland	20	3,378
Philippines	29	3,268
Nigeria	35	2,713
Morocco	28	2,660
Algeria	24	2,591
Bangladesh	28	2,408
Colombia	22	2,114
Ghana	41	1,683
Tunisia	24	1,550
Uganda	28	1,343
Mozambique	24	1,193
Kenya	24	1,075

*> $1 billion in commitments
or> 20 loans

COUNTRY AUDITS

Name of Project	Loan/Credit No.	Project Code
KENYA		
• Population III	C1904	1302
• Population IV	C2110	1312
• 3rd Nairobi Water Supply	C2060	1340
• Mombasa Water II Eng.		
PAKISTAN		
• Private Sector Energy	L-2982	10313
• Transmission Extension and Reinforcement Project	L3147	10345
• Rural Electrification	C2078/L3148	10344
• Domestic Energy Resources Dev. Project	L3500	10401
• Punjab Middle Schooling Project	C2354	10394
• Social Action Program	C2593	10456
• Third Primary Education Project	C1821	10280
POLAND		
• Telcoms	L3319	8574
• Heat Supply Restruct. *	L3377, L3378, L3379, L3381, L3382, L3383	8576
• Forestry Development	L3641	8610
• Katowice Heat Supply	L3809	8614
• Roads	L35640	8599

* Two of six districts to be selected.

cd/thirdpty2

Record Removal Notice

The World Bank Group Archives & Records Management

File Title	Barcode No.
James D. Wolfensohn - Chronological File - June 1995 through December 1996	1477082

Document Date	Document Type	
N/A	Terms of Reference	

Correspondents / Participants

Subject / Title
Country Audits of Project Execution by Third Party

Exception(s)
Corporate Administrative Matters

Additional Comments

The item(s) identified above has/have been removed in accordance with The World Bank Policy on Access to Information or other disclosure policies of the World Bank Group.

Withdrawn by	Date
Shiri Alon	May 18, 2017

THE WORLD BANK

Managing Director, Operations

May 29, 1996

Note to Mr. James D. Wolfensohn

Jim,

Attached is a Côte d'Ivoire update after the IMF technical mission.

GAUTAM S. KAJI

DECLASSIFIED
MAY 17 2017
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CONFIDENTIAL CÔTE D'IVOIRE

Update on the latest evolution on the alleged Customs Fraud.

Background

1. On April 23, the Bank and Fund offices in Abidjan were anonymously sent a set of documents showing the alleged mechanisms of high level customs fraud in Côte d'Ivoire. The evidence seemed damaging enough to be brought to the management's attention. After several high level meetings between the IMF, the Bank and the Ivorian authorities (including a meeting of Mr. Camdessus with the Prime Minister on May 13, meetings of Mr. Lafourcade with the Ivorian Minister of Finance on May 10 and with the Prime Minister on May 14), and several exchanges of letters between the IMF and Côte d'Ivoire, the Ivorian authorities requested on May 18th a technical mission of the IMF to analyze unexplained statistical discrepancies in the customs receipts. It is obvious that the alleged fraud might provide a good explanation for some of these discrepancies.

2. This IMF fact finding mission led by Mr. François has returned from Côte d'Ivoire Sunday, May 26 after five days of intensive work. On mission in Côte d'Ivoire during the period from May 19 to 24, I met with IMF representatives: I first met with Messrs. Mr. Van der Bogarde (the IMF Res Rep in Abidjan) and Christian Brachet on the 20th; with JL Sarbib and Shigeo Katsu we had a formal meeting on the 22nd with Mr. Christian François whom I met again on the 23rd. I had a final debriefing meeting with Mr. François in Washington on May 27.

Results of the IMF mission

3. During this technical mission, the IMF has been able to obtain full cooperation from the Ivorian authorities to try to identify the nature and reasons of the statistical discrepancies in the customs revenues. Although it was neither in this mission's terms of reference nor in its capacity to investigate the alleged customs fraud, the main conclusion that can be drawn is that some of the alleged accusations of the anonymous file are likely to be true. However, many informations contained in this file appear to be inaccurate and the figures are grossly overestimated for fraud regarding petroleum products, but underestimated for the fraud on cocoa. The global likely frauds should be in the range of CFAF 30 billions (about $ 60 m instead of $ 114 to 172 m as estimated in the file). The Ivorian authorities have now acknowledged the seriousness of the situation, which they have started to address, and they have provided assurance to the IMF mission that adequate measures will be implemented and carefully monitored by the IMF to (i) immediately stop the major frauds, and (ii) fully investigate the alleged cases and start legal action. On this basis, the IMF mission intends to recommend to the IMF management to proceed with the ESAF which might be presented to the Board on June 12 or 14.

4. As presented in the anonymous file, the fraud was supposed to cover petroleum products ($ 86 m), temporary tax exemption (without clear estimate), coffee and cocoa ($28 m from Jan to July 1995). The IMF's mission main assessment is the following:

Petroleum products

a) Customs fraud on petroleum products earmarked for re-export to neighboring countries has been important for years in Côte d'Ivoire. This issue had already been identified by the local authorities which had acted to try to stop it. However they acknowledge that remedial action has been inadequate thus far. This fraud which, according to the IMF mission, may have amounted in 1995 to about CFAF 5 to 6 bl ($ 10 to 12 m) is likely to also involve Malian and Burkinabe "maffias" well connected in their own countries and in Côte d'Ivoire. According to the Fund mission, Côte d'Ivoire had already complained about the unwillingness from the Malian and Burkinabe authorities to accept delivery of petroleum products by rail in Bouake, which would have reduced incentive for fraud. Côte d'Ivoire is now putting renewed pressure on its neighbors. The Ivorian government agreed with the IMF to implement a series of technical measures which should reduce considerably these fraudulent practices. Given the international dimension of this fraud the IMF recommends that a subregional coordination of customs authorities be established, at least at the level of the UEMOA, to help solve this issue. Petroleum trade to landlocked countries can indeed easily shift from Abidjan to other ports of the west African coast.

Temporary customs exemption.

b) The temporary customs exemption fraud is not new and has most likely been going on for a long period. This issue was already monitored by the Ivorian authorities but with insufficient attention. According to the IMF mission, fraud may amount to about CFAF 5 to 7 or 8 bl ($ 10 to 16 m) on a yearly basis. It mainly involves manufacturing companies, with good connections among mid level customs officials. The authorities agreed with the IMF mission to increase their control in this sector, particularly control of the warehouses, to accelerate issuance of related legal texts, restrict eligibility to firms with good credentials, and have pledged to sanction involved customs officials .In this context a precise time table of remedial actions has been defined.

Coffee

c) The IMF has been able to receive satisfactory answers on coffee exports statistical discrepancies regarding DUS taxation. Discrepancies between Caistab and customs data are apparently due to different statistical treatment and present findings have proved inconclusive. The mission's judgment is that even if there has been some fraud, the relevant amounts should not be significant. As low quality coffee (black beans) is not submitted to DUS taxation, the authorities recognized that a potential

loophole exist through reclassification of high quality coffee into low grade. To close this potential loophole the authorities have agreed that all coffee exports will now be submitted to DUS taxation.

Cocoa

d) The statistical discrepancies regarding cocoa exports and DUS taxation cannot seriously be explained without taking into account considerable fraud (in the range of $36 m). However the IMF mission has apparently not been able to substantiate evidence which would require extensive investigation. The issue is also made more complex as the two leading export companies allegedly involved, are well established firms, closely connected with the political elite. It also involves legal issues because these two companies took advantage of a loophole in the legislation and therefore the border between clear fraud and "abus de droit" (disputable interpretation of the law) is blurred. The Prime Minister has apparently been caught off guard on this subject which was most likely well known in other circles of power. Altogether about 47 000 t of "brizures de cacao", 50,000 T of "dechets de cacao" and 11,000 T of both "brizures and dechets" have been exported in 1995. These exports, which in accordance with the law, where not subject to DUS taxation, obviously represent much more than what should have been exported, as such "brisures and dechets" should not represent more than a small percentage of the total production. It is therefore likely that substantial exports of cocoa have evaded DUS taxation through reclassifying high quality cocoa as low quality one (dechets and brisures), generating considerable profit for these firms and involved individuals and loss of revenue for the Treasury.

5. Like with coffee, the government has decided to immediately subject to DUS taxation all cocoa exports independent of quality and grade in order to close the loophole. It is launching a complete fiscal investigation of the two export firms, with parallel investigations entrusted to Inspection générale d'Etat in the Presidency and Inspection générale Des finances in the Ministry of Finance. This should lead to ex-post taxation of the two firms ("redressement fiscal") and eventual sanctions in the customs hierarchy if complicity of fraud is substantiated. According to the IMF mission, the government has given all assurances that the investigations will be fully implemented and that the necessary measures will be taken to recover unpaid taxes. Preliminary investigation results should be available end of June, and definite (?) results before October and the beginning of the new campaign. Customs documentation will be harmonized to facilitate controls. The Prime Minister quoted in this respect the Government's forceful action to recover $34 m lost in 1995 due to mismanaged coffee/cocoa exports by a number of exporters (among whom are some influential political figures). Such action has led the Government to withdraw export licenses of these exporters and to establish a payment schedule including a cash payment. (In addition it has launched legal action against some of them in Paris to avoid potentially biased legal decisions in Abidjan...).

6. The IMF mission will complete its report this week. A copy of this report will be sent to the Bank. The IMF mission has obtained from the Ivorian authorities a highly confidential letter which has been cleared by President Bedié on Saturday in Paris. I read this letter which details the set of measures that will be undertaken to investigate and stop future customs frauds, accompanied by an action plan. We are awaiting IMF management to communicate this letter to the Bank. Based on its findings and agreement reached with the Government, the IMF mission intends to recommend to its management to proceed with the Board distribution of the ESAF documents which could be discussed to the IMF Board as early as June 12 or 14.

Conclusion

7. We need to be aware that the IMF mission has not investigated the frauds. This was not possible in such a short period and such an investigation was clearly out of the scope of its mandate which was technical and related to analysis of statistical discrepancies in export tax receipts. We therefore do not have a complete and detailed description of the frauds and we do not know the final beneficiaries which were obviously different in nature. We may nevertheless make some hypothesis:

- Fraud on petroleum products was most likely beneficial to some local Malian and Burkinabe networks closely associated with Ivorian interests.

- Fraud on temporary tax exemption is most likely linked to a number of easy to identify companies in the manufacturing sector with apparently strong links to the Lebanese business community and good connections with customs officials.

- Fraud in the cocoa sector is of a different kind. But we can only speculate: (a) was it a purely private fraud involving two export companies and a few customs officials ? Due to the nature of the companies involved, it seems difficult to accept this hypothesis. But if this were the case, the investigations under way would be quickly conclusive; (b) was it a politically motivated fraud, to help finance the costly 1995 PDCI political campaign? In this case there may be cause for concern that the investigations may stop at some intermediate level; or (c) was it a more elaborate scheme to channel funds towards a few individuals eager to reinforce their resources for political purposes and/or to participate in the next privatization round in Côte d'Ivoire? A few well connected individuals who seem to be eager to participate in future privatizations have in this respect, recently displayed considerable wealth.

The eventual response to these questions may not be fully known from the investigation - especially under assumption (b). The issue is whether (and how) the Fund and the Bank should get them. It does raise the question about the legal basis on which the Bretton Woods institutions could put into question the internal legal process in Côte d'Ivoire.

Governance issues in Côte d'Ivoire

8. The key issue which the IMF and the Bank need to address at any rate is that of ensuring prevention of these frauds from occurring again. One preliminary conclusion regarding this fraud scheme and recent events, is that present IMF and World Bank monitoring of the Côte d'Ivoire economy, combined with increased transparency within the country, is making more difficult the plundering of the economy that had taken place since the mid seventies. I strongly believe that we should build on the momentum brought by this issue, to strengthen the capacity and to diversify in the future, the Ivorian monitoring institutions such as the " Inspection Générale Des Finances", the "Cours Des Comptes", the "agent judiciaire du Tresor", the "Inspection générale d'Etat." We should also try to push for internal and external audit of the customs. Although this is a different issue, we should also monitor carefully the transparency of the important privatizations which are due to happen in the second part of 1996 and 1997. Governance has obviously been a serious issue in Côte d'Ivoire since independence. Support to local monitoring institutions and emphasis on governance issues are certainly areas in which the Bank, with IMF support, should become very active in the near future. But this approach which I would strongly recommend, is also likely to be resented by some high level officials in Côte d'Ivoire and may make the dialogue with the Ivorian authorities more difficult in the future.

Chron 6K

THE WORLD BANK GROUP

ROUTING SLIP	DATE: May 20, 1996

OFFICE OF THE MANAGING DIRECTOR OPERATIONS

NAME	ROOM. NO.
Mr. James D. Wolfensohn	

	To Handle		Note and File
	Appropriate Disposition		Prepare Reply
	Approval		Per Our Conversation
✠	Information		Recommendations

RE: Cote d'Ivoire

REMARKS:

Jim, (3 pages in total)

Please find attached the current status on Cote d'Ivoire.

Regards

FROM:	EXTENSION:
Gautam S. Kaji	81384

DECLASSIFIED
MAY 17 2017
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A L L - I N - 1 N O T E

DATE: 19-May-1996 12:36pm

TO: GAUTAM KAJI (GAUTAM KAJI@A1@WBHQB)

FROM: Olivier Lafourcade, AF4DR (OLIVIER LAFOURCADE@A1@WBWASH)

EXT.: 34880

SUBJECT: Confidential - Cote d'Ivoire

Gautam,

Following our conversation on friday, here is the latest on the Cote d'Ivoire situation.

I spoke yesterday evening with Christian Francois of the IMF. As expected, the Fund sent another letter to the Minister of Finance of Cote d'Ivoire on friday evening (signed by Stan Fischer). This is a fairly strongly worded letter (I have not seen it, but I have been given the full content), explaining that the Fund will not be able to present the ESAF paper to the Board (it has not yet been circulated) until the Ivorians provide the necessary explanations to reconcile the customs duty data. The IMF thus is keeping with the approach described in my previous note to you.

As a result of this letter, the Ivorians have now requested the technical mission of the IMF, which had been suggested all along by the IMF, the French and us. Christian Francois is therefore leaving this sunday afternoon for Abidjan. He will be accompanied by Mr. Grandcolas, the fiscal expert on Cote d'Ivoire at the Fund, and by a lawyer. Over a three or four day period, the mission will discuss strictly technical matters with the Ivorians, with the view to provide the explanations for the reconciliation of the data. The mission is presented as unconspicuous as possible, in fact under the guise of the forthcoming Annual Meetings of the AfDB in Abidjan.

As discussed with Mr. Francois, there is little technical expertise that the Bank could provide at this time that would be of significant use to the IMF mission (and neither we nor the French have been invited by the Ivorians to be part of this mission). On the other hand however, Mr. Michailof is arriving in Abidjan to day, and he and Shigeo Katsu (the Bank Res Rep), are fully aware of the details of the matter at hand. Mr. Francois has assured me that he will keep both of them fully in the picture of the mission's work and results.

As you know, Messrs. Madavo and Sarbib will be in Abidjan later in the week to attend the AfDB Annual Meetings. They are tentatively scheduled to meet at least with Prime Minister Duncan, and possibly with President Bedie. By the time they arrive in Abidjan, both Serge Michailof and Shigeo Katsu will be

in a position to brief them on the latest developments resulting from Mr. Francois's mission.

Since I am leaving on tuesday for Mexico (retreat of the new Mexico department, back in Washington on monday May 27), I will no longer be in a position to monitor the Cote dIvoire situation as closely as I did over the last two weeks. I trust however, that both Mr. Michailof and Mr. Katsu being in Abidjan at this time, will be able to give you the latest as soon as new developments occur.

You should be aware that we do not trust the EM system with Cote d'Ivoire to be totally secure, in terms of confidentiality. This explains why I am not copying this em to Michailof and Katsu, but I will send it by fax to-morrow (we believe immediate transmission after a telephone call is the safest way to send confidential material).

Please call me if there is anything more you wish to know at this time. I trust that you will keep Mr. Wolfensohn fully informed of these latest developments.

Olivier

CC: Caio Koch-Weser (CAIO KOCH-WESER@A1@WBWASH)
CC: Jean Louis Sarbib (JEAN LOUIS SARBIB@A1@WBWASH)
CC: CALLISTO MADAVO (CALLISTO MADAVO@A1@WBHQB)
CC: Stephen Denning (STEPHEN DENNING@A1@WBWASH)

Chron file

THE WORLD BANK

Managing Director, Operations

April 11, 1996

Note to Mr. James D. Wolfensohn

Jim,

You expressed interest in seeing more details on the Portfolio Improvement Program. Attached is a copy.

Caio and I would be happy to discuss this with you at your convenience.

Gautam

Attachment

cc.: Ms. Lomax

GAUTAM S. KAJI

PORTFOLIO IMPROVEMENT PROGRAM

I. Introduction

- Despite some improvements in recent years, the status of the Bank's portfolio remains a matter of concern. Given our complex developmental agenda and our mission of "stretching" what is feasible, a certain amount of risk-taking and "failures" are inherent to our work. While views may differ as to the "optimal failure rate" for an institution like the Bank, the current situation with one-third of the completed operations showing unsatisfactory outcomes is clearly unacceptable and is raising questions about our effectiveness as a development partner. Upgrading the overall health of the portfolio is therefore an important institutional priority.

- This note outlines a program of action that should lead to a higher quality portfolio and improved "results on the ground" over the coming years. It builds on preliminary portfolio improvement plans submitted by the Regions in February, on management commitments made in the ARPPs and on related OED recommendations.

- Central to the proposed program is the concept of *"projects at risk"* (i.e. projects with a high risk of unsatisfactory outcome at completion) as a mechanism for tracking and managing the portfolio health. Using this concept, the program identifies clusters in the portfolio (countries, sectors/sub-sectors, lending instruments, and projects) where enhanced Bank attention and assistance are likely to have a high pay-off and which, therefore, should command priority attention vis-a-vis our portfolio improvement efforts. It also identifies well-performing parts of the portfolio from which lessons should be derived, disseminated and applied to other parts of the portfolio.

- The focus of the note is on upgrading the management and performance of the current portfolio (1,481 operations[1] with total commitments of US$119 billion and an undisbursed balance of US$70 billion as of April 5, 1996) since that offers the quickest way to increasing the impact of our assistance to our borrowers. A companion note is planned for addressing quality-at-entry issues for future operations.

- In addition to this introduction, the note has five sections: (i) the current status of the portfolio to provide a diagnostic point of departure; (ii) the proposed program for portfolio improvement; (iii) the expected results and monitoring indicators; (iv) issues and risks of the proposed approach; and (v) next steps.

---

[1] This excludes 163 operations (US$14 billion of commitments) whose closing dates expired during 7/95-3/96 or which were fully disbursed during the same period; they are considered part of the FY96 portfolio as per the ARPP definition.

II. Current Situation

Portfolio Status

- As of April 5, 1996, 18% of the portfolio (260 projects and US$22 billion of commitments) was rated as unsatisfactory in terms of implementation progress (IP), or likelihood to achieve development objectives (DO), or both. The share of "problem projects" has remained roughly the same for the past several years.

- Besides these 260 problem projects, another 224 in the portfolio are considered "potential" problem projects[2] as they exhibit symptoms which are known to be precursors of future problems. Thus altogether, the portfolio includes 484 projects with high risk of failure at completion. *These "projects at risk" constitute 33% of the portfolio in terms of numbers of projects and 30% in terms of commitments (Table 1).*

- At the Regional level, the percentage of "projects at risk" ranges from 16% for EAP to 45% for MNA. Three regions--ECA, LAC and MNA--had over 40% of their commitments at risk. In contrast to the rest of the Bank, in ECA and LAC, the share of "commitments at risk" exceeds the share of "projects at risk", implying that on average larger projects are also the more risky ones in these two regions (Table 1).

- In terms of sectoral and sub-sectoral portfolios, the percentage of projects and commitments at risk ranges from below 10% for the Social Sector[3] operations to over 40% for the Water Supply, Energy, and Financial Sectors (Table 2). Among the major subsectors, irrigation and drainage, research and extension, highways,

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[2] Defined as projects *with satisfactory IP and DO ratings but which suffer from two or more of the following problems:*

- long elapsed time between Board approval and effectiveness (>12 months);
- slow disbursing (disbursement level < half of the original or revised forecast);
- extended problem status (≥ 2 consecutive years) any time during implementation;
- non-compliance with covenants (rating of 3 or 4);
- counterpart funding constraints(rating of 3 or 4);
- project management problems (rating of 3 or 4);
- procurement problems (rating of 3 or 4); and
- financial performance problems (rating of 3 or 4).
- located in a country with a history of high 'failure' rate (>50% unsatisfactory commitments for operations closed during past 5 years) and no major change in economic management.
- belonging to a lending instrument with a history of high 'failure' rate (>33% unsatisfactory commitments for operations closed during the past 5 years).

[3] The "Social Sector" category includes social investment funds and other social safety net operations.

urban water supply, and water and sanitation appear to have an above-average concentration of "risky" projects.[4]

- In terms of lending instruments, the percentage of commitments at risk was the lowest for SALs (below 10%) and very high (over 40%) for FILs and TALs, as well as Sector Investment Loans in education, transport, and agriculture. (Table 3)

- There is a high degree of country concentration in terms of "risky" projects; *10 countries[5] with about one-sixth of the total Bank portfolio account for over half of the total commitments at risk. In 37 of the 132 active country portfolios, more than half of the commitments fall into the "risky" category.*

- Of the 484 projects at risk, *50 projects, each with commitments of $195 million or more, account for almost 40% of the total commitments at risk (Table 4).*

- The Bankwide disbursements remain much below planned levels. As of end-March 1996, *over 600 projects had disbursement levels that were less than half of the original or formally revised forecasts.*

Portfolio Management

- *Portfolio management has improved considerably during the past few years* with several of the Wapenhans Task Force recommendations now a standard practice in the Bank. These include:

  - attention to implementation issues and portfolio-pipeline links in Country Assistance Strategies;

  - use of CPPRs to bring portfolio issues to center stage in our country dialogue;

  - greater realism and transparency in supervision ratings. In particular, improvements in the realism of supervision ratings for projects closed in recent years has led to a significant reduction in the "disconnect" between supervision and completion/audit ratings;

  - improved management of effectiveness and closing dates. The proportion of projects becoming effective within six months of Board approval has, for example, increased from about 35% in the late 1980s to over 50% in recent years;

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[4] Because of significant misclassification problems in the MIS, especially at the sub-sectoral level, these conclusions need to be treated with caution.

[5] Venezuela, Nigeria, Russia, Brazil, Colombia, Morocco, Argentina, Turkey, Mexico and Romania.

- increase in budgetary resources to portfolio management (from an average of 13 sws in FY91 to about 17 sws currently) and more efficient use of those resources through streamlining of supervision processes (e.g. use of standard bidding documents for procurement);

- increased use of country knowledge and local expertise in implementation and supervision, through delegation of portfolio management responsibility to field offices and more frequent involvement of local staff, consultants and stakeholders in supervision work; and

- increased attention to portfolio issues by the senior management.

♦ Several other important initiatives (e.g., use of performance monitoring indicators and attention to M & E aspects in new projects, "retrofitting" of ongoing projects with performance indicators, revision of Form 590 to improve supervision reporting, design of methodologies for improved assessment of country and sector risk factors, expanded training for staff in supervision techniques) are also progressing and should over time contribute to improved portfolio management and performance.

♦ There are, however, still many areas of concern:

- *Over one-third of the current problem projects have been in that status since the 94 ARPP.* This is a source of concern since extended problem status is highly correlated with unsatisfactory outcomes at completion. Less than one-third of the projects in problem status for more than a year have been restructured suggesting the need for a more pro-active stance by the Bank in working with borrowers for expeditious resolution of problems.

- *Though supervision intensity has increased to about 17 staff-weeks per project, recent surveys suggest that the quality of supervision remains uneven, especially as regards preparation for supervision missions and follow-up actions.* Supervision reporting also remains a problem; as of April 9, 1996, one-quarter of the projects in the portfolio had not had an updated Form 590 since end June 1995.

- *Although CPPRs were conducted during FY93-95 in 63 countries, covering 90% of the portfolio in commitment terms, the results have been mixed, with limited correlation between CPPRs and subsequent portfolio improvement.* In many cases, CPPRs would have benefited from better upfront preparation, greater managerial attention and more intensive follow-up subsequently. Greater focus on ascertaining the continued relevance of the various projects in the portfolio and the appropriateness of their project designs would also have been helpful.

- Despite the new rating methodology and greater management attention, *the project performance ratings still remain over-optimistic* especially during early years of implementation. This makes it difficult to identify and resolve problems in a timely fashion.

- *Timely submission of audits* remains a problem and warrants attention. Despite some recent improvement, about 20% remain overdue by at least six months.

- *The backlog in ICRs has reappeared* (157 at the end of FY95). New guidelines in place for them should result in consistent high quality, but as the backlog is reduced it will be important for managers to ensure that quality standards are met and the lessons are adequately disseminated to staff.

III. The Proposed Program

◆ The proposed program design has been guided by the following main considerations:

- Project implementation is the responsibility of borrowers and the Bank's portfolio improvement efforts will only be effective to the extent that these are owned by borrowers and complement their own efforts at maximizing the development impact of Bank-financed projects.

- Being closer to the clients, the Regions are best placed to establish country-specific targets, strategies and programs to underpin the institutional objective of a rapid and significant improvement in the health of the Bank portfolio.

- An adequate tool-kit of instruments and processes is already in place (or about to be in place) and the focus at this stage should be on better application of the existing tool-kit rather than designing new instruments and processes. *More than anything else, portfolio improvement is a matter of managerial attention and of persuading staff and managers at all levels that improving implementation is indeed an institutional priority.*

- Although not obvious from the portfolio indicators at this stage, the measures taken already (or those underway) should have a significant beneficial effect on portfolio health in due course. However, more can and should be done to accelerate the impact of these positive measures on the portfolio by concentrating our efforts on areas with potential for high pay-off.

- To avoid duplication and maximize synergies, the activities under the program should be fully synchronized with the FY96 ARPP.

- The portfolio improvement program builds on ongoing initiatives by the Regions and the CVPs by focusing efforts on selected countries, sectors, lending instruments and projects with the most severe implementation problems and risks, and where intensified attention can be expected to have high pay-off. The clusters targeted are:

  Country Portfolios at Risk

  - *Twenty countries accounting for 46% of total projects "at risk", and 59% of total commitments "at risk" are proposed for intensive attention (Table 5).* The list is based on "riskiness" of the various country portfolios, their current disbursement performance and their historic "disconnect" levels. Certain countries with small portfolios and/or where it is judged that little can be done at this stage through heightened attention were excluded from consideration.

Box 1: Countries Targeted for Special Attention

AFR	Guinea	LAC	Brazil
	Kenya		Colombia
	Nigeria		Mexico
	Rwanda		Venezuela
	Tanzania		
MNA	Algeria	ECA	Bulgaria
	Egypt		Romania
	Morocco		Russia
	Yemen		Turkey
EAP	PNG	SAS	Bangladesh
			Nepal

  - For each of the countries listed above, the Regions, building on their ongoing efforts and in collaboration with the borrowers would, by June 30, 1996, prepare portfolio improvement programs with timebound targets. The programs would include indications as to any assistance required from outside the Regions as well as mechanisms for progress monitoring.

Priority Sectoral/Instrument Clusters

- Selected sectors/sub-sectors and lending instruments showing severe implementation problems would be analyzed to identify generic implementation issues, and help develop strategies and approaches for addressing those issues. Based on the current portfolio status and consultations with the CVPs, reviews are proposed for (i) water, forestry, research and extension and highways sectors/sub-sectors and (ii) FILs, TALs and selected Sector Investment Loans. In aggregate, *the selected sectors/sub-sectors account for about half of commitments at risk (Table 6) and the selected lending instruments account for about one-quarter of commitments at risk (Table 7).*

- The sector/lending instruments reviews would be carried out by the CVPs, in consultation with the Regions. The diagnostic work on cross-cutting issues would be completed by July 31, 1996. Thereafter, the CVPs would field test their recommendations in collaboration with a few volunteer task teams in the Regions. Once successfully field tested, the CVPs would mainstream the recommendations through their training, dissemination and cross-support activities.

Largest Projects at Risk

- A list of 50 projects accounting for $13.5 billion (40%) of commitments at risk are proposed for priority attention. All but 7 of these projects are also part of the countries, sectors and lending instruments identified above for priority attention and hence would be looked at as part of the improvement plans for respective country and sector clusters. Due to their importance to the overall health of the portfolio, the Regions would also monitor them more intensively.

- Taken together and allowing for overlaps, the country, sector, lending instrument, and project clusters proposed for priority attention account for three-quarters of the projects at risk and 85% of the total "at risk" commitments. A key thrust of the proposed program would, therefore, be to seek major improvements in these clusters while continuing ongoing efforts to improve the rest of the portfolio.

Clusters with Outstanding Performance

- In parallel with the focus on "risky" clusters in the portfolio, the program would also examine selected country, sector and project clusters with outstanding performance to ensure that successful experiences are appropriately disseminated and replicated. Outstanding clusters identified for further analysis include:

  - Ten country portfolios each with less than 10% of the commitments at risk (Table 8);

- The Social Sector portfolio of 19 projects (US$1.1 billion of commitment) none of which is rated "risky";
- SALs (24 operations, US$3.2 billion of commitments) with less than 10% of the commitments being considered "risky"; and
- Seventeen well-performing projects (HS ratings on both DO and IP measures) located in countries with problem-prone portfolios (Table 9).

In each case, the analysis would aim at understanding better the reasons for the success of these clusters and distilling lessons both to guide the design of future operations and to improve management of the existing portfolio.

IV. Expected Results and Monitoring Indicators

- It is premature to forecast the impact of this program on the portfolio, as it depends on the specific country level programs and targets to be developed by the Regions. For illustrative purposes, assuming *Regional efforts on "problem" clusters are successful in reducing by one-half the performance gap between them and the rest of the portfolio and a modest (2%) reduction in the "at risk" portion of the balance of the portfolio, the aggregate share of projects at risk will decline to 25% in terms of numbers and 20% in terms of commitments*. These preliminary targets are proposed as the core monitorable proxies of Bankwide portfolio improvement efforts by July 1997 (Box 2).

- In addition, to strengthen credibility of supervision ratings, it is proposed that the "net disconnect" be reduced by concentrated management attention to the quality of supervision work for projects scheduled to close in the near future.

Box 2: Objectives for July 1997

* Reduction, by July 1997, of "at risk" portfolio from 33% to 25% in terms of numbers, and from 30% to 20% in terms of dollars.
* Reduction in net disconnect between final 590 and PCR/ICR ratings from 12% in 1994 to below 5% for projects to be closed in CY96.

- The Bankwide objectives presented above would be revisited and refined in July 1996 following preparation by the Regions of Country Portfolio Assessments in the context of the FY96 ARPP.

- The overarching objective of the program is, of course, "results on the ground" and the indicators proposed above are only imperfect proxies for that. A better proxy is the audit judgment delivered through OED's independent evaluation of project outcomes. However, unavoidably, there is a long lead time before the full impact of the program can be captured through OED evaluations. Nevertheless, we also need to think about medium-term targets in terms of OED assessments.

- Taking account of the Bank's development mandate, there is no "right" percentage for unsatisfactory outcomes, although all agree the present level is too high. To stimulate discussion on this important topic, it is proposed that the medium-term objective be a portfolio in which *no more than 10% by disbursed amount and 20% by number are judged unsatisfactory by the OED.* Of particular interest will be the implications, if any, of these objectives for the country/sectoral mix of the Bank's future lending programs.

V. Issues and Risks

- *Trade-off Between Project Risk and Broader Development Objectives.* The establishment of targets linked to portfolio success may have unintended effects on the portfolio composition as managers may take an excessively risk-avoiding stance shying away from risky countries and sectors. To reduce this danger, differentiated targets are proposed for outcomes in terms of number of projects and commitments thereby encouraging the use of smaller operations and pilot projects in risky situations. This should be further reinforced by the proposed up-front discussion of country and project risks in CASs.

- *Objectivity and Reliability of Ratings.* Several Regions had expressed concerns that setting targets for ratings may create perverse incentives jeopardizing the objectivity and transparency of project ratings. The choice of indicators proposed in the program reflects this concern. The share of problem projects in the portfolio has been replaced by a broader concept, the share of "projects at risk". Moreover, the targeted reduction in the disconnect between Form 590 and ICR ratings is expected to promote increased rating reliability. Ad hoc reviews by QAG of the supervision quality should further reinforce moves towards greater objectivity in supervision ratings.

- *Appropriateness of Proxy Targets.* The selected 1997 targets have been chosen as proxies for the ultimate objective, namely an increasing proportion of commitments and projects achieving their development objectives at completion. There is a risk, however, that the links between these intermediate proxies and the final assessment of project outcomes will not be as strong as anticipated. There is a clear need, therefore, both to keep the indicators under review and to search for

processes for collecting and analyzing portfolio information in a way that allows for real-time monitoring.

- *Incentives.* For the program to succeed, there is a critical need to change staff perception on how portfolio management work is valued and rewarded across the Bank. The existence of institutional incentives and rewards linked to improvements in portfolio health is essential in this regard. The Program includes monitoring and benchmarking required to promote Regional accountability for portfolio management. The Regions, in turn, will need to put in place their own systems for sharpening accountabilities for staff and managers at different levels, through the personnel management processes, and to reflect the priority assigned to portfolio quality in resource allocation decisions.

- *Resources.* The intensification of portfolio management activities may bring about an increase in the resources required for supervision work. The need may arise at the regional level from increases in frequency and quality (e.g., specialized skills) of missions, and at the center from the expanded analytical, advisory and training activities by OPR, CVPs, the LLC, and QAG. If necessary, the managers should redeploy resources from lesser priority tasks into portfolio management. Unit proposals on resource redeployment for portfolio management should be decided in the context of the FY97-99 business plans.

- *Information Improvements.* There is a clear need to improve the reliability and timeliness of portfolio data, as efforts to assess the status, define targets and monitor progress are handicapped by the unreliability of MIS data. In addition, the systems themselves need to become more user-friendly and flexible, and eventually offer the much needed real time information on portfolio status and trends. Only a revamped information system will allow a simpler, more systematic reporting that will facilitate managerial attention. Combined efforts by managers and the soon to be established [Vice Presidency for Information] will be required to address this important constraint to better management of the Bank portfolio.

VI. Next Steps

- By April 15, the CVPs, jointly with the Regions, will initiate portfolio improvement reviews for the selected sectors/sub-sectors/lending instruments and complete the diagnostic work by July 31, 1996.

- By April 15, OPR will establish a working group to identify areas for immediate improvement in the operational MIS, pending a more indepth review of institutional information systems. The group will complete the diagnostic work and provide specific proposals for improvement by May 31, 1996.

- By June 30, the Regions will verify and revise, as appropriate, the Form 590 data for all active projects in the portfolio to underpin the Portfolio Improvement Program as well as the FY96 ARPP.

- By June 30, the Regions will finalize action plans for improving the 20 targeted portfolios and the 50 targeted projects, including requests, if any, for central support.

- By July 15, the Regions and CVPs will complete the analysis of well-performing clusters in the portfolio to draw lessons of success.

- By July 31, QAG will update the Portfolio Improvement Program incorporating *inter alia* country/sector-specific targets and programs prepared by the Regions and the CVPs.

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Table 1

PROJECTS AT RISK BY REGION
Date: 04/05/96

Region	Current Portfolio		Actual Problem Projects		Potential Problem Projects		Projects At Risk		Commitments At Risk	
	No.	Commitment (US$M)	No.	%	No.	%	No.	%	US$M	%
AFRVP	444	15,628.6	71	16.0	94	21.2	165	37.2	5,776.1	37.0
EAPVP	261	30,559.3	29	11.1	12	4.6	41	15.7	3,348.2	11.0
ECAVP	180	15,587.1	38	21.1	26	14.4	64	35.6	7,299.8	46.8
LACVP	303	27,432.8	54	17.8	57	18.8	111	36.6	11,541.8	42.1
MNAVP	111	7,899.6	34	30.6	16	14.4	50	45.0	3,371.2	42.7
SASVP	182	21,417.4	34	18.7	19	10.4	53	29.1	4,754.2	22.2
TOTAL	1481	118,524.8	260	17.6	224	15.1	484	32.7	36,091.3	30.5

Note:
Potential problem projects are defined as having Satisfactory IP and/or DO in the last 590, but meeting two or more of the following criteria:

1. Elapsed time between Board and effectiveness > 12 months.
2. Compliance with legal covenants rated 3 or 4 in the last 590.
3. Management performance rated 3 or 4 in the last 590.
4. Counterpart funds rated 3 or 4 in the last 590.
5. Procurement progress rated 3 or 4 in the last 590.
6. Financial performance rated 3 or 4 in the last 590.
7. Slow disbursing (project age > 2 year; disbursement level less than half of the original or formally revised forecast).
8. Unsatisfactory rating for 2 or more consecutive ARPPs(IP and/or DO) in previous years.
9. Located in a country with a history of high 'failure' rate (>50% unsatisfactory commitments for operations closed during past 5 years) and no major change in economic management.
10. Belongs to a lending instrument with a history of high failure rate (>33% unsatisfactory commitments for operations closed during past 5 years).

Table 2

PROJECTS AT RISK BY SECTOR
Date: 04/05/96

Sector	Current Portfolio		Actual Problem Projects		Potential Problem Projects		Projects At Risk		Commitments At Risk	
	No.	Commitment (US$M)	No.	%	No.	%	No.	%	US$M	%
Agriculture	330	21,324.3	61	18.5	55	16.7	116	35.2	7,388.8	34.6
Education	172	11,874.8	33	19.2	18	10.5	51	29.7	3,078.6	25.9
Energy	47	5,370.0	11	23.4	9	19.1	20	42.6	2,492.1	46.4
Environment	24	1,238.2	5	20.8	1	4.2	6	25.0	640.5	51.7
Financial	76	8,171.1	19	25.0	14	18.4	33	43.4	3,195.6	39.1
Human Resources	2	40.0	0	.0	0	.0	0	.0	.0	.0
Industrial/IDF	37	3,443.6	8	21.6	6	16.2	14	37.8	1,126.7	32.7
Mining & other Extractive	11	603.8	2	18.2	1	9.1	3	27.3	32.0	5.3
Multi Sector	65	4,165.9	9	13.8	10	15.4	19	29.2	435.6	10.5
Pop. Health & Nutrition	142	7,814.3	20	14.1	25	17.6	45	31.7	2,472.0	31.6
Power	96	14,904.9	12	12.5	15	15.6	27	28.1	2,280.8	15.3
Public Sector Management	91	4,054.8	15	16.5	11	12.1	26	28.6	788.5	19.4
Social	19	1,138.6	0	.0	0	.0	0	.0	.0	.0
Telecommunications	24	2,291.9	3	12.5	3	12.5	6	25.0	323.2	14.1
Tourism	2	150.0	1	50.0	0	.0	1	50.0	130.0	86.7
Transportation	158	16,670.0	24	15.2	27	17.1	51	32.3	5,795.8	34.8
Urban	97	7,375.7	15	15.5	11	11.3	26	26.8	1,752.6	23.8
Water Supply & Sanitation	88	7,892.9	22	25.0	18	20.5	40	45.5	4,158.4	52.7
TOTAL	1481	118,524.8	260	17.6	224	15.1	484	32.7	36,091.3	30.5

Note:
Potential problem projects are defined as having Satisfactory IP and/or DO in the last 590., but meeting two or more of the following criteria:

1. Elapsed time between Board and effectiveness > 12 months.
2. Compliance with legal covenants rated 3 or 4 in the last 590.
3. Management performance rated 3 or 4 in the last 590.
4. Counterpart funds rated 3 or 4 in the last 590.
5. Procurement progress rated 3 or 4 in the last 590.
6. Financial performance rated 3 or 4 in the last 590.
7. Slow disbursing (project age > 2 year; disbursement level less than half of the original or formally revised forecast).
8. Unsatisfactory rating for 2 or more consecutive ARPPs(IP and/or DO) in previous years.
9. Located in a country with a history of high 'failure' rate (>50% unsatisfactory commitments for operations closed during past 5 years) and no major change in economic management.
10. Belongs to a lending instrument with a history of high failure rate (>33% unsatisfactory commitments for operations closed during past 5 years).

PROJECTS AT RISK BY LENDING INSTRUMENT
Date: 04/05/96

Instrument	Current Portfolio		Actual Problem Projects		Potential Problem Projects		Projects At Risk		Commitments At Risk	
	No.	Commitment (US$M)	No.	%	No.	%	No.	%	US$M	%
[illegible]ction Loan	1	.0	0	.0	0	.0	0	.0	.0	.0
Em[illegible] Reconstruction Loan	19	2,124.0	1	5.3	1	5.3	2	10.5	371.0	17.5
Financial Intermediary Loan	55	5,724.7	14	25.5	20	36.4	34	61.8	2,986.2	52.2
Rehabilitation Import Loan	5	762.7	1	20.0	0	.0	1	20.0	120.0	15.7
Sector Adjustment Loan	38	5,512.0	8	21.1	1	2.6	9	23.7	702.6	12.7
Sector Investment & Mainten.	158	14,645.3	37	23.4	28	17.7	65	41.1	6,314.3	43.1
Specific Investment Loan	1042	83,785.6	174	16.7	141	13.5	315	30.2	24,287.2	29.0
Structural Adjustment Loan	24	3,158.4	1	4.2	0	.0	1	4.2	50.0	1.6
Technical Assistance Loan	139	2,812.1	24	17.3	33	23.7	57	41.0	1,260.0	44.8
TOTAL	1481	118,524.8	260	17.6	224	15.1	484	32.7	36,091.3	30.5

Note:
Potential problem projects are defined as having Satisfactory IP and/or DO in the last 590, but meeting two or more of the following criteria:

1. Elapsed time between Board and effectiveness > 12 months.
2. Compliance with legal covenants rated 3 or 4 in the last 590.
3. Management performance rated 3 or 4 in the last 590.
4. Counterpart funds rated 3 or 4 in the last 590.
5. Procurement progress rated 3 or 4 in the last 590.
6. Financial performance rated 3 or 4 in the last 590.
7. Slow disbursing (project age > 2 year; disbursement level less than half of the original or formally revised forecast).
8. Unsatisfactory rating for 2 or more consecutive ARPPs(IP and/or DO) in previous years.
9. Located in a country with a history of high 'failure' rate (>50% unsatisfactory commitments for operations closed during past 5 years) and no major change in economic management.
10. Belongs to a lending instrument with a history of high failure rate (>33% unsatisfactory commitments for operations closed during past 5 years).

LARGEST 50 PROJECTS [redacted] IN TERMS OF COMMITMENTS
D[redacted]05/96

No.	Project ID	Region	Country	Name	Commitm US$M	Board Approval Date	Effective Date	Rev Closing Date	Impl Prg	Devl Obj	Mgmt Perfm	Comp w/leg Cond	Countp Funds	Procurement Progress	Financial Perfmce	Orig Disb Sched	Formal Rev Sched	Actual Disb US$M	No.of ARPPs rated PP
1	8809	ECAVP	RUSSIA	OIL REHAB.	604.8	06/17/93	11/15/93	12/31/96	U	U	2	2	3	2	3	594.7	.0	172.2	2
2	5988	LACVP	ARGENTINA	CAPITAL MKT DEVT	500.0	03/01/94	08/31/95	06/30/06	U	S	1	1	1	2	R	.0	.0	.3	1
3	8805	ECAVP	RUSSIA	OIL REHAB. II	500.0	06/29/94	05/25/95	06/30/97	U	U	2	3	3	2	3	396.7	.0	11.8	1
4	7710	LACVP	MEXICO	N. BORDER I ENVIRONM	368.0	06/09/94	06/21/95	09/30/01	U	S	2	1	3	2	2	134.6	.0	25.6	1
5	3945	EAPVP	INDONESIA	HIGHWAY SECTOR II	350.0	03/10/94	06/21/94	12/31/99	U	S	3	1	1	2	A	113.3	.0	76.3	0
6	7667	LACVP	MEXICO	IRRIG SCTR	350.0	12/03/91	06/18/92	07/30/97	S	HS	1	1	3	1	3	400.0	.0	225.9	0
7	7707	LACVP	MEXICO	WATER/SANIT II	350.0	06/09/94	06/20/95	09/30/98	S	S	2	2	3	1	R	151.7	.0	127.1	0
8	6003	LACVP	ARGENTINA	RD MAINT & REHAB SCT	340.0	06/03/93	12/30/93	06/30/00	U	S	2	2	2	3	1	232.5	.0	128.1	1
9	8806	ECAVP	RUSSIA	URBAN TRANSPORT	329.0	05/16/95	03/28/96	06/30/01	U	S	2	2	1	2	1	24.7	.0	.0	0
10	3970	EAPVP	INDONESIA	FINANCIAL SECTOR DEV	307.0	11/12/92	04/08/93	03/31/98	U	U	2	2	1	1	1	306.8	.0	216.8	1
11	9946	SASVP	INDIA	NAT. HIGHWAYS II	306.0	05/12/92	08/31/92	06/30/01	U	S	2	2	1	2	2	65.8	.0	40.2	1
12	6036	LACVP	ARGENTINA	YACYRETA II	300.0	09/29/92	01/13/93	12/31/98	S	S	1	2	3	2	3	298.3	.0	293.0	0
13	8214	LACVP	VENEZUELA	AG SCTR INV	300.0	12/03/91	06/26/92	06/30/96	U	S	1	3	1	2	R	284.0	.0	35.3	2
14	9071	ECAVP	TURKEY	TEK RESTRUCT.	300.0	06/13/91	04/27/92	12/31/97	S	S	1	2	1	2	2	300.0	.0	120.6	1
15	6407	LACVP	BRAZIL	WATER SCTR SAO PAULO	280.0	06/28/89	07/06/90	06/30/96	U	S	2	2	2	1	2	280.0	.0	150.8	2
16	8571	ECAVP	POLAND	PRIVATIZN & RESTRUCT	280.0	06/11/91	11/07/91	06/30/98	U	S	2	1	1	2	1	268.7	.0	106.0	2
17	5968	LACVP	ARGENTINA	SEGBA V	276.0	06/23/87	09/30/88	12/31/98	S	HS	1	1	1	2	1	276.0	.0	206.2	3
18	8903	MNAVP	ALGERIA	NAT. WATER SUPPLY II	270.0	01/28/88	07/05/88	12/31/96	S	S	2	2	2	2	2	250.0	268.0	209.6	6
19	6444	LACVP	BRAZIL	HWY MGMT AND REHAB	270.0	02/13/90	07/30/91	12/31/96	S	S	2	1	1	2	2	310.0	244.0	234.7	2
20	6873	LACVP	COLOMBIA	THIRD NATIONAL ROADS	266.0	03/26/92	04/13/93	06/30/97	U	U	2	3	1	2	2	244.2	.0	189.3	2
21	6492	LACVP	BRAZIL	HYDROCARBN TRNSP/PRO	260.0	06/26/91	01/22/93	12/31/97	U	S	2	2	1	1	2	260.0	.0	108.4	2
22	8569	ECAVP	POLAND	IND. EXPORT DEVT.	260.0	02/06/90	05/08/90	06/30/96	U	U	2	1	1	1	1	260.0	.0	75.9	3
23	9964	SASVP	INDIA	WATER RES CONSOLID H	258.0	03/29/94	06/24/94	12/31/00	U	U	4	3	2	3	3	49.0	.0	30.0	0
24	9553	SASVP	BANGLADESH	JUTE SECTOR ADJ.CRED	256.9	02/17/94	04/05/94	12/31/96	U	U	3	3	2	R	R	176.4	.0	55.6	1
25	2084	AFRVP	NIGERIA	WATER REHAB	256.0	05/21/91	08/27/92	06/30/99	S	S	2	1	2	2	1	169.7	.0	59.0	0
26	9872	SASVP	INDIA	TAMIL NADU URBAN	254.7	06/15/88	11/07/88	09/30/96	U	S	2	1	1	2	2	300.2	.0	189.3	1
27	6368	LACVP	BRAZIL	WATER SECTOR MODERNI	250.0	03/10/92	06/08/93	12/31/97	S	S	1	1	3	1	2	193.7	.0	41.0	0
28	7659	LACVP	MEXICO	IND RSTRUCTRNG	250.0	04/27/89	02/06/90	12/31/95	U	U	3	1	1	R	R	250.0	.0	242.0	2
29	34162	SASVP	INDIA	MAHARASHTRA EARTHQUA	246.0	03/31/94	06/27/94	06/30/97	U	S	2	1	1	1	A	111.6	.0	58.1	0
30	6364	LACVP	BRAZIL	INNOV BASIC ED	245.0	06/26/91	01/07/92	06/30/98	U	U	1	2	3	3	A	225.6	.0	52.4	2
31	6541	LACVP	BRAZIL	WTR Q/PLN(SP/PARANA)	245.0	07/02/92	09/28/94	09/30/97	U	S	2	2	2	1	2	211.6	.0	43.4	2
32	8811	ECAVP	RUSSIA	AGRIC. REFORM IMPL.	240.0	06/16/94	11/21/94	06/30/00	U	U	2	2	2	2	R	66.7	.0	.8	1
33	6442	LACVP	BRAZIL	ITAPARICA	232.0	11/17/87	12/08/87	12/31/95	S	S	1	1	1	1	2	132.0	232.0	221.1	4
34	7694	LACVP	MEXICO	TRNSPRT AIR POLL CON	220.0	12/15/92	06/27/94	06/30/97	S	S	2	2	2	1	1	203.3	.0	96.9	0
35	9034	ECAVP	TURKEY	ISTANBUL WATER SUPPL	218.0	12/01/87	02/23/88	12/31/96	S	S	2	2	3	2	2	217.3	.0	178.9	2
36	6403	LACVP	BRAZIL	NE BASIC HLTH SRV II	217.0	11/30/89	12/26/90	06/30/96	S	S	1	2	1	1	A	258.5	.0	116.9	2
37	5462	MNAVP	MOROCCO	SECOND LSI IMPROVEME	215.0	03/30/93	09/22/93	12/31/00	S	S	2	1	3	1	1	37.0	.0	23.5	0
38	6427	LACVP	BRAZIL	NE BASIC EDUC II	212.0	05/13/93	02/08/94	12/31/98	U	U	3	3	3	3	A	130.2	.0	47.0	2
39	6452	LACVP	BRAZIL	NE BASIC EDUC III	206.6	11/23/93	05/27/94	06/30/99	U	U	3	3	3	3	A	87.3	.0	34.3	2
40	6505	LACVP	BRAZIL	MATO GROSSO NAT RES	205.0	06/18/92	01/15/93	12/31/97	U	S	2	3	3	2	3	160.7	.0	60.6	2
41	9898	SASVP	INDIA	UPPER KRISHNA PHASE	205.0	05/04/89	08/17/89	12/31/96	U	S	2	2	1	1	R	316.3	.0	149.3	3
42	9057	ECAVP	TURKEY	SMI II	204.5	05/23/89	10/26/89	06/30/96	S	S	1	2	1	A	2	204.5	.0	167.5	2
43	2073	AFRVP	NIGERIA	HIGHWAY SECTOR LOAN	200.0	06/16/88	03/30/90	06/30/96	U	S	2	2	3	2	R	250.0	88.9	83.8	2
44	4976	MNAVP	ALGERIA	HOUSING COMPLETION &	200.0	03/04/93	09/09/93	12/31/96	S	S	2	1	1	1	R	181.3	.0	193.1	2
45	7648	LACVP	MEXICO	MEDIUM CITIES TRANSP	200.0	02/16/93	02/18/94	06/30/00	U	S	2	1	3	2	1	95.2	.0	27.9	1
46	8828	ECAVP	RUSSIA	FINANCIAL INSTITUTIO	200.0	05/19/94	07/28/95	12/31/98	U	HS	2	2	2	2	R	104.3	.0	2.3	1
47	8839	ECAVP	RUSSIA	ENTERPRISE RESTRUCTU	200.0	06/21/94	07/31/95	06/30/00	U	S	2	1	1	1	1	36.0	.0	.0	1
48	9036	ECAVP	TURKEY	PRIVATE INVESTMENT C	200.0	06/13/91	11/22/91	12/31/96	S	U	2	2	1	R	2	196.7	.0	135.9	4
49	6865	LACVP	COLOMBIA	IND RESTRUC	198.8	05/02/91	07/31/92	12/31/96	S	S	1	1	1	1	R	178.3	.0	168.5	0
50	9973	SASVP	INDIA	STATE ROADS 1	195.0	10/20/88	03/02/89	06/30/96	U	U	3	2	3	3	2	250.0	.0	156.2	4
BANKWIDE TOTAL					13,597.4														

Note:
Potential problem projects are defined as having Satisfactory IP and/or DO in the last 590, but meeting two or more of the following criteria:

1. Elapsed time between Board and effectiveness > 12 months.
2. Compliance with legal covenants rated 3 or 4 in the last 590.
3. Management performance rated 3 or 4 in the last 590.
4. Counterpart funds rated 3 or 4 in the last 590.
5. Procurement progress rated 3 or 4 in the last 590.
6. Financial performance rated 3 or 4 in the last 590.
7. Slow disbursing (project age > 2 years disbursement level less than half of the original or formally revised forecast).
8. Unsatisfactory rating for 2 or more consecutive ARPPs(IP and/or DO) in previous years.
9. Located in a country with a history of high 'failure' rate (>50% unsatisfactory commitments for operations closed during past 5 years) and no major change in economic management.
10. Belongs to a lending instrument with a history of high failure rate (>33% unsatisfactory commitments for operations closed during past 5 years).

Table 4

COUNTRY PORTFOLIOS FOR INTENSIVE EFFORTS
Date: 04/05/96

Table 5

Region	Country	Current Portfolio		Actual Problem Projects		Potential Problem Projects		Projects At Risk		Commitments At Risk	
		No.	Commitment (US$M)	No.	%	No.	%	No.	%	US$M	%
AFRVP	GUINEA	13	382.1	3	23.1	5	38.5	8	61.5	236.6	61.9
	KENYA	21	812.3	6	28.6	4	19.0	10	47.6	360.5	44.4
	NIGERIA	23	1,750.3	5	21.7	15	65.2	20	87.0	1,515.3	86.6
	RWANDA	12	249.5	9	75.0	2	16.7	11	91.7	199.5	80.0
	TANZANIA	21	1,092.0	4	19.0	5	23.8	9	42.9	572.1	52.4
EAPVP	PAPUA NEW GUINEA	9	204.7	4	44.4	3	33.3	7	77.8	166.7	81.4
ECAVP	BULGARIA	7	438.0	4	57.1	1	14.3	5	71.4	313.0	71.5
	ROMANIA	11	1,516.0	1	9.1	3	27.3	4	36.4	680.6	44.9
	RUSSIA	19	3,440.1	11	57.9	3	15.8	14	73.7	2,601.1	75.6
	TURKEY	22	2,928.2	5	22.7	11	50.0	16	72.7	2,014.2	68.8
LACVP	BRAZIL	45	5,836.3	16	35.6	15	33.3	31	68.9	4,548.4	77.9
	COLOMBIA	19	1,823.1	3	15.8	4	21.1	7	36.8	957.8	52.5
	MEXICO	29	7,367.8	5	17.2	4	13.8	9	31.0	1,831.8	24.9
	VENEZUELA	13	1,139.4	5	38.5	7	53.8	12	92.3	1,084.4	95.2
MNAVP	ALGERIA	17	1,489.4	6	35.3	5	29.4	11	64.7	1,040.4	69.9
	EGYPT	13	849.8	4	30.8	2	15.4	6	46.2	372.8	43.9
	MOROCCO	25	2,637.2	9	36.0	2	8.0	11	44.0	1,010.0	38.3
	YEMEN, REPUBLIC OF	19	368.0	9	47.4	5	26.3	14	73.7	226.5	61.6
SASVP	BANGLADESH	27	2,324.4	5	18.5	5	18.5	10	37.0	663.6	28.6
	NEPAL	13	470.8	6	46.2	1	7.7	7	53.8	239.5	50.9
TOTAL		378	37,119.5	120	31.7	102	27.0	222	58.7	20,634.9	55.6

Note:
Potential problem projects are defined as having Satisfactory IP and/or DO in the last 590, but meeting two or more of the following criteria:

1. Elapsed time between Board and effectiveness > 12 months.
2. Compliance with legal covenants rated 3 or 4 in the last 590.
3. [redacted]gement performance rated 3 or 4 in the last 590.
4. [redacted]terpart funds rated 3 or 4 in the last 590.
5. [redacted]curement progress rated 3 or 4 in the last 590.
6. Financial performance rated 3 or 4 in the last 590.
7. Slow disbursing (project age > 2 year; disbursement level less than half of the original or formally revised forecast).
8. Unsatisfactory rating for 2 or more consecutive ARPPs(IP and/or DO) in previous years.
9. Located in a country with a history of high 'failure' rate (>50% unsatisfactory commitments for operations closed during past 5 years) and no major change in economic management.
10. Belongs to a lending instrument with a history of high failure rate (>33% unsatisfactory commitments for operations closed during past 5 years).

SECTOR/SUBSECTOR FOR INTENSIVE EFFORTS
Date: 04/05/96

Table 6

Sector	Current Portfolio		Actual Problem Projects		Potential Problem Projects		Projects At Risk		Commitments At Risk	
	No.	Commitment (US$M)	No.	%	No.	%	No.	%	US$M	%
[illegible]lture										
[illegible]estry	32	1,720.1	4	12.5	7	21.9	11	34.4	461.1	26.8
Irrigation And Drainage	65	6,313.0	19	29.2	5	7.7	24	36.9	2,585.5	41.0
Research and Extension	45	1,408.1	7	15.6	11	24.4	18	40.0	637.0	45.2
Transportation										
Highways	82	9,520.7	15	18.3	13	15.9	28	34.1	3,614.7	38.0
Water Supply & Sanitation	88	7,892.9	22	25.0	18	20.5	40	45.5	4,158.4	52.7
TOTAL	312	26,854.8	67	21.5	54	17.3	121	38.8	11,456.7	42.7

Note:
Potential problem projects are defined as having Satisfactory IP and/or DO in the last 590, but meeting two or more of the following criteria:

1. Elapsed time between Board and effectiveness > 12 months.
2. Compliance with legal covenants rated 3 or 4 in the last 590.
3. Management performance rated 3 or 4 in the last 590.
4. Counterpart funds rated 3 or 4 in the last 590.
5. Procurement progress rated 3 or 4 in the last 590.
6. Financial performance rated 3 or 4 in the last 590.
7. Slow disbursing (project age > 2 year; disbursement level less than half of the original or formally revised forecast).
8. Unsatisfactory rating for 2 or more consecutive ARPPs(IP and/or DO) in previous years.
9. Located in a country with a history of high 'failure' rate (>50% unsatisfactory commitments for operations closed during past 5 years) and no major change in economic management.
10. Belongs to a lending instrument with a history of high failure rate (>33% unsatisfactory commitments for operations closed during past 5 years).

Table 7

LENDING INSTRUMENTS FOR INTENSIVE EFFORTS
Date: 04/05/96

Instrument	Current Portfolio		Actual Problem Projects		Potential Problem Projects		Projects At Risk		Commitments At Risk	
	No.	Commitment (US$M)	No.	%	No.	%	No.	%	US$M	%
[redacted]cial Intermediary Loan	55	5,724.7	14	25.5	20	36.4	34	61.8	2,986.2	52.2
[redacted]nical Assistance Loan	139	2,812.1	24	17.3	33	23.7	57	41.0	1,260.0	44.8
Sector Investment & Mainten.										
Agriculture	22	1,385.6	4	18.2	6	27.3	10	45.5	675.5	48.8
Education	26	2,683.7	7	26.9	3	11.5	10	38.5	1,164.6	43.4
Transportation	28	3,363.2	10	35.7	7	25.0	17	60.7	2,071.4	61.6
TOTAL	270	15,969.3	59	21.9	69	25.6	128	47.4	8,157.8	51.1

Note:
Potential problem projects are defined as having Satisfactory IP and/or DO in the last 590, but meeting two or more of the following criteria:

1. Elapsed time between Board and effectiveness > 12 months.
2. Compliance with legal covenants rated 3 or 4 in the last 590.
3. Management performance rated 3 or 4 in the last 590.
4. Counterpart funds rated 3 or 4 in the last 590.
5. Procurement progress rated 3 or 4 in the last 590.
6. Financial performance rated 3 or 4 in the last 590.
7. Slow disbursing (project age > 2 year; disbursement level less than half of the original or formally revised forecast).
8. Unsatisfactory rating for 2 or more consecutive ARPPs(IP and/or DO) in previous years.
9. Located in a country with a history of high 'failure' rate (>50% unsatisfactory commitments for operations closed during past 5 years) and no major change in economic management.
10. Belongs to a lending instrument with a history of high failure rate (>33% unsatisfactory commitments for operations closed during past 5 years).

Table 8

COUNTRY PORTFOLIOS WITH OUTSTANDING PERFORMANCE
Date: 04/05/96

[redacted]	Country	Current Portfolio No.	Current Portfolio Commitment (US$M)	Actual Problem Projects No.	Actual Problem Projects %	Potential Problem Projects No.	Potential Problem Projects %	Projects At Risk No.	Projects At Risk %	Commitments At Risk US$M	Commitments At Risk %
AFAVP	CHAD	12	254.9	1	8.3	0	.0	1	8.3	19.3	7.6
	MAURITANIA	11	176.9	0	.0	0	.0	0	.0	.0	.0
EAPVP	CHINA	96	16,024.6	5	5.2	3	3.1	8	8.3	991.5	6.2
	THAILAND	11	1,011.6	1	9.1	0	.0	1	9.1	32.0	3.2
	VIET NAM	10	1,119.7	0	.0	0	.0	0	.0	.0	.0
ECAVP	ALBANIA	19	207.6	1	5.3	0	.0	1	5.3	9.6	4.6
LACVP	CHILE	13	756.3	1	7.7	0	.0	1	7.7	49.8	6.6
	ECUADOR	14	858.0	2	14.3	0	.0	2	14.3	45.0	5.2
	NICARAGUA	7	250.7	0	.0	0	.0	0	.0	.0	.0
	PANAMA	5	205.0	0	.0	0	.0	0	.0	.0	.0
MNAVP	LEBANON	6	362.9	0	.0	0	.0	0	.0	.0	.0
TOTAL		204	21,228.2	11	5.4	3	1.5	14	6.9	1,147.2	5.4

Note:
Potential problem projects are defined as having Satisfactory IP and/or DO in the last 590, but meeting two or more of the following criteria:

1. Elapsed time between Board and effectiveness > 12 months.
2. Compliance with legal covenants rated 3 or 4 in the last 590.
3. Management performance rated 3 or 4 in the last 590.
4. Counterpart funds rated 3 or 4 in the last 590.
5. Procurement progress rated 3 or 4 in the last 590.
6. Financial performance rated 3 or 4 in the last 590.
7. Slow disbursing (project age > 2 year; disbursement level less than half of the original or formally revised forecast).
8. Unsatisfactory rating for 2 or more consecutive ARPPs(IP and/or DO) in previous years.
9. Located in a country with a history of high 'failure' rate (>50% unsatisfactory commitments for operations closed during past 5 years) and no major change in economic management.
10. Belongs to a lending instrument with a history of high failure rate (>33% unsatisfactory commitments for operations closed during past 5 years).

PROJECTS WITH GOOD PERFORMANCE IN COUNTRIES WITH PROBLEM PORTFOLIOS
Project Age: 2+
Date: 04/09/96

[redacted]	Country	Project ID	Project Name	Board Approval Date	Rev Closing Date	Impl Prg	Devl Obj	Commitments US$M
[redacted]	ROMANIA	8771	TRANSPORT	04/13/93	12/31/98	HS	HS	120.0
ECAVP	TURKEY	9030	HEALTH I	05/11/89	12/31/97	HS	HS	75.0
ECAVP	TURKEY	9051	STATE AND PROVINCIAL ROADS	05/14/91	06/30/97	HS	HS	250.0
ECAVP	TURKEY	9064	EMPLOYMENT & TRAINING	12/10/92	12/31/99	HS	HS	67.0
LACVP	BRAZIL	6448	LND MGMT I-PARANA	01/31/89	03/31/97	HS	HS	63.0
LACVP	COLOMBIA	6852	MUNIC DEVT	05/30/91	12/31/97	HS	HS	60.0
LACVP	MEXICO	7690	PRIMARY EDUCATION	09/26/91	12/31/96	HS	HS	212.6
LACVP	MEXICO	7696	HOUSING MARKET DEVELOPMENT	06/25/92	12/31/96	HS	HS	450.0
LACVP	MEXICO	7716	INITIAL EDUCATION	09/08/92	06/30/98	HS	HS	74.0
LACVP	MEXICO	7724	LABOR MARKET & PROD. ENHANCEME	12/15/92	06/30/98	HS	HS	174.0
LACVP	MEXICO	7725	PRIM.EDUC.II	03/31/94	12/31/99	HS	HS	372.0
MNAVP	ALGERIA	4952	FIRST PETROLEUM	07/30/91	06/30/96	HS	HS	100.0
MNAVP	EGYPT	5146	NATIONAL DRAINAGE	11/26/91	12/31/99	HS	HS	120.0
MNAVP	EGYPT	5149	IRRIG./PUMPING	05/15/90	12/31/97	HS	HS	31.0
MNAVP	MOROCCO	5433	PORT SECTOR	12/20/90	06/30/96	HS	HS	127.0
MNAVP	MOROCCO	5458	INDUSTRIAL FINANCE	12/05/89	06/30/96	HS	HS	169.0
SASVP	NEPAL	10396	TELECOMS. V	05/12/92	06/30/99	HS	HS	55.0

Chron GK

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director, Operations

March 25, 1996

Note to Mr. James D. Wolfensohn

Jim,

RE: Your attached note on hot-spots

You now should have the notes from Africa and South Asia in addition to Latin America. The East Asia note was delayed due to Russ' absence, but the acting RVP will be sending you the note this week. That means four of the six Regions are already in the loop. Caio will be speaking to Johannes and Kemal for those two Regions to initiate the hot-spots notes. In view of this, I do not believe there is merit in your having to send out a note to the VPs. Your reactions, comments and questions on their notes will serve to emphasize your interest in receiving such notes as significant events develop in the respective Regions.

Gautam

Attachment

cc.: Mr. Koch-Weser, Ms. Lomax

3122

The World Bank
Washington, D.C. 20433
U.S.A.

JAMES D. WOLFENSOHN
President

March 18, 1996

Mr. Gautam Kaji
Room D-10-065
The World Bank

ECA
MGWA
ESTP

LAC
Africa
South Asia

Dear Gautam,

I enclose a note I was just thinking of sending to the Vice-Presidents but ask you to review it before we send it out. I should also note, that I have just come across the Africa hot-spots note and I think it is also a great idea and would recommend that we send it out to each of the Vice-Presidents. May I leave the whole matter to you?

p.p. James D. Wolfensohn
(dictated and signed in his absence)

cc: Rachel Lomax

The World Bank
Washington, D.C. 20433
U.S.A.

JAMES D. WOLFENSOHN
President

March 18, 1996

Note to each of the Regional Vice Presidents

I have been working with Javed Burki, getting a weekly or bi-weekly update from him on hot-spots and I enclose a photocopy of the most recent note of March 8, 1996. It would be very helpful to me if every couple of weeks - or when necessary - you could let me have a similar note from your region and in view of the fact that all of us would benefit from this activity, we should consider sending it around to each of the Vice Presidents.

James D. Wolfensohn
(dictated and signed in his absence)

Chron 6K -

A L L - I N - 1 N O T E

DATE: 25-Mar-1996 03:22pm

TO: See Distribution Below

FROM: Joanne Salop, EXC (JOANNE SALOP@A1@WBWASH)

EXT.: 37499

SUBJECT: Zimbabwe CAS: Minutes of EXC Discussion

The above are attached. Kindly note that Mr. Kaji has cleared them.

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Zimbabwe CAS: Minutes of EXC Review

1. Mr. Kaji chaired the EXC discussion of the Zimbabwe CAS, which took place on March 20 at 3:30 pm. Attendees included: Messrs./Mmes. Shihata, Baird, Chopra, Denning, Marshall, McCalla, Stern, Haddad, Salop, Kafka, Shilling, Lav, Mills, and Garcia-Thoumi. The agenda for the discussion is attached. The Chairman concluded that the CAS should not be sent to the Board at this time, but should be put on hold pending further CAS development and consultations with the Cabinet, which may be reshuffled following last week's elections.

2. The Region said that the Bank's relationship with Zimbabwe had long been frustrating. In the 1980s the Bank had tried to develop the relationship and the relationship strengthened during a period of reform in the early 1990s in which Zimbabwe performed fairly well; but more recently there had been a period of less commitment to reform and slower growth. A speaker opined that the real issue was Zimbabwe's socialist orientation. The Region said that the difference between the Bank and Zimbabwe was less a matter of ideology than differences about the scope and pace of reform. In assessing the business relationship, the Chairman observed that the line agencies appeared to see the benefit of the Bank, while the center seemed unable to make clear decisions and to follow through on priorities, in part because of the lack of a Finance Minister for so long.

3. The Chairman asked how the Government could sustain borrowing at a rate of some 10 percent of GDP each year. The Region said that this was indeed a serious problem; Zimbabwe was in a debt trap, with 10 percent real interest rates and large domestic debt stocks. But there was scope for enhancing revenues through indirect and direct taxes (including petroleum taxes) and for cutting in discretionary expenditures, including military payments. The public expenditure review now underway involved a sector-by-sector cost-effectiveness review.

4. Participants discussed the criticisms of the Bank in Zimbabwe. Much of the discussion focused on the attitude of President Mugabe, who the Region said disliked the Bank and the Fund partly because of the role of the international community during pre-Independence era. The Region said that much of the international NGO critique of the Bank was rooted in Zimbabwe, hence the Zimbabwe case had wider institutional implications. The Chairman said that some of the criticisms appeared valid, noting that the fiscal situation had worsened during the adjustment program. The Region said that this was due to uneven implementation; when the reform program had been introduced, the Government had taken the revenue measures, which included tariff cuts, but had failed to cut expenditures correspondingly.

5. The Chairman said that the CAS's discussions of the high case IBRD and IDA programs was confusing, as the high case seemed very unlikely on current performance. The Region said that

Zimbabwe is now in the low case, but that the high case could not be entirely ruled out.

6. The appropriateness of taking the CAS to the Board was discussed. The Region said that there was a need to take a project to the Board; however, this was not the most convenient time to be presenting a CAS because the Cabinet might be changed, including the appointment of a Finance Minister. A participant said that we should delay the CAS, and give the new Government a chance; the current (rather negative) CAS might prejudice the relationship at the very outset. The Chairman said that the CAS should be delayed until there had been an opportunity to open up the dialogue with the new Cabinet.

ZIMBABWE CAS: Agenda for EXC Review

1. Growth, Poverty Reduction, and Sustainable Development

* At $520, Zimbabwe's per capita income is higher than most of its neighbors'. But its future prospects are subject to wide variation. In the high case, per capita income could reach $918 by 2020. But in the low case, it could fall to $384. What are the key steps that Zimbabwe needs to take to get onto the virtuous circle associated with the high case? What's keeping the Government from taking those steps? What are the risks of its getting onto the vicious circle associated with the low case?

* The CAS emphasizes the need to protect past investments in education and health, and to build on them, particularly by focusing on primary education and health. The CAS also notes the perception that the adjustment program has aggravated the plight of the poor. In light of this, should any future adjustment and social sector investment operations include specific expenditure and impact targets for the primary health and education sectors? Can the CAS be more specific not only about what would be needed for Zimbabwe, but also any such prerequisites for our operations?

* How is the Country Environmental Strategy that was prepared in 1994 reflected in the strategy? What is the relationship between the CAS and the preparations that are underway for the Ntional Environmental Action Plan? The CAS points to the importance of increasing particpation of indigenous people in the economy. What is the Government's strategy? How will the Bank support it?

2. Adjustment and Debt

* The CAS portrays the fiscal deficit as public enemy number one, and describes the largely unsuccessful effort Zimbabwe has been making over the past several years to contain it. What's the underlying political economy of the Government's inability to bring down the deficit? How does this political economy relate directly to President Mugabe? What was the outcome of the March 16-17 elections? What are the (political) prospects for getting a major fiscal correction?

* With expenditures around 40 percent of GDP and revenues around 29 percent, clearly expenditures have to come down, but which ones? How much do we expect privatization and parastatal reform to contribute to the expenditure reduction, apart from the impact that we expect to get from using the proceeds of privatization to reduce the stock of domestic debt? What findings are emerging from the PER? Do we agree, in principle, with the Government on the expenditure priorities and the components of expenditure to cut? To what extent is the expenditure control problem a reflection of a weak institutional systems, and what is the Bank doing in this area? How can the Bank protect itself against possible charges that it is hurting the poor by its stance on fiscal reform?

* The CAS argues that the Government would be better off substituting IDA borrowing for local market taps. While IDA adjustment money is fungible, investment credit resources are less so. What modalities for IDA lending are envisaged here? Also what magnitudes are up for discussion? Zimbabwe's Public Sector Borrowing Requirement (PSBR) totals some $500 million per year. Can incremental IDA lending covering some 10 percent of the PSBR be expected to catalyze a significant fiscal correction? What has been the experience with SAC II in catalyzing fiscal reform?

3. Bank Program, Portfolio, Participation, and Performance Indicators

* The relationship with Zimbabwe is troubled. The cover note cites three reasons: no Minister of Finance; weak commitment to poverty reduction; and weak demand for IDA/Bank-financed investment operations. But President Mugabe also is hostile to the Bank (and the Fund). What is the underlying problem? Should Bank-Government working relations be renegotiated? If so, how?

* The base case IDA program of $100 million per year exceeds Zimbabwe's allocation of $75 million. How can the higher program be justified -- particularly in the face of the apparently weak commitment to poverty reduction? Will Zimbabwe's FY96 rating be sustained in the FY97 exercise, given that the macroeconomic situation does not warrant the release of SAC II'S second tranche?

* The high case would include up to $50 million per year in IBRD financing, and the base case could include IBRD. What would be the triggers for the latter? Is there a role for guarantees in the IBRD program? For the analysis of creditworthiness for IBRD borrowing, what are Zimbabwe's relations with creditors access to external capital markets, in relation to likely policy and economic performance?

* What are the fiscal triggers for the high case? Given the Government's apparent reluctance to borrow from IDA, what are the carrots in the high case?

* The portfolio is generally in good shape, with only one closed project likely to earn an unsatisfactory rating from OED. What are the lessons learned from that project and how were thoses lessons taken into account in the follow-up enterprise devlopment project that is to be presented to the Board with the CAS?

* What is the Government's stance with respect to the Bank's engaging in active dialogue with non-governmental stakeholders and other third parties in Zimbabwe? Against this background, how far should the Bank go in opening a policy dialogue with NGOs and investing in major outreach efforts? Is it prudent to include an item in the Board agenda on the appropriateness of

consulting with stakeholders despite Government "hesitation"?

* What are the key performance benchmarks that should be used to evaluate Zimbabwe's performance over the next few years? By what benchmarks does the Bank's Zimbabwe team want to be judged? With the latter performance criteria in place, how would the proposed program change from that laid out in the CAS?

* In considering risks to the program: How broad-based is the ownership of the reform program? How vulnerable is Zimbabwe to adverse developments in South Africa? How much at risk is the program and the portfolio because of weak capacity? What are we doing to address these risks?

Clinton Bic

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director, Operations

February 22, 1996

Note to Mr. James D. Wolfensohn

Jim,

Re: Africa Region

After our discussion last night, Caio and I met with Cal and Jean-Louis to do some stock taking on the level of concern and frustration in the Africa Region as communicated to you by Kim Jaycox. Attached is a note from Cal and Jean-Louis which I wanted to share with you. I am also taking the liberty of asking them to join us in our meeting tomorrow with you on Change Management. Taking stock of Africa and your getting the feel of where we are heading would be the major agenda item.

Gautam

Attachment

cc: Ms. Lomax, Mr. Koch-Weser

The World Bank
Washington, D.C. 20433
U.S.A.

AFRICA REGION
Office of the Vice President

CALLISTO E. MADAVO
Vice President

JEAN-LOUIS SARBIB
Vice President

February 22, 1996

Note for Mr. Kaji

Gautam,

You asked for a brief note on the state of play and the state of mind on Change Management in the Africa Region.

When Kim introduced us to staff on February 13, we stated three priorities: (i) to clarify the assignment of responsibilities between us; (ii) to focus on the change effort; and (iii) to get hold of the work program.

The first of these priorities is under control, and the concept of "one Region, one vice presidential office, one team-two-in-a-box" is making headway.

To get hold of the work program, we met with the management teams of all 5 Country Departments (we are seeing the Technical Department this Friday). Much of the conversations during these meetings ended up focusing, in fact, on Change Management.

We have also organized a half-day brainstorm with the Regional Management Team (directors, Chief Economist, CAO, Chief Personnel Officer, and D. Wai) to define our work at Harvard. We will come to you for comments and guidance on the terms of reference we have developed for the Harvard program with inputs from our colleagues.

Our message in these conversations:

- The Africa Region has done a lot of good work to improve its ability to get results on the ground, and we intend to build on it.
- Bank wide, the Change Management Group has articulated a compelling vision of the future and broad concepts (some of which, such as the COMs, were 'invented' in the Region) with which we all agree. The task now is to translate these concepts into practical proposals fitting our operational and client realities.
- Our focus will be on marrying the work done in the Region with the ideas developed by the Change Management Group to come up with a "true pilot", which will allow us to test various organizational set ups against a set of agreed performance criteria. We will do so in a way that minimizes disruption in services to our clients.

- The CMG ideas have opened up new possibilities and created a new situation. By removing the constraint of staying within departmental structures, a broader array of alternatives can now be considered.
- In working on change proposals, we will maintain open communications with the Region, CMG, and other pilots (especially LAC).

Our assessment is:

- People (whether in the large staff meeting with the whole Region on in one-on-one meeting with directors) are generally receptive to our approach. They have accepted the need to give us space. And they see the need to allow the new VP's to revisit the Region's proposal, and to nest it within the broader concepts developed by the CMG.
- Some directors have raised the issue of who will perform some of their current functions (arbitration, maintaining a sub-regional perspective, high level chairing of CG's, staffing and staff development, etc.) if we delayer. Some directors are clearly energized and excited by the opportunities created by the new situation.
- There is ownership for the approach developed in the Region (particularly in departments which have worked in a participatory manner), but also openness to new ideas that would build on the work done.

Bottom line:

- People in the Region are prepared to give us time to think through the change process. In the meantime, we are asking them to focus on the clients and the work program.
- But there is clearly a pent-up demand for decisions, for clarifications on what lies ahead, and for who will be doing what.
- Provided we maintain an open process, with a "true pilot" as the outcome, the energy and ownership created by the Region's change process to-date can be recaptured, and re-directed to support future changes.

Our objectives are to come back from Harvard with a clear road-map (specifying all but 'detailed engineering' questions) and a timetable for change. We intend to remain in close contact with the Bank when we are in Harvard, to test ideas as we progress in our thinking.

Between March 15 (when we come back) and April 1 (when we take our new jobs), we intend to hold a series of town meetings to present our ideas and get feedback. The period April 1 - May 15 would be devoted to getting the 'detailed engineering' done. We can then use the second part of the Harvard program (second half of May) to put the final touches on our game plan. The objective is a July 1 "roll out" of the Africa pilot.

Callisto

J-L

Jean-Louis

THE WORLD BANK

Managing Director, Operations

2/22

A. Wapenhans

Jim.

We spoke about this today.

GAUTAM S. KAJI

THE WORLD BANK GROUP
WASHINGTON, D.C. 20433
U.S.A.

EXTERNAL AFFAIRS
OFFICE OF THE VICE PRESIDENT

DATE: February 12, 1996 PAGES: (7)
(Including cover sheet)

TO: **Mr. James D. Wolfensohn, President**

FAX NO.: 202/522-3031

FROM: **Mark Malloch Brown**
Vice President, External Affairs
1818 H Street, NW, Washington, DC, 20433
United States of America

FAX NO.: 202/522-2644

PHONE: 202/458-5914

SUBJECT: **PRESS CLIPPINGS**

MESSAGE: For your information...

President Has Seen

This item appeared on page C1 of the February 11, 1996 issue of the
WASHINGTON POST

The Plight of the Barking Bambi

In Laos, Rare Animals and Virgin Forest Stand in the Way of a Profiteer's Dream

By Doug Fine

VIENTIANE, Laos—It's tough to find someone who has a bad word to say about Gen. Cheng Sanyavog, a Laotian military honcho who doubles as chief executive officer of a timber front called the Mountainous Development Co. The praise I heard for the schools he builds, the jobs he provides and even the Ferris wheels he erects made me feel like I was covering a philanthropic entrepreneur in Cali or Medellin.

Cheng, I hasten to add, isn't exporting controlled substances. But he is cutting down large amounts of some of the most pristine and biologically diverse old-growth coniferous forest left on Earth. And he is spreading the profits around to a degree no one has ever seen in this remote country, so few complain.

I followed the general all over the country, trying to ask him if we could set up a time to discuss whether he was aware of some of the ramifications of his personal timber industry in general and the Nam Theun II dam project in particular. No one quite knows how many trees have been cleared in the 268 square-mile "inundation zone" for the hydroelectric project. The project hasn't even been formally approved as the various participants—Australian, Lao and Thai firms—wait to see if the World Bank decides to back Nam Theun II.

Meanwhile, these just aren't any old trees that Cheng is cutting down. The east central part of Laos, adjacent to the Annamite mountains along the Vietnam border and traversing the Ho Chi Minh trail, is home to diverse populations of tiger, clouded leopard, Asiatic Bear, and a species of barking deer identified by Western scientists less than two years ago. Two weeks ago, the first specimen of an elk-like animal called the soala was captured in the Annamite forest. There are also more than 4,000 ethnic Hmong people who live in this region, many of whom have never heard of a hydroelectric dam or even of the Vietnam War.

In the Vientiane offices of the savvy Mountainous Development Co., I was told the general wasn't in. But a manager had nothing to hide: "Oh, sure, we're pulling in a ton of money from the timber," Seugmany Viyaketh said, giving me an is-the-pope-Catholic? look. "These are some of the straightest, tallest evergreens in the world."

I tailed the general up to Lak Xio (staying at the MDC-owned hotel there), a timber boom town just outside of the inundation area. I visited his manorial mansion facing away from the town's hastily-constructed central square against the breathtaking backdrop of the Annamite range, and shouted inside his gate. No answer. It was the eve of the Hmong New Year, and locals dressed in traditional clothing were filtering into town on bicycle and on foot, unaware that it might be among the last years their villages have a water source. The dam, according to Owen Lammers, executive director of the International Rivers Network, a California-based conservation group, will divert and pollute the river upstream from their homes.

The general is famous as a nature lover. He had a pond constructed behind his house so exotic ducks and swans would be visible from his bedroom window, and he has a zoo nearby. A helpful man carrying an AK-47 machine gun showed me behind the grounds to what was indeed the general's private menagerie. There, tucked in an inconspicuous cage behind a neurotic Asian bear and a jungle gym for the kids, was the world's only known captive specimen of the barking deer.

The creature, known formally as the large-antlered Muntjac, was about the size of a large American deer but with tiny horns. When the barking deer gets excited it yelps like a lap dog, possibly to ward off predators. A rather ugly, timid prima donna, this Muntjac made itself extremely difficult to photograph. I had to chase it a while to get a decent shot.

Cheng proved even more elusive than his barking deer. So I abandoned my search for him and set out with a translator for the proposed dam area via a logging boom town called Thakhek, about 90 miles south of Vientiane. The trip took nine hours on a livestock-filled bus. When I pulled into town, logging trucks were lined 10 deep at a Shell station.

We traversed the periphery of the Nakai Nam Theun National Park, which would be ruined by the dam on its border, according to nearly every foreign aid organization working in the area. The major river, the Nam Theun ("Nam" is the Lao word for river), will be choked. "There could hardly be a place chosen which would have more impact," a scientist familiar with the region told me.

The logging industry is clearly no temporary phenomenon that will withdraw once the dam area is cleared. Less than an hour outside of Lak Xio, literally in the middle of the forest, we saw Western, suburban-style housing being erected for timber workers, complete with TV antennas and general stores. It is simply too profitable to stop. At $2,400 per tree, wholesale, these trees are more valuable than heroin (which was said to be the reason for Lak Xio's existence prior to the general's setting up shop).

As we sped out of Thakhek up the red clay road to the Annamite Plateau just after sunrise, we were greeted at every turn by a new layout of stark, bulbous peaks, lakes, flowering meadows and, here and there, a rice field with grazing water buffalo. As we climbed, vast vistas of undisturbed forest unfolded into view, as dense as I've seen in Amazonia or Africa. "Tiger country," my translator Boi said, and he was scared. "They attacked livestock here a few weeks ago."

But as we got deeper into the forest the roar of diesel engines betrayed increased human presence, and the blinding dust clouds from the approaching logging trucks started. The Russian vehicles, heading back to

Thakhek's plywood mills and the MDC shipping docks along the Mekong across the street from my hotel, made full use of roads being widened by crews of $50-a-month laborers. Cheng has every step of the process down. The trees (mostly cedar) are so huge that each truck could handle only three or four of them, each often 1,000 years old.

The farther you get along the route toward the dam site, the more construction you see. Brand new power lines teetering precariously beside cranes and Caterpillar construction vehicles were a reminder of the dreamer's credo: "If you build it, they will come." Lining the road in places were killing fields of orderly raw logs, each labeled with an ID number. Everywhere was evidence of deforestation and erosion. At times the dust in the road got so deep we had to walk the motorbikes.

Let's be quite 1990s about this. Let's leave aside the human and environmental impact of this proposed dam, and talk economics. Ask someone from the U.S. Bureau of Reclamation about big hydroelectric projects and you will learn that they are rarely constructed on time or under budget. It is even more rare that they generate the electric output their backers promise. The proposal for the Nam Theun II project, for example, assumes a wishful 80 percent output rate for the river's flow. (The output rate is the ratio between the volume of water that actually flows in the river and the maximum potential flow of the river.) Laos's existing dams run between 40 and 60 percent, according to sources in the country.

As for the budget, Laos would be a 25 percent owner of the proposed $1.2 billion project. Foreign companies would own the rest. The average dam goes over budget by 30 percent, according to World Bank records. If Nam Theun II is built, and goes over budget by a conservative 15 percent, that would leave Laos with a tab of $45 million. How will a destitute country of 4.2 million people which invested only $10 million in health care last year foot such a bill?

The answer: It can't. But the dam doesn't even have to be built for the damage to be done. The way things operate in this part of the world, all anyone needs from the government to get the ball rolling on a deal is something called a Memorandum of Understanding (MOU). This allows the timber interests—read Cheng and the Mountainous Development Co.—to start clearing huge areas of ancient forest growth.

The MOU also provides the dam construction companies such as Australia's Transfield Holdings, Ltd. with a valuable chip on the table in any kind of negotiation. As it was explained to me by an American businessman in Vientiane, a consortium of Transfield, French and Thai interests now control Nam Theun II. My repeated requests for comment on the Lao dam project went unanswered by Transfield.

The company might have no intention of following through on the 25-year lease from the Lao government. They might just sell off the rights when they need liquidity, or use them as a trump card to boost stock prices.

The wild card in this whole mess is the World Bank, the potential low-interest loan guarantor for Nam Theun II. Bank officials, reeling a bit from the cancellation of an obviously ridiculous dam project in Nepal last year, are caught in an ugly Catch-22. It's a wonderful idea to try to support development in poor countries but sources in the Bank are candid enough to admit that they're just learning how to bring true environmental and social awareness to the table in project proposals. The cacophony of protest around Nam Theun II is too loud to be ignored. Most World Bank people, itching to but afraid to talk on the record, call Nam Theun II "extremely sensitive" because of the Nepal fiasco. I asked Rachel McColgan-Mohamed, an external affairs official in Washington, if the bank would support Nam Theun II. "We are not committed either way," she said.

In Laos, government officials are not-so-privately very nervous that the bank will indeed abandon Nam Theun II. If that happens, many argue, the project will lose the bulk of its private investors. Once they're fully footing the bill (the argument goes) they will recognize what a shaky and historically money-losing endeavor they are getting into.

Another "lesser of two evils" school of thought, mostly propagated by economists who have spent very little time inside Laos, argues that even without the Good Housekeeping Seal of Approval from the World Bank and the environmental and socio-economic requirements such backing would require, the project will go forward anyway. This time, though, it might be financed by amoral Thai businessmen who (according to the local theory) couldn't care less if they flood out every rice field, tiger and villager in the country.

Meanwhile, the World Bank is financing a new environmental impact study to be conducted this time by the Wildlife Conservation Society and three other groups. After months of no-comment responses from the WCS while their evaluation was on-going, the Society's director for Asia programs, Alan Rabinowitz, announced in a letter Feb. 7 that, "I am giving my full support to the Nam Theun 2 Project as long as the World Bank remains involved." Bank officials decline to say when the bank will decide if it will help finance the dam.

The irony of it all is that not one kilowatt of theoretical power from Nam Theun II would go to Laos. A single dam north of Vientiane already takes care of the electricity needs of the whole country. All of the power generated would be exported to Thailand. I asked Inthavong what would make the normally suspicious Lao people (who do not hesitate to inform the foreign visitor that they fought and won a war with Thailand over timber poaching in 1987) trust foreign businessmen who come in and say a dam will be good for the Lao people and economy? This despite a long history that demonstrates the opposite and the fact that most developed countries, including the United States and Thailand, refuse to build any more large dams on their own territory. He thought about it for a moment, and then gave me the answer of bureaucrats everywhere: "That's really not my department."

Nam Theun II is being looked at by all sides as an indicator of the future of large hydropower projects in Southeast Asia. Will it be built? Claude Vincent, a French businessmen who moves widely in business and government circles, told me he thinks, "It has to, because to not build it at this point would entail a tremendous loss of face. But I think it will be the last big one."

It will also make 1998 (or so) the last Hmong New Year celebration for the several thousand people whose families have lived in the area for several thousand years. It would severely hamper the search for rare species of mammals and birds. If ever you want to see a barking deer, you'll probably have to go to Gen. Cheng's private zoo.

Doug Fine has reported from Africa, Alaska, South America and Southeast Asia. His work can be found on the Web at http://www.well.com/user/fine.

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THE WORLD BANK

Managing Director

15/18

Jim:

Perhaps Ibrahim has already sent the attached to you. In case he has not you may want to see this.

GAUTAM S. KAJI

THE WORLD BANK GROUP
CODE OF PROFESSIONAL ETHICS

Being a staff member of the World Bank Group offers a unique opportunity to contribute to the institution's mission: to reduce poverty and improve people's living standards throughout the world. Bank Group service also entails certain obligations: to promote the objectives of the World Bank Group; to serve with probity, integrity, and impartiality; and to hold oneself to the highest standards of professional ethics.

Staff members of the World Bank Group are expected to perform their assigned duties with the highest level of technical competence and efficiency. They are also expected to treat fellow staff members in a courteous, professional manner--free from any form of harassment or discrimination--and thus benefit from working in a diverse, multinational workplace. Staff members who serve as Managers should provide staff reporting to them with honest, clear and constructive evaluations of work free from bias or favoritism.

To meet the highest standards of professional ethics, staff members should:

-- observe the policies, rules and procedures adopted by the World Bank Group, including rules relating to situations of conflict of interest, and report to supervisors any departure by other staff members from such policies, rules, or procedures;

-- pay due regard to the appropriate use of World Bank Group resources;

-- undertake official actions without being influenced by personal relationships or considerations;

-- act within the scope of their authority;

-- retain full accountability and responsibility for tasks delegated to other staff and exercise adequate control and supervision;

-- consult appropriately with fellow staff and managers to ensure that decisions are based on full and accurate information consonant with the weight of the decision, and provide decision-makers with candid

analysis;

-- respect the dignity and privacy of colleagues in their personal lives.

Staff members should adhere to the same standards of professional ethics in their dealings with member governments and all others with whom they come in contact by virtue of their work.

In fulfilling these obligations, staff members should be mindful of the requirements imposed on staff by the Articles of Agreement, the Principles of Staff Employment, and the Staff Rules which apply to the Bank, IFC, and MIGA, in particular, of Chapter 3 of the Principles which relates to the general obligations of staff members and Staff Rule 3.01, Outside Activities and Interests, which implements that Chapter. (Staff members should refer to the Staff Manual for familiarization with all requirements of Staff Rule 3.01, "Outside Activities and Interests," which includes provisions on disclosure and use of inside information, on disclosure of financial and business interests, and where applicable on financial disclosure statements of senior staff. Provisions of the Articles and Chapter 3 of the Principles of Staff Employment are set out below.)

Staff members encountering a situation that may pose an issue of professional ethics may seek advice from their manager and/or consult with the Ethics Officer or the Ombudsman.

Articles of Agreement

Article V, Section 5(c) of the Articles of Agreement of the Bank (and corresponding provisions in the charters of other Bank Group institutions) provides that:

> "The President, officers and staff of the Bank, in the discharge of their offices, owe their duty entirely to the Bank and to no other authority. Each member of the Bank shall respect the international character of this duty and shall refrain from all attempts to influence any of them in the discharge of their duties."

Principles of Staff Employment

Chapter 3 of the Principles of Staff Employment (which applies to MIGA as well as the Bank and IFC) provides as follows:

> " The sensitive and confidential nature of much of their work requires of staff a high degree of integrity and concern for the interests of the Organizations. Moreover, as employees of international organizations, staff members have a special responsibility to avoid situations and activities that might reflect adversely on the Organizations, compromise their operations, or lead to real or apparent conflicts of interest. Therefore,

staff members shall:

(a) discharge their duties solely with the interest and objectives of the Organizations in view and in so doing shall be subject to the authority of the President and responsible to him;

(b) respect the international character of their positions and maintain their independence by not accepting any instructions relating to the performance of their duties from any governments, or other entities or persons external to the Organizations unless on secondment to them or employed by them while on leave of absence from The World Bank or the IFC. Staff members shall not accept in connection with their appointment or service with the Organizations any remuneration, nor any benefit, favor or gift of significant value from any such governments or other entities or persons, nor shall they, while in the service of The World Bank or the IFC, accept any medal, decoration or similar honor for such service. Staff members may retain employment rights or pension rights acquired in the service of another organization;

(c) conduct themselves at all times in a manner befitting their status as employees of an international organization. They shall not engage in any activity that is incompatible with the proper discharge of their duties with the Organizations. They shall avoid any action and, in particular, any public pronouncement or personal gainful activity, that would adversely or unfavorably reflect on their status or on the integrity, independence and impartiality that are required by that status; and

(d) observe the utmost discretion in regard to all matters relating to the Organizations both while they are staff members and after their service with the Organizations has ended. In particular they shall refrain from the improper disclosure, whether direct or indirect, of information related to the business of The World Bank or the IFC.

All rights in any work produced by staff members as part of their official duties shall belong to The World Bank or the IFC unless such rights are explicitly relinquished.

Privileges and Immunities

Staff members shall enjoy, in the interest of their Organizations, privileges, immunities, and facilities to which the Organizations, their officers and employees are entitled under their respective Articles of Agreement or other applicable treaties or international agreements or other laws. Such privileges, immunities, and facilities shall not excuse staff members from the performance of their

private obligations or from the due observance of the law. Having regard to the particular circumstances, the Organizations may decide whether, in the interests of the Organizations, an immunity shall be waived or invoked."

Questions: Contact the Ethics Officer on ext. 30276.

IS Keyword: The keyword for this information is ETHICS (once in IS, simply type FIND ETHICS).

Updated On:Thursday, June 22, 1995

Graham

He is meeting w
our Ps tomorrow —
may need prompting.

We also talked on the
Ranger — heard & seen
you about that too.

R

JN1 6 31

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

December 11, 1995

Note to Mr. James D. Wolfensohn

Jim,

FOR ACTION

ORIGINAL

RE: External Affairs Priorities and Resources

The Current Situation

1. External affairs activities are currently decentralized in the Bank. EXT is responsible for developing and implementing the Bank's communication strategy. But regions and thematic VPs carry out diverse public affairs activities independently of EXT.

2. On the basis of detailed stocktaking done by PBD and EXT, it has been determined that the Bank conservatively spends about $60 million annually on public affairs -- that is approximately 5% of the total budget. EXT has 40% ($24 million) of this budget, and the regions and thematic VPs have 60% ($36 million) - with significant concentrations in ESD, Africa and LAC.

3. Due to lack of coordination of public affairs programs, the Bank often does not communicate clear and consistent messages to external audiences.

What Needs to be Done

4. Two issues need to be looked at:

- Does the Bank have the right priorities in its public affairs programs?
- Should EXT have greater say over how the $60 million for public affairs is spent?

RECEIVED
DEC 12 1995
By

Next Steps

5. For FY97 business planning, the following actions are proposed. EXT should prepare an overall public affairs strategy for the Bank, with VPU participation and provide you with a Bank wide prioritized list of public affairs activities to implement the strategy. Once you decide on the activities, resources would be allocated to those charged to carry them out.

6. Until such a review is completed, the $36 million of VPU resources should be "sequestered" from their FY97 budgets for business planning purposes. The bulk of these funds would then be returned to the VPUs after your decision on priorities but not necessarily in the same proportion as their current distribution. Some of the funds may also be allocated to EXT for its public affairs activities.

7. VPUs are likely to protest vigorously the holdback of the $36 million, which amounts to about 5% of their total budgets. However, this step is essential in order for the Bank to have a well directed public affairs strategy and its implementation.

Are you comfortable with this approach?

cc.: Messrs. Malloch-Brown, Lynn

Chron 61C

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

December 11, 1995

Note to Mr. James D. Wolfensohn

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Next Steps

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cc.: Messrs. Malloch-Brown, Lynn

Chron

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

November 3, 1995

Note to Mr. James D. Wolfensohn

Jim,

RE: Guiding Principles for Change

The attached paper lays out for your review a set of principles and strategies to operationalize them. These emerge from our experience with individual change efforts already underway, the work of the two task forces and the discussions within the Sr. Management group.

As directed by you, the VPs and MDs have held several discussions. These served to confirm that there is a broad agreement on the institutional and managerial values that should guide the nature and direction of change. Our discussions were spirited but the tone and substance was always constructive. There are clearly individual concerns at the margin on some specific elements of strategies outlined for achieving the principles. But I do believe we have as much consensus as possible within a group of this size and that we have a solid enough foundation on which we can proceed further.

If after your review you are comfortable with the principles and strategies outlined, we need to launch a program of communication and consultations with staff. Mark is preparing proposals to initiate this and he will be sending you a separate note on the design of this process.

You may also wish to appoint a small group to provide more active and direct leadership on carrying this process further. Such a group would monitor progress; review proposals of individual Vice Presidents for their change effort to ensure that basic principles are respected, act as a clearing house to disseminate promising approaches and successful outcomes, and finally identify issues which need institution-wide response, e.g. personnel policy, budget, formal documentation, etc. I have some suggestions on the composition of the group which I would like to discuss with you.

There are plans to proceed with some change efforts in Africa and in one Department in Latin America. I would suggest that the group you appoint take a look at these proposals to ensure that they do not run counter to the principles and thereafter make recommendations to you on letting all or part of these proposals proceed. Concurrently, Shahid has launched an effort to examine some of the personnel policy related proposals, including performance assessment and reward systems.

It is important to emphasize that the strategies outlined are a starting point. These will be refined as we go through the process of consultations with staff and as we learn from the experience of efforts undertaken by individual VPs. The entire management group have agreed that we must do some collective stock taking periodically. Indeed, you may want to consider whether you should ask each VP to advise you say in six months, what if any change efforts they propose to undertake in their units.

Finally, we need to discuss how and when you would like to bring the Board into the loop.

GUIDING PRINCIPLES
FOR INSTITUTIONAL CHANGE

"We have to change the way we do business. We must focus on our clients and results and break the armlock that, I sense, bureaucracy has placed on this institution. I am talking here of liberating the talent and commitment of our wonderful staff and harnessing that directly to development. In short, creating a results culture."

- James D. Wolfensohn
October 10, 1995

In his Annual Meetings speech, Jim Wolfensohn reaffirmed the Bank Group's mission: to reduce poverty and improve the quality of people's lives. At his initiative, substantive discussions among management over the last few months have led to consensus on the following set of principles to guide institutional change that should help us to achieve our mission more effectively.

The five principles are:

1. **To focus on, be close to, and be responsive to our clients.**

2. **To hold ourselves accountable for achieving high-quality results on the ground.**

3. **To ensure maximum efficiency and cost-effectiveness in resource use.**

4. **To commit ourselves to professional and managerial excellence and to continuous learning.**

5. **To work in partnership with other public and private organizations, stakeholders, and external groups to help us reach the goal of sustainable development.**

Principle 1: **"To focus on, be close to, and be responsive to our clients."**

Strategies to operationalize the principle:

- To recognize as clients not only governments, but ***all*** those various actors in our individual borrowing countries who benefit from and contribute to the development process. Given the tremendous diversity among and complexity within our borrowing countries, strategies for meeting client needs can only be formulated on a country-by-country basis.

- The ***Country Assistance Strategy*** (CAS) is the key tool for ensuring client focus and it provides the essential framework for integrating, customizing and budgeting for the wide range of Bank Group services to meet individual country needs. The CAS should be viewed as dynamic and subject to change as circumstances evolve; it should be designed and implemented interactively with our clients; and allow for consultation with our other stakeholders and partners.

- The CAS also should be tied firmly to development ***outcomes***. Its objectives should be transparent; and the Bank Group's role and work program in helping to achieve them should be clear. In addition, the CAS should identify candidly issues on which there are different points of view, and offer an assessment of how these can be addressed.

- To bring increased clarity to the ***management of client relationships***, a **Country Manager** --directing a small team--will be responsible for the formulation of the CAS, and the use of budgetary resources in implementing it. The Country Manager should work closely with **Technical Managers** to arrange for the supply of the technical support needed for programs and products (thus unbundling existing functions into "country relationship" and "product" functions). The Country Manager should manage the overall country work program and have primary responsibility for the client relationship.

- To further strengthen our client focus, a much greater share of staff work should be focused on servicing our clients, rather than servicing our bureaucracy. This will require major change in the way we do business and will imply significant shifts in allocation of time to ***direct*** interactions with our clients, and increased decentralization of operational activity and decision-making to the field. The extent of these shifts should be driven by ***individual*** country needs and preferences.

Principle 2: **"To hold ourselves accountable for achieving high-quality results on the ground."**

Strategies to operationalize the principle:

- There should be clearly defined accountabilities for ***results*** at every level. For example:
  - The ***Country Manager*** should be accountable for the CAS, progress toward its objectives, and delivery of related Bank products within country budgets.
  - ***Technical Managers*** should be accountable for the technical excellence of our services and for the constant upgrading of the knowledge and skills base of the institution (Technical Managers will be recognized internally and externally as leaders in their fields).
- This will mean a departure from the current practice and perception where everyone is responsible for everything and no-one is made accountable for specific outcomes.
- To further strengthen accountability, greater emphasis should be given to ***continuity*** of product teams and ***identification*** of products with individual managers and staff by name.
- Financial and non-financial rewards should be geared to take into account such track record of outcomes and not just skillful presentation and packaging.

Principle 3: **"To ensure maximum efficiency and cost-effectiveness in resource use."**

Strategies to operationalize the principle:

- More explicit and significant value should be placed on the ***speed and timeliness*** with which we respond to our clients' needs:
  - Business processes which do not add real value to our products should be eliminated;
  - We should avoid over-engineered designs and needless layers of review; and we should improve the quality of products by putting emphasis on implementation, relying on stable product teams with the required skills, and introducing fewer but more substantive quality review steps;

- Ambitious but credible "stretch" targets for response time should be set to induce faster, more efficient processes as well as shorter, better documents -- and higher-quality results;

- Managers should become less involved in the details of operational transactions, but more involved in the management of staff and the quality of products.

- To be more effective, we should be more open to modifying and changing our products in light of evolving circumstances. This implies less emphasis on over-designing projects too early in order to ensure approval, but being more responsive and flexible during the life of the project. We need a culture that is less risk-averse and more open in order to achieve the ultimate development objectives of an operation.

- We must recognize that the ultimate key to improving our efficiency and effectiveness is ***high quality management.*** We need to hold managers accountable for judging when (and when not) to accelerate business processes. In parallel, we need to increase the proportion of staff with the capacity to deliver excellence quickly and reliably.

Principle 4: **"To commit ourselves to professional and managerial excellence and to continuous learning."**

Strategies to operationalize the principle:

- To strengthen ***overall*** standards of excellence by:

  - Strengthening incentives (financial and non-financial) to reward innovation, teamwork, and results;

  - Constantly raising the level of professionalism by recruiting externally as well as internally for ***all*** positions -- management and staff;

  - Creating a culture in which all management and staff recognize the personal responsibility to maintain and enhance their professional skills and performance--and accept that, if they do not, their utility to the institution is eroded;

- Encouraging a "learning culture" in which best practice and lessons learned are actively exchanged within the Bank Group; using external assignments to diversify staff experience and familiarize them with business practices elsewhere; and expanding internal and external training opportunities.

- To strengthen ***technical competence*** by:

  - Facilitating the development of technical career streams with people who have the best credentials in their field;

  - Introducing the explicit use of market benchmark tests of technical staff quality;

  - Providing a strong central anchor for technical staff to help capture the reservoir of the Bank's global experience and best practice;

  - Promoting the development of a strong professional and technical communities of "networks" or "colleges" dedicated to cross-fertilization across the Bank Group; and giving them a strong role in recruiting, selecting and training technical staff and managers;

  - Guarding against diffusion and fragmentation of technical skills which compromises the institution's ability to deliver quality service in a timely manner.

- To strengthen the ***quality of staff*** by:

  - Strengthening training processes to ensure professional growth and keep staff at the cutting edge of their discipline;

  - Instilling candor and honesty in the performance appraisal process, through a 360 degree evaluation and by insisting on assessment of relative performance of individuals within their staff groups;

  - Developing personnel and budget practices which do not discourage staff turnover and mobility (including review of incentives/disincentives embedded in pension and benefit plans);

  - Use of fixed-term contracts for all future appointments.

- To strengthen the ***quality of management*** by:

  - Being more rigorous in the selection of managerial candidates;

  - Making all new managerial appointments (including Vice Presidents) on a sunset basis;

  - Developing intensive management training programs (emphasizing leadership over management of transactions);

  - Improving communications among and within Vice-Presidential units -- and holding Vice Presidents accountable for such communication;

  - Introducing into each manager's annual performance appraisal a dimension of bottom-up evaluation from staff.

Principle 5: **"To work in partnership with other public and private organizations, stakeholders, and external groups to help us reach the goal of sustainable development."**

Strategies to operationalize the principle:

- Recognize that collaboration across the broad spectrum of our partners is vital to the achievement of all of the aforementioned principles as well as to the achievement of the Bank Group's overall mission.

- Recognize and reward staff when they share or defer leadership in order to achieve maximum effectiveness for our clients.

- Emphasize "results" partnerships over "process" partnerships (involving only more conferences or bureaucratic meetings.)

- Reach out to new partners (in civil society, the private sector, and NGOs) and strengthen relationships with traditional partners (in the UN, bilateral and regional agencies, and multilateral banks).

- Be open to constructive comment from our partners -- and be proactive in communicating with them.

- Recognize the importance of ***stakeholders***: those actors in ***all*** our member countries -- including the industrialized countries -- who have a direct interest in and commitment to the Bank Group's effectiveness as an agent of developmental change.

A Note on Implementation Guidelines

- The principles should be viewed as an institutional framework for change management and implementation, with individual Vice Presidencies tailoring their programs consistent with them.

- There should be a phased and purposeful approach to implementation, building on successful experiments and pilots -- and learning from experience.

- A number of these principles can be given effect without necessitating structural change.

- There must be broad staff participation in the design and implementation of the details of the change program.

- There will be clear and continuous communication -- internally and externally.

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director

Tel.: (202) 458-1384
Fax.: (202) 477-6869
Facsimile Transmittal Form

DATE: October 24, 1995

No. of Pages: 2
(including this page)

TO: Mr. James D. Wolfensohn
c/o Resident Mission in Moscou
Attention of Jane Holden

FAX #: 562 2042

DECLASSIFIED
MAY 17 2017
WBG ARCHIVES

CONFIDENTIAL

JANE,

KINDLY PASS THIS FAX ON TO MR. WOLFENSOHN. MANY THANKS.

TRANSMISSION RESULT REPORT (OCT 24 '95 07:45PM)

WORLD BANK

(AUTO)

THE FOLLOWING FILE(S) ERASED

FILE	FILE TYPE	OPTION	TEL NO.	PAGE	RESULT
086	MEMORY TX		5622042	27/27	OK

ERRORS

1) HANG UP OR LINE FAIL 2) BUSY 3) NO ANSWER 4) NO FACSIMILE CONNECTION

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director

Tel.: (202) 458-1384
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FAX #: 562 2042

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

DECLASSIFIED
MAY 17 2017
WBG ARCHIVES

October 24, 1995

CONFIDENTIAL

Note to Mr. James D. Wolfensohn

Jim,

1. ***IRAN***: Please find attached my letter to the Finance Minister sent today. We had arranged to meet with A. Lodhi after the Board meeting today, unfortunately he had to rush off at short notice to New York to see Mrs. Bhutto and at his suggestion we discussed the matter with Mr. Khazaee Torshizi, the Iranian advisor in his office. The approach set out in my letter to the Minister of Finance has already been agreed with the Iranian authorities and they are comfortable with it. It seems that the Reuters story was picked up and "embroided upon" by a farsi language broadcast from Israel, which has apparently fanned Iran's sensitivities even further. The Iranians accept that apart from our apologies for the unfortunate reference to the IMF and the Article IV discussion, our rebuttal on the issue as to where the economy stands is unlikely to improve matters. It is for that reason that we suggested, and the government has agreed, that we use the occasion of the release of our CEM to put out a more balanced and forward looking view on the Iranian economy. We expect to issue this press release in the next few days based on the CEM on which substantive discussions have already been concluded. I think the matter is well in hand. You should know that since the IMF will also be forced to react to our referring to their Board discussion on Article IV consultation, I have had Caio send them a note apologizing for this unfortunate reference. A copy of the note is attached

2. ***CHINA***: You are aware of the allegations made by Harry Wu on use of forced labor on our Tarim Basin irrigation project in the Xinjiang Autonomous Region. The Region's brief is attached. At the suggestion of the Treasury, conveyed to me by the US chair, I brought up the matter during other business at the Board table. I told them that the Bank was taking these allegations seriously. That we were aggressively investigating the matter and had asked Mr. Wu to provide us any evidence he has to substantiate his allegations. Finally that the Chinese authorities were cooperating with the Bank fully. I had pre-warned Mr.

Zhang that I would make such a statement, and hence, after consulting his authorities he also made a statement at the Board, reaffirming China's active support of our investigation, not only to preserve IDA's good name, but also theirs. He added that the Government was not only investigating this project but also the rural development and rural water supply projects also in the same region. He stated that as of today they had found no evidence but will continue their investigation. Both the US and the UK chair thanked management and the Chinese Government for their speedy and serious minded action and appreciated the fact that we had briefed the Board quickly.

A set of talking points prepared by EXT and the Region to help staff respond to queries is attached.

3. Subsequent to the Board meeting I ran into Jan Piercy in the street when she raised the issue of whether you should appoint an international human rights investigator. I reacted that given the wholehearted cooperation of the Chinese authorities such an action, against the backdrop of unsubstantiated allegations, could only be counterproductive. She said she agreed and volunteered that human rights groups were getting "fed up" with Wu's tactics.

4. ***IDA***: As the outcome of US Congress deliberations is imminent a set of questions and answers prepared by EXT is also attached.

5. ***JORDAN***: The Jordan single tranche adjustment loan was well received by the Board and so was the briefing on the West Bank Gaza Consultative Group meeting.

I trust your trip is proceeding well.

Encl.

P.S.: The meeting yesterday with the VPs on the principles driving the change agenda and next steps went well. I hope to have a distilled set of recommendations from the management group to you ready for your return.

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

October 24, 1995

H.E. Morteza Mohammad-Khan
Minister
Ministry of Economic Affairs & Finance
Tehran
Islamic Republic of Iran

Your Excellency,

I would like to acknowledge your letter of October 23, 1995, to Mr. Wolfensohn, regarding the press reports of Mr. Koch-Weser's recent comments on Iran's economic performance. Although Mr. Wolfensohn is currently in Moscow, he has seen your letter and has been in touch with me several times by telephone regarding our response. He is very concerned that we preserve our important relationship with Iran.

We regret very much that the wire service chose to highlight -- and take out of context -- Mr. Koch-Weser's generally positive assessment of Iran's economic management. He, in fact, cited examples of Iran's determination to continue the reform effort despite a difficult external environment. He did not say that the reforms of the early 1990's had been "taken away". He did mention, when pressed, that there had been a reintroduction of the dual exchange rate after it had been consolidated. However, even this was in the context of a long and wide ranging press conference covering many countries. Needless to say, Mr. Koch-Weser was extremely surprised and distressed to see the way in which his remarks were reported.

He also inadvertently referred to the IMF Article IV consultation discussion, disclosure of which is contrary to IMF and World Bank policy. He has expressed his apologies to the management of the Fund and to the Executive Director for Iran.

I wish to express the sincere apologies of the World Bank to you and your colleagues for this unfortunate misunderstanding. Our generally positive assessment of Iran's economic prospects is clearly highlighted in the forthcoming Country Economic Memorandum for Iran. The CEM also underscores the determination of the Iranian authorities to continue on the path of economic opening and liberalization. We propose to issue a press release based on the CEM, which has been discussed with your authorities. The press release would highlight the positive assessment of the Bank on Iran's prospects, the real progress achieved despite external constraints and the determination of the authorities to pursue the reform agenda in a difficult and demanding environment. This should demonstrate to the widest possible audience the Bank's appreciation for Iran's macro-economic effort.

Mr. Wolfensohn asked me to convey how very much he appreciated the opportunity to meet with you during the Annual Meetings, and exchange views on Iran's priorities and its expectations from the Bank. As you will recall, he fully supported that we remain constructively engaged in as many areas as possible, until such time that conditions permit restoration of a full working relationship. In that spirit, he genuinely hopes that the inadvertent remarks, taken out of context and used for the sake of sensationalism, will in no way diminish the very positive relations which he felt had been established by the staff of the Bank and their colleagues in Iran despite the recent difficulties, as well as the positive feelings he felt had been generated during your meeting with him.

Your Excellency, please accept once again our sincere apologies for any misunderstanding which may have arisen.

Sincerely yours,

Gautam S. Kaji
Managing Director

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: October 24, 1995 Confidential

TO: Mr. Stanley Fischer, First Deputy Managing Director, IMF

FROM: Caio Koch-Weser, Vice-President, MNA

EXTENSION: 35250

DECLASSIFIED
MAY 17 2017
WBG ARCHIVES

SUBJECT: Iran - Article IV Discussions

1. As you know, I gave a press conference last week in Paris, on the occasion of the WB/Gaza donors meeting. In the course of a long and wide-ranging question and answer period, I was asked about Iran's economic performance. In replying, and in an effort to avoid a potentially difficult discussion on Bank-Iran relations, I mentioned in passing the recent Fund Board discussion of the Article IV consultation with Iran. I indicated that there had been some policy reversal because of the very difficult external environment.

2. Unfortunately, one wire service took my response out of context and implied that I was reporting on the Fund discussion, which, of course, was not the case.

3. I realize that it is Fund policy not to disclose the outcome of such discussions, and wish to apologize for my inadvertent violation of this policy. I regret having put the Fund in an awkward position as well as putting our relations with Iran under such pressure.

4. We intend to issue a press release in the context of the forthcoming publication of our Country Economic Memorandum for Iran. The press release will acknowledge the progress achieved to date on economic reform, the challenges ahead and the potential for high growth provided the authorities maintain their commitment to reform. We hope this will help correct the misimpression left by the wire service report.

5. At the same time, I want to assure you that our Region places the utmost importance on maintaining our collaborative and constructive relationship with the Fund, which is exemplary. I regret very much having referred to the Fund discussion, which was clearly my mistake. Please be assured it will not happen again.

6. Thank you for your understanding in this regrettable incident.

cc : Mr. Gautam S. Kaji, Managing Director

Briefing Paper for Mr. James D. Wolfensohn on the Tarim Basin Project, Xinjiang Autonomous Region, China

At a press conference in Washington yesterday, the human rights activist Mr. Harry Wu claimed that this Tarim Basin agriculture project, financed by IDA, was benefitting at least 21 forced labor camps and 30 special farms run by the People's Liberation Army (PLA) (see copy of Mr. Wu's press release attached). The project is located in the remote north-west in the Xinjiang Uygur Autonomous Region.

We believe the allegation is false. Here are the facts.

Xinjiang Uygur Autonomous Region

The Xinjiang Uygur Autonomous Region is China's largest province -- four times the size of France. It is sparsely populated (16 million in 1993), with about 10 people per square kilometer. The Region is about 3,000 kilometers northwest of Beijing and is bordered externally by Mongolia, Russia, Kazakhstan, Afghanistan, Pakistan and India, and internally by Xizang (Tibet), Qinghai and Gansu. It is not the poorest province in China; it's GDP per capita is in the top 50 percent, but this is based on mineral resources. Farmers, especially the Uygur ethnic groups, are amongst China's poorest.

The Region's remoteness, arid climate and mountainous terrain exacerbate the Government's concerns about the security of its boundaries. In the 1950's, a particular concern was the long boundary with the USSR, and a strong military presence was established in Xinjiang to defend China's borders. During the 1960's, youths from cities in Eastern China were sent to work on Xinjiang state farms. Currently, there is wide knowledge, in China and outside, that there are prison camps and farms managed by the PLA in Xinjiang.

Project Background

The Tarim Basin project was approved by the Board in August 1991. It is designed to alleviate poverty in several poor, minority counties in Xinjiang Region, which comprise some of the poorest counties in China. Key activities include: (a) rehabilitation of irrigation and drainage facilities; (b) construction of a small hydropower station; (c) expansion of agricultural production; (d) expansion of livestock support services; and (e) restoration of degraded natural forest land to contain desertification. The project is expected to increase rural incomes for 137,700 low-income households, comprising 500,000 people, as a result of increased productivity of existing low-yield farmland and creation of new employment opportunities. The total project cost is $212 million, of which 59 percent ($125 million) is financed by an IDA credit and 41 percent by farmers and government. The project has been implemented very effectively during the past four years. Irrigation civil works have been completed ahead of schedule, the actual increases in crop yields have met or exceeded project targets, the quality of the hydropower construction has been quite high, and the environmental restoration plan has begun to generate significant environmental benefits.

As a result, the five Bank missions that have supervised the project since Board approval have rated the project highly in terms of economic development impact, implementation performance, compliance with legal covenants, etc. In particular, the project has already begun to generate higher incomes for poor households that will eventually raise them above the absolute poverty line. Minor implementation problems have occurred with timely provision of counterpart funding, which is common for many rural development projects in poorer areas of China.

Bank Policy on the use of Prisoners or Forced Labor

There is no explicit statement of Bank policy on forced labor and use of prisoners in Bank-financed projects. We do not condone the use of forced labor or prisoners and will not finance project components that rely on this source of labor.

Our procurement procedures provide an additional assurance that our projects do not use prisoners or forced labor. The Bank's procurement policies and rules specify the procurement methods and procedures that are acceptable to the Bank. For each particular project they are stipulated in the loan documents.

In the particular case of the Tarim Basin Project, civil works were required to be carried out on the basis of national competitive bidding. An exception was allowed for small works disbursed in about 104 townships stretching over about 700 kilometers, which were to be carried out by departmental force. Our investigation will review all of these contracts.

Accuracy of Mr. Wu's Allegations

Mr. Wu's report states, accurately, that:

- There are prison camps and farms managed by the PLA in the Tarim Basin project area. Their existence is known to Bank staff.

- Descriptions of prison camps and of the operations of the PLA and XPCC are excluded from the project SAR. Since they were to play no role in the project, the information was irrelevant for the purposes of project documentation.

Mr. Wu's report states, inaccurately, that:

- The project supports PLA or XPCC farms. All of the farms participating in the project are managed by individual households; none is managed by XPCC or the PLA. There are XPCC and PLA farms near project sites, but they do not participate in the project and do not receive Bank support for inputs, extension advice, or any other project activities.

We are still investigating Mr. Wu's characterization of the XPCC as a quasi-military organization outside the control of the Regional Government. The opinion of Bank staff familiar with the Region, supported by the Executive Director for China, is that the XPCC was restructured several years ago and now operates as an essentially commercial venture under the State Farm Bureau of the Ministry of Agriculture (see Annex).

What are we doing?

To respond to Mr. Wu's allegations we have:

- Issued a press statement (attached) and conducted a series of interviews to advise the media on the nature of the project, Bank practices and our responses.

- Asked Mr. Wu's associates to provide evidence to substantiate his claims. Today, we have had a response from Mr. Wu that agrees to a meeting, and requests access to documentation on the Tarim Basin project and other projects in Xinjiang. He provides no additional evidence to support his position. We are considering our response.

- Initiated an investigation of the Tarim Basin project as well as the other six projects in Xinjiang (especially, Agricultural Development Project, FY87; and Rural Water and Sanitation, FY92), which involve state farms as beneficiaries. To date we can find nothing amiss, but the examination of small contracts could take up to two weeks to complete.

- Requested, through RMC, that the Ministry of Finance in Beijing and regional officials investigate the allegations.

- Briefed the Chinese ED on the issues. In turn, Mr. Zhang has helped mobilize an official Chinese enquiry (see below).

- Consulted with the US Executive Director's Office, which has evident concerns about the accuracy of the statement and its impact on the support for IDA. We have discussed the issue with senior Treasury officials and volunteered any help that they, their staffs, or the Hill might need.

page 10 of 27

- Briefed the Board. Mr. Kaji spoke to the Board this morning and indicated the seriousness with which the Bank views these allegations. He indicated that a high level investigation of the project was already underway. Mr. Zhang also spoke to the Board. His statement is attached.

In addition, a supervision mission for another project will travel to Xinjiang within the next two weeks and will investigate the situation with local officials. We will extend our examination of the forced labor issue to the whole of the China portfolio. We anticipate that this could take a month or more, but will keep you informed of progress.

Preliminary Response by Chinese Authorities

We have received full cooperation from the Chinese authorities. Mr. Zhang has mobilized his colleagues in the Ministry of Finance (MOF), and we have an active exchange established between the MOF and the Resident Mission (RMC). The Ministry of Foreign Affairs refuses to dignify Mr. Wu's allegations with any response. Officials both in Beijing and in Xinjiang are examining contracts. Their initial check has found nothing untoward. The detailed check will take time, however, Mr. Zhang has assured Board members that the results of the Chinese enquiry would be reported to them. The MOF also plans to make the findings public.

Impact of the Story

Mr. Wu's assertions have generated huge international media interest, rendered all the greater by the timing of his press conference just a day before the meeting of Presidents Clinton and Jiang in New York as well as the IDA conference on Capitol Hill. An extensive program of briefing newspapers, television and radio stations with the Bank's position began as soon as the press conference ended. This is continuing, emphasizing repeatedly that we take Mr. Wu's assertions seriously; that we are investigating his claims, not just in the identified projects but in others; that we have the full cooperation of the Chinese authorities in this inquiry; that we have no knowledge of any direct benefits to the labor camps in question; and that all the people involved in the project are individual farmer families from a poor minority that has lived in the Tarim basin for centuries.

On IDA, the Wu allegations may have come too close to the Congressional conference on IDA-10 today, Tuesday, October 24, to have much effect on an outcome that was likely to be disappointing in any event. Nonetheless, it may have eroded our position among some Democrats. The potential impact on IDA-11 is deemed to be more serious. The Wu allegations give the Bank's critics new ammunition, the use of which may well succeed in eroding further US support for IDA.

The US Executive Director's office is concerned that fallout might continue to be damaging and anticipates the need for further information as our investigations proceed. That would assist the Treasury to respond to questions from the press or the Hill. Secretary Rubin has a press conference tomorrow that, amongst other things, would have dealt with IDA issues. The anticipation is that Mr. Wu's report might receive considerable play.

ANNEX

Key Agencies in Xinjiang

Our understanding of the roles of the key agencies operating in Xinjiang is:

- The army (PLA) has had no involvement with prison farms, though it has participated actively in establishing state farms through the Xinjiang Production and Construction Corps (XPCC).

- The armed police run the prison camps ("Laogai") under the direction of the Justice Ministry in Beijing.

- The XPCC has a clouded past. It did involve army personnel managing state farms originally manned by demobilized Chinese army regiments. Probably, prisoners who had completed their sentences also were assigned to these farms. We understand that the XPCC was restructured some years ago and is now essentially an arm of local government. It is currently called the Xinjiang Bureau of State Farms under the direction of the Ministry of Agriculture.

In investigating Mr. Wu's allegations, with the assistance of Chinese authorities, our focus will be (i) has the XPCC used forced labor and, if so, has it done so in Bank projects; and (ii) is the XPCC currently involved in any way with the prison system.

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PRESS STATEMENT

The World Bank

East Asia & Pacific Region

1818 H Street NW, Washington, DC 20433, USA

Contact: Graham Barrett (202) 458-0344
fax (202) 522-3405

World Bank responds to Laogai Research Foundation allegations

Washington, October 23, 1995 —The World Bank today expressed its concern at allegations by the human rights activist Mr Harry Wu that a Bank agriculture project in China was benefitting a number of forced labor camps and People's Liberation Army special farms.

The Bank has no knowledge of any link between the Tarim Basin Project in Xinjiang Province and the allegations by Mr Wu about the use of forced labor or associated activities. The World Bank's procurement policies, respect for human rights and insistence on good governance preclude it from involving forced labor in its projects.

It is regrettable that Mr Wu went public with his allegations without checking his information and assertions with the World Bank. A Bank spokesman made it clear to one of Mr Wu's publicists that Mr Wu would be welcome to discuss his concerns with the Bank this morning or at any other time. Mr Wu was unavailable to do so today.

The World Bank is looking into Mr Wu's assertions. If he can substantiate that components of the Tarim Basin project are being implemented with the help of forced labor, the Bank would discuss the issues with the Chinese authorities, whose responsibility is to implement the project. If Bank policies for the use of International Development Association (IDA) funds have been disregarded, the Bank has the option of requesting the repayment of loan funds.

The World Bank emphasizes that the Tarim Basin Project, like other Bank projects in China funded by IDA, its concessionary lending arm, is designed to alleviate poverty. The Tarim project, which is in one of China's poorest and topographically more distressed areas, is helping to rehabilitate irrigation and drainage , among other things, and raising food production, incomes and quality of life for hundreds of thousands of poor people.

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Record Removal Notice

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File Title	Barcode No.
James D. Wolfensohn - Chronological File - June 1995 through December 1996	1477082

Document Date	Document Type	
October 24, 1995	Board Record	

Correspondents / Participants

Subject / Title
Mr. Zhang's Statement at the Board Meeting

Exception(s)

Additional Comments
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The
Laogai
Research Foundation
勞 改 基 金 會

Contact: Jeff Fiedler
202-737-7200

For Immediate Release
Monday, October 23, 1995

Wu Calls for International Investigation of World Bank Loan to China
Evidence Bank Project Helps Gulag and Army

A World Bank project in the People's Republic of China benefits the Laogai, the Chinese equivalent of the Soviet Union's Gulag, and the Chinese Army, according to new report by the Laogai Research Foundation, whose Executive Director is Hongda Harry Wu.

The report, released at a press conference in Washington today discloses that a large World Bank-funded irrigation project in remote Xinjiang Province is benefiting at least 21 forced labor camps, and 30 special farms run by the People's Liberation Army (PLA).

The sources for the report include a World Bank document, official Chinese government documents, and information collected in Xinjiang by Harry Wu in a April 1994 visit to Xinjiang, also known as China's Siberia.

In a staff analysis of the project, known as the Tarim Basin Project, the World Bank neglects to mention either the existence of the Laogai camps or the extensive Production and Construction Corps operations run by the PLA.

An article from the Xinjiang Legal Journal, translated by the foundation, acknowledges that "Xinjiang is one of the provinces where our country's Laogai system plays a comparatively important role," in part by turning the desert into the farm land. Reclaiming the edges of the Taklimakan Desert in Xinjiang for cotton and grain production is one of the objectives of the $90 million World Bank project. In the area covered by the project, there are at least seven (7) Laogai camps run by the Ministry of Justice and at least fourteen (14) run by an arm of the People's Liberation Army.

The Foundation report calls upon James D. Wolfensohn, the World Bank's new president, to 1) appoint an independent international commission to investigate the Tarim Basin Project and other World Bank agricultural and infrastructure projects in China for their use of forced labor, 2) adopt an official policy that bars the use of forced labor on all Bank projects and imposes sanctions against violators, and 3) develop a training program for Bank staffers to sensitize them to the reality of forced labor and how to prevent its exploitation in Bank activities.

The World Bank, according to Reuters, "committed to China a total of $23 billion for 159 projects, with annual commitments of around $3 billion. China became its largest customer in 1993."

P.O. Box 361375, Milpitas, CA 95036-1375 USA

The
Laogai
Research Foundation
勞 改 基 金 會

THE WORLD BANK AND FORCED LABOR IN CHINA:
Mistake or Moral Bankruptcy?

October 23, 1995

P.O. Box 361375, Milpitas, CA 95036-1375 USA

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THE WORLD BANK AND FORCED LABOR IN CHINA:
Mistake or Moral Bankruptcy?

The Laogai Research Foundation has uncovered evidence that a World Bank project in China's remote Xinjiang Province is supporting cotton and grain production in at least twenty-one (21) forced labor camps (Laogai) as well as thirty (30) special farms controlled by the People's Liberation Army (PLA).

Known as the Tarim Basin Project, the World Bank effort involves at least $90 million in hard currency credits extended by the Bank's International Development Association (IDA).

Overall the World Bank has, according to Reuters, "committed to China a total of $23 billion for 159 projects, with annual commitments of around $3 billion. China became its largest customer in 1993."

The World Bank Project

Begun in 1991, the Tarim Basin Project seeks in large measure to improve irrigation and drainage for cotton and grain production in areas bordering the Taklimakan Desert (the world's second largest desert). The project is scheduled for completion in 1996.

The Bank in its Staff Appraisal Report, dated July 31, 1991, fails to mention the existence in the project area of some seven (7) large Laogai camps run by the Ministry of Justice, and at least fourteen (14) smaller forced labor camps run by the People's Liberation Army. While the Report does not mention the Laogai in its text, one of the project maps shows Pailou Farm, a Laogai camp, on it.

The Bank also fails to mention the significant role played in the area by the Xinjiang Production and Construction Corps, a quasi-military organization run by the PLA. There are at least thirty (30) Production and Construction Corps farms within the Project area.

The Tarim Basin Project is divided into three parts: The Yerqiang Irrigation Scheme, the Weigan Irrigation Scheme, and the Tarim Eco-Restoration Component. The Project intends to reclaim up to 80,000 hectares (approximately 200,000 acres) of desert land, rehabilitate and upgrade the existing irrigation to increase production output in 120,000 hectares (nearly 300,000 acres) of low yield land as well as the reclaimed desert land, build a 21 megawatt hydro-power station, improve transportation infrastructure, and make some other minor agricultural improvements to the area.

On April 24, 1995, the Chinese news agency Xinhua reported: " Since the early 1990's Xinjiang has been carrying out a large irrigation program funded by the World Bank, which is aimed at helping 540,000 people who live in the western part of the Taklimakan Desert...So far, about 53,000 hectares of desert land has been reclaimed with 70% planted with crops."

China's Siberia -- Xinjiang and the PLA

Xinjiang, located in the remote northwest of China, has long been known as China's Siberia along with the adjacent Qinghai Province. Desolate and underpopulated, the province contains the forbidding Taklimakan Desert. Xinjiang is home to the Uygur, a Muslim minority people, whom the Chinese government constantly endeavors to control.

Because of the Uygurs and the fact that Xinjiang borders Kyrgyzstan, Kazakhstan, India, Pakistan, Mongolia, Tibet and Russia, the province has a large People's Liberation Army presence. The PLA's role in Xinjiang is quite different from its operations in other provinces. Among the principal differences is the existence of what is known as the Xinjiang Production and Construction Corps.

The Corps, which is run by the PLA's Deputy Commanding General in the region, is a quasi-military organization with its own headquarters in Urumqi, the provincial capital. The provincial government has no control whatever over Corps operations, which are organized into divisions, regiments, and companies scattered throughout the province.

Xinjiang province has approximately 15 million people, 41% of whom are Han Chinese and 45% Uygurs. The Production and Construction Corps itself contains some 2.2 million people, 88% of whom are Han Chinese and 6% Uygurs. In 1990, approximately 1.13 million people within the Corps were engaged in agricultural production, principally growing grains and cotton.

The Corps has fourteen (14) Divisions, ten (10) of which are Agricultural Divisions, and four (4) are Administrative.

The Xinjiang Production and Construction Corps was originally established soon after the Chinese communist victory. Its original population consisted of Kuomintang soldiers who had surrendered en masse, and members of their families. They were essentially imprisoned under PLA control. In addition, throughout the 1950's and 60's tens of thousands of people from families labeled a "counter-revolutionaries" were forced to resettle in Xinjiang as members of the Corps. At the same time, an unknown number of prisoners who had finished their sentences, but who were not released (forced job placement personnel), were added to the Corps rolls. In 1965, for instance, 2,000 of these prisoners were sent to Xinjiang from a single Laogai camp near Beijing.

Those forced to join the Production and Construction Corps are rarely allowed to return to their original homes and workplaces, even after having been officially "rehabilitated." Belonging to the Corps is the equivalent of internal exile.

As stated earlier, the World Bank Project Appraisal Report totally ignores the existence of the Production and Construction Corps. This is a huge omission. If one looks at the fold-out map in this report, one can see that there are twenty-eight (28) numbered Production and Construction Corps agricultural regiments clearly marked as being located along the Tarim River throughout the primary benefit area of the Project. In these regiments are 263,732 people, the overwhelming majority of whom are Han Chinese. The World Bank would have us believe the Project primarily benefits Xinjiang's minority population.

The Laogai in Xinjiang - Prisoners from all Over China

The Laogai (forced labor camps) in Xinjiang has two distinct structures, one which is operated by the Ministry of Justice and local governments (like elsewhere in the country), and another run by the PLA within the Production and Construction Corps.

The forced labor camps run by the Ministry of Justice also have a unique character which reinforces the Siberia-like nature of the system. Since 1978, according to Chinese government documents, more than 100,000 prisoners have been shipped to Xinjiang camps. Among the municipalities and provinces known to have exiled prisoners to Xinjiang are Beijing, Shanghai, Tianjin, Guangdong, Jiangsu, Zhejiang, Liaoning and Anhui.

An article in the January 11, 1986 issue of the Xinjiang Legal Journal reports about prisoners at Pailou Farm (the Laogai camp shown on a World Bank Project map - attached to this report following the fold-out color map) and reveals that "a majority of prisoners are sent to Xinjiang from Beijing and Liaoning province for reform."

The Ministry of Justice and local government Laogai run at least fifteen camps, and three prisons in the province. There are an unknown number of re-education-through-labor camps, detention centers, and juvenile detention centers. The Laogai camps range in size from 2,000 to 10,000 prisoners.

The Xinjiang Production and Construction Corps operates its own Laogai system independent of the Ministry of Justice. Of the ten (10) Agricultural Divisions, six contain Laogai companies. These Divisions are the First, Second, Third, Sixth, Seventh and Eighth. The Laogai Research Foundation has found Chinese government documentation which states that in 1989, these six Agricultural Divisions ran 35 Laogai Regiments, which themselves contain 185 Laogai Companies. Not counted in this are an unknown number of re-education-through-labor detachments also run by these Divisions. The number of prisoners in these Companies varies from 100-500. The total number of prisoners within the Corps is estimated to be 100,000.

Laogai production within the Production and Construction Corp is significant. A 1983 Chinese government document states that prisoners produced 20% of the total agricultural production, 25% of grain output, 14% of the cotton production, and 10% of the total profit of the Xinjiang Production and Construction Corps.

Laogai Camps in the World Bank Project Area

The Laogai Research Foundation has gathered evidence which proves that, at a minimum, there are seven (7) Laogai camp farms run by the Ministry of Justice, and at least fourteen (14) Production and Construction Corps Laogai companies operating within the Tarim Basin Project area. While the exact number of prisoners is not known it is estimated to be between 25,000 and 60,000. A fold-out map of the project areas with the camps marked on it is on the page following the text of this report.

An October 6, 1990 Xinjiang Legal Journal article stated explicitly what is common knowledge in Xinjiang, when the author wrote: " Xinjiang is one of the provinces where our country's Laogai system plays a comparatively important role....They (prisoners) opened desert to make farmland, planted trees to make forests, built roads and bridges, made bricks to build buildings, explored mines to extract coal, and manufactured goods."

In April, 1994, Harry Wu, the Executive Director of the Laogai Research Foundation and a BBC reporter visited some of the camps in the World Bank project area (Wu did not know then know the Bank had a project). In one camp, Talimu Farm he photographed and videotaped prisoners under guard working in cotton fields, spoke with a duty prisoner at the cotton storage area, and was ordered to leave the area by a Laogai official (this encounter was recorded on film). Copies of some of these photos are attached.

Wu also visited the Tanan Labor Reform Detachment, which is a forced labor camp run by the 14th Regiment of the First Agricultural Division of the Xinjiang Production and Construction Corps.

International Investigation of World Bank-China Projects Needed

The Laogai Research Foundation calls on new World Bank President James Wolfensohn to:

1. Establish an independent international commission to investigate and determine the full extent of Laogai and Xinjiang Production and Construction Corps involvement in and benefit from the Tarim Basin Project; and investigate the question of World Bank staff knowledge of forced labor and PLA involvement in the project; and investigate why the Chinese government did not provide full and complete information to the Bank about the Project area.

2. Have the independent international commission investigate other World Bank agricultural and infrastructure projects in China for forced labor involvement.

3. Develop an official policy barring the use of forced labor on all World Bank projects, and implement appropriate sanctions against countries which violate the policy.

4. Develop a special program to train World Bank staff on the Laogai so that in the future they can recognize and take action against the use of forced labor on Chinese projects.

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The Laogai Research Foundation
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Graham Barrett
The World Bank
East Asia & Pacific Region
BY FAX: 202-522-3405

October 24, 1995

Dear Mr. Barrett,

I am writing in response to your public statements in The Washington Post of October 24 as well as the press statement issued by your office on the same day. It is the feeling of the Laogai Research Foundation that the information brought to light in the report, "The World Bank and Forced Labor in China: Mistake or Moral Bankruptcy?", has provided enough documentation and evidence to warrant an investigation into the Tarim Basin Project by your office and the President's office. The Laogai Research Foundation exists to serve as a watchdog over the Chinese Communist Party and its widespread use of forced labor in the *Laogai*, or Reform-through-Labor, system. Our report is the result of research into both the Provincial Judiciary Bureau Laogai Department and the Xinjiang Province Production and Construction Corps and the role these organizations have along the Tarim River Basin. The failure of the World Bank in even mentioning the existence of these forced labor camps in the benefit area of the Tarim River Basin Project further demonstrates the need for an outside organization to call attention to the Laogai and its prevalence in not only Xinjiang, but all across the People's Republic of China. It is the duty, then, of The World Bank to act upon this new information to investigate the details of why the existence of these organizations in the benefit area is not identified and if these forced labor camps are direct or indirect recipients of financial assistance from the IDA loan.

Although the Laogai Research Foundation strongly believes that this report and the evidence presented in it causes sufficient suspicion into the details surrounding the Laogai and the Tarim Basin Project, I am perfectly willing to meet with you personally or with any knowledgeable representatives of The World Bank to discuss our allegations. There are documents of The World Bank which involve this project that would assist in any understanding of the Tarim Basin Project that we would like to examine, including but not exclusive to the IDA reviews for local competitive bidding invitations, the list of directors and units involved in the projects' management offices, and the reports filed after staff visits (the most recent being in May 1995).

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It would also be necessary to understand the extent of the Laogai and the Production and Construction Corps by examining the past projects carried out in Xinjiang by The World Bank, including the Xinjiang Agricultural Development Project and the Xinjiang Highway Project. We are most interested in what The World Bank refers to as "state farms" in its project reports and the true definition of these entities. If we are to have such a meeting, I think it only fair that there be a free exchange of information so that all involved can better understand the exact situation surrounding the Laogai and PLA involvement in the IDA project in the Tarim River Basin and elsewhere in Xinjiang.

I feel that it is the moral obligation of all international organizations who enter into agreements with the Chinese Communists to acknowledge the fact that the largest forced labor system in modern history exists today in China. The Laogai Research Foundation aims to inform and educate the world of the abuses of the Laogai. I believe that The World Bank, in its pursuit of respect for human rights in all of its operations, ought to welcome the new information contained within our report and sincerely look into the background information available and present conditions in Xinjiang and address the discrepancies that we discovered in respect to the Tarim River Basin Project.

Due to my plans to travel to Europe on Wednesday , I am afraid that a meeting cannot be held immediately. In my absence, I have asked that Jeff Fiedler, a director of the Laogai Research Foundation, contact you and arrange a preliminary meeting to discuss a more comprehensive meeting to be held in the near future. I look forward to meeting with you or any other competent senior representative of The World Bank to discuss this matter.

Respectfully,

Harry Wu

Harry Wu
Executive Director

The World Bank
Washington, D.C. 20433
U.S.A.

MARK MALLOCH BROWN
Director
External Affairs

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October 26, 1995

Mr. Gautam Kaji

Gautam:

As discussed, attached are two press guidance pieces we are using today with our press team around the world, which you may wish to share with Jim:

(1) China: In addition to the issues covered in the attached, there has been, as you know, the unofficial suggestion by Jan Piercy that Jim appoints an international human rights investigator. You and I have both told her that this would open up and prolong the story and harm our relations with China and the timetable for IDA-11. Therefore, if asked about this, I strongly urge Jim to close the door on any such proposal.

agree

(2) IDA Conference Vote: We will notify Moscow by EM after the vote is concluded today. The attached has been prepared in likelihood that it will be.

Attachments

Mark

RCA 248423. WUI 64145 FAX (202) 477-6391

October 24, 1995

10pr 26 of 27

China, Harry Wu and Allegations of Forced Labor

Talking Points: For Bank staff use only; Not For Distribution

The World Bank is taking very seriously the allegations made yesterday by the human rights activist, Mr. Harry Wu, that forced labor may be being used on a World Bank project.

The project is targeted at a village and household level, which is why it seems so unlikely it would involve forced or prison labor. It is already generating higher incomes for these people and will, in time, lift them above the absolute poverty line.

The project in question is the Tarim Basin project in Xinjiang autonomous region, one of the poorest and most arid parts of China.

The Bank has already launched a high level investigation, involving staff in Washington and from the Resident Mission in Beijing, to determine if there is any truth to the allegations. The Bank will investigate all projects in Xinjiang -- not just the Tarim Basin project.

If the Bank finds substance in the allegations, we will immediately consult with the Chinese authorities. To the extent that funds have been diverted for such purposes, we will seek to have them immediately repaid to IDA. Initial findings, however, indicate that there is no forced labor in the project.

The project, funded by a $125 million IDA credit in 1991, is specifically aimed at helping more than 500,000 of China's poorest people, predominantly the Uygur (pron. "weegar") minority which has lived in the region for centuries.

The Bank is completely opposed to forced labor. If asked whether there is a specific Operational Directive against lending for projects with forced labor, you may add that there is not, but nor is there a policy against lending for child labor or drug trafficking -- two other purposes for which the Bank will not lend and which the Bank unequivocally opposes.

The Bank yesterday and today invited Mr. Wu, through the Laogai Research Foundation, to meet to discuss the allegations and to present the evidence, which was aired at a National Press Club briefing. As of midday Tuesday, he had not accepted the invitation.

The World Bank has made a total of $10 billion in IDA credits and $14 billion in IBRD loans to China. China's per capita income is about US$500, according to the World Bank Atlas.

For further information, contact Graham Barrett, East Asia and Pacific External Affairs: (202) 458-0344 or home (202) 364-0439 or fax (202) 522-3405.

DECLASSIFIED

APR 22 2021

WBG ARCHIVES

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: August 18, 1995

TO: Mr. James D. Wolfensohn, President, EXC

FROM: Gautam S. Kaji, Managing Director, EXC

EXTENSION: 81384

SUBJECT: **Letters from President Jacques Chirac**

1. Attached for your clearance and signature are two letters in response to those sent to you by President Jacques Chirac on the Garafiri dam in Guinea, and the *Société Nationale Industrielle et Minière (SNIM)* in Mauritania.

2. Concerning the Garafiri dam, also attached is an update of the briefing note originally prepared for you on June 29. The new version incorporates latest developments on the Garafiri dam, namely that: (i) as envisaged in the June 29 briefing note, by letter dated July 27 (also attached) IDA has formally notified to the Minister of Energy and Environment of Guinea, Mr. Assifat Dorank Diasseny, of its decision not to participate in the financing of the project if launched immediately, (ii) IDA has learnt informally that the Guinean authorities are planning to hold a Donors' meeting in Conakry during the first week of September to complete the financing plan of the project; and (iii) IDA has responded favorably to recent Government requests to provide support in the development of a strategy for rural electrification and household energy.

for attachments: fee AFR GB

pope 270/27

U.S. CONGRESS - DECISION ON IDA FUNDING FOR IDA-10

PRESS GUIDANCE FOR PUBLIC AFFAIRS STAFF

House and Senate Conferees are meeting today to work out an agreement on the FY96 foreign aid funding bill. One of the issues to be decided is the size of the U.S. contribution to the third year of IDA-10. The House recommended a contribution of $575 million - the Senate recommended $775 million.

The Conference is not expected to finish its work until this evening, and the IDA number may be one of the last issues to be decided. Preliminary indications are that the number could be $600 million, but some Conferees will be making an effort to raise the figure closer to the Senate level.

When a final decision is reached, we will let you know immediately. Then you should respond to any press calls along the following lines. **(If the $600 million figure should change, we will update this guidance).**

- Bank Management is profoundly disappointed by the decision to appropriate only $600 million of the Administration's total FY96 request for IDA of $1.368 billion. This decision will have a significant negative impact on the level of resources available through IDA to help people in the world's poorest countries.

- Bank Management is not in a position to speculate what this decision might mean for the future of IDA. This issue must be addressed by the IDA donors. The donors themselves will then decide how they wish to proceed from here to bring IDA-10 to a successful conclusion and to proceed with the negotiations for IDA-11.

If asked what this means for the IDA Deputies Meeting in Luxembourg in November, you should respond that this too is a question for the donors to decide.

October 24, 1995
5 p.m.

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director

Tel.: (202) 458-1384
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Facsimile Transmittal Form

DATE: August 18, 1995

No. of Pages: 13
(including this page)

TO: Mr. James D. Wolfensohn

FAX #: 307 733 9110

Please see the attached.

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

August 18, 1995

Note to Mr. James D. Wolfensohn

Jim,

Attached are:

1. The block on "What is the Bank" as an input into *your AM speech.* We tried to capture what you were seeking. Please let me know if the broad outline is correct. A number of data displays (on Global trends, lending trends, staffing and "nuggets" on specifics such as Inspection Panel, etc.) are being collected and should be available to you from Mark and Gerry next week.

2. *My hand-over notes* for Richard which give you a quick run down on where various matters stand as of today. On most of these items I have, I believe, kept you updated on a current basis

3. Copy of *my memorandum to the VPs* as issued, incorporating your comment.

I will be pouching to you the proposed responses - including the background material - to President Chirac on the two letters you sent over to me yesterday. If you have any queries or reactions, Kevin Cleaver is acting for Kim Jaycox.

Finally, we had a meeting yesterday with Ambassador Goulding. We talked about Angola specifically, but more importantly how the Bretton Woods Institutions relate/coordinate with the UN on failed states generally. We agreed to set up a mechanism for an informal, but regular and substantive exchange of information, particularly when the UN is initiating peace negotiations. For instance in the case of Angola, the arrangements made for consolidating the troops of the warring factions and subsequent demobilization, as well as the ultimate size of the army,

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Finally, I just want you to know where I can be reached: my home phone is 703-237 8557, my home fax 703-237 0839. I'm flying out on Sunday morning and my phone in the Virgin Islands is 809-779 1515. I hope to have a fax machine and answering machine hooked up at that number on Monday or Tuesday.

You were on CNN and CNN International with President Clinton playing golf. You looked great!

WHAT IS THE BANK?

1. Context

Bank engaged in most important challenge in the world: development--improving people's lives/social justice.

Serves a huge constituency--four out of every five people in the world are in the developing countries; 95% of the increase in the world's population over the next 25 years will be there.

Over next five years, developing-country GDP growth projected to be double that of OECD nations--reflecting the increasing importance of poorer countries in the global economy. Indeed, using purchasing power parity (PPP) exchange rates, about two-thirds of the addition to world GDP in the next decade will be contributed by the developing countries -- so that is where the action is in terms of business opportunities, growth in demand, production, investment, trade, etc.

And yet, more than a billion people still struggle to survive on a dollar a day or less--a standard of living that Western Europe and U.S. attained 200 years ago.

Tremendous diversity of Bank's clientele--e.g. Mozambique has an annual per capita income of less than $100; Argentina's is more than $7,000. Also diversity in size/population: from the Marshall Islands with 50,000 people, to China with well over one billion people.

Diversity of challenges -- e.g. challenges of basic development in Africa--hunger, disease, illiteracy--very different from challenge of transition to market systems in former Soviet Union; and, in middle-income countries, challenge of creating robust financial systems, social security and health insurance systems.

2. A Multifaceted Institution

An institution that brokers money, ideas, technologies, institutions, and people.

(a) A Complex Organization:

--IBRD: lender to the middle-income nations, has had flat lending level over last decade, yet has sufficient financial capacity (headroom) virtually to double its annual lending (from $15 billion to $30 billion).

--IDA, by contrast, is stretched and threatened financially--and yet it is the backbone of financial support to the world's poorest people; though IDA's formal eligibility level is per capita income of $865, average per capita income of the 78 IDA-eligible countries is $400 per year (and 90% of IDA lending over last 5 years went to countries with per capita GNP of $550 or less). The population of the IDA-eligible countries represents 65 percent of the total developing world (over 3 billion people).

--IFC, growing strongly at a projected 12% per year through the end of this decade--but questions about the Bank Group's overall private-sector strategy and operations.

--MIGA, small but important with an insurance portfolio of $1.6 billion--reaching its financial limits as currently structured.

(b) Complex Spectrum of Sectors

Bank Group involved in virtually every major sector in its client countries--a major player in economic reform programs, agriculture, energy, and transportation. But also now the world's largest lender in areas such as education, health, nutrition, and AIDS prevention.

Annual average lending for human resource development has increased five-fold over last decade to reach $3 billion--and this is projected to jump to $5 billion over next three years.

Lending for environment has grown ten-fold over last five years--now have active environmental portfolio of $10 billion.

(c) Complex Spectrum of Issues

National and global, local and international; macro and micro; from slum improvement to issues of governance--support provided directly through our loans/advice; and as administrator of over 2,000 Trust Funds amounting to about $2.2 billion.

Leading role on global issues such as environment--through Bank/IDA and the GEF; leading role in global agricultural research--through the CGIAR.

Involved in "failed states" issues (e.g. in Rwanda/Angola); involved in nuclear power issues in Eastern Europe and former Soviet Union; involved in international debt issues (e.g. workout of heavily indebted countries in Latin America and, more recently, in buy-back of commercial debt in Africa).

(d) Complex Spectrum of Constituencies

Shareholders--borrowers and non-borrowers;

Cofinanciers and donors;

Parliamentarians, NGOs, business, civil society;

And foremost, the PEOPLE who are the beneficiaries of our efforts.

Thus, the Bank has multiple objectives, demands, constituencies to satisfy. These are not always consistent with one another.

3. GREAT EXPECTATIONS

Expectations of Bank have increased dramatically in recent years. Expected to be:

Both a lender and advisor--critical source of financing for the poorest countries (especially through IDA); and at same time--repository of cross-country knowledge and experience and cutting edge of research on development;

An aid coordinator--Bank chaired around 60 Consultative Groups and similar meetings last year;

A tackler of new global problems as they arise e.g. FSU transition, global environmental challenges, failed states.

Many acknowledge the Bank's invaluable contribution--and want it to do more; but others question its effectiveness, its size, its "arrogance," and even its relevance.

Bank has been a major global asset for over 50 years; but it can--and must--be even more effective in the future. The challenge for its ownership and its new leadership is to identify both the constraints on it and the capacities available to it in order to realize its full potential.

In many ways, institution is at the most critical juncture in its history--a challenge, but a very exciting one. Can only be successful if owners and management form an active, functioning partnership. It's your institution--the stakes are great, but so are the rewards.

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

August 18, 1995

Note Mr. Richard H. Frank

Richard,

Re: Hand-over notes

I hope you had a good break in Florida. I am certainly looking forward to mine in the Virgins! Let me run down a list of issues you should be aware of. The sequence does not suggest any order of priority. Please call me for additional fillers, or items that are on your mind that I have missed. I'm flying out on Sunday morning. Hilde will know where to contact me.

1. Nepal - Arun. That seems to have gone as smoothly as could be expected. Some Board members, particularly Enzo, Fritz and perhaps Rill wanted to get their hands on Maurice Strong's and Joe Wood's memos to Jim. I refused. They did make the point that as the Board would most likely have approved the project on the basis of the appraisal which had already been distributed to the Board. They therefore did need to understand what were the changes in our analysis and institutional capacity assessment that we had made. I suggested that we would revisit those assessments to provide them the update, but the first priority for the staff was to come up with an alternative power strategy for Nepal. Let's keep this one in mind so that it does not fall between the cracks. Joe and Heinz are in Nepal. Two issues you might want to watch out: the basis of the environmental assessment we have seen Kali Gandakli seems questionable. Apparently it dries out a riverbed for 14 kilometers down stream. I have told Joe that we should be candid with the Nepalese. ADB does not want us to cofinance. The Nepalese have twisted their arm. We should tell the Nepalese to let ADB firm up the financing plan without necessarily bringing us in. As regard to power development fund, we need to be careful that, given the capacity constraints as well as the political uncertainties in Nepal, that we do not front load policy conditions so much that the Fund concept does not take off. We should be able to move with a first tranche of the Fund while other things are being sorted out contemporaneously. Finally, Jim feels that Nepal spent a lot of money on Arun

and the late stage at which we had to call it off, we are certainly "culpable" to some extent. He would like that we pick up say $5 million of any further preparation on alternatives through grants or other arrangements which we can engineer at no cost to Nepal. This needs careful handling. Any overt suggestion that all or part comes out of our administrative budget (including President's contingency) would set us up for claims for every project dropped after preparatory work.

2. Multilateral Debt. I have agreed with Johannes that a paper giving current state of play with the IMF should be sent over to Jim by the end of this month. We should then arrange a conference call with Jim, so that all the principal players (including Sven if he is reachable) can brief Jim on how the IMF is coming out on some of the central issues of stock reduction and funding. Jim will be seeing/talking to Camdessus in the short post-Laborday week that he is here. We need to come to closure on at least where we stand for the immediate future, because Jim will have to take a position at the Development Committee and during the course of the Annual Meetings. Johannes is also preparing a fall-back position which Jim could adopt should we fail to budge Michel and Stan Fischer.

3. Private Sector Development and Location/Field Office Seminar. Both Seminars are on September 7. Jim has opened up his calendar in the afternoon so that if it goes beyond the morning he can still be present. Shahid is distributing a report on the current situation to the Board members for information and will be back from home leave in time for the Seminar. You are very well aware of the PSD matters.

4. Annual Meetings Speech. I have a small group - Mark Malloch-Brown, Gerry Rice, Vinod Thomas, Myrna Alexander and Johannes Linn - working with the initial thematic approach that Jim had suggested. We have sent him a draft outline to which he has had reactions. Reactions to his comments are being sent back to him. Mark along with Gerry plan to go to Wyoming the week after next to work on the Annual Meetings speech, the China speech and the WRI speech. Mark will carry the ball on this one and will keep me in the loop on the AM speech through faxes or whatever.

5. Watch list. Post Arun, Jim had asked Sven to compile a list of projects either under implementation, or in the pipeline, which are likely to run into a public debate. Sven had made this request to the VPs but very little has trickled in. You might want to check on this and follow up as necessary. It is important, however, that the VPs personally review this list in their Regional/Functional areas.

6. Corporate Management Retreat - September 27, 1995 I will fax you a separate note I am sending to the VPs.

7. Controller's I have been getting a lot of flack from VPs at our lunch meetings and on an individual basis. Regions have had to produce monthly reports which talk about progress in achieving "strategic objectives" on a monthly basis and have to provide data which can easily be retrieved from the central information systems. Reports are being produced on issues such as liquidity policy, investment policy, etc. without full inputs from the concerned VPs. At the same time VPs continue to complain about how the cost accounting system and the BAS do not work. I am afraid that Jules is going about it the wrong way. While clearly Jim had said to him that he wants to receive Institutional reports and be comfortable with the control structure in place, the way he is proceeding in the President's name is passing all the wrong signals and eliciting dysfunctional reactions. Should he not sit down with the VPs and first talk about how they need to have from their own control and tracking point of view help that delivers appropriate reports for their own consumption and then aggregate them for Institutional reporting purposes? Shahid has also suggested that on the cost accounting and BAS it might be worthwhile bringing in an outside consultant to review, because with all the unhappiness expressed the responses have been just fiddling at the margins. You might want to have a "Dutch Uncle" chat with Jules. I couldn't resist the pun!!

8. FAOCP funding There is a note from Ismail to Sven on this matter. As you know this preordained allocation of FAOCP resources to Regions goes counter to the concept of dollar budgeting. A number of Regions do not wish to or are unable to utilize these resources. They feel we are giving them "Monopoly" dollars. Getting ourselves locked in again does not seem like a good idea. I have suggested that you bring this up at the RVPs meeting in September and invite Ismail to it.

9. CGIAR Funding Please see the attached note from Joe Wood. Do we really want to commit that we will provide a fixed percentage of funding CGIAR whatever it may mean in terms of dollars? You might want to discus this with Sven Sandström and give some guidance to Joe, Jules and Ismail.

10. Budgeting The memorandum on this year's budget cycle has been issued by PBD and Jim will meet with the RVPs, the CVPs, DEC and hopefully MPS. Timeslots have been allocated by Allison and PBD is handling the actual setting up of the meetings. Jim wanted to have in depth discussions. Copy of PBD's memorandum will be forwarded to you. For the other VPs perhaps we will need to set up an arrangement amongst us to handle.

11. Jim's Trip to Japan The issue of recruitment is sure to turn up. I have been talking to the chief of recruitment on the changed arrangements where we are withdrawing the Japanese staff member from the Tokyo office and having someone handling it from HQ making four visits to Japan. The underlying problem is that we are still largely captive to MOF for coming up with candidates.

I have asked them to examine what skill areas one would presume that the Japanese excel in. What Japan has achieved in terms of industrial pollution reduction, the cleaning up of its rivers, what it has achieved certainly in East Asia in terms of quality of construction, would suggest that we should be able to get some of these hard skills out of their private sector. We need to work much more actively with Keidanren to open doors as opposed to just depending on MOF and their Tokyo University, law graduates/ administrators being put forward to us. You may wish to pursue this with Shahid when he returns. The chief of recruitment is now considering hiring Abe as a consultant in Japan. We also need to be less Tokyo-centric and explore places like Osaka for recruitment leads.

Joe Wood is going to come back through Tokyo to assuage any bruised feelings on Arun. You might want to get him to provide a brief for Jim on where matters stand vis-à-vis the Japanese.

12. Main Complex We had distributed a paper to the Board on a no-objection basis for the incremental budget required for paying the sales tax. You are well aware of these issues, since you had chaired the previous meeting approving the payment! Secretary's informed us that a large number of EDs might register an objection. We therefore pulled it off the no-objection basis and planned to schedule it for regular consideration. I suggest this be done in September when Shahid and Ibrahim are back and when whichever one is acting for Jim could chair it. Shahid claims that his contingency is now down to $8 million with the E and D buildings still to be dealt with. As you know, we tried to "eat" the $1.3 million sales tax in our budgetary savings from FY95, but the external auditors insisted that this go to the construction capital account specifically. We therefore do need this authorization. If the Board insists that the present contingency be utilized, we should put on the record that what we are effectively doing is again making up unrealistic budgets which got us into trouble with the main complex project the first time around. The difference is that this time it is being done by the Board consciously.

13. MDs' Assistant I thought we had all agreed that we should get Yasmine from IFC. I understand that this never came to closure. Sven was handling it I think. You might want to follow up and see if we can bring it to closure. I understand Yasmine's managers are not giving her any assignments in case she were to move out and this is not fair to her.

cc: Messrs. Wolfensohn, Sandström

A L L - I N - 1 N O T E

DATE: 11-Aug-1995 09:47am

TO: Gautam S. Kaji (GAUTAM KAJI)

FROM: D. Joseph Wood, SASVP (JOE WOOD)

EXT.: 81429

SUBJECT: CGIAR Oversight

I am forwarding to you a note from Ismail to Jules in which Ismail takes strong exception to the proposal that the Special Grants Committee should "put ceilings on the Bank's support to the CGIAR". Before the Committee meets again in the fall, we need to be clear just what role it is expected to play vis-a-vis CGIAR.

As I understand the past practice, the Committee has played the same role vis-a-vis grants which are a charge against the budget (except for IDF) that PBD plays with respect to the administrative budget itself; that is, it recommends to the President an overall envelope within which detailed work programs and budgets are then formulated.

As you well know, the Board considers several VPU work programs (EDI;OED: Research budget) on an ad hoc basis during the year. The Board may "endorse" a program and even make comments on the change in budget it would like to see, but by convention these expressions of Board "approval" are considered subject to confirmation in the budget process when the President (and the Board) have the whole picture in front of them. This seems to me to be sound practice.

Some of the special grant programs -notably, CGIAR but also the Oncho program- have also been discussed in an ad hoc manner, but the recommendation for Bank support (typically expressed as both a percentage of total funding and an estimated total amount) have been treated as an explicit approval. Presumably the rationale is that the Bank representative needs to be able to speak for the institution in negotiations with other donors.

As a practical matter the Special Grants Committee has taken these "Board approved" amounts as a given in formulating a view about what overall envelope to recommend to the President for Special Grants. As far as I know, it has not been asked for its opinion when the (ad hoc) proposals for CGIAR support (or indeed for CGAP) have been put to the Board.

The issue for the coming year is a rather narrow one: should CGIAR be subject to a budgetary limit expressed as a US dollar amount or should it continue to be authorized to work on a percentage basis with the consequence that higher than expected overall funding can create a last minute budget problem? Jules proposed that a fixed limit be set and I agreed that that seemed sensible. Ismail apparently objects -or at least does not want the Special Grants Committee to have anything to do with establishing such a limit.

My view is that the President deserves an institutional recommendation on CGIAR, just as he gets an institutional recommendation on every other Bank program. In principle, he could get this institutional view from PBD, but it is not clear to me that PBD is in a better position than the Special Grants Committee. On the contrary, the Committee is the only group that has an overview of grants made by the Bank and hence is probably best placed to form judgments about priorities at the margin.

In any event, I would like a clear statement of just what the Committee should do with respect to CGIAR. Should we include it in the envelope on which we make a recommendation to the President or should we treat it as subject to independent determination? In the latter case, I think transparency would be enhanced by formally removing CGIAR from the Committee's responsibilities.

CC: Ismail Serageldin (ISMAIL SERAGELDIN)
CC: JULES MUIS (JULES MUIS @A1@WBWASH)

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

August 18, 1995

Note to Mr. James D. Wolfensohn

Jim,

Attached are:

1. The block on "What is the Bank" as an input into *your AM speech.* We tried to capture what you were seeking. Please let me know if the broad outline is correct. A number of data displays (on Global trends, lending trends, staffing and "nuggets" on specifics such as Inspection Panel, etc.) are being collected and should be available to you from Mark and Gerry next week.

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You were on CNN and CNN International with President Clinton playing golf. You looked great!

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Washington, D.C. 20433
U.S.A.

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WBG ARCHIVES

GAUTAM S. KAJI
Managing Director

August 17, 1995

CONFIDENTIAL

Note to all Vice-Presidents

RE: Corporate Management Retreat - September 27, 1995

With Jim's agreement, we plan to take the opportunity of this meeting to explore more constructively how to achieve the change in institutional ethos - the culture change, to reflect the values that Jim has been articulating in his meetings with us and staff, in particular his concerns for results and outcomes versus reports and inputs, his concern for technical excellence and continuing education, for quality, his focus on client responsiveness and his desire to foster partnership and collaboration.

So that we can have a structured and concrete discussion, two groups led by Caio and Russ respectively and including Jean-François and Johannes, in the respective groups, along with a cross section of six to eight staff to be selected from across the institution have been asked to come up with concrete ideas for actions on selective "levers" which would foster this cultural change. We hope that these two groups will be able to provide at least an interim report for our discussion in September. Hopefully we will come out of that retreat agreeing on directions to pursue and specific actions that we can undertake in the immediate and short term time horizons.

The purpose of this note is to brief you on these plans and to request your cooperation when Caio and Russ approach you for release of individual staff to work with them in this short but intensive effort. For those of you who have been away this summer, you should know that the place is rife with rumors and speculation on organizational and people changes, including further cut back of staff. It is important that we underline that these groups are working groups to help all of us better define issues, directions and critical levers and is not another reorganization task force spelling out some preordained design. What Jim wants to do is to understand from us how we might best embark on this change of culture that I believe all of us subscribe to. He is certainly not starting from any premise of just juggling boxes!

See you all in September.

cc.: Messrs. Wolfensohn, Sandström, Frank

Clinton

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director

Tel.: (202) 458-1384
Fax.: (202) 477-6869
Facsimile Transmittal Form

DATE: August 18, 1995

No. of Pages: __3____
(including this page)

TO: Mr. James D. Wolfensohn

FAX #: 307 - 733 9110

Jim,

As mentioned in my fax of this afternoon, please find attached the minutes of the meeting with Ambassador Goulding.

The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: August 18, 1995 03:46pm

TO: GAUTAM KAJI (GAUTAM KAJI@A1@WBHQB)

FROM: Katherine Marshall, AF1DR (KATHERINE MARSHALL@A1@WBWASH)

EXT.: 36923

SUBJECT: Angola: Meeting with UN Under-Secretary General for Political Affairs

On August 17, Messrs. Marrack Goulding, UN Undersecretary General for Political Affairs. Hedi Annabi, Director of the Africa Division for Peace-keeping Operations and Taye-Brook Zerihoun, Desk Officer, AF1, met with IMF and Bank teams led by Evangelos Calamitsis, director of the IMF African Department and by me; you joined the team at a working lunch after the meeting.

The meeting followed the recent summit of Mr. Wolfensohn with the IMF managing director and the UN Secretary General, at which they discussed ways to improve cooperation between the UN system and the Bretton Woods institutions. At that meeting, the three leaders pledged to coordinate their institutions' support for Angola's transition from war to peace and from a command system to a market economy.

The meeting yesterday involved informal but thorough briefings on the programs and strategies of each institution in Angola, specifically, with some broader implications for countries in the zone lying between peace and war. These very useful and up-to-the-minute briefings highlighted the interdependence of UN and Bank/Fund programs and the evident need for coordination among them. For example, public spending constraints, and specific agreements negotiated on the subject have evident linkages with specific provisions of peace agreements like targets for size of army, demobilization bonuses, land reforms, and training programs. This can, and has in some instances, influenced the progress of peace making in recent country cases, and some potential issues were flagged for Angola. Similarly, political agreements may be reached without a full appreciation of their implications for development policy and the management of the economy.

There was a clear consensus that close cooperation in the negotiation and implementation stages of each program would enhance the effectiveness of peace-keeping operations, macroeconomic stabilization and development assistance. We also agreed that post-conflict support should be designed whereever possible to enhance prospects for averting a resurgence of the tensions which led to conflicts. The Government and all its multilateral partners would benefit from close coordination of

political and technical assistance.

While there have been frequent exchanges at the working level in Angola, contacts between headquarters staff in Washington and New York have been rare. It was agreed that regular informal communications between UN desk officers and their counterparts in the Bank and the Fund would be useful. Relevant documents should be exchanged and, most important, staff would exchange information informally before decisions are made.

I described and noted the several aid coordination initiatives underway and the attendant potential for confusion and overlap. They include a Round Table planned by UNDP on September 26, a meeting of Friends of Angola to be organized by Portugal, an informal meeting of donors that may be held during the Bank/IMF annual meetings, and Consultative Group (CG) Meeting tentative scheduled for April 1996. Furthermore, Angola may become eligible for the Special Program of Assistance for Africa (SPA). To avoid confusion and to maximize aid mobilization opportunities for Angola, there is a need to ensure that the objectives of each activity are clear, agreed, and complementary, rather than competing. The UN, Mr. Goulding said, could help the Bank prepare the Angola CG meeting

This initial meeting did not involve UNDP, though there was recognition that they were an important actor. The UN team assured us that they would bring them into the picture, and that UNDP would clearly be involved in future coordination efforts.

Finally it was agreed that the three parties would meet again in about three months to review progress. These meetings would address the urgent and moving agenda on Angola, but would also address some of the broader issues involved in meeting the needs of countries emerging from strife.

CC:	Edward V.K. Jaycox	(EDWARD V.K. JAYCOX@A1@WBWASH)
CC:	Stephen Denning	(STEPHEN DENNING@A1@WBWASH)
CC:	Barbara Kafka	(BARBARA KAFKA@A1@WBWASH)
CC:	Florent Agueh	(FLORENT AGUEH@A1@WBWASH)
CC:	Silvio Capoluongo	(SILVIO CAPOLUONGO@A1@WBWASH)
CC:	Kevin M. Cleaver	(KEVIN M. CLEAVER@A1@WBWASH)
CC:	Africa ISC Files	(AFRICA ISC FILES@A1@WBWASH)

Chron

THE WORLD BANK

Managing Director

8/18

Mr. Wolfensohn:

Jim:

This responds to your earlier query.

I have not had a chance to review in detail this final version but I do think it attempts to respond to your questions.

I will also review them but I did want to pass them on to you.

GAUTAM S. KAJI

COLOR ANNEXES TO COME IN

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

Office of the President

August 18, 1995

Mr. Kaji

Re: Trends in IBRD/IDA Commitments and Disbursements by Region (FY91-95)

Attached, please find 4 sets of graphs (with annotated data) on the above topic.

Set 1:

Graphs in this set show Bank-wide (all Regions combined) trends in commitments (i.e., loan approvals), disbursements, and cancellations for: (a) IBRD and IDA combined; (b) IBRD; and (c) IDA. The dollar amounts involved are also indicated.

Set 2:

Graphs in this set compare Regions with respect to commitments, disbursements, and cancellations for (a) IBRD and IDA combined; (b) IBRD; and (c) IDA.

Set 3:

Graphs in this set compare Regions in terms of the ratio of disbursements to commitments each year, again for: (a) IBRD and IDA combined; (b) IBRD; and (c) IDA.

Not very meaningful.

Set 4:

Graphs in this set compare the ratio of undisbursed balances to outstanding commitments for each Region to a Region-specific "norm." The norm is derived by taking the weighted average age of each portfolio and referring to the Bank's "Standard Disbursement Profiles" for the type of loan: (a) Total portfolio (i.e., Investment and Adjustment Loans combined); (b) Investment Loans; and (c) Adjustment Loans.

This is a much more meaningful measure.

For example, the weighted average age of Africa's total portfolio (investment and adjustment loans) at end of FY95 was 4.6 years or approximately 18 quarters. According to the Standard Disbursement Profile for FY95, after 18 quarters, this portfolio should have an undisbursed balance of 34 percent of commitments, but the actual undisbursed balance for Africa was 58 percent.

Yaw Ansu
Acting Assistant to the Managing Directors

IBRD/IDA Disbursement Data as of 30 June 1995

REGION	(1) UNDISBURSED /EOY	(2) TOTAL COMMITTED	(1) AS % OF (2)
AFRICA	11,658.8	18.628	62.6
EAP	19,172.3	32.761	58.5
ECA	12,004.3	17.370	69.1
LAC	18,709.3	31.766	58.9
MENA	5,545.0	9.451	58.7
SA	14,970.8	24.369	61.4
TOTAL	82,206.9	134.630	61.1

5) Separate Adjustment from projects

6) Factor in age structure.

(7) Compared to Norms (Finance complex)

Thanks - I will be very interested in!

What is the trend?

What is normal?

Can someone put for me the last 5 yrs on basis of: (1) commitments IBRD + IDA (2) Total undisbursed end yr by Area + Total

(3) Total undisbursed as % age of commitments

(4) Graphs of any trends etc

Chron

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director

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Facsimile Transmittal Form

DATE: August 17, 1995

No. of Pages: 2
(including this page)

TO: Mr. James D. Wolfensohn

FAX #: 307 733 9110

Jim,

I was thinking of sending out the attached to the VPs so that we do not have all sorts of stories floating around the Institution. I do speak in your name and I wanted to be sure you are comfortable with what I am saying.

Gautam

Attachment → see confidential Chron file

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

August 16, 1995

Mr. Wolfensohn

Annual Meetings Speech Outline

Jim:

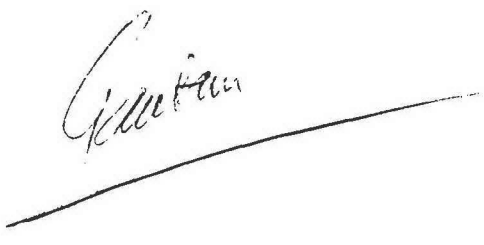
As discussed, attached is an outline of a proposed speech which attempts to synthesize the various ideas and themes suggested by yourself, Maurice Strong, DEC and others. I would like to stress that this is nothing more than a skeleton outline. There are many holes to be filled in terms of facts, numbers, and data. Before filling in more detail, however, we felt that we should get your sense of whether the basic storyline and theme are on track.

The theme is very much along the lines of your notion of the need for "a different Bank for our different world," with new thinking, new approaches and new partnerships. The storyline takes us through it as follows:

- Your observations from the last four months in terms of the new challenges and opportunities facing the development community and the Bank.
- How the Bank has changed over the last five years (your "scorecard" notion) as an indicator of future direction and further change required.
- A sense of the core values and principles that you see driving the "Wolfensohn Bank."
- Your immediate priorities (next 12 months).
- A vision of the future Bank -- as a global networker for excellence in the international development effort.

Since Friday is my last day, I hope to get your reactions before I leave so that Mark/Gerry can amend or beef up the outline prior to seeing you in Jackson Hole. We have begun also to assemble the various "scorecard" data you had requested.

Best wishes.



Mr. Wolfensohn Draft: 8/16/95

ANNUAL MEETINGS SPEECH
OUTLINE

1. INTRODUCTION

- Proud to head the Bank
- Tribute to Lew

2. THE PAST FOUR MONTHS: LISTENING AND LEARNING

- Four months on the job. Too soon to have all the answers, but long enough to see the diversity of Bank's clients and challenges.
- Long enough, too, to begin to make sense in my own mind of the basic directions this institution must steer.
- Accelerating pace of change -- a different world. Need a different Bank, with different approaches and partnerships.
- Key question guiding change at the Bank is: what are those client needs where we can add value and make the critical difference? What do you in this room want from us today, next year, five years from now? These are the parameters within which, together, we must redesign the Bank.
- Spent much of past four months travelling -- wanted a first-hand, personal perspective on what Bank is doing. Wanted to be in touch directly with clients, shareholders, partners, friends and critics **(anecdotal travelogue -- Africa, Latin America, Middle East, China).**
- What did I learn?

First, that development is stretched as never before

- Speed of global economic change.
- Diversity of spectrum of challenges.
- But everywhere saw the constant, tenacious challenge of poverty: one billion people and growing.

Second, struck by how hard the development choices are in our new world.

- Challenge of balancing growth with poverty reduction and environmental sustainability.

- Managing growth in a way that builds and does not destroy: our cultures, religion, our tolerance of each other and our sense of self.

Third, last four months have been a lesson in institutional humility. We do not have all the answers.

As well as these challenges, saw enormous opportunities for progress:

First, emerging clearer than ever that what matters above all is improving the quality of people's lives.

- Country after country now focusing more on that priority and on quality and sustainability issues e.g. reductions in fiscal deficits, defense expenditure/increases in spending on human resources (**need numbers/trends**).

- See great opportunity to bring our collective experience/resources to underpin this priority to improve the quality of life.

Second, the resources -- people and financial -- are out there to do the job, if those resources can be harnessed and used more effectively for the common good.

- Increasing desire for partnerships -- not just governments or markets, but civil society that shows signs of being ready to be mobilized (**anecdotal evidence?**)

- Multilateral and other agencies must take advantage of this opportunity.

Third, while globalization is indeed a challenge, it is a tremendous opportunity to do more development, more efficiently.

- Private flows now 3:1 over official; multilateral agencies must add value to menu of private finance.

- Countries more open than at any time in memory; opportunity for gains from networks and connections (**need concrete examples**)

- Globalization also obliges us to look beyond borders, seek global solutions to global problems e.g. failed states (**what are the issues as Bank sees it?**)

Lastly, there is the great opportunity offered by the new power of choice that more and more countries and people can exercise in our new world.

- Will drive competition, quality, and accountability.

- New players, new ideas, "democratization" of development -- no more monopolies.

3. CHANGE AT THE BANK

Where is the Bank in this world of new challenges and opportunities -- a world in which our clients have alternative options on our lending and advice.

- Has been changing. Review last five years -- as a glimpse at the future shape of the institution and a guide to further change/action needed.

  Significant change trends (**to be underpinned by data/numbers**):

- New clients: from former Soviet Union to Gaza -- diversity.

- New emphasis: rise of non-lending services and advice -- increased focus on outcomes/results/quality (**data required**)

- New lending patterns: growth in human and "quality of life" lending: environment, education, health, and private sector (**need specifics**)

- New products: guarantees, single-currency loans, institutional development fund (**what have been implications?**)

- New partnerships: GEF, regional MDBs, cofinancing, NGOs, C-GAP (**are these as effective as should be?**)

- New approaches: the Country Strategy at center of our work; encouraging exchange of development successes/lessons learned among developing countries e.g. work on East Asian miracle; and outreach to universities, journalists, and segments of civil society (**other new approaches?**)

- New openness: information disclosure, Inspection Panel.

These changes have mirrored changes in the world and in our clients -- linked to the new challenges and opportunities.

But we must go further and faster. If last five years have provided seeds of change, where do we take the Bank from here?

4. FUTURE DIRECTION

Future direction must rest on a set of core values:

- Our clients must drive our products and services. Must organize ourselves better to hear and stay ahead of evolving client needs rather than becoming a creature of internally-driven priorities. Want a multi-product line institution; and a culture of innovation/excellence/ accountability.

- Must be the ultimate "relationship Bank". Long-term commitment to clients -- through good times and bad; bringing global experience/lessons learned to bear.

- Must strengthen and expand our partnerships -- not only with our clients, shareholders and sister institutions, but also with private sector actors and civil society.

Foremost, we must reaffirm our place in the vanguard of the fight against poverty. (**e.g. are we doing all we can on agriculture/rural poverty issue?**)

Note: Are these the right core "values" -- more that you would like to say?)

5. IMMEDIATE PRIORITIES

This is my sense of the values and general direction forward for the Bank. In terms of immediate priorities for the next twelve months, I have six (**are these the right ones --more/less?**)

- IDA -- need for fulfillment of commitments to IDA-10/IDA-11 (**make a strong "political" statement on importance of IDA**).

- The "failed states" issue (**how do we intend to do more?**)

- The multilateral debt issue (**a proposal?**)

- Strengthening private-sector relationships (**plans for improving cohesion of IBRD/IFC/MIGA**)

- Strengthening Civil Society relationships (**have begun, but needs to be done more systematically -- how?**)

- Changing internal staff incentives to promote culture of innovation, accountability for results, and excellence (**specific action?**)

6. CONCLUSION: VISION

- To achieve our goals, need to transform the Bank into a global networker for development, to place it at the center of a web of excellence that connects:
  - governments to the private sector;
  - NGOs to the official development process;
  - experience, know-how, and finance with those who need it;
  - and the poor people of this world with opportunity and a better quality of life.
- To deliver, we must be constant but responsive; approachable but clear in our goals. Open in our partnerships but uncomprising in the independence of our advice; seeking out partners and as often deferring leadership to others as frequently as we claim it.
- That is the imperative for change and the opportunity for the World Bank as we work with all our partners to improve the quality of life for people everywhere -- in rest of this decade and into next century.

THE WORLD BANK

Managing Director

August 14, 1995

Mr. J. D. Wolfensohn

Jim,

Re: Tibet

This is not important. Only for lighter reading if you have a few moments to spare.

A staff member went to Tibet on a holiday accompanying his wife who heads up an NGO. The commitment of individual staff, their perspective, their curiosity and interest continues to impress me even after all these years in the institution. Wish we could somehow capture and channel it more effectively.

This makes interesting reading anyway.

GAUTAM S. KAJI

Tibet: Observations of a Tourist

The following observations are based on a week spent in Tibet accompanying a mission of senior staff of The Mountain Institute (TMI) to their community-based conservation project for the Qomolangma Nature Preserve (QNP), the second largest conservation project in the world -- covering some 38,000 sq. km. (Qomolangma is the Tibetan name for Mt. Everest.) Arrangements were courtesy of TMI, and I benefited from discussions with their staff and counterparts. I had access to little quantitative data -- I don't know how much exists -- so these are qualitative observations. We spent three days in Lhasa, and then five days driving across south-central Tibet into Nepal along the major East-West highway (Route 318), which leads initially from Xi'an through Sichuan to Lhasa and then to the boarder with Nepal (over 5,000 km). We also made several excursions on side 'roads' to more remote areas, including Rongphuk, the highest permanently inhabited settlement and monastery in the world, which is along the pass to the base camp for Mt. Everest ascents from Tibet . Altitudes of the visit varied from 3,600m to 5,800m. With proper medication and normal precautions about exercise, altitude was not a problem. Yak Butter Tea, on the other hand, laid me low both times I tried it.

Overview: The Tibet Autonomous Region (TAR) covers about 1.2 million square kilometers at an average altitude of 4,000m and has a population of an estimated 2 million or more. These are mostly comprised of ethnic Tibetans, but there is a growing proportion of inhabitants of Han Chinese origin, primarily in the urban areas. TAR is divided into 8 prefectures and further into 74 counties. Below the county are numerous 'shengs' (groups of villages or large village centers) and villages.

On arriving in TAR, I was struck by the similarity of the architecture and building styles, land use and cultivation patterns, animal husbandry, and general life style to areas on the desert side of the High Atlas Mountains in -- including such items as the welcoming arches over the road entering and leaving towns. The 100 km ride from the airport to Lhasa gave ample opportunity for such reflections. Others in the group reported similarity to features in comparable areas in Afghanistan and among the Zuni Indians in the United States.[1] Apparently, the rigors of living in arid and high locations lead to similar 'optimal' methods of surviving, especially in the absence of modern technology. In any event, one has to admire the hardiness and ingenuity of these people to survive and often thrive in such harsh conditions with good grace based on our encounters with a broad spectrum of Tibetans.

The vast northern reaches of the country are dry steppe where a few nomads live. There are few roads or permanent settlements. The area in the southeast of TAR is lower and receives more rainfall than the rest of the region. It contains one of China's largest remaining primary forest areas.[2] Neither of these areas was visited. Tibet is considered by the Chinese as a region

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[1] The Zuni are the highest altitude tribe in the US living at an average altitude of 9,000' in the Southwest. Indeed, Zuni visiting Tibet have reported that customs and religious practices are also strikingly similar.

[2] WWF completed a report last year indicating that this forest was being logged at an unsustainably high rate to meet timber demands in nearby provinces and to help reduce China's dependence on imported wood. Following

potentially rich in natural resources, though there has been little exploration and discovery to date. There is some copper and gold mining. The existence of a uranium mine was reported, as was a recent discovery of oil north of Lhasa. Given the remoteness and difficulty of the terrain, mineral finds would have to be very rich to justify their development.

We visited the South central area -- the 'back side of the Himalayas'. This is where most of the population lives, and it includes numerous fertile river valleys and most of the cultural and historic sites of interest. It has been the home of several important secular and religious kingdoms over the past centuries. Many fortifications and monasteries remain in both ruined and functional states -- attesting to the ability of these valleys to produce enough of a surplus to sustain such civilizations. Soil fertility has been based on traditional irrigation systems, many still in operation. The annual average rainfall of 300 mm/yr. (mostly during the South Asian monsoon season) is inadequate for permanent agriculture or even forests without irrigation. The land outside of the irrigated areas is barren save for some hardy scrub vegetation that provides grazing for sheep, goats, cows, and yaks. This region is geomorphically active. It is not subject to major earthquakes as is the case on the other side of the mountains, but it is subject to other forces that reshape the land. The land is not protected by vegetation from high winds and occasional heavy rains, so there was evidence of extensive erosion by both wind and water. It was surprising to note 'peaks' of 20,000' that looked to be no more than rounded hillocks. However, where inclines were steeper, such as where roads passed through narrow gorges or valleys, landslides were common. Much of this erosion seemed independent of human action, though human activity, such as road building, has provided opportunities for additional erosion. And conversely, the instability of the land added to the difficulty in overland communications. This part of Tibet contains the headwaters of many of Asia's mightiest rivers, and we visited the upper reaches of streams that eventually become the Bhrama Putra and the Arun rivers.

It was reported that the central Chinese government directly transfers about RMB200 million a year to TAR for public expenditures since local revenues are very limited. They are clearly making an important effort to improve the living standards in TAR, which has among the lowest per capita income levels in all of China and limited potential for modern economic activities. It appears that most of the central government funds go to roads, irrigation, and education. Furthermore, it prices of a number of consumer goods brought in from other parts of China appear to be subsidized. For example, gasoline costs between 2.16 and 2.60 RBM/liter (a bit more than $1/gal.). It was reported that other goods were also sold at low prices, enough to support an active border trade re-exporting them to Nepal. I do not know whether these prices are particular to TAR, or just a reflection of lags in price adjustments generally in China. High transport costs would be expected to lead to relatively high prices in TAR in absence of intervention.

Local government systems seem to function well, given all the constraints. It appears to be a blend both traditional and modern practices, and there is evidence that it is possible to build participatory programs in conjunction with local authorities and populations. Tibetan officials that

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the circulation of this report, TMI staff also brought this issue to the attention of Forest Department authorities, who subsequently intervened to reduce the logging. Both TMI and WWF studies have reported that several indigenous and endemic species in TAR are threatened by encroachment and poaching.

TMI staff deal with on their project business are reported to be competent, practical, and knowledgeable about local problems; and able to articulate their priorities. The QNP and other projects observed demonstrate local officials and populations are open to initiatives to organize community participation for conservation project design and implementation.

Urban Areas: Lhasa is the largest city in TAR, with an estimated population of about 300,000. It is the only city with regular telecommunication and air links (to Chengdu and Kathmandu) outside of TAR. As such, it is the central staging area for most tourism and has built up a reasonable infrastructure to accommodate the inflow of tourists. The tourist sights in and around Lhasa (Potala, Jokhang, Norbulingka, etc.) are impressive, and Lhasa is the starting point for most trekking expeditions, which are controlled by various permits to travel in specific parts of the country. Ease of access to Tibet and to permits for the various trekking itineraries has reportedly improved considerably in the past few years.

Lhasa is growing rapidly, and there is a great deal of construction in evidence. This is partly due to a concerted effort by the government to 'spruce up' the city for the 40th anniversary of the reassertion of Chinese rule in Tibet. Major roads are being repaved, the area in front of the Potala is being cleared of slums and replaced with a large plaza (with, we were told, appropriate resettlement), and the modern end of the city is being expanded. So the city was pretty torn up, and traffic was difficult. Given its size and location, Lhasa seemed 'typical' for a small central city in a relatively poor developing region. Most amenities were available, the markets seemed well supplied, power seemed reliable, and the people seemed to be reasonably well off (albeit on a basic level and on very limited observation). Various micro- and small-scale private sector activities were in evidence and thriving. Public transportation was readily available, usually based on wagons pulled by the nearly ubiquitous two-wheeled, one-cylinder diesel tractors of Chinese origin that seemed well adapted to roads in Tibet.

A joint public-private Chamber of Commerce was recently formed specifically to encourage small private and community enterprises. It has over 800 members, presumably mostly in Lhasa and Shigatze (the second city). It was reported that the authorities were much more serious about promoting such activities than had been the case a couple of years ago, and there was considerable enthusiasm for the Chamber in the Tibetan community. It is worth noting that it was headed by a respected and very able Tibetan. In addition to providing advice and encouragement to local entrepreneurs, it has expanded to act as a kind of mutual investment bank. It has helped members with excess capital to invest in promising enterprises of members in need of funds. This investment seems to be some kind of combination of deposit with the intermediary and equity investment in the recipient enterprise -- I couldn't quite figure it out. It has been generally satisfactory and profitable. This 'bank' seems to have a surplus of funds and is seeking additional profitable investments. From what I could gather, most of the enterprises are handicrafts, service, and repair activities supporting the local market, and of course tourism. There is limited production for sale outside of TAR. There are four spring water bottling companies that ship to nearby provinces, a leather factory with a foreign partner (it was not clear whether it is fully operational), carpet weaving and tent making enterprises, and handicrafts sold to local tourists and for export to Tibet shops abroad. There is also a booming construction industry related to the building program in Lhasa and the perennial road construction and maintenance needs throughout the country. Most of the 'modern' construction activity is

dominated by Chinese firms, as they have the experience and capital, but there appeared to be a significant amount of 'traditional' construction going on as well in both urban and rural areas using Tibetan methods, materials, and labor.

If Lhasa is a budding modern city, Shigatze, the second city with an estimated population of 100,000, is a flourishing town. It is in the center of the 'breadbasket' region of Tibet and has all the markings of an agricultural market center. Plus I must add, at least one lawyer who advertises his skills in Tibetan, Chinese, and English at the main intersection. With the exception of a couple of wannabe shopping 'malls,' and a partly functional modern hotel, the construction is traditional clay brick and cement. The central town is well laid out and consists of two-three story buildings with shops underneath. Most things seemed available, though in lesser amounts and lower quality than Lhasa. As befitting the center of the country's major agricultural zone, the town seemed relatively prosperous. It also is the home of the second most important monastery, the Tashilhunpo, believed by some to be of greater religious importance than the Potala. It is an active teaching center and 'monastic city' with an estimated 400 monks in residence. Behind the main streets, which seemed permanently torn up for water main work (i.e. lots of holes and no apparent repair activity), were traditional residential areas. They were very similar to traditional medinas or casbahs in North Africa -- narrow winding paths among walled compounds containing houses and courtyards for living quarters and for domestic animals. This was also the style of the villages we visited. The power supply suffered occasional interruptions during our stay there. The number of back-up generators in shops and workshops around town indicated this was a normal occurrence. In the smaller towns we visited, power seemed to be locally generated in hotels and guest houses and rarely plentiful. There was no evidence of electricity on most villages.

The urban areas would benefit from additional expenditure on public utility services, particularly power, water supply and sanitation, and waste removal. It was hard to tell about the adequacy of such things as the housing stock, but it is likely that this could be handled by the private sector if there were some assistance on the basic utilities and perhaps some credit. There is quite a bit of potential for hydro power in TAR. There is at least one large installation serving the Lhasa region. Some mini hydro sites are beginning to be developed on some of the rivers gushing down from the mountains. I don't know about the costs, but it should be possible to do small diversions into generators to supply local power systems rather than tying major projects into a regional grid. This approach should also have fewer detrimental environmental impacts. In addition, there may be potential to use solar or wind power in some areas, although few experiments with alternative energy sources have been attempted. Solar panels would require protection from wind-driven sand particles, and data on wind forces and frequency would be required to evaluate the potential from that source. In addition to power generation, or perhaps instead of it, solar could easily be used for passive heating (water and housing) and cooking. This would take some of the pressure off of wood and peat-sod for cooking and heating and improve inside air quality (see below on the environment).

Communications and Transport: Lhasa has adequate telecommunications links with the rest of the world. Long distance phone and fax was possible to the rest of China and other countries, though it is not clear how reliable this is. Some international satellite TV broadcasts are also received. We were able to watch the Wimbleton Tennis Tournament in both Shigatze

and Lhasa, but only local television broadcasts in Shegar and Zhangmu (boarder town with Nepal). Phone service from points other than Lhasa in TAR was limited to calls within TAR, and in many cases probably non-existent as we observes many of the phone lines alongside the road were down, washed out by landslides or knocked over by other forces. Local authorities often had access to a separate radio network that would be available for emergencies.

The region would benefit from some non-landwire based telecommunications system. Depending on costs, some system of radio, microwave (line of sight distances could be quite long), and/or satellite communications would be important to reduce isolation, provide emergency assistance, help link producers to markets, and support tourism (see below).

Lhasa is served by regular air flights from Chengdu in Sichuan and from Kathmandu, Nepal. Primary roads connect TAR to Yunnan in the Southeast, Sichuan (Chengdu) to the east (two roads), Qinghai (Golmod) to the north, and Xinjuang in the Northwest. In addition, roads cross international borders into Nepal at Zhangmu and into India through Sikkim. Even the primary roads are slow and difficult, and it takes several hard days to drive overland from any of the entry points to Lhasa. It was reported that a rail connection from Lhasa to Chengdu is planned for 2010.

A great deal of effort has been put into building and maintaining the roads under exceedingly difficult conditions. The basic engineering and construction seems sound, but the extreme climatic and geomorphic conditions mean that even the most basic road beds require constant maintenance. One official estimated that he had to spend much more maintaining roads in his district than in building them. The portion of the main highway between Lhasa and Shigatze varied from full two lane asphalt to hard surface to minimal dirt and stone track and back again, often in the course of a few kilometers. A lot of road work was in evidence, partly because it was summer and possible, and partly because government preparation for the 40th anniversary includes improving the infrastructure.[3]

Some sections of the road were quite good, others quite bad due to erosion or washed out bridges. Some blockages required extended detours and fording of rivers and large streams (including getting stuck in the middle on one occasion). The mountainous areas were steep and prone to landslides. Travel here was inherently treacherous, and serious slides could block the road for days or even be fatal.[4] I gather that repairs were usually made in due time for any given break. Outside the mountainous areas, the main dirt roads were generally in good shape and one could make good speed. The side roads were narrower, but passable for a rugged vehicle. Long distance travel was primarily by trucks and the occasional Land Cruiser. Busses operated on some sections of the roads where conditions were favorable, but they could not always get through other sections. Local transport by two-wheel tractor was common, as were horse carts. Transport is high cost, which increases the isolation of rural areas.

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[3] We did note a complete lack of gender discrimination on road crews, and in irrigation repair crews, though this hardly looked like a blow for women's rights.

[4] Several people were killed in a slide on the road on the Nepal side of the border the week before we came through.

Maintaining and expanding the road network is critical for further development of TAR to reduce the isolation of most of the population, to give better access to markets, and to expand tourist possibilities. The basic skills and materials seem to be available. More capital assistance for building would probably be desirable, freeing more local resources for maintenance.

Agriculture: The central river valleys between Lhasa and Shigatze are well irrigated by a combination of traditional and modern systems, and the crop yields reported were good (up to 5 tons of grain per hectare). The government, with some foreign assistance, has invested heavily in the main irrigation systems. The mineral content of the glacial-melt water in the rivers and the high level of ensolation probably account for this fertility. Sedentary agriculture in the major valleys apparently supports income levels above those in nearby upland Nepal, according to some members of the party familiar with both places. The variety of crops, and thus the diet, is severely limited -- some wheat, barley, mustard seeds, beans, and a few vegetables and tree crops (fruits and nuts) cultivated in gardens. Potatoes have also been introduced, but are considered an inferior food and thus are not widely grown. More extensive horticulture is being introduced in the lower areas of Southeastern Tibet, but I do not know how successfully.

Outside of the main river valleys, production systems tends toward more semi-nomadic or nomadic. In many of the smaller valleys near water sources, traditional irrigation systems are in use, and some of the fields (usually carefully terraced) appeared quite productive, though the apparent fertility varied from place to place. In addition to irrigated areas, some of the farmers seed upland areas in the spring and return at harvest time to collect anything that might have grown on natural moisture. Many of the isolated villages were semi-nomadic. During the summer months, the villagers take herds of animals to higher pastures and return in the fall. The entire QNP area is reported to be in chronic food deficit. While this is most severe among the nomadic herders, it was reported that even in some agricultural villages up to 30% of the adult (males?) must go to the urban areas to seek casual employment or beg during the winter months.

There is an agricultural research institute in Lhasa and some experimental stations. Some extension service was also reported, but not its effectiveness. I did later learn that the initial efforts of the research station had been based on trying to adapt lowland crops and practices to Tibet, which were not successful. Now there is more effort to address the specific problems of the area.

Sheep, goats, cows (often intricately crossbred with yaks), and yaks are kept, by both sedentary and nomadic folk, so meat and milk are also produced, as well as a variety of wool. Wool and other animal products are the primary source of cash income for most rural families. The quality of wool on the hoof did not look very good. This is unfortunate as there is a ready market for wool in Nepal's carpet industry, but a substantial share of Nepal's wool is imported from New Zealand. Tibet exports some wool to Nepal, but cannot supply the quantity and quality desired. Weaving, handicrafts, and occasional day labor (e.g. on road repair) provide some additional income.

There appears to be scope for substantial improvements in agriculture. More exchange of information with other dry, high altitude regions would be desirable, given the striking ecological and cultural similarities notes. Some initial exchanges between QNP and the Zuni Tribe have

been promoted by TMI, but such initiatives are currently limited by the difficult challenges of raising funds for activities in Tibet. In particular, it would be desirable to expand the restricted variety of subsistence crops to include more tubers and other grains such as sorghum, millet, and triticale. It should also be possible to introduce appropriate fruits and vegetables to improve diets and to add cash crops to supplement incomes in rural areas. There may be some scope for cultivating traditional medicinal herbs and plants (see below) for export. Assistance in animal husbandry would clearly be desirable to improve the quality of the stock, of the wool, and of the means for collecting and grading it for export. This would also help improve the incomes of pastoralists. Trial exchanges of yak and llamas or alpacas between TMI programs in Tibet and the Andes are under discussion.

Education: Tibetans with whom we spoke indicated a high priority for education. This is significant since literacy rates, as well as attendance rates, are the lowest in all of China. Efforts are being made to improve this situation, and some officials indicated that education did indeed account for a substantial amount of their budgets -- 17% of local funds and 17% of transfers from the central government were quoted in Lhasa, but it is hard to say just what this covered. Attendance rates of as high as 80% for primary school age children were reported in some urban areas, about equally distributed between male and female. Rural attendance was lower, reportedly varying between 20 and 60%. Our discussions with several rural villagers confirmed low attendance rates, though there were schools in most of the villages we passed through. The economic incentives are clearly for the children to tend animals and help in the fields. Attendance rates in middle school are low, especially in rural areas where low population densities dictate boarding schools and state subsidies. But some students continue though upper middle school and go on to university, usually in Chengdu or Beijing. I was told there is a university in Lhasa, though it is not highly reputed. I have no idea the number of students attending university outside of TAR, but the two daily 757 flights from Chengdu were fully booked with students returning for the holidays during the first two weeks of July, which was one of the reasons why it was difficult to book reservations into Lhasa. There seemed to be a reasonable mix of males and females and students of Tibetan and Chinese origin in the unrepresentative sample of the flights we took, and they were all in very good humor.

Primary education begins in the Tibetan language in rural areas and in either Chinese or Tibetan or both in urban areas. Middle schools are apparently taught mostly in Chinese, as would be necessary for continuation of studies in other parts of China. I am sure this poses many of the same problems of dual language education that we encounter in the Pacific Islands. In addition to, or perhaps in parallel with, the modern education system, there still exists the monastic education for young males. Visits to monasteries revealed a rigorous and heavily rote education system. It is not clear to me to what extent this education system has an impact on the economy outside of the monasteries or whether some of the monks later return to lay life.

They do manage monasteries and monastic lands, so there must be some economic value to the larger community from this education. In addition, several Buddhist leaders have explained that the monastic system absorbed surplus males from the breeding population, which reduced population growth and the pressure to subdivide scarce arable land. Prior to the cultural revolution, many rural monasteries operated as fiefdoms, collecting as much as half the agricultural production from their 'domains.' Monasteries thus often served as stores of surplus

grain for redistribution in lean years, but also the surpluses were used to enhance the power of the monasteries. Some monasteries built up a warrior tradition to defend or expand their territories. We were told by local Tibetans that during the Cultural Revolution, resentment against the monasteries' feudal control contributed to their destruction of some monasteries and shrines by Tibetan youth. We were also told that a number of these sites have since been rebuilt by the central government.

Somewhere between the modern and traditional education systems exist at least two Tibetan medical schools -- one in Lhasa, which teaches a mixture of traditional and western medical practices (to the level of a medical aid or primary health worker), and one in Shigatze, which is purely traditional. We visited the latter, and two members of the group were diagnosed and treated, apparently with good success, with traditional medicines. In fact, there is a traditional Tibetan medicine -- based on the root of the high altitude plant, *Rhotiola Tibeticos* -- that is effective against altitude sickness. It was used by the Russian cosmonauts. One member of our group used it in lieu of Diomox, the sulfa based Western medicine which she could not tolerate. She had at least as good results as those of us on Diomox. Graduates of these schools are sometimes employed as health workers in the public health system and are respected by Tibetans for their skills. It is doubtful that they could make an independent living practicing medicine as most people are too poor to pay much and expect to be treated in the public health system, if at all. However, the potential for export of some of the traditional remedies is worth exploring. They seem effective for some ailments, and a *Rhotiola* preparation is marketed in China. One would need to assure that any medicinal plants could be sustainably harvested and that Tibet received a fair return.

Improving participation in the education system is critically important to raising living standards in TAR. The physical infrastructure seems to be in place. I have no idea about the quality of teaching and materials, but I gather that it is not untypical of regions at this low level of development. What does seem important is generating meaningful income earning opportunities in the local economies that give realistic incentives for families to send their children to school. The possibilities of learning to apply better agricultural techniques (see above) and of working in local tourism related activities (see below) offer two such opportunities. Moreover, primary education should emphasize the values of basic sanitary and health practices and family planning. Discussions with several villagers indicated that some family planning services were reaching even remote villages in the areas we visited. There has been some assistance from external agencies and NGOs in education.

Public Health: It was reported that a hierarchical system of village health centers staffed by the contemporary equivalent of 'barefoot doctors' up through sheng level clinics to more complete regional hospitals exists and is used. Not all villages had health services, and not all villagers would take the time to visit centers that were not convenient. Travel is long and arduous outside of urban areas and the main highway corridor, so this is not surprising. Tibetans we spoke to felt there was a lot of room for improvement in the health system and that it would high on most people's priorities. A new program is being implemented this year assigning a pair of Village Welfare Workers to each village, one male and one female. The man would be expected to work more with farmers and pastoralists to improve practices while the woman would have more responsibilities for looking after health care and educational issues. The expectation is that

they would have broad enough training to back each other up and compliment each other with their assistance. This is a promising approach that could develop strong links into villages to provide a variety of support and services. It is likely that constrained resources will direct this assistance toward helping the villagers help themselves, and this is as it should be. It is not clear how many villages will be affected or at what intensity, but I imagine that it will begin slowly. The program is receiving support from UNDP.

Casual observation indicates that a great deal could be gained from more preventative medicine and basic hygiene. Latrines, where they existed, left a great deal to be desired; garbage was strewn everywhere in cities and villages alike; and children showed many afflictions due to lack of basic cleanliness. In some villages, international NGOs and others have begun basic education on hygiene with beneficial results. More of this will be necessary if the tourist potential of the TAR is to be effectively tapped (see below).

Poverty: Casual observation also indicated low nutrition levels were persistent in the rural areas. Small body-size-for-age among children encountered and small stature among adults were very common. This was compared with observations in urban areas, where adults were of markedly greater stature. We did no systematic sampling, but low nutritional levels were also reported by more experienced observers. It was reported that many of the rural areas in the south central region were in food deficit 3-6 months of the year, and that substantial parts of the population migrated to the cities seeking work or to beg. It was also reported that the local welfare systems run by the county governments for (re)distribution of food (obtained in part through required government procurement at low prices) and other necessities to the destitute functioned effectively when the resources were available. The limitations seem to be the basic productivity of the agricultural systems (see above) and the isolation of the villages. Again based on informal comparisons, outside the central valley areas near the cities, people seemed at least as poor as in neighboring areas in Nepal, and dramatically poorer than much of the rest of China.

Tourism: One of the principal income earning occupations for TAR could be tourism. Tibet has rich physical and cultural assets to attract tourists, and it has been closed enough in the past to attract a premium as an exotic destination. Some tourism is already occurring, limited by the number of entry permits issued and the extent of the territory open to various classes of tourists. At this point, TAR does not have the resources to handle a major influx of tourism, nor should it seek mass tourism. It is too remote and difficult a destination, and the impacts of large-scale tourism would be detrimental to the very attractions that it has to promote. Similarly, it would not benefit many Tibetans to try for an exclusive, high-end tourism based on a string of luxury hotels, as some have proposed. That often does little to improve the incomes of local people, exacerbates income and class differences that are unhealthy, and usually adds little to the local economy. It would be more appropriate to develop a tourism based on the hospitality and resources of the local economy and the physical (outdoors) and cultural attractions of the country.

This would involve some expansion of staging (two - four star) hotels in the larger cities -- clean, well maintained, functioning plumbing, and a reasonable number of local activities. Tourists planning any trekking or other strenuous activity require several days of acclimatization to the altitude. These staging hotel should be supplemented by a series of small, locally operated lodges or hostels that offer basic overnight services (food, clean sleeping quarters (private or

dormitory), sanitary facilities, etc.). These could be established in villages that could be reached either by means of Land Cruiser or bus, or by trekking. Villages along tourists and trekking routes could develop meal service and handicrafts. Villagers could also earn additional income as guides and porters. A critically important complementary element would be the intensification of participatory, community-based conservation activities. International NGOs, such as TMI, have worked with local groups to initiate such activities on a modest scale in the QNP. Some park entrance and climbing fees could be used to support additional training and salaries of guides, rangers, and scouts. It is entirely appropriate to involve local people in these activities and generate incomes for them. This source of employment enhances their stake in conserving the environment that attracts the tourists -- a mutually beneficial enterprise.

The routes themselves could be designed to offer visitors a range of interesting cultural and physical sights. We met a couple of tour groups on busses that brought their own supplies and did virtually nothing to contribute to the local economy. On the other hand, we stopped at a couple of villages where villagers were trying to establish tourist services. They had learned to provide clean facilities and offered reasonably good local food, which provided a pleasant break. A few external NGOs and agencies are working to develop this kind of tourism and providing the basic training to interested Tibetans on how to exploit its potential. In addition to innkeeper training, some language training will also be necessary. Experience in Nepal and elsewhere with this relatively low-intensity, locally-based tourism has proven successful in significantly increasing local incomes and mitigating the negative impacts of tourism on the local culture and the environment. This kind of development, along with improvements in agriculture mentioned above, may prove the most effective way of raising low income levels and reducing poverty. They provide alternative income sources to people living in rural areas, allowing them to preserve their cultures and reducing the incentive to migrate to the urban areas. At this stage, Tibet cannot absorb large-scale tourism, nor should it. It can still command some 'rent' from limited access, and should use tourism to help increase local incomes and reduce poverty. The potential incomes from tourism should also provide incentives to the rural population to pursue more education and health services.

Given the stress and capacity limitations of tourism beginning in Lhasa, there is also a need to explore developing alternative entry points and tourist itineraries. Departures by land from Nepal and India through Sikkim would permit more gradual adaptation to the altitude and offer a greater variety of experiences to tourists. Itineraries in the reverse direction are also quite attractive, as our excursion demonstrated. Discussions to establish such trans-border trekking and automobile based routes are in the exploratory stage, supported by TMI and IUCN. We did observe one small group of bicyclists peddling uphill into Tibet from Nepal, but I am not sure there is much of a market for that particular sport.

Environment: There are two distinct environmental issues in Tibet, indoor pollution and outdoor pollution. Inside dwellings, traditional practices of burning dung, peat sod, and scrub wood in unventilated kitchens and houses (keeping warm in mud brick houses during the harsh winters is not easy in such a sparse environment) leads to a number of respiratory problems. Even in the summer, we observed evidence of health problems and noted the polluted air in dwellings visited. Furthermore, basic sanitation is absent in most villages and all sorts of garbage is strewn around. The problem of indoor pollution is well known in other parts of China as well, but less

amenable to solution in Tibet because of the lack of alternative local fuels and extreme distances involved for transporting other alternative fuels. Solar, wind, and local hydro-electricity (see above) offer some options to be explored, along with improved stove design and ventilation. Considerable work has been done on this issue in other parts of China (by the East-West Center among others).

Part of the outdoor environmental problem can be traced to the indoor problem of heat. As populations have expanded, the demand for fuel has increased, as has the extent of grazing. Collecting peat-sod and cutting scarce brush for fuel exposes the land to further erosion of meager topsoil, as does more extensive grazing, thus exacerbating natural erosive forces. To my knowledge, few studies have been done, but some preliminary work indicates overgrazing on some lands. Traditional communal practices augmented by more modern governance do not seem adequate to prevent overuse of the grazing commons. The larger environmental question involves preserving the unique and fragile environment of the high altitude plateau and interior approaches to the Himalayas. Natural erosion is already present as a result of water, wind, and orogenic (mountain-building) forces. Roads, careless trekking, litter (we noted beer cans and the like in some pretty remote places), and more extensive cultivation may accelerate these natural destructive processes. In addition, there are some indications that hunting (poaching) is diminishing endemic wildlife, plus the problem of timbering in the Southeast (footnote 2). The authorities are well aware of these problems and are establishing extensive nature preserves in key areas, generally with the assistance of foreign NGOs such as TMI and OKO-Himal. Some of these efforts are linked to managed tourism development that gives the local populations a stake in preserving the environment as a source of income (see above).

Final Observations: From our observations, the central government is devoting substantial resources to improving living standards in TAR. But the needs are very large, and well conceived external assistance could be of great value in furthering the objectives of improving living standards in Tibet. Foreign NGOs are able to provide some technology and training and to work in a participatory way with the local populations. Their activities are expanding as the authorities are becoming more comfortable with this approach. But more capital is also needed to help in both infrastructure and human resource development. As much as physical capital, transfer of appropriate technological capital from other areas in the world facing similar conditions would be highly valuable. Bilateral or multilateral development institutions could help provide some of this assistance.

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To: Mr. James D. Wolfensohn
From: Gautam S. Kaji, Managing Director

Subject / Title
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Exception(s)
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The World Bank
Washington, D.C. 20433

Gautam S. Kaji
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Facsimile Transmittal Form

DATE: August 9, 1995

No. of Pages: 10
(including this page)

TO: Mr. James D. Wolfensohn

FAX #: 307 733 9110

Jim, See confidential BB

As promised, attached is a proposal for a way in which you may wish to approach the issue of defining and introducing changes at the Bank.

Just to keep you abreast of two other developments:

- On Angola: I have spoken to Under-Secretary General Goulding. He is visiting with us next Thursday. I have arranged to meet with him - also with IMF - and for appropriate staff to provide a full briefing.

- Re Enron and the Dhabol Project: I have clarified exactly what our 92-93 review had indicated. I arranged for Mark to have and Indian reporter ask Joe Wood appropriate questions. This was done today and has served to clarify that our review did not have bearings on the Enron project and hence claims by the State government are not founded on any Bank review. A report of this interview is attached in case you need to respond to any US queries.

Finally, would you please spare me 20 minutes tomorrow so that we can talk about your Annual Meetings speech and the approach to the budget discussions (and implications for your December travel plans).

I am sorry to harp in this, but I am getting a bit nervous!

Gautam

A L L - I N - 1 N O T E

DATE: 09-Aug-1995 05:48pm

TO: JAVAD KHALILZADEH-SHIRAZI (JAVAD KHALILZADEH-SHIRAZI @A1@D
TO: BIMLA N BISSELL (BIMLA N BISSELL @A1@DELHI)

FROM: Paul Mitchell, SASCA (PAUL MITCHELL)

EXT.: 81423

SUBJECT: ENRON: Interview with Economic Times

Mr. Wood had a short telephone interview with Mr. Sankaran of the Economic Times today at 1430. (The Economic Times is part of the Times of India Group). Mr. Sankaran said he would write a broader, more positive story on the power sector and the Bank.

In the interview Mr. Wood stated:

- The facts of the matter are that the Bank was asked by the Government of India in 1992-93 to comment on a 2015 MW baseload LNG project. The comments were offered to the Government of India. That is not the project which was subsequently put forward and approved by the Government of Maharashtra and the GOI.

- This key point was made to Chief Minister Joshi of Maharashtra when he was here (in Washington).

- We have not been asked to nor have we evaluated the current project.

- We have made it clear to the GOI that we would have no objection if they wished to make those comments (from 1992-93) available to the Mundi committee in order to avoid any possible misunderstanding.

- The Bank has said all along that the foundation for a healthy power sector in India is reform of the State electricity boards and we are encouraged by the progress on this in at least one State. The Orissa project is still going ahead.

- The Bank has no desire to get involved in the debate (about Enron). Our goal has always been to help India meet its power generation requirements on a sustainable basis. A way needs to be found to get the customer to pay for the power they use. The amounts of money needed to meet India's power requirements are too huge for the GOI and/or multilateral lenders to take on this burden.

- At the India Development Forum the Bank circulated the outline of a framework indicating how we could work in the future in the power sector. (This is still a draft document and discussions are continuing).

CC: D. Joseph Wood (JOE WOOD)

Chron 6K

The World Bank
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Gibney - FAX
202 963 5065
Sec Gen's Reports

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Facsimile Transmittal Form

DATE: August 8, 1995

No. of Pages: ___3___
(including this page)

TO: Mr. James D. Wolfensohn

FAX #: 307-733 9110

ANY HOT
AFRICA TOU

RE: Angola

Jim,

Jane passed me a message on Angola. I have not yet heard from Ambassador Golding (sic) who was supposed to call me. But, in any case, you should know that we are well geared up to respond and, in fact, the appraisal mission is completing its field work right now.

Attached is for your information.

Gautam

P.S. Matt is doing an update on IDA situation.

L - I N - 1 N O T E

DATE: 07-Aug-1995 10:27pm EDT

TO: Andrew Rogerson (ANDREW ROGERSON@A1@WBWASH)

FROM: Roger Grawe, AF1HR (ROGER GRAWE@A1@WBWASH)

EXT.: 34049

SUBJECT: Angola - Immediate Support to Reconstruction

Activities underway to support peace and reconstruction in Angola are as follows:

- Social Action Fund ($20 m. proposed)
  appraisal mission currently completing fieldwork
  Board presentation scheduled 12/95
  pilot phase funded by $2m PPF well implemented

This operation will support community initiatives through a decentralized funding mechanism at the provincial level. It represents a complete reversal of the top down planning approach that has characterized development efforts in Angola and has generated enthusiastic community and NGO support. It will concentrate on economic and social infrastructure; but will also pilot income generating activities, given the demand and lack of other institutional support at the local level.

- Emergency Recovery Credit ($50m tentative)
  preparation mission scheduled 9/95
  Board presentation FY96

Proposed financing for key imports to support reconstruction and urgent investment in priority sectors - agricultural tools and inputs, materials and supplies for private contractors, transport and communications equipment and spares, water purification chemicals, basic drugs, textbooks. This financing would be intended as a catalyst in the international effort to jumpstart reconstruction and as counterpart to Angola's own restructuring of public investment resources. In this context it would support both the rehabilitation program identified with UNDP support (to be discussed at the upcoming Roundtable in Brussels, Sept 26-29) and the staff monitored program currently being negotiated with the IMF.

- Donor Coordination

Following the UNDP Roundtable which will focus on community rehabilitation, a full CG is being considered for April, 1996 to mobilize donor resources to support the Government's long term reconstruction and investment program. Resources requirements are currently estimated to reach about $3b by FY97.

- NGO Collaboration

In addition to the support of local NGOs through the Social Action Fund, active collaboration is underway with international NGOs having special interests in Angola, such as the Gulbenkian Foundation (interested in supporting a greater role for the Church in providing health services) and Rev. Leon Sullivan's IFESH which is supporting pilot income generating activities and job training centers in a parallel financing arrangement to our own activities in these areas.

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Facsimile Transmittal Form

DATE: August 8, 1995

No. of Pages: 4
(including this page)

TO: / MR. WOLFENSOHN

FAX #: / 307-733 9110

/ JIM

BOSNIA

VICE PRESIDENT GORE'S OFFICE REQUESTED A BRIEF NOTE ON WHAT WE ARE DOING IN BOSNIA. ATTACHED IS A COPY OF THE NOTE PROVIDED TO HIS OFFICE THIS EVENING.

Gautam

The World Bank
Washington, D.C. 20433
U.S.A.

Christine Wallich
Acting Director
Central Europe Department

Telephone: (202) 473-7686
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August 8, 1995

Mr. Richard Wurtz
Adviser to the Vice President of the United States
Office of the Vice President
Old Executive Office Building, Room 298
Washington, D.C. 20501

Dear Mr. Wurtz,

Further to our telephone conversation this morning, some additional details you requested on the status of World Bank group activities in the Balkans, and in particular, in the successor republics to the former Yugoslavia, are provided below. (The Croatia strategy note was faxed to you separately.)

Following the break-up of the old Yugoslavia, a process started whereby the World Bank Group defined its relationship with the newly-formed states. Croatia and Slovenia became members of the World Bank group rather easily on February 25, 1993, after taking on responsibility for their portion of the total debt due the World Bank by ex-Yugoslavia. The case of FYRMacedonia was much more difficult, because of the tensions associated with the name and the limited capacity of FYRMacedonia to clear arrears and service the World Bank debt arising from its share of the total Yugoslavia debt. However, with the active help and resources from the government of the Netherlands, as well as several other countries (and George Soros who provided a loan), the World Bank put together a financing package that allowed FYRMacedonia to clear its arrears on February 14, 1994; succession to membership was made retroactive to the date of membership of Croatia and Slovenia.

In the case of the Federal Republic of Yugoslavia (Serbia and Montenegro), the UN sanctions in force led to a freezing of the relationship with the World Bank group and there has been minimal contact between Belgrade and the World Bank group over the last three years. Total arrears due to the World Bank from loans benefitting Serbia and Montenegro are now at $1.06 billion, and total debt outstanding is $1.32 billion.

Regarding Bosnia and Herzegovina the ongoing hostilities, as well as the loss of control by the internationally recognized Bosnian government over portions of its territory have prevented both progress towards membership, and any project-oriented activity by the World Bank group in Bosnia. Membership would require a plan to clear arrears, acceptable

to the board of the World Bank group, whereas actual disbursements to Bosnia and Herzegovina from eventual new projects would require the clearance of these arrears. (These arrears were $415 million as of June 1995, on debt to the World Bank group of approximately $450 million). Should such a plan be successfully concluded and membership attained, Bosnia's very low income level might allow it to be eligible for concessional resources. Despite these difficulties, an active dialog has been taking place between World Bank staff and the Bosnian authorities on possible approaches towards future arrears clearance, as well as on issues of economic policy and economic reconstruction.

On March 2, 1995, a small trust fund was created, thanks to a grant of Dutch Guilders one million by the Government of the Netherlands. The objective of the fund is to support technical assistance and economic advisory work (in cooperation with the Bosnian authorities) in planning for economic recovery and reconstruction. Last month, the United States government also announced its intention to contribute a small amount of money ($100,000) to this trust fund. This support, together with resources from the World Bank's own administrative budget, has allowed the preparation of an Economic Memorandum on the overall economic policy issues facing the Bosnian authorities and the Bosniak-Croat Federation. Two important meetings were held on these issues with Bosnian counterparts at the Warsaw, Poland office of the World Bank in the weeks of January 9 and May 23 this year. This work has strongly emphasized the need to strengthen the Bosniak-Croat Federation by building up key macroeconomic policy functions to be carried out by the federal authorities. At the same time, we have been sensitive to the concerns of the Bosnian authorities that this emphasis on the Bosniak-Croat federation should not be interpreted as a *de facto* acceptance of the partition of the internationally recognized Republic of Bosnia-Herzegovina into a Bosniak-Croat part, and a Serb-controlled part. The policy work, therefore, takes the view that, while the strengthening of the Bosniak-Croat federation is urgent and cannot await an overall final settlement, the arrangements between a federal center, cantons, and local authorities at the sub-cantonal level that would function within the Bosniak-Croat federation could be extended to the entire Republic of Bosnia and Herzegovina. This would preserve the integrity of this Republic within its internationally recognized borders while, at the same time, building a very decentralized economic and political structure in recognition of the events of the past years and the desire for a large degree of autonomy by the three major groups that make up the population of the Republic.

Apart from this work on institutions and macro-economic strategy, a parallel effort is currently underway in close cooperation with the European Bank for Reconstruction and Development on preparing the strategic approach to reconstruction in the various sectors of the economy. We expect the first phase of both the macro-economic and the sectoral reconstruction work to be completed by early September in the form of two summary papers - one on overall economic issues, and the other on reconstruction strategy, and seven or eight more technical sectoral notes discussing priorities at the sectoral level (transport, housing, power, telecommunications, industry and mining, agriculture, water supply, education and health).

Throughout this work we have maintained particularly close contact with Mr. Mohamed Saçirbey, first Ambassador to the U.N. and now Foreign Minister of the Republic of Bosnia-Hercegovina, as well as with Ambassador Sven Alkalaj in Washington, and have coordinated with staff in the U.S. Treasury, State Department, and USAID. We have also kept our Croatian counterparts (Prime Minister Valentić's office, Ministry of Finance, etc.) informed about the substance of this work with the hope that, within the framework of the confederation foreseen in the Washington agreement, there would evolve over time close economic cooperation between the Republic of Croatia and the Republic of Bosnia and Herzegovina. We are of the opinion that economic performance in both countries, for structural and geographic reasons, will always greatly benefit from such close cooperation. It is our hope that this work will make some contribution to encouraging a peaceful settlement and will facilitate the next important step, which will have to be a major international effort in support of re-integrating Bosnia into the international financial institutions, and financing the reconstruction.

It is very difficult to put any single estimate on the total financing needs, which are clearly huge. The strategy will have to be one of first concentrating on the most urgent needs in transport, housing, power, telecommunications, etc., as highlighted in our forthcoming papers on reconstruction strategy. Then, as the very basic social and economic infrastructure is repaired, Bosnia would draw on a combination of public concessional aid and private initiative to rebuild a market-oriented, private-sector led economy. In the short-term, the task is an immense one, and the international aid effort will have to be measured in the billions of dollars, at least $2-3 billion annually in the first years. However, there are two positive factors which should be stressed: first, a very large number of countries have expressed an interest in contributing to an internationally-backed reconstruction effort, so that the burden on any one country could be kept within acceptable limits. Second, the level of education and skill of the population of the Republic of Bosnia and Herzegovina compares favorably to that of other countries in the region. History has shown, again and again, that when foreign aid is combined with good economic policy and a skilled and motivated population, economic recovery can be surprisingly rapid, even after devastating wars.

We hope that this will be useful, and we stand ready to answer any further questions that might arise.

Yours sincerely,

Christine Wallich
Acting Director
Central Europe Department

Copied: Ms. Jan Piercy, Executive Director for the United States

Chron 6U

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Facsimile Transmittal Form

DATE: August 3, 1995

No. of Pages: 6
(including this page)

TO: Mr. James D. Wolfensohn

FAX #: 307 733 9110

Jim,

RE: ARUN

Attached please find a revised press release. Please call me as soon as you have had a chance to look at it. If I am not there, please speak to Tim Cullen at 202-473 1782 if you wish to have changes made.

Regarding the talking points: I attach the detailed notes prepared by Heinz Vergin. To recap quickly what we just discussed on the phone, the response to the three questions raised is:

- **Power Development Fund**: we are prepared to follow up vigorously on a fast track approach. Please recognize that this will require hard work from both of us, establishing the necessary policy and regulatory framework, and is not a "soft" option. If the concept can be developed satisfactorily we would be prepared to commit up to the amount we had contemplated for Arun, as well as seek funding from bilaterals. However, creating too large a fund which then does not disburse quickly is not in their interests. Start modestly and replenish as it is utilized.

- **Valley Development**: This could be the trickiest, particularly if they push us on ridge alignment. We are keen to work with them on a phase development of the Arun Valley. Any road requirements need to be assessed in the context of the immediate benefits and costs, including environmental and social costs. We should therefore examine all aspects of design costs and benefits of roadworks necessary for development of the Valley.

- **Kali Gandaki**: ADB has not completed appraisal. If there is a financing gap and the project meets our normal criteria, we would, in principle, be happy to cofinance with ADB in the lead.

Gautam

FOR IMMEDIATE RELEASE

The World Bank

1818 H Street NW, Washington, DC 20433, USA

Contacts: Paul Mitchell (202) 458-1423
Tim Cullen (202) 473-1782

WORLD BANK AND NEPAL TO DEVELOP ENERGY ALTERNATIVES TO ARUN PROJECT

WASHINGTON, August 3, 1995 — The World Bank and the Government of Nepal have agreed to work expeditiously to develop alternative approaches to meeting Nepal's energy needs following a decision by the Bank not to proceed with plans to support the Arun III hydropower project.

The agreement follows discussions between World Bank President James D. Wolfensohn and Man Mohan Adhikari, the Prime Minister of Nepal. Mr. Wolfensohn assured the Prime Minister that the Bank attaches the highest priority to helping Nepal in devising and implementing an alternative strategy for meeting its needs for electric power. The Prime Minister has requested the Bank's financial support for alternative approaches and Mr. Wolfensohn indicated that, subject to proposals meeting the Bank's normal lending criteria, the institution would be prepared to provide such assistance. As a result, talks have already begun between the World Bank and the Government on specific proposals to take advantage of alternatives available for meeting Nepal's power needs.

The World Bank had considered supporting the Arun III project through a $175 million credit from the International Development Association. Mr. Wolfensohn advised the Prime Minister that, following a comprehensive review of developments since the project was appraised in 1993-94 and the subsequent recommendations of senior staff, he had concluded that the Bank could not support the project.

" Large complex projects require institutions like the World Bank to weigh the benefits against the risks and then decide on their feasibility. The judgment made over a year ago in the case of Arun came out in favor of the project after substantial internal debate. Irrespective of whether that was the right or wrong decision at the time, I concluded that under today's circumstances and with the information at my disposal, the risks to Nepal were too great to justify proceeding with the project." Mr. Wolfensohn said.

" The public debate on this controversial project was valuable in that it served to heighten the concerns of Bank staff about the risks faced by the project. It also led to a

review by the World Bank's Inspection Panel of environmental and social aspects of the project with the result that measures to address these concerns were strengthened . Although this project will not go ahead, the Panel's work remains relevant to the Bank's operations in general and to future investments in Nepal's power sector in particular ", the World Bank President added.

While the Bank's review, as well as the findings of the Inspection Panel confirmed that the environmental and social mitigation actions that were currently stipulated for the proposed project were satisfactory, Mr. Wolfensohn's decision to advise the Government of Nepal that the Bank could not move ahead with support for the project was based on three main considerations:

- The Bank had always recognized the demands that a project of this size and complexity would place on a small country like Nepal. Since the initial appraisal, the Bank had established increasingly rigorous standards for the implementation of the project, and these reinforced initial concerns about the burdens being placed on the Government. The Government recognizes these constraints and had agreed to collaborate with capacity-building efforts recommended by the Bank's management in 1995. However, the limited capacity of institutions in Nepal to implement the long list of actions that would have to be taken to ensure success means that it could take up to five years longer than originally anticipated for this highly complex project to be completed. Demanding tasks relating to the operations and financial management of Nepal's power utility and the need to implement effectively the social and environmental actions highlighted by the Inspection Panel, would have imposed requirements which the Bank now judges to be beyond what Nepal could realistically have achieved at present.

- While there is support for Arun III, both among all Nepal's political parties and from most of the residents of the valley, the Government would still have had to implement a number of measures such as adjusting tariffs and prioritizing expenditures and sustain them over the next few years to ensure that the project did not crowd out priority social expenditures. While not questioning the Government's commitment to take these steps, the Bank recognized the difficulties inherent in developing widespread popular support and understanding of such measures.

- In addition to the financing from the World Bank, the project had always depended on funds being provided from several other sources. Some cofinancing partners did not feel they were in a position to commit the necessary funds within the next 12 to 18 months. This extremely difficult financing picture was further complicated by the fact that the estimated cost of the project had increased by $30 to $40 million as a result of delays that have already been incurred. As a result, the Bank felt there was no realistic prospect of firming up the financing plan in the near future.

The President's review reaffirmed the hydropower potential in the Arun valley as a promising option for meeting Nepal's long term energy needs, subject to improving the capacity to address social and environmental impacts of the likely projects and the creation of a more pro-active community development program in the valley.

A team of senior Bank staff is expected to visit Nepal shortly, and the President has instructed the team to give this effort top priority.

"Nepal's growth and efforts to alleviate poverty hinge heavily on the country's ability to generate power. These are the benefits that the Bank had hoped would be generated by Arun. The challenge is to work with the international community to bring alternatives to fruition as quickly as possible. Energy is crucial to Nepal's prosperity". Mr. Wolfensohn said.

This news release is being issued simultaneously in Washington and Kathmandu.

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Nepal: Power Sector Development - Alternative Strategy

The components of the alternative assistance strategy suggested by the Prime Minister deserve the following response:

1. Establishment of a Power Development Fund:

The Bank is prepared to consider establishment of such a Fund on a "fast track" on the following understandings:

- o The Fund would support accelerated pursuit of smaller hydropower projects for meeting Nepal's power requirements, improvements in transmission and distribution, as well as overall systems efficiency.

- o The Fund would also finance actions for mitigation of social and environmental impacts of priority power investments.

- o In parallel with the establishment of the Fund, GON would address itself to selected sector policy reform so as to establish an improved policy and regulatory framework which is also suitable for the induction of private power investors.

- o The Fund would be sized to ensure a reasonable pace of disbursement for the concessional aid commitments.

  [A mega fund, equivalent to the concessional aid commitments totalling $640 million envisaged for Arun III, is not justifiable. A first guess at the maximum size of such a fund would be $150 to 200 million. It needs to be emphasized that the Fund cannot be regarded a soft alternative to Arun III.]

2. Support for a Valley Development cum Arun Project Access Road on the Ridge Alignment.

The Bank cannot support a ridge alignment for the reasons stated in the Inspection Report. In order to help Nepal meet its longer term power needs, the Bank is prepared to assist in a carefully phased preparation of the Arun Valley for the eventual development of its hydro-power resources. This would include improving the capacity of Government agencies and NGOs to address the social and environmental impacts of the likely projects and designing and implementing a more pro-active community

development program in the Valley. The justification and timing for any road investments would have to be derived in the context of this area development.

[We should be extremely cautious in our response so as not to dilute the message of our withdrawal of support from Arun III.]

3. Co-Financing for Kali Gandaki Hydropower Project

The Bank does not have the latest information about the technical, economic and financial feasibility of this project. Nor does it have a clear understanding of the project's social and environmental impact and related mitigation programs. However, on principle, the Bank would be prepared to consider contributing to a viable project which meets the Bank's policy requirements, if a financing gap had to be filled.

[Indications are that ADB is not interested in our participation but some parts of Government are. Preliminary information suggests that this is a weak project which, in its environmental impact could become controversial. We should not be the ones to have to point this out. In this case, quality assurance should be left to ADB Management and Board with the help of friendly NGOs. Provided that concerns over project quality prove to have been unwarranted, we should be ready to become lender of last resort.]

vergin\power.doc
8/3/95

Chron BK

THE WORLD BANK

Managing Director

August 3, 1995

Note to Mr. James D. Wolfensohn

Jim,

Re: Greenpeace letter

In respect of your query on the attached, I feel that the final sentences were unnecessarily belligerent. I have had the letter revised to maintain the substance but to get away from the belligerence.

GAUTAM S. KAJI

THE WORLD BANK
Washington, D.C. 20433
U.S.A.

JAMES D. WOLFENSOHN
President

August 3, 1995

Mr. Cameron Duncan
Coordinator
Economic Policy
Greenpeace International
1436 U Street NW
Washington DC 20009

Dear Mr. Duncan:

Thank you for your letter and for your nine pages of proposals for changing the World Bank. These will be helpful as I address my new challenge at the World Bank in the months ahead.

From my preliminary reading of Greenpeace's proposals, I am pleased to note a good deal of common ground. Your suggestion to shifting towards a greater emphasis on sustainability, a more aggressive search to energy efficiency and renewable energy, a stronger focus on implementing the Bank's policies, improving transparency and participation and so on, are goals that I share wholeheartedly. The Bank has of course moved strongly in the right direction over the past few years in these areas. But with ongoing changes in management practices and in technology, and in our understanding of the development process, I, and most World Bank managers, would agree we need to do more.

I am keen that the Bank benefits from the insights from Greenpeace and vice versa, and I look forward to more constructive interaction than those we have had in the past. I hope you share my view that if the conversation is to be genuine, there needs to be consistency in our interaction. I stand ready to have constructive engagement with Greenpeace, on the understanding that this attitude is reciprocated in spirit and in practice.

Again, many thanks for your suggestions.

Yours Sincerely,

James D. Wolfensohn

Chron GK

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director

DATE: August 2, 1995

TO: Mr. James D. Wolfensohn

FAX #: 307-733-9110

Jim,

Further to our conversation of this afternoon we explored the options of a joint statement by the Bank and Nepal. It does get a bit tricky. If we try to issue the full statement as a joint affair, the Nepalese will try to "negotiate" the specifics that we bring out in your decision statement and dilute the foundation for your decision, which we must bring out clearly. We therefore propose not to meddle with the statement but have two alternative cover/transmittal sheets marked as A and B (attached).

A: is the unilateral statement by the Bank
B: is a more inclusive statement reflecting Nepal's likely views.

While you should offer a "joint" statement, it is important for them to realize that we would make an announcement anyway if we cannot come to closure on the statement quickly. The ResRep at the other end, Mr. Joe Manickavasagam will be sitting in with the Prime Minister when you call and will have copies of the attached alternative statements, which he can finalize on the basis of your conversation and in consultation with Vergin.

In your conversation with the Prime Minister you might want to emphasize that Arun, while important, is not

the only ongoing relationship with the Bank. We are addressing a number of other priority projects, for instance:

-- Village Water supply: appraisal to commence this month - in fact project plans are scheduled for review by the Cabinet in 2 hrs.

-- Agricultural, Research and Extension project: is at the preappraisal stage.

-- Social Fund project: with far-reaching implications for support of community development (including Arun Valley) is under active preparation.

Final point. We need to get our internal communications right on this. I have asked the VPs or their Actings to meet with me tomorrow so that I can brief them and ask them to get the "right" message to their staff.

P.S. JUST HEARD OF A MAJOR CABINET RESHUFFLE IN ~~SAUDI~~ ARABIA — ABALKHAIL THE MIN OF FIN IS OUT.

A

FOR IMMEDIATE RELEASE

The World Bank

1818 H Street NW, Washington, DC 20433, USA

Contacts: Paul Mitchell (202) 458-1423
Tim Cullen (202) 473-1782

WORLD BANK WILL NOT PROCEED WITH NEPAL HYDROPOWER CREDIT

WASHINGTON, August 2, 1995 — World Bank President James D. Wolfensohn has decided that the Bank should not proceed with plans for a $175 million credit from the International Development Association in support of the Arun III hydropower project in Nepal.

The reasons for the decision, which follows a comprehensive review and recommendations of senior staff, are spelled out in the attached statement which was presented to the World Bank's Board of Executive Directors earlier today.

(This news release is being issued simultaneously in Kathmandu, Washington and South Asia.)

B

FOR IMMEDIATE RELEASE

The World Bank

1818 H Street NW, Washington, DC 20433, USA

Contacts: Paul Mitchell (202) 458-1423
Tim Cullen (202) 473-1782

WORLD BANK WILL NOT PROCEED WITH NEPAL HYDROPOWER CREDIT

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The reasons for the decision, which follows a comprehensive review and recommendations of senior staff, are spelled out in the attached statement which was presented to the World Bank's Board of Executive Directors earlier today.

Mr. Wolfensohn has discussed the review and recommendations with the Prime Minister of Nepal. He assured the Prime Minister that the Bank attaches the highest priority to supporting Nepal in devising and implementing an alternative strategy for meeting its needs for electric power. While accepting these assurances, the Prime Minister expressed serious concerns over the consequences of the Bank's decision for the security of Nepal's medium term power supply.

They agreed that the Bank and the Government would move ahead rapidly in reviewing proposals to take advantage of alternatives available for meeting Nepal's power needs.

This news release is being issued simultaneously in Kathmandu, Washington and South Asia.

President's Review of Arun III Project

One of Mr. Wolfensohn's first actions on assuming the presidency of the World Bank was to commission a comprehensive review of the Arun III hydropower project in Nepal. This review, which included an assessment of both the initial project proposals and all the developments that have taken place since the project was appraised in 1993-94, was carried out by senior managers of the South Asia region and other senior Bank staff.

In light of this review and the recommendations received from senior staff, Mr. Wolfensohn has decided that the Bank should not proceed with supporting the project. He has however, assured the Nepalese authorities that the Bank attaches the highest priority to supporting Nepal in devising and implementing an alternative strategy for meeting its needs for electric power.

While the Bank's review, as well as the findings of the Inspection Panel confirmed that the environmental and social mitigation actions now stipulated under the project were satisfactory, the decision not to move ahead with support for the project is based on three main considerations:

- The Bank had always recognized the demands that a project of this size and complexity would place on the capacity of a small country like Nepal. Since the initial appraisal, the Bank has established increasingly rigorous standards for the implementation of the project, and these have reinforced initial concerns about the burdens being placed on the government. The government recognizes these constraints and has agreed to collaborate with capacity-building efforts recommended by the Bank's management in 1995. However, the limited capacity of institutions in Nepal to implement the long list of actions that would have to be taken to ensure success means that it could take up to five years longer than originally anticipated for this highly complex project to be completed. Demanding tasks relating to the operations and financial management of Nepal's power utility and the need to implement effectively the social and environmental actions highlighted by the Inspection Panel, would impose requirements which the Bank now judges to be beyond what Nepal can realistically achieve at present.

- While there is support for Arun III both among all Nepal's political parties and from most of the residents of the valley, the government still has to take tough decisions such as adjusting tariffs and prioritizing expenditures and sustain them over the next few years to ensure that the project does not crowd out priority social expenditures.

- In addition to the financing from the World Bank, the project had always depended on funds being provided from several other sources. A number of cofinancing partners did not feel they were in a position to commit the necessary funds within the next 12 to 18 months. This extremely difficult financing picture was further complicated by the fact that the estimated cost of the project has increased by $30 to $40 million as a result of delays that have already been incurred. As a result, there is no realistic prospect of firming up the financing plan in the near future.

The President's review reaffirmed the hydropower potential in the Arun valley as a promising option for meeting Nepal's long term energy needs, subject to improving the capacity to address social and environmental impacts of the likely projects and the creation of a more pro-active community development program in the valley.

The President's decision not to proceed with support for the Arun project was accompanied by a strong reaffirmation of the Bank's commitment to accelerate its efforts to assist Nepal in devising and implementing an alternative strategy for meeting its undisputed power needs. He is in direct contact with the Prime Minister of Nepal to underscore this commitment.

A team of senior Bank staff is ready to visit Nepal as soon as the Government indicates its readiness. The President has instructed the team to give this effort top priority. A number of proposals have been formulated by Bank staff for discussion with the Nepalese authorities. These proposals aim to take full advantage of the alternatives available for meeting Nepal's power needs.

August 2, 1995

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INSP/SecM95-5

FROM: The Deputy Secretary

August 2, 1995

ARUN III HYDROELECTRIC PROJECT

Management Response to the Inspection Panel's Investigation Report dated June 21, 1995

Attached for information is a President's Memorandum on the Management Response to the Inspection Panel's Report on the then Proposed Arun III Hydroelectric Project.

Distribution:

Executive Directors and Alternates
Office of the President
Senior Management, Bank, IFC and MIGA
Inspection Panel

This document has a restricted distribution and may be used by recipients only in the performance of their official duties. Its contents may not otherwise be disclosed without World Bank authorization.

Memorandum to the Executive Directors

Re: Arun III Hydroelectric Project

Management Response to the Inspection Panel's Investigation Report of June 21, 1995

Management has carefully reviewed the Inspection Panel Investigation Report of June 21, 1995 on the then proposed Arun III Hydroelectric Project in the Kingdom of Nepal and is in broad agreement with the Panel's findings and conclusions. The Panel's work on this Project has been constructive and helpful, and is highly appreciated by Management.

I am pleased to note that, after due consideration of the remedial measures which were set out in the memorandum dated May 23, 1995 from Management to the Panel, the Panel concluded that IDA was moving towards, and intended to comply in substance with, the requirements of the three relevant operational directives (environmental impact assessment (OD 4.01); involuntary resettlement (OD 4.30); and indigenous peoples (OD 4.20)). The Panel, which had earlier indicated possible inadequacies in its preliminary report, recognized the substantial effort made by Management after the Investigation was authorized to bring the Project into compliance with these three policies.

I also note the Panel's conclusion that the proposed remedial measures, which covered the three areas of investigation (environmental impact assessment, involuntary resettlement and indigenous peoples), appeared to be adequate, provided they were carried out in a manner consistent with the applicable operational directives and appropriate follow up mechanisms were introduced. The interaction with the Inspection Panel helped Management and staff to develop these remedial measures.

As the Executive Directors know, soon after assuming the presidency of the Bank, I have commissioned a comprehensive review of the Project by senior managers of the South Asia region and other senior Bank staff. This review included an assessment of both the initial Project proposals and the developments that have taken place since the Project was appraised in 1993-1994. It considered

the potential for significantly higher cost overruns, the uncertainty regarding cofinancing at this stage, as well as implementation and management aspects of the Project relative to its size and risks. The review also assessed alternative means for assisting Nepal in meeting its power needs.

In light of this review, and recommendations received from senior staff, I have decided not to proceed with the Project, as explained in my statement circulated to you on August 2, 1995. I have also assured the Nepalese authorities that the Bank attaches the highest priority to supporting Nepal in devising and implementing an alternative strategy for meeting its needs for electric power.

In view of the above, there is no need to elaborate here on the corrective measures which Management discussed earlier with the Government of Nepal and intended to assist the Government in their implementation, in case IDA's assistance for the Project was approved. However, the work of the Inspection Panel on the Arun III Hydroelectric Project remains relevant to the Bank's work generally, and to future Bank investments in the power sector of Nepal in particular.

James D. Wolfensohn

by Gautam Kaji
Acting President

THE WORLD BANK

Managing Director

July 31, 1995

Note to Mr. James D. Wolfensohn

Jim,

Africa: Agricultural Program

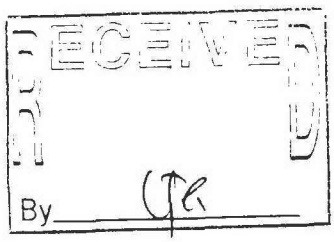
Re priority A: I think the focus on selected national programs and creating national institutions is absolutely right.

Re priority B: Streamlining documentation is a bit of a red herring. I have no problem with simple reports for follow-up operations. What is more important, is having credible indicators by which we assess whether the program is successful and what fine-tuning, if any, is called for. Such indicators, if they are to be credible, need to be result oriented. e.g. impact on yields, crop diversification, etc. as opposed to input measurement such as number of extension officers, published research results, budgetary allocation, etc. If we have the focus right, it is not so much a question of whether it is a 10 page or a 20 page report!

GAUTAM S. KAJI

The World Bank
Washington, D.C. 20433
U.S.A.

EDWARD V. K. JAYCOX
Vice President,
Africa Region



July 27, 1995

Mr. Wolfensohn,

Africa: Agricultural Program

The Africa Region will continue to give high priority to agriculture. Sustainable agriculture development in African countries can contribute significantly to economic growth, poverty reduction, and environmental protection. To this end, we are committed to improving the development impact of African agricultural projects.

Since early 1994, we have already initiated the first phase of significant restructuring and consolidation of ongoing projects in the sector. We have closed a number of problem projects and have eliminated non-performing components of other projects. We have simplified complex projects, linking them to national programs with a long-term focus. Our agricultural divisions have prepared comprehensive agricultural action plans to improve project implementation. This task was achieved through a collaborative effort involving managers and staff, both at headquarters and in the field, dealing with agriculture, as well as through consultations with the clients.

The above progress notwithstanding, more is needed to improve results in the field. Therefore, we are now intensifying our efforts, as noted below, to move forward in assisting African countries to revitalize agriculture.

Priority A: Focus on a few selected national programs. The core areas of support in agriculture would concentrate on systemic solutions, including research, extension, animal health, and natural resource management, plus one or two other areas. We will finance only time slices of these long-term national programs and eliminate financing of operations that fall outside the core areas.

Outcome: We will concentrate on fewer operations, focusing on those with high impact. Initially, the national programs will improve systems, such as extension, research, and animal health, that provide services to rural populations. These subsector national programs will eventually lead to financing of integrated sector programs. To support the above priorities, we will link the current 5-year lending program to the core areas of focus. We will also integrate existing operations into national programs in these core areas of support. These efforts should lead to successful agriculture sectors in operating countries.

We are proceeding with the implementation of the above priority. However, for Priority B, outlined below, we would like your support and concurrence before engaging in any substantive changes in streamlining documentation of future operations.

Priority B: Streamline documentation. We want to reduce documentation -- preferably to a single report of less than 10 pages including supporting tables -- for repeater operations or when financing a subsequent time-slice of a national program.

Outcome: We will move away from excessive paper work and processing of operations, placing emphasis on field work and responding to clients' needs. There will be substantial savings in time and costs by producing a more concise document. But, more importantly, there will be a mental change in our practice, shifting away from giving importance to paper work and instead placing more emphasis on quality and implementation.

We will continue to improve the quality of our agricultural products, making them more responsive to our clients' needs and priorities. We want our products to reflect ownership by the recipient countries and beneficiaries and to generate sustainable development results in the field. Good performance in the sector will generate more support for agriculture and will place agriculture in the forefront of the development agenda of African countries. More importantly, sustainable agriculture will increase the income of the rural poor and make households in rural areas more food, water, and energy secure. It will also create opportunities for education and improved health services for the rural population.

We are proposing a major change in terms of (a) concentrating our efforts on a few major areas that will have high development impact; and (b) streamlining documentation. This change can be viewed as a pilot test case for the Bank. Therefore, your support is important to the success of this undertaking. Ultimately, we will be judged by the quality of the products resulting from this initiative.

Thank you for your consideration of this plan.

Kim Jaycox

Distribution

cc: Messrs. G. Kaji, S. Sandstrom, R. Frank (EXC)
Messrs/Mmes. S. Denning, D. Benor (AFR); K. Marshall (AF1); J. Adams (AF2); A. Rogerson (AF3); O. Lafourcade (AF4); J. L. Sarbib (AF5);
K. Cleaver, N. Sharma (AFT);
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C. Cook (AF4AE); R. Harris (AF5AE)

NS:lrb

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director

Tel.: (202) 458-1384
Fax.: (202) 477-6869

Facsimile Transmittal Form

DATE: July 31, 1995

No. of Pages: ___7___
(including this page)

TO: **Mr. James D. Wolfensohn**

FAX #: 307 - 733 9110

URGENT

Please see attached.

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

July 31, 1995

Note to Mr. James D. Wolfensohn

Jim,

RE: Arun

Attached please find for your approval the statement on your review of the Arun project, which we would use for the Board and Press statement. Also attached is a letter from you to the Prime Minister.

There is a general strike in Kathmandu tomorrow and the Prime Minister will not be available. On Wednesday the PM is going to be in the provinces and would not be able to receive your telephone call. We are informed by his office that the earliest he could talk with you would be Thursday morning at 8:00 a.m.

I would therefore suggest the following sequence of events:

(i) I brief the Board in an informal meeting in the ED's lounge on Wednesday;

(ii) You call the Prime Minister Wednesday evening at 8:00 p.m. your local time which would be 8:00 a.m. Thursday morning in Nepal. We could arrange a conference call so that Heinz Vergin could also be on the line with you from his home. The Prime Minister is likely to have his Minister of Finance with him when he speaks with you. We would have your letter to him hand delivered by our Resident Representative before you talk to him;

(iii) Press statement would be issued late Wednesday p.m. Washington time after you have spoken to the Prime Minister.

I had originally intended to brief the Board on Tuesday. Given the fact that you are not going to be able to speak to the PM

until Wednesday evening there might be merit in briefing the Board on Wednesday so that the story does not leak to the papers before you have the opportunity of talking to the PM.

Appreciate a telephone call from you either tonight or tomorrow morning. My home phone number is 703 - 237 8557.

I hope you are enjoying Wyoming.

P.S.: I hear that you turned Michel around on Multilateral Debt! Awesome!

President's Review of Arun III Project

One of Mr. Wolfensohn's first actions on assuming the presidency of the World Bank was to commission a comprehensive review of the Arun III hydropower project in Nepal. This review, which included an assessment of both the initial project proposals and all the developments that have taken place since the project was appraised in 1993-1994, was carried out by senior managers of the South Asia region and other senior Bank staff.

In light of this review and the recommendations received from senior staff, Mr. Wolfensohn has decided not to proceed with the project. He has however, assured the Nepalese authorities that the Bank attaches the highest priority to supporting Nepal in devising and implementing an alternative strategy for meeting its needs for electric power.

While the Bank's review, as well as the findings of the Inspection Panel confirmed that the environmental and social mitigation actions now stipulated under the project were satisfactory, the decision not to move ahead with the project is based on three main considerations:

- The Bank had always recognized the demands that a project of this size and complexity would place on the capacity of a small country like Nepal. Since the initial appraisal, the Bank has established increasingly rigorous standards for the implementation of the project, and these have reinforced initial concerns about the demands being placed on the government. The government recognizes these constraints and has agreed to collaborate with capacity-building efforts recommended by the Bank's management in 1995. However, the limited capacity of institutions in Nepal to implement the long list of actions that would have to be taken to ensure success means that it would take up to five years longer than originally anticipated for this highly complex project to be completed. Demanding tasks relating to the operations and financial management of Nepal's power utility and the need to implement effectively the social and environmental actions highlighted by the Inspection Panel, would impose requirements which the Bank now judges to be beyond what Nepal can realistically achieve at present.

- While there is support for Arun III both among all Nepal's political parties and from most of the residents of the valley, the government still has to take tough decisions such as adjusting tariffs and prioritizing expenditures and sustain them over the next few years to ensure that the project does not crowd out priority social expenditures.

- In addition to the financing from the World Bank, the project had always depended on funds being provided from a number of other sources. Because of the delays already incurred, the estimated cost of the project has increased by $30 to $40 million. This complicates what was already an extremely difficult financing picture, with a number of cofinancing partners not finding themselves in a position to commit the necessary funds with the next year. As a result, there is no realistic prospect of firming up the financing plan in the near future.

The President's review reaffirmed the hydropower potential in the Arun valley as a promising option for meeting Nepal's long term energy needs, subject to improving the capacity to address social and environmental impacts of the likely projects and the creation of a more pro-active community development program in the valley.

The President's decision not to proceed with the Arun project was accompanied by a strong reaffirmation of the Bank's commitment to accelerate its efforts to assist Nepal in devising and implementing an alternative strategy for meeting its undisputed power needs. He is in direct contact with the Prime Minister of Nepal to underscore this commitment.

A team of senior Bank staff is ready to visit Nepal as soon as the Government indicates its readiness. The President has instructed the team to give this effort top priority. A number of proposals have been formulated by Bank staff for discussion with the Nepalese authorities. These proposals aim to take full advantage of the alternatives available for meeting Nepal's power needs.

The World Bank
Washington, D.C. 20433
U.S.A.

JAMES D. WOLFENSOHN
President

July 31, 1995

The Right Honorable Man Mohan Adhikari
Prime Minister
Government of Nepal

Dear Mr. Prime Minister,

Proposed Arun III Hydroelectric Project

In my letter of June 14, 1995 I indicated that I was reviewing our involvement with the Arun III project. I have now completed my review and would like to share my conclusions with you and your Government.

Overall, I have concluded that it is not possible to complete Arun III by the very tight commissioning date which you had posed to us and which we had appraised. The requirement to implement the project and in particular the Arun Valley access road in a socially and environmentally sustainable manner, the need for strengthening of Nepalese implementation capacity, as well as the issues which have arisen in securing the necessary co-financing are the main reasons for concluding that the project cannot realistically come on stream until at least two or three-- and more likely--four to five years later than was projected in the appraisal report.

This conclusion and the recognition that the sustained growth of the Nepalese economy and the realization of your poverty alleviation objectives require an increased supply of power lead me to suggest an alternative assistance strategy for your power sector.

The Bank will support an alternative strategy with initial focus on the following elements:

- Accelerated pursuit of smaller hydropower projects for meeting Nepal's power requirements.

- Establishment of a Power Development Fund which would finance activities that promote investments in your power sector including actions for mitigation of social and environmental impacts of such investments. The Fund would be designed to support sector reform and modernization within an investment framework suitable for the induction of private power investors.

As regards Nepal's longer-term hydropower development, we continue to believe that development of the Arun River can be a cost-effective and environmentally justifiable and sustainable means of meeting Nepal's longer-term energy needs. However, the timing of such undertakings needs to be reconsidered in light of the speed with which the various constraints that have emerged in the protracted implementation planning can be eased.

I shall give the development and implementation of an alternative strategy very high priority and, subject to your response, intend to set up a high level team in the Bank to plan and implement this assistance on an accelerated basis. I have also asked Messrs. Wood and Vergin to be available on short notice to visit Kathmandu for detailed follow-up.

Sincerely yours,

James D. Wolfensohn

World Bank/IFC/MIGA
OFFICE MEMORANDUM

DATE: July 23, 1995 04:45pm

TO: Edward V.K. Jaycox (EDWARD V.K. JAYCOX@A1@WBWASH)

FROM: Olivier Lafourcade, AF4DR (OLIVIER LAFOURCADE@A1@WBWASH)

EXT.: 34880

SUBJECT: Ghana - Dr. Botchwey's Resignation

Kim,

This is to inform you that Kwesi Botchwey's resignation is now fully confirmed. I spoke with him and he did confirm that he has spoken with President Rawlings who has accepted his resignation. A successor has not yet been named (there are speculations that Joe Abbey may be the one). Kwesi explained that he and the President are keen to ensure a smooth transition to whomever will be the new Finance Minister. I suppose an announcement will come shortly. Kwesi is making plans to come to Washington towards the end of August to discuss with the IMF and with us, with the objective of convincing us that his departure will not change the commitment of the Ghana Government to the continuation of the implementation of the program of economic reforms which he has managed himself over so many years.

I'll keep you posted of further developments.

Olivier

CC: GAUTAM KAJI (GAUTAM KAJI @A1@WBHQB)
CC: Stephen Denning (STEPHEN DENNING@A1@WBWASH)
CC: Ibrahim Shihata (IBRAHIM SHIHATA@A1@WBWASH)
CC: Johannes Linn (JOHANNES LINN@A1@WBWASH)
CC: Caio Koch-Weser (CAIO KOCH-WESER@A1@WBWASH)
CC: Mark Malloch Brown (MARK MALLOCH BROWN@A1@WBWASH)
CC: Stephen Denning (STEPHEN DENNING@A1@WBWASH)
CC: Katherine Marshall (KATHERINE MARSHALL@A1@WBWASH)
CC: JAMES W. ADAMS (JAMES W. ADAMS @A1@WBHQB)
CC: Rest of Distribution Suppressed

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

July 21, 1995

Note to Mr. James D. Wolfensohn

Jim,

Welcome back from what I'm sure was a rather grueling trip, particularly given your hectic schedule in Europe and Middle East in the proceeding week!

There are a number of matters which will need your attention during the week that you're here. You have papers on them. The high priority list includes:

- Arun;
- Quality Management;
- Multilateral Debt;
- Budget approach for the next cycle;
- Annual Meeting speech - themes;
- Beijing speech.

In addition to these major topics we need to brief you on "Bureaucrats in Business" and your meeting with Mr. De Paiva. We also need to discuss issues that you might want to bring up at your informal meeting with the Board Members, in addition to the Development Committee.

We have set up time on your calendar on Monday morning, so that we can do a quick run through and agree on how you want to follow up on these issues and set up arrangements accordingly.

Gautam

cc: Messrs. Sandstrom, Frank

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

July 12, 1995

Note to Mr. James D. Wolfensohn

Jim:

Annual Meeting Speech

As we had discussed I got together with Michael Bruno and Mark Baird to sketch out a menu of some themes.

I would very much appreciate your taking a look at what Mark Baird pulled together so that we can discuss when you return. We could then develop/refine/enhance these and other thoughts which could provide you something to chew over at Jackson Hole.

It would be important to have something for a speech writer to start polishing in September for your final review on return from China.

I am sharing this with Sven and Richard. Did you want to solicit at this stage thoughts from a wider group of VPs? Do you want me to share it with Maurice?

Attachment

cc: Messrs.: Sandstrom, Frank

Talking Points for Discussion of Annual Meeting Speech

Main theme:

THE WORLD CHANGES FAST; SO DOES (AND SHOULD) THE BANK

Introduction:

LP started a process of change in the Bank which I will continue and enhance. I have spent my first four months consulting with our stakeholders: governments, civil society, private sector in developing countries; also governments, financial markets, NGOs in developed countries. I have benefited from the wisdom of Presidents and villagers. I have seen that development can work and that the Bank can play a vital role. But I also know that we have made mistakes and could do things better. Today, I want to share with you my vision for the future of the Bank and my priorities for the coming year. Our objective remains the same: poverty reduction. But our role and way of doing business must change to remain relevant in a rapidly changing world.

Message 1:

The global environment is changing fast. This poses challenges and opportunities for the developing world:

- Advances in technology
  - Requires change but also enables development leap-frogging.

- Globalization of trade and investment
  - Developing countries must hook on, not opt out.
  - Integration raises the returns to good policies and compounds the losses from poor policies (Mexico).
  - Developed countries must help, by keeping economies open (Uruguay Round), and will also benefit from stronger global economy.

- Changing structure of capital flows
  - Private flows now dominate capital for developing countries.
    - But concentrated in a few middle-income countries and China; attracted by good policies.
  - Strong IDA is still essential for poorer countries without access to private capital
    - But must be linked to good policies, which improve the climate for private investment.
    - Must also address basic constraints to development: education, health, infrastructure.

- Political democratization of client countries

- People will demand greater participation and transparency in decision making, and accountability for results.
- Same standards must also apply to aid.

Note: Some of these changes are the by-product of a successful economic reform effort in which the Bank has been instrumental. We can take pride in what has been achieved. But we cannot afford to rest on our laurels. We must also change, and change quickly, if we are to remain relevant in this new world environment.

Message 2:

Changes in the global environment dictate a **shift in the Bank's strategic role** which is commensurate with its changing comparative advantage:

- Redefine the Bank's development services
  - Bank provides a range of financial and advisory services; there are strong synergies between them and they often work best as a package.
  - But the mix will vary depending on country conditions:
    - For higher-income countries with access to private capital, Bank can focus on enabling environment (macro policies, regulatory framework etc). Very little money is needed.
    - For poorer countries, our financial role still vital. But to be effective, it must be linked to good policies and tackle basic development constraints.

- Be selective: based on commitment and good governance
  - Experience clearly shows that aid is wasted when governments are not willing or able to make development and poverty reduction their number one priority.
  - We have also been culpable: when our money has helped sustain poor policies and corrupt officials (Zaire).
  - Tighter budgets and increased accountability make focus on aid effectiveness even more essential.

- Strengthen participation and dialogue
  - We do not have all the answers. We need to listen (and respond) to those who are affected by our activities, and those who have different points of view.
  - We need to focus on what happens on the ground. This means an enhanced role and responsibility for Res Reps, and closer ties to effective operational NGOs.
  -We need to share experiences across countries: what works and under what conditions? The role of research and EDI.
  - We need to facilitate global and regional initiatives: Middle East peace, world trade liberalization (with WTO), the new infometrics initiative.

- Focus internal incentives on excellence
  - The Bank has a great staff. But the systems in place do not let them excel.

- Too much emphasis has been given to the volume of lending rather than the quality.
- We need to change budgets, performance contracts, and staff rewards to recognize development impact.

Note: The Bank provides an important bridge between the macro and micro underpinnings of development. Clearly macro adjustment is necessary but not sufficient. It has to be enhanced (and/or followed) by good investment and sector policies. In Mali, for example, devaluation has given farmers added income to send their children to school. But without teachers and teaching materials, this demand will be frustrated. This is why good public expenditure analysis--fitting spending priorities to the overall budget constraint--is so important. Promoting grassroot initiatives is also crucial (as seen in Uganda urban and extension projects). This is where collaboration (rather than confrontation) with local development-oriented NGOs can pay rich dividends.

Message 3:

Against this background, I propose to focus on the following **four priorities over the coming year:**

- **Address the issue of SILIC debt**. One of my top priorities since becoming President has been to look at ways in which the Bank could contribute to a solution, without undermining our own financial standing or the commitment of our client countries to sound policies. Today, I am pleased to announce .....

- **Finalize a strong IDA 11**. A strong IDA is still crucial for many developing countries. But we also have an obligation to ensure that IDA resources are well used. A new "development contract" should involve continued donor support in return for enhanced commitment to reform and demonstrated results on the ground.

- **Work more closely with civil society**. I have met with NGOs and representatives of civil society in all of my country visits. I have also initiatied a series of issue-focussed meetings in Washington. However, I want this process to become a routine and regular part of Bank culture. I am therefore proposing .....

- **Change internal staff incentives**. I am sending a clear signal to staff that excellence in our business is defined by development impact. This will be backed up by changes in our approach to country strategy, the budget process and staff incentives. Specifically, I propose to ....

THE WORLD BANK

Managing Director

Mr. Wolfensohn. 7/12

Jim!

Decision Making
Lending Operations.

We have prepared a package for my meeting with Ishrat on Friday.

I thought these Annex might be of interest to you.

Gautam

GAUTAM S. KAJI

LENDING—DECISION MAKING

Country Assistance Strategy
(BP 2.11)

— sets out the framework for next 3-5 year lending program, including general reference to individual operations

Reviews: At working level according to Regional procedures; IMF also consulted

Approved by: **EXC**

I. Investment Loans

Initial Project Concept[1]
(BP 10.00)

— sets out project idea, objectives, likely components, approach

Approved by: **department director**

Final Project Concept[2] **and Appraisal**
(BP 10.00)

— contains the proposed project content, design, likely conditions, costs, implementation plan

Approved by: **regional vice president**

Pre-Negotiations Package
(BP 10.00)

— consists of full loan documentation, including draft legal agreements

Cleared by: **department director, legal department, procurement, LOA,**[3] **environment**

Approved by: **regional vice president**[4]

Final Loan Package
(BP 10.00)

— documents that are presented to the Board of Executive Directors for approval

Cleared by: **legal department, LOA**

Approved by: **department director (RVP approves submission to Board)**

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1. IEPS and/or Initial PID.
2. FEPS and/or Final PID, and draft Staff Appraisal Report.
3. Loan Department.
4. Flexibility in processing procedures allows the RVP to delegate this authority to the department director. This is decided at the regional level.

Loan Approval by Board of Executive Directors

Signing
(OP/BP 13.00)

II. Adjustment Loans

Initiating Memorandum and Appraisal
(Circular Op 87/06)

— sets out rationale and scope of operation, including policy matrix and proposed conditionality

Approved by: **Loan Committee**

Pre-Negotiations Package
(Circular Op 87/06)

— consists of full loan documentation, including draft legal agreements

Cleared by: **legal department, LOA, environment, disbursements**

Approved by: **regional vice president (or Loan Committee)**[5]

Final Loan Package
(Circular Op 87/06)

— documents that are presented to the Board of Directors for approval

Cleared by: **legal, LOA**

Approved by: **department director (RVP approves submission to the Board)**

Loan Approved by Board of Executive Directors

Signing
(OP/BP 13.00)

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5. Level of decision depends on initial instructions of Loan Committee and extent of changes to original loan proposal and policy matrix.

III. Project Implementation/Supervision (Investment and Adjustment Loans)

Extension of Effectiveness
(OP/BP 13.00)

— extensions up to 18 months

Approved by: **department director**

— extensions beyond 18 months

Approved by: **managing director**

Changes to Loan Allocations
(OD 13.05)

— adjustments to amounts allocated to different categories of expenditures (unless amendment to project scope is required)

Approved by: **division chief**

Amendments to Project Scope
(OD 13.05)

— non-substantial changes to project description

Approved by: **department director**

— substantial changes to project description

Approved by: **Board of Directors**

Extensions of Closing Dates
(OD 13.05)

— up to two years extension to loan

Approved by: **department director**

— up to three years extension to loan

Approved by: **regional vice president**

— extensions beyond three years

Approved by: **managing director**

Changes to Loan Conditions
(OD 13.05)

— minor changes (e.g., dates)

Approved by: **division chief**

— more significant changes (e.g., percentage of expenditure financed by the Bank, eliminating a condition)

Approved by: **department director**

Release of Loan Tranches for Adjustment Loans
(OpMemo "Tranche Release for Adjustment Operations," 1/21/92)

— release of funds in accordance with policy matrix without waivers

Approved by: **RVP in consultation with managing director**

— release of funds with non-material loan amendment or waiver

Cleared by: **RVP in consultation with managing director**

Approved by: **Board of Directors (on no objection basis)**

— release of funds with material amendment or waiver

Cleared by: **RVP in consultation with managing director**

Approved by: **Board of Directors (at a regular Board meeting)**

IV. Implementation Completion Reporting (Investment and Adjustment Loans)

Implementation Completion Report (OP/BP 13.55)	— Bank and borrowers[6] evaluate separately the outcome of completed projects
	Cleared by: **according to regional guidelines (e.g., country department director)**
	Approved by: **according to regional guidelines**

6. The borrower's unedited contribution is attached to the ICR as an annex.

THE WORLD BANK/IF

OFFICE MEMORANDUM

DATE: July 11, 199

TO: Mr. Gautam [illegible]. Ka[illegible], EXC

THROUGH: Mr. Ishrat [illegible]cting Vice President HCO

FROM: Myrna Alexander, OPRDR, and Ian Scott, OBPDR

EXTENSION: 3-3262 and 8-2330

SUBJECT: LENDING DECISION MAKING: Briefing Materials for Mr. Strong

1. In response to your request for background information for Mr. Strong on the way that lending decisions are made, please find attached a compilation of material on the Bank's existing processes and procedures as well as innovations being tried in the East Asia and MNA Regions. This material covers lending activities only and does not include decision making on non-lending services, such as country economic and sector work. For ease of review, we have divided the materials into current Bank-wide practice (Annex 1) and evolving practices that are emerging from the business process innovation exercise (Annex 2). Both are described below.

Current Operational Policies and Procedures

2. . We have attached sections of current operational policies and procedures (ODs, OP/BPs), as set out in the Bank's operational manual, starting with the preparation of the Country Assistance Strategy (CAS), through project supervision and implementation to implementation completion reporting. For the CAS, it is BP 2.11. In the case of investment lending, it is BP 10.00. For adjustment lending, we have circular Op 87/06 which continues to be valid pending preparation of an OP/BP. For supervision and implementation, we are using OD 13.05 which is still in the old format. Other OD/BPs are included as appropriate. Annex 1 contains a quick reference of the key stages in the project cycle plus the supporting extracts from the operational manual. Sections pertaining to specific decisions are highlighted.

3. There are two features to note about the current lending procedures. The first is that BP 10.00 allows the regions flexibility in defining their own processing procedures. BP 10.00 defines core steps that are mandated Bank-wide and, within that, regions are able to institute procedures adapted to their own needs. An example of this is the investment loan processing guidelines issued by the LAC Region in April 1995. These are attached for reference. The second is that regional vice presidents can exercise their existing administrative authority to delegate specific decisions to country department directors. This has been done in several regions, allowing directors to authorize processing of certain or all operations, once reviewed at the initial project concept (IEPS or PID) stage by the regional vice president.

Regional Process Innovations

4. As part of the Bank's business process innovation exercise, launched in 1994, many regions have been reevaluating how they go about their business. This has led to a number of recommendations for changing lending procedures and documentation. The most advanced of the innovation exercises are in East Asia and Pacific and Middle East and North Africa Regions.

THE WORLD BANK/IFC/M.I.G.A.

OFFICE MEMORANDUM

DATE: June 30, 1995

TO: Mr. James D. Wolfensohn, President, EXC

THROUGH: Mr. Edward V.K. Jaycox, Vice President, AFR

FROM: Jean-Louis Sarbib, Director, AF5

EXTENSION: 34946

SUBJECT: **GUINEA - Second Power Project (Cr 2416-GUI)**
Contract for Extension of Diesel Power Station: Complaint by MAN B&W Diesel AG

1. On June 21, 1995, Dr. H. J. Schulte, Executive Vice President and Mr. G. Thulman, President of MAN B&W Diesel AG wrote to you to express their concern about the award of the contract for the construction of a 30 MW diesel power plant called Tombo III. In their opinion, the non-objection given by IDA was not consistent with our procurement policies.

2. The Operations Procurement Review Committee (OPCR), chaired by Mr. Srinivasan, carried out a detailed review of this case and cleared the procurement decision. In our view, the Borrower's decision is consistent with the criteria specified in the bidding documents and the Bank's procurement guidelines. There is no need to seek an additional independent opinion as suggested by the firm. The Executive Director for Germany was provided with a detailed explanation on the reasons why IDA agreed with the Borrower's evaluation that MAN's bid was not responsive due to commercial deviations.

3. As per your request, I have answered MAN's letter on your behalf. Attached, for your information, is a copy of our answer.

cc: Messrs./Mmes. Kaji (o/r), Horiguchi (EXC); Choksi (HROVP); Srinivasan (o/r), Ginnsz (OPRPR); Ayub, Raoul, Bhattacharya (AFRSA); Roman (Acting RPA, AFRSA); Sarbib, Schebeck, Laporte, Abeillé (AF5DR); Sagari, Durand, Burmeister, Sefta (AF5IE); Fredriksen, Franco, Martinez (AF5CO); Melkonian (LOAAF); Mpoy-Kamaluayi (LEGAF); Locatelli (Res. Rep. Conakry); Africa Files.

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

July 7, 1995

Mr. James D. Wolfensohn

Jim,

This is an important paper. While we initially came at the issue from the angle of how do we plan, execute, evaluate and pay for our non-lending services (the often invisible and hence undervalued part of our "product") we quickly concluded the issue was broader. It goes to the heart of how we seem to focus on inputs vs. outcomes, reports vs. impact and that our resource allocation procedures are driven by historical trends and decisions at the margin as opposed to need and performance.

This working group that I appointed when I came into this office has done an excellent job. We discussed the report with the Vice Presidents who were quite enthusiastic. We have already started work at developing some normative standards. A number of regions are already experimenting with the matrix which translates country strategy into country objectives, monitorable actions and performance indicators which are to be supported by Bank Services provided through tasks at an agreed budget cost.

It also touches upon the issue of cost recovery from our "richest" clients (as opposed to cost sharing which takes place in varying degrees today) which could be contentious with some of our developing country Board members.

I would very much welcome an opportunity to discuss this paper with you. If you are comfortable with the approach proposed we need to alert the Vice Presidents on the framework within which Regional budgets and work program would be reviewed. We also need to develop a comparable framework for reviewing our non-regional work program to provide the same discipline.

Attachment

Rethinking our Approach to the Bank's Development Services

Report of the Working Group on Non-Lending Services

June 30, 1995

RETHINKING OUR APPROACH TO THE BANK'S DEVELOPMENT SERVICES

Executive Summary

1. The World Bank is a multi-product development institution, providing a wide range of financial, analytical and advisory services. Currently, most management attention is focussed on the Bank's lending activities. Yet for many of our clients--especially those with access to private capital--the Bank's analytical and advisory services are often more important than our financial role. These services also contribute indirectly to the quality of the Bank's lending activities. Because of the strong synergies among our various services, they are often provided as a package. However, the mix of services varies from country to country. The challenge is to find ways to recognize and value the contribution of our analytical and advisory services, while also providing incentives to minimize waste and maximize development impact.

2. We therefore recommend that:

- **All of the Bank's services should be assessed in terms of development impact: proxied by monitorable actions and performance indicators.** Current practice in the Bank focusses on resource inputs and task completions rather than impact, and clusters of tasks (such as lending and ESW) rather than services. This paper proposes an alternative framework which links **country objectives** to **monitorable actions and performance indicators**, supported by **Bank services** provided through **tasks** at an agreed **budget cost** (see Table 2). Well-defined actions and performance indicators can serve as legitimate proxies for development impact in the client country. In some instances (e.g., creditworthiness analysis), the primary client is the Bank.

- **The CAS should be the primary vehicle for deciding on the level and mix of Bank services.** The CAS is still very much focussed on the lending program. This paper proposes using the CAS to define the full range of Bank Group services, including analytical and advisory services, and the role of IFC and MIGA. Non-conventional tasks--such as informal policy notes and networking seminars--would also be covered. CASs should be prepared for all client countries, whether or not they have an active lending program. Tasks would be linked to country objectives and Bank services using the framework in Table 2. This matrix could also be used to provide a "living" summary of the country program, to guide management and budget decisions between CAS reviews.

- **Country priorities, determined through the CAS process and evaluated against Bankwide norms, should be carried over into budget decisions.** The budget process should consider trade-offs across countries, add global and regional issues, and develop proposals for CVPU support. Performance-based Bankwide norms should be established for budget allocations by country, against

which CAS proposals can be evaluated. These norms should be used as indicative benchmarks, not rigid allocation criteria or entitlements. Over time, the budget envelope should be adjusted to reflect the country program's record of delivering results at reasonable cost.

- **The Bank's services should be subject to more systematic quality management and evaluation.** For lending, existing processes need to be strengthened. For analytical and advisory services, new processes need to be put in place. The focus should be on the development impact of the service. A stronger system of evaluation should be based on: (a) *ex ante* review of IMs explaining the costs and benefits of all major tasks (not just ESW); (b) *ex post* evaluation of selected tasks, focussing on relevance and impact, as well as technical quality; (c) *ex post* evaluation of work on selected policy issues and sectors, focussing on examples of best practice; and (d) *ex post* evaluation of major country programs through assistance reviews and client surveys. Evaluation results should feed back into country budgets and staff rewards.

- **Greater use should be made of user fees for some analytical and advisory services.** Fees can provide valuable flexibility to deliver specific *ad hoc* services for our client countries. They can also help to gauge demand and strengthen budget discipline. However, they are not appropriate for core country strategy and lending-related services, or when the benefits accrue to other countries. Low-income IDA countries should retain access to free or highly-subsidized services on equity grounds. We therefore recommend that user fees be introduced initially for higher-income countries only. They would cover the marginal costs of staff and consultant time and travel, and be additional to the country program agreed in the CAS. Cost sharing--in the form of counterpart contributions--would continue to be encouraged for all countries and tasks.

3. Feedback from staff and managers on the approach proposed in this paper has been very positive. The common reaction has been: 'let's get on and do it". Indeed many similar initiatives are already underway at the regional and country levels. In addition, the MNA Region has agreed to move ahead with implementing many of the working group's proposals. The priority now is to introduce these examples of best practice on a Bankwide basis. We believe that this can be done with minimal changes in Bank policies (the one exception is the proposal to introduce user fees for some analytical and advisory services, which should be discussed and endorsed by the Board). Some further discussion is also needed on the role of the Central Vice Presidencies in budget norms and evaluation mechanisms. However, the real key to success will be a strong signal from Senior Management, including the new President, about what is expected from the CAS and budget processes. Without this, it will be difficult to achieve the needed shift in Bank culture and staff incentives.

RETHINKING OUR APPROACH TO THE BANK'S DEVELOPMENT SERVICES[1]

1. The Bank is a multi-product development institution, providing a wide range of financial, analytical and advisory services. Currently, most management attention--for example, in country strategies and budgets--is focussed on the Bank's lending activities. Lending activities can be easily measured in dollar terms, are subject to standard approval procedures, are supervised during implementation, and are evaluated *ex post*. They also earn income for the Bank. In FY95, the direct cost of financial services (including supervision) was $503 million, or 49% of the gross administrative budget (excluding administration and overheads). Including central support for financial programs and legal services, this share rises to 61% (see Table 1).

Table 1. Composition of World Bank Administrative Budget: FY95

SERVICE	$ MILLION	% OF TOTAL
Financial services	**633**	**61**
- Regions and CVPUs /a	503	49
- Central support /b	133	13
Analytical and advisory services	**403**	**39**
- ESW	166	16
- Other /c	237	23
Total services	**1,036**	**100**
Administration and overheads	313	
Total gross budget	**1,349**	

a. Lending and supervision.
b. Financial programs (excluding pension management) and legal services.
c. Aid coordination, cofinancing, technical assistance, training, external affairs, research and supporting client services.

Source: PBD, "Review of World Bank Programs and FY96 Budgets" (May 12, 1995).

2. The Bank also provides a range of analytical and advisory services. Many of these services actually support the Bank's lending activities: by shaping country strategies, managing aid coordination and cofinancing, maintaining client relations, and assessing country risk and creditworthiness, etc. Without these services, it would not be possible to create and maintain a

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1 Report of the working group on non-lending services. The membership and terms of reference of the working group are attached. Our findings draw heavily on various initiatives already underway in the Regions and feedback from a wide range of Bank staff. An earlier draft of this report was discussed and endorsed by Senior Managers on May 24, 1995. A workshop to get feedback from outside experts from the public and private sectors was held on June 16, 1995.

healthy asset portfolio.[2] In addition, the Bank does a lot more than just lend money. For example, the Bank often provides analysis and advice directly to our clients through economic and sector work (ESW), research, technical assistance and training programs. More generally, our clients can access the Bank's reservoir of knowledge on cross-country experience and best practice. As a global public institution, the World Bank is well-placed to act as a broker and networker for information on development. However, unlike for lending, these analytical and advisory services are difficult to measure, are not subject to systematic evaluation and rarely generate income for the Bank. Yet, they account for more than one-third of the Bank's total administrative budget.

3. The proposed budget cuts over the next three years are projected to fall most heavily on analytical and advisory services. For example, in FY96, ESW is projected to be cut by 17% and research by 11%, while lending declines by less than 4%.[3] It is generally accepted that a lot can be done to improve the cost-effectiveness and relevance of our analytical and advisory services. However, there is also a very real risk that cuts in these areas will also undermine the quality of our lending activities. Furthermore, for many of our clients--especially those with access to private capital--the Bank's analytical and advisory services are often more important than our financial role. The challenge therefore is to find ways to recognize and value the contribution of these services, while also providing incentives to minimize waste and maximize development impact. To this end, the working group makes the following five recommendations.

I. All of the Bank's services should be assessed in terms of development impact: proxied by monitorable actions and performance indicators

4. The Bank's fundamental objective is clearly stated in the vision document: "helping borrowers reduce poverty and improve living standards through sustainable growth and investment in people."[4] The contribution of our services therefore should be assessed against this objective. Development impact has to be the touchstone of all that we do. However, in practice, the links between what the Bank does and what happens in the country may be tenuous; there may be long lags before development impact can be properly assessed and, even then, the Bank's unique contribution may be hard to isolate from other variables. Therefore careful thought has to be given to how best to gauge development impact in a given country. In the first instance, actions by the government (e.g., budget allocations for health) may be a suitable proxy. Various output measures (e.g., provision of health services) may also provide early signals on eventual outcomes (e.g., improvements in health indicators).

5. By contrast, current practice in the Bank often focusses on resource inputs and completion of tasks (e.g., number of ESW reports or CG meetings) rather than on the effects in terms of government actions or development impact. We also tend to focus on clusters of tasks (e.g., lending or ESW) rather than the service they provide. An illustrative example of an alternative

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2 Lending also provides a vehicle for accessing information and implementing our policy advice. Because of these synergies, we have dropped the term "non-lending" services in favor of "analytical and advisory" services.

3 See PBD, "Review of World Bank Programs and FY96 Budgets" (May 12, 1995).

4 The World Bank Group, "Learning from the Past, Embracing the Future" (July 1994).

framework is provided in Table 2.[5] The basic logic is to link **country objectives** to **monitorable actions and performance indicators**, supported by **Bank services** provided by **tasks** at an agreed **budget cost**. Note the following:

- Traditional distinctions between activities (e.g., lending and ESW) disappear. Tasks are now associated with the services they provide. Non-conventional tasks--such as informal policy notes and networking seminars--are also included.

- One task can provide more than one service. For example, the SAL combines import support and policy advice. The public expenditure review (PER) supports policy advice, aid coordination and country strategy.

- Several tasks can contribute to the same objective. For example, the SAL, PER and Consultative Group are all directed to improving social programs. With this framework, the links between tasks become more transparent.

- Development impact is proxied by monitorable actions and performance indicators. For example, the ultimate objective of the rural roads project may be to raise farmer incomes. But the monitorable action, within the control of the government, is rehabilitation of 100 kms of rural roads.

- In some instances, the Bank is the client. For example, the CAS itself is needed to gain management and Board approval for the proposed strategy and program of services. And analysis of creditworthiness is needed to justify the proposed lending program.

- All costs--whether financed from the administrative budget or trust funds--are covered. For tasks covering more than one objective, costs have been allocated according to their relative importance. As a result, costs can be disaggregated by objective and service. A breakdown by funding source could also be added.

II. The CAS should be the primary vehicle for deciding on the level and mix of Bank services

6. According to the new BP 2.11, "The Country Assistance Strategy (CAS) is the central vehicle for Board review of the Bank Group's assistance strategy for IDA and IBRD borrowers." Over the past year, there has been considerable improvement in both the coverage and substance

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5 The Africa Region is currently developing a similar framework for planning and budgeting non-lending services. See note from Steve Denning, Steen Jorgensen, Ravi Kanbur and Phyllis Pomerantz on "Non-Lending Outputs" (February 21, 1995).

Table 2. Illustrative Framework for Country Program

COUNTRY OBJECTIVES	MONITORABLE ACTIONS AND PERFORMANCE INDICATORS	BANK SERVICES /a	TASKS	BUDGET COSTS /b (US$'000))		
				FY95	FY96	FY97
Maintain macroeconomic stability	Implement agreed fiscal envelope Finance BOP and budget gaps	Policy advice Import support Aid coordination	Fiscal policy note Structural adjustment loan Consultative group	50 20 -	- 40 40	- - -
Improve public sector management	Privatize 10 large loss-making PEs Change power tariff structure	Policy advice Networking	Structural adjustment loan Power sector seminar	20 -	40 -	- 40
Develop the private sector	Rehabilitate 100 km of rural roads Develop long-term bond market	Project financing Guarantee	Rural roads project Capital market guarantee	- -	20 -	80 50
Develop human resources	Reallocate public spending to basic health and education programs Refocus primary education program on classroom supplies and teacher training	Policy advice Policy advice Aid coordination	Public expenditure review Structural adjustment loan Consultative group	60 10 50	60 20 -	- - 50
Strengthen environmental management	Revise environmental law Establish pollution monitoring unit	Policy advice Technical assistance	Environmental management study Environmental TA project	50 -	- 50	- 30
		Country strategy	Creditworthiness study Public expenditure review Country assistance strategy	20 20 20	- 20 -	20 - 20
		Management & overheads	Miscellaneous	60	50	50
			Total	**380**	**340**	**340**

a. For simplicity, stages of the project cycle (e.g., approval, supervision) are not shown separately.
b. Includes all costs financed from the administrative budget and trust funds (services funded from client fees should be shown separately). For tasks serving more than one objective, costs have been allocated according to their relative importance.

of CAS documents. Even so, while the CAS guidelines talk broadly about the country strategy and the role of the Bank, most of the analysis is still focussed on the lending program. Indeed, CAS documents are not prepared for countries without a current lending program, even when the Bank is actively involved in providing analytical and advisory services (e.g., South Africa). In practice, the CAS coverage of non-lending services--primarily ESW and aid coordination--is usually little more than a summary of the existing program, with no explanation of how it fits into the overall Bank strategy or contributes to the client country. The CAS is rarely used to rethink the Bank's role and contribution.

7. It is recommended that the framework illustrated in Table 2 should be applied in the CAS.[6] This could be done in a number of ways. Our proposal would be to provide the complete matrix in the cover note, with a simplified version--excluding the actions (due to government sensitivities) and the costs--in the CAS itself. The matrix could also be used to provide a "living" summary of the country program, to guide management and budget decisions between CAS reviews. In our view, this approach is consistent with the spirit of the current CAS guidelines: it would help to clarify the costs and benefits of CAS proposals and turn the CAS into a more operationally useful document. As required by the guidelines, the CAS would be "prepared with the government in a participatory way". It would also take account of the contribution of other donors and agencies in defining the role of the Bank. All Bank Group services--provided by IBRD, IDA, IFC and MIGA--would be considered. A CAS should be prepared for all client countries, whether or not they have an active lending program.

8. The CAS should remain a short, focussed, strategic document. It cannot cover all of the preparatory work, but should simply summarize the main points of the underlying analysis in various areas (e.g., advisory services, lending, portfolio management). The CAS will sometimes have to be supplemented with more informal, regular and detailed strategy statements. This is already happening for the ESW program. The South Asia Region, for example, is introducing country ESW strategies, which would "provide an intersectoral framework for prioritizing tasks, for allocating ESW resources across competing tasks, and for developing country dissemination/communications strategies."[7] Similarly, the draft OPR Report on ESW suggests that more detailed sector strategies should be prepared on the CAS cycle, and reviewed with the relevant CVPU, to ensure that ESW is systematically linked to the lending pipeline.[8] These are useful initiatives. However, consistent with the framework developed in this note, this strategic approach should not be limited to ESW, but extended to the full range of analytical and advisory services.

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6 This matrix has been applied to the Hungary program on a pilot basis. A similar framework has already being used in several CASs prepared by the Africa and East Asia Regions. The LA2 Business Modernization Team is also proposing to introduce well-defined "progress benchmarks" in their CASs. More detailed "activity markers" would be used for the annual business plan.

7 EM from Joanne Salop on "South Asia ESW: The View from the Practitioners" (February 6, 1995).

8 See Robert Schneider, "Economic Sector Work and Results on the Ground" (draft report distributed by James Adams on March 8, 1995).

III. Country priorities, determined through the CAS process and evaluated against Bankwide norms, should be carried over into budget decisions

9. The CAS decisions on Bank services and tasks for a given country should be carried over into the budget process: the Prospects Summary and Business Plan. Where necessary, the CAS decisions should be updated for more recent developments. The budget documents should provide additional details on costs and sources of funding, consider trade-offs across countries (consistent with the overall budget envelope), add global and regional issues, and develop proposals for CVPU support. Budget discussions should focus on the cost-effectiveness of the full range of Bank services, drawing as appropriate on recent evaluations of services and country programs (see below). Responsibility for ensuring that CAS proposals are consistent with the overall budget envelope would lie with Regional management. Proposals for expanding one country program would have to be offset by cuts elsewhere, unless Senior Management approves budget reallocations among Regions.

10. CAS proposals could be evaluated against actual budget allocations in the base year and projected changes in the budget envelope. However, it has to be recognized that base-year allocations may have little to do with future requirements, especially if more attention is given to country performance and the role of analytical and advisory services. We therefore propose that Bankwide norms be developed for allocating the administrative budget, against which the CAS proposals could be evaluated. These norms should reflect country performance, as well as population and (inversely) per capita income.[9] They would provide some discipline on overall budget allocations and reduce the current bias in favor of lending activities. However, it would be important to ensure that the norms were used as indicative benchmarks not rigid allocation criteria or entitlements. For some countries, actual budget requirements may be less than norms, because of constraints on absorptive capacity or access to alternative sources of finance and advice. On the other hand, allowance would have to be made for high overheads for small countries and high start-up costs for new members. The case for deviations from the norms would be made in the CAS.

11. Whatever norms are used, the budget envelope should be adjusted over time to reflect the country program's record of delivering results at reasonable cost. Results would be measured by development impact as proxied by actions taken by the government and progress on agreed performance indicators. However, we also have to be concerned about the quality of cost data. Although the recent shift to dollar budgeting is an improvement, there are still major deficiencies in the treatment of overheads and staff salaries, and in the costing of cross support and tasks financed by trust funds. These issues, which go beyond the scope of our work on non-lending services, are being pursued by others (e.g., the Trust Fund Fee Policy Working Group). Actions to improve the cost data warrant high priority.

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[9] Performance ratings are calculated annually for IDA countries and used to allocate IDA resources. Preliminary analysis suggests that, while these ratings have a significant impact on actual IDA commitments, they are not good predictors of administrative budget allocations (which seem to be largely determined by population). Performance ratings are currently not available for IBRD countries.

IV. The Bank's services should be subject to more systematic quality management and evaluation

12. Lending services are subject to a range of quality and evaluation checks:

- All loans and credits are processed through a standard project cycle and approved by Management and the Board. Adjustment operations and selected projects are reviewed by the Central Loan Committee.

- All operations are supervised during implementation, and regularly rated on both implementation performance and expected development impact. These results are reported to the Board through the Annual Review of Portfolio Performance (ARPP).

- All operations are evaluated ex-post by Regional staff through the Implementation Completion Report (ICR). OED also carries out selective evaluations (based on the ICR and later impact evaluations) and reports to the Board through its Annual Review of Evaluation Results.

13. However, there are legitimate concerns about how effective these checks are. *Ex post* evaluation results provide no grounds for complacency on the quality of our lending, and there remains a large disconnect between supervision ratings and OED completion ratings. At root is the quality of the *ex ante* project analysis.[10] There is also strong evidence to support the view that the Bank's analytical and advisory services, especially good quality ESW, are closely linked to project performance in part through its impact on the quality of project analysis.[11] As already noted, recent budget cuts are expected to fall heavily on ESW. To the extent that these cuts reduce wasteful expenditures, and help us to refocus our work on client needs, they are fully justified. However, we also need to ensure that we do not cut into the core of our non-lending work: upstream investments in improving the quality of the downstream portfolio and supporting analysis for the policy dialogue.

14. As we place greater emphasis on the full range of development services, we will need better processes for evaluating analytical and advisory services in terms of development impact. This will require reorientation on the part of Bank economists and sector specialists--to focus on quantifying the likely benefits of policy and institutional changes being discussed in the task. Without strong quality management and evaluation, the above proposals for integrating analytical and advisory services into the CAS and budget processes would quickly break down. To be effective, evaluation results should feed back directly into decisions on country budgets and staff rewards. A number of Regions are now moving to address this issue, especially for

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10 See OED/OPR, "Review of the Quality of Economic Analysis in Staff Appraisal Reports for Projects Approved in 1993" (February 10, 1995).

11 See, for example, analysis presented by Robert Schneider (footnote 8).

ESW tasks.[12] These efforts should be generalized across Regions and services as soon as possible.

15. We recommend the following approach to evaluating analytical and advisory services:

- More systematic *ex ante* review of IMs for all major tasks (not just ESW). The IM should clearly explain the cost of the task, the service to be provided, the actions and outcomes to be achieved, and the process to be followed (including the dissemination strategy). A report might be part of the process but not an end in itself. The Regional Chief Economist or Lead Economist should sign off on the IM and appoint "expert" peer reviewers.

- *Ex post* evaluation of selected tasks. The focus should be on relevance and impact, as well as technical quality. These evaluations should be managed by the Regional Chief Economist, drawing on expertise from the CVPUs and outside the Bank, and incorporating client feedback. They should be supplemented by independent evaluations by OED.

- *Ex post* evaluation of work on selected policy issues and sectors. The focus would be on examples of best practice from across the Bank. These evaluations would be managed by the CVPUs, and follow up on issues emerging out of the Regional task evaluations. In addition, OED would continue to carry out its own independent program of policy studies.

- *Ex post* evaluation of major country programs. OED recently initiated a series of country assistance reviews. These reviews--if undertaken in sufficient numbers--might provide a useful mechanism for assessing the overall impact of the country strategy and the Bank's services. They can also be supplemented by more frequent client surveys.

V. Greater use should be made of user fees for some analytical and advisory services

16. Charging for the Bank Group's analytical and advisory services is not a new idea.[13] For example, the Foreign Investment Advisory Service (FIAS), a joint venture of IFC and the World

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12 See, for example, memoranda by Marcelo Selowsky on "New Procedures for ESW" in ECA (October 24, 1994) and by Javed Burki on "Economic and Sector Work in LAC" (draft, February 10, 1995). The East Asia Region is experimenting with a set of "critical success factors" as proxies for impact. These include indicators of the primary audience, timeliness, dissemination and evaluation. See note by Vinay Bhargava on "Improving ESW Performance Measurement System in EAP" (March 17, 1995). The South Asia Region has developed an ESW Strategy Worksheet which summarizes proposed actions in the country, estimates their potential impact, assesses who will gain and lose, and proposes ways to relax constraints on adoption and implementation.

13 OP 8.40 (October 1994) on Technical Assistance states: "When the Bank provides services to member countries (both TA donors and recipients) that go beyond its normal work or practice, it usually recovers both the direct cost and the institutional overhead cost of these services (as established by the Planning and Budgeting Department)." The previous OMS No. 4.00 (September 1984) provided specific criteria for providing reimbursable technical assistance by Bank staff or by consultants monitored by Bank staff.

Bank, has always insisted in at least partial reimbursement from client governments. The current FIAS policy requires that, on average, 20% of costs are covered by clients (although, in practice, a large part of the client contributions are donor funded). Similarly, the Bank provides reimbursable technical assistance to Saudi Arabia, Kuwait, Oman and UAE. All costs--including staff salaries and travel--are covered by the client governments. Increasingly, the focus of this technical assistance is shifting from project preparation to policy advice. More generally, client countries often contribute to the Bank's work through providing access to data and counterpart teams, and purchase advisory services (albeit not from Bank staff) through project-financed studies.

17. More recently, with enhanced access to private capital, a number of countries have been seeking ways to maintain access to the Bank's analytical and advisory services without borrowing. This was a recurring theme at the Annual Meetings in Madrid (e.g., from the South African, Slovenian and Chilean Delegations). For Chile, a new framework has been proposed, under which the Bank would prepare one loan or guarantee and one ESW report per year. The loans would be for a minimal size (to justify the Bank's administrative costs) and the ESW reports would cost no more than $220,000. The mechanism for financing additional ESW is to be agreed on a case-by-case basis. This represents progress in that Chile can now offer to buy marginal analytical and advisory services (although, in practice this may be difficult to implement, without clear procedures for reimbursement). However, the provision of such services is still linked, at least implicitly, to Chile's acceptance of minimum financial support. With the budgetary changes proposed above, this link would be broken and the case for financial, analytical and advisory services could be decided on their own merits.

18. We believe the time has come to establish clear Bankwide criteria for charging for analytical and advisory services.[14] Client countries need to be reassured that they will continue to have access to certain core services free of charge and that any fees will be applied in a consistent way. They also need to know that any requests for fee-based services will be handled in a prompt and responsive manner. Charging mechanisms can provide valuable flexibility to undertake marginal tasks for client countries, especially those at or nearing graduation.[15] Since such mechanisms mean that these services would be provided only at the client's initiative, they can also help to assess demand while imposing additional budget discipline. However, charging is not appropriate for all services or for all countries. We therefore recommend the following guidelines.

19. In our view, the following analytical and advisory services should always be provided free of charge:

- core country services (such as creditworthiness analysis and strategy work) required to do business in the country;

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[14] For more discussion on these issues, see the note by Ken Chomitz, Ross Levine, Lyn Squire and Sethaput Suthiwart-Narueput on "Improving Development Services in a Leaner and More Efficient World Bank: A Proposal to Restructure the Funding of Non-Lending Services" (October 21, 1994).

[15] More generally, we need to consider ways to market our economic and technical work for sale to the private sector and other aid agencies.

- analytical and policy work related to specific lending operations (and effectively paid for by the loan charge); and

- global and cross-country analysis, where the benefits accrue to all Bank members.

20. A case can also be made, as with lending, that low-income IDA countries should continue to receive highly-subsidized or free analytical and advisory services on equity grounds. As income rises, the case for full cost recovery is more clear cut. We therefore recommend that user fees be introduced initially for only higher-income countries (Categories IV and V in the Per Capita Income Guidelines for Operational Purposes). This would include countries such as Chile, Slovenia, South Africa and Malaysia. User fees would only apply to non-core services (as defined above). The fees would cover the marginal costs of staff and consultant time and travel, and would be additional to the country program agreed in the CAS. Of course, cost sharing--in the form of counterpart contributions to data collection, analysis and dissemination--would continue to be encouraged for all countries and tasks. This provides a valuable opportunity to build local ownership and capacity, but does not involve direct payment for Bank services.

Next Steps

21. Feedback from staff and managers on the approach proposed in this paper has been very positive. The common reaction has been: "let's get on and do it". Indeed, many similar initiatives are already underway at the regional and country levels. In addition, the MNA Region has agreed to move ahead with implementing many of the working group's proposals. The priority now is to introduce these examples of best practice on a Bankwide basis. We believe that this can be done with minimal changes in Bank policies (the one exception is the proposal to introduce user fees for some analytical and advisory services, which should be discussed and endorsed by the Board). Some further discussion will also be needed on the role of the Central Vice Presidencies in budget norms and evaluation mechanisms. However, the real key will be a strong signal from Senior Management, including the new President, about what is expected from the CAS and budget processes. Without this, it will be difficult to achieve the needed shift in Bank culture and staff incentives.

Attachment

TERMS OF REFERENCE FOR WORKING GROUP ON NON-LENDING SERVICES

1. The working group has been established to prepare a concept/issues paper for Senior Management on:

- the conceptual framework for thinking about the role and contribution of non-lending services (NLS) in the Bank;
- the measurement and evaluation of the cost-effectiveness, quality and impact of NLS;
- recent experience and proposals for cost sharing and charging for NLS in the Bank; and
- the implications for the Bank's budget system, work programming and staff incentives.

2. The focus will be primarily on economic and sector work. However, other Regional NLS (e.g., aid coordination) will be considered as appropriate. Central NLS (e.g., Bank policy and research) will be excluded at this stage.

3. The working group will comprise:

Mark Baird (chairman)	DECVP
Jim Adams	OPRDR
Richard Lynn	PBDDR
Mieko Nishimizu	FRSDR
Gobind Nankani	LA1DR
Joanne Salop	SASVP
Richard Stern	IENDR

4. The working group will identify appropriate staff (or consultants, if necessary) to prepare background material on specified topics. The group will also draw on related ongoing work in other Bank units (e.g., AFR, OED) and relevant experience from outside the Bank.

5. The group will report back to Gautam Kaji by March 31, 1995. The group's report, for review by EXC and discussion with Bank managers, should be no longer than 10 pages. If necessary, additional background material will be attached.

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

July 6, 1995

Mr. James W. Wolfensohn

Dear Jim and Sven,

Re: the Net Income Paper . In addition to Richard and my concerns about the additional 10 basis point waiver, attached is a note from Jessica which I think you should see. Do you think we should have this paper reviewed at the Finance Committee, so that issues of fact and perspective can be ironed out?

Today's Board meeting went pretty smoothly, though Fritz Fischer brought up the issue of the Inspection Panel and the Board's role. He particularly tried to push for his pet idea of a Board Committee to review on behalf of the full board issues of jurisdiction and mandate of the panel in respect of individual cases. This received no support at the Board. Our interpretation as far as it pertains to the Ethiopia case was endorsed and they welcomed the modus operandi we have worked out with Bröder - in terms of Management and the Panel coming to the Board jointly when we have "agreed to disagree".

Trust the trip is going well. See you next week

Gautam

Attachment

The World Bank/IFC/MIGA
O F F I C E M E M O R A N D U M

DATE: July 6, 1995 11:30am

TO: GAUTAM KAJI (GAUTAM KAJI @A1@WBHQB)

FROM: Jessica P. Einhorn, TREVP (JESSICA EINHORN@A1@WBWASH)

EXT.: 80784

SUBJECT: Net Income Paper

Gautam:

Having returned to Washington, I now discover that the net income paper schedule was expedited last week, with a draft provided to Messrs. Sandstrom and Wolfensohn.

The present paper seems to be grossly inept in its handling of market risk. Indeed, I believe you (and Mr. Wolfensohn) should know that I could not associate myself with the approach adopted regarding market risk, in this paper. I deeply regret sharing with you the notion that this is not because of poor communication; our views are well known. The FPR draft reflects their historic approach to risk management which this year (in light of impending changes in our management of the duration of net worth) has given rise to particularly anomalous prose.

In a nutshell, the market risk discussion in this net income paper is faulty in two key areas:

(1) Rather than looking at the balance sheet in modern risk management terms (duration gaps, sensitivity to interest change, etc.) a base case is put forward and then happy results are shared (see attached note for detail). It reminds me of an old story about a young man who comes home and tells his grandfather that he "earned a nickel" that day by walking home from school rather than taking the bus. The grandfather replies "you should have earned a dollar and walked home instead of taking a cab!". If I understand the paper correctly we are being told that we do not need to add reserves, in spite of increased loan risk, because a base case interest rate environment is yielding a lot of additional income. This really does not seem to me a respectable way for a large bank to brief its directors.

(2) There is repeated emphasis on the notion that the Bank is going to get rid of a negative spread in "funding liquidity". This is simply untrue. In so far as the Bank expresses the negative spread, for illustrative purposes, as the difference between the average cost of borrowing and the average return on liquidity, nothing much changes no matter how much risk management we introduce in the balance sheet. We will still be overwhelmingly funded by medium and long term fixed rate debt in

the next few years and we expect our liquidity to be invested at an average duration of one year or even less.

The real change, the major management decision in the area of risk management, is that we have decided to lengthen the duration of our reserves. Viewed in terms of our convoluted financial policies, this means we will allocate our reserves to loans outstanding by effectively shortening the duration of either old debt or new, excluded from the lending rate formula.

The really odd element in this whole debate is the fact that the Board is not even being told that we are lengthening the duration of reserves. If accounting conventions should change such that reserves are also required to be marked to market, our Directors will be wholly unprepared to learn that the net worth of the institution will rise and fall with interest rates in the same way that income used to rise and fall with interest rates. In other words, we are not changing the negative spread on investments, we are altering the market risk of our net worth -- substituting volatility in value for volatility in income. The change is well thought out; matching the duration of reserves to loans will mean that the risk bearing capacity of reserves will go up and down with loans. This has always been a second order issue to currency but it is a worthwhile change. For some reason that I have never been able to understand, our colleagues in FPR choose not to explain it that way.

This argument has been going on for years. When Mr. Stern was here, FPR was directed to delete almost all references to this issue. I am pleased to note that the actual financial actions being taken can be aligned with either viewpoint. Therefore, the issue arises with greatest severity only during the drafting of the net income paper.

In conclusion, I believe the discussion of market risk is both false and misleading. False because, using the definitions of the paper, there is still interest risk even if risk management is in place. Misleading because the directors are not being made aware of the major change in the management of our reserves and, instead, are being misled by income projections based on notional numbers arising out of a base case. The risk is repeatedly and forcefully misrepresented as a funding/investment risk. The duration gaps of the balance sheet are ignored.

CC: Richard Frank (RICHARD FRANK@A1@WBWASH)
CC: Johannes Linn (JOHANNES LINN@A1@WBWASH)
CC: Jules Muis (JULES MUIS@A1@WBWASH)
CC: Mieko Nishimizu (MIEKO NISHIMIZU@A1@WBWASH)

TRANSMISSION RESULT REPORT (JUL 06 '95 03:19PM)

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THE WORLD BANK GROUP
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Tel. No. (202) 477-1234 • Fax (202) 477-6391 • Telex No. RCA 248423

FACSIMILE COVER SHEET AND MESSAGE

DATE: July 6, 1995 **NO. OF PAGES:** 4 (including cover sheet) **MESSAGE NO.:** {#}

TO: **Mr. James W. Wolfensohn** **DESTINATION FAX NO.:**47-22-11-30-65
Title: President, World Bank
Organization: C/O Grand Hotel
City/Country: Oslo

FROM: Mr. Gautam S. Kaji **DIVISIONAL FAX NO.:** (202) 477 6869
Title: Managing Director Dept./Div. No.: {Div-#}
Dept/Div: EXC
Room No.: E-1227 Telephone: (202) 82384

SUBJECT: **PLEASE DELIVER TO MR. WOLFENSOHN ASAP!**

MESSAGE:

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

June 30, 1995

Note to Mr. James D. Wolfensohn

Jim,

RE: Multilateral Debt

Further to our conversation of yesterday, attached is a status report on the work on multilateral debt. We hope to have for you by mid-July, when you are back, a full review of our options and the issues associated with them (both internal and external), so that you may have a basis for deciding how you wish to proceed.

P.S.: In particular you will wish to see the attachments which provide the views of individual donors on this issue. This might be useful for your forthcoming meetings in Europe.

Attachments

RECEIVED
JUN 30 1995
By

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

June 30, 1995

Note to Mr. James D. Wolfensohn

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Attachments

June 30, 1995

Status of Work on Multilateral Debt

Following the meeting chaired by Mr. Wolfensohn on June 13, the staff team working on multilateral debt issues has focused on three aspects, the current status of which is summarized below.

A Multilateral Debt Facility.

A working group from various vice-presidencies has been fleshing out the issues and options in setting up a Multilateral Debt Facility that would help to deal with the debt overhang in the highly indebted poor countries (HIPCs) and enable the Bank to re-establish a leadership role in the international debt arena. The draft report of this group has just been completed and is being reviewed by the concerned managers. The Group concludes that the preferred approach would be to set up a broad based Facility which would deal in a comprehensive way with the multilateral debt burden of the heavily indebted poor countries, and which would be funded by grants from multilateral institutions and other donors. This approach has the strong attraction of promising a return to debt sustainability for the beneficiary countries. Its main drawback is that it can only work if the other multilateral creditors are willing to join in and agree to play by the same rules. In particular, initial reservations expressed informally by IMF management will need to be overcome since IMF co-sponsorship of such a scheme will almost certainly be needed.

Given the difficulties (and at least protracted delay) in setting up such a comprehensive scheme, the Working Group has also been asked to examine the pros and cons of more limited options that the Bank might undertake to deal with its own concessional debt burden in the HIPCs, possibly as a prelude to a more ambitious comprehensive approach. The initial findings of the Group are that the preconditions for mounting a more limited scheme are in fact quite onerous (mainly because of concerns about the impact on the Bank's preferred creditor status). However, additional work on this is underway and a clearer notion of what is feasible and at what cost, should be available in two weeks. Interest in some type of more limited Facility - such as a Sinking Fund for IDA - continues to be high among donor countries; this was confirmed at the IDA Deputies meeting in Johannesburg this week.

IBRD Debt Relief Options.

Another team has been reviewing the scope of the IBRD debt problem in low income countries, focusing on options to deal with the few problem cases identified at the last meeting. Their conclusion is that our current approach of Fifth Dimension plus new IDA allocations is all that is needed in most countries with high IBRD debt. However, in three or four countries this approach generates very large negative transfers to the end of the decade. For these countries, the team is looking at the option of exceptional IDA allocations, separate from normal lending, that would be linked to good policy in the recipient country and to parallel efforts by other creditors. This approach does raise some thorny accounting and disclosure issues, which need to be addressed in the coming week. This will enable us to come to a firm judgment on the relative merits of this option. One other option that had been proposed in the IDA Debt Options paper -- extending the cutoff date for the 5th dimension to cover post 1988 IBRD loans -- received no support at the IDA deputies meeting.

Next Steps on Debt Options Analysis.

The next two weeks provide an opportunity to review the work in hand and to complete additional analysis on options not yet fleshed out, notably those relating to a more limited debt facility focused on IDA. This review will also help to crystallize those issues where there are inter-unit differences of view on the cost and feasibility of various options. Based on this work, Mr. Wolfensohn would receive a package by mid July, that sets out the various options and the issues associated with moving ahead on them.

Donors Views on Debt.

Finally, in response to the request of Mr. Wolfensohn, the staff have put together a summary of the views and positions on multilateral debt of various donors, stakeholders and influential NGOs. This summary reflects the latest comments made on the IDA Debt Options Paper at the IDA Deputies meeting this week in South Africa. A copy of this paper is being circulated in parallel.

THE WORLD BANK/IFC/MIGA

OFFICE MEMORANDUM

DATE: June 30, 1995

TO: Distribution

FROM: Masood Ahmed, Director, IEC

EXTENSION: 33800

SUBJECT: **Donors' Views on Multilateral Debt**

Attached please find a note summarizing the views expressed by donor governments, important NGOs and selected individual analysts on the issue of the multilateral debt of poor countries. This note incorporates the views expressed during the IDA deputies meeting this week in Johannesburg.

Comments on this note should be sent to Keith Jay (ext. 80529).

Attachment

Distribution: Messrs./Mmes. Frank, Kaji, Sandstrom (o/r), Horiguchi (2 copies), Bruno (o/r), Linn (o/r), Shihata, Muis, Einhorn (o/r), Adams, Baird, Donovan, Malloch Brown, Nishimizu, Bhattacharya, Clark, Kamel, Mitchell, Rueda Sabater

VIEWS ON MULTILATERAL DEBT

1) **Is there a Multilateral debt problem and are new Bank instruments needed?**

The views of donors and others can be grouped in the three broad categories below. Under each the key positions are highlighted. A fuller discussion of the positions are set out in the annex based on our impressions after the IDA Deputies discussion of 4 sets of options: elimination of the Fifth Dimension cutoff; a "seventh dimension" which raised the idea of an IDA debt sinking fund; IDA support for Brady-style DDSR operations, and more differentiated IDA terms.

A) There is a significant multilateral debt problem and new World Bank instruments/actions are needed.

- The US is concerned about the debt stock issue. They have suggested a "Washington Club" to address multilateral debt in a coordinated manner, as the Paris Club deals with bilateral debt. They have also suggested the use of IDA grants to "retire" IDA debt and thus support the IDA "sinking fund" idea.
- The UK has specifically proposed an "IDA debt allocation facility" which involves additional IDA lending to heavily indebted countries which would improve the predictability of this supplemental IDA assistance. The "seventh dimension" idea set out in the recent IDA Deputies' paper incorporates many features of this proposal.
- Denmark has proposed the cancellation of MDB soft loans and future MDB assistance to the poorest in grant form only.
- Canada is concerned that adverse conditions could quickly create a broad scale debt problem and some parts of the government are pushing for multilateral debt relief.
- Most NGOs and critics argue that there is a generalized problem that requires further World Bank action in the form of debt forgiveness or rescheduling.

B) There is not a generalized problem but specific targeted changes by IDA are needed to address the few countries that do have a multilateral debt problem.

- France, while arguing that there is not a generalized problem and emphasizing the importance of financial integrity of the Bank, nonetheless has pushed strongly for a change in the Fifth Dimension cutoff date and some coverage of principal since this would largely benefit Côte d'Ivoire and Cameroon.
- Germany, while opposing most suggested options, has supported IDA grants if carefully targeted.
- Japan has traditionally taken a hard line in the area of debt forgiveness and rescheduling. While having questions about each of the individual options they consider the package in the IDA Deputies paper a basis for compromise and could

support a consensus. Also, surprisingly they have expressed interest in the IDA debt sinking fund idea.

- The Netherlands would like to keep the broad range of options on the table at this time including the sinking fund and Fifth Dimension coverage of IBRD principal. They are supportive of the options set out in the IDA Deputies paper.
- Switzerland believes that some strengthening of the IDA menu is needed to address the rare cases that cannot be addressed with existing instruments and has in the past suggested the rescheduling of IDA credits.
- Nordic countries other than Denmark see the political need for the Bank to show that it is taking action and have indicated that they could be fairly flexible on a range of options.

C) <u>There is no generalized problem and current instruments are adequate (opposed to new instruments or options)</u>

- Italy has been very vocal, arguing strongly against changes in IBRD or IDA policies to address what they believe is not a problem requiring new instruments. Debt is a symptom of a more basic development problem.
- New Zealand, Austria, Australia and Belgium have raised serious questions regarding any new instruments to address multilateral or Bank debt.

2) <u>IDA debt "sinking fund"</u>

This new option that Bank staff is looking at would consist of a fund to cover portions of IDA debt service of selected countries. Many IDA Deputies, including several from countries (e.g. Japan and Germany) which have taken a very strong stand on Bank financial issued and IBRD debt forgiveness, have expressed significant interest in the idea and encouraged us to work on it further.

3) <u>IBRD debt forgiveness or rescheduling</u>

There is virtually no support among donors for actions (such as forgiving or rescheduling IBRD loans) that would alter IBRD's fundamental financial policies and position or for the expansion of the Fifth Dimension program to cover IBRD principal payments for IDA-only countries. The only exceptions are Switzerland which has argued for consideration of IDA debt rescheduling and Denmark which advocates debt cancellation for all MDB soft loan windows (including IDA). Many NGOs and some academics as well as parliamentarians, in contrast have specifically argued for forgiveness or rescheduling of World Bank loans with IBRD reserves frequently cited as the source of funding. The UK government <u>does not</u> advocate IBRD or IDA debt rescheduling or forgiveness.

ANNEX

VIEWS ON MULTILATERAL AND WORLD BANK DEBT

A. Major Donors

1. *The Halifax Economic Summit*

The G-7 Halifax Communiqué states "we recognize that some of the poorest countries have substantial multilateral debt burdens. We will encourage:

- the Bretton Woods institutions to develop a comprehensive approach to assist countries with multilateral debt problems, through the flexible implementation of existing instruments and new mechanism where necessary;

- better use of all existing World Bank and IMF resources and adoption of appropriate measures in the multilateral development banks to achieve this objective and to continue concessional ESAF lending operations."

2. *United States*

The US has increasingly pushed for action by the Bank to address the IDA/IBRD debt stock issue. In the context of the May 12 COW discussion of options they proposed a so called "Washington Club" to address, in a coordinated and collective manner, multilateral debt. They also proposed a program, limited in time, that would use IDA grants to retire a portion of outstanding IDA debt, conditioned on good economic performance. They have also indicated support for more differentiated IDA terms, harder and softer, with the softer terms, in contrast to the above grants, provided to countries with less severe debt problems. They are opposed to changing the Fifth Dimension (either cutoff date or coverage of principal). They could support the use of IDA for DDSR operations.

3. *United Kingdom*

The British have for a number of years taken a lead role on the debt issue, pushing for increasingly concessional treatment in the Paris Club (Toronto, Trinidad and Naples terms). This issue is an important one for senior British authorities (Major, Clarke—whose wife is a trustee of OXFAM—Lady Chalker) who have raised it in public fora and private discussions. The issue has also been raised by members of Parliament (such as the bipartisan All-Party Group On Overseas Development, APGOOD) and major NGOs in the UK such as OXFAM. The government is now actively arguing for action by the multilaterals on debt; raising the issue in the Bank and Fund Boards and in the Development Committee. They have argued that there is

an increasingly serious multilateral debt problem in the very poor countries. Uganda has been a particular case in point for the UK. For the Bank they have proposed the introduction of more differentiated IDA terms (including grants for a few selected countries with a firm graduation mechanism, i.e. 10 years) and an IDA Debt Allocation Facility that would make specific additional predictable and transparent IDA allocations to heavily indebted poor countries. They have specifically ruled out rescheduling or forgiveness of Bank debt. These IDA allocations would be in the form of balance of payments/budget support, the level would be a function of the country's multilateral debt service and would be conditioned on strong country performance. They welcome the "seventh dimension" idea since it comes close to their proposal. They do not support a change in the Fifth Dimension cutoff date or a general move to cover principal. They do not support the use of IBRD reserves to address the debt problem.

In the IMF the UK is calling for an extension of ESAF and a softening of ESAF terms. The Chancellor proposed at this springs Interim/Development Committee meeting the sale of IMF gold to finance these changes.

4. *Canada*

While Canada agrees with the general analysis and conclusion that there is not a generalized multilateral debt problem, like the US and UK, they are concerned that this conclusion is dependent on the convergence of favorable outcomes. There is an element within the government pushing for multilateral debt relief on the grounds of equitable treatment vis-à-vis bilateral debt reductions. They continue to emphasize a case by case approach, particularly for softer IDA terms which they believe should be limited to poor countries with high total debt service where multilateral debt is a significant proportion and who are committed to comprehensive economic reform. They support IDA grants. They do not support an expansion of the Fifth Dimension or the use of IDA for Brady-style DDSR operations.

5. *Denmark*

Denmark's position on the debt issue departs from that of other Nordic countries. One factor is the fact that the government was elected on a strong aid platform. The Minister of Development Cooperation (Poul Neilson) prior to the April Development Committee stated in a letter to the Committee that: (i) the debt of the soft windows of the MDBs should be canceled; (ii) donors should make up for the loss of reflows and, (iii) future assistance to the poorest countries from the soft windows should be in the form of grants. They presented this position also at the Social Summit. They have indicated support for an IDA sinking fund, the "seventh dimension" with a lower threshold and grant funding.

6. *France*

The French have taken a firm position that there is not a generalized multilateral debt problem and that the Bank should not forgive or reschedule its debt or take other action that could impair its financial soundness. (As chair of the Paris Club the French are very sensitive to perceived encroachment on the lead role of the Paris Club on the debt issue). They believe that

the multilateral debt issue can be addressed with existing instruments. A major issue for the French is the maintenance of positive net transfers from the Bank. Within existing instruments, they have sought action that would be of particular benefit to the major Francophone countries; all CFA countries except Gabon are considered heavily indebted. Because of the large IBRD debt over hang of Cameroon and Côte d'Ivoire they have argued for an elimination of the Fifth Dimension cutoff date and some coverage of principal. Recognizing that there is little support for full coverage of principal they have suggested that it cover something like 25 percent. They are not enthusiastic about changing IDA's terms although they could go along with the maturity/grace period extension. They do not think that grants or the US or UK proposals are a good idea.

7. *Germany*

The official German position is firm and continues to be opposed to rescheduling/ moratorium or debt forgiveness. They emphasize that there is not a generalized multilateral debt problem and would not want to go beyond the options that have been identified in the earlier Bank options papers. They are interested in an increased differentiation of IDA terms including grants (extended maturity was a second best option) as long as it is cost neutral. They do not like the elimination of the Fifth Dimension cutoff or the proposal to use IDA for Brady-style DDSR operations on the grounds that these measures benefit the wrong set of countries.

8. *Japan*

The Japanese have historically taken a very firm position against debt rescheduling and forgiveness. They support the basic conclusions of the Fund and Bank analysis that the existing instruments can address specific country problem. They would oppose any change that could affect the Bank's financial standing. Only a small number of countries have a potential multilateral debt problem which should be addressed strictly on a case by case basis. Concessional new money can be as effective as outright debt reduction (a position they have also taken in the Paris Club). Expanding the Fifth Dimension would be costly and extension to principal would be in effect rescheduling IBRD debt. They, however, view the options set out by the Bank as the basis of a compromise among donors and could support them if a consensus developed. They may also be interested in an IDA sinking fund to which they might provide parallel financing.

9. *Nordics*

They support the conclusion that MDB debt seems manageable but that a problem remains for a few. Concessional flows are critical and they would support softer terms for a few (including targeted grants to address the debt overhang, i.e., retiring some IDA debt). The UK proposal is worth looking at. Criteria should be performance and the poorest. On the Fifth Dimension they do not like the elimination of the cutoff since it helps the better off. They see the need for the Bank to demonstrate action and therefore indicated a willingness to be very flexible.

10. *Netherlands*

The Netherlands is not in favor of multilateral debt forgiveness/rescheduling, however, they believe more needs to be done to assist the heavily indebted countries. They could support in principle the UK proposal but believe that it needs further work and needs to be selective. Expansion of the Fifth Dimension would be very expensive and few of the seriously indebted poor would benefit but they could support a new cutoff date. Grants could be considered if applied to a very small group. They support the use of IDA for Brady-style DDSR operations but would consider softening and hardening only if highly targeted.

11. *Belgium*

The Belgians have taken a fairly conservative stand on the debt issue. They consider IDA/IBRD debt overall to be a small problem (for many of these countries they see Fund and AfDB debt to be a larger issue). As a result IDA should not implement new mechanisms for dealing with debt. They could support a change in the cutoff date of the Fifth Dimension. Indebtedness should not be a criterion for IDA allocations since it would come at the expense of other poor countries.

12. *Switzerland*

The Swiss along with Sweden took an early lead in focusing attention on the debt issue in the low income countries, sponsoring the debt seminar in May of 1994. They believe that multilateral debt may be a problem in the future for some countries. However, it is a manmade problem that can be avoided and needs to be addressed. There needs to be a menu of options to address the rare case that goes beyond traditional actions. It needs to be case by case and include other creditors. Any special debt package would need to be bought with special conditionality. They can support the changes set out in the menu paper. They have also suggested rescheduling IDA debt which may reflect the strong political pressure from NGOs and Parliamentarians to take action on multilateral debt.

13. *Italy*

Italy has taken a very firm stand to date on the issue of World Bank debt. They support the analytical conclusion that there is no systemic multilateral/Bank debt problem and believe that the existing Bank instruments are adequate to address country specific issues. They have, therefore, opposed even the exploration of options. The government is pushing a very conservative financial position vis-à-vis both Bank financial management and developing country policies. They oppose the elimination of the cutoff date, and differential terms (suggesting that differentiation would better be based on the type of instrument rather than the country). The use of IDA for Brady-style DDSR operations was considered possible if funds were part of the country's normal allocation.

14. *Australia*

They believe that poverty not debt should be the focus. There is no need for changes in IDA instruments. The "seven dimension" access and allocations should be highly restrictive and not on a simple percentage rule basis. They question the need for softer terms but would consider if cost neutral and oppose the idea of grants since it violates a basic principle of financial discipline and a change in the cutoff date.

B. NGOs and Noted Critics

1. *OXFAM*

As you know, OXFAM has recently written to you summarizing the points they made to you in London including the centrality of the multilateral debt issue. There appears to be some softening in their position in part as a result of our intensive discussions with them about multilateral debt. For example, the points they made to you were more nuanced than those in an earlier letter to Mr. Sandström. They had been strongly proposing the use of IBRD reserves to convert IBRD loans in the heavily indebted countries into IDA credits. They also supported the sale of IMF gold to convert IMF debt to IDA terms and the issue of SDRs.

2. *Non-Aligned Movement (Suharto)*

Indonesia currently chairs the NAM. Last summer the NAM Ministerial Meeting reviewed and endorsed a report of their group of experts on debt. That report called for debt reduction applied to the total debt stock (private, bilateral and multilateral). In order to avoid jeopardizing the credit standing of the IFIs they proposed the use of reserves, a new issue of SDRs and the conversion of debts into equity options (e.g. an IBRD-IFC debt equity swap type arrangement aimed at promoting programs of privatization).

3. *EURODAD/WEED*

EURODAD is a network of NGOs in 16 European countries. It aims to coordinate the activities of NGOs working on debt and structural adjustment issues. They see debt including multilateral debt as a major development problem in the low income countries having serious social and human development consequences. They propose for the multilaterals: the sale of IMF gold in order to cancel all IMF debt of the poorest countries in Africa; extra allocations of SDRs and interest free use of SDRs for these countries; and the use of World Bank (as well as other MDBs) reserves and profits to cancel all market rated debt of the heavily indebted countries. They also envision the conversion of debt into local currency for financing development and the environment. WEED is a German advocacy NGO, vocal on debt. It collaborates closely with EURODAD.

4. *Hellinger*

He has played an important role in providing analysis and advice to the UN on the debt issue and his proposals re: the Bank, AfDB and Fund are reflected in the UNICEF positions (below).

5. *Percy Mistry and Chandra Hardy*

These are disaffected former Bank staff (both having worked among the Bank's senior financial staffs) who have pushed for Bank debt rescheduling/forgiveness in publications which are cited among NGOs. The G-24 have drawn on the Hardy analysis in their position statements.

6. *Tony Killick*

He is currently preparing a report for the Commonwealth Secretariat on the multilateral debt issue. Killick is a moderate Bank critic who has good academic credentials in the UK development community. He has requested information from us in his capacity as a consultant to the commonwealth secretariat.

C. UN System

The UN has increasingly taken an active role in highlighting debt as a major development issue. They see multilateral debt as part of that problem and have felt that the Bank and Fund have been ignoring/downplaying the issue and resisting change. UNICEF in 1993 called for conversion of non-concessional MDB loans to IDA terms—a Fifth Dimension scheme for other MDBs (largely aimed at the AfDB)—and the application of IDA type terms to all IMF lending with the interest subsidy covered by gold sales and donor contributions. UNICEF sees debt service payments to the multilaterals as a drain on the government budgets in these poor countries, reducing the funds available for social development expenditures. The upcoming ECOSOC meeting (July 1995) and the UN's 50th anniversary this Fall are the next UN forums where this issue will be raised. ECOSOC would like to elevate its position to that of an "honest broker" between the low income debtor countries (particularly in Africa) and the creditors. UNCTAD has long argued for both increased disbursements and debt and debt service reduction by the IFIs. World Bank resources should be used to finance debt reduction schemes for its debt.

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

June 20, 1995

Note to Mr. James D. Wolfensohn (o/r)

Jim,

I hope you had a productive and enjoyable trip to Africa. The newspaper reports certainly suggest that you were a big hit!!

As I will be leaving tomorrow for Tokyo and Hong Kong - I will be back in office on Thursday, June 29 - I thought it might be useful to leave you a brief note on a few issues.

Arun

We met with Maurice last night and spent over one hour going over some of the issues with him. We have arranged to provide him additional documents on the choice of alternatives, the "commercial" viability of Arun and the likely issues which would arise during implementation. Maurice will review these additional documents. He is also meeting on a "personal" basis with one of the members of the Inspection Panel whom he knows well. We agreed to take stock when I am back in office on June 29. He liked the questions that we laid out for him. He asked me whether you had any particular view on how you wanted his report. I suggested that we should first talk this one through before he worries about producing a piece of paper.

Budget

You will be having a Board meeting on Tuesday, June 27. The Budget Committee meeting which we had last week went pretty well. No major issues, though a number of chairs continue to vent their anger at how they had been presented a fait accompli by Lew making a public announcement of budget cuts without any consultation with the Board. As I expected there were a number of questions on where you stood on the budget. As we agreed, I told them that while we had briefed you on the budget you personally were "inheriting" this budget. While you were comfortable with the underlying premises, maintaining essential client services, selectivity and efficiency, you certainly were not in a position this early in your tenure to pass judgment on specific numbers. What you would expect to do after your familiarization with the needs in our client countries and discussions with your Managers would be to take a much more focused and substantive look on what we need to do and what that costs in determining what

are the appropriate budgetary needs. This led to some questions as to whether the Bank should proceed with the redundancy exercise in case you would determine that the budget in fact had to grow. I again explained that the budgetary reductions could not be achieved without reduction in staff costs. Staffing cuts were driven by business needs and dictated by the skills necessary to carry out our work. There were some concerns that if you were to come forward seeking a large increase in resources and staffing, this would pass very mixed signals both internally and externally. I suggested that it was premature for them to speculate on where you would come out, but clearly, if you were to come out for a significant budget increase you would obviously take all these factors into consideration in making a recommendation.

There is a continuing concern about the implications of the budgetary cuts on lending, (can we meet the needs of the countries if they were in a position to absorb more projects/loans), supervision (reductions/flattening out in some regions. They seem to ignore the fact that supervision resources have grown at 9% per year in the last four years and major efficiency/effectiveness initiatives are underway), and economic and sector work (whether reductions here would weaken the basis for the Bank's activities in the years to come. Are we cutting out muscle?). Some of these issues also surfaced at today's Board meeting on India CAS. I have suggested to Jules and Richard that you might find it very useful to have a couple of RVPs in the Board Room to give a "grass roots" feel of what these aggregated numbers mean in terms of conducting their business. Perhaps Javed could talk on ESW and Joe Wood on lending and supervision.

Staff compensation

Following your meeting on the Hill you had expressed the desire to better understand the Bank's compensation system. I spoke to Shahid on this. He had provided you a brief note on this subject earlier. A copy is attached. I have had his people supplement this with a note which describes the "system" in more detail. Perhaps after you see these, it might be useful for you to have a briefing session. I do believe this has some urgency, because if you wish to make any changes or at least review your options, it would be better to do so before we kick-off the next survey of comparators starting in October/November this year.

Attachments

COMPENSATION

The Bank Group's approach to compensation reflects the variety of employment relationships, labor markets for recruitment, and duty stations of its staff. The main systems cover: regular staff, consultants, and local staff. In contrast to most private organizations, there are no separate compensation arrangements for executives, below the level of the President.

Regular Staff Compensation

The system is shared with the IMF. The organizations consult on major issues and normally agree on the recommendations to be presented to their Boards ("parallelism".) The system was specified in considerable detail by a joint committee of the two Boards, which met over 1984-89. It provides for salaries to be based on annual surveys of actual pay for positions comparable to jobs in the Bank/IMF, drawn from a large data base, and subject to certain requirements on company size. The US financial, industrial, and public sectors receive equal weight. The benchmark is the 75th percentile of this "market".[1] The international competitiveness of the US market is checked against a similar sample obtained in France and Germany, it being assumed that a minimum 10% premium is required to attract staff from overseas. If the US market provides such a premium, it becomes the basis for revising the pay scale. If not, the pay scale is modeled more closely on French/German data.

Benefits available to all regular/fixed term staff are compared every four years with a similar sample. Other benefits, namely benefits tied to work outside of Washington, and "expatriate benefits"[2], consisting of home leave and education subsidies, are reviewed at management's initiative.

Strengths

The system has provided a transparent and reasonably predictable framework for compensation adjustments for staff at large over the last 6 years. Politics is not of course totally absent from discussions nowadays: despite protestations of support for the salary system, certain shareholders (Australia, Canada, New Zealand, UK, US) have consistently opposed the results it has produced. This has led to much debate on technical arcana. Most shareholders, however, have been steadfast supporters, particularly the Continental Europeans.

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[1] Using the 75th percentile is roughly equivalent to omitting the public sector and using the midpoint.

[2] Available only to non-US staff who are not US resident aliens.

Weaknesses

The salary system reflects the civil service orientation of most Board members. Use of one payline for an extremely wide range of jobs and labor markets inevitably results in difficulties in recruiting for specific occupations and certain nationalities (Germans, Italians, Japanese, etc.). The system leads to overpayment to lower level professionals and underpayment to higher level professionals and managers. We will review expatriate benefits for their effectiveness in recruiting and retaining expatriates. We will also review that salary line for equity and relation to the market.

The current pay scale is as follows:

Level	No. in Bank	Typical Functions	Annual Salary (Net of Taxes) (Minimum-Maximum) (S'000)
30	3	Sr. Vice Presidents[3]	155-182
29	18	Vice Presidents & Managing Directors	141-169
28	76	Directors	123-154
27	54	Sr. Advisors & Managers	111-139
26	379	Advisors & Division Chiefs	92-134
25	439	Principal Specialists	81-122
24	1237	Sr. Country/Technical Officers	69-111
23	785	Mid-career Recruits	62 - 99
22	362	Jr. Economists/Project Officers	57 - 86
21	238	Recent Graduates/Sr. Researchers	51 - 77
20	198	Sr. Administrators/Researchers	46 - 69
19	162	Administrators/Jr. Researchers	41 - 61
18	137	Jr. Administrators	36 - 55
17	402	Executive/Administrative Assistants	31 - 50
16	450	Office Managers	28 - 45
15	687	Sr. Office Support Staff	25 - 40
14	474	Office Support	22 - 35
13	112	Secretarial Recruits	20 - 32

[3] One of the Vice Presidents is also at level 30 (through grandfathering).

DETERMINING THE WORLD BANK PAY STRUCTURE

1. The World Bank's salary structure is arrived at through a process specified by the Board in 1989, following 5 years of study by a joint committee of Executive Directors of the Bank and Fund. The main thrust is to set the salary structure on the U.S. market, as long as this provides adequate international competitiveness. The process is somewhat mechanistic, which provides a significant buffer from political considerations. The main steps in this process are as follows.

2. **Market Definition.** Salary scales for the Bank and IMF are determined in light of pay practice in a number of defined markets. The primary comparator market for Bank/IMF salaries for staff at grades 19-26 (paraprofessionals through first-line managers) is comprised of high quality U.S. employers from three equally weighted sectors: the public sector, the private industrial sector and the private financial sector. A secondary market, used to test for international competitiveness (see below), is an equally weighted composite of markets in France and Germany. The French and German components are each comprised of high quality organizations from the public, private industrial and private financial sectors—each given a weight of one-third. The reference market for staff at grades 11-17 is the Washington, D.C. private sector market for secretarial staff. Comparators organizations are listed in the Annex. Annual salary data for these markets are obtained primarily through access to large, established survey databases supplemented by custom surveys. The selection of comparator organizations is based on specific quality criteria (such as organization size) and on consistency of survey participation (to promote continuity of the comparator markets).

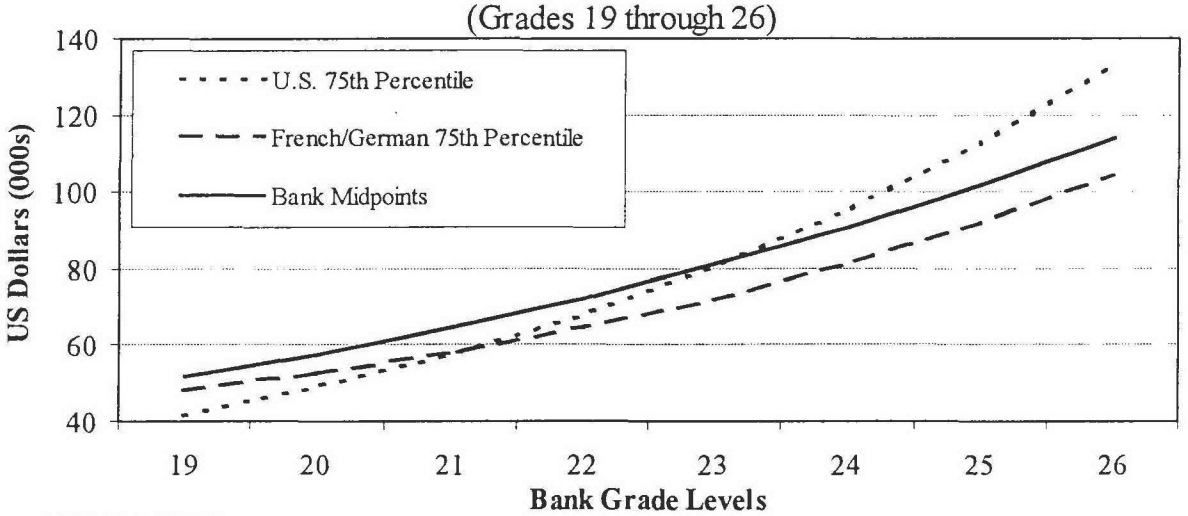
3. **Relationship to the Market.** For higher level grades, Bank salary range midpoints are related to the 75th percentile of the U.S. market defined above (except that, for the U.S. public sector, the reference is to the average comparator pay practice plus 10 percent). For the French/German comparators the 75th percentile is the reference point. The use of the 75th percentile offsets the inclusion of the public sector (where the Bank recruits few staff). For support staff, the midpoints of grades 11-17 are compared to the 75th and 90th percentiles of the private secretarial market in the Washington, D.C. area. However, these reference points are not the primary determinants of the salary structure for support staff; instead, they serve as a check that the structure for support staff, established by downward extrapolation from the higher level structure, is reasonably related to market realities. In 1995, the Bank support payline is slightly below the 75th percentile.

4. **International Competitiveness.** The degree of international competitiveness of the U.S. market is measured by the extent to which U.S. salaries (at the 75th percentile) lie within or

outside a "test range" of 10-20 percent above the combined French/German markets.[1] The rationale behind this margin is that, to persuade potential candidates to undertake international relocation of their families, the Bank must offer a premium over prevailing market rates.

5. **Salary Structure.** The salary structure is established by setting the salary range midpoints for grades 19-26 against the relevant market pay levels. For lower (support) grades, the midpoints are extrapolated from grade 19. The results are shown in the following chart. As can be seen, the Bank payline follows the slope of the European payline more closely than that of the U.S. This leads to higher pay than in the U.S. market for junior recruits and paraprofessionals, and lower pay for senior professionals and first-line managers. At the Bank's prime recruitment grade (23) the Bank's payline is on the U.S. market and 12.5% above France/Germany. For grades higher than 26, salary range midpoints are interpolated to a point below the salary of the President.

1995 Bank Midpoints vs. U.S. and French/German Markets
(Grades 19 through 26)



US FrGr95.xls-Figure 3
06/20/95-PSCPS:bg

Weighted Margin Over U.S. = 0.0%
ICM Over France/Germany = 11.2%

PSCPS
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1. Translated at the average of the previous year's (November-October) exchange rates and purchasing power parities, weighted equally.

ANNEX

COMPARATOR ORGANIZATIONS INCLUDED IN THE 1995 REVIEW OF STAFF COMPENSATION

(Extract from the Hay Survey Report)

COMPARATOR ORGANIZATIONS INCLUDED IN EACH SEGMENT OF THE SURVEY

U.S. HIGHER LEVEL

Federal Civil Service

- General Schedule (GS)
  The survey covered GS positions throughout the country in six U.S. Departments with more than 100 staff, which are listed below with their rank order (descending) in terms of the number of full-time civilian employees:

Treasury	4
Agriculture	7
Commerce	13
Energy	16
Labor	17
State (Agency for International Development)	20

- Senior Executive Service (SES)
  SES positions were drawn from the same six Departments as the GS positions.

- Foreign Service (FS)
  Data on FS positions were collected from USAID, a State Department Agency.

- Senior Foreign Service (SFS)
  Data on SFS positions were collected from USAID.

Federal Reserve System

Data on professional and senior management positions were collected from:

The Federal Reserve Board, Washington, D.C.
The Federal Reserve Bank of New York.

Financial Sector

- Nineteen commercial banks and diversified financial companies with assets over $5 billion were included in the survey.

- The following 17 organizations were included in 1994 as well as 1995:

Participants in 1994 and 1995

American Express
Bank of America
Bank of Boston
Bankers Trust
Bay Banks
Chase Manhattan Bank
Chemical Bank
Citibank, NA
Comerica (Manufacturers National Bank of Detroit)
Continental Bank
Corestates
First Chicago
First Interstate Bank of CA
National Bank of Detroit
Royal Bank of Canada
State Street Bank & Trust
Wells Fargo Bank

- The following two organizations are new this year:

Boston Company
NationsBank

Industrial Sector

- Seventy-one industrial companies from Hay ACCESS® with annual revenues over $1 billion were included in the survey.

- The following 70 organizations were included in 1994 and 1995:

Company	*Primary Business*
Air Products	Industrial Chemicals
Alcoa	Metal Production
Amerada Hess	Natural Gas
Amoco	Petroleum & Chemical
ARMCO	Metal Production
Armstrong World Industries	Building Products
Ashland Oil	Oil Production
BASF	Agricultural Chemicals
Bell Helicopter	Aircraft Production
Bell South	Telecommunications
BOC	Industrial Gases
Borg Warner	Industrial Engineering
BP America	Oil/Gas
Cargill	Agricultural Products
Caterpillar	Construction Machinery
Central Soya	Commodity Operations
Chevron	Petroleum & Oil
Ciba Geigy	Pharmaceutical
Consolidated Freightways	Transportation
Cooper Industries	Electronic Products
CSX	Transportation
Diamond Shamrock	Oil Refining
Dow	Chemical Products
Eaton	Electronics
Engelhard	Chemicals/Metals
Firestone	Tires
General Electric	General Engineering
General Signal	Instrumentation Manufacturing
Goldkist	Agricultural Commodities
Goodrich	Tires
Goodyear	Tires
GTE	Telecommunications
Heinz	Food Production
Hoechst Celanese	Chemical Production

Industrial Sector (continued)

Company	*Primary Business*
Hormel	Food Production
ICI Americas	Chemical Production
International Paper	Paper Products
Johnson (S.C.) & Son	Personal Care
Kellog	Food Production
Kimberly Clark	Paper Products
McGraw Hill	Publishing
Mead	Paper Products
Merck	Pharmaceutical
Miles	Chemical Production
Murphy Oil	Natural Resources
Norfolk Southern	Transportation
Occidental Chemical	Chemical Production
Owens-Corning Fiberglass	Fiberglass Production
Pacific Telesis	Telecommunications
Peabody Holding	Engineering
Pennsylvania Power & Light	Power Utility
Pepsico-Corporate	Food Production
Philip Morris	Tobacco & Food Production
Pitney Bowes	Business Equipment
PPG Industries	Glass/Resins
Quaker Oats	Food Products
Rockwell International	Aerospace/Electronics
Scott Paper	Paper Products
Sea Land (CSX)	Shipping Containers
Southern New England Telephone	Telecommunications
Staley	Food Production
Tenneco	Oil/Natural Gas
Texas Utilities	Power Utility
Timken	Roller Bearings
Union Pacific	Transportation
USG	Building Products
USX	Petroleum & Steel
Valero Energy	Natural Gas
Whitman	Food Production
Zenith	Electronics

Industrial Sector (continued)

- The following organization has participated in previous years and is participating again this year:

Company	*Primary Business*
Sears	Merchandising

FRANCE - PROFESSIONAL

Public Sector:

Banque de France
Ministère de l'Economie
Caisse Francaise de Development

Industrial Sector

- Thirty-three organizations were selected for inclusion in the 1995 survey. They comprise 32 of the 33 organizations included in the 1994 survey, plus one new organization.

- The following 32 organizations were included in 1994 and 1995:

Aerospatiale
Air Liquide
Airbus Industries
Arjomari Prioux
Bergerart Monnoyeur
B.P. Group
B.S.N. Group
Ciba Geigy
DMC
Elf
General Medical System (formerly GE CGR)
Hutchinson
IBM
ICI
Lafarge Copee
Merlin Gerin
Pechiney
Peugeot
Philips
Rhone Merieux
Rhone Poulenc
Roussel Uclaf
SAGEM
Saint Gobain
Sanofi Sante
SAT
Shell
Snecma
Sopad Nestle
Spie Batignolles
Thomson
Total (Group)

- The following organization is new this year:

  Wagon Lits (parent of Eurest, which participated in 1994)

- The following organization participated in the 1994 survey, but not this year:

  Eurest (subsidiary of Wagon Lits, which participated in 1995)

Financial Sector

- Twelve institutions were selected for inclusion in the 1995 survey. They comprise 11 of the 12 institutions included in the 1994 survey, plus one new institution.

- The following eleven institutions were included in 1994 and 1995:

  AXA
  Caisse Centrale des Banques Populaires
  Caisse Nationale DU Credit Agricole
  Compagnie Bancaire
  Credit Lyonnais
  Credit Mutuel
  Federation Nationale du Credit Agricole
  GAN
  Groupe CIC
  Societe Generale
  UAP

- The following institution is new this year:

  Reseau des Banque Populaires

- The following institution participated in the 1994 survey, but not this year:

  Caisses d'Epargne (CENCEP)

GERMANY - PROFESSIONAL

Public Sector:

Bundesministerium der Finanzen
Deutsche Bundesbank
Kreditanstalt für Wiederaufbau

Industrial Sector

- Twenty-five organizations were selected for inclusion in the 1995 survey. They comprise 24 of the 25 organizations included in the 1994 survey, plus one new organization.

- The following 24 organizations were included in 1994 and 1995:

  Akzo Unternehmensbereich Fasern und Polymere Enka AG
  Appollinaris & Schweppes GmbH & Co.
  Beiersdorf AG
  Chemische Fabrieken Grünau GmbH
  Continental AG
  Datev e. G.
  Deutsche BP AG
  Eckes AG
  Henkel
  Hoogovens Alu Werk Koblenz
  Hoogovens Aluminum Profiltechnik
  ICI
  Kraft Jacobs Suchard Deutschland
  Lucas Automotive GmbH
  Martin Brinkmann AG
  Mathes & Weber GmbH
  Pirelli Reifenwerke
  Quelle Schickedanz AG & Co.
  Schmalbach Lubeca AG
  Solvay Deutschland GmbH
  Uniroyal Englebert Reifen
  Veba Oel AG
  Vorwerk & Co. Elektrowerke
  Zeneca

Industrial Sector (continued)

- The following organization is new this year:

  Porsche AG

- The following organization participated in the 1994 survey, but not this year:

  Iveco Magirus

Financial Sector

- Twenty institutions were selected for inclusion in the 1995 survey. They comprise all of the 17 institutions included in the 1994 survey, plus three new organizations.

- The following 17 institutions were included in 1994 and 1995:

  Bank für Gemeinwirtschaft AG
  Banque Paribas (Deutschland) OHG
  Barclays Bank PLC
  Barmer Ersatzkasse
  Bayerische Landesbank Girozentrale
  Bayerische Vereinsbank AG
  Berliner Handels - Frankfurter Bank KGaA
  Canadian Imperial Bank of Commerce (Deutschland) AG
  Commerzbank AG
  Credit Lyonnais SA and Co (Deutschland) OHG (merged with BFG Bank AG)
  Deutscher Ring Lebensversicherungs AG
  Dresdner Bank AG
  Equity and Law Lebensversicherungs AG
  Frankfurter Sparkasse
  IKB Deutsche Industriebank AG
  The Royal Bank of Canada AG
  Société Générale - Elsässische Bank & Co.

- The following organizations are new this year:

  Westdeutsche Landesbank AG
  Münchener Rückversicherungs-Gesellschaft AG
  Kölnische Rückversicherungs-Gesellschaft AG

U.S. SUPPORT: WASHINGTON, D.C.

Federal Civil Service

- General Schedule (GS)
  The survey covered GS positions in six U.S. Departments in the Greater Washington Metropolitan Area. They were the same six Departments as for higher level positions.

Federal Reserve System

- As in 1994, data on support positions in Washington, D.C. were collected from the Federal Reserve Board.

Private Sector

- The following 22 private sector organizations from the Greater Washington Metropolitan Area participated in the 1995 survey.

  1995 Participants:

  The Acacia Group
  American Bankers Association
  American Chemical Society
  American Gas Association
  American Petroleum Institute
  Arnold & Porter
  Arthur Andersen & Company
  Blue Cross/Blue Shield of the National Capital Area
  Chamber of Commerce of the United States
  Covington and Burling
  Crestar Bank
  DynCorp
  GEICO
  Jones Day Reavis & Pogue
  Marriott Corporation
  MCI
  Mobil
  Morgan, Lewis & Bockius
  Potomac Electric Power Company (PEPCO)
  Price Waterhouse
  Student Loan Marketing Association (SLMA)
  Wilmer, Cutler & Pickering

- The following organization participated in the 1994 survey, but not this year:

  Communications Satellite Corporation (COMSAT)

The World Bank
Washington, D.C. 20433

Gautam S. Kaji
Managing Director

Tel.: (202) 458-1384
Fax.: (202) 477-6869
Facsimile Transmittal Form

DATE: June 9, 1995

No. of Pages: 5
(including this page)

TO: **Mr. James D. Wolfensohn, President**
Burgenstock Hotels, Burgenstock, Switzerland

FAX #: 9 011 41 41 61 04 34

PLEASE PASS THIS FAX ON TO MR. J.D. WOLFENSOHN. MANY THANKS.

Jim,

As I informed you yesterday, I have spoken to Maurice Strong and sent over the package of documents for his review. We have just confirmed that the documents were in fact delivered to his appartment today. Maurice has promised to come back to me on Monday. As I told you over the phone, I have attempted to put on paper what I believe to be the central questions that need to be answered to permit you to make a decision and establish a rationale for it. Attached is the list of questions which I am also circulating to the other MDs, Joe Wood, etc. Should you have the opportunity, I would appreciate you casting your eye over it and let me know if you see any flagrant omissions. I hope to share these questions with Maurice when I speak with him on Monday.

The attached update from our Resident Mission in Nepal on the political developments do not bode well for Arun.

Finally, I remember your saying that you would be informing the Board about Maurice becoming your advisor on matters that you would refer to him from time to time. I would recommend that you do not go much beyond that. In particular, I do not believe there is merit in underlining that the first task Maurice will undertake for you is Arun. The juxtaposition of these two developments would kindle fears/ expectations of another Morse/Narmada type of exercise, which I believe you would wish to avoid.

Best regards,

Gautam

ARUN

The project has a long history dating back 10 years. Even after the Bank made the decision to proceed with the project (after considerable internal debate) nearly two years ago, a number of developments have taken place. With the imminent issuance of the Inspection Panel's findings and the arrival of the new President, it is important that we reaffirm the decision to proceed with the project after taking account of all factors as they impact Nepal and the World Bank.

To do so, the President needs to satisfy himself on the following three critical questions:

1. Is the choice of Arun amongst alternatives for meeting Nepals' power needs still valid?

   Specific developments to be taken into account in answering this question include:

   a. Cost increase of $30/40 million for Arun.
   b. Higher level of readiness of alternatives.
   c. Political developments which signal improved prospects for the import option.
   d. Realism of cost overruns, time overruns incorporated into evaluation of alternatives.
   e. Environmental implications of Arun and of alternatives.

2. Can Arun be financed?

   Factors to be evaluated:

   a. External financing uncertainties - while in both Germany and Japan there is support at the technical level, at the political level, particularly in Germany, there is significant hesitation - instigated by domestic NGO opposition and reinforced by perception of lack of Nepalese "ownership".

   b. Domestic financing - will Nepal be able to generate the necessary counterpart funds? And at what costs in terms of swamping other critical expenditures on the social

sectors.

3. Is it likely that Arun can be implemented as designed in totality?

Given the institutional capacity constraints of the country, can a project which will be subject to intense scrutiny be implemented within tight tolerances? While major civil works and equipment will be let out to international contractors, other aspects depend heavily on Nepali capacity.

Is the level of Government "ownership" and willingness/ability to make difficult decisions undermined by its political weakness?

If the answers to these three central questions are affirmative, we then need to evaluate the issue in terms of impact on the Bank, and hence, the totality of its membership. This leads to two further questions:

4. What is the impact on the Bank of proceeding with this contentious project?

Even with a favorable outcome from the Inspection Panel, critics will continue to point to this project as an example of the Institution's proclivity towards large projects when valid smaller alternatives are available. Any difficulty with implementation (howsoever caused) will be used to underline this.

Could it become the lighting rod for those who for various reasons want to work against IDA? How large is this risk?

Is this the project where the case is so strong and principles to be upheld so central that we must take this risk?

5. What is the impact on the Bank and Nepal if we decide not to proceed with Arun and opt for alternatives?

What are the implications for Nepal being able to meet its power needs - in terms of cost and timeliness?

Would the Bank be seen by other borrowers and staff as abandoning our professionalism and bowing to NGO/US pressures? Would it signal to staff and countries that the Bank will shy away from every contentious project?

Message No.: 1322/1

THE WORLD BANK

Resident Mission in Nepal
SA2NP
DIRECT FAX NO.: (977-1) 228970

FACSIMILE TRANSMISSION FORM

Facsimile No. : 202 477 4510
Date : June 9, 1995

CONFIDENTIAL

CONFIDENTIAL

URGENT

Number of pages 2 *(including this page)*

From : Joe Manickavasagam, SA2NP

To : Mr. Heinz Vergin, Director, SA2DR

Copy : Mr. William Nickel, SA2CI
Company/Organization : The World Bank
City and Country : Washington D.C., U.S.A.
Re : Nepal - Political Situation - Continuation

DECLASSIFIED
MAY 17 2017
WBG ARCHIVES

1. Some dramatic events took place since yesterday. Late yesterday the King summoned Parliament to meet on June 25 in accordance with Clause 53(1) of Nepal's Constitution. This clause provides for the regular session of parliament; normally this is a routine formality. However, the announcement came only hours after the Nepali Congress - the main Opposition Party - petitioned the King in accordance with Clause 53(3) of the Constitution for a special session of Parliament to move a motion of no confidence against the present government led by the Communist Party of Nepal - UML faction. There is no significance in the sequence of events - as they are dependent on the time the requests are registered by the Palace Secretariat.

2. We have just learnt from reliable sources that the King in response to the petition by Nepali Congress has summoned parliament to a special session on June 16. We have also heard from a source that the Prime Minister is contemplating asking the King to dissolve parliament. At this stage we are treating this as a rumour. A Press Conference is scheduled by the Prime Minister for this evening, and we will know more.

3. In view of the above developments there are several possible outcomes. These are:

(a) The no-confidence motion is carried. In this event the King has the option to either ask the Opposition to form a coalition government or call for fresh elections. It is however, unlikely UML will give up power without elections and hence a coalition of non-UML parties may trigger ugly/unconstitutional events.

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MAY 17 2017
WBG ARCHIVES

1322/2

CONFIDENTIAL Message No.:

(b) The no-confidence motion is carried and a coalition is formed with UML participation - a rather ideal outcome.

(c) The no-confidence motion is not carried because NDP (RPP) supports UML.

4. Whatever the outcome, the next two weeks will be a period of some tension and great uncertainty. The government has apparently asked all travel of senior civil servants and ministers to be postponed. For example, a delegation led by the Vice-Chairman, NPC was to have left on Sunday for Manila to finalize Khimti Khola project. This has just been postponed. Further we have heard from reliable sources that the security forces including the military has been put on alert. Nonetheless, life in Kathmandu is continuing as normal, and there is no evidence for concern at this stage.

5. While it is still too early to form any firm conclusions, **Bank missions to Nepal for the next two weeks are unlikely to be very productive** as the entire government machinery will be involved in preparing for the parliamentary session on June 16. The IMF mission however, is planned for next week but there is some doubt whether it will take place. The IMF Res Rep is unsure, as one person arrived today. We are still hopeful by the end of June things would be OK for the Rural Water Supply mission. However, depending on events of the next few days we will provide advice in regard to the forestry mission scheduled for June 17.

Joe Manickavasagam

cc: Mr. William Nickel, SA2CI - Please share this fax with Divisions Departments Division Chiefs.

JManickavasagam:as

Original to be filed in: _____

If you experience any problems with this transmission, please call back as soon as possible.
Phone Nos. 226766, 226792, 226793 & 223761; Fax No. 225112; Telex No. 2228 INDEVA NP

THE WORLD BANK

Managing Director

Mr. Wolfensohn:

Jim:

Further to my note on items requiring follow up attached is a note on Housing in Gaza and Jordan.

The Regional Staff are available to meet you at your convenience.

GAUTAM S. KAJI

The World Bank
INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL DEVELOPMENT ASSOCIATION

Inder K. Sud
Director, Middle East Department
Middle East & North Africa Region

1818 H Street, N.W.
Washington, D.C. 20433
U.S.A.

Tel.: (202) 473-1190
Fax: (202) 477-1482

June 5, 1995

Mr. Kaji

Re: Housing in West Bank & Gaza and Jordan

Mr. Peres' proposal for the Bank to support the construction of 50,000 units of housing in West Bank & Gaza (WBG) and Jordan is not a very practical one, particularly if the assumption is that these need to be built on a crash basis by the public sector. Experience with public sector-provided housing has been poor in most countries: Public sector agencies often face serious capacity limits (in Jordan, the public agency responsible has been providing about 1,000 units per year); public housing invariably ends up providing subsidies to the middle and upper-income groups; and there is no hope of the public sector ever being able to make a dent in the housing situation of a country (Hong Kong is one notable exception but is a special case). There is no reason to believe that it would be any different in WBG or Jordan.

The Palestinian National Authority (PNA) has made a commitment to more and better housing, interpreted to mean building something in the public sector. We have been working with them to steer their thinking in the direction of getting the private sector to do this with public sector playing an enabling role. Proposals currently under consideration include the Bank helping set up a housing fund that can be used to provide liquidity support to commercial banks making mortgage loans. We are also exploring direct subsidy support for housing finance for the very low-income families. We expect the project to be ready within the next 8-12 months.

The housing situation in Jordan is not very acute. There has been considerable private investment in housing in the last several years, fueled particularly in 1991 by the Jordanians returning from the Gulf investing in housing. There is no apparent housing shortage but there is some evidence of crowding at the lower end of the income. The Government in Jordan only plays a modest role in housing. A public sector housing corporation is involved in housing construction (on a modest scale). The Government also provides subsidies through the housing bank. But the government is keen to move out of this area and to phase out subsidies. We are working with them on the possibility of setting up a secondary mortgage finance institution.

In neither case is there any likelihood of the Bank or the donors being able to mobilize funds to finance the scale of housing proposed by Mr. Peres.

Both places have a serious housing problem in the refugee camps. But this is a complex issue that can only be tackled once some political decisions are made about the status of the refugees. The most attractive option for these camps would be to provide infrastructure, titles to the land in-situ, and perhaps credit for upgrading of the dwellings.

Unfortunately, there are no quick fixes in this area. There is no short-cut but to get the housing market functioning supported by a housing finance system that can stimulate private investment. Domestic savings mobilization is the key.

Our suggested bottom line:

- Assure Mr. Peres that we indeed are giving priority to housing.
- Discourage him from thinking about any approaches that envisage public-sector involvement in construction or financing.
- Assure him that we are indeed working on these areas, with priority being given to the issue in WBG.

My colleagues and I are available to brief you and Mr. Wolfensohn further on this issue.

cc. Robert Mertz
Deane Jordan
Nigel Roberts
Caio Koch-Weser (o/r)

Through GK

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

June 2, 1995

Mr. James D. Wolfensohn

Jim,

This is to update you on things you wanted followed-up.

1. Regarding *Housing in Jordan and Gaza*. We are ready to brief you on what we know about the housing situation in general in both the areas, as well as housing finance, etc. I have asked Jane Holden to find us time on your calendar. A brief write-up to set the stage for the meeting will be available on Monday.

2. Regarding your desire to nominate a *group of Advisors from the private sector*. As you know, IFC already has a Business Advisory Council. (List of members is attached). We need to be careful not to trip into the Advisory Council as provided for in the Bank's Articles (Relevant extract attached) but which has never been established. Could we meet with Ibrahim Shihata when he is back on Monday to discuss what exactly you are contemplating and how we can structure it so that it does not get governments and other international organizations involved? Some Regions also have Advisory Councils (Listings attached)

3. *Maurice Strong*. There is no impediment to your asking him to be your advisor on a "pro bono" basis. However, if he is going to be traveling and carrying out specific missions for you, Legal would suggest that we bring him on our books as a consultant which would facilitate official visas, etc. Legal is also reviewing coverage under insurance arrangements, etc., particularly if he would be traveling at your behest.

4. Finally, regarding *clients' surveys*. Attached please find a precursor of the Africa Region's structured survey in terms of what we did in East Asia in 1994. This was part of our efforts to improve Bank- countries' relationships and effectiveness in terms of relevance, shared priorities and results. There has been significant follow-up on the issues validated in the client feedback and which I am sure you will be briefed on when you meet with the East Asia Region. Josie is getting a copy of the survey instrument used in the Africa initiative and the detailed survey reports on the countries. At the risk of being accused of defensiveness, it is important to note that the nature of the survey instrument, the diversity of the respondents in terms of their knowledge of the totality of the Bank's activities and interventions in a country would suggest caution in interpreting what those very dramatic numbers we saw this morning might suggest. In addition, in some areas, such as project preparation and implementation, the effectiveness of the Bank needs to be prefaced by asking questions on the effectiveness of the government. While surely we have a role to play, the bulk is the governments' responsibility. Having said that, there is no question that even in areas which we control such as appraisal, provision of analytical work, we take too long and do not communicate effectively. We present stuff in indigestible fashion and more often than not, we get so enamored by analytical purity that we pay very little attention to implementability on the ground. Deliberate efforts are being made in various pockets of the Bank to address these concerns. However, you are right in that we do not yet have a strong enough institutional push in these areas and that we may require a quantum leap forward as opposed to incremental steps. I would be happy to discuss this further with you.

Attachments

(d) In appointing the officers and staff the President shall, subject to the paramount importance of securing the highest standards of efficiency and of technical competence, pay due regard to the importance of recruiting personnel on as wide a geographical basis as possible.

Section 6. *Advisory Council*

(a) There shall be an Advisory Council of not less than seven persons selected by the Board of Governors including representatives of banking, commercial, industrial, labor, and agricultural interests, and with as wide a national representation as possible. In those fields where specialized international organizations exist, the members of the Council representative of those fields shall be selected in agreement with such organizations. The Council shall advise the Bank on matters of general policy. The Council shall meet annually and on such other occasions as the Bank may request.

(b) Councillors shall serve for two years and may be reappointed. They shall be paid their reasonable expenses incurred on behalf of the Bank.

Section 7. *Loan committees*

The committees required to report on loans under Article III, Section 4, shall be appointed by the Bank. Each such committee shall include an expert selected by the governor representing the member in whose territories the project is located and one or more members of the technical staff of the Bank.

Section 8. *Relationship to other international organizations*

(a) The Bank, within the terms of this Agreement, shall cooperate with any general international organization and with public international organizations having specialized responsibilities in related fields. Any arrangements for such cooperation which would involve a modification of any provision of this Agreement may be effected only after amendment to this Agreement under Article VIII.

(b) In making decisions on applications for loans or guarantees relating to matters directly within the competence of any international organization of the types specified in the preceding paragraph and participated in primarily by members of the Bank, the Bank shall give consideration to the views and recommendations of such organization.

Section 9. *Location of offices*

(a) The principal office of the Bank shall be located in the territory of the member holding the greatest number of shares.

(b) The Bank may establish agencies or branch offices in the territories of any member of the Bank.

Section 10. *Regional offices and councils*

(a) The Bank may establish regional offices and determine the location of, and the areas to be covered by, each regional office.

(b) Each regional office shall be advised by a regional council representative of the entire area and selected in such manner as the Bank may decide.

Section 11. *Depositories*

(a) Each member shall designate its central bank as a depository for all the Bank's holdings of its currency or, if it has no central bank, it shall designate such other institution as may be acceptable to the Bank.

IFC

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AFRICA REGION

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To: Hilde Peterss

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(MENA)
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Former Minister of State and Former Governor, Saudi Arabian Monetary Agency

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Former Minister of Planning & Development
Former Ambassador to the United Nations (Geneva)

**H.E. Abdul-Aziz Abdul-Ghani was a Council member until October, 1994 when he became Yemen's Prime Minister.*

H.E. Selim El-Hoss (Lebanon)
Member of Parliament
Former Professor of Economics at the American University of Beirut
Former Prime Minister, Minister of Education, Foreign Affairs, Labor; Banker.

Honorable **Mona Makram-Ebeid** (Egypt)
Professor of Political Science, American University of Cairo; Author;
Member of People's Assembly.

Dr. **Fatima Mernissi** (Morocco)
Professor of Sociology, Mohamad V University; Author.

Dr. **Hanan Mikhail-Ashrawi** (Palestinian Territories)
Commissioner General, The Palestine Independent Commission for Citizens' Rights
Former Spokesperson of the Palestine Delegation to the Peace Talks;
Former Dean, Faculty of Arts, Birzeit University

H.E. **Mohammed Sahnoun** (Algeria)
ICRC Fellow, Ottawa, Canada
Former Ambassador to Morocco and United States
Former National Security Adviser to the President.

H.E. **Leila Sharaf** (Jordan)
Member of the Senate
Former Minister of Information.

H.E. **Firouz Tofigh** (Iran)
Consultant;
Former Professor of Economics at Teheran University
Former Minister of Housing and Urban Development.

World Bank Staff:

Mr. **Abdallah Bouhabib**
Adviser to the Vice President, Senior External Affairs Counsellor, MENA
Former Ambassador of Lebanon to the United States
With the Bank from 1976-1983 and since 1992

Mr. **Andre Hovaguimian**
Director, Central Asia, Middle East and North Africa, IFC
Joined the Bank in 1974

Mr. **Tariq Husain**
Senior Operations Adviser, MENA
Former Resident Representative, Nigeria
Joined the Bank in 1966

Mr. **Khalid Ikram**
World Bank Resident Representative in Cairo
Former Division Chief, Country Operations, East Asia and Pacific Region

Joined the Bank in 1975

Mr. Jagannathan Murli
Chief Administrative Officer, MENA
Former Division Chief, Corporate Planning Division, Planning & Budgeting Department
Joined the Bank in 1977

Mr. John Page
Chief Economist, MENA
Former Senior Economic Adviser, Policy Research Department
Joined the Bank in 1980

Mr. Daniel Ritchie
Director, North Africa and Iran Departments, MENA
Former Director, Technical Department, South Asia/East Asia and Pacific
Joined the Bank in 1968

Mr. Anil Sood
Director, Technical Department, MENA/Europe & Central Asia (MENA/ECA TD)
Former Senior Advisor, Private Sector Development, MENA/ECA TD
Joined the Bank in 1975

Mr. Inder K. Sud
Director, Middle East Department, MENA
Former Director, Cofinancing & Financial Advisory Services
Joined the Bank in 1971

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A L L - I N - 1 N O T E

DATE: 02-Jun-1995 02:55pm

TO: Hilde Pieters (HILDE PIETERS)

FROM: Emilia Arriola, LACVP (EMILIA ARRIOLA)

EXT.: 37293

SUBJECT: RE: Advisory Council

Hilde,

In response to Mr. Kaji's request, the following are the members of LAC's External Advisory Group:

Mr. Andres Bianchi
Banco Continental Groupe Credit Lyonnais
Former President, Central Bank of Chile

Mr. Eduardo Escasany
President, Banco de Galicia y Buenos Aires

Mr. Peter Hakim
President, Inter-American Dialogue

Mr. Rudolf Homme
Visiting Scholar, Inter-american Development Bank
Former Minister of Finance of Colombia

Mr. Carlos Langoni
Director, Center for International Economy
Getulio Vargas Foundation
Former President, Central Bank of Brazil

Sir Alister McIntyre
Vice Chancellor, University of the West Indies
Former Deputy Director, UNCTAD

Mr. Moises Naim
Senior Associate, Carnegie Endowment for International Peace
Former Minister of Industry of Venezuela

CC: NINA SMITH (NINA SMITH @A1@WBWASH)
CC: AVITA DE LA CRUZ (AVITA DE LA CRUZ @A1@WBWASH)

THE WORLD BANK / IFC / MIGA

OFFICE MEMORANDUM

DATE: July 11, 1994

TO: EA1 Staff

FROM: Callisto Madavo, EA1DR

EXTENSION: 82856

SUBJECT: Business Process Innovation -- Client Feedback

As you know, two EA1 teams visited Laos, Malaysia, the Philippines and Thailand in June, 1994 to obtain our clients' reactions to the BPI recommendations and to gather broader views of our clients' perspectives of the Bank. The teams held discussions with government officials and representatives of other important segments in the four countries. The messages given to the teams are highly instructive and important for the Department's future work with our clients. A summary of the findings of the two teams is attached.

Attachment

Business Process Innovation (BPI)

Progress Report on Client Feedback

Introduction

1. The purpose of this note is to communicate feedback from the June 1994 mission by two teams to four of our borrowing countries (Laos, Malaysia, Philippines and Thailand). The mission's goal was twofold: to test BPI recommendations and to gather broader insights on clients' perspectives of the Bank. Within each country, the mission met with a range of stakeholders including central agencies, line ministries, NGOs, the private sector and the donor community. After completing the five day consultations, the teams reconvened to synthesize feedback and formulate recommendations. Section I of this note represents the key issues raised by clients, articulated from their perspective. Section II provides feedback on the specific BPI recommendations that would directly impact our clients.

2. All clients want more from the Bank, but they want more of a slightly different Bank. To meet country needs the Bank must change the way in which it works. While there was widespread support for the thrust of the BPI recommendations, there was also consensus that process changes alone are not enough. In order to be more effective, the Bank must be more responsive to country conditions. We should (i) work in genuine partnership with our client countries; and (ii) tailor services and processes to fit country needs.

I. Feedback on General Themes

Genuine Country/Bank Partnerships

3. Effective partnerships are considered the best means of achieving development impact. While the level of partnership will vary between countries, the characteristics of the relationship are consistent across countries. Partnership requires commitment, two-way communication and compromise. These traits are often lacking in country/Bank relations. It is felt that whereas the Bank often pretends to consult, in practice it often ignores objections and pursues Bank objectives single-mindedly. To build genuine partnerships, change is required in several areas:

- **Make more of an effort to understand clients**. Clients ask that the Bank learn more about them. Understanding country priorities, sensitivities, processes and capacity will make the Bank more effective. An effort to understand requires respect, and this is a stumbling block in country/Bank relations.

- **Deliver advice in a digestible and timely manner**. The quality of advice is generally considered high, but academic presentation, limited dissemination, lack of marketing and delayed delivery often undermine development impact. While the importance of technical skills is undisputed, clients stressed that these are not enough. Clients ask for more input from staff with practical experience in the fields in which they give advice.

- **Listen, don't impose**. The Bank should listen better to clients' perspectives. Communication seems to flow one way.

- **Personality matters.** Clients want the Bank to include the personal dimension in our recruiting and promotion policies. Specific attributes that are sought include respect, cultural sensitivity and ability to collaborate.

- **Personnel policies should reinforce the desired skill set.** Clients want more continuity in Bank staffing. Staff turnover is disruptive, and clients ask that the Bank reduce rotations and task reassignments. Changing policies on local consultants would improve the effectiveness of TA.

- **Adopt participatory approaches to all phases of Bank activity**. The client and the Bank should jointly define the roles and responsibilities of each partner. While recognizing the merits of participation, central oversight agencies are concerned about controlling the pace and nature of consultation.

- **Information technology can help reduce the distance from HQ.** While most countries are not ready for direct access, they were keen to use resident missions as an initial I.T. bridge. Clients suggested that RMB and RMP build capacity to support procurement/disbursement, provide electronic links to HQ, assist with CPM, and facilitate access to cross country experience (see below).

Tailor Services and Processes to Fit Country Needs

4. Not all countries were satisfied with the existing range of services or procedures. Client needs are different, both between and within countries, yet the Bank has a "one size fits all" approach. Clients want different types of services, modes of delivery and processes.

- **Customize services to suit the client.** In terms of lending, Bank terms are increasingly unattractive for some of the NICs. The currency pool is antiquated and countries have insufficient access to single currency loans. Clients also ask that the Bank de-link lending and ESW. In fact, there is growing demand for non-lending services such as TA funds, fee-based advice, capacity building and access to the Bank's international experience.

- **Adjust Bank schedule to fit with country schedule.** The Bank assumes that countries can and will adjust to its own schedule. While some compromise is necessary, the Bank should try to synchronize its scheduling with that of the client.

- **Help countries to build their own capacity.** The Bank could be more active and effective at capacity building. Many clients want help to be able to comply with Bank processes, particularly those that effect project implementation.

- **Improve access to Bank's global experience.** The Bank's international experience is highly valued, yet somewhat difficult to tap into. Clients ask that the Bank develop mechanisms (perhaps through I.T.) that make it easier to access its rich pool of data.

- **Facilitate South/South cooperation.** While the Bank's cross country experience is highly valued, many clients think that resources (ranging from TA to lessons learned) drawn from within the region are often most effective. The Bank is in a strong position to facilitate this information flow, and clients ask that the Bank actively encourage it.

- **Systematically seek and use client feedback.** Clients appreciated being asked for feedback and suggest that this loop be built into Bank processes. Monitoring client satisfaction - with both services and processes - will enable the Bank to adjust to client needs. Clients understand that the Bank cannot acknowledge every input, but some response is critical to retain creditability.

Summary

5. To enhance development impact, the Bank must change more than business processes. While the BPI initiative was perceived as a step in the right direction, clients were quite articulate about the need for widespread reform. Clients supported the Bank's goal of strengthening development impact, but the strategy and structure of the Bank must align with this goal. At present, they do not. Clients feel that the Bank has no longer a clear sense of purpose: there are too many sub-goals being imposed by shareholders on all borrowers including non-IDA recipients. Our clients believe that the BPI recommendations can only yield substantive results if the Bank tackles these deep-rooted issues.

II. Feedback on Specific BPI Recommendations

A. Country Assistance Strategy: quality through client involvement

6. There was widespread endorsement for greater client involvement in the CAS process--early in-country workshops; early opportunity to comment on the CAS draft; periodic mid-term evaluation and adjustments--wherever this was tested[1]. Central ministries in particular saw this as an opportunity to better align country economic and investment priorities with Bank assistance, and limit supply driven Bank activity (Phil, Thai). Laos strongly endorsed the idea of a more participative CAS, but requested Bank assistance in preparing for it.

7. While supportive of the concept of more collaboration, clients:

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[1] The idea was not pursued in Malaysia, since the dominance of the central agencies and the small Bank program already result in effective coordination.

* stressed that the timing of workshops should be linked to country calendars--eg. the budget cycle; formulation of medium-term public investment programs--rather than internal Bank criteria.

* were often cautious about widening the CAS interface to the private sector, NGOs, and other donors.

* stressed the risks of not listening to country views or acknowledging unresolved differences.

B. Economic and Sector Work

8. **Enhance impact through participation.** Clients agreed that participating in ESW would be beneficial. But since human resources are limited, nonparticipation should not be construed as a lack of interest. In particular there was little enthusiasm for applying a "market test" in a rigid manner. All clients viewed Bank ESW as a privilege of membership. Malaysia and Thailand felt that they were "paying" for ESW indirectly, by borrowing from the Bank at the Bank's terms. The Philippines and Thailand were quite enthusiastic about client-initiated ESW, in which the Bank plays a supportive role.

9. **Make ESW more user friendly**. Countries welcomed the idea of making ESW more user friendly and adopting different modes of dissemination. But they were also very appreciative of existing products. Thus widening the menu would be appreciated, but not at the expense of existing ESW that in some cases they obviously value highly. Each country valued the Bank's ability to bring in cross-country experiences at short notice, and asked for more such analysis. The usefulness of quick, short notes on specific policy issues as well as regular economic monitoring was emphasized in the Philippines.

C. Lending

10. **Client prepares Project Implementation Plan (PIP).** All clients supported the concept. However, they cautioned that Bank assistance will be needed to build up capability of weaker implementing agencies for project preparation. Hence, there was emphasis on joint responsibility and only a gradual withdrawal of Bank from preparation process. Adequate Bank assistance (and resources) to complement and develop client capabilities was seen as essential. In order to clarify their respective roles, the Bank and client should agree on a Project Preparation Plan (PPP) with the objectives of: (a) clarifying Bank and client responsibilities; (b) including client project implementation staff in project preparation; (c) identifying client's TA needs ; (d) determining a realistic schedule; and (e) estimating costs. The PPP would not commit either the client or the Bank to approve the final project proposal.

11. **More Use of Pilot and Demonstration Projects (PDPs).** Clients supported the idea of using PDPs for exploring innovative approaches to address high priority issues (such

as local government funding in Philippines). However, they expected a clear definition of the concept and a strong say in the selection of pilots.

12. However, clients would be willing to borrow for PDPs only to address high priority issues. Typically, they expected soft financing or some form of "shared risk" with the Bank. Client's internal reviews, even for demonstration projects, could be as cumbersome as for large projects and hence delay implementation (e.g. ICC in PHL). It was noted that other donors may have a comparative advantage over the Bank to implement PDPs (access to grant funding/TA), especially for poorer countries.

13. **More use of negotiations in the field and by fax.** Clients welcomed more flexibility in using alternatives to formal negotiations at HQ, which is already current practice for their ADB borrowing. However, central ministries emphasized the value of formal negotiations for the government team to reach consensus on project issues among various government agencies.

14. **Streamline legal documents and increased use of side-letters for implementation related conditionality.** Client response was mixed, welcoming simpler legal documents with less specific conditionality, which allows for more flexibility and adjustments during implementation, but emphasizing the usefulness of some rigidity in implementation arrangements to discipline implementing agencies.

D. Portfolio Management

15. **Results on the ground**. In all four countries, officials consulted felt that supervision (SPN) is essentially carried out from the Bank's perspective. For instance:

* The timing of missions is "dictated" by Washington; it should be agreed on the basis of country or project needs (Mal., Laos);

* Compliance with Bank Guidelines, standards and reporting requirements tends to be the dominant concern during missions. At least Laos and the Philippines would want to receive more, higher quality implementation assistance. In particular, NEDA would like to see more frequent SPN missions and routine sharing of Aide-memoires;

* Aide-memoires, the key document in SPN, are not always used effectively as tools for management/communications and support. They should be less wordy and more action-oriented, e.g., show more clearly what are the next steps. They should at least record diverging views and be fully discussed/agreed with Government. The practice of unilateral revision in HQ and long waiting periods before the final Aide-memoire is received reduces its operational value and should be abandoned (Laos, Thai.).

* Too many decisions remain centralized in Washington (procurement, project reviews), slowing down implementation and depriving the concerned agency of a

chance for a fair hearing or an opportunity to learn. These should be brought closer to the field. When decisions are sought from HQ, the response time may be up to several months, and should be sharply reduced.

* The lack of continuity in Task Managers was frequently mentioned as contributing to slow implementation.

16. **Client involvement**

* All our interlocutors welcomed the proposed move towards more participatory supervision.

* Both the Philippines and Laos cautioned that they need to build their implementation capacity. The concept of a free-standing operation that would strengthen core and line Ministry supervision/monitoring capabilities, and improve procurement, disbursements, accounting and auditing systems was accepted in the Philippines, where CCPAP volunteered to be the project's institutional locus. In Laos, it will require a brokering effort.

17. **Proximity to the client**

* Implicitly, the Laotians made a compelling case for opening a small RM in Vientiane, based on the felt need to contextualize Bank interventions, improve relations with Washington, and provide implementation support.

* The Thais were interested in upgrading the Bank's RM into a "hub" that would (a) have review authority in procurement, (b) process corresponding disbursement requests (possibly electronically as proposed under BPI) and have access to loan disbursement data bases, (c) provide support to the three Indochina countries in these areas, and (d) promote South-South cooperation (consultant roster, dissemination of lessons of cross-country experience).

* The Philippines, the only country where IT has been used to support participatory project work, was appreciative of the Computerized Project Management and Geographic Information System softwares. Depending on the cost, Thailand would be interested in the idea of on-line access to All-in-one, shared data-bases and an interactive MIS that would serve the needs of core and line agencies and Bank staff/managers.

18. **Customized Procurement and Disbursement**. Although all countries had grievances in these two areas, the two NICs were particularly vocal in their criticisms (procurement guidelines that reflect mainly Part I country interests; rigidities; slow response; lack of trust). Malaysia was keenly interested in a more flexible procurement process, such as the pilot proposed by the BPI team, that would raise the threshold for, or eliminate mandatory ex-ante reviews and replace them by selective ex-post audits, in recognition of its more advanced institutional/ regulatory frameworks. Thailand wanted delegation of

procurement review authority to its RM. The desirability of standardizing LCB documents was recognized.

19. **Feeding back the lessons of experience though normal business processes.** The four countries were unanimous in requesting more systematic dissemination of the lessons of experience, be it from a sequence of projects or from cross-country development research.

* Clients reiterated the message given at the Wapenhans workshop, namely that the perceived usefulness of, and local interest in, the PCR are limited.

* The CPPR discussions highlighted the potential and conditions for success. The exercise was described as "mechanistic" in Malaysia. In Laos, the very thorough CPPR conducted a year ago has hardly had any impact for lack of systematic follow-up. By contrast, in the Philippines the RM has played a major role in this, to the satisfaction of both parties.

To: Mr. Callisto Madavo, Director, EA1DR

Copy: Mr. Walter Schwermer, Project Advisor, EA1

From: M. Sheppard, K. von Ritter, O. Nyanin, F. Delannoy, S. Dhar, B. Babson and J. Shivakumar

Subject: BPI Phase II - Client Consultations - Mission Report

Purpose of Mission[1]

1. The mission sought the views of four borrowing countries (Laos, Thailand, Malaysia and Philippines) on the specific recommendations of Business Process Innovation (BPI) second phase, set in the context of the broader client perceptions of the Bank's development effectiveness. The output of the mission is a report to EA1 Director and BPI Phase II Team Leader on the client responses and its implications for BPI.

Mission Modus Operandi

2. Having selected a diverse set of clients to consult with, the mission interacted with a wide range of stakeholders within each country. Borrower officials at policy and project levels, NGO's, persons who had past experience dealing closely with the Bank and donor reprsentatives were consulted. A list of persons met and meetings held is attached. The mission split into two teams; [1] one visited Malaysia and Philippines; the other Laos and Thailand. After the five day consultations were over, the two teams merged and held internal discussions in Bangkok for two days to analyze and synthesize the feedback received, formulate recommendations and prepare the mission report.

3. The discussion with the clients focussed on three of the eight guiding principles of the BPI viz: Client Orientation, Quality and Flexibility. Internal Bank issues such as clarity of purpose and role, supportive effective Management, accountability, efficiency and incentives were not directly addressed. However, clients emphasized time and again that the mission of the Bank had been diluted and required renewed emphasis.

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[1] The teams were: Malaysia and Philippines: J. Shivakumar, S. Dhar and K. von Ritter; Laos and Thailand: B. Babson, F. Delannoy and M. Sheppard. Mr. Ohene of RMP joined the mission during the Philippines visit and the Bangkok discussions.

Structure of the Report

4. The report is presented in four sections. The first section reports on the main themes emerging from the client visits. The second section deals with specific feedback on BPI Phase II recommendations. The third section points out some of the organizational implications emerging from the consultations, and finally, the last section summarizes the main messages of the report.

I. Client Feedback: General Themes

This section lists the main issues raised by clients as articulated from their perspective.

The Bank's effectiveness stems from several sources. The Bank is objective. This boosts credibility and, consequently, the effectiveness with which the Bank mobilises and delivers resources. Clients value the technical expertise, analytical and policy advice, and cross-country experience. They appreciate our contribution to capacity building and technology transfer. Finally, in terms of funding, the Bank can efficiently mobilise loans and grants.

Nonetheless, there is considerable scope for improvement. When developing country strategies, the Bank seldom involves Government in a meaningful way. Consequently, ownership is one-sided and strategies are less effective. This was less true in the Philippines, where the collaborative programming introduced was seen to make a difference. There was frequent praise for existing ESW. Quality is consistently high, content is useful and the major area for improvement was dissemination. Lending operations are satisfactory in terms of design and packaging. However, clients were keen for better terms and more diversified financial instruments. Supervision was widely criticised. Rigid regulations and procedures make compliance difficult, and this is exacerbated by the lack of implementation assistance.

The Bank needs to be more responsive to country conditions. To pursue this strategy, the Bank should get closer to its clients. Working in partnership was proposed as the most effective way to achieve this goal. However, this mode of operations requires a substantial change in the Bank - well beyond business processes.

Services should be customised to suit country needs. No country was satisfied with the existing range of services. Client needs are different, both between and within countries, yet the Bank does not seem to recognise or be able to respond to diversity. Clients want different types of services and modes of delivery. In terms of lending, Bank terms are uncompetitive for some countries (e.g. high interest rates and structure of commitment fees). The currency pool is antiquated and preempts opportunities for exposure

management. Clients also want the bank to de-link lending and ESW. In fact, there is growing demand for non-lending services, such as technical assistance funds, fee based advice, capacity building and access to the Bank's international experience.

An effective partnership was considered the best means of achieving development impact. While the level of partnership will vary between countries, the characteristics of the relationship were consistent. Working as partners requires commitment, investment and compromise. Clients felt these traits were often lacking in bank/country relations. Whereas the Bank pretends to consult, in practice, it often arrogantly ignores objections and pursues Bank objectives single-mindedly. This characteristic is evident in all phases of Bank activity, from strategy development through supervision. To build an effective partnership, the Bank must change the way it works.

Make more of an effort to understand clients. Countries want the Bank to communicate more effectively. The Bank asks but seldom listens to the clients' perspectives. Conflict is quashed and the Bank's perspective portrayed as consensus, often when it is not. Clients also asked that the Bank learn more about them. Understanding country priorities, sensitivities, processes and capacity will enable the Bank to operate more effectively. While the Bank need not agree, it does need to understand the country's position and reasons for it. An effort to understand requires respect, and this was perceived as a stumbling block in Bank/country relations.

Adjust Bank schedule to fit with country schedule. The Bank assumes that countries can and will adjust to its own schedule. While some compromise is necessary, the Bank should try synchronise its scheduling with that of the client.

Help countries to build their own capacity. The Bank should continue to provide quality advice and information in order to build client capacity. Adjust the skill set to suit country needs. While traditionally strong on technical skills, the Bank needs to build capacity for integrated and strategic approaches. Clients also want assistance complying to Bank processes, particularly in implementation. Countries also asked the Bank to take an indirect role as an information broker. Help countries tap into the Bank's rich, cross-country experience and facilitate south/south communication.

Deliver advice in a digestible and timely manner. The quality of advice is generally considered high, but academic presentation, limited dissemination, lack of marketing and delayed delivery often undermine the development impact. While the importance of technical skills is undisputed, clients stressed that these are not enough.

Personality matters - sometimes more than technical qualifications. The Bank is not perceived as valuing the human element of TA. Clients want to include this personal dimension in our recruiting and promotion policies. Specific characteristics that were sought include respect (less arrogance), cultural sensitivity (less paternalism), and collaboration (not substitution).

Adopt participatory approaches to all phases of Bank activities. The Bank and client should jointly define the roles and responsibilities of each partner. While keen for more responsibility, clients recognise that they have limited capacity and want the bank to provide assistance where capacity is lacking.

Adjust policies on staff and consultants to suit country needs. Clients want more continuity in Bank staffing. Staff turnover is disruptive, and the rotation policy is costly. Changing policies on local consultants would improve the effectiveness of TA, as would more information earlier in the selection process.

Systematically seek and use client feedback. Clients appreciate being asked for feedback and suggest that this loop be built into Bank processes and performed on a regular basis. Monitoring client satisfaction will enable the Bank to adjust to client needs. Clients understand that the Bank cannot conform to every input, but some response is critical to retain credibility.

To achieve development impact, Bank must change more than processes. While the BPI initiative was perceived as a step in the right direction, it is not enough. Clients supported the Bank's goal of making a development impact, but the strategy and structure must align with this goal. At present, they do not. To achieve sustainable results, the BPI exercise must be followed by broader changes in the Bank.

II. Client Feedback: Specific BPI Recommendations

A. Country Assistance Strategy: quality through client involvement

There was widespread enthusiasm for greater client involvement in the CAS process--early in-country workshops; early opportunity to comment on the CAS draft; periodic mid-term evaluation and adjustment.[2] Central ministries in particular saw this as an

[2]The idea was not pursued in Malaysia, since the dominance of the central agencies and small Bank program already result in effective coordination.

opportunity to better align country economic and investment priorities with Bank assistance, and limit supply driven Bank activity (Phil, Thai). Laos strongly endorsed the idea of a participative CAS, but requested Bank assistance in preparing for it.

Pre-CAS Assistance. Surprisingly, Thailand also expressed interest in pre-CAS assistance in terms of dialogue with the Bank on development strategies and priorities (inputs into 8th plan; social sectors).

Timing. The CAS (and the workshops) should be linked to country calenders--eg. the budget cycle; formulation of medium-term public investment programs-- rather than internal Bank criteria. Programming missions should be part of the CAS process (of evaluation and adjustments--Phil, Laos) and appropriately synchronized.

Scope of Participation. The dominant view was: proceed cautiously, ie. initially limit to Government (central and line agencies) before widening to include the private sector or other donors.

Image. Philippines considered CAS involvement as an opportunity to improve the Bank's image.

Risks. There would be negative repercussions if country comments were not reflected and the document did not acknowledge country/Bank differences (Thai). Philippines in particular was concerned about negative press coverage of politically sensitive issues.

Mission Comments. The participative CAS process should be pursued in Laos, Philippines, Thailand--these countries are clearly appreciative of our efforts in this direction. Particularly during the introductory phases, careful management of expectations as well as the workshops themselves will be needed.

B. Economic and Sector Work

Enhance impact through participation. Clients agreed that participating in ESW would be beneficial. But since human resources are limited, nonparticipation should not be construed as a lack of interest. In particular there was little enthusiasm for applying a "market test" in a rigid manner. Some clients viewed Bank ESW as a privelege of membership.

Malaysia and Thailand resent the current linkage of ESW to the maintainance of borrowing from the Bank. Since borrowing

terms from the Bank are currently noncompetitive, they are already "paying" for ESW.

Thailand might be prepared to accept fee-based ESW/advice if there is de-linkage with lending. Laos viewed participation in Bank ESW as good training for its officials, but questioned the value-added of their contribution.

ESW appears entirely demand driven in Malaysia, where the consultation process works well, and the authorities routinely request specific thematic CEMs and sector work.

Philippines and Thailand were quite enthusastic about client-initiated ESW, in which the Bank plays a supportive role.

Make ESW more user friendly. Countries welcomed the idea of making ESW more user friendly and adopting different modes of dissemination. But they were also very appreciative of existing products. Thus widening the menu would be appreciated, but not at the expense of existing ESW. Each country valued the Bank's ability to bring in cross-country experiences at short notice, and asked for more such analysis.

The usefulness of quick, short notes on specific policy issues as well as regular economic monitoring was emphasized in the Philippines. Laos was less aware that informal ESW was an option.

Clients reinforced our view that dissemination to the primary audience should be enhanced beyond green cover discussions. However, in Malaysia, this would be appropriate only after cabinet approval of the report.

Malaysia has also internalized the Bank's turnaround times, which are hence not viewed as particularly burdensome.

Mission Comments. Enhancing greater client participation in ESW was supported. The lack of enthusiasm for a rigid test for the Bank to proceed is not surprising, since the existing product is either viewed as free and a right, or one that is already paid for indirectly. Efforts to limit supply driven ESW are still needed, but tests of client committment should be a tool for decision-making, and not applied rigidly.

Widening the menu of ESW may be appropriate, particularly in the Philippines and Thailand. But we should be careful about tinkering with a product that is already highly valued.

C. Lending Subprocess[3]

1. The main recommendations regarding the lending subprocess are:

(a) client ownership: make client responsible for preparation of a PIP and thereby increase the client's role in project design and preparation, and

(b) flexibility: customize Bank processes (e.g negotiations) and products (pilot and demonstration projects) to client needs.

The following reactions to these recommendations were received from the clients.

2. Client prepares Project Implementation Plan (PIP). In general, all clients supported the concept, however cautioned that Bank assistance will be needed to build up capability of weaker implementing agencies for project preparation. Hence, there was emphasis on joint responsibility and only a gradual withdrawal of Bank from preparation process.

Endorsement: Sophisticated borrowers (e.g. DBP) already prepare projects as standard practice for other donors; welcome an increased responsibility for project design.

Reservations: Weaker clients point out their limitations in staff and resources and see risk of delays in project preparation. Hence the need for adequate Bank assistance and shared responsibilities.

Conditions of Success: Project Preparation Plan (PPP); In order to clarify their respective roles, Bank and client would mutually agree on a PPP with the purpose to: (a) clarify responsibilities of Bank and client in project preparation; (b) invite project implementation staff of client in project preparation; (c) identify TA needs of client; (d) determine a realistic schedule; and (e) estimate costs. The PPP would not commit either the client nor the Bank to approve the final project proposal.

[The format of the PPP should be flexible and adjust to specific project needs. We suggest, a draft PPP would be reviewed at the Concept Review

[3]The format adopted for the discussion on lending reflects the discrete nature of BPI recommendations in this area.

Meeting (first decision point) and would form the basis for resource allocation.]

Adequate Bank Assistance (and resources) to complement and develop client's capabilities. Clients saw Bank's relative strength in preparation typically in the following areas: (i) technical assistance to build client's capability for project design; (ii) packaging: convert strategies in actionable projects; (iii) advise on policy framework; (iv) transfer of technologies and know how; (v) mobilization of resources.

As clients develop their capability, they would assume responsibility for the above areas, in addition to: (vi) building consensus and support among stakeholders, including participation of non-government groups; (vii) developing institutional framework; (viii) preparing project details, including the project implementation plan.

3. More Use of Pilot and Demonstration Projects (PDP). Generally, clients in the PHL supported the idea of using PDPs for exploring innovative approaches to address high priority issues (such as local government funding in PHL), however expected clearer definition of the concept and a strong say in the selection of pilots.

Endorsement: DOF (PHL) supported the idea on several grounds: (a) limit risk when exploring new approaches; (b) reduce risk of paying commitment fees for slow disbursing projects with complex designs (e.g. cottage enterprise). Volume could average around US$5 million.

Thailand expressed interest in a related proposal of time-sliced sector lending whereby the Bank would finance annual investment programs within a previously agreed sector program. Thailand would expect to thereby reduce commitment fees.

Selection of pilots would be primary client responsibility and should be discussed during CAS and programming missions.

Reservations: Clients willing to borrow only to address high priority issues they have selected. Typically, expect soft financing or 'shared risk' with Bank. Client's internal reviews, even for demonstration projects, could be as cumbersome as for large projects and delay implementaion (e.g. ICC in PHL). Other donors may have comparative advantage over

Bank to implement PDPs (access to grant funding/TA), especially for poorer countries.

Conditions of Success: Concept and criteria for PDP clarified; informed selection of pilots with good likelihood of success;

Bank internal approval process for PDPs facilitated; e.g. generic Board approval during CAS discussion and delegation of specific approval to RVP; or piggy-backing on regular projects;

Some soft funding can be mobilized from donors.

4. More use of negotiations in the field and by fax. In general, clients welcomed more flexibility in using alternatives to formal negotiations at HQ, which is already current practice for their ADB borrowing, however central ministries emphasized value added of formal negotiations for government team to reach consensus on project issues among various Government agencies.

Endorsement: In case of repeater projects or thorough preparation, clients (particular line agencies) generally welcomed the possibility to save costs and time by skipping formal negotiations.

Reservations: central ministries (PHL) pointed out usefulness of negotiations 'as a kind of a retreat' to focus on project, ensure consistency with country policies, and come to closure, specifically for projects with complex conditionalities.

Conditions of Success Clear criteria when to use which type of negotiation;

Bank management decides during decision meeting (2nd decision point) on modality; should consult borrower informally; [formal consultation would entail delays].

Effort to resolve issues upstream;

Effective internal clearance process between central and line agencies; [Note: emphasis of central ministries on need for formal negotiations reflects lack or difficulty of consultation with line agencies in earlier project stages, e.g. in Thailand and the Philippines].

5. Streamline legal documents and increased use of side-letters for implementation related conditionality. Client's response was mixed, welcoming on the one hand simpler legal documents with less specific conditionality which allow more flexibility or adjustments during implementation, but emphasizing on the other hand the usefulness of some rigidity in implementation arrangements to discipline implementing agencies. Regarding Bank lawyers, clients complained about (a) lack of continuity (fast turn over), (b) lack of consistency among lawyers, (c) the lack of familiarity of some Bank lawyers with country's laws, and (d) the dominance of lawyers in final stages of project preparation ("it becomes a lawyer's project).

D. Portfolio Management

1. The main recommendations regarding Portfolio Management were: (a) **"results-on-the-ground"**: focus more on implementation assistance and shift to an action & support mode; (b) **client involvement**: more participatory approaches, Implementation Capacity-Building free-standing projects; (c) **proximity to clients**: expanded role for Resident Missions and use of I.T.; (d) **flexibility**: where applicable, streamline processes especially in procurement and disbursement; and (e) **feedback through normal business processes**.

2. **Results on the ground**. In all four countries, officials consulted felt that supervision (SPN) is essentially carried out from the Bank's perspective. For instance:

* The timing of missions is "dictated" by Washington; it should be agreed on the basis of country or project needs (Mal., Laos);

* During missions, compliance with Bank Guidelines, standards and reporting requirements tends to be the dominant concern (all). This raises the question of whether these standards are unnecessarily stringent (cf below) and how best can the Bank help the countries meet them. At least Laos and the Philippines would want to receive more, higher quality implementation assistance. In particular, NEDA would like to see more frequent SPN missions and routine sharing of Aide-memoires;

* Aide-Memoires, the key document in SPN, are not always used effectively as tools for management/communications and support. They should be less wordy and more action-oriented, e.g., show more clearly what are the next steps. They should at least record diverging views and be fully discussed/agreed with Government. The practice of unilateral revision in HQ and long waiting periods before the final Aide-memoire is received reduces its operational value and should be abandoned (Laos, Thai.).

* Too many decisions remain centralized in Washington (procurement, project reviews), slowing down implementation and depriving the concerned agency of a chance for a fair hearing or an opportunity to learn. These should be brought closer to the field (all). When decisions are sought from HQ, the response time may be up to several months. It should be reduced and the reply should be clear, practical, and actionable (mainly Laos).

* The lack of continuity in Task Managers was frequently mentionned as contributing to slow implementation.

Mission's comment: The above points confirm the diagnosis of the BPI team. While some of these recommendations (such as decentralization or reduced control) have strategic and budgetary implications, many have to do with changes in attitudes and operating mode and offer scope for quick wins.

2. **Client involvement**

* All our interlocutors welcomed the proposed move towards more participatory supervision.

* Both the Philippines and Laos cautioned that they need to build their implementation capacity. The concept of a free-standing operation that would strengthen core and line Ministry supervision/monitoring capabilities, and improve procurement, disbursements, accounting and auditing systems was accepted in the Philippines, where CCPAP volunteered to be the project's institutional locus. In Laos, it will require a brokering effort.

Mission's comments: (a) As pointed out earlier, the benefits of participatory tools will only be realized to the extent that the Bank is genuinely committed to hearing its clients; (b) it is within EA1's mandate to follow-up with the two Capacity - Building projects.

3. **Proximity to the client**

* Implicitly, the Laotians made a compelling case for opening a small RM in Vientiane, based on the felt need to contextualize Bank interventions, improve relations with Washington, and provide implementation support.

* The Thais were interested in upgrading the Bank's RM into a "hub" that would (a) have review authority in procurement, (b) have authority to process corresponding disbursement requests (possibly electronically as proposed under BPI) and have access to loan disbursement data bases, (c) provide support to the three Indochina countries in these areas, and (d) promote South-South

cooperation (consultant roster, dissemination of lessons of cross-country experience). At a minimum, they would want (a) and (b).

* Regarding technology, the Philippines, the only country where IT has been used to support participatory project work, was very appreciative of the Computerized Project Management and Geographic Information System softwares. Depending on the cost, Thailand would be interested in the idea of on-line access to All-in-one, shared data-bases and an interactive MIS that would serve the needs of core and line agencies and Bank staff/managers.

Mission's comments: The justification for upgrading the Bangkok RM into a hub will depend on the approach taken to customize procurement processes in Thailand: if we chose to eliminate mandatory prior reviews, as proposed by the BPI team (see below), the procurement capacity would only be required to support the Indochina programs, and the hub could be anywhere in the region (see Nyanin's note on RMs at the end of this report).

3. **Customized Procurement and Disbursement**. Although all countries had grievances in these two areas, the two NICs were particularly vocal in their criticisms ("Procurement is biased towards Part I/large suppliers"..."The thresholds are too low, procedures are too rigid and complex" ..."Bank's response time can be longer than our own approval process". In disbursement, "the Bank does not trust us"..."we are interrogated... as if we were crooks"... "we feel belittled".). Malaysia was keenly interested in a more flexible procurement process, such as the pilot proposed by the BPI team, that would raise the threshold for, or eliminate mandatory ex-ante reviews and replace them by selective ex-post audits, in recognition of its more advanced institutional/ regulatory frameworks. Thailand wanted delegation of procurement review authority to its RM. It also liked the idea of using the RM to pilot the new softwares developped by the Loan Department to accelerate and monitor disbursements. The Philippines had similar aspirations, but on a national scale. The desirability of standardizing LCB documents was broadly recognized.

Mission's comments: The appropriate balance between flexibility and control will have to be determined in consultation with OPRPR and LOOA on a case-by-case basis, in light of risks, transaction volume, costs, etc. In Thailand, the procurement climate was highly sensitive and the mission refrained from giving details on the proposed pilot to avoid creating expectations. However, we feel that it would be worth exploring there as Malaysia.

4. **Feeding back the lessons of experience though normal business processes**. The four countries were unanimous in requesting more systematic dissemination of the lessons of experience, be it across projects or countries. The issue is how best to deliver these

reviews. Already, thematic reviews are being conducted each year by NEDA.

* The clients reiterated the message given at the Wapenhans workshop, namely that the perceived usefulness of, and local interest in, the Project Completion Report are limited.

* The CPPR discussions reflected a wide range of experiences which highlighted the potential of this tool, and conditions for its successful use. Three CPPRs were prepared last year, all according to high standards. The exercise was described as "mechanistic" in Malaysia. In Laos, it has had a limited impact for lack of systematic follow-up. By contrast, in the Philippines, the RM has played a major role in the follow-up, to the satisfaction of both parties.

Mission's comments: The lack of local support for the PCR/ICR raises the question of how realistic is the expectation that countries will produce an operation plan for the newly introduced ICR. It also puts on the Bank the onus of ensuring that the feedback loop is present, possibly by using local consultants and a workshop format to discuss the lessons at the time of the CAS or at the design stage of a new project. As for the CPPR, it illustrates the contribution the RM can make to trouble-shooting and implementation support.

III. Some Organizational Implications

To meet client expectations in regard to developing a Bank - Country partnership and being more responsive to the local context it is necessary to strengthen the country management function at headquarters, improve the effectiveness of Resident Missions and upgrade information technology applications in RMB and RMP.

The Country Management functions at headquarters would require strengthening with a view to improve:

(i) CAS quality through client participation;

(ii) country programing (CESW, lending, portfolio management aid coordination and technical assistance), linking budgetary resources to outputs;

(iv) the CPPR process to get results on ground and

(v) Country - Bank relationships and headquarters aspects of Resident Missions management and administration.

The Resident Missions need to be strengthened in the area of

implementation support through the placement of international and local staff to cater to the countries, and specifically the needs of Indo-China. The focus would be on implementation aspects such as procurement, disbursement, accounts and audit, support to project management (including CPM) and the speeding up of Bank decisions on routine project matters, besides of course building client capability.

RMB and RMP would need to be strengthened to serve as centers for use of information technology to improve communication between client agencies and the Bank on policy and operational matters, including access to the Bank's information base.

IV. Summary of Main Messages

- Bank process innovations, recommended by Phase II of the BPI study, were well received by the four clients (borrowing countries) covered by the mission. The proposals were endorsed as sound steps in the right direction.

- Our clients contributed in a significant way to assessing the merits and risks of specific recommendations. They assisted the mission in developing improvements to several of these recommendations.

- The expectations of our Clients on what the Bank can provide is high. While this on one hand reflects the reputation and confidence the Bank enjoys in these countries, it also generates disappointment with the level of actual services provided by the Bank. Our Clients are not appreciative of the constraints imposed by the size of the Bank's budget and by the Bank's fiduciary responsibilities to its shareholders.

- The range of countries covered by the mission, viz Thailand, Malaysia, Philippines and Laos provided diversity in regard to level of development, country capacity, intensity of Bank involvement and cultural, social and political factors. However, there was remarkable consensus among the clients on the assessment of the Bank's strengths and weaknesses. All the clients pressed for closer involvement with the Bank and stressed the importance of customizing and diversifying the Bank's product range to make this happen. A greater role by the Bank in local capacity development and transfer of global experience were stressed by all the borrowers.

- The role of the Bank in transferring financial resources is one area where client views did not converge. The

NIC's do not highly value such transfers as they have other options. They recourse to it as a means of obtaining non-financial value-added from the Bank. Thailand pressed for new financial products more suited to its requirements. Malaysia sees borrowing from the Bank as the price that has to be paid for obtaining Bank support for analytical work, policy advice and capacity building.

- The Bank's CESW work is highly valued for its objectivity, technical excellence and reflection of cross-country experience.

- The Bank's lending operations are valued for their contribution to mobilization of external resources and their packaging of investments within a carefully developed framework. The technology transfer impact of these operations received mixed reviews.

- The Banks supervision effectiveness was less appreciated. Our clients are not fully satisfied with the implementation support received from the Bank. This compounds problems created by cumbersome procurement and disbursement procedures and complex accounting and reporting arrangements, mandated under Bank operations.

- Our clients believe that the Bank is not sufficiently responsive to local conditions. Bank procedures have the "one size fits all" characteristic and do not recognize differences in country capacities and needs. The need for customized products and procedures was stressed time and again.

- The need to build effective Client-Bank partnerships was emphasized repeatedly. The importance of client participation, two way communication between the Bank and the Client, greater sensitivity of Bank Staff and consultants to social, cultural and political conditions in the country and better interpersonal relationships were the points stressed by the Clients. The lack of continuity of Bank staff came in for particularly severe criticism, since Bank staff were frequently on the learning curve in regard to the country and sector situation at the expense of the clients time and patience.

- The themes of promoting greater trust, delegation, empowerment, and accountably and reducing the rigidity of the clearance processes stressed by Task managers to Bank's Management was voiced equally strongly by the client counterparts with respect to Bank Task Managers. It was interesting to note the strong feelings at each

level involved on the importance of trust from above but the need for control below.

- There was praise for the resident missions' role in improving responsiveness to local conditions and building partnerships with clients. Clients see the need for improving further the effectiveness of RM's by increasing both international and local high level staff and upgrading their communication links with headquarters through information technology to foster access to information and rapid response capacity. There was a strong demand for establishing a full-fledged RM in Laos but no such need was articulated in Malaysia.

- While expansion and establishment of residents missions was widely welcomed, the response to the establishment of a regional hub was less enthusiastically received. This is because of the importance of Bank staff actually living in the country and being accessible. However, the case for a regional hub to provide implementation support in specific areas, complementing the work of Resident Missions, was endorsed. The areas for implementation support identified were CPM/information technology, training in project management, procurement, accounts, audit and disbursement.

- The need for the Bank to fit into the countries' calendar, systems and procedures was emphasized by a number of clients representatives.

- While the rhetoric on the merits of participation is strong, the central oversight agencies are cautious expanding consultation with NGOs; except of course if the pace and nature of participation is fully controlled by the central oversight agencies.

- The challenges posed to the Bank in respect of improving responsiveness to local conditions, promoting effective partnership, widening participation through workshops enhancing Bank staff appreciation of local social and political conditions, improving communications to better use information technology, strengthening the Resident Missions and customizing Bank products and processes call for significant strengthening of the country management function at Bank headquarters. Such strengthening will be invaluable in fostering smooth resolution of conflicts between Bank standards and country standards on a wide range of issues.

- On the BPI phase II recommendations, there was a remarkable consensus among clients representatives on the thrust and the details of the main recommendations. Some

refinements proposed by our clients relate to :

.. Careful management of the timing and participation of the CAS workshop proposed;

.. Support for increased client participation in CESW but resistance to linking such support to rigid tests of client commitment;

.. Greater stress on measures to widely disseminate formal CESW findings;

.. Acceptance of borrower responsibility for project preparation including the preparation of the PIP provided Bank assistance is available to the degree required in the area of policy, technology transfer, capacity building, project design and packaging and external resource mobilization.

.. Endorsement of a project preparation plan, which would inter alia clearly delineate the Borrower and the Bank responsibilities for project preparation, detail processes involved and describe the funding mechanism for project preparation. This was seen as a tool to foster transfer of responsibility from the Bank to the Borrower in a time frame consistent with building up capacity in the area of project preparation.

.. Simplification of procurement, disbursement and accounting requirements;

.. Careful selection processes for pilots which were government and not Bank pilots and the need for the Bank/Donors to share risks in the pilot by providing grant funding.

. A message that rang clear and loud from all clients is that while the BPI phase II is an importance step towards providing better services to the Clients, the full benefits of this initiative will be secured only if the Bank had a clear sense of purpose, renewed its missionary zeal, reoriented staff attitudes and skills, diversified the range of its products and improved the effectiveness of its technology transfer activities.

. It is clear that there are several trade-offs between the various objectives of the BPI which would require exercise of judgement as BPI proceeds. For example, greater client orientation, quality and flexibility would involve larger Bank budget allocations and longer lead

times for upstream Bank processes. The expectation is that this would be offset by improved development effectiveness and by savings downstream through simplification of processes and better project management and implementation. For this expectation to materialize, reforms beyond the present scope of BPI may be required.

Lastly, more systematic efforts are necessary to obtain frequent and reliable client feedback. Our external relations strategy needs to address this issue.

The World Bank
Washington, D.C. 20433

Office of
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DATE: March 17, 1995

No. of Pages: 8
(including this page)

TO: **Mr. James D. Wolfensohn, CEO**

FAX #: 57--1-212-6668

At: Hotel Casa-Medena - Bogota
Colombia

Please see the attached.

VERY URGENT PLEASE. DELIVER IMMEDIATELY. THANK YOU.

The World Bank
Washington, D.C. 20433
U.S.A.

GAUTAM S. KAJI
Managing Director

March 17, 1995

Note to Mr. James D. Wolfensohn

Mr. Wolfensohn,

Mark tells me that you wanted to have the schedule of major events for 1995. Attached is a listing of such events.

You will note that in the context of the ECOSOC/Tidewater visit to Europe in July, we have suggested that you might wish to also cover the three major European capitals. The Women's Conference in Beijing in September would provide an opportunity for incorporating a broader based visit to China as well as a visit to Tokyo. In addition to these, it would be useful to consider whether an early trip to one or two countries in Africa and possibly one or two countries in the Middle-East could be accommodated in your schedule . Depending on your schedule and your preferences a trip to the Indian Sub continent and a visit to a major Latin American country such as Brazil might be worthwhile.

I am also enclosing a four page executive summary of the Global Economic Prospects Paper produced by the Bank, which will be discussed at a Board Seminar on Monday and will subsequently be published in April.

Richard, Sven and I look forward to seeing you on Monday.

Gautam

1995 – Confirmed Dates of International and Bank Group Meetings

April 20-21	Maryland	Corporate Management Meeting - The President, Managing Directors, EVPs of IFC and MIGA, VPs. Meeting starts at 5:00 p.m. the first day and ends at 5:00 p.m. the next day.
April 26	Washington	Interim Committee
April 27		Development Committee/G24 - Brief statements, press conference with the Fund.
May 1	Washington	Bank's ABCD Conference - Opening remarks
May 18-19	Washington	IFC Bankers Meeting - Speech
May 22-23	Washington	IFC Business Advisory Council - Dinner address
June 15-17	Halifax	G-7 Meetings - The Bank is normally not invited, while the Fund is asked to attend because of its surveillance role.
July 6-7	Maryland	Corporate Management Meeting - Date to change to accommodate the July 7 ECOSOC meeting, originally scheduled for June.
July 7	Geneva	U.N. - ECOSOC - Short statement; The Managing Director of the Fund expects to attend this meeting. You may want to combine this trip with visits to European capitals.
July 9-11	Annecy, France	OECD/DAC - Tidewater Conference - No speech; closed informal meeting of development leaders. Mr. Preston had not planned to attend. Gautam Kaji was to attend in his place. You may want to consider going to it. Mr. Camdessus expects to attend this year.
Sept. 4-15	Beijing	U.N. World Conference on Women - Major speech; You only need to attend for a day or so. It will be useful to combine with an overall visit to China and Japan.

Oct. 1	Washington	Annual Conference on Environmentally Sustainable Development - Opening Remarks
Oct. 8 Oct. 9	Washington	Interim Committee Development Committee/G24 - Brief statements
Oct. 10-12	Washington	World Bank/IMF Annual Meetings - Major speech and statements to regional caucuses, press conference.
Oct. 12-13	New York	U.N. - ACC - Brief statement
Oct. 22-24	New York	U.N. 50th Anniversary Celebration - Speech - Heads of State and Government will attend
Oct. 29-30	Maryland	Corporate Management Meeting

Summary

World merchandise exports have risen from 11 to 18 percent of world GDP over the past two decades. Services have increased from 15 percent of world trade to over 22 percent since 1980. One of seven equity trades worldwide involves a foreigner as a counterparty. And world sales of foreign affiliates of multinational corporations may now well exceed the world's total exports. What do these statistics have in common? Globalization, a change that is transforming the world economy, and a theme that cuts across this report. This change is reflected in widening and intensifying international linkages in trade and finance. It is being driven by a near-universal push toward trade and capital market liberalization, increasing internationalization of corporate production and distribution strategies, and technological change that is fast eroding barriers to the international tradability of goods and services and the mobility of capital. Markets for merchandise trade are expanding, more and more services are becoming tradable, and capital is flowing in increasingly diverse ways across countries in search of profitable investments.

While international economic integration has taken major strides, and recently received another shot in the arm with the successful conclusion of the Uruguay Round, its smooth progression is by no means assured. Protectionist pressures are never far beneath the surface when the process of change involves both gainers and losers and exacts adjustment as the price for the benefits it offers, as international economic integration inevitably does. Such pressures from industries and groups that will need to adjust to stronger international competition will continue to test the firmness of policymakers' commitment to more open markets, in both developing and industrial countries.

A prominent feature of the ongoing global economic change is that the developing countries are active participants in it, both as agents and beneficiaries of the change. The outward-oriented reforms being embraced by a growing number of developing countries are both contributing to globalization and expanding opportunities for them to share in its benefits. By promoting domestic efficiency and productivity and providing an environment that is friendlier to exports and foreign investment, these reforms lie at the heart of developing countries' improved economic prospects. In the seven years since the launching of the Uruguay Round in 1986, developing countries were responsible for 58 of the 72 autonomous liberalization actions reported to the GATT. Since 1986, international trade in goods and nonfactor services (exports plus imports) as a proportion of their GDP has risen from about 33 to 43 percent, and foreign direct investment inflows have increased sixfold.

Alongside the new opportunities in trade and external finance offered by globalization have come new challenges of economic management in an increasingly open, integrated, and competitive global economy. Policymakers are confronted more and more with a new discipline, the need to maintain the confidence of markets, not only domestic but, increasingly, also international. In this setting sound economic policies command a rising premium. To an extent, globalization is having the effect of "endogenizing" policy reform in developing countries. Greater integration into the world economy raises the payoffs to increased competitiveness, but also compounds the losses from failure to act. Increasingly, it is the more efficient policy regimes that will win out.

Countries best placed to benefit from the new opportunities offered by globalization are those that are successfully transforming their policies and structures to support outward-oriented growth. Some of the poorest countries are least integrated internationally. Finding ways to accelerate their integration into the international economy is a special challenge.

The increasing global economic role and integration of developing countries also implies growing economic feedback from developing to industrial countries, making the links between them increasingly important in both directions. For example, about one-fifth of industrial country exports went to developing countries in the late 1980s. Today, this share has risen to about one-quarter, and it appears likely to exceed one-third by the end of the next decade.

Globalization in these various dimensions is the unifying theme of this report. The report reviews the prospects of developing countries in the context of their increasing integration into world markets for goods, services, and capital, highlighting the new opportunities and challenges that stem from this process of integration. It also develops the argument that the integration of developing countries brings them major benefits but holds important benefits for industrial countries as well. The realization of these benefits, however, will require adjustment.

The report's central message: the increasing integration of developing countries into the global economy represents a major—perhaps the most important—opportunity for raising the welfare of both developing and industrial countries over the long term. The process of integration will not be frictionless, or without bumpiness, but both groups of countries have a large stake in ensuring that it continues. As elements of this central message, the report develops five main points:

The global economic environment is brighter, and provides a propitious setting for continued integration of developing countries into the world economy.

The global economic environment, invigorated by buoyant world trade that promises to grow at more than 6 percent over the next ten years and benefiting from low inflation, is better than it has been since the 1960s, but better policies are needed to capitalize on it. Important challenges remain. Industrial countries need to foster a sustained economic recovery. Developing countries need to take advantage of the improved external environment, including strong commodity prices, to further their reforms and strengthen the foundations for continued robust growth. A key element of reform will be continued progress on opening up economies to international trade and investment. Provided policies remain supportive, growth in the next ten years could approach 5 percent in developing countries and average 2.8 percent in industrial countries.

The aggregate growth outlook for developing countries masks significant differences. Growth is expected to recover in Sub-Saharan Africa and the transition economies, but will likely average well below overall developing country growth. Outward-oriented structural reform will be an especially important challenge in countries in Sub-Saharan Africa and elsewhere that are at an early stage of this process. Also, there are risks in the outlook that policymakers in developing countries in general need to be alert to, in particular the risk of a slackening of macroeconomic discipline and structural reforms induced by the favorable economic conditions.

But the road ahead will not be smooth, as the crisis in Mexico shows.

The increasing integration of developing countries into the global capital market brings them important benefits, but as Mexico's experience shows, it also requires stricter discipline in economic management as it leaves them less room for policy errors. Mexico's is an individual country crisis, not a systemic one threatening a general reversal of private flows to developing countries. But it serves to underscore the critical role of sound country policies in sustaining the confidence of financial markets. It also shows that when a crisis of confidence develops, its impact can be sudden and damaging and with some spillover to other countries that market participants perceive as being in a similar situation. Nevertheless, the rise in private capital flows to developing countries is underpinned by important ongoing structural shifts in the world economy. It may take some time for confidence in emerging markets to be reestablished following the Mexican crisis, but in the medium term private capital flows to developing countries are expected to resume growth, albeit at a slower pace than in the early 1990s.

The Uruguay Round advances international trade integration significantly, but much remains to be done.

The Uruguay Round's achievements in improving market access and security are significant: average reduction of tariffs on manufactures of over one-third; major scaling back of nontariff barriers with the abolition of the Multifiber Arrangement and voluntary export restraints; extension of multilateral discipline to trade in agriculture and services; stronger and clearer rules, standards, and dispute settlement procedures; and strengthening of the trading system through the creation of the World Trade Organization. But these are not grounds for complacency. A sizable agenda for reform remains in all the areas tackled by the Round, but especially in agriculture where the liberalization achieved was limited and in the use of antidumping measures where stricter discipline is needed. Firm implementation of the Round and building on its achievements will be necessary to ensure that international trade remains the "engine of growth" it is today.

Gains from improved market access under the Round will be widespread, but unevenly distributed across regions and countries. Countries' overall gains from trade liberalization will depend more on their own trade policy actions than those of others. Losses to developing countries in two areas of major concern to them during the negotiations—preference erosion and higher food import costs—are likely to be smaller than initially feared, the latter in part because the liberalization in agriculture has been more limited than expected earlier.

The internationalization of services will likely lead the next stage of economic globalization.

Services are internationalizing rapidly. In both trade and foreign direct investment, services are the fastest-growing component. For developing countries, promising new avenues for exports are opening, such as relatively labor-intensive long-distance services, which alone could potentially double their commercial service exports, now valued at around $180 billion. But access to efficient services is becoming increasingly important to the competitiveness of the whole economy, reflecting the rising service intensity of production in general. Together with creating

new possibilities for exports, the increasing tradability of services is expanding the access of firms and businesses in developing countries to efficient, state-of-the-art producer services and a widening body of technical know-how through imports. In particular, the declining costs of information technology and telecommunications are opening up possibilities for developing countries to leapfrog stages of technological development. To maximize benefits from the internationalization of services, adopting a liberal trade and investment regime will be essential.

The increasing integration of developing countries into the global economy carries major benefits for industrial countries, but also entails adjustment costs. Managing the transition successfully will be a difficult, but crucial challenge.

Contrary to populist rhetoric, the growth of developing countries and their increasing integration into world trade and finance benefit rather than hurt industrial countries. Gains to industrial countries from increased trade integration with developing countries are potentially larger than from additional integration among industrial countries, as cost/price differences between developing and industrial countries can be more than twice as large overall as those among industrial countries. Beyond a more efficient use of resources, medium- to long-term gains through increased investment and innovation and higher productivity growth are likely to be substantial. These gains arise from increased market size, competition and technology spillovers. Insufficiently recognized in traditional analyses of trade, such dynamic gains are likely to be a multiple of the initial efficiency gain from trade integration. Dynamic gains from trade are likely to be especially important in the case of integration with developing countries, which are forecast to grow about twice as fast as industrial countries.

Industrial countries also stand to gain from increased financial integration with developing countries. Increased foreign direct investment allows firms in industrial countries to reap the benefits of specialization in production and distribution on a global scale. In portfolio investment, emerging markets provide an outlet offering higher returns and risk diversification to the savings of the aging populations of industrial countries.

But the process of increased integration with developing countries will not be without adjustment costs. Labor-intensive and low-skill industries and low-skill workers in industrial countries are likely to be disproportionately affected. Economy-wide and over time, these costs should be far outweighed by the gains from integration. Trade with developing countries will spur other industries and services where industrial countries will retain comparative advantage. But the reallocation of resources that this structural change entails is not easily accomplished, and will inevitably generate frictions and protectionist demands. Indeed, possible intensification of protectionist pressures poses a major risk to the realization of increased, mutually beneficial integration between developing and industrial countries. A successful transition will depend heavily on industrial country policies aimed at mitigating the social costs of adjustment and facilitating the reallocation of resources toward activities that will be spurred by integration. Increasing the flexibility of labor and product markets will be central to this effort. Protectionist pressures to slow or reverse integration must be resisted, as that would make both industrial and developing countries lose, and dearly.