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Report to Congressional Requesters

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WORLD BANK

U.S. Interests Supported, but Oversight Needed to Help Ensure Improved Performance

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The Honorable John Kasich
Chairman, House Committee on the Budget
House of Representatives

The Honorable James Leach
Chairman, House Committee on
Banking and Financial Services
House of Representatives

This report responds to your request that we undertake a review to determine whether continued participation in the World Bank is in the U.S. interest. To address this question, we assessed (1) the Bank's role in enhancing the flow of international private investment capital into developing countries, (2) the extent to which Bank projects achieve their development objectives, (3) the Bank's progress in reforming its operations to improve effectiveness, and (4) the extent to which the Bank supports U.S. foreign policy goals.

We are sending copies of this report to the Secretaries of the Treasury and of State; the Administrator, U.S. Agency for International Development; the President of the World Bank; and other interested parties. Copies will also be made available to others on request.

This report was prepared under the direction of Benjamin F. Nelson and Jayetta Z. Hecker, Director and Associate Director, respectively, International Relations and Trade Issues. They can be contacted on (202) 512-4128 if you or your staff have any questions concerning this report. Other major contributors are listed in appendix VII.

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Executive Summary

Purpose

With the end of the Cold War, some political and economic analysts have questioned the underlying rationale for U.S. participation in multilateral institutions such as the World Bank. The recent rapid increase in private investment in developing countries (more than a threefold increase since 1988) has raised questions about whether the Bank works to enhance or inhibit this trend. Weaknesses in project effectiveness have raised questions about the ability of the Bank's programs to promote economic development. Finally, the Bank has had difficulty demonstrating the impact of reforms designed to improve its effectiveness.

Prompted by such concerns, the Chairmen of the House Committees on the Budget and on Banking and Financial Services requested that GAO undertake a review to determine whether continued participation in the Bank is in the U.S. interest. To address this question, GAO assessed (1) the Bank's role in enhancing the flow of international private investment capital into developing countries, (2) the extent to which Bank projects achieve their development objectives, (3) the Bank's progress in reforming its operations to improve effectiveness, and (4) the extent to which the Bank supports U.S. foreign policy goals.

To conduct its assessment, GAO obtained access to Bank officials and information through the Department of the Treasury, which has the lead role within the executive branch regarding U.S. policy toward the Bank, and through the staff of the U.S. member of the Bank's Board of Executive Directors. GAO analyzed data and internal reports on Bank operations, project performance, and management reforms. In addition, GAO examined trend data on international private and public sector financial flows to developing countries and obtained information from international private investors on their experiences with the Bank. GAO also discussed the Bank's role and performance with officials from nongovernmental organizations, academics, and foreign government agencies.

Background

The purpose of the World Bank is to promote economic growth and the development of market economies by providing finance on reasonable terms to countries that have difficulty obtaining capital. Following its initial efforts to reconstruct Europe after World War II, the Bank expanded the scope of its activities to the rest of the world. The Bank's development strategy has evolved to include emphasis on poverty alleviation; economic adjustment; and, most recently, private sector development. Implicit in Bank actions during most of its history was the need to ensure the availability of capital for countries that might otherwise turn to communism.

To achieve its goals, the Bank developed four major institutions: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), and the Multilateral Investment Guarantee Association (MIGA). IBRD and IDA make loans to developing country governments, with IBRD lending at market-based terms and IDA lending to the poorest countries on highly subsidized terms. IFC and MIGA work directly with the private sector to spur investment in developing countries. Between fiscal years 1993 and 1995, the United States contributed an average of $1.2 billion per year to support these institutions. In fiscal year 1996, the United States contributed $824 million to support the Bank,[1] $700 million of which was directed to IDA.

Results in Brief

Bank operations support U.S. economic and foreign policy goals and leverage other donors' funds to do so. However, performance weaknesses have limited the effectiveness of many of the Bank's projects. The Bank has recognized many of its problems and has developed a reform program that holds promise for improving projects' effectiveness. However, it is too soon to assess whether the reform program will result in better outcomes. The United States can, by virtue of its leadership role, continue to influence Bank actions and advance reform efforts to ensure that Bank projects make a greater contribution to development in the future.

Through the Secretary of the Treasury and the U.S. Executive Director, the United States influences the Bank to take actions consistent with the U.S. post-Cold War foreign policy agenda. These include providing assistance to countries making the transition from communism to market economies and financing economic reconstruction in areas of foreign policy importance to the United States (e.g., Bosnia, Haiti, and the West Bank). The Bank promotes economic development consistent with U.S. interests. It provides financing for countries that have little access to private capital. It also works to expand opportunities for private investment in developing countries by reducing the associated investment risk and encouraging banking and legal system reforms. Such Bank services generally do not displace the private sector.

[1]This includes $35 million for the Global Environment Facility, which is technically separate from the Bank.

Although the Bank's goals are generally in accord with U.S. foreign policy interests, the institution has performance problems that have proven difficult to address. More than a third of the IDA and IBRD projects most recently evaluated by the Bank itself were rated "unsatisfactory" (that is, they had not met most of their major goals or achieved acceptable contributions to development), and over half of the projects in sub-Saharan Africa were rated unsatisfactory. In terms of achieving project objectives, the Bank's rate of success is much higher in meeting physical objectives (e.g., completing buildings and administering social services) than in improving market and policy conditions for economic growth.

The Bank has undertaken a reform program that holds promise for improving project effectiveness. For example, the Bank is taking steps to reduce funding to countries that do not adopt growth-oriented market and policy conditions and to increase funding to those countries that do. Although institutional change is still ongoing, clear improvements in project design and portfolio management are not yet evident. Continued monitoring and reporting by Treasury on the progress of these reforms, as GAO recommends, is important to help ensure that the reforms improve performance.

Principal Findings

World Bank's Impact on Private Investment in Developing Countries

While concerns have been raised that the Bank negatively distorts international capital flows and developing country decision-making, the available aggregate data does not permit an analysis of the distortion directly attributable to Bank programs.[2] However, GAO obtained 65 private sector firms' views on whether Bank programs have displaced private investment and whether the Bank's efforts have enhanced the environment for private investment in developing countries.

Nearly 90 percent of the private sector representatives we spoke with said that Bank Group operations serve to enhance the environment for private investment in developing countries by reducing the risks associated with such investments. For example, MIGA's political risk insurance program helps promote the flow of foreign direct investment by insuring

[2]Public funding can positively or negatively affect or distort the underlying variables of a given market (e.g., prices and quantities demanded and supplied) when compared to a market that does not have public funding.

investments against political and other noncommercial risks. IFC loans to private sector borrowers act as incentives for businesses to become involved in new projects or markets. IBRD's guarantee programs, thus far limited in use, help address private sector concerns about the ability of borrowers to repay their obligations. The Bank's advisory services help borrowing countries strengthen their regulatory and legal systems.

According to firms GAO interviewed, the World Bank has displaced private sources of capital only in a few developing country markets where private sector interest had become well established. These firms were concerned primarily about IFC, which in certain cases displaced private sector firms in particular projects. IFC is working to address these concerns by reducing its presence in contested markets and has revised its guidelines to better clarify the importance of not competing with private investment. Little or no concern about displacement was raised regarding the Bank Group's other elements, which tend to operate in countries and sectors where conditions are not conducive to private international investment. In fact, despite the rapid rise in the flow of private funds to the developing countries as a whole, less than 8 percent of foreign resources flowing into countries that borrow from IDA comes from the private sector.

Development Effectiveness of World Bank Projects

It is extremely difficult to measure the impact of Bank activities on borrowing countries' overall level of development. However, the Bank collects data on IDA and IBRD projects' effectiveness. These data show that the projects have had significant difficulty in achieving their objectives. About 36 percent of the most recently completed projects, evaluated by the Bank in 1993 and 1994, have been judged unsatisfactory. Though Bank projects are inherently risky and some unsatisfactory results are to be expected, the Bank's President agreed that this performance level needed to be raised.

The Bank projects have had their greatest rate of success in building physical infrastructure. The record of Bank projects in achieving goals in other critical areas, such as improving market and policy conditions, has been weaker: only about one-third of Bank projects with such objectives have substantially achieved them.

The Bank and borrowing countries share responsibility for performance problems. A major 1992 report on portfolio performance commissioned by the Bank cited project design problems, unfavorable country conditions, and a volatile international economic environment as major factors. A recent Bank study also indicates that greater use of economic and sectoral analyses prior to lending funds might have led to better results in many cases. According to Bank officials, projects have also become increasingly demanding, complex, and risky, making it more difficult to achieve development objectives.

Bank Reform Efforts

The Bank has implemented a reform program aimed at improving its portfolio performance. Many of these efforts are in their early stages, and their final impact may not be seen for several years. However, some indicators are available to evaluate the preliminary progress of these reform efforts, and they show mixed results thus far.

A key component of the reform effort has been to systematically assess country performance and direct lending to countries that have demonstrated progress in project implementation and in market and policy reform. Recent data on IDA lending show that an increased proportion of loans has been directed to top-performing countries and that allocations for poorer performers have been reduced.

Improvement of project design, or "quality at entry," has been another major focus of reform. Recent Bank studies show that some small improvements have been made in the quality of new projects but that significant project design problems remain. According to one study, nearly 40 percent of recently approved projects have been based on less than acceptable economic analyses.

The Bank has also worked to improve project management by being more proactive in identifying and attempting to resolve problems during project implementation. Results in this area have been mixed. The Bank has been successful at resolving long-standing problem projects and at more realistically assessing problems. Overall, however, the percentage of problem projects has not decreased since 1992. Furthermore, implementation problems are often not detected early enough in the project cycle, and the results of increased efforts to review and restructure projects have been inconclusive.

Other reform efforts appear promising, though GAO could not measure the extent of these reforms or their impact. They include greater emphasis on policy and market reform objectives in projects, increased use of nonlending services, and more focused Bank management attention to reforms. The Bank's greater emphasis on policy and market reforms, in particular, may increase the potential for Bank projects to positively impact development in borrowing countries. However, since these objectives are often difficult to achieve, increased emphasis in this area may impede the Bank's ability to raise the portion of its projects rated as satisfactory.

U.S. Foreign Policy Considerations

The United States has played a leading role in shaping the Bank's agenda, and Bank projects often support U.S. foreign policy goals. For example, the Bank is providing resources to assist in the transition of central Europe and the countries of the former Soviet Union from communist to market-based systems. The Bank has also directed significant resources to crisis areas where the United States has strong interests, such as Bosnia, Haiti, and the West Bank and Gaza. Compromise is sometimes necessary in the Bank as in any multilateral organization. For example, the United States favored immediate graduation of China from eligibility for IDA credits but agreed that new IDA lending to this country should end in 1999 after other members, particularly Japan, opposed the U.S. position. However, insofar as the United States can ensure that Bank projects support U.S. foreign policy goals, U.S. contributions are multiplied many times over by those of other member countries.

Recommendation

The benefits of U.S. participation in the Bank are limited by problems with the effectiveness of Bank projects. Through its leadership, the United States is positioned to ensure that the Bank reforms continue to progress and have a positive impact on development effectiveness.

To ensure that the Bank reforms have the desired impact, GAO recommends that the Secretary of the Treasury monitor and periodically report to the Congress measurable indicators of progress, such as the extent to which (1) the Bank allocates financing to those countries that make Bank-advocated policy and market reforms, (2) projects substantially achieve policy and market reform objectives, (3) project design problems decrease, and (4) implementation problems are identified and resolved early in the project cycle. If the indicators do not show satisfactory progress, the Secretary should report on the actions being taken by the Treasury to improve progress.

Agency Comments and GAO's Response

GAO received comments on a draft of this report from the Department of the Treasury and, through it, the World Bank; the Department of State; and the Agency for International Development. These comments are reprinted in appendixes III-VI.

Treasury agreed with many of the report's basic findings and conclusions, stating that they tracked well with its own views and with major positions taken by successive U.S. administrations. In addition, Treasury supported GAO's recommendation that Treasury monitor and periodically report to the Congress on Bank progress in improving project quality and effectiveness. However, Treasury expressed concern that GAO's analysis did not fully reflect the impact of ongoing reforms on Bank operations.

The Bank disagreed with many of the report's findings and criticized its "exclusive reliance" on quantifiable indicators of project effectiveness. The Bank contended that GAO's failure to evaluate the entire scope of the Bank's operations, including policy dialogue and other activities undertaken outside the framework of lending projects, prevented GAO from presenting a balanced view of the Bank's operations and effectiveness. The Bank also commented that GAO did not give the Bank adequate credit for the progress it has made in implementing reforms. In addition to these overall comments, Treasury and the Bank offered clarifications, technical corrections, and updated information, which GAO incorporated throughout the report as appropriate.

The State Department and the U.S. Agency for International Development highlighted the important role that the World Bank plays in development as well as in the furthering of U.S. foreign policy interests. The State Department also commented that the report did not fully acknowledge the Bank's role in promoting market-oriented reform in developing countries.

GAO agrees with the Bank that the effectiveness of projects financed by IDA and IBRD is only a partial measure of the overall impact of the Bank's efforts. We report performance data for these projects in detail because they capture the effectiveness of a large portion of the Bank's activities; indeed, IDA and IBRD lending represented 86 percent of the Bank's outlays in fiscal year 1995. Similar data is not available to capture the overall effectiveness of the Bank's other activities, and GAO did not consider anecdotal information to be a satisfactory substitute.

In reaching its overall conclusions, however, GAO acknowledges the breadth of the Bank's operations, as well as its shortfalls in performance. The report states that the Bank is a focal point for official efforts aimed at facilitating economic development; that in addition to functioning as a source of investment capital it provides a broad range of nonlending services, such as advice on legal, regulatory, and policy reform; and that the Bank is a key player in the transition to market economies.

GAO believes that the Bank's reform agenda addresses key performance problems and holds promise for improving project effectiveness. However, progress in some areas has yet to be demonstrated, and it is too soon to assess actual results. GAO believes this report provides a good baseline for the Congress and the executive branch to use in evaluating the Bank's implementation of its reform program. Continued monitoring and reporting by Treasury of the progress of these reforms, as GAO recommends, is important to help ensure that the reforms improve performance.

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Abbreviations

CAS	Country Assistance Strategy
CODE	Committee on Development Effectiveness
FIAS	World Bank Foreign Investment Advisory Service
GAO	General Accounting Office
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
MIGA	Multilateral Investment and Guarantee Agency
OED	Operations Evaluation Department
OPIC	Overseas Private Investment Corporation
USAID	U.S. Agency for International Development

Introduction

During the closing days of World War II, the United States and its allies created the original “World Bank”—the International Bank for Reconstruction and Development (IBRD)—as well as the International Monetary Fund and the General Agreement on Tariffs and Trade—to provide the underpinnings for a new international economic order.[1] The economic and political leaders of the time developed these multilateral mechanisms to prevent a return to the destructive trade and investment isolationism of the 1930s. Among other concerns, these leaders feared that private capital markets would not provide the investment capital needed to stimulate growth, raise living standards, and promote political stability in war-torn and underdeveloped countries. Creation of a new public sector institution was deemed necessary to supplement private lending and investment in these countries. By guaranteeing the financial integrity of the institution, the member countries would enable it to borrow private capital on the open market to lend to needy countries at reasonable rates.

To expand the potential impact of IBRD, the member countries subsequently created three affiliated institutions: the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA),[2] created specifically to encourage private investment in developing countries, and the International Development Association (IDA), which lends to the poorest countries in the world at concessional rates.

Operationally, IBRD and IDA are one organization. Similar procedures are followed by the Bank’s core staff to generate, administer, and evaluate IBRD and IDA loans. IFC and MIGA have independent staffs and procedures.[3] Collectively, these four institutions are known as the World Bank Group.[4] Figure 1.1 and table 1.1 provide additional information on each institution.

[1]In 1994 the members of the General Agreement on Tariffs and Trade replaced that agreement’s organizational structure with the new World Trade Organization.

[2]Membership in other Bank Group institutions is open to IBRD members. As of June 1995, IBRD had 178 member countries, while IDA had 158 members, IFC 165, and MIGA 128.

[3]IDA pays IBRD a fee for its share of common administrative expenses. Similarly, IFC and MIGA pay IBRD for administrative services that IBRD provides to them.

[4]The Bank Group also includes the International Center for the Settlement of Investment Disputes. This organization was not included within the scope of our review because its quasijudicial functions are fundamentally different from those of the other four institutions.

Figure 1.1: World Bank Group Institutions

IBRD (established in 1945) makes loans to member governments and provides associated nonlending services such as policy advice, economic analysis, and training.[a] IBRD derives a small percentage of its capital needs from member country contributions but obtains most of its capital through borrowing on international financial markets and reflows from old loans. IBRD lending rates are market based; interest charged covers the cost of borrowing and provides a small profit margin. Reflows are used to cover operating expenses and for other purposes, including support for subsequent lending. In principle, IBRD lends to governments of countries with moderate levels of Gross National Product (GNP) per capita.[b]

IDA (established in 1960) makes loans using the same technical and operational standards as IBRD and provides associated nonlending services. However, IDA obtains capital primarily through member country contributions, supplemented by income transfers from IBRD and repayments of prior loans. IDA credits are considered to have an 80-percent grant element because (1) they are interest free, with borrowing governments required to pay only a small service charge, and (2) repayment is spread out over 35 or 40 years and begins after a 10-year grace period. In principle, IDA lends only in countries with low levels of GNP per capita. Countries are deemed eligible for IDA credits (as opposed to IBRD lending) on the basis of relative poverty and lack of access to credit. The poverty-level transition point for moving from IDA credits to IBRD loans was set at a 1994 GNP per capita level of $865 for fiscal year 1996. A small number of "blend" countries with incomes below this level, including China and India, are deemed eligible to receive funds from both institutions. While relatively creditworthy, these countries have large numbers of very poor citizens.

IFC (established in 1956) makes loans to and takes equity positions in private companies and financial institutions in developing countries without government guarantees and provides associated nonlending services. IFC has its own capital base from member country contributions. However, it now obtains most of its working capital through borrowing on the open market and from retained earnings. IFC terms are market based, and the corporation makes a profit, which helps support operations. IFC invests in developing countries at various income levels.

MIGA (established in 1988) promotes private direct investment in developing countries by providing insurance against political and other noncommercial risks as well as advisory and consultative services that facilitate investment growth. Though originally capitalized through member country contributions, MIGA now uses premiums on its outstanding portfolio as its primary source of income. Premiums are based on the risk associated with each project. MIGA operates in developing countries at various income levels.

[a]IBRD and IDA can also lend to private or public bodies whose national governments guarantee repayment.

[b]As of June 1995, eligible countries ranged from Argentina (1994 income per capita of over $8,000) to Indonesia (1994 income per capita of under $800).

Table 1.1: Assistance Provided by Bank Group Institutions in Fiscal Year 1995

U.S. dollars in billions

Type of assistance	Value of assistance
IBRD disbursements	$12.67
IDA disbursements	5.70
IFC loans and equity investments (disbursements)	1.81
MIGA guarantees[a]	0.67
Other nonlending services[b]	0.54

Note: Contributions made to projects by other donor agencies, borrowing country governments, and the private sector are not included.

[a]Total amount of coverage issued.

[b]Includes economic and sector work, research, policy work, trust funds, and development training.

Source: Analysis of World Bank data.

The Bank is the world's single largest official source of investment capital for developing countries. While data published by the Organization for Economic Cooperation and Development show that other donors frequently provide more resources in individual countries, the Bank is generally acknowledged as a focal point in the world community's official efforts to facilitate economic growth and development in poor countries.

As explained in figure 1.1, three of the four Bank Group institutions do not rely primarily on annual donor contributions for support. The one exception is IDA, which has absorbed about 88 percent of the approximately $8 billion appropriated by the Congress for the Bank Group in fiscal years 1990-96. Table 1.2 provides detailed information on annual appropriations for Bank Group institutions during the 1990s.[5]

[5]These figures do not include U.S. support for IBRD in the form of "callable capital"—a contingent liability created to back Bank borrowings on world financial markets. As of June 30, 1995, the total callable capital committed to support IBRD market operations amounts to over $165 billion, with the U.S. share amounting to about $29 billion. The Bank may only call upon these member country guarantees in the event that it encounters such severe financial difficulty that it is unable to pay its own creditors. This has not occurred.

Table 1.2: U.S. Appropriations to Support Bank Group Institutions

U.S. dollars in millions

	Fiscal year						
Bank Group institutions	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**
IDA	$961	$1,032	$1,044	$1,024	$1,024	$1,175	$700
IBRD	50	111	69	62	28	23	28
IFC	75	40	40	36	36	69	61
MIGA	0	0	0	0	0	0	0
GEF[a]	0	0	0	30	30	90	35
Total	**$1,086**	**$1,183**	**$1,153**	**$1,152**	**$1,152**	**$1,357**	**$824**

[a]The GEF (Global Environment Facility) is not a Bank Group institution. It is a financial mechanism, implemented by the Bank in partnership with the United Nations Development and Environment Programs, that provides grant and concessional funds for projects intended to protect the global environment. U.S. contributions to GEF are included in annual appropriations for the international financial institutions.

The United States Has Exercised Substantial Influence Over Bank Operations

As the largest provider of financial support to the Bank and a recognized leader in the international community, the United States has exercised leadership within the Bank Group since its creation. The United States proposed the basic design of IBRD and provided much of the impetus for the subsequent creation of IDA. Much of these institutions' management and staff comprise Americans or foreign nationals educated in U.S. universities, and the Bank President has traditionally been a U.S. citizen.[6]

Support for the Bank has been the subject of periodic controversy in the United States, and the Congress has enacted a number of measures directing the U.S. Executive Director to vote against certain categories of loans (e.g., for countries that have expropriated U.S. property without compensation).[7] Nonetheless, the Bank continued to receive support from the executive branch and the Congress through the Cold War era. The need to continue U.S. participation was challenged during the early 1980s. Even then, however, a comprehensive executive branch review of the World Bank and the regional development banks concluded that these banks continued to serve U.S. foreign policy interests and that the United

[6]U.S. nationals made up more than one-quarter of the Bank Group's staff as of September 1994.

[7]The Board of Executive Directors considers and decides on specific project proposals presented by the President of the Bank and also decides policy issues that guide the Bank's general operations. Though appointed by the President of the United States with the advice and consent of the Senate, the U.S. Executive Director is an official of the World Bank.

States should, with some qualifications, continue to support them.[8] (App. I explains how Bank projects are developed and approved.)

In the years immediately following World War II, the U.S. government and financial markets were the primary sources of capital for the Bank. The U.S. contribution to support the Bank has declined substantially over the years as other member countries have increased their contributions and the Bank's financial dealings have diversified. For example, the U.S. share of donor contributions to IDA declined from about 42 percent when the association was formed to about 21 percent during the first half of the 1990s. Nonetheless, as of June 30, 1995, the United States still held the greatest share of the votes in each Bank Group institution's Board of Executive Directors. This preserves the U.S. leadership position and allows the United States to keep the Bank's headquarters in Washington, D.C. The United States retains sufficient votes to veto changes in IBRD's basic articles of agreement. Table 1.3 lists the percentage of voting share the United States has in each Bank Group institution, along with the relative voting share of the four other largest donors.

Table 1.3: Voting Share in Bank Group Institutions as Percentage of Total Votes (as of June 1995)

Donor	IBRD	IDA	IFC	MIGA
United States	16.98	15.34	21.96	17.39
Japan	6.24	10.51	7.38	4.43
Germany	4.82	6.90	5.57	4.41
France	4.62	4.13	5.23	4.23
United Kingdom	4.62	5.08	5.23	4.23

Post-Cold War Evaluation of U.S. Foreign Operations Includes Challenges to Continued Support for the Bank

U.S. policymakers have supported participation in the World Bank as a means for advancing U.S. humanitarian, economic, and security interests through alleviating poverty and encouraging economic growth and political stability in developing countries. However, much of the impetus behind U.S. participation in the Bank during the Cold War era was derived from the perceived utility of the Bank in containing communist expansionism in the developing world. One Bank official commented, for example, that because of U.S. concern about communist insurgency in the area, the Bank remained active in several sub-Saharan African countries long after the corrupt nature of these countries' governments became evident.

[8]United States Participation in the Multilateral Development Banks in the 1980s, Department of the Treasury, Washington D.C. (Feb. 1982).

The fall of the Berlin Wall in 1989 and the subsequent collapse of the Soviet bloc have dramatically altered the international status quo. In the post-Cold War environment, the need to actively oppose communist expansionism no longer serves as an underlying rationale for U.S. foreign policy activities. Virtually all traditional U.S. foreign policy assumptions and instrumentalities, including support for the Bank, have come under increased scrutiny. Mounting government budget deficits in the United States (and other donor countries) have lent added urgency to scrutiny regarding the effectiveness of foreign operations spending.

A variety of critics have opposed the continuation of traditional levels of U.S. support for the Bank, stressing that the Bank is not an effective agent for economic development. The critics argue that, good intentions aside, the Bank has not effectively facilitated real economic growth in the developing world or made progress toward reducing poverty. They point out, for example, that the number of impoverished persons in the world continues to rise despite the efforts of the Bank and other multilateral and bilateral assistance agencies. Some of the harshest criticism of Bank intervention has been leveled at the Bank's activities in sub-Saharan Africa, where the gross domestic product per capita continues to decline. Some critics argue that the availability of Bank financing permits developing countries to avoid tough choices that, if made, would lead to a better investment climate and, hence, increased private investment. Some critics point out that the Bank's own data show significant shortfalls in the ability of IBRD and IDA to achieve their objectives. In fact, as shown in figure 1.2, the Bank's evaluation results showed a significant decline during the 1980s in the portion of IBRD/IDA projects achieving satisfactory results.

Figure 1.2: Projects With Satisfactory Outcomes by Year of Evaluation
(1974-94)

Note: For a project to be rated satisfactory, its goals must be consistent with the Bank's country and sectoral assistance strategies and it must have achieved, or be expected to achieve, most of its major goals in a timely and cost-efficient manner.

Source: World Bank, Operations Evaluation Department (OED).

Concern about the performance of the Bank's portfolio led the President of the Bank to establish a Portfolio Management Task Force in February 1992. The Task Force's report concluded that the Bank needed to adopt a comprehensive plan of action to remedy problems with project design, management, and implementation. It emphasized that a contributing factor was the Bank staff's preoccupation with getting loan funds committed rather than with effectively managing existing projects. In June 1993 the Bank adopted a plan of action to remedy the problems identified by the Task Force. We reported on two occasions on the Bank's progress toward implementing these reforms.[9]

Objectives, Scope, and Methodology

Our review of the World Bank was requested by the Chairmen of the House Committees on the Budget and on Banking and Financial Services. On the basis of our preliminary examination of the issues, the results of an expert panel on the Bank that we convened in September 1995, and discussion with the staffs of the requesters' committees, we focused our review on

- the Bank's role in enhancing the flow of international private investment capital into developing countries,
- the extent to which Bank projects achieve their development objectives,
- the Bank's progress in reforming its operations to improve effectiveness, and
- the extent to which Bank activities are aligned with U.S. foreign policy goals.

To obtain official U.S. views on these issues, we met with representatives of the Department of the Treasury, which has the lead role within the executive branch regarding U.S. policy toward the Bank,[10] and with officials from the Department of State and the U.S. Agency for International Development. We also obtained the views of academic experts and representatives of nongovernmental organizations on relevant topics.

As an agency of the United States, we have no direct authority to review the operations of multilateral institutions such as the World Bank. However, we obtained broad access to Bank officials (including the President) and information through the staff of the U.S. member of the Bank's Board of Executive Directors. We also met with a number of other Executive Directors to broaden our understanding of member country views on Bank operations. We met with appropriate Bank officials, including representatives of IBRD, IDA, IFC, and MIGA, with a concentration

[9]Multilateral Development: Status of World Bank Reforms (GAO/NSIAD-94-190BR, June 6, 1994) and Multilateral Development: World Bank Reforms on Schedule but Difficult Work Remains (GAO/NSIAD-95-131BR, Apr. 5, 1995). Our 1994 report includes a complete list of the actions in the Bank's reform plan.

[10]By executive order, the President has delegated to the Secretary of the Treasury, in consultation with the National Advisory Council on International Monetary and Financial Policies, his authority under law to instruct the U.S. representatives at the international financial institutions. In practice, Treasury takes the lead in working with the staff of the U.S. Executive Director's office on developing and implementing U.S. policy toward the Bank.

on those offices that are particularly concerned with private sector development, such as the Vice-Presidency for Finance and Private Sector Development, the International Economics Department, and the Foreign Investment Advisory Service.

To assist us in assessing the Bank's role in providing international financial flows to developing countries, we examined data on the composition of these flows compiled by the Bank, the International Monetary Fund (IMF), and the Organization for Economic Cooperation and Development. To better understand the relationship between Bank operations and private sector flows, we interviewed 65 representatives of major commercial banks, investment houses, multinational corporations, and investment rating services that do business in developing countries and are familiar with the Bank's operations in these countries. These firms are listed in appendix II. To ensure that we obtained a broad perspective in this area, we interviewed representatives of such firms in four of the world's most important international financial centers—New York, London, Tokyo, and Hong Kong—and in Washington, D.C., Los Angeles, and San Francisco; and national financial centers in the developing countries that we visited. We particularly sought these companies' views on the Bank's role, if any, in encouraging or discouraging the flow of foreign investment capital into developing countries.

To better understand the nature and impact of Bank interventions in developing countries and the impact of the Bank's recent reforms, we examined Bank operations in five countries: China, India, Kenya, Tanzania, and Armenia. While China, India, and Armenia are also eligible to borrow from IBRD (and are, therefore, known within the Bank as blend countries), all five of these countries are eligible for IDA assistance. We concentrated on IDA recipients because IDA absorbs most of the funds provided to the Bank Group by the United States and is the object of most of the discussion of reducing U.S. support to the Bank.

We selected Kenya and Tanzania because some of the sharpest criticism has been directed at the Bank's operations in sub-Saharan Africa. We selected Armenia, formerly a part of the Soviet Union, to provide us with a better understanding of the utility of the Bank in facilitating a peaceful transition toward democracy and open markets among former Eastern bloc countries. We included the two largest blend countries for a number of reasons. China and India absorb a large portion of the Bank's annual lending. As of mid-1995, the two countries combined had received more than one-third of the IDA credits ever granted and about 16 percent of all

IBRD loans. The two countries continue to absorb a significant share of IDA's concessional credits (over a billion and a half dollars in new commitments in fiscal year 1995) despite their recent success in attracting international private investment. Some critics have proposed that these countries, particularly China, be graduated from eligibility for IDA credits because of their increased access to international capital markets. Data on the portion of IDA, IBRD, and IFC resources directed to the countries we visited, as well as the portion of current foreign private investment in developing countries going to these countries, are displayed in table 1.4.

Table 1.4: Percentage of Bank and Private Sector Resources Directed to Each Country We Visited (weighted averages for 1993-94)

Country	IDA gross disbursements	IBRD gross disbursements	IFC loan/equity disbursements (average for 1990-95)	Net foreign private sector investment
China	14.2	9.7	0.8	29.6
India	15.0	8.1	13.3	3.1
Kenya	3.0	0	0.3	–0.1
Tanzania	3.0	0	0.1	0
Armenia	0	0	0	0
Total	**35.2**	**17.8**	**14.4**	**32.7**

Note: Zeros indicate less than 0.05 percent. Totals entries may not add due to rounding.

Within the countries we visited, we discussed Bank operations with Bank field staff, U.S. embassy officials, officials of relevant national and local government bodies (e.g., ministries of finance and agencies using Bank funds in their operations), local representatives of the foreign assistance agencies of other major donor countries, concerned nongovernmental organizations, and the local business community. In each country, we visited several sites where Bank-funded operations were underway and spoke with project administrators and intended beneficiaries.

To assess the development effectiveness of IDA and IBRD projects, we analyzed numerous studies and annual reports from the Operations Policy Department, which monitors the performance of ongoing projects, and the Operations Evaluation Department, which evaluates completed projects.

In several cases we requested additional data from the Operations Evaluation Department's database on evaluation results. The Bank declined to provide us with much of the data we requested, citing its disclosure policy and concerns about confidentiality. The lack of detailed data significantly limited the extent of our analysis. We interviewed several OED evaluators and reviewed their reports to become familiar with their methodology and ensure that evaluations are conducted with an appropriate degree of independence and subject area expertise.

To evaluate the Bank's reform efforts, we again obtained relevant studies from the Operations Policy and OEDs. The former is responsible for overseeing implementation of the reforms, while the latter has evaluated many of those efforts and their results. We also reviewed the report of a working group convened to study the Bank's nonlending services. We discussed many of these studies with representatives of the Operations Policy and OEDs to ensure that our interpretation of the results was appropriate.

We performed our review from October 1995 to June 1996 in accordance with generally accepted government auditing standards.

World Bank's Impact on Private Foreign Investment in Developing Countries

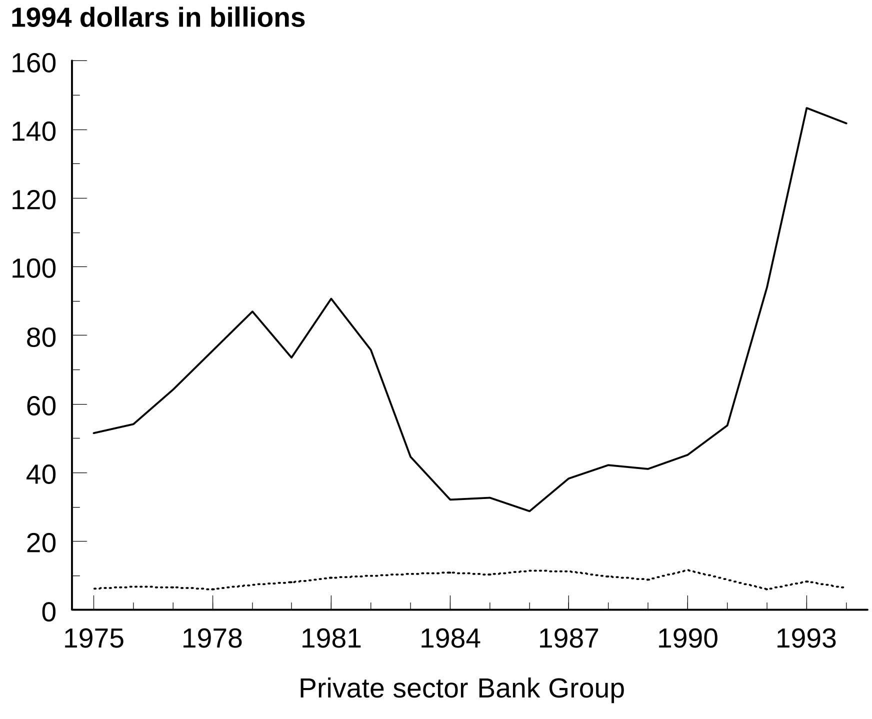
The recent expansion of private foreign investment in developing countries has renewed interest in the relevance of the Bank to economic development and in the relationship between the Bank and private capital flows. Critics have asserted that Bank involvement in markets inhibits private investment. However, supporters of the Bank claim that its efforts are enhancing the environment for private sector investment. Private sector firms we interviewed said that, with the exception of a limited number of markets that have substantial private sector activity, the Bank did not appear to displace the flow of private capital. In fact, these firms cited the Bank's guarantee programs and efforts to promote legal and regulatory reform as important elements in attracting private sector investment.

Rapid Growth in Private Capital Investment Raises Questions About the Relevance of the Bank

Since 1991, net resource flows from the private sector to developing countries have grown rapidly and have substantially exceeded the amount provided by the IBRD, IDA, and IFC (see fig. 2.1).[1]

[1]The financial data presented in this report were obtained from the World Bank, are based upon net foreign resource flows, and include World Bank-eligible borrowers only. "Net foreign resource flows" are the sum of net financial flows on long-term debt, including IMF loans, plus net foreign direct investment, portfolio equity flows, official grants, and technical cooperation grants. As of June 30, 1995, the World Bank listed 140 countries as eligible for IBRD loans and/or IDA credits. Of these, 63 low-income countries were eligible only for IDA credits. Sixty-two middle-income countries (1994 per capita gross national product between $790 and $8,060) were eligible only for IBRD near-market rate loans. Fifteen countries are eligible for a blend of IBRD and IDA funds with the four highest income countries being small island economies. These data exclude countries such as South Korea, Portugal, and Singapore, which have already graduated from eligibility for World Bank financing. While these countries may continue to receive disbursements from the Bank Group, they are no longer eligible for new financing.

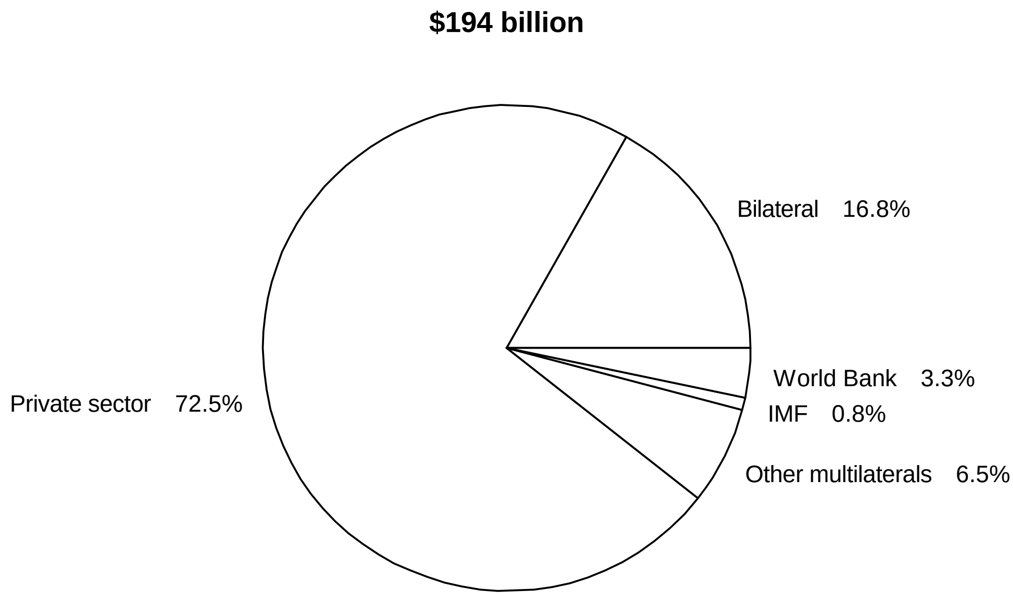
Figure 2.1: Comparison of Bank and Private Sector Net Resource Flows to Developing Countries (fiscal years 1975-94)



Source: Compiled from 1996 World Bank Debt Tables.

Net resource flows from the private sector accounted for nearly three-quarters of the $194 billion invested in developing countries in 1994 (see fig. 2.2).

Figure 2.2: Composition of Net Foreign Resource Flows to All Developing Countries (fiscal year 1994)



Note: World Bank category includes IBRD, IDA, and IFC.

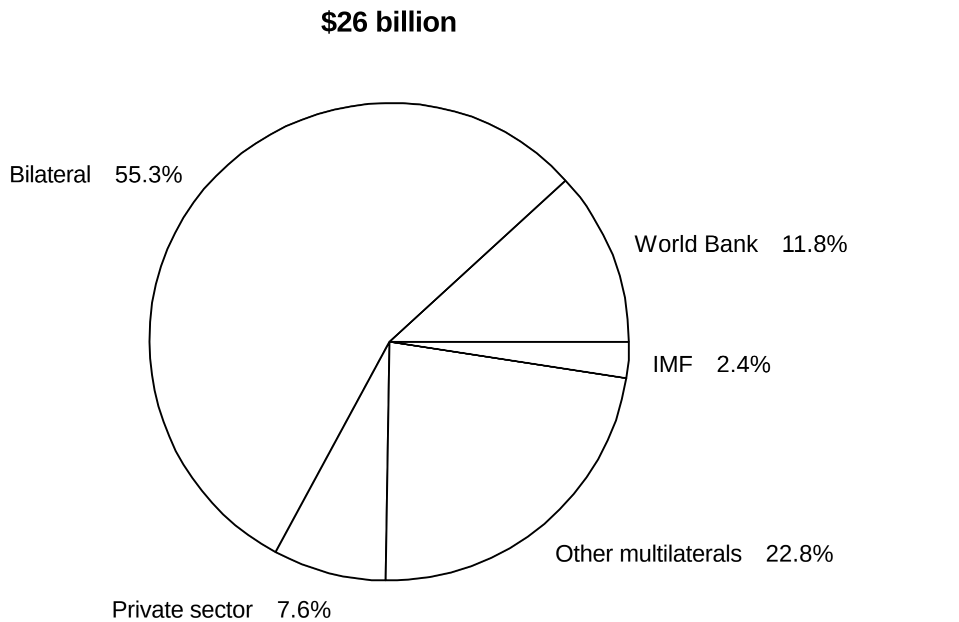
Source: Compiled from 1996 World Bank Debt Tables.

The U.S. government has long promoted the idea that the private sector should have an important role in development. The recent growth in private capital is clearly consistent with that goal. As private sector flows have dramatically increased, the share of net resource flows attributed to the Bank has rapidly fallen and only accounted for about 3.3 percent in 1994, down from about 6.8 percent in 1991.

This rapid fall in the Bank's share of net resource flows has raised some concern about the Bank's continued importance in development. However, this recent rise in private capital flows has not been experienced by lower income developing countries. As shown in figure 2.3 private capital represented less than 8 percent of total net resources flowing to

IDA-only countries in 1994. The private sector's share is lower than the World Bank's share and much lower than the share from bilateral donors.

Figure 2.3: Composition of Net Foreign Resource Flows to IDA-Only Countries (fiscal year 1994)



Note: World Bank category includes IBRD, IDA, and IFC.

Source: Compiled from 1996 World Bank Debt Tables.

Somewhat paradoxically, concerns have also arisen as to whether the Bank's involvement in developing countries inhibits the flow of private capital to those countries. This issue and concerns regarding the continued importance of the Bank are subsets of a larger discussion on the "distortionary" impact of Bank programs and policies.

Market Distortion Is Difficult to Measure

The World Bank states that it acts as a catalyst for private sector investment by covering risks that the market is not willing to bear, thus reducing overall financing costs and aiding development. Bank officials also point out that, at least in recent years, the Bank has worked with governments to create better investment climates that will encourage the growth of markets in general and private foreign investment in particular.

Critics counter that these public finance services, provided at subsidized rates, displace companies that are subject to market rates, distort market signals, and inhibit business development. Also, the presence of lower cost public money may enable recipient governments to delay necessary market reforms, further inhibiting the growth of the private sector.

Public funding affects or distorts the underlying variables of a given market (e.g., prices and quantities demanded and supplied) when compared to a market that does not have public funding. This distortion can have either positive or negative consequences depending on the goals and effectiveness of the intended public policy, the initial conditions of a given market, the occurrence of any unintended consequences, and the impact of unforeseen external events, such as the subsequent collapse of commodity prices or the worsening of civil discord. This basic principle applies to the programs supported by the World Bank. However, measuring the impact of public funding can be quite speculative. Since public financing is available to developing countries from a wide variety of sources, both domestic and foreign (multilateral and bilateral), it is extremely difficult to establish the conditions that would have existed in the absence of public funding or to assess the amount of distortion directly attributable to the World Bank. The available aggregate data do not permit such an analysis, and thus we cannot establish a causal link between the Bank's efforts and the success or failure of a particular country's development effort.

In lieu of such analysis, we obtained 65 private sector firms' views regarding their experiences with the World Bank and with private investment in developing countries.[2] Specifically, we asked these firms whether Bank policies and programs interfered with or displaced their investment in developing countries. We also explored the views of these private firms on the effectiveness of Bank efforts to enhance the environment for private sector investment.

[2]See appendix II for a list of the 65 firms we visited. The firms came from a total of 47 companies in 12 different locations across 8 different countries. The reason that the number of firms exceeds the number of companies is that we spoke with representatives of 10 of these companies in 2 or more locations. The responses of these duplicate companies often varied across location, due to differing experience in investment and with the World Bank. Of our total of 65 firms, 58 were directly engaged in private investment, while 7 worked to support it. In our analyses on the frequency of displacement and enhancement, we used only the data from the 58 firms engaged in investment.

Concern About Displacement Is Confined to a Limited Number of IFC Markets

According to the firms we interviewed, the World Bank inhibited efforts to invest in a limited number of developing country markets. Their concern has been mostly with the activities of IFC, which is taking steps to address this issue. Few concerns were raised regarding the other Bank Group institutions, which tend to operate in countries where conditions are not yet favorable to international investment or in sectors of little interest to the private sector.

IFC Displacement Identified as a Problem by Some Firms

More than one-quarter of the private sector officials we spoke with cited instances in which IFC's presence conflicted with their participation in a given project. These instances occurred in commercially viable sectors, including pulp and paper, oil and gas, power generation, and telecommunications, where private firms were increasing their level of participation. Some private sector officials commented that IFC regularly takes equity positions in projects they are considering investing in. Such involvement acts as a disincentive for their firms' participation because they either prefer not to share equity or perceive that IFC exerts more influence than merited by its financial position in the project.

We were also told that IFC's nonlending services (e.g., advisory services) have displaced commercial and investment banks that wanted to provide these services for development projects. A former U.S. Executive Director told us that during his tenure, he heard complaints from private sector officials that IFC competed with private companies in contracting for advisory services. Some business officials told us that IFC encourages borrowing entities to use IFC nonlending services or to have IFC review previously completed services, even when private partners do not see the need. Several commercial bank officials in Hong Kong and Japan also noted that IFC displaces the private sector by arranging financing, a service they would like to provide.

Private sector officials provided several examples in which IFC displacement occurred in specific markets. One commercial bank official described a situation in which IFC displaced a small investment firm where he was formerly employed. The firm, which helped create local capital markets, had an opportunity to invest in a single-family housing project in a suburb of Jakarta, Indonesia. His firm was asked by local businessmen to participate as an equity holder and provide a medium-term loan for the project. Subsequently, IFC became involved in the project, offered a lower interest rate for the same services, and edged out the small firm.[3] The

[3]This commercial bank official also told us that the project was subsequently terminated, but he was not aware of the reason for termination.

commercial bank official said that he doubted that IFC should have been involved in the project because it already had sufficient commercial interest. In another instance, a commercial bank official told us that his bank wanted to arrange financing for a telecommunications project in Indonesia but lost out to the IFC. He said that the project's sponsors selected IFC to arrange financing for the project without going through a bidding process. He believed that the IFC typically obtained information about projects earlier than commercial banks, allowing it to outpace commercial banks that want to arrange financing.

Problems with IFC stem, to some extent, from its somewhat contradictory mandate. According to a Managing Director of the Bank, IFC is supposed to achieve two goals: make profits and have a developmental impact (that is, catalyze investment where the private sector would otherwise be unwilling to go). He told us that Bank management had received complaints from World Bank board members that IFC is excessively oriented toward earning profits. IFC's Executive Vice President emphasized that IFC does not seek to maximize profit but instead to achieve an acceptable rate of return on its investments. He acknowledged, however, that IFC at times may choose projects where the occurrence of competition was a judgment call. Nonetheless, he explained that IFC is now committed to addressing not only the possibility but also the perception that it is competing with the private sector.

IFC Working to Minimize Future Displacement

Citing increased activity and overlap with the international private sector, IFC reviewed its operating practices and guidelines in November 1995 to clarify the importance of not competing with private investors. This review of selected policies and practices stressed collaboration with the private sector to underscore the supplemental value of IFC's basic services: project finance, stand-alone advisory services, and securities underwriting and placement. The review emphasized three guiding principles for IFC's mandate:

- to participate in projects that otherwise would not be possible at all or would not be completed in a timely fashion;
- to stimulate the flow of private capital, both domestic and foreign, to productive enterprises; and
- to bring the discipline of the market (i.e., profitability) to bear upon the investments in which it participates.

IFC's Executive Vice President told us that a contact point within the institution had been established to receive complaints from the private sector regarding its experience with IFC. He also said that IFC is working to reduce its participation in markets where private sector interest is well established, such as Thailand. He said that IFC has generally withdrawn from competitive bidding against the private sector for contracts to provide advisory services to recipient governments.

U.S. and foreign private sector officials suggested to us that IFC should provide financial services in more risky markets and sectors, such as constructing road systems, or to facilitate projects that would have difficulty gaining access to foreign exchange. The Executive Vice President of IFC explained that both the IFC Board and the market are primary factors in directing where IFC financing goes. For example, he said that prior to the Mexican peso crisis, the IFC portfolio in that country was declining; however, after the crisis, due to the shortage of private sources of long-term financing, the Board decided IFC financing in Mexico should increase. He also said that both aggregate economic data and IFC's own experience can determine whether continuing IFC assistance is required in particular markets. He pointed to the Czech Republic as an example of a country where IFC financing was needed over 3 years ago; however, IFC's role has since been reduced, and it is currently participating only in special privatization projects.

Displacement Not an Issue for IDA, IBRD, and MIGA

Private investors we spoke with expressed little interest in investing in IDA-eligible countries, and none of them said that IDA loans displaced their investments. Figure 2.3 showed that very little private capital is going to IDA-only countries. Private firms also indicated to us that the activities of the IBRD tend to be in sectors and markets in which the international financial sector has very little interest. IBRD also lends to the governments of developing countries, further limiting the potential interest of the private sector. However, three of the private sector firms we spoke with noted that IBRD potentially displaces private institutions by lending at low rates for projects that may have been commercially funded instead.

MIGA's political risk insurance services do not displace private sector insurers. Privately provided insurance is currently not available for the length of time investors require and does not offer the full range of coverage offered by MIGA. MIGA provides investment insurance against noncommercial risks, such as currency inconvertibility, expropriation, war and civil disturbance, and breach of contract, particularly for the longer term (8 to 20 years). One private provider of political risk insurance is planning to expand its coverage in the future, but the duration of insurance (up to 7 years) will still be less than what is offered by MIGA.

World Bank Programs Aim to Enhance Private Capital Flows

Despite instances in which private sector officials noted that the IFC displaced their involvement in projects, nearly 90 percent of the firms we spoke with said that Bank Group services enhance opportunities for international private capital by reducing the risks associated with investing in developing countries. These services include guarantee and political risk insurance programs as well as loans and technical assistance that help borrowing countries strengthen their regulatory and legal systems.

Bank Activities Help Minimize Risks for Investors

In September 1994 IBRD revitalized its guarantee program and now uses partial risk and credit guarantees to address lenders' concerns about borrowers' ability to repay loans. These two programs have had very limited use thus far, but several private sector firms expressed interest in their potential for reducing noncommercial risk. Partial risk guarantees cover risks associated with the borrowing government's contractual commitments to a project (also known as sovereign risk)—for example, the stability of the regulatory regime, tariffs, and nonpayment by a publicly owned utility. Partial credit guarantees cover all events of nonpayment (both sovereign and noncommercial) for a designated period of financing. These guarantees encourage extension of maturities by covering repayments in the later years of the project (e.g., beyond 10 years). According to Bank officials, both guarantees can be used for large, expensive, long-term projects, such as infrastructure projects, to meet the needs of commercial bankers. World Bank officials added that as a substitute for typical IBRD loans, which are provided to governments, the Bank Group has recently been combining IFC loans with World Bank guarantees to focus more resources toward the private sector.

Several private sector officials noted that the Bank's guarantee programs encouraged their participation in projects. For example, IBRD provided a partial risk guarantee for the Hub Power Project in Pakistan. Officials from some of the Japanese banks that participated in the project said the guarantee was helpful because it would have been impossible to get a guarantee from the private sector for the length of the project (about 12 years). The private sector would have guaranteed only 2 to 3 years of the project. Officials from a U.S. investment bank told us that the partial credit guarantee program was instrumental in the successful financing of a power project in the Philippines. They doubted the project would have been financed without the guarantee. They also said they are working with IBRD's partial risk guarantee program to help create an infrastructure development corporation in the Philippines. If this project goes forward, the guarantee program will significantly reduce the interest rate offered by the development corporation to finance infrastructure projects.

Some private sector officials told us that political risk insurance, such as the type offered by MIGA, was critical to their operations in some developing countries. MIGA was established to help promote the flow of foreign direct investment by insuring investments against noncommercial risks. Although MIGA has a lower insurance limit than bilateral providers of political risk insurance, such as the U.S. Overseas Private Investment Corporation (OPIC), it offers businesses a multilateral alternative when bilateral insurance is unavailable. For example, some U.S. private sector officials said that they use MIGA in countries where OPIC does not operate because of U.S. foreign policy concerns or because OPIC has already reached its exposure limits.

Lending Activities Aim to Increase Participation of Private Investors

Some of the World Bank's lending activities are designed to encourage private sector participation in development projects. For example, the volume of cofinanced World Bank assisted operations totaled $8.2 billion in fiscal year 1995.[4] In cofinancing arrangements, commercial banks typically provide loans for up to 10 to 12 years, with the World Bank and other lenders (e.g., regional multilateral development banks and bilateral financing agencies) providing the remainder of the loans. Commercial lenders told us that their level of confidence of being repaid is greater when they are involved in World Bank projects because borrowing countries are less likely to default on a World Bank loan than on a commercial loan. According to the Bank's Cofinancing and Financial Advisory Services officials, cofinancing creates an umbrella effect, fostering increased participation by commercial banks in the development process. They estimate that about 42 cents for every $1 the Bank loans is cofinanced.

IFC deals exclusively with private sector development, primarily providing lending services and advice. According to its Executive Vice President, IFC has devoted about one-fourth of its work to capital market development,

[4]Fifteen of 114 Bank cofinanced projects in fiscal year 1995 were with the private sector.

another one-fourth to one-third to development of private infrastructure, and the remainder to other purposes (e.g., privatization and small enterprise development). IFC provides loans for its own account, called A loans, and mobilizes international private capital for projects through syndicated loans, called B loans. For B loans, IFC shares the commercial risks of projects with cofinancing partners and is the lender of record.[5] Loan syndications and underwriting have represented almost half of IFC financing for investment approvals since 1991.

Several private sector officials we interviewed said that IFC involvement in some projects has acted as an incentive for their participation. For example, IFC arranged a syndicated loan for a textile project in Suzhou, China. While the officials acknowledged that the project was strong on its own merit, they said project financing in China was difficult because China does not have a sound legal structure and a convertible currency. Business officials told us that IFC participation helped increase investors' confidence and attract private financing.

IFC involvement can also help businesses enter new markets. One private sector official told us that his company is trying to establish a presence in the securities market to finance costly infrastructure projects. His company has joined with IFC and other private sector investors to establish a new entity that would provide credit enhancement to developing countries by issuing securities. The new company would be able to facilitate both domestic and cross-border investments. According to the chief executive officer, the company could not have undertaken such a project on its own because of the need for regulatory backing from the host country government (governments trust the World Bank/IFC's advice) and the high risks involved.

Nonlending Services Address Foreign Investors' Interests

The Bank's nonlending services, such as economic and sectoral work, policy dialogue, and training, help host governments establish regulatory and legal structures to protect investors' interests and create an environment that is conducive to private sector investment. Private sector officials told us that sound regulatory and legal structures are important elements in determining whether to invest in a market. Because borrowing

[5]As the lender of record, IFC incorporates provisions in its loan agreements for the loans for its own account and for the accounts of the remaining participants, and IFC is the sole contract party with the borrower. In this capacity, IFC has rights and responsibilities vis-a-vis the participants, borrowers, and IFC's shareholders that arise from the operation of law and from the contractual undertakings set in various agreements. These responsibilities include monitoring the project/borrower, informing banks about any material developments, administering the loan documentation, and distributing to the participants their respective shares of payments received.

countries view the Bank as a neutral and objective intermediary, the Bank has a unique role in encouraging regulatory and legal changes that help attract foreign investment. According to the Bank's Vice President for Finance and Private Sector Development, the Bank is the world's largest force for this kind of work.

This Bank official also told us that this division is working in 70 countries to advise governments in areas such as

- reforming their banking systems through training in bank supervision, accounting and auditing standards, payment/settlement systems, and bank insurance systems;
- modernizing their legal systems, including commercial and bankruptcy laws, and establishing arbitration systems; and
- privatizing their assets by helping them establish privatization ministries and auction and voucher systems and by providing legal advice.

In addition, the Bank and IFC have together prepared a series of private sector assessments in various countries to gauge the individual needs of a particular country. According to the Bank's Vice President for Finance and Private Sector Development, a private sector assessment helped the government of Morocco develop a program jointly financed by the public and private sector to help overcome constraints to private sector development.

IFC also provides technical assistance for projects that seek to develop capital markets, draft securities market laws and regulations, and create or develop stock exchanges. According to Bank officials, this type of assistance helps prepare the way for infrastructure privatization. For example, an investment company official stated that U.S. custodial banks are reluctant to provide complete custodial services to clients in Russia because of the lack of efficient share registration facilities. He added that the Bank and IFC are best suited not only to provide the necessary finance but also to persuade the host government to adopt more efficient and safer systems.

In the mid-1980s, IFC established the Foreign Investment Advisory Service (FIAS) to review government policies and laws with respect to foreign direct investment. Now a joint venture of IFC and the Bank, this Service advises countries on how to eliminate impediments to foreign direct investment and, in some cases, helps countries develop investment promotion agencies. Using IFC's financial experience in developing countries, FIAS works as a consultant to any government that wishes to increase foreign direct investment. Working only on requests by developing country governments, FIAS can provide a wide range of assistance, including diagnostic reviews of policy impediments, reviews of specific investment policies, and institutional strengthening. The distribution of FIAS reports is typically restricted. China and several other countries have sought FIAS advice on policies governing foreign direct investment in infrastructure sectors. Altogether, FIAS has worked in over 90 developing countries.

In addition to technical assistance, the Bank provides information on macroeconomic policies of borrowing countries. Private sector officials told us that the Bank provides information on various markets, which is useful for analyzing industries and for making investment decisions. Officials from two rating agencies told us that World Bank information is useful to them in their analysis of country risk. One rating agency official added that the private sector does not have the resources to do the kind of in-depth analyses that the World Bank does and that insufficient information would result in poorly functioning markets and inefficient investment decisions.

Development Effectiveness of World Bank Projects

The most current information available from the World Bank indicates that IDA and IBRD projects have experienced significant problems in achieving their stated development objectives during the last decade. A significant portion of recently completed Bank projects are judged by the Bank itself as unsatisfactory. Bank projects have had a much greater rate of success in building physical infrastructure than in transforming the underlying structure of developing economies. Weaker performance in leveraging needed sector policy reforms and facilitating private sector development through lending is of particular concern, as the Bank itself has concluded that progress in these areas is critical for economic growth and poverty alleviation. Prominent among the causes of weak performance have been project design and implementation problems, borrowing countries' inadequate commitment and capacity, and the increasingly challenging nature of Bank projects.

Measuring Development Effectiveness

It is difficult to demonstrate the impact of Bank projects on countries' overall development. The Bank's contributions to development cannot usually be separated from those of other donors, the countries themselves, and private sector investors. Furthermore, it is not reasonable to use country macroeconomic indicators alone to judge the effectiveness of the Bank, especially since one can only speculate about the course of a country's development in the absence of Bank assistance.

Given these limitations, we relied on project-specific data to assess whether Bank projects achieved their goals. The most comprehensive data the Bank provided to us on project performance were IBRD and IDA project evaluation data. These data do not reflect the outcome of the contributions that the Bank makes through MIGA guaranties; IFC private sector investment; and nonlending services, including economic and sectoral work, research, policy work, trust fund projects, and development training. In fiscal year 1995, the Bank's outlay for IDA and IBRD loans was six times greater than for these other activities combined.[1] Few evaluation data are available for these other activities, though the Bank is now developing evaluation systems for them.[2] In future years, as evaluation

[1]Outlays for other activities consist of IFC disbursements for loans and equity investments, MIGA's maximum aggregate liability, and the cost of providing nonlending services (estimated at 38 percent of the Bank's administrative budget for fiscal year 1995).

[2]IFC does not systematically report on the development effectiveness of its investment portfolio as the Bank does for IDA and IBRD projects. IFC assesses the development effectiveness of many of its projects, but these assessments were not made available to us at the time of our review. The Bank did provide some aggregated IFC project evaluation data, but this information did not address development effectiveness, focusing instead on financial returns.

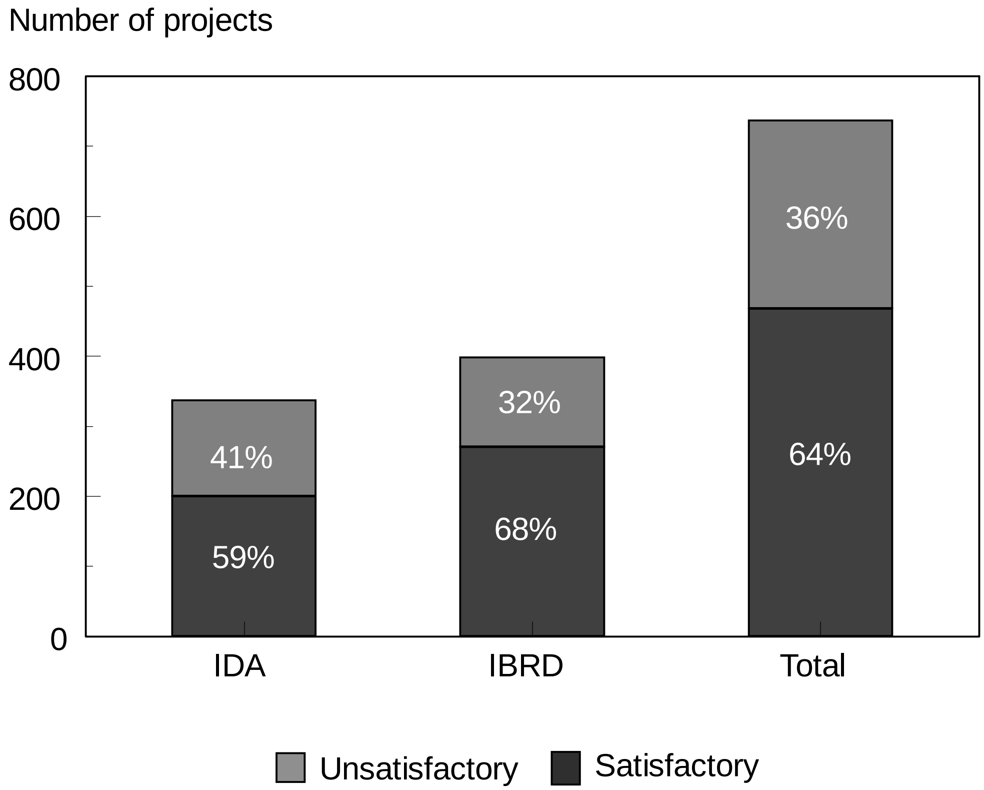
becomes more systematic, the Bank and other observers may be better able to evaluate the overall performance and effectiveness of all Bank programs. Even with these limitations, Bank and U.S. Treasury officials have indicated that, among all bilateral and multilateral donors, the Bank has the most rigorous and systematic methodology for evaluating the performance of its projects.

Significant Percentage of IBRD and IDA Projects Judged Unsatisfactory

The most recent IBRD and IDA project evaluations available reflect the outcomes of 737 projects that were implemented primarily between 1985 and 1993. The results of these evaluations are displayed in figure 3.1. The Bank judged 36 percent of these projects to be unsatisfactory and 64 percent satisfactory.[3]

[3]For a project to be rated satisfactory, its goals must be consistent with the Bank's country and sectoral assistance strategies (relevant), and it must have achieved, or be expected to achieve, most of its major goals (efficacious) in a timely and cost-efficient manner (efficient).

Figure 3.1: Outcomes of Projects Evaluated in 1993-94



Source: World Bank, OED.

The Bank generated these data from an extensive evaluation process that determined completed projects' relevance, efficiency, and efficacy. Evaluation data were compiled by the Bank's OED from a combination of self-assessments prepared by project managers and audits of those self-assessments prepared by OED evaluators. For each project, the specific objectives and other aspects of the project were examined, and an overall outcome rating was assigned, ranging from highly unsatisfactory to highly satisfactory. Ratings based on self-assessments done by Bank managers, which represent about 65 percent of all project ratings, tended to be more optimistic than those based on OED audits.[4] An unsatisfactory project is one that, in the evaluators' judgment, has not met its major relevant goals

[4]In fiscal year 1995, OED audited the results of self-assessments and found that they overstated the number of projects with satisfactory outcomes by about 9 percentage points.

or has not made an acceptable contribution to development. According to OED, however, even projects rated unsatisfactory have made useful contributions to development to the extent that some of their objectives were achieved. OED also cautions that development projects are inherently risky enterprises and some unsatisfactory outcomes should be expected. We could not identify any objective, widely accepted criteria as to what percentage of unsatisfactory projects would be deemed acceptable.[5] However, the Bank's President has expressed concern about this record of performance and the need to improve.

Variations in Performance by Region and Sector

The overall satisfactory rate of recently evaluated Bank projects masks substantial differences in achievement among regions, as shown in table 3.1. In sub-Saharan Africa, where about one-third of these projects were implemented, only about half of the projects were judged satisfactory. In the East Asia and Pacific region, on the other hand, 81 percent of the most recently evaluated Bank projects achieved a satisfactory rating.

Table 3.1: Satisfactory Project Outcomes by Region and Loan Type (for projects evaluated 1993-94)

	Percentage of projects judged satisfactory		
Region	**IDA**	**IBRD**	**Overall**
Sub-Saharan Africa	51	51	51
East Asia and Pacific	71	85	81
Europe and Central Asia	100[a]	60	60
Latin America and the Caribbean	73	61	62
Middle East and North Africa	67	69	68
South Asia	70	76	71
Total	**59**	**68**	**64**

Note: IDA data include a small number of projects financed jointly by IDA and IBRD.

[a]Reflects performance on only one IDA project in this region.

Source: World Bank, OED.

Bank evaluation data also show mixed results across sectors and between IBRD and IDA projects (see table 3.2). While IBRD projects have fared better than IDA projects overall, this was not the case in all sectors. Most notably, projects that provided some of the most basic needs—water and sanitation

[5]The Bank President told us that it was his goal to reduce the number of unsatisfactory projects to 20 percent.

and human resources projects[6] in IDA countries—had the highest rate of satisfactory outcomes of any type of project (91 percent and 86 percent satisfactory, respectively). Two types of projects with primarily nonphysical objectives, namely technical assistance and financial sector projects, were among the least successful (49 percent and 43 percent satisfactory, respectively). According to OED, financial sector reform is a key component of the Bank's private sector development efforts.

Table 3.2: Satisfactory Project Outcomes by Sector and Loan Type (for projects evaluated 1993-94)

	Percentage of projects judged satisfactory		
Sector	**IDA**	**IBRD**	**Overall**
Agriculture	57	64	60
Energy	62	73	69
Finance	38	56	49
Human resources	86	76	80
Industry	50	64	58
Pollution control and solid waste	•	•	•
Power	63	74	68
Program and policy	60	68	64
Technical assistance	38	57	43
Telecommunications	75	50	63
Tourism	•	•	•
Transport	52	71	62
Urban	73	83	80
Water and sanitation	91	62	70
Total	**59**	**68**	**64**

Note: IDA data include a small number of projects financed jointly by IDA and IBRD. No pollution control and solid waste or tourism projects were evaluated in these years.

Source: World Bank, OED.

Greatest Rate of Success in Physical Objectives

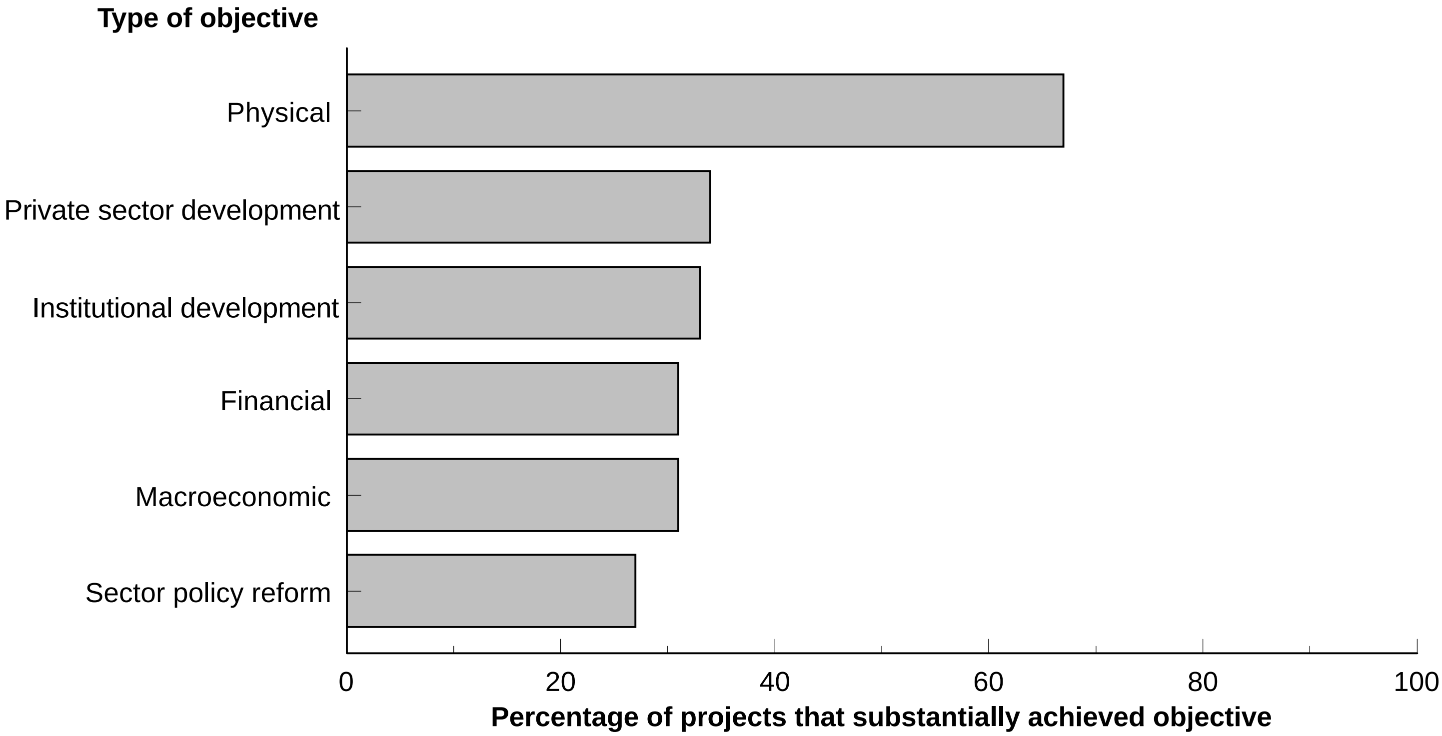
Bank evaluation data show that the area with the greatest rate of success for projects evaluated in 1993 and 1994 was in meeting physical objectives. As illustrated in figure 3.2, 67 percent of these projects substantially achieved their physical objectives, such as constructing buildings and infrastructure and providing social services to project beneficiaries.[7] In

[6]These include education, population, health, and nutrition projects.

[7]Projects that were judged to have highly or substantially achieved these types of objectives are included in this category. Projects that were judged to have achieved their objectives only moderately or negligibly are not included.

contrast, other objectives were substantially achieved in only one-third or fewer of the projects in which they were included. Thus, Bank projects have had markedly less success in leveraging market and policy reforms and furthering the growth of the private sector.[8]

Figure 3.2: Evaluation Results by Project Objective (for projects evaluated in 1993-94)



Note: Data on private sector development objectives available only for projects evaluated in 1993.

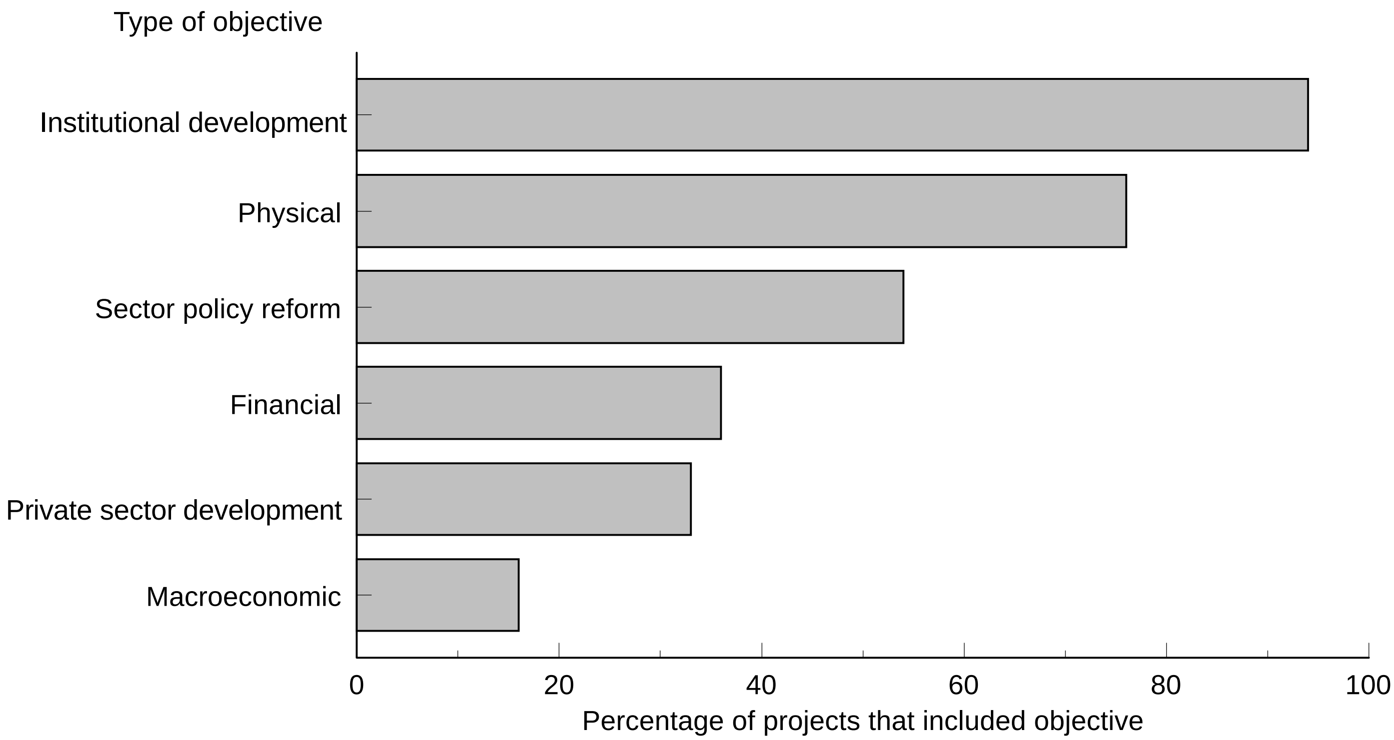
Source: World Bank, OED.

In addition to being more often substantially achieved, physical objectives were more often included in these projects than most other types of objectives. As shown in figure 3.3, 76 percent of projects evaluated in 1993

[8]"Private sector development" refers to activities specifically aimed at promoting private enterprises, such as privatization of state-owned operations, and may not include some policy reforms that would more generally foster private sector development.

and 1994 included physical objectives. Data on project objectives also indicate that Bank projects frequently impacted borrowing country institutions, because, although the success rate in this area was low (as shown in fig. 3.2), institutional development was the most common objective, included in 94 percent of Bank projects. Bank projects less frequently attempted to achieve other nonphysical objectives, such as macroeconomic reform (included in 16 percent of the projects), private sector development (included in 33 percent), financial reform (included in 36 percent), and sector policy reform (included in 54 percent). Given the absence of such objectives in many projects and the poor success rates in achieving such objectives when included, it appears that Bank projects overall have had considerably less impact in improving countries' underlying market and policy conditions than in building physical and institutional infrastructure.

Figure 3.3: Objectives Included in Projects (for projects evaluated in 1993-94)



Note: Data on private sector development objectives available only for projects evaluated in 1993.

Source: World Bank, OED.

According to senior Bank officials, many of these projects did not include market and policy reform objectives because at the time that these projects were approved the Bank's preferred vehicle for achieving such reform was "adjustment" lending. Adjustment projects, which since the early 1980s have represented about a quarter of the Bank's portfolio, provided hard currency loans in exchange for an agreement by the borrowers to make certain policy and market reforms (or adjustments) and did not include physical objectives.[9]

[9]In general, adjustment projects have been somewhat more successful than their investment-oriented counterparts in meeting policy and market reform objectives. For example, 44 percent of adjustment projects evaluated in 1993 and 1994 substantially achieved their sector policy reform objectives. Only 24 percent of the investment projects that had this type of objective substantially achieved it. Overall, 27 percent of all projects with this objective substantially achieved it.

Regardless of the instrument used, success in achieving policy and market reform objectives has important implications for the development effectiveness of Bank projects. A 1995 OED study on the social impact of structural policy adjustment showed that when Bank projects achieved policy reform objectives, the results for development were very positive. According to the report, countries that successfully implemented the adjustment policies agreed to with the Bank have achieved growth in per capita income and reduced the proportion of their populations in poverty. This study also indicates that substantial success in meeting policy reform was very important. It concluded that the most common reason why adjustment operations failed was that the agreed policies were only partly adopted or were soon abandoned.

A project in one sub-Saharan African country illustrates the limitations of achieving only physical and institutional objectives. This project was aimed at promoting tourism by improving the protection of wildlife, a major tourist attraction that was being threatened by poaching. By providing funds for equipment and game park infrastructure, the project enabled government rangers to stem poaching, especially in the rhinoceros population. However, since it was considered an emergency project, it did not include any policy reform requirements. According to a U.S. embassy official and the Bank official who monitors this project in the field, despite improvements in wildlife protection, the tourism industry continues to decline, in large part because of poor government policies, such as opposition to private sector tourism promotion and the lack of maintenance of tourist-related infrastructure. The Bank official commented that economic and sectoral research was needed to convince the borrowing government of the economic importance of protecting the environment. Officials responsible for the Africa Region at Bank headquarters believe that, although this project did not include policy reform objectives, it has strengthened the government's policy-making capability and will facilitate the achievement of policy reform objectives in future projects.

Causes of Weak Performance

The 1992 Portfolio Management Task Force's report identified three basic, closely interrelated factors as causes of portfolio performance problems. These factors are (1) problems with the way projects are structured; (2) unfavorable country conditions, such as poor macroeconomic policies, changing development priorities, and poor capacity of local institutions; and (3) a volatile international economic environment. The report identified many project design problems and made a series of recommendations to the Bank to ameliorate these problems, and the Bank has been making efforts to improve in this area.

Data from the 737 IBRD and IDA projects evaluated in 1993 and 1994, displayed in table 3.3, confirm that this combination of factors also negatively impacted these project outcomes. They show that the lack of borrowing countries' commitment and the poor quality of institutions in borrowing countries were the most prevalent negative factors—each identified as such in nearly one-third of evaluated cases. Bank performance was a negative factor for about one-fifth of the projects, as were domestic shocks external to project management, such as political upheaval, natural disaster, and economic disruption.

Table 3.3: Major Factors Negatively Influencing Project Outcomes (for projects evaluated 1993-94)

Major factors negatively influencing outcome	Percentage of projects negatively affected
Government commitment	32
Quality of implementing agency management	32
World Bank performance	22
Domestic shocks	22

Source: World Bank, OED.

Projects Increasingly Challenging

Bank projects have become more challenging in recent years, which could also help explain poor performance. OED analysis indicates that during the 1980s Bank projects became increasingly complex, risky, and demanding on the borrowers. Complex projects may involve a wide range of reforms; a large number of institutions, project components, and cofinanciers; or wide geographic dispersion. Risky projects are ones that are based on key assumptions about the underlying conditions in a country that may be especially vulnerable to changes. Demanding projects may stretch the country's implementation capacity. According to OED, given this increased difficulty, the recent stabilizing trend in outcome ratings may actually represent a noteworthy achievement by project implementers.

Economic and Sector Work Underutilized in Projects

Another important factor identified more recently as affecting portfolio performance is the use of economic and sector work to support the development of new projects. The Bank conducts economic and sector work to identify and diagnose countries' development problems. This work includes specialized sectoral studies, policy research that supports project development, and other analytical and advisory work. A 1995 Bank study found that when sector- and project-related economic and sector work is conducted, it can contribute to the eventual success of a project. This work has the advantage of focusing on issues of institutional support, budgetary provisions, project alternatives, and risks. The report concluded that "relatively small expenditures by the Bank on economic and sector work can leverage up large increases in development impact on the ground in client countries."

However, the results of the study suggest that not enough economic and sector work has been done. The study indicates that only 39 percent of the 431 completed projects that were examined for this study had been preceded by relevant economic and sector work in the 3 years prior to approval.[10] The report stated that for the 35 poorest performing countries, "greater attention to country fiscal performance—a function of economic and sector work—might have reduced the number of poorly performing projects." Another OED study concludes that more attention to policy research during project preparation and appraisal and policy dialogue with stakeholders can significantly overcome borrowing governments' reluctance to press ahead with policy reforms.

[10]Some Bank officials commented that the Bank's economic and sector work effort may be understated in this study because some relevant analyses were not considered as economic and sector work. However, the report did not include this qualification.

World Bank Reform Efforts

The Bank has taken a number of steps in recent years to improve IDA and IBRD portfolio performance. Some of these reforms appear promising, especially increased efforts by the Bank to link lending to countries' performance in establishing a market and policy environment conducive to development. Other reforms, however, such as improving project design and implementation, have been slow to take hold, and their discernible impact on portfolio performance has been limited. However, it is too early to assess the long-term impact of these reforms on development effectiveness. Decisive evidence on this issue may not be available for several years, when projects designed and implemented under the new environment are completed and evaluated.

Portfolio Management Problems Being Addressed

Since the 1992 report of the Portfolio Management Task Force, the Bank has undertaken a wide variety of initiatives to address its performance problems. The Bank has taken measures to implement this report's recommendations under the Next Steps Program, which involves

- linking country portfolio performance to the bank's core business practices,
- providing for more active project and portfolio restructuring,
- improving the quality of projects entering the portfolio,
- defining the Bank's role in and improving its management of project performance,
- enhancing OED's role as an instrument of independent accountability and giving greater emphasis to evaluation of completed projects,
- creating an internal environment that promotes better portfolio management, and
- giving attention to generic and institutional factors that affect portfolio performance.

Many of these efforts are in their early stages, and for some of them it is too early to see results reflected in current performance measures. However, in some cases, data are available to evaluate to what extent specific reforms are taking hold and are having a discernible impact.

Linking Lending Levels to Country Performance

The 1992 report of the Portfolio Performance Task Force criticized the Bank for not assessing its overall program in particular countries but instead assessing proposed loans largely on their individual merits. A key component of the Bank's reform efforts has been to make IBRD and IDA lending decisions based on an in-depth reexamination of the portfolio performance and policy reform progress of each country. Through the Country Assistance Strategy (CAS) process, established in 1992, the Bank can set lending levels for a country and periodically reassess them on a well-reasoned basis. These levels can be changed based on a country's performance, as the Bank has done in several of the countries we visited. Linking performance to lending levels could be an effective way for the Bank to (1) leverage change in country practices and (2) increase the likelihood that Bank projects will achieve their development objectives.

Quality of CASs Uneven but Improving

The effort to create well-researched CASS, backed up by in-depth, country-specific analyses of poverty, private sector performance, and government expenditures, is a demanding one. Early efforts were very uneven in quality. In January 1995, the Bank issued updated guidance for CAS preparation. Among other things, the new guidance calls for clear linkages between country performance and lending levels as well as defined scenarios to justify lending decisions. According to OED, CASS prepared in the last half of 1995 expanded their coverage of portfolio performance issues. However, while OED officials and a senior Bank officer agreed that the format and content of more recently prepared CASS have improved, they also commented that the overall quality of CASS is uneven and further improvements are still needed. According to a January 1996 status report on the Bank's Mid-Year Operational Work Program, CASS need to demonstrate better linkages between portfolio management and new lending and create more measurable benchmarks for evaluating progress and the size of the country program. According to a Bank official, the recognition of this problem by Bank management in this report is, in itself, an important indicator that the Bank is taking the CAS process seriously and discussing its portfolio in relation to country performance.

Lending Levels Adjusted Based on Country Performance

Our review of CASS for five borrowing countries supports the Bank's claim that it has begun to develop performance criteria that will serve as a basis for adjusting lending volumes. Furthermore, the Bank has, in some instances, reduced or withheld lending to countries that do not meet established performance criteria. For example, new IBRD commitments to one major borrower in fiscal year 1994 were reduced to about $100 million, down from a planned $1 billion, because of the government's slow progress toward policy reform associated with specific projects. Due to poor economic management practices, one sub-Saharan African country received only about 30 percent of the new IDA credits that the Bank had originally envisioned. In addition, IDA reduced its lending to another sub-Saharan African country in fiscal years 1994 and 1995 because of years of inadequate policy reform and macroeconomic management. Bank officials have not yet reached agreement on new funding levels for this country.

The Bank is also rewarding strong performance. For example, the Bank responded to one small eastern European country's commitment to reform by providing about $145 million in loans in fiscal years 1994 and 1995. The Bank's strategy for this country provides for as much as $250 million in additional loans over the 3 ensuing years if progress is sustained in implementing stabilization and structural adjustment measures or as little as $50 million if this expectation is not met. In the case of one major Asian borrower, the Bank has refrained from linking lending levels to specific performance triggers because a major slippage in this country's reform program is viewed as unlikely. Almost all of the completed Bank projects in this country have achieved satisfactory results, and, as pointed out in a March 1996 CAS progress report, the quality of this country's portfolio remains high.

Data provided by the Bank suggest an increased focus on performance in allocating funds among IDA-eligible countries. As table 4.1 indicates, the top-performing countries[1] tended to receive more assistance under IDA-10 than under IDA-9,[2] while weaker performers received less. In fiscal years 1994-95, the top fifth of IDA performers received an average per capita increase of about 30 percent, while the bottom fifth experienced a reduction of about 53 percent.[3]

[1]Performance ratings were based on evaluations of macroeconomic stability, structural reforms, poverty reduction, and the quality of portfolio implementation.

[2]IDA categorizes its loans according to the number of the replenishment in which IDA members donated the funds for the loans. Thus, the terms IDA-9 and IDA-10 refer to loans made under the 9th and 10th replenishments, respectively, of IDA's concessional loan fund.

[3]While the correlation between lending levels and country performance appears to be stronger in IDA-10 than in IDA-9, other factors, such as shifts in lending priorities and the absorption capacity of certain countries, may also have affected lending patterns.

Table 4.1: IDA Commitments and Country Performance (IDA-only countries)

Level of performance	Annual average commitment per capita: IDA-9 (fiscal years 1991-93)	Annual average commitment per capita: IDA-10 (fiscal years 1994-95)	Change from IDA-9 to IDA-10
Top 20%	$7.0	$9.1	30%
Upper 20%	6.5	6.1	–6%
Middle 20%	10.1	6.0	–41%
Lower 20%	6.7	5.7	–15%
Bottom 20%	1.7	0.8	–53%

Source: World Bank, Resource Mobilization Department.

Comparable data for IBRD lending was not available at the time of our review, and we did not find evidence of a similar shift in IBRD lending toward better performing countries.

Quality of Project Design

One of the Bank's major reform initiatives, resulting from the 1992 report of the Portfolio Management Task Force, has focused on improving the quality of projects entering the portfolio. According to this report, ensuring quality at entry is critical to achieving project success; this entails, among other things, demonstrating borrower commitment and careful analysis of the risks. Since 1992, units throughout the Bank have reported initiatives to improve quality at entry through the use of clear and realistic goals, better defined studies, detailed action plans that can be monitored, performance indicators, regular project reviews, and emphasis on borrower ownership, beneficiary participation, and application of lessons learned.

Design Problems Persist in New Projects Despite Some Improvement

Despite the Bank's efforts, recent studies indicate that project design problems continue. A 1994 OED assessment of Bank initiatives to improve quality at entry concluded that "these initiatives have yet to show their effects on quality at entry." A staff survey conducted by OED supported the conclusion that improvements in quality at entry have been slow to take hold, especially in assessing risks.

In a 1995 Bank study, the quality of the Bank's project economic analysis—a key element in ensuring new project quality—was strongly criticized. The study concluded that economic analyses were less than satisfactory in 38 percent of the projects approved in calendar year 1993 and that the ratings had shown no significant improvement since 1991.[4] The report commented that "this finding is cause for concern, since there is every indication that the quality of economic analysis makes a significant difference in project performance. . . and is a robust proxy for quality-at-entry more generally." According to a senior OED official, unpublished results from a new study show a small improvement in the quality of economic analyses for new projects in the first half of fiscal year 1996.

The Bank undertook a special study of 34 policy adjustment projects approved in fiscal years 1993 and 1994 to assess their quality at entry. The results of this study indicated that the following project design problems were common:

- insufficient consideration of borrowers' level of political commitment,
- inadequate implementation capacity in borrowing countries,
- inadequacies in risk assessments, and
- borderline to excessive complexity.

OED has independently assessed quality at entry as part of its review of a sample of recent project proposals and concluded that quality at entry appeared to be improving but that problems remained. For the 128 project proposals OED reviewed in fiscal years 1994 and 1995, progress was mixed—problems worsened in some areas and other areas showed improvement (see table 4.2). Most noteworthy among the improvements is a substantial decrease in project proposals with unsatisfactory provisions for monitoring and evaluation. However, project managers declined to take OED's comments into account in 50 percent of the 1994 project proposals that OED could track.

Table 4.2: Quality at Entry Problems in New Project Proposals

	Percentage of projects with deficiency	
Project design deficiency	**1994**	**1995**
Poorly defined project objectives	27	36
Inadequate use of evaluation experience	60	65
Unrealistic risk assessments	48	34
Unsatisfactory provisions for monitoring and evaluation	67	32

Source: World Bank, OED.

[4]The Portfolio Management Task Force report cited work carried out in 1990-91 by the Working Group on Economic Analysis, which concluded that economic analysis was less than acceptable in 45 percent of the reviewed projects. The 1995 study concluded that this 7-percentage-point change was not statistically significant.

Project Management Reforms

Among the criticisms included in the 1992 report of the Portfolio Management Task Force was the Bank's reluctance to take action to remedy ongoing problem projects. In response to this criticism, the Bank has increased the amount of staff resources devoted to project supervision. Intensity of project supervision has increased steadily, from an average of 12.5 staff weeks per project per year in fiscal year 1991 to 17.2 in fiscal year 1995. This supervision has included use of mid-term reviews and country portfolio performance reviews to identify and assess implementation problems and project restructuring to resolve them. In addition, individual regional offices within the Bank have undertaken a wide range of complementary initiatives to further enhance the quality of new projects and portfolio management. The Bank has also made a greater effort to be more realistic when assessing performance so that it can identify and remedy problems that arise during project implementation.

Limited Impact on Problem Projects

The Bank measures the performance of its portfolio of ongoing projects by the number of projects it deems to be problem projects. A problem project is one in which managers have concluded that unsatisfactory progress has been made in implementation or in meeting development objectives. The Bank's increased supervision efforts are beginning to show some promising results for long-standing problem projects, which were of particular concern in the 1992 task force report. The percentage of projects that have been in problem status for 3 or more consecutive years has declined by 16 percentage points from fiscal year 1993 to fiscal year 1995.

However, data on problem projects indicate that little or no improvement has been made in the overall performance of ongoing projects. Assessments of progress in the implementation of projects and the extent to which the projects are likely to meet their development objectives, updated annually, provide an early indication of the likely effectiveness of the Bank's current portfolio. Table 4.3 presents recent results of these assessments. The data indicate that virtually no improvement has been made in implementation or the prognosis for projects' eventual impact on development. For ongoing projects, the Bank does not differentiate among types of development objectives as it does after completion. Therefore, we were unable to separately evaluate the Bank's progress in meeting physical and nonphysical objectives for these projects.

Table 4.3: Extent of Problem Projects in World Bank Portfolio

	Percentage of problem projects				
Type of problem	1991	1992	1993	1994	1995
Poor implementation progress	[a]	[a]	16.9	18.4	17.8
Low likelihood of meeting development objectives	12.7	11.8	12.1	13.4	11.5

[a]No data was available for implementation progress prior to fiscal year 1993.

Source: World Bank, Operations Policy Department.

It is too early to discern how the Bank's greater use of restructuring, mid-term reviews, and country portfolio performance reviews has affected portfolio performance. Assessments of ongoing projects in fiscal years 1993-95 did not show consistent improvement in projects that had undergone special reviews or restructuring. However, Bank studies show that these tools are potentially valuable for improving portfolio performance if used more effectively. OED has found that many mid-term reviews need to be more extensive and that country portfolio performance reviews should be done more frequently for smaller countries, which tend to have more problem projects.

Some Progress in Ability to Recognize Problems

In the past, the Bank has had difficulty recognizing deep-seated problems in ongoing projects that require additional supervisory attention. Typically, a significant number of projects were not identified as problem projects during implementation but were ultimately judged unsatisfactory after completion. This disconnect is partly attributable to undue optimism about potential outcomes during implementation. This optimism is especially pronounced for projects in their early stages, because problems are rarely expected and are more difficult to discern. The 1992 Portfolio Performance Task Force report highlighted excessive optimism, and it is recognized within the Bank as a barrier to resolving problems and improving portfolio performance.

The disconnect in ratings between implementation and completion of projects has improved considerably in recent years. In fiscal year 1988, 29 percent of projects rated satisfactory at the time of their final supervision rating were downgraded to unsatisfactory by OED after completion. The disconnect was reduced in fiscal year 1994 to 12 percent—its lowest point since the Bank started measuring this phenomenon in 1980.

Despite the encouraging progress in reducing the disconnect in ratings, OED pointed out in 1995 that overoptimism is still a major concern because problems are often not identified early enough to be remedied. For example, during fiscal years 1991-95, less than one-fourth of projects ultimately judged to be unsatisfactory were flagged as problem projects midway through implementation. OED found that to improve, the Bank needed a better definition of project objectives and greater attention to those objectives during supervision. According to OED, "what is needed is a change in supervision culture, to one which emphasizes early recognition of problems related to development objectives."

Staff Monitoring and Evaluation Still Deficient but Improving

A 1994 OED report on staff monitoring and evaluation in ongoing projects and projects completed in the previous 20 years concluded that performance in this area had been "dismal." A 1995 follow-up study indicated that some significant improvements had been made but that major monitoring and evaluation deficiencies remained. The study reported that 47 percent of the projects appraised by the Bank in fiscal year 1995 had inadequate or negligible provisions for monitoring and evaluation. Moreover, the institutional support promised by Bank management in response to the 1994 study had not materialized by the end of 1995. One Bank Executive Director we spoke to cited the slow pace of Bank action in this area as a major cause for concern but added that in the spring of 1996 management had finally taken meaningful steps toward providing needed support for monitoring and evaluation.

Increased Management Attention to Problems Holds Promise

Bank management has sharpened its focus on reform and performance issues and taken steps that have potential for improving oversight and project quality. In 1994, the Board of Directors formed a Committee on Development Effectiveness (CODE) to oversee the operations evaluation function. CODE is intended as a vehicle for focusing in-depth Board attention on evaluation studies and management responses to OED recommendations. According to one CODE member, CODE was instrumental in prompting increased management commitment to improved monitoring and evaluation systems.

In June 1996 the Bank's Operations Policy Department and OED took stock of all OED recommendations and management responses and presented a report of their findings to CODE. This report indicated that substantial progress had been made overall in implementing actions promised by Bank management in response to these recommendations.

In addition, Bank management has created a Quality Assurance Group that will enable management to undertake objective, independent project evaluations throughout the project life cycle. However, the Quality Assurance Group just became active in 1996, and it is too early to assess its impact.

Greater Emphasis on Market and Policy Conditions and Nonlending Services

As described in chapter 3, Bank lending projects have achieved relatively little success in fostering market and policy reform in borrowing countries compared to their achievement of other project objectives. In addition, the Bank has not made optimal use of economic and sector work to maximize the effectiveness of its lending services. According to senior Bank officials, the Bank has recognized these shortcomings and has been taking steps to remedy them. If successfully implemented, such reforms could be very positive, since Bank research has concluded that these activities have strong potential for boosting development effectiveness. However, the magnitude of these reforms and, hence, their probable effectiveness in the future are difficult to determine.

Bank officials stated that they have increased and broadened their focus on policy and market reform. According to these officials, the Bank has moved away from pursuing policy reform primarily through adjustment loans, which represent only about a quarter of the Bank's portfolio.[5] Instead, the officials indicated that emphasis on reform has been broadened by a greater use of conditionality in loans throughout the portfolio. One indicator of the shift toward policy reform is that, according to OED, the number of Bank lending operations with private sector development components increased almost 30 percent between fiscal years 1988 and 1995. The Bank's revised policy on electrical power projects also indicates a shift toward market and policy reform objectives. This policy, revised in 1993, places less emphasis on providing electricity to the poor and greater emphasis on transparent regulation, commitment to reform, commercialization and corporatization, and greater private investment in this sector. In its strategy statement for fiscal years 1997-99, the Bank's Africa Region indicates that it intends to devote greater attention to economic reform, including public finances and macroeconomic stability. However, since the Bank does not maintain detailed data on project objectives for new and ongoing projects, we could not measure the extent to which it has shifted toward policy and market reform objectives.

[5]Adjustment loans provide funds in exchange for an agreement by the borrowers to make certain policy and market reforms. These operations do not involve the construction of physical infrastructure.

Senior Bank officials have also indicated that the Bank will devote more attention and resources to nonlending services, including economic and sectoral work. The Bank had been reducing its funding for these activities: in fiscal year 1996, for example, the budget for economic and sector work was cut 17 percent from the previous year, while lending was cut by less than 4 percent. However, in studying the effects of economic and sector work as part of its reform efforts, the Bank concluded that conducting this work can contribute to eventual project success and increase development impact. According to senior Bank officials, an increase in the budget allocation for economic and sector work is planned for fiscal year 1997. The Bank's President told us that he intends to devote to nonlending services a level of effort on par with that devoted to lending.

New Direction's Impact Uncertain

The full impact of the current reform efforts on the ability of the Bank to achieve its objectives will not be apparent for several years. The management improvements described above, especially the use of the CAS process to direct greater Bank resources to those countries that are most committed to positive change, should improve the Bank's effectiveness. However, the Bank's commitment to addressing key development challenges, while appropriate, may have an adverse effect on the satisfactory ratings of Bank projects.

As described in chapter 3, the Bank's experience to date shows that policy and market reform objectives have been relatively difficult to achieve. These reform efforts rely on the active cooperation of the recipient country, and national leaders are often reluctant to accept the short-term economic and political costs of making many of these changes. These political realities often limit what the Bank can reasonably expect to accomplish. In one country, for example, Bank officials working to rationalize the inefficient, state-dominated banking system decided, out of political necessity, to retain a large number of superfluous bank employees. The likely alternative would have been intense labor union opposition.

Effective implementation of improved management practices and concentration of resources on countries that display a greater commitment to reform may enhance the ability of Bank projects to achieve satisfactory outcomes. However, increased concentration on more challenging tasks and more challenging environments (e.g., implementing effective basic policy changes in sub-Saharan Africa) may make project success even more difficult to achieve in the future. It is possible that the

Bank's reforms will sharpen the focus on efforts that have a greater potential for long-term positive impact but may result in little or no improvement in the proportion of projects that are judged to have achieved satisfactory results, at least in the short run.

It is also possible that the Bank's increased emphasis on country performance as a criterion for lending will hold overall lending below the levels experienced in the past. Bank and Treasury Department officials pointed out that 1994 and 1995 lending in sub-Saharan Africa was already lower than expected as a result of the Bank's holding back funds until policy environments improve.

U.S. Foreign Policy Considerations

The United States has influenced the Bank's policy orientation through its leadership position. The Bank has supported important U.S. foreign policy goals such as addressing transition difficulties in the former Soviet Union and Central Europe and in directing resources for crisis situations like those in Bosnia, Haiti, Mexico, and the West Bank and Gaza. Insofar as U.S. leadership influences the Bank's agenda, the United States multiplies its scarce foreign assistance funds by directing them through the Bank. However, compromise has sometimes been necessary since the United States has not always concurred with the views of a majority of its fellow Bank members.

Changes in Bank Orientation Reflect U.S. Views

The United States maintains the largest voting share in the Bank institutions and is the only member country that can veto changes in IBRD's Articles of Agreement. U.S. government officials stressed, and Bank officials concurred that, through the offices of the Secretary of the Treasury and the U.S. Executive Director at the Bank, the United States has played a leading role in shaping the development of the Bank's general orientation and in shifting its focus to new challenges. Treasury and State Department officials commented that U.S. leadership has in recent years played a critical role in the Bank's increased commitments to environmental protection,[1] market-oriented reform, and private sector development and concern for the impact of its programs on the poor in borrowing countries. One senior bank official commented that no major Bank initiative has gone forward without the support of the United States.

Bank Supports U.S. Foreign Policy Objectives

Bank activities generally support U.S. foreign policy goals in the post-Cold War environment. For example, the Bank is addressing transition difficulties in Central Europe and the former Soviet Union. Since the collapse of the former communist governments in this region, the World Bank has been working to facilitate the successor governments' movement toward market-oriented systems. The Bank committed over $20 billion to Europe and Central Asia (including the former Soviet republics) during 1990-95, including $4.5 billion in 1995.[2]

[1]A high-level Bank official agreed that the Bank's efforts regarding the environment can still be improved. However, the Bank has adopted uniform environmental standards and is allocating $485 million in 1995 to environmental projects. Also, the Bank and the United Nations created the Global Environmental Facility in 1991. Through the end of fiscal year 1995, $558 million was allocated for 63 World Bank Global Environmental Facility investment projects.

[2]This figure includes loans made to Turkey and to the following former communist states: Albania, Armenia, Azerbaijan, Bulgaria, Croatia, Estonia, Georgia, Hungary, Kazakstan, the Kyrgyz Republic, Latvia, Lithuania, the former Yugoslav Republic of Macedonia, Moldova, Poland, Romania, the Russian Federation, Turkmenistan, Ukraine, and Uzbekistan.

The U.S. foreign policy agenda has also been supported through the Bank's ability to direct resources to crisis areas. Recent examples where such support has been provided include Bosnia, Haiti, Mexico, and the West Bank and Gaza. In Bosnia, Treasury officials commented that the scale and rapidity of the Bank's response to the need for resources to support the U.S.-brokered peace process was helpful in furthering U.S. goals in that country. The Bank created a special $150 million trust fund for Bosnia in February 1996 to provide assistance in advance of the country's membership in the Bank and announced in April 1996 that it intended to provide Bosnia with substantial IDA reconstruction assistance over the ensuing 3 to 4 years.

The Bank also initiated a lending program that supported U.S. interests in reconstruction in Haiti following the reinstatement of President Aristide. IDA lending in that country was curtailed in 1996 in an effort to encourage reforms, an effort that is also supported by the United States. In Mexico, the Bank provided $2 billion in loans and associated technical assistance in cooperation with the U.S.-led effort to help that country address its 1994 financial crisis.[3] In the West Bank and Gaza, the Bank has played an important role in support of U.S. foreign policy objectives. In 1993 the Bank prepared an initial economic strategy for these territories that served as a basis for discussion at a donors conference, at which over $2 billion was pledged. Since then the Bank has continued to act as a conduit for donor funding and provided its own funds through a $170 million trust fund.

U.S. Contributions to Bank Are Highly Leveraged

Insofar as U.S. leadership influences the Bank's agenda, the United States leverages its foreign assistance funds by directing them through the Bank. The annual volume of activity generated by the Bank far exceeds that which the United States could generate if it were to apply its contributions to the Bank to U.S. bilateral foreign assistance programs. The United States provides about 22 percent of total donor contributions to support the Bank Group institutions, and these contributions are further augmented through cofinancing with other donors and the private sector. For example, as of July 31, 1996, about $2 billion in U.S. paid-in capital had supported IBRD loans of nearly $286 billion.

The Bank's perceived neutrality helps to further increase the potential impact of these funds. Developing country officials generally perceive the

[3]For more information on the events in Mexico, see Mexico's Financial Crisis: Origins, Awareness, Assistance, and Initial Efforts to Recover (GAO/GGD-96-56, Feb. 23, 1996).

Bank—a multilateral institution counting their own governments as members—as a neutral institution that provides objective advice. Bank officials, developing and donor country officials, and private sector representatives commented that Bank advice is less likely to be viewed as motivated by self-interest than advice offered by private businesses or bilateral donors and is therefore more likely to be acted upon, particularly in cases where proposed changes are costly and politically difficult.

Compromise Necessary in Multilateral Environment

In some instances, the United States has not concurred with the views of a majority of Bank members. The United States has voted against proposed loans that were nonetheless approved. One former Bank executive director commented that during the 1980s the United States unsuccessfully opposed Bank lending to India, arguing that the Indian government should be required to undertake reforms before further credit was granted. More recently, the United States opposed the granting of additional IDA credits to China, despite the fact that China has a level of per capita income that justifies continued access to IDA. U.S. government officials pointed to China's high level of foreign currency reserves and its relatively high credit rating on international capital markets, which provide it with substantial access to other sources of finance. The United States has taken the position that concessional IDA resources should be reserved for countries that, unlike China, do not have the creditworthiness to access alternative finance. In recent negotiations, the United States proposed that China be denied eligibility for IDA credits. However, other donor countries, particularly Japan, opposed this position. In the end, a compromise was reached wherein China's IDA borrowing will rapidly decline over the next few years and end in 1999. Despite the need for such compromises, many analysts agree that U.S. views on the overall direction of the Bank's operations have generally prevailed.

Conclusions, Recommendation, and Agency Comments

Bank operations support U.S. economic and foreign policy goals and leverage other donors' funds for doing so. However, significant performance weaknesses limit the effectiveness of Bank projects, and management reforms intended to improve the quality of the Bank's portfolio have had limited impact to date.

Bank efforts are enhancing the environment for private sector investment. We found that the Bank's guarantee programs and legal and regulatory reform efforts are important elements in attracting private sector investment. We also found that the Bank did not appear to displace private foreign investment in developing countries, except in a limited number of markets with substantial private sector involvement.

During the past decade, IDA and IBRD projects have experienced significant problems in achieving development goals. Bank managers and evaluators have judged 36 percent of the most recently evaluated projects to be unsatisfactory and, thus, having made an unacceptable contribution to development. The greatest rate of success of these projects has been in building physical infrastructure. The projects have had much more difficulty achieving policy and market reform objectives, which the Bank has shown to be crucial for economic development. Weak performance has been the result of a variety of shortcomings on the part of both the Bank and the borrowers as well as external factors. Pervasive project design and implementation problems must be overcome in order for ongoing and future projects to improve.

The Bank has implemented a series of reforms in recent years to improve the performance of its lending portfolio. Preliminary indicators show mixed results, though the full impact of these reforms on development effectiveness will not be discernible for several years. Among the more promising results is a greater linkage between IDA lending and borrowing countries' performance in making Bank-recommended policy and market reforms. Other reforms have made slower progress, especially efforts to improve the quality of new projects.

Through its historical position of leadership at the Bank, the U.S. has ensured that Bank activities generally support the U.S. foreign policy agenda. This continues to be true in today's post-Cold War environment. For example, in countries in Eastern Europe and the former Soviet Union the Bank has financed projects supporting transition from communism. The Bank has also complemented U.S. bilateral efforts in crisis areas, such as Bosnia, the West Bank and Gaza, and Haiti. The United States has been able to magnify the impact of its assistance by financing projects through the Bank and, thus, leveraging funds from other donors. Occasionally, however, the interests of the majority of members have taken precedence over U.S. priorities, as in graduation of China from IDA eligibility.

Recommendation

Although continued participation in the Bank is in the U.S. interest, the benefits of the Bank are limited by problems with project effectiveness. Through its leadership, the United States is positioned to ensure that Bank reforms continue to progress and have a positive impact on development effectiveness.

To ensure that Bank reforms have the desired impact, we recommend that the Secretary of the Treasury monitor and periodically report to the Congress measurable indicators of progress, such as the extent to which (1) the Bank allocates financing to those countries that make Bank-advocated policy and market reforms, (2) projects substantially achieve policy and market reform objectives, (3) project design problems decrease, and (4) implementation problems are identified and resolved early in the project cycle. If the indicators do not show satisfactory progress, the Secretary should report on the actions being taken by the Department to improve progress.

Agency Comments

We received comments on a draft of this report from the Department of the Treasury and, through it, the World Bank; the Department of State; and the Agency for International Development. These letters are reprinted in appendixes III-VI, along with our additional comments where appropriate. In addition to their overall comments, Treasury and the Bank offered several clarifications and technical corrections as well as updated information, which were incorporated throughout the report as appropriate.

Comments From the Department of the Treasury

Treasury agreed with many of the report's basic findings and conclusions, stating that they tracked well with its own views and with major positions taken by successive U.S. administrations. In addition, Treasury supported our recommendation that Treasury monitor and periodically report to the Congress on Bank progress in improving project quality and effectiveness.

Treasury also noted that existing legislation already imposes heavy reporting requirements on those elements of the Department that are concerned with the multilateral development banks. As a general principle, we support periodic reevaluation of reporting requirements to ensure that they do not require agencies to invest scarce resources in providing information that is not useful in Congressional oversight. We believe, however, that the reporting requirement recommended by this report will provide meaningful information for effective oversight of the Bank's operations and reform efforts.

Treasury commented that our analysis relied heavily on data from projects that were completed prior to the 1992 report of the Portfolio Management Task Force (Wapenhans report) and the start of the Bank's recent reform efforts. Our analysis of 737 recently evaluated Bank projects is based on systematic and reliable performance data and provides the most current picture available of project outcomes. This analysis also illustrates the effectiveness problems that the Bank is currently attempting to resolve through its reform efforts. Performance data from these evaluations provide an essential baseline for the evaluation of improvement in the outcomes of ongoing and future projects. Data on the outcomes of projects initiated since the Wapenhans report will not be available for at least several more years. However, in chapter 4 we present other information, including performance data for all ongoing projects, to reflect the impact of these reforms.

Treasury stated that the report's observation that Bank projects were less successful in achieving policy reform than in achieving physical objectives was based on a data set in which the vast majority of projects discussed are investment projects. Treasury commented that investment projects should be discussed separately from adjustment loans, which are the Bank's primary instrument for promoting policy reform. However, we found in our discussions with Bank officials that investment lending has been a major tool for promoting sector policy reform, and the Bank provided us with additional data to support that this is the case. The principal focus of our discussion of development effectiveness is on the Bank's rate of success in achieving various types of objectives, including policy reform. As discussed in chapter 3, adjustment lending has had a somewhat better record in achieving policy reform objectives than investment projects have; however, the rate of success of adjustment lending is still relatively low. Our report acknowledges the impact that Bank-promoted policy reforms have had when substantially implemented, especially their generally positive effect on reducing poverty.

Treasury asserted that our report does not sufficiently highlight the wide regional differences evident in project success rates. Treasury believes that these differences suggest that local conditions rather than inherent design flaws and implementation management are a key determinant of project success. Our report does point out regional differences in project success rates (see table 3.1), but our analysis of available data did not indicate that local conditions were necessarily a more important determinant of project success than other factors such as the adequacy of project design or implementation management. The Bank also considers factors other than local conditions to be critical, and several of its reform initiatives focus on them.

Finally, Treasury emphasized that the Bank is making a serious effort at meaningful reform but that continued monitoring of the results of these reforms is important to ensure that they have a positive impact. Treasury also believes that continued U.S. leadership will be indispensable for following through on the World Bank's reform agenda. We concur with Treasury on these points.

Comments From the World Bank

The Bank criticized our "exclusive reliance" on the results of the Bank's project evaluation system as a vehicle for assessing development effectiveness. The Bank stated that our failure to evaluate the entire scope of its activities prevented us from presenting a balanced view of the Bank's operations and effectiveness. According to the Bank, the report missed the Bank's catalytic role in development, because it overlooked the most important areas of Bank involvement, including policy dialogue undertaken outside the framework of specific projects and efforts to enhance the underlying environment for private sector investment.

We acknowledge that project effectiveness is only a partial measure of the overall impact of the Bank's efforts. We report these data in detail because they capture, in coherent fashion, the effectiveness of a very large portion of the Bank's activities (representing 86 percent of the Bank's outlays in fiscal year 1995). Similar data was not available to capture the overall effectiveness of the Bank's other activities, and in our view anecdotal information is not a satisfactory substitute. Furthermore, as noted on the first page of chapter 3, measuring the Bank's broader impact on developing countries is virtually impossible, given the variety of other factors at work and the fact that one can only speculate as to what might have happened in particular countries in the absence of the Bank's activities.

While we do not attempt to capture the overall impact of the Bank's nonproject operations, our report does acknowledge and describe these activities and comments on their effectiveness to the extent possible. Chapter 5 reports that the Bank's overall efforts, both lending and nonlending, support U.S. foreign policy goals. As the Bank's response to our report noted, chapter 2 states that the private sector officials with whom we spoke viewed the Bank as a positive force for market-oriented reform in the developing world. Chapter 4 reports that the Country Assistance Strategy (CAS) process, initiated 4 years ago, is helping the Bank to focus its resources more effectively. Chapter 4 also reports that we reviewed a number of CASs and that this review, in addition to other available data, shows that the Bank appears to be adjusting lending levels to reward better performance in borrowing countries. As Bank officials have often pointed out, the impact of these efforts on project performance will not be fully demonstrated for several years.

The Bank also commented that the report neglected to credit IFC for its wide range of activities promoting private investment throughout the world. A significant portion of chapter 2 is devoted to describing IFC's efforts to enhance private investment. The report highlights IFC's lending and advice services as well as its efforts to facilitate the entry of businesses into new markets.

The Bank commented that our report gave little attention to the progress of its reform efforts. We reviewed the Bank's reform actions and agree that the Bank has made some progress and that the reform agenda addresses key performance problems. However, in several areas the impact of the reforms has yet to be demonstrated or it was too soon to assess actual results. Continued monitoring and reporting by Treasury on the progress of these reforms, as we recommend, is important to ensure that the reforms have a positive impact.

Comments From the Department of State and the U.S. Agency for International Development

In its comments, the State Department emphasized the important role that the World Bank plays in development as well as in furthering U.S. foreign policy. The State Department reiterated the World Bank's concern that we did not fully acknowledge the Bank's role in promoting market-oriented reform in developing countries. The State Department also mentioned the importance of U.S. leadership in promoting reform at the Bank.

The U.S. Agency for International Development stated that the World Bank plays an important role in the effectiveness of the U.S. bilateral aid program. USAID noted that at the country level the Bank coordinates policy reform and donor assistance efforts of bilateral donors, including the United States. USAID also stated that the Bank has played a leadership role in coordinating donor efforts in pursuing environmental concerns.

International Bank for Reconstruction and Development and International Development Association Project Cycle

The International Band for Reconstruction and Development (IBRD) and the International Development Association (IDA) project cycle includes six phases: identification, preparation, appraisal, negotiation and board presentation, implementation and supervision, and evaluation. Each phase can last several months or years, depending on the nature and complexity of the project. The following description of the six phases is derived primarily from The Project Cycle, a pamphlet by Warren C. Baum, published by the World Bank.

Identification

The first phase of the cycle is identification of projects that are suitable for Bank support within the context of the Bank's Country Assistance Strategies in particular countries and that are a high priority for the borrowing entities.[1] The Bank encourages and helps borrowing countries develop their own planning capabilities, and it often assists in planning by carrying out economic and sectoral analyses to provide a framework for understanding a country's problems and the potential for development. The Bank also assesses a country's creditworthiness and, according to a senior Bank official, reviews the potential for private sector support of proposed investments. For a project to be considered for Bank financing, the cost of likely technical and institutional solutions must be commensurate with expected benefits. Once identified, projects are incorporated into a multiyear lending program for each country.

Preparation

In the preparation phase of a project, a brief is written that describes the project's objectives, identifies principal issues, and establishes a timetable for its further processing. Formal responsibility for preparation rests with the borrower; only in exceptional cases does the Bank itself do preparatory work. However, the Bank can provide financial and technical assistance for project preparation, either independently or in cooperation with other bilateral and multilateral donors. Documents prepared during this phase must identify and compare alternative approaches and address the full range of technical, institutional, economic, and financial conditions necessary to achieve the project's objectives.

Appraisal

Appraisal constitutes a comprehensive review of the technical, institutional, economic, and financial aspects of the project and lays the foundation for implementing the project and evaluating it when

[1]A borrower from the Bank may include a member government, a public agency or corporation, or a private body or corporation with the government's guarantee. IDA credits are made only to governments, to be passed on, if necessary, to the entity responsible for carrying out the project.

completed. Appraisal is solely the Bank's responsibility and is done by Bank staff, who typically spend 3 to 4 weeks in the field for this purpose.

- Technical appraisal is done to ensure that the project is soundly designed, appropriately engineered, and follows accepted standards. Bank staff review the technical alternatives, proposed solutions, and expected results.
- Institutional appraisal addresses whether the institution implementing the project is properly organized and its management is adequate, local capabilities and initiatives are used effectively, and policy or institutional changes outside the entity are required to achieve project objectives.
- Economic appraisal includes final review and assessment of the cost-benefit analysis of alternative project designs to ensure that the design selected contributes most to the country's development objectives. Bank personnel also examine the country's entire investment program for the sector, the strengths and weaknesses of relevant public and private sector institutions, and key government policies.
- Financial appraisal is conducted to ensure that the borrower will have sufficient funds to implement the project, that the project is financially viable, and that pricing and cost recovery policies are appropriate.

The Bank staff prepare a staff appraisal report that sets forth its findings and recommends terms and conditions of the loan. A project may be extensively modified or redesigned to correct flaws identified during the appraisal. Bank management officials review the report before approving further negotiations with the borrower.

Negotiations and Board Presentation

At the negotiation phase, the Bank and the borrower come to agreement on the measures necessary to ensure the success of the project. These agreements are then converted into legal obligations, which are set out in the loan documents. All of the principal issues that have been raised prior to and during appraisal are addressed in the loan documents.

After negotiations are completed and the project has been approved by Bank management, it is presented to the Bank's executive directors for final approval. The executive directors review and consider the appraisal report (amended to reflect the agreements reached), the loan documents, a memorandum and recommendation of the Bank President/President's report, and the related Country Assistance Strategy. These documents include a discussion of how the proposed project takes into account the country's priorities and its portfolio performance.[2] If the executive directors approve the project, the loan documents are signed in a simple ceremony.

Implementation and Supervision

Project implementation is the responsibility of the borrower, although the Bank may provide assistance in such forms as organizational studies, staff training, or the provision of consultants to help supervise construction. The Bank supervises implementation to ensure that the project achieves its objectives and works with the borrowers to identify and deal with problems. Supervision is also meant to ensure that the borrower procures goods and services in accordance with agreed-upon guidelines.

During negotiation, agreements are reached on a schedule of progress reports to be submitted by the borrower. Progress reports are reviewed at headquarters, and problems are dealt with by correspondence or in the course of the field missions periodically sent to every project.

Using a standard evaluation form, Bank staff regularly assess the performance of each project during implementation and upon the final disbursement of loan funds. The assessments address implementation progress and the likelihood that the project will achieve its development objectives. Projects performing poorly in either of these two areas are deemed problem projects. In addition, the Bank and borrowers may jointly conduct mid-term reviews of individual projects and more comprehensive country portfolio performance reviews. If major problems are persistent or circumstances change significantly, jeopardizing successful implementation of a project, the Bank and borrower may restructure the project, modifying its scope, objectives, and/or implementation methods.

Evaluation

In 1970, an evaluation system was established as the final phase of the project cycle. After completion of a project, when the loan funds have been fully disbursed, the Bank project staff—and/or the borrower—prepare a completion report. In this report, the project is assigned one of six ratings, ranging from highly unsatisfactory to highly satisfactory. The Bank's Operations Evaluation Department (OED),[3] reviews each report and provides evaluative comments to the executive directors. In addition, for a portion of the projects (currently about

[2]The requirement to submit the Country Assistance Strategy was added in January 1995.

[3]OED is entirely separate from the operating staff of the Bank and reports directly to the Board's executive directors.

25 percent), OED conducts an independent audit and assigns its own project ratings. Most audits are based on a desk review of all materials pertaining to the project and, when necessary, a field review, sometimes as comprehensive as the original appraisal. Borrowers are asked to comment on the OED audits. Completion reports and audit reports include reestimation of the economic rate of return, when applicable, on the basis of actual implementation costs and updated information on operating costs and expected benefits. OED also conducts impact evaluations at least 5 years after the last disbursement for a small number of carefully selected projects.

Private Sector Firms Interviewed

Firm	Location
ANZ Securities, Inc.	New York, New York
Chase Manhattan Bank, N.A.	New York, New York
Chemical Bank	New York, New York
Citibank	New York, New York
Daiwa Securities America Inc.	New York, New York
Financial Securities Assurance	New York, New York
Merril Lynch	New York, New York
Peregrine Securities	New York, New York
TIAA-CREF	New York, New York
Standard Chartered Bank	Los Angeles, California
Union Bank	Los Angeles, California
Bank of America	San Francisco, California
Bechtel	San Francisco, California
ANZ Grindlays Bank plc	London, England
Chase Investment Bank Ltd	London, England
Chemical Bank	London, England
ING/Barings	London, England
Standard Bank London	London, England
West Merchant Bank Ltd	London, England
AES China Generating Co. Ltd	Beijing, China
Louis Berger International, Inc.	Beijing, China
Motorola (China) Electronics Ltd.	Beijing, China
Salomon Brothers Inc.	Beijing, China
Westinghouse Electric (China) S.A.	Beijing, China
Chemical Bank	Shanghai, China
Citibank, N.A.	Shanghai, China
ING/Barings	Shanghai, China
Price Waterhouse	Shanghai, China
American International Assurance	Hong Kong
Bank of America	Hong Kong
Caterpillar China Ltd	Hong Kong
Chemical Bank	Hong Kong
Citicorp International Ltd	Hong Kong
Consolidated Electronic Power Asia Ltd	Hong Kong
Credit Suisse	Hong Kong
First Chicago	Hong Kong
Goldman Sachs (Asia) L.L.C.	Hong Kong
Hong Kong & Shanghai Bank	Hong Kong

(continued)

Firm	Location
Mass Transit Railway Corporation	Hong Kong
Morgan Stanley	Hong Kong
Parsons Brinkerhoff (Asia) Ltd.	Hong Kong
Standard Chartered Bank	Hong Kong
Bank of Tokyo/Project Finance	Tokyo, Japan
Bank of Tokyo/Capital Markets	Tokyo, Japan
Fuji Bank and Fuji Research	Tokyo, Japan
Sumitomo Bank	Tokyo, Japan
Marubeni	Tokyo, Japan
Mitsubishi	Tokyo, Japan
Nomura Securities	Tokyo, Japan
Yamaichi Securities	Tokyo, Japan
Daiwa Securities	Tokyo, Japan
Bank of America	New Delhi, India
Chemical Bank	Bombay, India
Citibank	New Delhi, India
Standard Chartered Bank	Singapore
Templeton International	Singapore
Midland Armenia Bank jsc	Yerevan, Armenia
Hill International Overseas, Inc.	Yerevan, Armenia
Other private entities[a]	
American International Group, Inc.	New York, New York
E.W. Payne Ltd/Sedgewick House	London, England
HISCOX Syndicates Ltd (Lloyd's)	London, England
Moody's	New York, New York
Morrison & Foerster	Hong Kong
Standard & Poor's	New York, New York
Standard & Poor's	Hong Kong

[a]These private sector companies were not included in the displacement and enhancement analysis because they are not directly involved in capital investment.

Comments From the Department of the Treasury

Note: A GAO comment supplementing those in the report text appears at the end of this appendix.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

September 9, 1996

Mr. Charles A. Bowsher
Comptroller General
General Accounting Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Bowsher:

I welcome the opportunity to comment, on behalf of the Treasury Department, on the General Accounting Office's report on U.S. participation in the World Bank. The report is an ambitious effort to address a difficult issue, and one in which the degree of public interest -- domestic and international -- has never been greater. Although funding for the Bank accounts for only six percent of our foreign assistance program, we have come to rely heavily on the institution to advance vital U.S. foreign and economic policy interests around the world. We therefore appreciate the very thorough and candid dialogue we have had with GAO staff throughout its work, as well as the constructive engagement of World Bank staff in supplying the extensive data and background material needed to complete the study.

See pp. 8 and 64.

Many of GAO's basic findings and conclusions track well with the Department's own views and with major positions taken in the institution by successive U.S. Administrations. Specifically, we fully agree with the GAO that:

- The World Bank's goals are broadly in accord with U.S. foreign policy interests, and its operations support priority U.S. economic and foreign policy objectives.
- U.S. leadership remains an important and constructive force in the institution, including in advancing the reform efforts needed to improve the Bank's effectiveness.
- The Bank is working in a variety of ways to expand opportunities for private investment in developing countries, including through direct support for market-oriented policy reforms.
- There is little evidence that Bank operations displace private sector investment, and private investors generally see Bank engagement as advancing their interests.
- Fundamental operational reforms, strongly supported by the United States, are ongoing.
- U.S. financial participation in the institution is highly leveraged by the far larger combined participation of the other member countries.

We also agree fully with many of the GAO's more specific findings, such as:

- o The scope and complexity of Bank operations has increased dramatically over the past fifteen years, making implementation and measurement of performance more difficult.

- o The Bank must further sharpen its focus on project performance by improving project design quality, linking lending more closely to performance, and intensifying supervision in order to detect problems early.

- o In recognition of these priorities, the Bank is actively addressing lending strategy and portfolio management problems with a wide array of operational and policy reforms.

- o These promising reforms should improve the Bank's effectiveness, but it is still too early to assess their full impact, and decisive evidence is not likely to emerge for several years.

See pp. 64-65.

Finally, we support GAO's recommendation that Treasury monitor and periodically report to Congress on Bank progress in improving project quality and effectiveness. The specific reporting items identified by GAO appear appropriate. However, given staff limitations and the heavy reporting requirements that already exist with respect to Treasury oversight of the multilateral banks, we would ask the relevant Committees to consider eliminating or consolidating other reporting requirements no longer needed to meet Congressional oversight objectives.

Against the background of these important areas of agreement, however, we are concerned about some key elements of the report and urge caution in interpreting some of its findings.

See pp. 8 and 65.

1. The project sample underlying GAO conclusions predates extensive reforms instituted in recent years, most particularly the sweeping internal reform agenda arising from the unprecedented self-examination and critique widely known as the "Wapenhans Report."

The majority of the IBRD and IDA projects evaluated in the Operations Evaluation Department (OED) report on which the GAO study draws were completed and "closed" by the time the Portfolio Management Task Force issued its findings (the "Wapenhans Report") in 1992. In fact, virtually all of these projects were conceived, designed and implemented in the 1980s.

The point is not that the serious portfolio performance issues cited by GAO (and, initially, OED) ought to be of less concern because they are "old." The point is that the Bank -- with very strong U.S. encouragement -- examined the lessons of the past intensively and candidly four years ago. As a result, it put into place an extensive set of operational reforms that we, the GAO, and most critics agree are an appropriate and comprehensive plan of action offering real prospects for better results in the future.

This, we believe, is the core of what we should expect and demand of the Bank in the years ahead: lending programs tied directly to borrower performance; clear accountability of project managers for project results; close engagement of the full cross-section of society in project identification and design; intensified supervision and early corrective steps when problems appear; and much greater initial selectivity on a project, sector and country basis. These commitments are now in place within the Bank, codified in the form of new personnel evaluation procedures, internal budgeting practices, specific operational directives, and use of comprehensive country strategies to build project pipelines and establish performance triggers for new lending.

See comment 1.

The priority now -- as we, the Bank and the GAO fully recognize -- is implementation and follow-through. The Bank's detailed and candid OED reports, annual portfolio performance reviews, and country-specific portfolio performance evaluations will provide both it and us with the information needed to monitor results as they emerge and to intervene constructively when necessary. Moreover, the Bank's commitment to focus lending operations increasingly on the better performing borrowers should, in and of itself, produce improved success rates over time. Overall, the many substantive reforms we have seen to date give every reason to expect steady improvement in success rates.

Finally, it must be noted that the monitoring and evaluation results on which the GAO study is based are the product of an internal, but rigorous and independent, review process that is virtually unique among development institutions. As a result of this uniqueness -- the fact that the Bank's evaluation process is well out in front of other development assistance providers -- it is not possible to gauge with any precision how the Bank's operational effectiveness and project success rates stack up relative to those other providers.

See p. 65.

<u>2. The GAO observation that Bank operations have been less successful in achieving policy objectives than in achieving physical objectives is based on a data sample that excludes a major share of the Bank's specific policy-based work.</u>

The vast majority of the 737 projects covered by the OED evaluation examined by the GAO are categorized by the Bank as "investment" operations. That is, they are by design focussed primarily on the tangible investments typically characterized broadly as infrastructure building: irrigation and sanitation systems, power generation and distribution, transportation networks, schools and health clinics. While these projects can (and increasingly do) include specific policy components, these are not their principal objective.

The primary instrument through which the Bank works toward basic policy reforms is its policy-based "adjustment" operations, and more particularly its "sector adjustment loans." The "deliverables" in these operations are not easily measurable physical assets, such as roads or power lines; rather they are specific policy changes designed to remove structural, policy-based obstacles to development of key sectors. An agricultural sector adjustment loan, for example, would typically include: elimination of price controls on rural farmers; reducing or eliminating state-owned marketing boards; establishing market-based small credit facilities in rural areas; and, reorganizing ministries to reduce their intervention in the economy. A power sector adjustment loan (such as a 1991 operation in India) would typically include: break-up of state monopolies;

market-based pricing; divestiture of some operations to the private sector; and, opening the sector to private competition, including from abroad.

If individual country policy performance over the past several years is examined closely, it is clear that the Bank (together with the IMF) has played a leading role in supporting the welcome shift toward free market policies in such key areas as trade and investment liberalization, privatization and financial sector reform. It is true that borrowers too often do not move as quickly or efficiently on market reform as we -- or the Bank -- would like, but the long-term cumulative effect of Bank operations and policy has been substantial. This is explicitly recognized by bilateral donors who rely heavily on the Bank to establish the basic conditions within which their own operations can be most effective.

We recommend that the report distinguish clearly between the Bank's investment and adjustment lending, noting the impact of the latter on borrowers' policies.

See p. 66.

3. The report does not discuss in detail the wide regional differences in project success rates, which suggest that local conditions, rather than inherent design flaws, are a key determinant of success.

A useful addition to the report would have been an analysis of differences in project success rates among regions. As the report notes in table 3.3, the project success rate in East Asia is a very credible 81% while the project success rate in sub-Saharan Africa is a very worrisome 51%. Obviously, a huge array of circumstances, only some of which are quantifiable, lies behind these very different results. Nevertheless, the data suggest strongly that local conditions must be of greater importance than inherent project design or implementation flaws. For example, the incidence of problem projects in agriculture and environment in East Asia and Latin America is roughly one-third of the observed rate in sub-Saharan Africa. Financial projects have very high success rates in South Asia and much lower rates in the Middle East and North Africa.

Understanding these striking differences requires a selective interpretation of the data, and resolving the underlying problems requires a selective approach to project design and implementation. Also, lest these differences be misunderstood, however, I want to emphasize that neither we, nor the Bank, nor the vast majority of observers and practitioners conclude that a disappointing overall rate of project success means that successful projects cannot be done. Nor would it be justified to conclude that irrigation work can be successfully done in Asia but not in Africa, or that financial market work ought to be avoided in North Africa.

We fully share with the GAO, with the World Bank, and with the Wapenhans Report, the conclusion that project work can only be successful if local conditions are conducive. Borrowers must be committed to its success and to assuring adequate financing for their fair share; mistakes of the past must systematically inform plans for the future; local populations, on which project success ultimately depends, must be fully engaged throughout the often long project cycle; and, detailed early analysis and appropriate information disclosure are essential.

See pp. 8-9 and 66.

5

These are among the most important specific elements of the Bank's new operational strategy that promises better results, sectorally, regionally, and overall. The Bank's own work makes clear that the absence of such elements greatly diminishes the prospects for success and greatly reduces the justification for new lending. We fully support this pragmatic approach and, as noted above, fully expect the emerging evidence to bear out its essential correctness.

4. The ongoing program of major reforms, successfully urged by the U.S., offers good reason for confidence that tangible progress will emerge in the next several years. However, continued U.S. leadership-- which is now seriously threatened by growing payments arrears and uncertainty about our future engagement -- will be indispensable for following through on the reform agenda.

The GAO has done considerable work over the past few years to catalogue and assess both the content and the status of the Bank's internal reform efforts. Its June 1994 report, entitled "Status of World Bank Reforms," reviewed the findings of the Wapenhans report in some detail, outlined the Bank's program to implement the recommendations, and discussed the role played by the United States in securing these constructive steps. GAO's subsequent April 1995 report ("World Bank Reforms on Schedule but Difficult Work Remains") concluded that while the effort was largely on schedule, time would be needed to see it to fruition. Both reports specifically identified, with general approval, important operational reforms that are reshaping the way the Bank does business and reinforcing its capacity to deliver cost-effective development assistance, including:

- Establishment of a Public Information Center
- Establishment of an independent Inspection Panel
- Lending operations determined through comprehensive country assistance strategies
- Lending levels determined by performance
- Intensified and more detailed reporting on project completions
- Better internal dissemination of OED and other evaluation information
- Revised internal budgeting process to increase accountability
- Steps to improve project design.

A wide range of independent analysis, cutting across the opinion spectrum, agrees that these reforms are fundamental, that they go to the heart of problems with lending effectiveness, and that over time, and with full implementation, they will produce the desired results.

Sincerely,

Jeffrey R. Shafer
Jeffrey R. Shafer
Under Secretary
International Affairs

The following is GAO's comment on the Department of the Treasury's letter dated September 9, 1996.

GAO Comment

1. We agree that the Bank's follow-through on its commitments is critical. We also agree that the Bank generates a considerable volume of information that is useful in assessing progress. We note, however, that much of this information is not sufficiently highlighted in Bank documents or is not publicly available. Our recommendation is intended to provide Members of the Congress and other interested observers with meaningful and readily available information to objectively evaluate the Bank's progress toward achieving greater effectiveness.

Comments From the World Bank

Note: GAO comments supplementing those in the report text appear at the end of this appendix.

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

UNDER SECRETARY

September 9, 1996

Mr. Charles A. Bowsher
Comptroller General
General Accounting Office
441 G Street, NW
Washington, D.C. 20548

Dear Mr. Bowsher:

We asked the World Bank to provide its independent views on the General Accounting Office's report on U.S. participation in the World Bank. Attached is a letter from World Bank President Wolfensohn to Treasury Secretary Rubin setting forth his comments.

Sincerely,

Jeffrey R. Shafer
Under Secretary
International Affairs

Enclosure

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

JAMES D. WOLFENSOHN
President

September 6, 1996

The Honorable Robert E. Rubin
The Secretary of the Treasury
Washington, D.C. 20220

Dear Mr. Secretary,

See pp. 8-9 and 66-67.

I welcome this opportunity to comment on the United States General Accounting Office's *Draft Report on the World Bank*, which I have read with great interest. I disagree with many of its findings and I am distressed by its tone. As you know, we have embarked on a major program of internal reform aimed at improving the Bank's effectiveness in promoting sustainable poverty reduction and private sector development. We have made extraordinary progress in reshaping our organization to build upon its considerable past achievements. It is regrettable that little attention is given to this fact.

See pp. 8-9 and 66-67.

Excellence is the objective of this reform program, and the lessons of past experience are an important guide in helping us meet that objective. Against this background, while the Report includes a number of useful observations, I found it disappointing. It does not provide a balanced perspective on Bank activities, hence its assessment of Bank effectiveness is similarly wide of the mark. Of utmost importance, it misses the Bank's catalytic role in development in general, and private sector development in particular. While I can appreciate GAO's desire to zero in on specific issues that can be quantified with "hard data," the exclusive reliance on this narrow methodological approach overlooks the most important areas of the Bank's involvement. Through its policy dialogues with member countries, the Bank is a major advocate and supporter of policy reforms, particularly aimed at helping countries to realize the potential of the private sector in stimulating investment, job creation, and growth. It is the largest external investor in education, health care, and environmental improvement in the developing world. These are critical, albeit hard-to-quantify, sources of development impact.

An alternative approach, complementing the use of quantitative evidence with qualitative analysis of Bank Group Country Assistance Strategies — possibly for some of the countries that GAO staff visited — might have produced a report with a better appreciation of this broad range of activities and an assessment of their effectiveness in promoting sustainable poverty reduction and private sector development. Such a perspective also would have resonated better with how Bank management, staff, and clients see things on the ground, and would have allowed the Report to play a constructive role in our internal reform program.

See comment 1.

See pp. 8-9 and 66-67.

- 2 -

At the same time, the Report's findings may be misinterpreted by external audiences unfamiliar with the Bank's culture of self-criticism and high standards. In this connection, I note — with satisfaction — that all the negative evidence on Bank performance that the Report cites comes from internal Bank reports and sources; whereas, all the positive evidence comes from external sources. This is precisely how we want it to be. We aim high, and we are constantly scrutinizing our activities for problems and looking for lessons on how to do a better job. But it is in *this* context that the Bank's own data and self-evaluations, which the GAO Report relies on, must be understood.

The remainder of this letter summarizes my specific comments on the Report. They cover three topics: (1) the Bank's impact on private investment; (2) the Bank's development effectiveness, especially in securing policy reforms; and (3) the Bank's internal reforms. A point-by-point response on these issues is being provided under separate cover.

I. The Bank's Impact on Private Investment

I welcome the fact that — as reflected in the GAO's own survey results — market participants appreciate the Bank's positive contribution to facilitating private sector transactions. The Report acknowledges the importance of the Bank in supporting an enabling environment for the private sector in its client countries; but we would like to have seen more emphasis on this critical dimension of our work — and to the importance of human capital for private sector development.

Evidence from country after country demonstrates that broad systemic reforms are crucial for creating and sustaining the enabling environment. Among the multilateral development banks, the Bank has taken the lead on these reforms. They include investments in people as well as macroeconomic stability, structural reforms in public finances, banking sector reform, privatization, and price and trade liberalization. The overall economic framework and the credibility of government policy are what matter most for investors, and no amount of individual guarantees or transactions can compensate for those factors.

The Bank's non-lending services, policy dialogue, and support for policy reforms play a major role in creating the enabling environment for private sector development, so it is unfortunate that the Report pays little attention to them. I was particularly concerned that virtually no attention was given to our work on the financial sector, since this is a major area where our analytical and advisory work can and does help domestic and foreign investors. The Report could usefully have analyzed how the increase in private capital flows has responded to macroeconomic and structural reforms, how much more substantial these flows are than those triggered by individual transactions, and how the Bank has played a significant role in encouraging countries to undertake the reforms.

- 3 -

See p. 67.

I also was disappointed with the treatment of IFC in the Report, which neglects the vast range of IFC's work in promoting private sector investment throughout the world. By successfully investing in viable projects in countries where few foreign investors are willing to go, IFC's pioneering work has a vital demonstration effect. In addition, IFC invests in a broad range of sectors, often using innovative financing techniques, and provides an array of services, to meet the unique development needs of the private sector in a country. For example, in the West Bank and Gaza, it is investing in microenterprises; in Africa, it is working to help African entrepreneurs develop bankable projects; in Pakistan, it is supporting the expansion of a private school system.

IFC's role is to catalyze the private sector, and not to displace it. This means that IFC always works in partnership with private financial markets and brings together domestic and foreign investors and sponsors. IFC directly syndicates more from other financial institutions than it lends directly on its own account. Moreover, IFC has begun, with my strong support, to examine ways to expand its development impact even further. I would also note that the Bank and IFC are now working closely to make sure that private sector issues are fully integrated into our Country Assistance Strategies.

II. The Bank's Development Effectiveness

The Report highlights the problems that Bank-supported projects face. Development is, after all, a tough, demanding, and high-risk business in which some ventures are bound to fail. Moreover, the Bank typically bases the success of the projects it supports on a very ambitious set of objectives. Against this background, I would emphasize that two-thirds of our projects have succeeded even when measured against the tough Bank standard — despite the riskiness and inherent difficulty of the development challenge — and that the majority of them support policy reforms. To be sure, I want these numbers to go up, but in the meantime, we all need to be clear about what they mean, so that appropriate judgments about performance can be drawn.

See comment 2.

The Report relies on the fact that one-third of completed projects are considered by the Bank to be "unsatisfactory" — and the Bank's and my own dissatisfaction with this share — to conclude that the Bank has major problems. Yet, there is ample evidence that a number of these operations have in fact made significant contributions to development in client countries. In 1993, for example, more than half of the "unsatisfactory" projects in the relevant category had real rates of return above 6 percent; and more than a third of them had real rates of return above 10 percent. These are high rates of return by any standard. It would be difficult to argue that these projects "failed" in the conventional sense; rather they were unsatisfactory in terms of having not met the ambitious objectives that the Bank had set for them.

The Report also argues that the Bank is far more oriented towards supporting physical goals than policy reforms. This simply does not resonate with our own and our clients' perceptions. I know that there are problems with the data used to support this conclusion, and that GAO and Bank staff disagree on the numbers. But regardless of how the numbers come out, they need to be seen against the following background:

- First, as noted above, much of the Bank's policy work is done *outside* of project development. The nature of the policy dialogue is captured in our Country Assistance Strategies, from which the Report might usefully have built case studies.
- Second, even in a project context, policies are frequently agreed and implemented *upfront*. A case in point is the power sector in India, to which the Bank stopped lending between June 1993 and May 1996, while we had intensive dialogue with the authorities on sector policy reforms.
- Third, the projects covered by the Report's data base are *old*. Evaluated in 1993 and 1994, most of them were completed by 1992 — and more than half had been approved in 1985 or before. This means that, in essence, the Report's conclusions refer to the mid-1980s. This was a particularly turbulent period in the world economy and a difficult one for many developing countries — especially in Latin America and in Africa — suffering the ravages of the debt crisis. This was also a different era in the Bank, when the development paradigm it supported via investment projects was oriented more to financing hardware, bricks and mortar, and physical capital than it is today.

III. Bank Reform Efforts

Under Lew Preston's leadership, the Bank began to take a series of critical steps toward improving its operations. Of particular importance was the Wapenhans Task Force Report, which provided a wake-up call on our approach to portfolio management. Following extensive discussions of that report, the Bank introduced a number of measures to improve portfolio management, including increased supervision resources and management attention devoted to it. We are now beginning to see the pay-off to those investments, in terms of fewer long-standing problem projects and improvements in other performance indicators. At the same time, the Bank also launched a number of initiatives to improve "quality-at-entry", although these have been slower in bearing fruit. This is because a fundamental change in culture was needed. At root, the Bank needed to move away from an "approval culture" to a "results culture".

This is a change that I have been pursuing with vigor since my arrival at the Bank. And it lies at the heart of our internal reform program. Critical here are the changes in staff incentives and management signals. My management team and I have been clear about the fact that lending commitments are not the bottom line of our efforts, but simply one instrument of our Country Assistance Strategies, which aim at our real bottom line — catalyzing sustainable development impact and results on the ground in our client countries. As I stated at the outset, excellence is the objective, and I am determined to make the Bank perform at such a level in every arena in which it operates.

In closing, let me emphasize that the Bank is the only development institution — bilateral or multilateral — that undertakes the kind of broad-based comprehensive reviews that has allowed GAO to pursue the analysis underlying this Report. We challenge other institutions to look at themselves as closely and as critically as we do. I believe that this perspective needs to be fully reflected in the Report, lest those unfamiliar with the Bank's culture of high standards and self criticism draw the wrong conclusions.

Sincerely,

James D. Wolfensohn

The following are GAO's comments on the World Bank's letter dated September 9, 1996.

GAO Comments

1. We acknowledge that the Bank invests considerable resources in evaluating its own operational effectiveness, that the Bank's evaluation efforts are commonly held in high esteem by experts on international development organizations in general, and that the information generated by these efforts is very useful. However, we did not attempt to evaluate the Bank's evaluation systems or compare them to those employed by other multilateral or bilateral assistance agencies.

2. To avoid as much misinterpretation as possible, we have used the Bank's own nomenclature and published definitions and explanations of that nomenclature to describe project performance. We also included the Bank's own caveat that unsatisfactory projects may have made significant contributions to development. Also, we specifically avoided equating the term "unsatisfactory project" with failure.

Comments From the Department of State

United States Department of State

Assistant Secretary of State
for Economic and Business Affairs

Washington, D.C. 20520

SEP - 6 1996

Dear Mr. Bowsher:

The Department of State is pleased to have an opportunity to comment on the report prepared by the General Accounting Office on the World Bank and U.S. interests. The World Bank, which the United States helped create, has long been a pillar of American influence. We have a major stake in the Bank's continued success.

Following a pattern established over the last five decades, this Administration has turned consistently to the World Bank to advance our foreign policy and economic interests. The GAO's report lays out the critical role which the Bank has recently played in supporting U.S. interests in key countries. The list of occasions where the Bank has been called upon to play a leading role reads like a highlight film of U.S. foreign policy priorities: Gaza and the West Bank in support of the peace process; reconstruction in Bosnia; revitalization and modernization in Haiti; Russia and the NIS in support of the transition to market economies. Without the Bank's financial support and policy advice, we could not have advanced effectively U.S. foreign policy interests.

See pp. 8-9 and 66-67.

We believe the report does not do justice to the Bank's leading role in advancing market economic reforms, and in laying the foundation for private sector-led growth. While the United States has been the strongest proponent of the new global consensus in favor of open markets, it is the Bank that often is engaged in the trenches, fostering the transition to free markets. The impact of the Bank's sectoral reform and technical assistance programs has been powerful from Indonesia to Eastern Europe. The Bank has helped support a move toward privatization that has made Latin America once again a major market for U.S. exports.

Mr. Charles A. Bowsher
Controller General of the United States
United States General Accounting Office
Washington, DC 20548

We commend the GAO report for its treatment of the broad reform agenda being pursued by the Bank. The United States has been a driving force behind recent Bank efforts to modernize its institutional structure and its approach to development. We believe these efforts are already bearing fruit. Particularly under the leadership of its new President, James Wolfensohn, who is advocating a more results-oriented culture, the Bank is proving itself to be adaptable and effective in responding to evolving development needs. Guided by U.S. leadership, the Bank is promoting basic American values by encouraging environmentally sustainable development, good governance and poverty alleviation.

The U.S. contribution to the World Bank provides good value. The multilateral development banks, anchored by the World Bank, provide over $40 billion in assistance annually; the United States contributes less than $2 billion. Through our contribution to the World Bank, we leverage not only our money, but also our influence. However, our leadership is threatened by our continuing arrears to the World Bank and the other international financial institutions.

Sincerely,

Alan Larson

Alan P. Larson

Comments From the U.S. Agency for International Development

See pp. 8 and 67-68.

USAID

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

SEP 5 1996

Mr. Henry L. Hinton, Jr.
Assistant Comptroller General
National Security and
International Affairs Division
U.S. General Accounting Office
441 G Street, N.W. - Room 4039
Washington, D.C. 20548

Dear Mr. Hinton:

I am pleased to provide the U.S. Agency for International Development's (USAID) formal response to the draft GAO report entitled "World Bank: U.S. Interests Supported, but Progress on Reforms Needed". As a bilateral donor agency, USAID has a unique perspective within the U.S. Government on multilateral institutions such as the World Bank. USAID plays only a minor role in the governance and monitoring of the World Bank, but is an active partner with the World Bank supporting development in the field. In this context, the World Bank is a critical part of our everyday working environment.

The effectiveness of bilateral donor development efforts, including that of the United States, depends on the effective performance of three World Bank functions:

First, for more than a decade, the World Bank and the IMF have coordinated donor efforts at the country level to affect policy reform and structural change at both the macro and sectoral level. While the GAO report notes that these efforts have not been uniformly effective, it is very important to recognize that without the Bank's leadership in this area we would not have seen the dramatic development improvements that have occurred as a result of Bank-led policy reform and structural adjustment efforts. We would suggest that success is most probable when the international financial institutions are able to harmonize their efforts with the major bilateral donors--creating a consistent political and economic environment for reform and linking policy change to effective implementation.

Second, country level donor coordination by the World Bank, including the Bank-led Consultative Group process, has been the foundation of effective and reinforcing development assistance. The World Bank's role in staffing this process, focusing the issues, and representing the donor community with the host country has in the past been critical to effective development. It is also clear,

320 TWENTY-FIRST STREET, N.W., WASHINGTON, D.C. 20523

however, that the requirements of coordination are changing as environmental issues, the expanding importance of civil society in the development dialogue, human rights and governance conditions, and conflict resolution become ever more central to donor development efforts. In addition, a new concern with measuring results adds yet another dimension to the partnership among donors and recipient countries. Finally, although the GAO Report emphasizes U.S. leverage and influence on the World Bank itself, in this period of declining resources, the importance of a forum in which our policies can be harmonized with both multilateral and bilateral donors is ever more critical. Many of these new perspectives are captured in the OECD/DAC paper "Shaping the 21st Century: The Contribution of Development Co-operation."

Third, much of the Report is focused on the effectiveness of World Bank projects. USAID observes most of these projects first hand in the field. This perspective has been utilized in the design phase of World Bank projects on a selective basis and has served to inform U.S. positions on the Bank Board. We have discovered that if we can get "upstream" in the design process, the World Bank has been increasingly responsive to the input of USAID field missions. In fact, we have been able to document a number of instances in which USAID Mission pilot efforts paved the way for major World Bank activities and USAID Mission in country presence facilitated institutionalization of World Bank initiatives. It is clear that when Bank projects are effectively harmonized with bilateral grant activities, the developmental outcome can be impressive.

USAID does have a legislative mandate to review projects of the multilateral development banks for their possible adverse environmental impact and to issue an annual report to Congress. This review of the Bank's process has revealed a significant improvement in both environmental policies and procedures over the past five years. It is important that Bank leadership continue to play an increasingly active role in leading donor policy dialogue on environmental issues as an integral part of its coordination role.

Thank you for the opportunity to respond to the GAO draft report and for the courtesies extended by your staff in the conduct of this review.

Sincerely,

Larry E. Byrne
Assistant Administrator
Bureau for Management

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