ASSESSING DEVELOPMENT EFFECTIVENESS

Evaluation in the World Bank and the International Finance Corporation

The World Bank and the International Finance Corporation

The World Bank is a development institution owned by the governments of 176 countries. Its purpose is to assist its developing member countries to further their economic and social progress so that people now in poverty may live better and fuller lives. To do this the Bank lends money for priority development operations and provides economic advice and technical assistance. Often Bank-financed activities serve as catalysts for development assistance from other agencies.

The name World Bank refers to two legally and financially distinct entities: the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA). The IBRD, which began operations in 1946, finances its lending operations by borrowing in world capital markets. The interest rates and repayment periods of IBRD loans are generally more favorable than member governments can obtain from commercial banks. IDA, founded in 1960, assists the poorest developing countries out of resources provided by its wealthier members. IDA credits are interest free and have longer repayment periods.

Most of the Bank's lending is used for investment projects. These build up physical and human capital to help countries increase their agricultural productivity, provide basic health care, train teachers, build roads, power stations, schools, and health clinics, modernize industries, expand telecommunications networks, and construct water and sewerage facilities.

Adjustment operations account for about 20 percent of lending. They provide fast-disbursing finance to support the borrower's balance of payments while the borrower implements reforms in policies and institutions to make the economy more efficient and flexible and in a better position to achieve long-term growth.

The International Finance Corporation (IFC), an affiliate of the World Bank, seeks to promote growth in developing countries' private sectors by mobilizing foreign and domestic capital to invest alongside its own funds in commercial enterprises. It was established in 1956.

Assessing Development Effectiveness

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Foreword

Effective management of development requires reliable feedback about the impact of ongoing and completed operations. This is the major goal of evaluation.

Learning from development experience calls for a well-focused and well-structured system of operations evaluation. The World Bank's operations evaluation organization has been in existence for more than two decades. It provides comprehensive information for management decisions at all levels and supports a continuing process of performance improvement.

Closely linked to the project cycle and to policy reform, evaluation in the Bank incorporates contributions from borrowers, who are the owners of the operations that the Bank finances. Operations evaluation provides insights and recommendations of value to development practitioners both within and outside the Bank.

Lewis T. Preston
President
The World Bank

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1
Introduction

The basic mandate of evaluation in any organization is twofold: to measure to what extent and how efficiently operational programs and activities are producing the desired results, and to feed the information back into the formation of new directions, policies, and procedures. The reporting aspect of evaluation strengthens accountability. The learning dimension assists management with decisionmaking.

The World Bank, an organization that promotes development through international cooperation, has special features that were taken into account in the design of its evaluation processes.

- *Its substantial resources.* Allocative decisions have to be made about both the resources the Bank lends (about US$24 billion annually) and those it spends on administration (about US$1.3 billion annually).
- *A decentralized decisionmaking structure.* The Board of Executive Directors makes decisions on policies, budgets, and lending and borrowing commitments; the president sends recommendations on these matters to the board and makes major administrative decisions; and day-to-day operational and administrative decisions are delegated to the lowest possible level to ensure that the Bank responds flexibly to borrowers' needs.
- *Shared responsibility for outcomes.* Operations supported by Bank lending are primarily the responsibility of borrowers. Many of these operations involve participation by other development agencies and nongovernmental organizations as well as by the Bank.

All lending and nonlending services need evaluation. If useful lessons are to be absorbed effectively, evaluation staff need to interact closely with operational staff at all levels, and borrowers and other stakeholders should be involved in the evaluation process. This said, evaluation in the Bank and the International Finance Corporation (IFC)

has full freedom to review, assess, and derive lessons from operational experience.

Overview

The Bank's first operations evaluation unit, established in 1970, reported to the president through a vice president with no operational duties. The evaluation function took on its present independent character in 1975, when the post of director-general, Operations Evaluation, was established. The director-general reports to the Board of Executive Directors.

Goals

Evaluation measures achievements in relation to institutional policies, Bankwide program objectives, and the goals set for each operation. It is designed to:

- Provide an objective basis for assessing the performance of policies, programs, projects, and processes
- Improve policies, programs, and projects by identifying and disseminating the lessons learned from experience.

Structure

Evaluation has two major dimensions: (a) self-evaluation by the managers responsible for particular programs and activities; and (b) independent evaluation by the Operations Evaluation Department (OED). Box 1 outlines the basic principles underlying evaluation activities.

The director-general, Operations Evaluation, is directly appointed by the Board of Executive Directors for renewable terms of five years and is responsible to the board under the aegis of the Joint Audit Committee. The director-general also has an administrative link to the president.

The director-general is responsible for:

- Appraising the World Bank's operations evaluation system and reporting on its adequacy to the Bank and member governments
- Conducting independent reviews, on a selective basis, of operational programs and activities to determine whether they are realizing their goals and whether changes are needed to make the activities more effective, efficient, and responsive to the needs and concerns of member governments
- Encouraging and assisting member countries to develop their own evaluation systems.

Box 1. Basic Principles of the World Bank's Evaluation System

- *Independence.* If evaluation is to be impartial, its findings, analyses, and conclusions must be free of bias. This means that evaluation must be independent from line management at all stages of the process, including planning of work programs, formulation of terms of reference, staffing of evaluation teams, and clearance of reports.
- *Usefulness.* For evaluation to affect decisionmaking, decisionmakers must perceive the findings as useful and as geared to current operational concerns. To ensure a practical focus, evaluation involves operational managers, borrowers, cofinanciers, and beneficiaries of Bank assistance.
- *Credibility.* If Bank managers and staff are to use the lessons learned from evaluation, they must perceive the evaluation as objective, rigorous, and impartial. The credibility of evaluation rests on the professional quality of the staff, the rigor of its methods, and the transparency and ready availability of its findings.
- *Transparency.* All evaluation reports are issued to all Bank member governments and to the Bank's management and are available to all staff. The evaluation process itself (including self-evaluation) is subject to independent annual reviews by the Joint Audit Committee of the Bank's Board of Executive Directors. The OED issues an *Annual Review of Evaluation Results*, evaluation studies, and a series of abstracts, the *OED Précis.*

The director-general discharges these responsibilities for the World Bank through the OED and for the IFC through functional oversight of the IFC's Operations Evaluation Unit (OEU).

The Joint Audit Committee, which oversees the operations evaluation system, is a standing subcommittee of the Board of Executive Directors. The committee consists of eight directors who are appointed by the full board for terms of two years. With regard to operations evaluation, the committee's terms of reference are to:

- Oversee the operations evaluation standards, procedures, and activities of the World Bank and the IFC
- Satisfy itself that operations evaluation in the Bank Group is adequate and efficient
- Report annually to the full board on evaluation performance and output and recommend issues for consideration by the board as necessary.

The committee reviews the annual work programs and budgets of the Bank's OED and the Corporation's OEU, the approach papers for proposed studies, the director-general's annual report on operations evaluation, the OED's *Annual Review of Evaluation Results*, and all studies prepared by the OED and the OEU.

Evolution

In its early years, operations evaluation in the Bank concentrated mainly on individual investment projects. In the mid-1970s, the focus was broadened to cover the Bank's operational policies and processes by means of cross-country evaluation studies. The late 1980s saw an increased emphasis on dissemination and feedback—on ensuring that evaluation programs focus on topics relevant to operational needs and make their results and recommendations readily accessible to decisionmakers.

In 1992 a seminal report by a task force on the Bank's portfolio management raised awareness of the evaluation function and created fresh demand for evaluation output, both inside and outside the Bank.[1] The Bank's president had commissioned this report in response to a decline in the performance of the Bank's lending operations. Both operational staff and the OED had noted a decrease in the proportion of successful lending operations during the 1980s and had highlighted the importance of improved portfolio management practices in determining outcomes.

In May 1993, adopting the recommendations of management, the board called for improvements in independent operations evaluation activities and for a stronger OED.

Related but Distinct Functions

To protect its independence, operations evaluation in the Bank steers clear of involvement in operational decisionmaking. Although operations evaluation provides opportunities for institutional learning and for the adjustment of policies and programs in the light of experience, it cannot guarantee that lessons are learned or that policies and programs are corrected in a timely and effective way. This is the responsibility of the Bank's management and of the board.

Evaluation in the Bank covers only one aspect of accountability: the authoritative assessment of the economy, efficiency, and effectiveness of the pursuit of development goals. The other, "sanctioning," aspect of accountability—through which action is taken to reward good per-

formance and penalize poor performance—is a management rather than an evaluation function.

The director-general is not concerned with the functions of the external auditor, who is appointed by the executive directors to examine and report on the annual financial statements of the World Bank and its affiliates. The director-general does, however, keep abreast of the Internal Auditing Department's activities by maintaining contact with the auditor-general on matters affecting the Bank's effectiveness and efficiency.[2] The director-general also provides advice, as needed, to the independent Inspection Panel, which was established to investigate claims by affected parties that the Bank may have failed to adhere to its operational policies and procedures in the design, appraisal, or implementation of ongoing or new operations.[3]

Notes

1. "Effective Implementation: Key to Development Impact," Report of a Task Force on Portfolio Management. World Bank, Washington, D.C., November 1992.

2. The Internal Auditing Department furnishes management with periodic independent appraisals and audits of financial, accounting, administrative, and other activities. Its main responsibilities are (a) to determine the soundness, adequacy, and application of systems and procedures and of related internal controls and to promote effective control at reasonable cost; (b) to determine the extent of compliance with prescribed policies, plans, and procedures; (c) to determine the extent to which the World Bank's assets are accounted for and protected from losses; (d) to determine the reliability and validity of significant accounting, financial, and other data used by management; and (e) to recommend improvements to strengthen internal control, improve administrative efficiency, and eliminate wasteful use of resources.

3. The panel consists of three highly qualified individuals appointed by the executive directors; they come from outside the Bank and are from different countries. Inspections by the panel are not a regular feature of the Bank's work; rather, they provide a safety net for use in exceptional circumstances where, because the Bank's own policies and procedures have not been followed, there have been or could have been adverse consequences for people affected by ongoing projects or projects under consideration by the Bank.

2
Self-Evaluation

To encourage effective learning and application of lessons, much of the evaluation activity in the Bank is decentralized and is based on self-assessment. The first section of this chapter describes self-evaluation processes for lending operations. The second section deals with non-lending activities.

Lending Operations

Lending operations are evaluated by the responsible operational staff both while they are being implemented and later, after disbursements on the Bank loan have closed (box 2).

Current Operations

LOAN SUPERVISION. The Bank's operational staff regularly evaluate lending operations in progress through loan supervision. Currently, the Bank uses more than a quarter of its operational staff time to supervise its US$140 billion portfolio of operations in progress around the world. Implementation is largely the responsibility of the borrower, who bears the costs and realizes the benefits of the investments. By supervising its loans, the Bank both carries out a fiduciary responsibility and assists the borrower with implementation. As a lending institution, the Bank monitors progress in implementation and compliance with legal loan conditions to ensure that loan proceeds are used appropriately. As a development institution, the Bank helps borrowers obtain the greatest benefit from their loans. By interacting with borrowers and their implementing agencies in supervising individual operations, it helps borrowers identify and resolve operational and management problems and respond suitably to changing circumstances. Of course, more complex projects and weaker institutions require more supervision support.

Box 2. Self-Evaluation Instruments in Lending Operations

The following self-evaluations are performed:

For *all individual lending operations:* supervision reports prepared regularly for ongoing operations, and implementation completion reports prepared soon after the closing of the loan.

For *country lending portfolios:* country portfolio performance reviews, which the Bank's country departments carry out annually for major borrowers and over a longer but regular cycle for countries with smaller portfolios.

A general overview of evaluations is provided by the *Annual Report on Portfolio Performance*, which is based on country and sector summaries. The report informs the Bank's board and management of strengths, weaknesses, and trends in the whole portfolio of current projects.

The Bank's supervision system covers all operations under implementation. Once a loan has been approved by the Bank's Board of Executive Directors, supervision concentrates on getting the project off to a good start and familiarizing new borrowers and implementing agencies with the Bank's requirements regarding procurement, disbursement, reporting, and auditing. Most supervision is carried out during the investment or project execution stage. The Bank reviews all progress reports by the borrower, and Bank staff visit project sites and facilities to review progress, provide advice, and obtain information. Once a loan account has been closed, at the end of the investment phase, Bank staff prepare a completion report to assess the outcome of the project and make recommendations for its future operation.

Guidelines for monitoring and rating the performance of current operations are being enhanced to deal not just with financial and economic indicators but also with issues of equity, sustainability of benefits, and participation by project beneficiaries in decisionmaking. Operational staff are expected to take the findings of supervision reviews into account in planning and implementing new operations.

Supervision relies on information from the monitoring and evaluation systems that are now incorporated in most projects and programs (box 3). Supervision reports feed into country portfolio performance reviews and into the "Annual Report on Portfolio Performance."

COUNTRY PORTFOLIO PERFORMANCE REVIEWS. For country portfolio performance reviews, the Bank's regional staff discuss with borrowers issues that affect the performance of Bank-supported operations. The purpose of these reviews is to:

Box 3. Monitoring and Evaluation in Investment Projects

Since the 1970s the Bank has promoted monitoring and evaluation as tools for managing the operations it supports.

Monitoring is the continuous assessment of project implementation in relation to agreed schedules and of the use of project outputs, including infrastructure and services, by project beneficiaries.

Evaluation is the periodic assessment of the relevance, performance, efficiency, and impact of the project in relation to stated objectives.

Monitoring and evaluation is an integral part of good management by a project-implementing agency. Its main goals are to provide continuous feedback on implementation and to identify potential successes and problems as early as possible to facilitate timely adjustments to project operation.

Plans for monitoring and evaluation are included in all Bank-supported operations. Their relative importance, scope, and organization vary depending on the operation and the implementing agency. The Operations Evaluation Department advises on methods and indicators for use in monitoring operations. It also advises on the monitoring and evaluation components of new operations entering the portfolio to ensure that the evaluation criteria are sound and can yield the information required for assessing the operation's impact after its completion.

- Take stock of progress in implementing the operations in the portfolio
- Identify solutions to problems in individual projects and programs
- Identify systemic problems that need attention
- Agree on remedial actions
- Establish clear links between the performance of the operations in progress and the Bank's future assistance to the country.

ANNUAL REPORT ON PORTFOLIO PERFORMANCE. The "Annual Report on Portfolio Performance," prepared by the Bank's central staff for the Bank's board and management, evaluates strengths, weaknesses, and trends in the entire current portfolio and pinpoints problem areas that need special attention at both the country and sector levels. In preparation for the report, task managers update the performance ratings of all ongoing operations on the basis of reports from supervision missions during the year. The Bank's regional managers review these ratings to ensure consistency of judgment. The process is subject to independent review by the OED.

Completed Operations

The regional staff evaluate all completed operations for which they are responsible. Subsequently, the OED independently evaluates a representative sample of completed operations.

For each operation, regional staff prepare an *implementation completion report* (ICR) in conjunction with the last supervision mission (which takes place as the Bank is completing its disbursements for the operation). The ICR assesses the outcome of the operation and the plan the borrower has proposed for its future management and makes recommendations (box 4). Contributions from borrower agencies—either a whole report or a set of comments—are annexed to the report. The Bank invites cofinanciers to participate in evaluations of operations they have cofinanced.

All ICRs are issued to the Bank's Board of Executive Directors and management and, through the executive directors, to the authorities in all the Bank's member countries. The OED reviews all ICRs to extract data and record assessments. For each completed operation, the director-general sends the board a transmittal note that summarizes the OED's comments, assesses the quality of the ICR, and validates completion ratings.

Nonlending Activities

Economic and Sector Work

So that it can better understand the problems of the countries it assists, the Bank carries out economic and sector work to analyze these problems and their causes. Country assistance programs and project design build on the recommendations arising from this work. Economic and sector work represents about a fifth of the Bank's operational budget (making it the largest of the nonlending activities) and uses almost as much of the Bank's resources as does portfolio management.

The Bank's regional offices, with advice from technical experts in the central vice presidencies, assess economic and sector work. In their evaluations, the regional chief economists generally consider three criteria:

- *Relevance* to the country's development issues, to the client's priorities and interests, to Bank operational requirements for adjustment and investment lending, and to aid coordination
- *Quality* of analytical techniques, empirical work, and presentation
- *Impact* on decisions by the country or the Bank about policy or the design of its investments.

Box 4. Typical Questions Addressed by Implementation Completion Reports

- *Goals of the operation.* Were goals clearly defined? Were they realized, in the judgment of Bank and borrower? In retrospect, were the original goals appropriate?
- *Economic and social benefits.* Are the operations's economic and social benefits likely to reach the expected levels? Are they being distributed as expected?
- *Institution building.* Was the institution-building strategy that was adopted appropriate and effective? Have the intended policy and structural reforms been successfully carried out? Were the project management arrangements satisfactory?
- *Efficiency.* Could similar operations be prepared, appraised, and implemented more quickly or economically in the future without undue risk to their own or sectoral goals?
- *Financial performance.* Has the operation met its financial goals?
- *Implementation.* Were the operation and its main components fully completed, on time, and within realistic estimates of costs? What changes were made during implementation, and why? Did the borrower and its consultants perform as expected?
- *Compliance.* Did the borrower and the government comply with the loan covenants and related agreements?
- *The World Bank's contribution.* How does the borrower perceive the Bank's involvement with this operation? Did the Bank influence the design or implementation of the operation, and was this influence constructive?
- *Other considerations.* Did the operation have unintended social, economic, or environmental effects? Does the investment remain worthwhile even after delays, increases in costs, or shortfalls in expected benefits? What lessons does the experience yield for the Bank and the borrower?
- *Development impact.* What measures are underway or planned to ensure that full and sustained benefits are secured from the financial assets?

Research

Research, which accounts for about 3 percent of the Bank's budget, is the most systematically and rigorously evaluated nonlending activity in the Bank. Research projects are selectively evaluated by outside experts who assess the goals, design, method, supervision, results, and dissemination of research, drawing conclusions about cost-effective-

ness, value, and lessons for further research and practice in the field. For each research topic selected, evaluators comment on the consistency of the group of projects with the Bank's comparative advantage and on how the results have affected the Bank's operations and policy advice.

Policy Work

In general, the self-evaluation of the Bank's operational policies follows a long-term agenda agreed on by the board and management and proposed by the Bank's Policy Review Committee, which is headed by a managing director. Most of the evaluations of policy take the form of papers on best practice and lessons of experience or sector or subsector policy reviews prepared by the Bank's central staff. To review major policy matters, the Bank sets up a formal group that represents all the relevant vice presidencies. For certain special studies the Bank assembles review panels of outside experts.

Special Grants

Self-evaluations of special grants are of two types: external, done every three to five years outside the Bank by the sponsoring agencies, independent experts, or advisory committees; and internal, done annually by the grant-managing units in the Bank. The longer-established special grant programs, such as the Consultative Group on International Agricultural Research, undergo both types of evaluation.

Development Training

The Economic Development Institute is responsible for the Bank's development training programs. The institute carries out self-evaluation to assess the quality and usefulness of its training activities in achieving regional and thematic objectives and feeds the results back into the design of its work programs. The institute shares these evaluation results with agencies that have financed or cofinanced the activities and the evaluation.

3
Independent Evaluation

The OED is headed by a director appointed by the director-general, Operations Evaluation. The department's responsibilities are to

- Help the director-general assess the adequacy and effectiveness of the Bank's operations evaluation system
- Carry out performance audits of Bank operations and conduct evaluation studies
- Maintain the Bank's institutional memory regarding operational performance
- Disseminate evaluation findings on Bank operations both within and outside the Bank
- Assist member countries to develop their own evaluation systems.

The OED's mandate covers the Bank's operational policies and programs and its nonlending services. The department's budget accounts for about 1 percent of the Bank's total administrative budget.

Independence and Relevance

The Bank's Board of Executive Directors oversees the OED's work through the Joint Audit Committee, which is made up of selected executive directors. The OED has unrestricted access to the Bank's staff and records. OED staff—most of whom have had extensive development experience in the Bank and elsewhere—may work in other departments after working in the OED, but they may not participate in evaluations or reviews of operations for which they were responsible before joining OED.

To help ensure that independent evaluation work responds to the Bank's needs for information to guide policy and operational decisions, the OED's annual work programs are widely discussed during preparation with executive directors, managers, and Bank staff. The Joint Audit Committee reviews the annual work program and recommends its endorsement to the board.

Evaluation Methods

To assess the development effectiveness of completed operations, the OED examines their technical, financial, economic, social, and environmental aspects and provides ratings of their outcomes, sustainability, and effect on institutional development. The OED also evaluates the performance of the Bank, the borrower, and implementing agencies. The evaluation process is grounded in the same criteria and policies that are used to judge new operations proposed for financing (box 5).

Box 5. OED Evaluation Methods

Evaluating Outcomes

Completed operations are analyzed from three perspectives:

Relevance. Evaluators determine whether the operation's goals were consistent with country and sectoral assistance strategies and whether the design was appropriate in terms of one or more of the Bank's goals of reducing poverty, protecting the environment, developing human resources, and fostering growth in the private sector.

Efficacy. Evaluators review the operation's effects and compare them with its goals, whether physical, financial, institutional, or policy related.

Efficiency. Evaluators assess outcomes in relation to inputs, looking at costs, implementation times, and economic and financial results. Where practicable, the evaluators reestimate the economic rate of return in relation to a minimum threshold of 10 percent.

Outcomes are also assessed in terms of three interdependent criteria:

Overall outcome ("satisfactory" or "unsatisfactory"). Satisfactory performance means that an operation has achieved most of its major goals and has achieved, or is expected to achieve, satisfactory development results with only a few shortcomings.

Sustainability—the probability, at the time of evaluation, of maintaining the achievements generated or expected to be generated in the operational plan.

Institutional development—the process of improving a country's ability to make effective use of its human, organizational, and financial resources. Evaluators assess the institutional development progress achieved, or expected to be achieved, as a result of the operation. Not all operations have institutional development goals, but many depend on

(Box continues on the following page.)

Box 5 (continued)

institutional change for achieving a lasting development impact. Examples of such change include strengthening, eliminating, or reforming particular agencies; supporting regulatory or legal reforms; and supporting education and training.

Evaluating Performance

The OED assesses the reasons for operational outcomes in terms of the role in or contribution of the following factors at various phases of the project cycle (see appendix A):

The Bank's performance at the identification, preparation, appraisal, and supervision stages of the project cycle.

The borrower's performance, evaluated in terms of the policy environment created for the project, the level of commitment of the government and of key institutions associated with the project, the provision and reliability of domestic funds for the operation, the administrative procedures, and the quality of decisionmaking.

The performance of implementing agencies, rated on such elements as the quality of management and staff associated with the project; the use and effectiveness of technical assistance, including training, advisers, and contractual services; the adequacy of monitoring and evaluation systems; and the extent and quality of participation by intended beneficiaries, including their contribution to the project's outcome.

Exogenous factors, such as changes in prices and world market conditions, natural disasters, civil disorder and armed conflict, and actions of partners who are independent decisionmakers—for example, cofinanciers, nongovernmental organizations, contractors, and suppliers.

Evaluation Instruments

Review of Completion Reports

The OED reviews all implementation completion reports to assess and report on their quality, collect evaluation data for aggregative analysis, extract findings and recommendations useful for new operations, and select operations to be audited (box 6). On the basis of the OED's independent review of each ICR, the director-general transmits to the board an evaluative note that comments on the quality of the ICR, the performance rating of the operation, the lessons to be drawn, and whether the operation is a candidate for performance auditing.

Box 6. Independent Evaluation Instruments

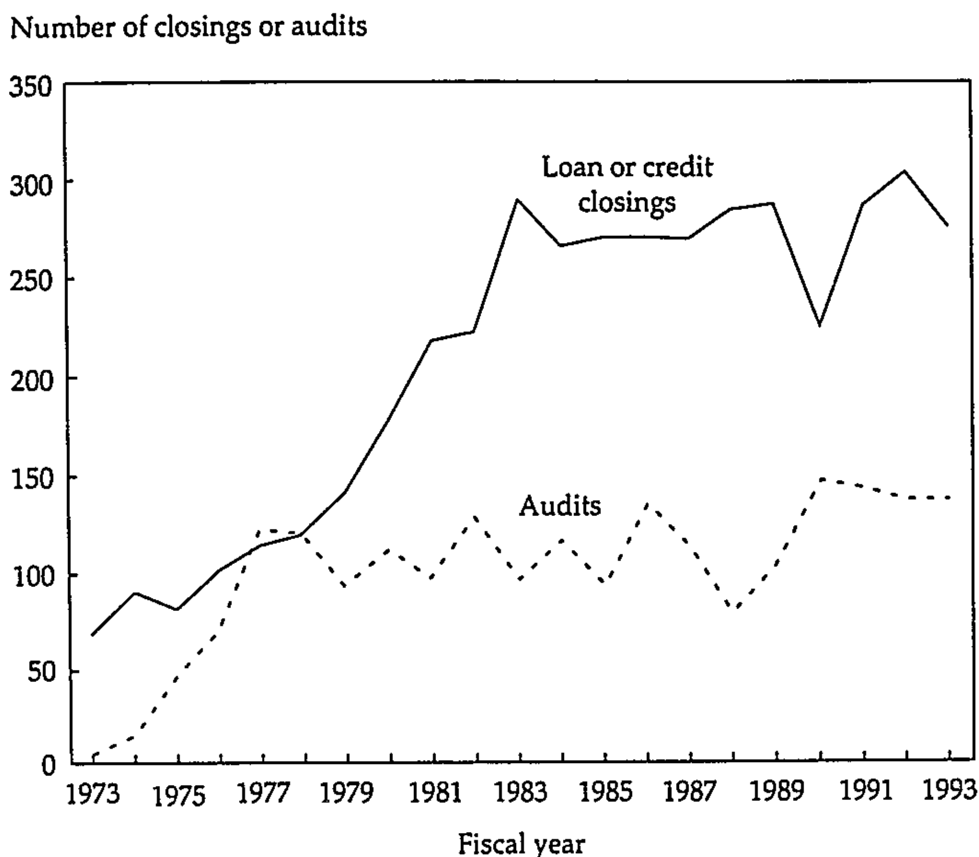
- *Performance audit reports* are prepared by the OED on the basis of reviews of ICRs and field work for a sample of fully disbursed investment operations and for most adjustment operations. They validate and augment the information provided in the implementation completion report, but they also examine issues of special interest related to broader studies that are underway. Together with ICRs, they provide the basis for assessing outcomes.
- *Impact evaluations* attempt to assess the performance of projects at full development, which usually occurs five to ten years after the close of disbursements on the Bank's loan. Usually based on field studies, they focus on the project's impact, including its intended and unintended effects on people, institutions, and the physical environment. By following investments through to their ultimate goals, they maintain the accountability of the Bank and borrowers for the effects of the project on sustainable development.
- *Evaluation studies* build on individual evaluations to address broader development issues—including policy and experience in countries, regions, sectors, and areas of special emphasis—and the Bank's operational processes.
- The *Annual Review of Evaluation Results* draws on the evaluation experience gained from completion reports, audit reports, and studies done in the prior calendar year to ascertain trends in the Bank's operational performance and to review experience in particular areas.

Performance Audits

The OED audits the bulk of adjustment lending operations and a representative sample—currently about 40 percent—of the Bank's investment projects (figure 1). In selecting operations for audit, preference is given to those that are innovative, large, or complex; those for which executive directors request audits; and those that, individually or as part of a cluster, are likely to generate important lessons. Thus, projects, topics, and analytical approaches for the audit work program are chosen to provide inputs for comparative evaluation studies.

To prepare audits OED staff examine project files and other documents, interview operational staff, and, in most cases, visit the borrowing country for on-site discussions. The operational staff concerned, and subsequently the borrowers, receive draft audits. The borrowers' comments are incorporated into the document that is sent to the Bank's

Figure 1. Evaluation and the Portfolio, Fiscal 1973–93



board. When an audit report is released to the board by the director-general, it is also widely distributed within the Bank and to concerned authorities in member countries.

Impact Evaluations

The ultimate test of the Bank's programs is their long-term effects on people, policies, and domestic capacities. OED impact evaluations take an independent second look at projects five to ten years after completion to assess what lasting contributions the Bank is making to the borrower country's development (box 7).

Impact evaluations assess projects against the goals that were stated at appraisal and also against a broader set of criteria that relate to social dynamics, income distribution, effects on women and families, institutional development, and the environment. They examine what has happened to the infrastructure created under the project, the experience with production of goods and services aided by the project, the distri-

Box 7. Assessing the Effects of Projects

The OED evaluates a project's overall impact of a project in terms of its effects on beneficiaries and the natural environment and the sustainability of these effects. Evaluators pay particular attention to the Bank's areas of special emphasis: poverty reduction, the development of private enterprise, the environment, and conditions for women.

Impact evaluations build up their overall assessments from investigations using the following typology:

- *Technical impact,* including changes in technology, effects on output, changes in the use of inputs, changes in cropping patterns, resource flows, and resource productivity.
- *Institutional impact*—development of markets, establishment and operation of financial systems, changes in trading relations, and effects on local government or on regulations.
- *Economic impact,* reflected in changes in consumption, savings, asset levels, and other indicators of change in families' net worth. An overall assessment is made through cost-benefit analysis, which reflects both positive and negative benefit flows.
- *Social and cultural impact,* assessed through changes in income distribution, migration, household structure, family size, gender roles, demographic patterns, labor force participation, and patterns of community interaction. Evaluators note changes in life span, health, education, and other social indicators. They assess working conditions, as well as changes in the burdens of different family members.
- *Environmental impact*—changes in the natural resource base, water and air quality, and other indicators related to specific locations, including genetic diversity and the survival of wildlife.

bution of the benefits created, and the performance of the implementing organizations.

Most impact evaluations to date have used relatively formal study methods—in particular, field surveys that use key questions to gather opinions of stakeholders, including the ultimate beneficiaries. The OED also uses low-cost evaluation methods of the rapid appraisal type, including interviews, direct observation, informal surveys, and reviews of existing information.

Even though they may be relatively costly to execute, impact evaluations give unique insights into the conditions needed to sustain benefit flows over the long term. They provide evidence of the Bank's development impact, which represents the true worth of the Bank's portfolio.

Evaluation Studies

The OED uses findings from completion, audit, and impact evaluation reports, supplemented by further investigation, including staff field work and surveys, to prepare evaluation studies. These studies assess the effectiveness of Bank policies, processes, and practices from the perspective of operational experience. The work program for the studies is planned so as to feed into the Bank's reviews of its operational policies.

Approach papers for proposed evaluation studies are reviewed by the Joint Audit Committee. The studies are reviewed in draft form with borrowers and Bank staff in the same way as are audit reports. Completed studies are distributed to executive directors and their authorities and to Bank management; they are available to all Bank staff on request. Studies of broad interest are published.

SECTOR STUDIES. Sector studies address such issues as the effectiveness of dialogue between borrowers and the Bank on sector policies or on project selection, design, and implementation; the socioeconomic impact of sector policies and programs; institutional development; or manpower needs. Many of these studies compare experience across countries; others are in-depth reviews of particular sectors in individual countries.

PROCESS STUDIES. Evaluating the Bank's business processes from a development perspective is part of the OED's mandate. Process studies examine how well the Bank applies its policies, as well as the efficiency and effectiveness of the Bank's business practices in reaching their intended development goals. Examples of such processes include project identification, loan supervision, and the monitoring and evaluation components of projects.

COUNTRY ASSISTANCE REVIEWS. Country assistance reviews are, in essence, countrywide impact evaluations that concentrate on the impact and development effectiveness of the Bank's whole program of assistance to each country. They have essentially the same relationship to the Bank's overall assistance program that performance audits have to individual lending operations. They provide an opportunity to assess lending and nonlending services in the context of the overall country assistance strategy (box 8).

QUICK RESPONSE STUDIES. Quick response studies respond to executive directors' requests for information on particular topics. They are

Box 8. Country Assistance Reviews

The OED's country studies are issues oriented and are geared toward current decisionmaking, in keeping with the Bank's increased emphasis on better management of operations in progress. For each country to be covered they (a) evaluate the effectiveness of the Bank's country assistance strategy, taking into account country conditions (for example, economic policies and budget constraints), the impact of external factors, and the role of other development agencies and financiers, and (b) assess the effectiveness of the various instruments of Bank assistance: investment project lending, adjustment lending, technical assistance, economic and sector work, policy dialogue, and aid mobilization and coordination.

The studies give particular attention to institutional development and capacity building, project and borrower ownership, the sources of long-term growth in the real economy, human resource development, governance and the political economy of development, and environmental sustainability. They offer lessons and recommendations for the Bank's regional staff to feed into country portfolio performance reviews and the design of country assistance strategies.

desk studies based on existing information and may take the form of fact sheets or short analytical reports.

Annual Review of Evaluation Results

The OED synthesizes its findings in its *Annual Review of Evaluation Results,* which is discussed by the Bank's board and is published. The review summarizes the findings of evaluations done during the preceding calendar year and reports on trends in the Bank's operational performance. It also analyzes selected topics (such as experience with adjustment lending, the effects of Bank operations on the environment, and support for institutional development) in detail, using evidence from evaluation work.

Review of Annual Report on Portfolio Performance

The OED reviews the preparation of the "Annual Report on Portfolio Performance" by operational staff (see chapter 2). It evaluates the methods used to measure progress and performance and provides a commentary for the executive directors and management on the report's treatment of systemic issues in the management of country portfolios.

Annual Report on Evaluation Activities

Each year the director-general reports to the executive directors and the president on the status of evaluation in the Bank and the IFC. This "Annual Report on Evaluation Activities" provides an overview of the major activities of the OED and of the IFC's Operations Evaluation Unit during the past fiscal year and reports on the effectiveness of evaluation, dissemination, and feedback processes for lending and nonlending services.

Institutional Memory

The database that the OED uses for its annual review provides information on the operational performance of all individual completed Bank operations. The data, which are derived from completion reports and performance audit reports, include ratings of overall outcomes, institutional development, and sustainability, as well as variables such as economic rates of return, project costs, delays, and loan cancellations.

4
Dissemination and Application of Evaluation Results

The OED's dissemination program communicates the results of evaluation work to audiences within and outside the Bank. Within the Bank, dissemination makes lessons and recommendations accessible, helps to shape debate about policies and practices, and influences the design and implementation of policies and lending operations. Externally, the program helps to enhance the Bank's accountability and transparency by providing an accessible track record of performance.

Feedback within the Bank

The Bank's management is responsible for applying lessons of experience. The feedback process is buttressed by formal directives (box 9 and figure 2). The OED's dissemination program provides essential support to this process.

The findings of performance audits and evaluation studies begin to be disseminated well before the reports are completed. All operational units responsible for work that is being evaluated have the opportunity to comment on the OED's reports in draft. (Unresolved differences of opinion between the OED and operational units are recorded in the reports sent to the Bank's board.) The department holds seminars and workshops for Bank staff to exchange views on ongoing and completed evaluation studies. By the time evaluation reports are submitted to the executive directors, many of the staff who need to be aware of the findings have already debated them actively.

All the Bank's senior managers receive copies of all evaluation reports. And all evaluation reports are available to Bank staff on request.

The OED has a "proactive" dissemination program. It distributes synopses of evaluation results and recommendations throughout the Bank and targets particular findings to staff who can feed them directly into the design and implementation of policies and lending operations.

Box 9. World Bank Operational Directives on Feedback of Evaluation Results

Operational Directive 13.60: Dissemination and Utilization of OED Findings (May 1989). Instructs the Bank's managers and staff to "seek out the findings of relevant evaluation reports, disseminate them to others concerned, and ensure they are taken into account in future activities . . . Relevant OED findings should be reflected and cited in Country Strategy Papers, Staff Appraisal Reports, Project Briefs, and President's Reports."

Operational Directive 2.10: Country Strategy Papers (September 1990). Requires the Bank's country strategy papers to identify "any key factors that have constrained the effectiveness of Bank assistance . . . The relevant studies by OED should serve as guides."

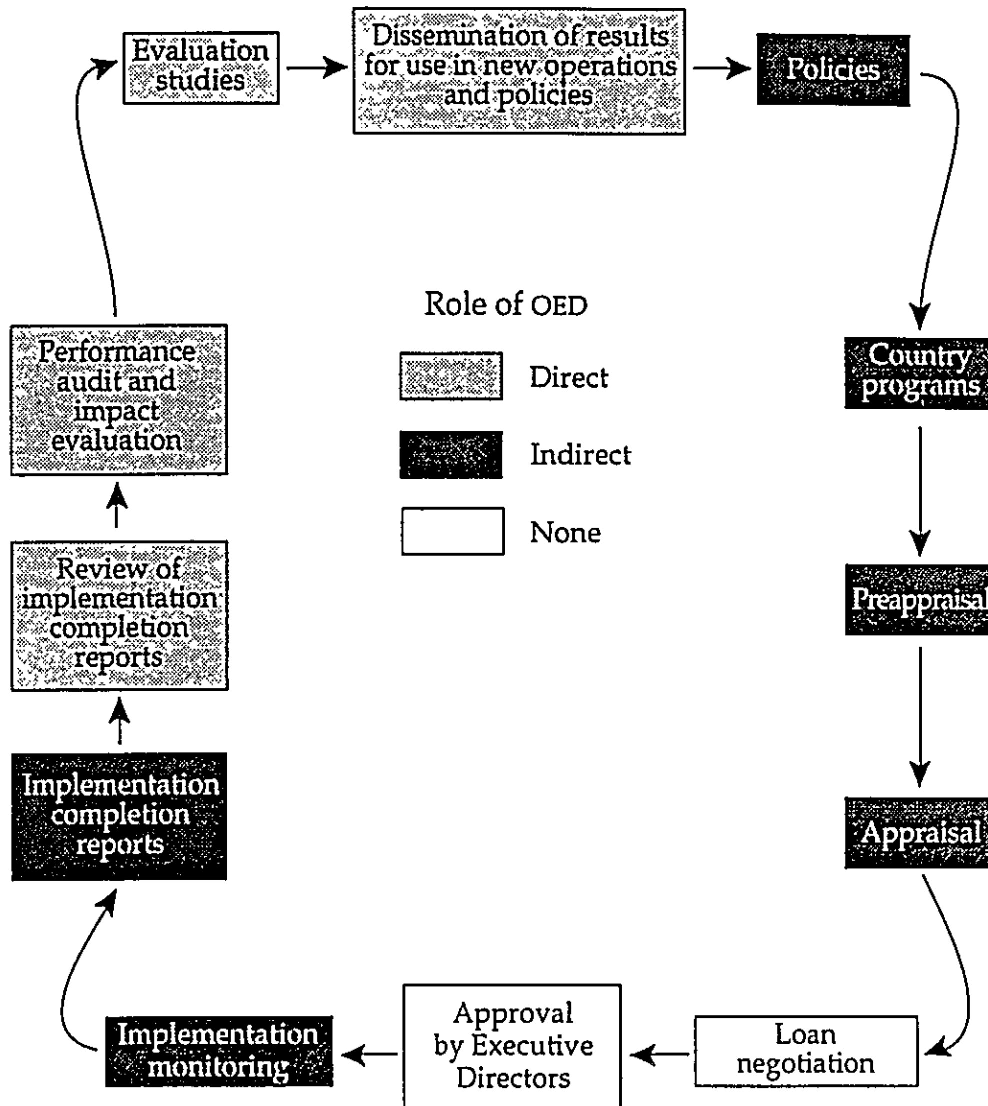
Operational Directive 9.00: Processing of Investment Lending (June 1991). Instructs the task manager of each new operation being proposed for Bank financing to identify relevant lessons from ongoing and completed operations and from studies, including OED studies, the results of which should be considered in the design of the operation. These lessons are to be discussed in the Bank's first formal review of each proposed operation. The next stage of review (the final executive project summary stage) must "examine whether lessons learned are appropriately reflected in project design." When the proposed new operation is presented to the board, the Memorandum and Recommendation of the President must "summarize relevant lessons learned from ongoing and completed operations. [The Memorandum of the President] also spells out results from relevant completion reports and special studies prepared by the Policy and Research complex, OED, and other Bank units. It indicates how the present project design reflects those lessons."

All senior managers receive copies of all evaluation reports, and all evaluation reports are available to Bank staff on request. Managers and staff receive the *OED Précis* on topics relevant to their work, and all operational and central staff receive copies of the OED's *Lessons and Practices*. All Bank staff have access to the Evaluation Textbase from their workstations (box 10).

To contribute ideas and draw attention to relevant lessons of experience, the OED reviews all proposals for future Bank operations. Evaluators look especially at the definition of objectives, the analysis of risks, and the plans envisaged for monitoring and evaluation.

The Bank's directives to its staff require the OED to identify clearly in its studies any differences between its recommendations and the Bank's policies and practices. The directives also state that unless the Joint Audit Committee decides otherwise, the Bank's management should

Figure 2. Evaluation and the Policy Cycle



respond formally to every OED study—either at the Joint Audit Committee meeting to discuss the report or in due course thereafter—indicating the actions it proposes to take (box 11). To monitor these responses, the OED uses a "Ledger of Evaluation Recommendations, Management Responses, and Actions," which is made accessible electronically to all Bank staff.

The OED also monitors the application of lessons from evaluation when, in the course of evaluation studies, evaluators review operations in progress and compare them with those that have been completed.

Attached to the director-general's annual report to the board on operations evaluation is a section in which the Bank's regional manag-

Box 10. Dissemination Instruments

Seminars and workshops are held for major performance audits and studies. Many are organized by borrower countries; others are for agencies in the development community, at universities, and within the Bank. OED staff also disseminate evaluation findings in the course of participating in the Economic Development Institute's training seminars for participants from borrowing countries.

OED Précis highlight findings and recommendations from evaluation studies and audits for development practitioners in and outside the Bank. Issued in English, French, and Spanish, they summarize key findings and recommendations from the OED's evaluation work.

Lessons and Practices is a reference handbook issued by the OED in serial form that synthesizes lessons and recommendations arising from the Bank's development experience. Copies are available to the public on request.

Electronic information is available to Bank staff and executive directors through a searchable textbase maintained by the OED. This Evaluation Textbase reproduces the summaries of the more than 3,000 evaluation reports the Bank has issued, along with basic data on the lending operations evaluated.

Publications include the *Annual Review of Evaluation Results* and a selection of evaluation studies.

ers describe the follow-up to OED evaluation findings issued during the year. Their contributions range from simple acknowledgment of the OED's recommendations to accounts of how their staff are implementing recommendations in particular operations. Inevitably, regional staff may not always agree with evaluation staff on findings and recommendations, but the contributions suggest a healthy interaction.

Borrower Agencies

Implementing agencies and their authorities in borrowing countries receive all completed evaluation reports on operations in which they have been involved. Most have already discussed and contributed to these documents in draft.

Authorities in all the Bank's member countries receive all ICRs, performance audits, impact evaluations, and evaluation studies.

OED staff hold seminars with borrower agencies to discuss evaluation results and recommendations arising from them.

Box 11. Discussions by the Joint Audit Committee

In its reviews of evaluation findings and of management responses to these findings, the Joint Audit Committee highlights, for the attention of management and the Board of Executive Directors, areas of the Bank's work in which changes in policy may be warranted or practice may be falling short of policy or operational guidelines.

During discussions of an OED study of the Bank's experience with involuntary resettlement, for example, the committee endorsed the OED's finding that problems with resettlement stemmed from failure to implement the Bank's own policies adequately, rather than from poor policies. Committee members emphasized the need for operational work to recognize seven key factors highlighted by the evaluation study that affect whether people being resettled are able to maintain or improve their old standard of living. In particular, the study noted the importance of borrower governments' political commitment and the need for better monitoring of resettlement programs while they are in progress.

Responding to the OED study, representatives of the Bank's management explained that a comprehensive review of resettlement programs would identify best practices whose use would help to improve the management of resettlement operations. Following standard practice, the committee chairman informed the Board of Executive Directors of the conclusions reached and the implications for action by management.

The Development Community

Development agencies with which the Bank exchanges official documents receive copies of all the Bank's evaluation studies and the *Annual Review of Evaluation Results.* A broader group of agencies, including nongovernmental organizations active in development work, receive copies of the *OED Précis.* The OED disseminates its results through seminars and conferences with development agencies and shares information electronically through the Evaluation Inventory of the Development Assistance Committee of the Organization for Economic Cooperation and Development.

Borrowers' Participation

The Bank's experience consistently shows that borrowers' sense of ownership and commitment is vital to successful development operations. For the Bank, the challenge is how to deliver necessary assistance

to borrowing countries, many of whose capacity to conceive, design, and implement projects is weak, without taking over responsibility for projects and their results. To achieve a genuine partnership between Bank and borrower requires broad, meaningful participation and leadership by governments and private agencies in borrowing countries throughout the project cycle—for example, through joint work with the Bank on implementation planning, workshops to launch new projects, evaluation of current and completed projects, evaluation of country assistance strategies, and discussions of possible new operations.

For current operations supported by the Bank, borrowers create and run monitoring and related management information systems. In ex post evaluation, borrowers' involvement is just as crucial. The monitoring and evaluation components of projects provide fundamental inputs to completion reports and performance audits. Although levels of participation vary among countries, borrowers typically provide valuable insights about project design and implementation and about the Bank's and their own performance. Increasingly, borrowers prepare their own completion reports and performance audits and share them with the Bank.

The OED involves borrowers' personnel in its evaluations and sends all performance audit reports to borrowers for comment. It also asks borrowers to comment on all impact evaluations and evaluation studies. Borrowers' comments are incorporated verbatim in the reports sent to the Bank's board.

Getting Stakeholders' Views

To measure the development effectiveness of the operations the Bank supports, the Bank and its borrowers must find out how these operations actually affect people. If this is to be done reliably, the views of all groups of people affected must be considered.

Groups affected by a development project include the intended and unintended beneficiaries, those who bore the costs of the project, the borrower and its agents, the Bank, and cofinanciers. The OED's impact evaluations seek to identify and explain how these groups judge the achievements and impacts of the intervention and to record the measures of impact that each group considers important.

How evaluators do this varies according to the case. Field surveys, focus group discussions, beneficiary assessments, and rapid rural appraisal techniques are often used. Evaluators interview individual beneficiaries and members of local organizations—such as community associations, cooperatives, and peasant unions—that mediate between

government agencies and communities. Evaluators recognize that women's views need to be captured separately from those of men. Afterward, seminars or workshops are held with stakeholders to discuss the findings of the impact evaluation.

The Bank still needs to find ways to involve the intended beneficiaries of projects more closely in the process of evaluation, both individually and in groups. Experience shows that people assess accurately the positive and negative effects of projects on their living conditions and that they may highlight effects which professionals have not thought worth measuring. In several countries, for example, farming communities affected by irrigation projects felt that the projects' most significant impact was not the increases achieved in crop yields or cash incomes but the new educational opportunities that the projects had made possible for their children. Such measures of impact may be the ultimate test of a project's validity.

Evaluation of Capacity Development

In many borrowing countries, recent years have seen a gradual, persistent growth of interest in establishing or strengthening national capacities for evaluation. Tighter government budgets and increased demands from electorates for accountability in public expenditures call for a reliable flow of objective information about how governments use resources.

Helping borrower countries to establish or strengthen their own evaluation capabilities is part of the Bank's evaluation mandate. The OED provides technical assistance on evaluation within the context of public sector management projects and programs that are managed by the Bank's regional offices. The OED arranges activities in response to the interests of individual countries (box 12).

Disclosure of Information

At the request of the executive directors, the OED is reviewing its practices for disseminating evaluation information outside the Bank. The broad discussions triggered by the report of the portfolio management task force raised awareness of the OED's function and highlighted the need for the department to take a more proactive role in delivering the lessons of experience to the broader development community. In 1994 the Bank's executive directors will review proposals on policy toward the disclosure of evaluation findings and for expanding the OED's publication program.

Box 12. Development of Evaluation Capacity

Support for evaluation in borrowing countries is an explicit part of the Bank's evaluation mandate. In countries that are interested in receiving such assistance, the support takes several forms:

- *Designing action programs.* Project managers and staff from borrowing countries visit Bank headquarters to discuss goals and constraints with evaluation and operations staff and the Bank's Economic Development Institute. Action plans are developed, and a framework for cooperation is laid. Follow-up meetings take place in Washington or in the country concerned.
- *Providing documentation.* Documentation provided by the OED and other sources includes evaluation materials, information about methodology, and examples of organizational systems and practices.
- *Building awareness.* The OED holds seminars and workshops on evaluation findings for government officials and development agencies.
- *Providing training.* OED staff members arrange seminars and workshops on the role and conduct of ex post evaluation. In addition, they contribute course material and case studies and give lectures.
- *Assisting with on-the-job training.* Country staff observe or participate in OED audit work and studies. The OED also takes country staff on secondment, and OED staff spend time discussing evaluation issues with host institutions during evaluation missions.

Publications

The OED publishes its *Annual Review of Evaluation Results* and a selection of its evaluation studies in the World Bank Evaluation Studies series (appendix B). For the sake of transparency, the published studies are the same as those issued to the Bank's management and board. The studies offer a valuable source of empirical information on development for scholars and practitioners. They are listed in the World Bank's *Index of Publications* and are supplied to the public through the Bank's network of distributors.

People with a professional interest in development—in government agencies, nongovernmental organizations, banks, and the academic community—receive copies of the *OED Précis* by direct mail.

5
Operations Evaluation in the International Finance Corporation

The IFC's Operations Evaluation Unit (OEU) is responsible for operations evaluation within the IFC. The OEU carries out its functions under the general oversight of the director-general, Operations Evaluation and the Joint Audit Committee of the Corporation's Board of Directors.

The OEU is responsible for:

- Appraising the adequacy of the IFC's self-evaluation system and reporting its findings to the IFC's Board of Directors through the director-general, Operations Evaluation,
- Conducting independent reviews, on a selective basis, of the IFC's operational programs and investments to determine whether they are realizing their goals and whether changes are needed to make the activities more effective, efficient, and responsive to the needs and concerns of member countries
- Disseminating and encouraging the use of evaluation findings within the IFC.

The principles underlying operations evaluation in the IFC are essentially the same as in the World Bank (see box 1), but their application has been modified because of the market-based character of IFC operations. To avoid repetition, this section focuses on the main differences.

Self-Evaluation of Investment Operations

All IFC operations are subject to a market test. The Corporation makes equity investments and loans without government guarantees and thus receives clear feedback on the financial results of its investments. It requires audited financial statements and other periodic reports and supervises its investments as long as it continues to hold any equity or has any loan balance outstanding. Regular periodic reports, including the "Annual Portfolio Evaluation Report" prepared by the IFC's Port-

folio Operations Support Division, bring significant portfolio developments to the attention of management and the Board of Executive Directors. Thus, the IFC's normal supervision systems strengthen accountability and involve regular feedback about the financial health of the portfolio.

To supplement these systems, IFC staff prepare investment assessment reports (IARs) on half of the Corporation's investments. These IARs can be submitted at any time following substantial completion, but most are prepared after a venture has had enough operational experience to permit informed judgments and the identification of lessons relating to operating performance, as well as the implementation record. The selection of investments for evaluation is made partly by IFC management and partly by the OEU, which has the right to require IARs on any investments it considers important to review—either because of lessons expected from the specific investments or because IARs are needed to expand the empirical basis required for particular evaluation studies.

Each IAR is discussed by IFC's Portfolio Committee, which is chaired by the Corporation's executive vice president or one of its vice presidents. The meetings allow representatives of IFC management and others to exchange views on the findings of the IARs and to add their own insights into the lessons from the investments.

The OEU participates actively in the Portfolio Committee's discussions of all IARs. It also sends the Portfolio Committee and the director-general, Operations Evaluation, brief notes on the comprehensiveness of the IARs reviewed.

Evaluation Studies

The OEU focuses its efforts on evaluation studies. These studies, on business sectors, regions, instruments, or business processes, are based on in-depth reviews of sets of investments to identify underlying patterns and broadly applicable lessons. The studies provide an empirical input into the design of policies and strategies and help the IFC select, appraise, structure, and supervise its investments and other activities.

Dissemination and Application of Evaluation Results

Because the output of the IFC's evaluation efforts can affect the interests of its private clients and partners, the OEU's dissemination program is necessarily more limited than the OED's. Nevertheless, the OEU uses a number of instruments for dissemination within the World Bank Group; those methods include distributing abridged versions of its

reports, making presentations to the IFC's Portfolio Committee, holding seminars for IFC and World Bank staff, preparing training cases, and providing periodic summaries of findings.

To encourage the use of operations evaluation findings, the IFC's procedures call for staff to:

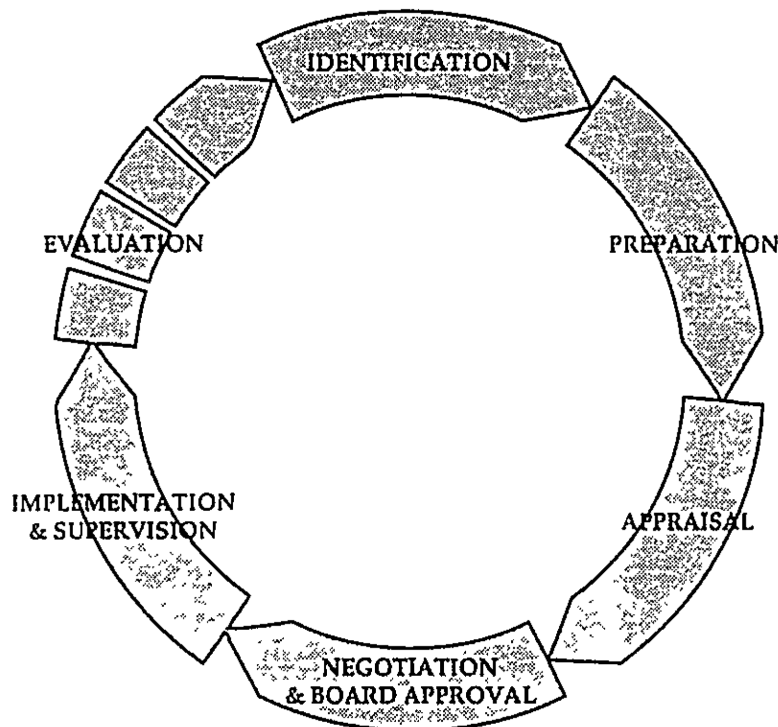
- Review the substantive elements of relevant OEU studies before presenting new investment proposals for initial review.
- Ensure that the lessons of experience are taken into consideration in assessing and structuring new investments.
- Indicate, in new investment proposals submitted to the IFC's Board of Directors, how relevant OEU findings have been taken into account.

Appendix A. The World Bank Project Cycle

Borrowing countries have full responsibility for the design, preparation, and implementation of individual projects, but the World Bank is deeply involved in each of these stages.

Once a project has been identified as having a high priority and being able to contribute significantly to the economic development of the country, it undergoes intensive preparation and analysis by the borrower and the Bank to ensure that it is soundly designed, properly organized, and up to standards of economy and efficiency. This process of project identification, preparation, appraisal, and implementation and supervision is referred to as the project cycle (figure A-1).

Figure A-1. The Project Cycle



Identification

The first phase of the project cycle—identification—proceeds against the background of country economic and sector work. Although only governments can propose projects for financial assistance, identification can come from several sources, including Bank identification missions, the work of other United Nations agencies, or even private sponsors, in some cases. However, for the project to be formally identified as a priority investment and included in the Bank's multiyear lending program or "pipeline" of projects, it must have the provisional support of both the borrowing country and the Bank to ensure that its objectives are shared by both.

Preparation

Preparation begins when there is mutual agreement on project objectives. The process of preparing a project entails developing an idea into a detailed proposal that considers all aspects of the project—technical, economic, financial, social, and institutional. The goal is to come up with the best method of achieving the project's objectives, by comparing alternatives on the basis of their relative costs and benefits.

Responsibility for project preparation rests primarily with the borrower, but the Bank has an obvious interest and often provides advice and assistance to ensure that the work is done well.

Appraisal

After project preparation has been completed by the borrower, the Bank reviews the proposals and undertakes a full-scale project appraisal. There is a comprehensive review of the technical, economic, financial, and institutional aspects of the proposal. It is conducted by Bank staff, sometimes helped by outside consultants.

Cofinancing may be provided by bilateral aid agencies, regional development banks, export credit institutions, or commercial banks. These and other details of the project are outlined in an appraisal report.

Negotiations and Board Approval

After the appraisal report is issued and reviewed, formal loan negotiations begin between the Bank and the borrower. Both sides agree on the conditions necessary to ensure the project's success, including detailed schedules for implementation. These agreements, including procurement arrangements, are then formalized in loan documents, which are submitted to the executive directors of the World Bank for approval. After approval, the loan agreement is signed by the Bank and the borrower and thus becomes a legal obligation of both parties.

Implementation and Supervision

After the loan is approved, funds are available to implement the project and purchase the items, works, and expertise needed. Implementation of the project is the responsibility of the borrower, as is procurement of goods and services. The World Bank is not a party to any contract, but it does require that procurement follow agreed procedures as reflected in the legal documents. It carefully supervises implementation and the procurement process to ensure that these procedures are followed and the process is fair and impartial.

Evaluation

Once the project is completed and the loan is fully disbursed, the Bank undertakes an independent evaluation. The project may later be re-evaluated, five to ten years into its operational phase, to assess the impact it has had on people, policies, institutions, and the physical environment.

Appendix B. Publications

Operations Evaluation Studies

Operations Evaluation Studies are available from the bookstores at the World Bank's offices in Washington, D.C., and Paris or through the Bank's authorized commercial distributors and depository libraries throughout the world.

World Bank Approaches to the Environment in Brazil, John Redwood (1993)
New Lessons from Old Projects: The Workings of Rural Development in Northeast Brazil, Judith Tendler (1993)
Evaluation Results for 1991 (1993)
Evaluation Results for 1990 (1992)
World Bank Support for Trade Policy Reform (1992)
World Bank Support for Industrialization in Korea, India, and Indonesia (1992)
Population and the World Bank: Implications from Eight Case Studies (1992)
Forestry: The World Bank's Experience (1992)
Evaluation Results for 1989 (1991)
The Aga Khan Rural Support Program in Pakistan: Second Interim Evaluation (1990)
Agricultural Marketing: The World Bank's Experience, 1974–85 (1990)
Renewable Resource Management in Agriculture (1989)
Educational Development in Thailand: The Role of World Bank Lending (1989)
Project Performance Results for 1986 (1988)
Cotton Development Programs in Burkina Faso, Côte d'Ivoire, and Togo (1988)
Rural Development: World Bank Experience, 1965–86 (1988)
The Aga Khan Rural Support Program in Pakistan: An Interim Evaluation (1987)
Sri Lanka and the World Bank: Review of a Relationship (1987)
Twelfth Annual Review of Project Performance (1987)
The Jengka Triangle Projects in Malaysia: Impact Evaluation Report (1987)

OED Précis

OED Précis are available from the Operations Evaluation Department of the World Bank.

Number	*Title and date*
1	Trade Policy Assistance in Indonesia (June 1990)
2	Free-Standing Technical Assistance for Institutional Development in Sub-Saharan Africa (July 1990)

Number	*Title and date*
3	Structural Adjustment in Jamaica, 1981–85 (July 1990)
4	The AKRSP in Pakistan: Is It Succeeding? Is It Replicable? (February 1991)
5	Agricultural Extension and Research in India (April 1991)
6	Producing and Marketing Horticultural Exports: Bank Lending in Mediterranean Countries (April 1991)
7	World Bank Support for Small and Medium Industry (June 1991)
8	The World Bank and the Bangladesh Population Program (June 1991)
9	Forestry Development: A Review of World Bank Experience (June 1991)
10	Colombia: The Power Sector and the World Bank, 1970–87 (June 1991)
11	Designing and Implementing Trade Adjustment Lending (June 1991)
12	World Bank Support for Flood Control in Bangladesh (June 1991)
13	Irrigation in the Humid Tropics (December 1991)
14	Project Sustainability in Education (October 1991)
15	Indonesian Education and the World Bank (October 1991)
16	Rice Irrigation in Malaysia (October 1991)
17	World Bank Lending for Population (October 1991)
18	The China Investment Bank (October 1991)
19	Lending for Railways: Pakistan (December 1991)
20	Modernizing China's Ports (December 1991)
21	Supervising and Monitoring Structural Adjustment Loans (January 1992)
22	Steel Production: Policy and Management Issues (January 1992)
23	Development Finance Corporations in Three Latin American Countries (January 1992)
24	Natural Resource Management in Nepal (March 1992)
25	Factors in Successful Rural Development: Northeast Brazil (March 1992)
26	Support for Adjustment in Colombia (May 1992)
27	Supervising the Bank's Investment Projects (June 1992)
28	World Bank Approaches to the Environment in Brazil (May 1992)
29	Urban Water Supply and Sanitation (June 1992)
30	Agricultural Higher Education (June 1992)
31	World Bank Lending for Natural Gas: Policy and Institutional Issues (June 1992)
32	Adjustment Lending: Lessons from a Decade of Experience (June 1992)

Number	*Title and date*
33	The World Bank and Pacific Island Countries (September 1992)
34	Environmental Benefits and their Cost: Istanbul Sewerage Project (October 1992)
35	Integrated Urban Projects: Experience in Ecuador, India, Brazil (October 1992)
36	Nucleus Estates and Smallholders Projects in Indonesia (March 1993)
37	Rural Development in Sri Lanka (March 1993)
38	Issues in Watershed Management: A Pilot Project in Colombia (March 1993)
39	Maintaining Rural Roads (March 1993)
40	Evaluation Results for 1991 (March 1993)
41	Environmental Issues in World Bank Projects (March 1993)
42	Structural Adjustment in Panama (March 1993)
43	Support for Economic Recovery in the Philippines (May 1993)
44	Natural Resource Management in Bolivia (May 1993)
45	Electric Power in India: Institutional Development, Sectoral Issues (May 1993)
46	Supply Response to Adjustment in Low-Income Countries: Lessons from Zambia (June 1993)
47	Bank Lending for Reconstruction: The Mexico City Earthquake (June 1993)
48	Coal for Power Generation (June 1993)
49	Northwest Tunisia: Rural Development and Natural Resource Conservation (June 1993)
50	Agricultural Development Projects in Nigeria (June 1993)
51	Support for Adjustment in Hungary (June 1993)
52	Involuntary Resettlement (June 1993)
53	Adjustment in Sub-Saharan Africa (October 1993)
54	Developing Human Resources in Sub-Saharan Africa (November 1993)
55	Evaluation Results for 1992 (December 1993)
56	Evaluation Results for 1992: Agriculture (December 1993)
57	Support for Institutional Development (December 1993)
58	Lending Policy for Beverage Crops (December 1993)
59	Lending for Telecommunications (January 1994)
60	Rural Finance: Time for a Policy Change? (February 1994)

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NUMBER 10

OED Précis

Operations Evaluation Department June 1991

Colombia: The Power Sector and the World Bank, 1970–87

In less than 20 years, the World Bank and the InterAmerican Development Bank each lent nearly $2 billion for electric power in Colombia—a very high lending level for one sector in a country of 30 million people. At the request of the Colombian government, OED recently reviewed the World Bank's lending through this period of rapid generation expansion and financial crisis. The study benefited from the active support of the Colombian power authorities. The government followed up with a two-day seminar, in which OED and other Bank staff participated, to discuss the results of the study and the reform of the sector.*

The study finds the analytical basis for the lending program weak, and notes that the Bank did not insist forcefully enough upon the policies and conditions needed to make the sector profitable. The sector's development is still hampered by the same basic problems as 20 years ago. Its claims on fiscal resources and its external debt are now so large that these problems need urgent resolution. In particular, decisions are needed on how the sector is to be financed in future. The report makes recommendations on sector regulation, management, resource mobilization, investment strategy, and financing.

Achievements, costs

Colombia's installed power capacity quadrupled in 1970-87, to some 8.4 gigawatts, and the number of power subscribers increased about 3.5 times. By 1987, more than 60 percent of the population, and 45 percent of the rural population, had access to electricity. Households used more electricity than either industry or commerce; their share of consumption rose to 48 percent by 1986. Reasons for this trend: the very high rate of connection of new users (7.6 percent a year), in line with government's social policy; massive subsidies on residential tariffs; and slow growth in industrial value added (5.6 percent a year), combined with little change in electricity use per unit of value added in industry.

Achievements in the power sector fell short of forecasts, and by the mid-1980s, the sector was in financial crisis. The large investments made in power depended heavily on government transfers and on external borrowing, and were a major cause of fiscal deficits and balance of payments problems (see box).

Goals of Bank lending

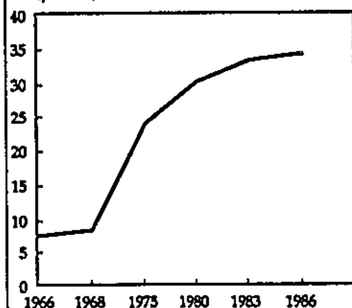
Why did the Bank lend so much for power in Colombia? The goals mainly related to sector policy, and the rationalization of the sector's development. Many institutional improvements were achieved. But the policy goals seem at times to have slipped out of sight, while year after year the power sector provided ready uses for Bank loans, and absorptive capacity elsewhere in the economy looked more limited.

Economic and sector work for power in Colombia did not match the volume of lending, and with hindsight the analytical foundations of the lending strategy seem weak. In Colombia, like many other developing countries, experience has belied expectations about the direct contribution power development would make to the creation of an industrial base. By 1986, in terms of value added, power still supplied only 2 percent of Colombia's GDP. Forward and backward linkages from the sector—and hence the multiplier effects of power investments—have remained limited. Labor needs are small. About 60 percent of the sector's needs for goods and services are still imported. Domestic manufacture of capital goods for power is only economic in large markets, which Colombia's is not.

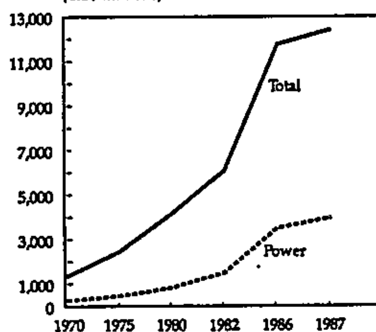
** "Colombia: The Power Sector and the World Bank, 1970-87", Report No. 8893, June 28, 1990. OED reports are available from the Internal Documents Unit and from Regional Information Services Centers.*

Power and the economy

Public Investment in Power as a Share of Public Investment, 1966-86
(percent)



Public Debt of Power Sector and Total Public Debt, 1970-87
(US$ millions)



Within the power sector, Bank lending supported the following endeavors, but success was generally limited.

Nationwide master plan for energy/power development: Plan preparation was drastically curtailed, to accommodate provincial interests early in the process.

Least-cost planning for generation and transmission systems: Generation and transmission planning techniques vastly improved, though the outcome was much influenced by noneconomic factors. But little attention to risk factors and sensitivity analysis tilted the investment selection in favor of projects with long lead times and high front-end capital expenditures, and, with the recession of the early 1980s, resulted in overcapacity by the mid-1980s.

Reduction of system losses: Overall system losses grew rapidly from 1978 onward; by 1987 they were about 25 percent of net power generated.

Marginal cost pricing: Ultimately borrowers accepted the principle, but average tariff levels stayed very low and tariff distortions worsened.

Better self-financing: After 1977, sector revenues never contributed more than about 5 percent of investment (a recommended range would be 30 - 50 percent).

Reduced dependence on official borrowing: Not achieved. The World Bank and IDB provided 80 percent of external borrowing for power in 1970-87.

Balanced investment program: Investments stayed skewed toward generation and transmission, at the expense of distribution.

Unified data presentation, compatible financial accounting, across utilities: Not achieved; arriving at an overall view of sector finances is still very difficult.

To sum up, Colombia's power entities have over the years achieved a high level of technical expertise. At issue is a more enabling framework in a few areas of policy making and organization.

Though the Bank has helped the sector to achieve substantial progress, most of the problems noted in those areas by OED evaluation studies of 20 years ago are still unresolved:

- grossly inadequate local resource mobilization;
- poor financial performance;
- unbalanced investment program;
- investment selection procedures that may lead to suboptimal projects;
- complex and cumbersome institutional structure.

Tariffs

Tariffs have been set too low to cover costs, and central and municipal governments have not derived any dividends from their investments. Very low tariffs for households were a major factor in the poor performance of the power sector. The heavy subsidies largely benefited well-off consumers. Meanwhile commercial and industrial retail tariffs were much above the costs of service, creating incentives for the large-scale theft and fraud that occurred.

Tariff issues caused persistent tension between the sector and the Bank, but the Bank did not act forcefully in favor of financially and economically adequate power prices. Policy dialogue in the 1980s downplayed problems of internal resource mobilization, and their sectoral and fiscal implications. Later, the Bank did play an important role in the 1986/87 tariff reforms, which were the first to link retail tariffs to economic costs (albeit with large residential subsidies still in place). But with the slow pace of tariff increases agreed to under the 1987 Sector Adjustment Loan, tariffs will not catch up with the marginal cost of supply until well after 1992—when a new phase of investment expansion is scheduled.

The bulk tariff at which ISA sold power to its shareholders applied to nearly 40 percent of the electricity used, but during the review period this tariff was kept at about half the average incremental cost, crippling ISA's finances (see box).

Tariffs need to be high enough both to reflect the economic cost of service and for utilities to service debt, finance expansion, and

remunerate equity holders. The Bank should make a broad sectoral approach to tariffs the center of its involvement in the sector, to help improve tariff levels and structure, and resource mobilization.

Finances

Power development takes large amounts of capital. However, when well managed and regulated to ensure sound tariff rates, it can provide low-risk, attractive opportunities for private capital. In Colombia, most of the capital came from official sources, either as foreign loans or government transfers (loans and equity capital). Policies and actions in the sector, and—for much of the review period—the Bank's relations with the sector, convey the impression that profitability was not a main goal, because financing gaps would be met by government. To help the sector survive financially, central government transferred $1.1 billion (30 percent of its total capital transfers) between 1978 and 1985.

These government contributions went far beyond those economically or socially justified. Financial performance was poor partly because of tariff policies, but also because financing plans were unrealistic, operational performance was poor, and investment programs were too large and inflexible.

Since the late 1970s the Bank has progressively lowered its standards of financial performance for Colombian power operations—whether those required for Board presentation, set forth in covenants, or tolerated without suspending disbursements or stopping further lending. An important reason was the difficult macroeconomic situation in the mid-1980s. But overoptimism probably played a large detrimental role in several of the projects reviewed.

The resource mobilization strategy of the review period—totally inadequate consumer contributions, massive reliance on government equity and loan funds, and excessive reliance on foreign borrowing—cannot be sustained any longer. Ways must be found to raise resources without government guarantee. For this, the utilities need to become financially profitable, and able to attract local private capital, either as equity or long-term debt. This would imply that consumers (except, perhaps, low-income consumers) would need to bear the full cost of power. Utilities would need to operate largely on strict commercial principles, improving their efficiency. Foreign borrowing would be used only for absolutely essential foreign costs.

To put the sector on a sound financial footing those responsible will need to agree on:

- sources of finance;
- utilities' capital structure, need for autonomy, and diversified ownership;
- much higher tariffs;
- cost-cutting and system loss-reduction measures;
- sound financing plans with firmly committed resources.

It is unlikely that, overall, efficiency can be much improved, as long as profitability is not a main goal. An important first step should be a reasonably uniform presentation of the utilities' accounts, to permit a clear view of sector finances. If the utilities become financially profitable, ways to raise equity capital from the local capital market, as well as the flotation of long-term bonds in this market, should be considered.

Investment program

Regional concerns among ISA's shareholders impeded assessment of economic costs and transparent choices among alternative investment projects. Other major influences on investment planning were: consistently high demand forecasts and fear of power outages; delays in project implementation, which increased that fear; and a persistent shortage of sufficiently prepared projects. All this led to the implementation of those projects that happened to be at hand and suited ISA's shareholders, even though they were not necessarily best for the economy.

Balance: Installed capacity was skewed toward generation, with too little investment in subtransmission and distribution. In the 1970s and 1980s the Bank repeatedly drew attention to this imbalance and in 1980 began to address it through distribution and village electrification projects. But financial crisis soon forced the utilities to concentrate only on completing operations already in progress—which were mostly in generation.

Flexibility: Making assumptions about critical variables such as power demand and fuel prices is more risky today than 20 years

Sector Structure and the Role of ISA

Seven companies generate, transmit, and distribute power in Colombia: three municipal companies in the main cities; three public regional companies; and Interconexion S.A. (ISA). ISA, a national entity owned by the other power utilities, was set up in 1968 with Bank support to assure power exchanges between them. It became the central planner of generation and transmission plant for the interconnected system, generated its own power, and by the late 1980s was coordinating distribution planning. It was also to have built and run the major additions to the interconnected power system. But its shareholders prevented it from doing so, preferring to keep individual control of the facilities needed to meet demand in their service areas. Further, to minimize the costs of their purchases of power, they prevented ISA from charging a bulk tariff that reflected economic cost, and thus prevented it from achieving satisfactory financial performance.

ago. This calls for more focus on the flexibility and affordability of proposed power investment programs (see box). It may be most useful to design a core program that will meet the projected baseline demand and a complementary program of plants—such as gas-fired combined-cycle plants—with shorter lead times that will cover excess demand above the baseline.

Institutional issues

The Bank helped with most of the institutional improvements in the review period. But by preferring to overlook Colombia's regionalism, it lost opportunities for fruitful policy dialogue. For the future, the Bank should encourage candid discussion of issues, especially the politically sensitive sector organization and structure, and the roles of government and private enterprise.

To confront the sector's problems, and the broader problems these create for the economy, Colombia needs to clarify the basic goals for its power sector, consistent with energy sector goals and macroeconomic policies. It also needs a strong independent regulatory body, to act as a buffer between government, utilities, and consumers.

System Planning: Avoid Outages or Avoid Surplus Capacity?

Utility managers and governments often see power shortages as politically costly, to be avoided if possible. But it is important to value likely shortages accurately from an economic standpoint, since high estimates can lead to overinvestments in supply, costing more than government is willing to ask consumers to pay for.

Colombia had power shortages in 1977, 1980, and 1981, and past trends suggested demand would grow at 10 percent a year in the 1980s. But in fact, 1981 also saw the start of recession, and power sales thereafter grew by only 6 percent a year. Excess energy available was about 18 percent of actual requirements by 1985, rising to 24 percent by 1989; it is expected to decline slowly to about 10 percent by 1993. The sector's investment plan, dominated by large long-gestating hydro projects, was too rigid to be cut back.

The economic cost of the excess capacity over 1986-1992/3, at $450 million in 1985 prices, is estimated at about 3.5 times that of the most severe 1981 power outages, of $130 million.

The highly visible and hence politically costly effects of rationing seem to have been much less important, in economic terms, than the invisible and seemingly costless excess capacity. System planning can easily focus too strongly on outage avoidance and neglect surplus avoidance.

Broader implications

In several countries, power now accounts for a large share of public investment and external debt. In Colombia, proper financial management of the power sector is key to stabilizing the balance of payments, reducing the fiscal deficit, and achieving sustainable growth. Its experience emphasizes the need to integrate power sector policies, for resource mobilization and management, with macroeconomic policies, as well as with policies for energy development in general.

The discount rate used in project analysis can strongly affect choices on types of plants and sequences for implementation. In its lending for power in Colombia, the Bank raised the discount rate used in its analyses only slightly over the past 15 years. It would be worthwhile to verify that the discount rate in use reflects the opportunity cost of capital. Such an analysis might lead to a different sense of priorities for Bank-financed investments within country lending programs.

Experience in Colombia emphasizes the crucial need for thorough power sector work and strategic thinking. At important points in the review period, lack of analysis negatively affected lending, as did the lack of a shared vision, by Bank, government, and sector.

Tariff and institutional reform in the power sector are so crucial that perhaps the Bank should not have abandoned its earlier practice of verifying progress against monitorable benchmarks before undertaking new lending. A case could also be made for measures applied during implementation (e.g. tranching disbursements) to see that progress is maintained.

Pressure to lend, as a pervasive aspect of the Bank's culture, appears to have played a strong role in several of the Colombia projects reviewed. The experience illustrates two consequences of this pressure. One is the persistent overoptimism reflected in many areas of the Bank's presentations to its Board of Directors. The other is to undermine the Bank's capability to enhance and control project quality for a major program of lending.

OED Précis is designed to help inform Bank managers and staff of new evaluation findings and recommendations for the Bank's current and future work programs. It is produced by the Operations Evaluation Department of the World Bank for distribution to the Bank's executive directors and staff. The views here are those of the Operations Evaluation staff and should not be attributed to the World Bank or its affiliated organizations. Please address comments or enquiries to the managing editor, Rachel Weaving, T7-015, World Bank, ext. 31719.

June 1991

APPROACH PAPER

THE CARIBBEAN REGION: A REVIEW OF WORLD BANK ASSISTANCE

I. INTRODUCTION

In 1992, OED prepared a study of the Bank's relations with its small island members in the Pacific.[1] Like the Pacific, the prevalence of very small island economies poses conceptual and operational questions for the Bank about providing these members with cost-effective development banking services. In response to a request from the LAC Region, and with the support of the JAC, OED is undertaking a review of the effectiveness of Bank assistance strategies for a group of small member countries in the Caribbean region. Without losing sight of individual country experiences, it will focus on the regional aspects of the Bank's program.

For purposes of this review, the Caribbean region is defined to include the 12 countries which are both members of the World Bank and the Caribbean Community and Common Market (CARICOM).[2] The establishment of the Caribbean Development Bank (CDB) in 1970 under the aegis of the World Bank, marks the formalizaton of a Bank regional strategy. However, since the independence of some of the Eastern Caribbean islands was not acquired untill 1977 and 1978, and since a region-wide and consistent economic and social data base adequate to assess country and regional economic performance is only available since 1977, the time period to be covered by this review stretches roughly from 1977 to the present.

II. OBJECTIVES

The review will aim to:

- trace the impact of the main external factors and internal development constraints on regional economic performance since the mid-1970s;
- identify the thrust of Bank assistance strategies intended to help overcome these development constraints and indicate how these strategies were related to those of other donors;
- evaluate the cost-effectiveness of the instruments - lending, free-standing technical assistance, economic and sector work (ESW), aid coordination and policy dialogue - and the main regional institutions employed by the Bank in implementing them - the Caribbean

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1/The World Bank and Pacific Island Countries: An OED Review (Report No. 10693, May 5, 1992).

2/The 1973 Treaty of Chaguaramus, which established the Caribbean Community, designated the four larger CARICOM countries - Barbados, Guyana, Jamaica and Trinidad and Tobago - as "most developed countries" (MDCs) as opposed to Belize and the Eastern Caribbean states - Antigua and Barbuda, Dominica, Grenada, St. Christopher(St. Kitts) and Nevis, St. Lucia, and St. Vincent and the Grenadines. The Bahamas, has opted out of the Common Market, but not the Caribbean Community; it has also "graduated" as a borrower from the World Bank as of 1986.

Development Bank (CDB) and the Caribbean Group for Cooperation in Economic Development (CGCED); and,

draw on the lessons of experience as to how the Bank can cost-effectively help the Caribbean region overcome the impediments to attaining sustainable economic and social development.

III. DEVELOPMENT ISSUES

The economic performance of the Caribbean region as a whole over the past decade was mixed, reflecting a number of stubborn structural problems that have defied solution, despite the efforts of the countries themselves, the World Bank and other agents. The main problems have been: (i) economic diversification, a difficult process, despite major efforts by the Bank and other donors; (ii) poor macroeconomic management in the three largest MDCs due to the limited absorptive capacity by public administrations not well geared up to design and effectively implement investment projects nor to formulate and implement appropriate macroeconomic policies; (iii) inordinately high levels of unemployment resulting from the complex interactions of economic, cultural and social phenomenon; and (iv) failure to adapt the educational system which all the CARICOM countries inherited, to the changes in regional demographic patterns and in the economic environment.

In designing and implementing an assistance program for the Caribbean region today, the Bank faces a rather different environment. The Caribbean is no longer regarded as a strategic area and will have to compete for resources with high priority areas in other parts of the world. At the same time, in addition to the problems mentioned above, the Caribbean region faces: (i) the loss or reduced value of preferential markets for its sugar and banana exports; (ii) a declining trend in external capital inflows, which in turn implies that the efficient implementation of aid throughout the region is critical as its volume declines; (iii) the need to design effective incentive systems for the private sector and reverse the deterioration of domestic institutions; and (iv), halt, if not reverse, the severe degradation of the marine ecosystems in many of the islands that rely on sea, sand and sun tourism as the major source of foreign exchange earnings. These challenges will have to inform any future Bank assistance programs.

IV. THE BANK'S ASSISTANCE STRATEGY

The evolution of the Bank's assistance strategy in responding to the development needs of the region, has been "traditional". Thus, beginning in the 1960s, investment lending with modest conditionalities was the main instrument employed. Agriculture, transport and later in the 1970s, education, were the main sectors targeted. With the global recession and the sharp decline in the terms of trade in the middle 1970s and, for some countries stretching into the late 1970s, the strategy shifted to program lending, with stiffer conditionality. The second oil price shock in 1979, the consequent rise in international interest rates and the severe recession that gripped the industrial countries in 1980-1982, induced a sharp shift in Bank strategy towards adjustment lending and the associated policy dialogue. Currently, the Bank's regional strategy has continued to emphasize the policy dialogue, given the widespread persistence of structural impediments.

In implementing its regional strategies, the Bank has employed two institutions. One is the Caribbean Development Bank (CDB), established in 1970, and the other is the Caribbean Group for Cooperation in Economic Development (CGCED), established in 1977 under the chair of the World Bank. Created under the aegis of the Bank, the ***CDB*** seeks to promote economic development and integration in the Caribbean, with special regard to the needs of the less developed countries of the region.[3] The Bank's relations with the CDB were reviewed by a Bank mission in 1988 and once again will come under scrutiny in this review. The ***CGCED's*** purpose is to pursue three objectives: (i) to mobilize external cofinancing resources in support of economic development in the Caribbean, especially for the smaller islands; (ii) to coordinate aid flows so as to avoid duplication of effort; and, (iii) to improve the quality of the policy dialogue between donor and recipient countries. Likewise, the effectiveness of the CGCED in ***mobilizing resources, aid coordination*** and ***enhancing the policy dialogue*** will be evaluated.

The Bank faces a number of complex issues affecting its own operations. ***Graduation policy*** vis-a-vis IDA, currently affects five Caribbean countries; they are eligible to borrow IDA resources onlent by the CDB in the form of a 50/50 blend of IDA and IBRD funds. All the countries have per capita incomes well above the IDA eligibility threshold, but (along with Tonga) were given temporary access for the IDA 8 replenishment period and extended for IDA 9, and now for IDA 10, on the grounds of vulnerability. The operational policy issue is whether, on grounds of equity, these countries should continue to receive IDA funds or should they be graduated to IBRD borrowing status? A related operational issue is graduation from IBRD borrowing. Six of the Caribbean countries are above the IBRD graduation threshold. Of these, Bahamas have graduated, Barbados is in process of graduating (although it is currently in extremely difficult economic straits), while for the remaining four, graduation has not yet been addressed. Should the Bank take steps to graduate these four countries?[4]

A vexing operational issue concerns the very ***high overhead costs of operations*** in the Caribbean. Using the CDB as a retailer helps to reduce average costs, but there are still numerous operations which the Bank undertakes directly. The operational dilemma for the Bank is how to provide the assistance due a small member state at a reasonable cost? What is the Bank's comparative advantage in servicing some of the regional member states? The Bank has taken advantage of two institutions to facilitate its assistance program. But there are other ***regional institutions*** that the Bank has virtually ignored; these include CARICOM, the University of the West Indies (UWI), the OECS Secretariat, the regional business and labor organizations, and others. The question is whether the Bank can effectively use these institutions - perhaps not at the level of the CDB and the CGCED - to facilitate the implementation of its assistance program.

3/Five loan operations totalling US$ 63 million in IBRD funds and US$ 32 million from IDA have been approved. These funds are intended for "retailing" to the Caribbean countries with five (OECS) countries eligible for an IBRD/IDA blend. Total Bank lending to the 12 countries and the CDB amounted to US$ 1.9 billion as of April 1993.

4/Of the four countries, Trinidad and Tobago had been graduated from IBRD borrowing in light of its financial windfall from petroleum exports in the 1970s. However, with the fall in oil prices and economic management failures, that country is once again an IBRD borrower.

V. GENERAL APPROACH OF THE REVIEW

Evaluation Criteria

The methodology to be employed in evaluating the effectiveness of Bank assistance in the Caribbean is drawn largely from earlier OED country studies. Thus the cost-effectiveness of the instruments and regional institutions employed in addressing the region's major development problems will be evaluated against the following criteria:

- was the intervention relevant - i.e., did it address a development problem which analysis showed could be solved through the application of Bank instruments and appropriate country policy conditionality?

- was the intervention appropriate and adequate for the task - i.e., were the instruments applied appropriate for small island economies, and were enough financial and staff resources applied towards accomplishing the objective?

- was the intervention timely and flexible? i.e., was the intervention made when needed and with an allowance for mid-course corrections and adjustments as needed?

- in sum, was the outcome cost-effective i.e., was the specific objective or objectives of the intervention attained at least cost?

Preparation

The preparation of the review will be phased over a time period that will yield a discussion draft for Joint Audit Committee (JAC) review in March 1994, and subsequently meet the LAC Region's request to present the findings from the review to the next CGCED meeting in June 1994. Given this tight timetable, the review will have to rely heavily on secondary source materials.

The *first phase* of the work will mine the extensive documentation available in the Bank. The study will draw heavily on: (a) OED's completed performance audit reports (PARs) and the regions project/program completion reports (PCRs); and (b) the extensive documentation in the LAC Region's files, including intra-Bank communications, country studies, sector reports and project appraisals, country and regional program papers of the 1970s and early 1980s and the more recent country and regional strategy papers. Recent supervision reports would provide a measure of the current performance status of the Bank's ongoing portfolio in these countries. There is also a very large stock of analytical materials produced by Caribbean and other university scholars and by practitioners that will be reviewed. An update of the CEM, "Long-Term Economic Prospects of the OECS Countries", is being undertaken jointly by the CDB and the World Bank: this should provide valuable source material for this review as well as complement the formulation of Bank's assistance strategy for the future.

This first phase will also entail interviews in Washington D.C. with Bank, IMF and InterAmerican Development Bank (IDB) staff and others outside the Bank who have been engaged in designing and implementing regional assistance strategies for the Caribbean. For the major donor agencies, it is proposed to send a questionnaire to their headquarter agencies, to be supplemented by visits to their field offices in the region. The US Agency for International Development (USAID) has already been contacted and documents exchanged.

At a *second phase*, a small mission will visit a sample of countries to assemble information not available in Washington and elicit the views of Governments and the major Caribbean regional development agencies. A *third phase* will entail the preparation of a first draft of the review, and a *fourth phase* will involve the process of review and clearance. A follow-up second brief field visit to a few Caribbean countries and regional institutions is planned to discuss the draft report.

The total dollar cost of the study, including consultant fees and travel, is estimated to be $110,000.

Report No. 13708

The Caribbean Region
A Review on World Bank Assistance

November 14, 1994

Operations Evaluation Department

THE CARIBBEAN REGION

A REVIEW OF WORLD BANK ASSISTANCE

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THE CARIBBEAN REGION

A REVIEW OF WORLD BANK ASSISTANCE

PREFACE

1. In 1992, OED prepared a study of the Bank's relations with its small island members in the Pacific. Like in the Pacific, the small island economies in the Caribbean pose conceptual and operational questions for the Bank to provide these members with cost-effective development banking services. In response to a request from the Latin America and the Caribbean (LAC) Region, and with the support of the Joint Audit Committee (JAC), OED undertook this review of the effectiveness of Bank assistance strategies for a group of member countries in the Caribbean region.

2. The review has drawn heavily on: (a) OED's completed performance audit reports (PARs) and the LAC Regions project/program completion reports (PCRs); and (b) the extensive documentation in the region's files, including intra-Bank communications, country studies, sector reports and project appraisals, country and regional program papers of the 1970s and the early 1980s, and the more recent country and regional strategy papers. Recent supervision reports have provided a measure of the current performance of the Bank's portfolio in these countries. The large stock of analytical materials produced by Caribbean and other university scholars and by practitioners was also canvassed. An update of the Country Economic Memorandum (1992), "Long-Term Economic Prospects of the OECS Countries" (Report No. 8058-CRG), undertaken jointly by the CDB and the Bank, provided valuable source material for this review. Within the regional perspective, special attention was given to a few countries selected for their contrasting size and performance, so as to permit a detailed tracing of the impact of Bank assistance strategies.

3. The first phase also entailed interviews in Washington with Bank staff who were engaged in designing and implementing regional assistance strategies and with agencies and individuals outside the Bank such as the International Monetary Fund (IMF), the Inter-American Development Bank (IDB), the US Agency for International Development (USAID) and other representatives of bilateral donors located in Washington. For the major donors, the Approach Paper of the review was submitted to their head offices and this was supplemented by visits to their field offices in the Caribbean. At a second phase, a small mission visited a sample of countries to assemble information not available in Washington and elicit the views of assistance recipients and the Caribbean regional development agencies. Their views have been incorporated in the report.

THE CARIBBEAN REGION

A REVIEW OF WORLD BANK ASSISTANCE

EXECUTIVE SUMMARY

Introduction

i. The small island economies in the Caribbean, pose conceptual and operational questions for the Bank to provide these members with cost-effective development banking services. In response to a request from the Latin America and the Caribbean (LAC) Region, and with the support of the Joint Audit Committee (JAC), OED undertook this review of the effectiveness of Bank assistance strategies for a group of member countries in the Caribbean region over the last fifteen years.[1]

ii. The objectives of the review have been to: (a) identify the thrust and assess the effectiveness of Bank assistance strategies designed to overcome the region's development constraints; (b) evaluate the cost-effectiveness of the instruments—lending, free-standing technical assistance, economic and sector work (ESW), aid coordination, and policy dialogue—and the main regional institutions employed in implementing them: the CDB and the Caribbean Group for Cooperation in Economic Development (CGCED); and (c) draw lessons of experience as to how the Bank can effectively help the region address some of the major emerging new obstacles to attaining sustainable economic and social development.

iii. Caribbean countries have had in common a number of stubborn structural problems including uneven economic diversification away from agriculture and preferential markets, poor macroeconomic management in the three largest MDCs, high levels of unemployment and an inadequate educational system. The average annual GDP growth for the CARICOM countries ranged between 6.3 percent and -0.8 percent over the 1970-79 period. Over the 1980s, the average annual growth rates widened to between 6.3 percent and -2.2 percent. The MDCs recorded negative or low growth rates for output, especially during the 1980s, whereas growth in all the other Caribbean countries was comparatively robust. Trinidad and Tobago, Guyana and, to a lesser extent, Jamaica, were the worst performers. Such economic growth as was achieved in the Caribbean was propelled by the expansion of exports, tourism, and the high volume of inflows such as aid and remittances from abroad. The smaller countries also managed to weather the terms of trade and natural shocks of the 1970s and early 1980s without acquiring large external debt burdens.

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[1] For purposes of this review, the Caribbean region is defined to comprise the 12 countries that are members of the Bank and the Caribbean Community and Common Market (CARICOM). Specifically, the countries include the four most developed countries (MDCs), i.e., Barbados, Guyana, Jamaica, and Trinidad and Tobago, the six countries forming the Organization of Eastern Caribbean States, i.e., Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines, along with The Bahamas and Belize. In addition, the review includes the Caribbean Development Bank (CDB).

The Bank's Assistance Strategy, Relevance, and Timeliness

iv. In dealing with the challenges facing the Caribbean economies, the Bank adopted the following approach: (a) initial formulation of a strategy for the region as a whole; (b) continuation of traditional as well as policy-based lending to the MDCs, notably Guyana and Jamaica, throughout the 80s, and Trinidad and Tobago in the early 90s; and (c) reliance, after 1977, on the Caribbean Development Bank (CDB) for lending to the LDCs while maintaining them under the umbrella of a sub-regional development strategy. The regional assistance strategy for the Caribbean led to gradual disenchantment with the initial approach of regional lending and to a shift in focus to the sub-regional context of the LDCs. Between 1975 and 1984, the Region produced three Regional Program papers. The regional approach, based on the assumption that economic interrelationships existed between the various Caribbean countries, did not really succeed. Its abandonment was formalized in the last 1984 RPP, which recognized that progress at the regional level had been much slower than anticipated (mainly due to different country interests) while the Bank had become less influential in regional matters. The failure of the regional approach, in the sense of a unit of economically interrelated countries, should not come as a surprise, considering that the makings of economic integration based on relative comparative advantage were not there to start with.

v. For the MDCs, the initial approach can be characterized as "traditional". Beginning in the 1960s, investment lending with modest conditionalities was the main instrument employed. Agriculture, transport and, later in the 1970s, education, were the main sectors targeted. For the least developed country among the MDCs, Guyana, the Bank targeted its assistance strategy initially to building up the necessary infrastructure especially for sea defenses, highways development, and power—together with projects to promote agricultural and livestock development with particular attention to farm mechanization. Similar sectors were the focus of attention both in Jamaica and Trinidad and Tobago. After the second oil price shock in 1979, the rise in international interest rates, and the severe recession that gripped the industrial countries in 1980-82, the Bank's strategy shifted sharply towards adjustment lending and the associated policy dialogue. Adjustment lending was characterized by very modest success until the late 80s, especially in the cases of Guyana and Jamaica. Since then, there has been a progressive shift in Bank strategy back towards investment lending while continuing to rely, for selected countries, on adjustment lending, with greater success than in the earlier period. One area in which the Bank's regional strategy does not seem to have been sufficiently developed is unemployment for which no real in-depth study was carried out.

vi. For the small island economies, the basic assumption underlying the Bank's strategy is that these countries are especially vulnerable to the vagaries of international markets, to changes in donor policies (levels and composition of assistance, provision of preferential trading arrangements, and immigration policy) and to natural disasters. In this context, the Bank addressed the main constraints through sectoral loans for power, agricultural rehabilitation, transport and education. However, the Bank's assistance in banana and sugar-related projects did not take into account that these two main products had lost their comparative advantage and were being artificially supported by preferential markets in the EC and the USA. The Bank could have been more forceful in exploring, together with the countries, the venue of economic diversification.

vii. The Bank's assistance strategy until the early 90s adapted reasonably well to the development needs of the region, in particular of the OECS, but it entailed a lengthy learning process especially when the strategy moved away from the traditional investment lending to the program and adjustment loans. A close look at current Bank strategy, as reflected in the Business Plans for the

Caribbean and other program documents, shows first of all a remarkable awareness of the problems facing the Caribbean countries. These range from the decline in aid flows to the region, the erosion of preferential arrangements, especially for bananas and sugar, and the decline of the Caribbean Basin Initiative in relation to NAFTA, on the external side, to the fragility of the macroeconomic framework in most countries, the need to move from stabilization to sustainable growth; the poor quality of public sectors and government services, the weakness in the human resources basis, the high level of unemployment and the vulnerability of the eco-system, on the domestic front. The action programs reflect these concerns, both at the country specific level and at the regional one. With respect to the individual countries, the ESW includes an appropriate balance of macro and sector specific issues, including cost-effective farming out of relevant components to CDB for the smaller countries. The lending program shows an increasing role of investment projects with respect to adjustment lending, and the sector focus on basic infrastructure, health and education and private sector development, appears to be the right one. At the same time, there is a renewed regional focus on unemployment, trade and environment.

The Instruments of the Bank's Intervention

CDB and CGCED

viii. In implementing its regional strategies, the Bank relied on two institutions in addition to its own lending and ESW. One is the CDB, established in 1970, and the other is the Caribbean Group for Cooperation in Economic Development (CGCED), established in 1977 under the chair of the Bank, with the first meeting held in June 1978. The creation of the CDB satisfied the Bank's goal to channel additional development funds to the IBRD/IDA member countries at a lesser cost for the Bank. Over the years the Bank has put considerable effort in strengthening the CDB's organization to make it a more effective regional development institution and in improving CDB's ability to appraise and supervise projects. Significant progress has been made in the achievement of these objectives and, although certain manpower shortcomings still remain to be overcome, the Bank's future lending activity should continue to rely heavily on CDB. The CGCED's purpose was to pursue three objectives: (a) to mobilize external resources in support of economic development in the Caribbean, especially for the smaller islands; (b) to coordinate aid flows so as to avoid duplication of effort; and (c) to improve the quality of the policy dialogue between donor and recipient countries. Since its establishment in 1977, the CGCED has met 11 times. Judging from capital flows to the Caribbean countries, the CGCED, at least initially, appears to have been successful in mobilizing a large volume of external financial resources, including a large volume of concessionary financial aid. In addition, it has provided a forum for policy dialogue on issues affecting the whole region. From the recipient's perspective, especially the OECS countries, the resources mobilized were highly effective as shown by their overall good economic performance.

Country Economic and Sector Work (ESW)

ix. ESW expanded during periods of economic stress and contracted as the situation improved. A review of a sample of economic and sector reports from the mid- 1970s and from the latter half of the 1980s showed the latter, generally, to have covered a wider scope of issues such as the impact of external shocks, to have employed more sophisticated analytical analysis, and displayed a better understanding of the special development problems of small (island) countries.

Free-Standing Technical Assistance (FSTA)

x. The main issue with the FSTA projects, and especially those on public sector management has been the very slow pace of implementation and the longer term sustainability. The Bank did not employ this instrument extensively, partly because of numerous other multilateral and bilateral agencies engaged in overlapping or duplicating technical assistance, and partly because Bank experience has shown it to be a difficult and costly instrument to employ effectively. Of the eight free-standing operations approved by the Board during the period, the MDCs accounted for all the projects. Four were approved for Jamaica, two for Guyana, and one each for Trinidad and Tobago and Barbados.

Inter-Agency Resident Mission (IARM)

xi. The resident mission is a good example of the kind of technical assistance the UNDP can mount. IARM was in operation for about four years. Its main objective was to help enhance the benefits that the OECS countries could derive from the CGCED. The immediate objectives were to assist OECS countries to formulate and implement appropriate development policies, and improve the management of public sector resource, specifically the programming and monitoring of public sector investments. The main lessons yielded by the project were: the IARM's operational life was much too short to accomplish all its objectives, and the preparation of Public Sector Investment Program (PSIP) was a critical step in formulating a sound development program.

Policy Dialogue

xii. The policy dialogue, advice and, sometimes, direct inputs into the design and formulation of policy reforms, have become a key instrument of Bank assistance to Caribbean countries. Toward this end, the Bank has increasingly resorted to its ESW as input in the preparation of PSIPs, Medium-term Policy Framework Papers (MPFPs), and Country Assistance Strategy (CAS) papers—specific materials which facilitate the policy dialogue. The original expectations were that the CGCED would facilitate this dialogue. In the event, however, the CGCED has proven to be an imperfect forum for the Bank's policy dialogue with its borrowers. In fact, one-on-one discussions between Bank staff and government officials have been essential ingredients for an effective dialogue and the Caribbean governments have become increasingly responsive to this assistance instrument and are usually ready to participate actively.

Lending: OED Evaluation Experience

xiii. As of end-August 1993, Bank lending to the 12 CARICOM countries and to the Caribbean Development Bank (CDB), reached US$2 billion, comprising 147 investment projects and policy-based programs. Of the 147 loans/credits, PCR-PAR performance ratings are available for 76 completed operations (representing commitments of US$ 1.1 billion) to eight countries in the region (and the CDB). Among these completed projects, 66 percent have been judged as satisfactory against a Bank-wide satisfactory average of 75 percent and the LAC Region's satisfactory average of 71 percent. Notably, the percentage of adjustment programs judged satisfactory, 45 percent, is considerably lower than the Bank-wide average of 73 percent. However, following a 1974-79 deterioration in portfolio performance with the percentage of projects rated satisfactory declining to the mid-50s range, for projects approved in the second half of the 1980s, performance trends show the satisfactory ratios oscillating around the 70 percent level. There are large differences in performance among countries in the Region. Among the MDCs, average performance levels range from the highest of 100 percent satisfactory in Barbados to the lowest of 54 percent both in Guyana and Jamaica. All the smaller borrowers: Bahamas,

Belize, the CDB, Dominica, and Grenada—with a low number of projects evaluated—have achieved a 100 percent satisfactory performance rating. The main factors behind the poor performance of projects include, in the case of SALs, the Bank's insufficient attention to the country's ownership and absorptive capacity vis-à-vis the reform packages proposed (Guyana, Jamaica), and to local conditions (conflicts among agencies and levels of government) and inadequate reliance on local expertise, including CARICOM, the OECS and the University of the West Indies.

xiv. Currently, 47 ongoing projects and programs in the 10 countries (more than half in the MDCs) and the CDB have received supervision ratings as reported by the Bank's Operational Policy Review (OPR) Department. Only one of these projects and programs (Jamaica's Population and Health Project) is considered as "problem" project with severe implementation problems indicating a possible improvement in the Region's aggregate portfolio performance in the years ahead.

Lessons of Experience

xv. The review of the Bank's assistance effort in the Caribbean yields many lessons for the Bank, other donors and aid recipients. Among the more instructive are the following:

- In the earlier days of Bank involvement in the Caribbean, a region comprising mostly small-island countries, the Bank came with pre-determined views in terms of the countries' ability to respond to the prescriptions derived from the larger non-Caribbean countries with which Bank staff worked. This was especially true for policy based lending in countries such as Jamaica and Guyana and for investment lending in Trinidad and Tobago. There is evidence that the Bank has became more flexible in its approach to country needs, including the involvement of local staff in projects and other assistance activities.

- The pace of economic reforms has been an especially irksome issue in the Caribbean. Most of the times, the Bank tried to persuade the country to implement the reforms at a quick pace, which was the common orthodoxy in the rest of the Bank. Recipient governments (Jamaica, Guyana, Trinidad and Tobago) have argued that too fast a pace of reform is unrealistic in the Caribbean, given the cumbersome decision-making process and consensus building requirements. The Bank should have realized that whenever the desired rapid reform pace was not achievable it would have been preferable to adjust the size of the lending program accordingly, including moving away from policy-based quick-disbursing lending towards investment lending with adequate sector policy conditionality.

- While the Bank could not project the fate of banana and sugar exports in the late 1980s and the early 1990s, it was inconsistent in its approach to the development of the agriculture sector in the region. Although the comparative advantage of both products had long since been lost, production was sustained because of preferential markets offered by the EC and the USA and because of the monetary rewards obtained by traditional interest groups with strong links to the two crops. The Bank should have researched more intensively and much earlier alternative diversification strategies, especially considering the very long lead time that a diversification process requires.

- In some aspects of the assistance program, the Bank identified the issues properly but failed to follow up. The critical problem of unemployment in the region was identified early in the 1970s, and mentioned in various documents since then. However, no in-depth study of this regional "time bomb", or the strategies to tackle it, took place. Further outmigration is a function of the state of the global economy and more specifically of the countries around the region where the potential for

workers immigration lies. All the demographics point to a situation which will worsen over the next 10 years; an early start on analyzing the problem is highly desirable.

• The Bank, in devising its projects, has often neglected (Jamaica, Guyana) the limited indigenous capacity for implementation, including insufficient interministerial coordination, while at the same time failing to tap local expertise when available. Furthermore, the mechanisms for beneficiary involvement were either not in place or the process was very time-consuming (Guyana). Finally, in some cases, the socio-political aspects of projects were not adequately taken into account (Jamaica, Sites and Services Project). In such situations, the Bank should have scaled down its lending program.

Agenda for the Future

(i) Regional vs. Country Focus: Need for Balance

As with the Pacific Islands, the Caribbean countries constitute a region more in logistic than in substantive terms. More specifically, the benefits of integration are limited by the fact that their factor endowments are very similar. Furthermore, the Caribbean countries have quite different features between the MDCs and the LDCs and even among the countries within each group. This explains the importance of maintaining a specific country focus (as the LAC Region has done so far), and to design a regional or subregional strategy for specific issues. While substantial benefits are associated with common services and coherent policies, the design and implementation of regional arrangements is demanding. Therefore, the main prospects for the regional approach is in the analysis of some common development issues such as trade, human resources, environment and the role of the private sector.

(ii) Economic Diversification and Comparative Advantage

As indicated above, the Caribbean countries, because of the poor perspective of the primary products, from bananas and sugar to bauxite and oil, are facing serious constraints to their development prospects. Maintaining their current productive basis is already a major achievement and it would imply turning around the negative economic trends of the more recent years, especially for the MDCs. Looking at individual countries, likely areas of concentration would seem to be financial services for **Barbados**; food-processing activities for Guyana; for **Trinidad and Tobago**, while maintaining their fairly significant agricultural basis, and possibly converting it from primary products to more marketable crops, continued reliance on its oil related activities in association with Venezuela; and finally for Jamaica, further expansion of its relatively more developed industrial basis, once proper market signals are provided and the institutional fabric of the country drastically overhauled. For the smaller Caribbean countries, tourism should remain a key sector, while additional growth prospects could come from a "division of labor" in a number of areas which are of common interest such as health and education facilities, financial services, coast guard services, etc. Unemployment remains a key problem in the Caribbean and the diversification and specialization efforts indicated above are imperative to prevent unemployment from becoming a worsening feature.

(iii) Institutional Development and Human Resources: Further Constraints to Growth and Employment

Growth of output and employment are constrained not only by a limited productive basis but by weaknesses in the institutional setup and in human resources. These two problems are present in different degree among the countries. They are most acute in Guyana and Jamaica, less serious in

(v) **CGCED: The Need for Increasing its Relevance for the MDCs**

It would seem that the LDCs find the CGCED an interesting forum for the discussion of their individual interests. At the same time, the MDCs rely more for their "business" on the direct relationship between them and the Bank. An interesting innovation introduced by the LAC Region, implemented at this year's meeting, has been to extend the participation to private financial institutions. This novelty appears to have been well received by the larger Caribbean countries as it offers them an opportunity for direct discussions with potential lenders in the broader context of the regional development framework.

(vi) **Relying on Other "Local" Expertise: CARICOM, OECS and the University of the West Indies**

A greater use by the Bank of the institutions such as CARICOM and the OECS should be made when it comes to formulating the strategy for the Caribbean. We have already discussed above the role of the University of the West Indies. A lot more could be achieved if the partnership with CARICOM and OECS were to be strengthened. The Bank has traditionally been reluctant to interact with such institutions. This attitude is often at the basis of the criticism levelled by non-government organizations and governments alike, of the Bank's lack of understanding of the local conditions.

(vii) **Aid Coordination: Improving the Quality of Declining Aid**

Aid flows to the Caribbean from all parts of the international financial community have been declining steadily over the last ten years. The Caribbean is moving from an age of high aid, often dictated by geopolitical consideration, to an age of aid retrenchment, also in part dictated by new geopolitical considerations. In this context, aid coordination between the Bank and IDB, and with bilateral donors, becomes imperative. The quality of the assistance in terms of its relevance for the recipient countries, is under continuous discussion. Occasions such as the CGCED meetings, and the donors meeting before that, should be used to coordinate the quality of the flows more than their level. The danger of aid dispersion among many areas of intervention answering to the parochial considerations of individual donors and of multilateral organizations remains very high. If the priority intervention areas in the Caribbean are those of human resources, institutional development, environment and privately led economic diversification-cum-employment, then the role of the Bank is to make sure that the bulk of the dwindling aid flows into these areas. From the view point of the development process, concentrating the efforts in this area should be more important than "assigning" areas of interventions to one or the other among the donors.

Barbados and the smaller islands, and significant in Trinidad and Tobago. With respect to institutional development, the negligible results of the administrative reform programs launched in some of these countries (e.g. Jamaica), confirms that, as OED has observed in its evaluation work, without a serious overhaul of the civil service system the prospects for serious institutional development are dim. The Bank may have contributed to the problem by focusing on the formulation of sophisticated blue prints for reforms, leaving their implementation to domestic unskilled staff and "passing through" foreign consultants.

The human resources issue is related to the institutional aspect and to the issue of unemployment. An inadequately skilled labor force has very little chance to find gainful employment whether domestically or abroad. In those countries where the human resource basis, also as a result of migration of the more talented people, is especially weak, i.e., Guyana, Jamaica and Trinidad and Tobago, the Bank as well as the other donors should make special efforts. This is an area in which a regional approach could be taken including the Bank and all the other institutions such as IDB, OECS, and the private donors. In particular, the University of the West Indies should be the central focus of the higher and technical education for the Caribbean with particular attention devoted to the training of teachers at the lower levels of learning.

(iv) The Role of the Bank: Defining an "Appropriate" Role

The appropriate role of the Bank in the Caribbean is influenced by the obligations of the institution towards its member countries and by the "transaction" costs linked to Bank assistance for small countries. Clearly, small countries are entitled to the Bank's attention in terms of policy dialogue within the framework of a well defined development strategy based in turn on a well focussed ESW.

Ongoing ESW in the LAC Region for the Caribbean countries indicates that by and large, especially with the increasing reliance on Medium-Term Policy Framework papers, the Bank is well placed to capture the development issues facing the Caribbean and to develop the consequent policy recommendations. The reaction of some of the Caribbean countries, expressed in the course of the visits of the OED study team, is that greater effort should be made by the Bank to understand the sociological and political aspects when analyzing their economic problems and formulating development strategies. More important, however, is the Bank's need to reflect a greater perception of the countries' varied cultural background into its lending program especially in terms of beneficiaries and their participation in the design of the projects. The reality of ethnic composition in some of the Caribbean countries is often neglected in this phase of the Bank's assistance strategy.

With respect to the Bank's operations, the following aspects appear of particular relevance. First, given the poor experience of the past, further reliance on SAL type operation should remain limited. The last SAL to Trinidad and Tobago, albeit a successful one, should give way to assistance at the sectoral (e.g., agriculture) investment level. SALs should not be considered priority instruments in Jamaica and Guyana where the reform pace is severely hampered by outstanding development constraints which make the countries less equipped for effective use of broad resource transfer operations. SECALs and Sector Investment loans would seem a more appropriate venue for Bank lending at this stage. Finally, special attention should be given to self-standing technical assistance projects. While their number has been limited, their poor outcome represents a wasted opportunity to make progress in the critical institutional areas which technical assistance projects normally address.

INVESTING IN DEVELOPMENT

Lessons of World Bank Experience

WARREN C. BAUM STOKES M. TOLBERT

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PART V

Summary and Conclusions

Kneading clay for pottery, a handicraft industry, rural Mexico

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Highlights of Experience

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IT HAS BEEN SAID that to govern is to choose. In the economic arena, the most basic choice that all societies must face in allocating resources is between current consumption of goods and services and investment in future growth. In developing countries, the choice must be made in the face of the deplorably low, often subsistence, level of consumption of a large proportion of the population and the urgent need to invest as the best hope of achieving higher living standards. When the choice is made in favor of investment, it is imperative that the scarce resources be deployed to obtain the maximum benefit. Packaging these investments into projects through the disciplined approach described in this book can be a very effective means toward this end. In this concluding chapter, we highlight some of the principal lessons that can be drawn for the benefit of developing countries from the World Bank's more than thirty-five years of experience with the project approach.

At the beginning of the book, we described economic development and the project work which is an integral part of it as a long, slow, and often painful process of learning from experience. Investing in development through projects is subject to all the vicissitudes and constraints that hamper development generally. Projects take years to prepare and implement. Throughout this time, project managers must confront and deal with the scarcity of human skills and material resources that are synonymous with underdevelopment, with a chronic shortage of funds, and with shifts in political support. They must operate within often fragile economic structures that are exposed to the worldwide forces of inflation and recession and to the unpredictable forces of nature.

Project work is thus highly demanding, and it sometimes seems to demand most from those countries with the least capacity to respond. It is more difficult, but also more important, to do project work well when there is little or no cushion to absorb the effects of unsound policies, weak public administration, or unskilled project management. This is true of all types of projects, particularly those intended to alleviate poverty and raise the living standard of large numbers of people.

Fortunately, the rewards of project work are commensurate with the demands. Done well, project work pays high dividends. In the postwar era, it has become one of the most potent instruments for promoting economic growth. By setting investment priorities within a national and sectoral strategy, getting the policies right, and combining investments with technical assistance to strengthen institutions and train people, the project approach can enable countries to take more rapid strides along the path of economic development.

Doing project work well is as much an art as a science. Drawing on the wealth of World Bank experience, we can identify many of the ingredients of success as well as many of the pitfalls. Developing countries can profit from this experience and thereby telescope the learning process. Some may be able to achieve in decades the economic progress that took generations in the now developed world .

In reviewing the lessons of the Bank's experience, we have been struck again and again by how obvious many of them seem to be. They often

read like little more than the dictates of common sense. But to say that something is obvious does not mean that it is simple. Perhaps simple to understand—except for a few esoteric subjects such as cost-benefit analysis—but not simple to put into practice. If the lessons of experience have not yet been learned, it is not because of irrationality or obduracy, but rather because a powerful constellation of forces makes things what they are and serves as a formidable obstacle to change. Moreover, economic development, as we have repeatedly observed, is a long-term process; when governments change frequently, the continuity of effort that is a sine qua non of development is soon broken. Even in reasonably stable political conditions, public officials are often and understandably preoccupied with more immediate considerations. They are more likely to suffer the short-term political penalties of policy changes such as raising the prices of basic commodities than to reap any political rewards from their long-term benefits.

To take just one example of the difficulty of applying a simple lesson of experience: it is by now widely accepted that developing countries should use the technology most "appropriate" to their circumstances. These circumstances usually include a surplus of low-cost, unskilled labor and a shortage of capital—facts which suggest that the technologies adopted should be relatively labor-intensive. The point seems obvious; which government would knowingly or willingly espouse an "inappropriate" technology? Yet in countless instances—and this book cites a number of them—developing countries have adopted or retained technologies clearly unsuitable to their circumstances.

Why does this happen? Foreign consultants or advisers may advocate the technology with which they are most familiar. Local engineers, if educated abroad or the heirs of a colonial legacy, may have acquired a similar bias in favor of advanced technology, or they may simply presume, as do their superiors, that what is most modern is best. Special interest groups may favor a particular technical approach, while those who would benefit most from some other approach may be either unaware of the choice or politically disenfranchised. Deep-seated customs and traditions may favor certain solutions and make others unacceptable. Economic policies that overprice labor (through minimum wage or other legislation) or underprice capital (through subsidized interest rates or an overvalued currency) may send distorted signals to decisionmakers. A simple lack of knowledge or reluctance to experiment may limit the range of choice. Bilateral lending agencies may themselves be part of the problem; when aid is tied to the supply of equipment from the donor country—a policy as widely practiced as it is deplored—freedom to choose an appropriate technology may be compromised. With so many factors at work, it is not surprising that a "simple" lesson—such as selecting an appropriate technology—may prove far from simple to apply.

Trying to summarize the lessons of the World Bank's experience in a single chapter is a daunting task. We can only highlight the more important lessons, with no expectation of doing justice to the many issues and problems that these lessons raise. The presentation generally follows the sequence in which the book is organized: national investment man-

agement, sector analysis and management, the project cycle, and the various dimensions of project analysis. The sector chapters of part II are not referred to as such, since the broader lessons emerging from them underlie the points discussed in parts III and IV.

No attempt is made to indicate the relative importance of these lessons, although some are clearly more important than others. Not getting prices right, for example, or not providing adequate recurrent funds to operate and maintain project investments can have more far-reaching consequences than not regularly evaluating completed projects. Since the lessons relate to different aspects of investment planning, sector analysis, and project work, it should be possible, at least in theory, to apply them all. But to many officials in developing countries, they may appear to constitute a formidable agenda. It is for each official, knowing the local circumstances, to establish priorities for action at any time. Progress may often be slow and partial, but responding flexibly to changing circumstances, combining rational economic choice with informed political judgment, avoiding the more egregious mistakes, and maintaining a steady pace are the best way to keep the country on the path to sound economic development.

National Investment Management

Project work in its broadest sense takes place at three levels:

- At the national level, where national investment plans are formulated, priorities among sectors are established, and the macroeconomic framework of policies for economic growth is put in place
- At the sector level, where priorities for investment within each sector are determined and the issues and problems affecting the development of the sector are addressed
- At the project level, where individual projects are identified, prepared, and implemented and attention is given to their technical, economic, financial, social, institutional, and other dimensions.

Only in the abstract can the project process be described as a sequence of steps proceeding in logical order from the national to the project level. Project work is in fact a continuum; decisions or actions affecting individual projects may take place at each of the three levels simultaneously and in interactive ways.

Development planning. At the national level, the surge of enthusiasm for comprehensive development planning, which reached a peak in the 1950s, was followed by disenchantment with its limited accomplishments. No clear association could be found between a comprehensive planning effort and sustained economic growth. The elaborate and data-hungry models employed were unable to cope with the complexity and rapid change that characterize the process of development; nor did most developing countries have the administrative capacity to implement comprehensive plans. The technical and administrative deficiencies of comprehensive planning proved to be inherent in the process and,

therefore, unlikely to be overcome by more strenuous efforts to improve the planning machinery.

Planning is therefore being directed increasingly toward new goals. Countries covering a wide political and economic spectrum no longer seek to rely on positive commands and negative controls to carry out a long-term plan that targets inputs and outputs for all sectors of the economy. Instead, they have turned to a strategy that focuses on two elements: a macroeconomic framework of policies to spur economic growth and elicit desired behavior from both public and private entities; and a public sector investment program that allocates scarce resources to high-priority public needs. The success stories of postwar economic development come from those countries that have managed these two tasks effectively.

The macroeconomic policy framework—comprising fiscal, monetary, exchange rate, wage, and trade policies—affects all aspects of economic behavior, including resource allocation, capital accumulation, balance of payments equilibrium, and, ultimately, the pace of economic growth. No single set of policies, and no specific institutional arrangement for managing those policies, are appropriate to all countries in all circumstances; what is appropriate varies with a country's natural and human resources, level of development, and development strategy and objectives.

Pricing Policy. Central to any policy framework, however, is pricing policy. Many of the macroeconomic policy variables—interest rates, wage rates, exchange rates—are prices. Whether determined in free markets, or established by a central planning agency, or modified by government intervention, prices strongly affect a country's rate and pattern of development. The importance of "getting the prices right" is therefore a fundamental lesson of development experience. The basic pricing rule for obtaining the most efficient use of an economy's resources is to set the price of each good or service at its marginal cost—a result that a free competitive market would achieve and that public pricing policy should, in principle, emulate. In the real world, however, actual market conditions nearly always diverge from the competitive ideal. Moreover, in pricing public sector goods and services (power, water, rail transport, and so on), public agencies must take into account not only the objective of economic efficiency but also other objectives such as achieving a more equitable distribution of income or generating additional revenue. These considerations may justify departure from a rigorous marginal pricing rule (a point we return to in the discussion on cost recovery below) and may call for carefully designed intervention in the market to achieve both social and economic objectives. It is important that such intervention be devised to make use of market forces rather than to supplant them.

In many developing countries, however, a persistent and often massive distortion of prices has resulted from a multiplicity of government interventions, many of them poorly conceived or mutually incompatible. These distortions have reduced the efficiency of investment and slowed economic growth. The countries that have enjoyed relatively high growth rates are those that have managed to avoid significant price distortions; specifically, they have

- Avoided an overvalued exchange rate
- Kept the rate of effective protection for manufacturing industry relatively low and uniform among products
- Avoided underpricing of agricultural products and other disincentives to farmers
- Kept interest rates and hence the price of capital positive in real terms
- Avoided real wage increases not justified by rising productivity
- Applied cost recovery principles in pricing infrastructure services
- Avoided high inflation.

Many examples from the developing world in the past twenty years demonstrate how critical the proper management of this interconnected system of prices and incentives is for economic progress. Furthermore, the effects of macroeconomic policies are felt with full force at the project level. Thus, another fundamental lesson is that it is virtually impossible to have good projects in a bad policy environment.

Public investment programs and budgets. In formulating public investment programs, detailed and overly sophisticated forecasting exercises have generally proved counterproductive because of inadequate data and limited understanding of how sectoral investments and outputs are linked. Analytical efforts should therefore concentrate on designing investment programs in key infrastructure sectors, where the market alone cannot guide investment decisions, and on checking the consistency of these programs with the likely requirements of the productive sectors. Governments also need to be selective; they can effectively address only the most important public investment issues at any one time.

Experience has further shown that it is advantageous to combine the programming of public investment with indicative forecasting (not targeting) for the private sector. Emphasis should be placed on coordination and consultation—between departments of government as well as between government and the private sector. Governments also need to develop the capacity to respond quickly to changing events by modifying their policies and programs; this will usually require a much improved data base and information flow as well as centralized responsibility for policy coordination.

Establishing investment priorities among sectors—the attention to be given, for example, to programs in health, education, or housing relative to the productive or infrastructure sectors—is particularly difficult and ultimately entails political choices. Economic analysis can make only a limited contribution to this process, but it may still be crucial in clarifying the costs of alternatives and providing data on which informed judgments can be based. In establishing investment priorities within a sector, however, cost-benefit analysis can be very helpful in improving choices.

Experience has taught a number of other lessons about formulating and implementing public sector investment programs.

- Care should be taken that the investment plan is not too ambitious given the available resources. There is a widespread tendency to underestimate the cost of implementing specific projects and the time required. When too many projects are started at the same time,

available skills are dispersed, project implementation is slowed, and economic and financial returns from the investments are reduced.

- New projects should not be started at the expense of adequate funding for those projects already under way. Completion of ongoing projects, if they are still justified given the incremental costs and benefits, should have a high priority for funding, as should the operation and maintenance of completed projects.
- The "free" resources left after the needs of ongoing and completed projects have been met should be calculated. This makes possible rational decisions about how much funding can be devoted to new projects in any budget year.
- Planning agencies need to strengthen their project appraisal capacity and to make greater use of cost-benefit analysis to identify and screen out projects with low rates of return.
- Investment plans need to be kept flexible and modified as circumstances change. In addition, a "core program" of investments should be identified so that cuts in programs made necessary by a shortfall in resources can be determined by priorities established in advance. Another technique found useful in many countries is to have a rolling investment program—usually a three-year program—that is updated annually or more frequently if circumstances warrant.

The government budget is the principal administrative instrument for translating public investment programs into concrete action. But the link between the two needs to be made much stronger in most developing countries. Many countries do not have a consolidated public sector budget, which is essential if the government is to obtain a full picture of both resource mobilization and expenditure. When such a budget is prepared, it will reveal whether public funds are being invested in activities or in proportions that are not in accord with the public sector investment program, and whether a substantial redirection of resources is desirable.

In fulfilling its budgetary responsibilities, a government must also concern itself with

- Organization and location of the budget and planning functions (although recruitment of qualified staff and establishment of proper procedures for reviewing investment proposals may be no less important)
- Budget classifications that will facilitate planning and management and improve the integration of budget appropriations with the investment program
- Monitoring and evaluation of the budgetary outcome, with emphasis on the accomplishment of programs and projects in addition to the traditional concern for financial propriety.

Even when investment requirements are appropriately matched with financial resources, two budgetary shortcomings common to many developing countries have adverse effects on projects. First, budgets often fail to provide sufficient recurrent funds to operate and maintain projects once the investment phase is over. Second, tight central budgetary

controls, by frequently delaying the provision of funds to project managers, have plagued the implementation of investments. In most countries, there is a clear need to give spending agencies greater operational freedom to carry out their assigned tasks. The corollary—that spending agencies should be held more accountable for results—has encouraged the search for new systems, such as program and performance budgeting, which seek to make evaluation of results an integral part of the budgeting process. Implementation of such systems, however, has proved difficult; experience suggests that the way to more effective budgetary management in a developing country is probably through careful identification of specific problem areas, followed by adaptive and evolutionary change, rather than through the large-scale import and installation of new systems.

SECTOR ANALYSIS AND MANAGEMENT

Sector analysis bridges the gap between the macroeconomics of national investment management and the microeconomics of individual projects. It is indispensable for resolving questions of choice, of priority, and of interrelations among projects. Yet it is a neglected activity in many countries. Compared with the elaboration of theories and models for national investment planning or of cost-benefit and other techniques for project analysis, theoretical and practical guidelines for the conduct of sector analysis are much less developed. Nevertheless, many sectoral issues are amenable to analysis, analytical capability is growing with experience, and the number of countries carrying out systematic sector work is steadily increasing.

Sector analysis is clearly useful to external lending agencies—including the World Bank, which has helped to introduce it to many of its member countries—in guiding project selection and design. But it is no less important to officials of ministries and operating agencies in developing countries, who can understandably lose sight of the broad objectives, needs, and priorities of a sector amid the day-to-day tasks of administering regulations and managing crises.

Sector analysis serves several purposes:

- It provides a better understanding of development policies and issues in the sector. This is useful both in enhancing the contribution that the sector can make to the overall strategy for economic development and to the planning of public investment, and in ensuring that the framework for sector policy, no less than that for macroeconomic policy, is conducive to sound project work.
- It makes possible the determination of investment priorities in the sector, which guide the identification and selection of specific projects.
- It evaluates the capacity of the principal institutions in the sector to implement desired policies, programs, and projects.

Most sector analysis falls into one of two broad categories: comprehensive surveys of an entire sector (or important subsector) and special studies of particular topics within a sector. Because the former tend to yield a low return for the heavy investment of manpower and other

resources, governments are generally well advised to devote most of their sector work to a program of sharply focused special studies of high-priority issues. Much painful experience argues for keeping the reports on these studies brief and concise, in line with their operational purposes. Good sector analysis requires that qualified staff and other resources be made available for long periods, and this in turn requires that there be sustained commitment from high-level authorities. When these are not forthcoming, the quality of project work also suffers.

Each of the main sectors that we have discussed in part II has distinctive characteristics as well as differing objectives and development issues. No effort is made to summarize them here. At the same time, the sectors share three basic areas for action: policy improvement; institutional strengthening; and better selection, design, analysis, and management of investment projects. The main lessons of experience in these areas are highlighted in the following sections on the project cycle and project analysis.

THE PROJECT CYCLE

It is convenient to think of project work as comprising several distinct stages, commonly referred to collectively as the *project cycle*. The idea of a cycle underscores the point that the stages are closely linked and follow a logical progression, with the later stages providing the basis for a renewal of the cycle. The principal stages of the cycle are the identification of a project; its design, preparation, and appraisal; its implementation; and its evaluation once the investment phase has been completed.

Project identification. The project cycle begins with the identification of project ideas that appear to represent a high-priority use of a country's resources to achieve important development objectives. The identification and preliminary screening of ideas is a critical part of the process. Decisions made at this stage, either explicitly or by default, have a far-reaching impact on the final outcome of the project. It is particularly important at the outset to consider as wide a range of alternative approaches as feasible. All too often, project ideas are put forward and accepted without adequately weighing alternative, and possibly cheaper or more effective, means of achieving the same objectives. Whether the result of vested interests, political pressures, or simply lack of information about viable options, the consequences are the same: opportunities lost at this stage can seldom be recaptured. There is no substitute for being right in the first place.

Explicit attention should be paid to defining a project's objectives at the earliest stage and to ensuring that all the parties concerned, including external lending agencies, agree on those objectives and on the strategy for achieving them. The intended beneficiaries of the project must be consulted when their participation in designing and implementing the project is important to its ultimate success—as it is, for example, in rural and urban development. Failure to reach an understanding about objectives and to secure a firm commitment from all those concerned has often generated friction later and resulted in poor project implementation.

A project can be considered to have passed the identification test when

- Major options and alternatives have been identified and some initial choices made
- The principal policy issues affecting project outcome have been identified and appear to be amenable to solution
- The project options selected are likely to be justified, given rough estimates of the expected costs and benefits
- It appears that the project will have adequate support both from the political authorities and from the intended beneficiaries
- The prospects are reasonable that adequate funding will be available from local and, if needed, external sources
- A specific plan for preparation of the project has been established.

Project preparation. At the next stage, that of project preparation, a feasibility study should be undertaken for all but the simplest and most routine projects. As the term implies, its purpose is to establish the feasibility or justification of the project, both as a whole and in its principal dimensions—technical, economic, financial, social, and so forth. Each dimension must be analyzed both separately and in relation to all the others. This is done in a series of approximations that test, for example, different technical approaches for their economic benefit and financial viability. The purpose of the analysis is not to determine whether a particular project idea is good enough to proceed with, but to arrive at the best one possible under the circumstances. Although the feasibility study should be designed with due regard for cost, this is not the place to skimp; if done well, the study is bound to pay for itself many times over through cost savings or increased benefits.

Good project preparation reduces the likelihood of difficulties during implementation by anticipating the problems that may arise and devising measures to deal with them. For most types of projects, detailed engineering should be completed, cost estimates made relatively reliable, institutional arrangements specified, and financial plans worked out before funds—whether from an external lender or from the domestic budget—are committed. One of the common causes of delayed or poor implementation of Bank-assisted projects has been inadequate or incomplete project preparation.

A pervasive shortcoming of preparation work, as already noted, has been to underestimate the cost of implementing projects as well as the time required. This optimism on the part of planners is found in all projects, large and small, complex and simple, and in virtually all countries. The cost overruns that ensue can have adverse effects on both the financial and economic viability of projects. Including physical and price contingencies as an integral part of the cost estimates helps to improve their accuracy.

One of the thorny issues of project design is how to achieve the right balance between simplicity and complexity. Projects that have a few, well-defined objectives and are based on proven technologies or approaches stand a better chance of being implemented successfully than projects that embody many objectives or unproven methods. Given the scarcity

of trained staff, managerial skills, and administrative capacity in developing countries, special efforts to simplify objectives and to select technologies and approaches that have a high probability of working in a particular environment have paid off very well.

At times, however, projects suffer from being too restricted in scope. There are countless examples of projects that did not yield their full benefits, or even failed, because the need for complementary investments and activities had not been recognized and met. This is true of many kinds of agricultural projects (in which research, extension, credit, inputs, marketing, processing, and storage may all be necessary elements), of urban and regional development projects, and of highway maintenance projects, among others. Projects can be too simple as well as too complex; indeed, the swing of the pendulum in recent years toward greater complexity reflects the unimpressive results of projects that were too simple.

There is, however, a middle ground. Even when a multicomponent approach, with its inherent complexity, is necessary, it is possible to concentrate efforts and resources on those elements that are essential to achieving the primary objectives and to leave desirable but secondary objectives to subsequent projects or to parallel operations outside the project. Adjusting the scale of a project or the timing of its components can be another way of matching complex project design with limited implementation capacity. Furthermore, the administrative capacity of an agency can be expanded under a project through well-designed technical assistance.

Project implementation. All project identification and preparation work is directed toward facilitating project implementation and helping to ensure its success. In turn, the lessons learned during project implementation are fed back into the planning and design of the next generation of projects. Ideally, if all the preceding work has gone well, project implementation should hold few surprises. But events seldom go according to plan; circumstances change, and implementation therefore becomes a critical stage of project work.

Projects should be designed with a view to how they will be implemented. There must be a close match between a project's objectives and the capacity of local institutions to implement, operate, and maintain it. Also, projects should be prepared in as much detail as is feasible under the circumstances. Since experience shows that projects are seldom implemented exactly as designed, sufficient flexibility must be preserved so that management can change course, sometimes drastically, during implementation if this becomes necessary.

Particular attention should be paid to the start-up period, before implementation has reached full stride. Use of critical path analysis, monitoring and evaluation techniques, and management information systems can facilitate this and later phases of the implementation process.

How to organize the management of project implementation and how to ensure effective coordination among the various parties can be vexing questions. There has been a tendency, fostered in part by external lending institutions, to assign responsibility for the management of projects in the public sector to special project implementation units established outside

the regular line ministries. Such "enclave" units have helped to insulate project implementation from some of the bureaucratic, staffing, and salary weaknesses of the traditional ministries, thereby contributing in some instances to better implementation. But they have been without lasting institutional benefit, since they have operated under conditions that could not be replicated by the line agencies. Project implementation units should be confined to such special cases as projects that embody innovative or very large-scale activities. Even then, arrangements should be made to reincorporate the units as soon as possible into the agencies that bear permanent responsibility for such activities, in accordance with a strategy for strengthening the capacity of those agencies.

Ensuring effective coordination when several agencies or organizations are responsible for different components of a project is inherently difficult. Unless well planned, it can be very time-consuming and unproductive. Some coordinating mechanism must be found; the basic requirements are a clear definition of the responsibilities of each of the participating agencies and adequate incentives for them to cooperate in achieving the project's objectives. If a coordinating committee is used, its authority needs to be clearly demarcated, and its members should be as close as possible to the operating level. Committees composed of ministers or other high-level officials with many other responsibilities have rarely performed well.

The Bank is continually reviewing its experience with project implementation to determine the principal factors that account for the success or failure of projects. Several factors emerge as essential ingredients of successful implementation.

- Probably the most important reason for the success of a project is strong commitment by the government to its objectives. A coalition among the interested agencies and principal actors needs to be formed early in the planning stage and continued throughout implementation. When financial resources allocated to a project dry up, tariffs are not increased on time, or prices and other incentives become distorted, lack of effective support may be the cause. Similarly, mutual commitment and support is needed between the government and any external financing agencies.
- Appropriate design and adequate preparation—both already alluded to—are essential. The objectives and design of projects need to be adapted to local political, administrative, economic, and cultural conditions, particularly if success hinges on changing behavior. When technologies and approaches have not been fully worked out, a pilot project to test them can save both time and money.
- There is a close correlation between good managers and good projects. Many examples can be cited of projects in serious difficulty that were turned around by the appointment of a particular individual; in others, performance declined markedly when a good manager departed. This does not gainsay the importance of the policy environment, but it does affirm that good managers make a difference.

The underlying reasons for success and for failure are largely mirror images. But some of the specific difficulties that projects typically encounter during implementation deserve special mention.

- Managerial problems are the most pervasive. Weak public administration and weak management at the enterprise or project level are often at the root of delays and cost overruns. Such weaknesses are manifested in inadequate planning, delays in land acquisition, protracted bidding and contracting procedures, insufficient project supervision, slow response to changes in the policy environment, and low staff morale and productivity.
- Financial difficulties are common. They can arise from an imbalance between the national investment plan and available resources, which leads to underfunding of publicly supported projects across-the-board; from worldwide or domestic inflation; from a government's reluctance (heightened during inflationary periods) to authorize tariff increases for public services or basic commodities; or from bureaucratic delays in providing funds or even in paying the government's bills. Whatever the reasons, the consequences are the same: physical delays in project implementation, cost overruns, reductions in the scope of the project when this is possible, and deferred implementation of institutional and policy reforms. Cost overruns are a barometer of the implementation process since practically all of the problems encountered result in additional costs as well as delays.
- Technical problems arise continually. These can include difficult or unexpected soil conditions, materials of poor quality, design defects, and unsuitability of imported equipment for local conditions. In agriculture, inadequate technical packages or disappointing results from newly introduced technologies are common. In people-oriented activities such as health delivery systems or education, well-tested approaches to the particular circumstances of a country or region may be lacking. It often takes longer than expected to ease institutional bottlenecks and to develop the services necessary to provide new technologies and to persuade beneficiaries to adopt them. But in most instances, solutions are worked out eventually. Technical problems tend to be less intractable than financial or managerial ones.

Ex post evaluation. The project cycle does not end when implementation is completed and the project goes into operation. There remains yet another stage, that of ex post evaluation, so called to differentiate it from the monitoring and evaluation that should be a regular part of project implementation. Actual results are viewed with the advantage of hindsight. The main purpose is to learn lessons for the design of future projects that supplement those gathered during the course of implementation. A second purpose is to help ensure accountability, whether of international aid agencies to their government shareholders or of national agencies and enterprises to their government and people.

Ex post evaluation should provide a comprehensive and detailed review of the elements of success and failure of the project: what went well and deserves to be repeated; what went wrong and why; how to avoid similar mistakes next time. It normally takes place shortly after the investment phase of the project is completed, at which time the construction costs are known but, for many types of project, a large portion of the benefits still lies in the future. It may be desirable, therefore, to undertake

a second evaluation some years later; such a "second look" can yield fresh insights into projects that undergo significant changes while in operation.

The World Bank has a well-established procedure for evaluating completed projects, based on the principles of close involvement of operational staff, objectivity, full disclosure of results, and comprehensive coverage. The process has resulted in a gold mine of information, on which this book has drawn heavily. Developing countries have been slow to take up the Bank's example, in part because of shortages of trained staff and the need to give priority to the operational stages of project work. Those countries that do have an ex post evaluation system, however, are discovering that systematic efforts to learn from experience are invaluable for enhancing the developmental impact of project work.

PROJECT ANALYSIS

Throughout the several stages of the project cycle, various dimensions of project work are addressed, both separately and in relation to each other, and in varying degrees of detail.

Technical analysis. Of these dimensions, technical analysis is perhaps the most familiar. Among the issues of technical design are size, location, timing, and choice of a technology package. We have already alluded in this chapter to the need to select a technology appropriate to the circumstances of the country and the requirements of the project. The point bears repeating in any list of lessons. "Appropriateness" is a relative concept. It generally means that the technology should be determined in relation to the objectives of the project, to the impact on intended beneficiaries, and to local conditions, including the availability and cost of capital, raw materials, and labor, the size of markets, and the present and potential capacity for planning and implementation.

Numerous tradeoffs are implicit in these considerations; for example, a technology may often have to be reduced in complexity to fit the capabilities of local institutions or the sociocultural traditions of the beneficiaries. The range of choice is very wide, from sophisticated, high technology for long-distance telecommunications even in the least developed countries to a labor-intensive approach for maintenance of rural roads, schools, or tertiary irrigation canals even in middle-income countries. Whatever the choice, it is important that it not be unduly biased by government interventions or price distortions of the kind referred to earlier.

Technical analysis also provides an opportunity to consider how a country can best take advantage of its investment plan, policy framework, and development projects to build a capacity to use science and technology effectively throughout the economy. Both trained people and institutions capable of utilizing their skills are required. In the early stages of a country's development, the emphasis should be on building local capacity to import technology from abroad knowledgeably and to adapt it to local conditions. At later stages, the emphasis should shift to the development of local technology and its integration with imported technology, and to the encouragement of local research and innovation.

Economic analysis. The basic question that economic analysis addresses is how to allocate scarce resources among many competing uses. It seeks to determine not only whether a project can be expected to provide a satisfactory return to the economy, but also whether there is an alternative way of achieving the same objectives that would offer a higher return. The analysis entails a comparison of costs and benefits with and without the project, both discounted to present values, through the use of analytical techniques that by now are highly refined—though no more accurate than the underlying data. The central concept—that, for purposes of economic analysis, resources should be valued in terms of their opportunity cost to the economy in their best alternative use—is applicable to all economic systems, whether market-oriented, centrally planned, or a combination of the two.

Most lending agencies use cost-benefit analysis to assess the projects they help finance, and many developing countries are applying this analysis in one form or another to projects that they fund from public resources. Private industrial enterprises also use cost-benefit analysis for major investments. If done properly, it can be a powerful tool for guiding investment choices.

Cost-benefit analysis encounters some practical problems, among them: how to define the situation "with" and "without" the project (which should not be confused with the situation "before" and "after" the project); how to handle sunk costs incurred before the analysis (the short answer is to disregard them); how to establish the shadow (that is, opportunity) prices for labor and capital when market prices are distorted for various reasons; and how to deal with nonquantifiable benefits. For most of these problems of definition or measurement, reasonable approaches can be found that are consistent with the reliability of the available data. The results of the analysis can be presented as a measure of net present value, as an internal rate of return, or as a cost-benefit ratio; each has its particular uses.

Not all types of project are amenable to cost-benefit analysis; it is not customarily used, for example, in evaluating education or health projects. Nor does it have the same meaning in different sectors. In power and water, for example, where prices are publicly administered rather than fixed by the marketplace, the economic rate of return is a minimum estimate, more indicative of the appropriateness of the regulated tariffs than of the real return to the economy. Cost-benefit analysis, therefore, is not very useful in comparing the merits or relative ranking of projects in different sectors. Much depends on the common sense, judgment, and even ingenuity of the analyst. Whim, bias, and intuition will also inevitably play a part. These caveats notwithstanding, economic evaluation can introduce rationality into the decisionmaking process, identify and measure risks, and avoid some of the more serious mistakes that can occur even in the best-laid investment plans.

Financial analysis. Issues of financial analysis arise in the course of project design in several ways. The first and most universal concern, applicable to all types of projects, is that there be sufficient funds both to complete the project and to operate and maintain it subsequently. This sounds obvious, but far too many development projects have been

launched without adequate consideration of the future availability of funds. This is notably true for education projects, in which recurrent costs for teachers' salaries may quickly exceed the capital costs of the facilities; or for projects in irrigation, roads, health, water supply, and other infrastructure, in which facilities once completed may deteriorate rapidly for want of adequate maintenance. This reluctance to provide adequate recurrent expenditures reflects in part the greater political appeal of new investments and in part the unwillingness of most external lenders to finance such expenditures.

A second financial concern is to recover an appropriate portion of the costs from the beneficiaries or users. A cost recovery policy has three separate but related objectives:

- *Economic efficiency.* The resources provided under a project are used most efficiently when they are priced in accordance with their marginal or opportunity cost. The extent to which efficiency prices can be applied, however, varies widely from sector to sector.
- *Income distribution.* In the interests of equity, the prices or other charges levied to recover costs should take into account differences in income levels (as affected by the project) and in ability to pay.
- *Revenue generation.* Governments in developing countries, being short of resources, need to generate revenue from projects. In addition, revenue-earning enterprises need to be made or kept financially viable. If rural and urban development, water supply, and other projects are to be replicable on the scale necessary to reach the large numbers of potential beneficiaries, a substantial contribution from the initial beneficiaries will often have to be secured.

Difficult tradeoffs may be required among these sometimes conflicting objectives, and the poorer the country the more painful the choices may be. Cost recovery for basic services can be an explosive political issue. This fact, together with administrative considerations, will determine what can be accomplished and how quickly. Two important rules to follow are that new or increased levies should be related to benefits as they materialize and imposed in small but regular increments, and that similar situations should be treated similarly to avoid the appearance of discrimination.

The financial viability of revenue-earning enterprises—electric and water utilities, public and private industries, railways, telecommunications entities, and so on—can be translated into three subsidiary objectives or tests of performance:

- Will the enterprise have sufficient revenue to earn a reasonable return on its invested capital? As part of the test of "reasonableness," will it be able to generate enough funds internally from its operations to make a satisfactory contribution to its future capital requirements?
- Will the capital structure of the enterprise enable it to meet all of its capital obligations, including the service of its debt, in a timely manner?
- Will there be adequate liquidity, that is, sufficient working capital to cover all current operational requirements?

Insistence on financial viability is an important means of imposing discipline on an enterprise and encouraging efficient management and use of resources. There is almost always some scope for improving financial performance by raising operating standards and reducing waste. Achieving financial viability will, however, ultimately throw issues of tariff policy into bold relief. In many cases, increases in prices—often substantial—will be necessary to reach the financial objectives. To raise the price of a basic product or service that figures prominently in the cost of living is an act of political courage. But not to raise the price may, in the long run, have even more adverse economic, and therefore political, consequences. During an inflationary period, governments are especially reluctant to increase the cost of basic goods and services. This is understandable, but failure to raise prices may also have an inflationary impact if the government must borrow to cover the deficits.

One means of easing the bureaucratic and political pain of raising the price of public services, as we have noted, is to adjust prices in small increments and at regular intervals. Another is to make price increases automatic or quasi-automatic, as when fuel costs are passed on to users through equivalent increases in electricity prices without the need for government approval each time.

Social analysis. The role of social analysis, which deals with the impact of projects on people, is to consider the suitability of the proposed project design to the people it is intended to serve, to make proposals for improving the "fit" between the two, and to fashion strategies for project implementation that can be expected both to win and hold people's support and to achieve project goals by inducing changes in social attitudes and behavior. Some projects—in such fields as rural development, education, and health—are clearly oriented toward people. Infrastructure projects are less so, but even these may have to deal effectively with people, as workers or consumers, in order to achieve their objectives. A project that runs counter to or ignores the traditions, values, and social organization of the intended beneficiaries, or that is based on objectives which they do not share, has little prospect of success.

Social analysis is a relative newcomer among the dimensions of project analysis. It focuses on four principal areas:

- The sociocultural and demographic characteristics of the project population
- The way in which the project population is organized to carry out productive activities
- The project's cultural acceptability, including its capacity both for adapting to people's behavior and perceived needs and for bringing about changes in them
- The strategy necessary to elicit commitment from the project population and to ensure their sustained participation throughout the project cycle.

Predicting social behavior is even more uncertain than forecasting financial or economic behavior. Project planners have often made unduly optimistic assumptions about local people's interest in and need for a

project, the economic and social incentives for them to participate, and the rate at which change in their social condition can be brought about. Social analysts with professional training and broad experience can improve the projections, however; more important, they can make a significant contribution to a project's success by helping to design effective organizations and approaches to achieve desirable changes in social behavior.

Social analysis of projects has frequently failed to take adequate account of the particular interests and needs of women. Although they constitute half the world's population, women have reaped far less than their share of the benefits of development. Women tend to have less schooling than men, their mobility is constrained by economic and social considerations, and they often face legal barriers to their ownership of assets or access to credit. Yet women play a key role in the development process, both as producers and consumers; for example, they provide most of the agricultural labor used in production, harvesting, marketing, and storage. Moreover, the central position of women in family life profoundly influences attitudes and decisions on education, nutrition, health, and family size. Thus, even if women never enter the formal labor market, ensuring that they receive an adequate education may be one of the best investments a country can make.

Failure to appreciate the role of women and introduce it into the way projects are designed and implemented is not only inequitable but also retards the pace of economic growth. Decisions about which technologies to use and about how to provide a wide range of services must be made with full regard to women's needs and constraints; otherwise, project benefits will be reduced and the position of women made even worse. In many respects, women are the largest underutilized resource for development.

Institutional analysis. In recent years, institutional analysis has become one of the important dimensions of project work. The outcome of development projects depends on the quality of the institutions responsible for them. Yet institutions in developing countries typically suffer from an acute shortage of experienced managers and staff, an excess of untrained staff, overstrained services and facilities, low wages and salaries, inadequate data and information systems, and an inimical policy environment. There are no standard solutions and few readily transferable institutional models from either developed or other developing countries. Institutional development must be seen as a lengthy process of experiment and adaptation, subject to many reverses when political or economic fortunes change. Still, when strong institutions have been forged, they have played a key role in development.

The overall policy environment affects the performance not only of projects but also of the institutions responsible for them. If managers of these institutions are compelled to spend time and effort counteracting the impact of government economic policies (such as a critical shortage of foreign exchange for spare parts owing to an overvalued exchange rate), they cannot build long-term capacity effectively. Institutional problems multiply rapidly when government policies seriously distort the economic environment or when government regulations impose ex-

traneous requirements, such as the employment of extra staff for political or social reasons.

Institutional problems have been compounded as more complex development objectives have been assigned to projects. Executing multicomponent projects or projects focused on alleviating poverty or upgrading social services has placed heavy demands on institutions. Knowledge of the economic, social, and behavioral characteristics of small farmers, urban squatters, or disadvantaged tribal peoples is still rudimentary. Understanding of the management and institutional techniques for dealing with such projects is also at an early stage.

Institutions in the public sector present a particular challenge, both because of their importance and because of the many problems they characteristically confront. A comprehensive reform of the public administration—however badly needed—is a very ambitious undertaking. Few countries, developed or developing, have successfully carried out such a reform in the face of the strong resistance that these efforts generate. While careful diagnosis of the problems of the public service is a necessary first step in establishing an overall strategy for change, implementing the strategy will almost invariably call for a selective approach. The best results have been achieved by concentrating on a few of the more critical problems. The ones to tackle first are those that seriously constrain the performance of the public administration and that are within its capacity to solve; in addition, it should be possible to mobilize and maintain public support for the reform effort.

Parastatals and other forms of state-owned enterprise have proliferated in recent years. Their performance has at best been mixed, and concern has been growing about the need to increase their efficiency, reduce their deficits that burden the public budget, and avoid political interference in their affairs. Given the preponderance of public enterprises in the economies of many developing countries, reforming them has repercussions going far beyond improved project performance. Some governments, in fact, are beginning to devote considerable effort to limiting the spread of public enterprises and to transferring ownership of some of these enterprises to the private sector. The legitimate demands on the public sector are very large, and the capacity for public management is among the scarcest of development resources. This capacity should, therefore, be reserved for use where it is most needed and most likely to be efficacious; governments should exercise great caution in deciding which fields are appropriate for public ownership.

For those agricultural and industrial parastatals carrying out processing, manufacturing, or marketing operations that private producers and merchants can do efficiently, the simple answer may be to abolish them. For others, reducing the number of staff, rationalizing their structures, and appointing and promoting staff on the basis of merit are among the measures that are needed. In several countries, policy reforms are being tried that will improve the "rules of the game" under which the enterprises operate. This reform has two objectives: to give public enterprises greater authority and autonomy to carry out their activities in accordance with broad goals and specific performance targets agreed on with the government; and to hold the enterprises accountable for their results, while improving the flow of information to government about their performance.

A widespread weakness of development institutions, particularly but not exclusively in the public sector, is the shortage of qualified managers at the middle and upper echelons and of experienced specialists such as accountants and engineers. This is a basic characteristic of underdevelopment that can change only gradually. In the long run, the educational system in all its forms—from primary education through universities, vocational schools, and management institutes—must provide the solution. But some steps can be taken immediately. Expatriate managers and consultants can be used to free bottlenecks in the short run—as long as care is taken that this does not delay the development of local managerial capacity, but rather fosters it through counterpart and on-the-job training. Whatever the source of management, greater attention to organizational questions and improved management, accounting, and information systems and procedures can enhance effectiveness. Continuity of management is also important; frequent changes for political reasons are highly disruptive.

One fruitful approach to strengthening management in the public service is through improved incentives. Salary and other financial incentives for public officials cannot normally match those in the private sector, but disparities can be narrowed. In particular cases, elements of the financial package other than pay can also be improved without disturbing prevailing standards in the public service. Establishing "super-grades" outside the normal system may be a way to meet special needs, while making lateral entry and exit easier can encourage managers to view public service as a natural stage in a career.

Programs for training managers and staff also deserve much more attention. The potential contribution of such programs is very large, yet experience shows that too often they have little effect. Training programs cannot be added to projects at the last moment, but must be planned carefully in advance and properly executed. Adequate resources must be provided and skilled trainers recruited. As a general rule, the closer training is to the workplace in which it will be used, the more effective it is likely to be. This argues for on-the-job training when feasible.

Environmental analysis. It is now widely recognized that environmental analysis is necessary for a country to ensure the sound management and use of its natural resources as an integral part of its strategy for economic growth. Desertification, deforestation, soil erosion, overexploitation of such renewable resources as fisheries, and air and water pollution are lowering the carrying capacity of the environment. Usually the poor are disproportionately affected by environmental degradation. The objective of environmental management should be to achieve a balance between human demands on the natural resource base and the ability of that resource base to meet these demands on a sustainable basis in the interests of future generations as well as those alive today.

With careful environmental management, the pace of economic and social progress need not be slowed. In environmental work, the "ounce of prevention" is almost always more important and less costly than the "pound of cure." Sometimes remedial action may not be feasible at all. All proposed development projects should be screened to detect those with a potentially harmful impact on the environment. Most environmental problems, if properly anticipated, can be dealt with at relatively small cost—usually less than 5 percent of total project cost. Analysis of the

tradeoffs between different design features and their environmental impact should be a routine part of project work; the analysis is complicated, however, by the fact that the standard time-discounting methodology gives insufficient weight to environmental costs and benefits because of their long-term nature.

Procurement. For all kinds of projects, managing the procurement process is an important aspect of project implementation. Delays in acquiring the necessary goods and works are likely to be compounded into further delays and increased costs for the project as a whole. Procurement is therefore a process to be carefully planned, organized, and managed, the more so since the number of ways things can go wrong sometimes appears endless.

Procurement must serve three objectives. The first is to help ensure the efficient execution of the project by acquiring goods and works with the optimal combination of quality, price, and delivery time. The second is to promote such national goals as the development of local industry, the balanced regional development of industry, or the support of small-scale enterprises. The third is to comply with the procurement regulations of any external lending institutions helping to finance the project.

There are a wide variety of types and methods of procurement. Which is the most appropriate depends on the size and nature of the project, the particular goods or works to be procured, and the regulations of lending agencies. For large projects, international competitive bidding is generally the best way of ensuring efficient procurement, safeguarding against waste or corruption, and satisfying the interest of lending agencies that all qualified firms be permitted to bid. Local competitive bidding is more appropriate for small-scale procurement of goods and works in which foreign firms will not be interested; changes in procedures may be necessary to ensure effective competition among local firms.

Use of consultants. Procurement of consulting services raises different issues. There is, first, the question of need. Most of the services for which consultants might be recruited can, in principle, be done by local staff of the project agency if they are competent, experienced, and available. When such in-house capacity does not exist (as may often be the case) and cannot be put in place by additional training soon enough to meet the demands of the project, the next best choice is the use of local consulting firms. Establishing a local consulting industry is desirable both to provide some competition to stimulate agency staff and to supply more specialized skills or expert services. When local services are not available, firms from other developing countries may offer the dual advantages of better knowledge and understanding of comparable local conditions and relatively low costs. There will, however, remain some assignments—especially for large or complex projects and those requiring highly technical knowledge—for which only expatriate consultants from developed countries are qualified. Joint ventures between foreign and local consulting firms, if entered into voluntarily, are often a good way of developing local capacity.

The consultant-client relationship is a close, personal one; when a satisfactory partnership already exists with a particular firm, it may be

eminently sensible to continue it. When no such relationship exists, or when for other reasons it is desirable to invite proposals from a short list of qualified firms, the selection process should ensure that price considerations are subordinated to a concern with quality. The cost of consulting services is usually only a small fraction of total project costs, but the quality of the work performed can have an impact on the final project out of all proportion to the cost.

These, then, are some of the principal lessons that the World Bank has learned in more than thirty-five years of assisting its member countries in managing their investment resources. We offer them not in the belief that they provide final answers to the formidable problems of development, but in the conviction that better national investment planning, macroeconomic and sector policies, and project work can ease the path of development, bring its benefits to people sooner, and distribute them more equitably.