

Précis

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Development Effectiveness, 1998: Opportunities in a Volatile Environment

THE RESULTS OF WORLD BANK OPERATIONS HAVE continued to improve steadily. More than three-quarters of development projects supported by the Bank have achieved satisfactory outcomes, including 7 percent rated as outstanding, according to OED's *1998 Annual Review of Development Effectiveness (ARDE)*, which presents the evaluation results for operations that exited the Bank's portfolio in FY97–98. At the same time, the review warns that weak financial and social sector institutions in developing countries undermine project success and render countries more vulnerable to external shocks.

The 1998 ARDE comes at a time of crisis. In East Asia, approximately 20 million people have fallen back onto poverty in the past year. Japan is in recession. Russia has been struggling with social and economic upheaval. Economic problems have been compounded by natural disasters, including deadly floods in Bangladesh, China, and Central America. The prospects for achieving the poverty reduction targets established by the OECD have been postponed for at least five years.

Performance trends

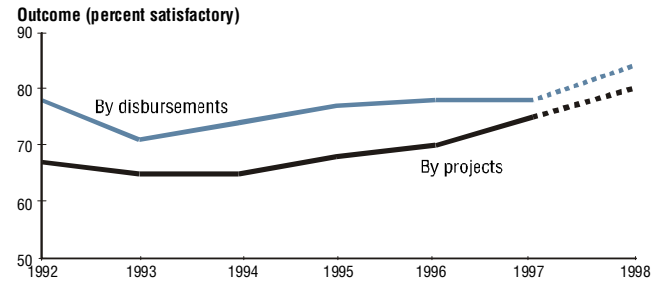
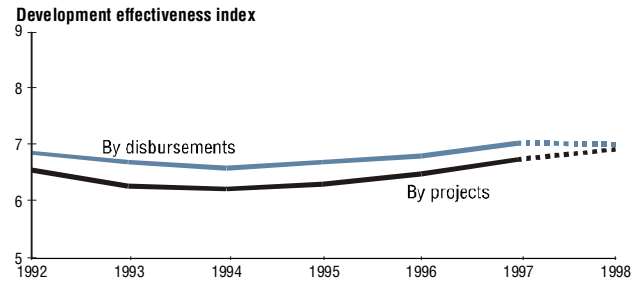
In the early 1980s, the performance of completed Bank operations deteriorated, as global changes began to erode the Bank's quality at entry. By the end of the 1980s, completed Bank operations rated as satisfactory had dropped to 60 percent. Bank management recognized that profound changes in attitudes, skills, and incentives were needed to strengthen portfolio management, and that greater attention needed to be paid to quality at entry, borrower participation, and development achievements.



FIGURE 1. MEASURING CHANGE

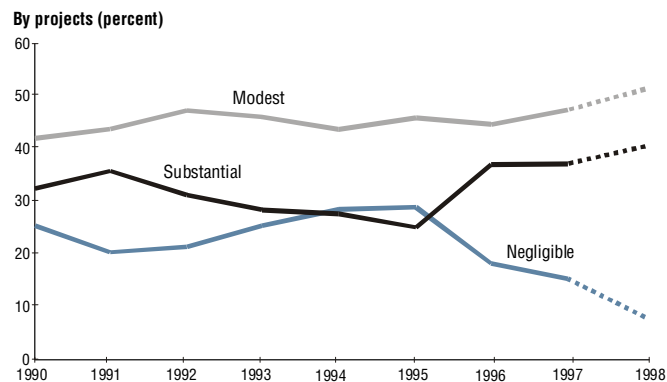
Two measures of project performance

While showing improvement over the past two years, the development effectiveness index trend is less dramatic than the trend in outcomes.



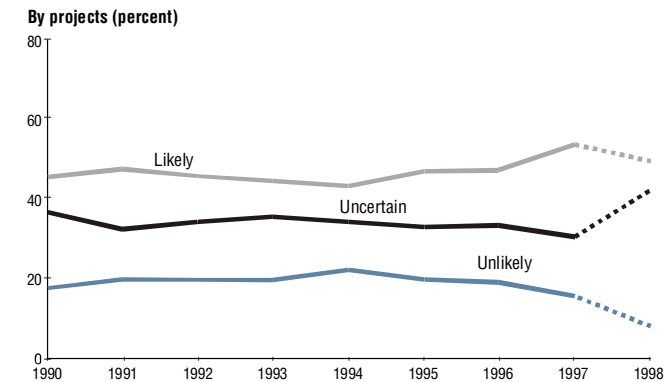
Institutional development impact

Institutional development impacts of Bank projects are improving, but there is enormous scope for further improvement.



Sustainability

A mixed signal on sustainability may well be a precursor of future declines in performance caused by a deteriorating external climate.



Note: Broken lines (exit fiscal year 1998) indicate preliminary results, with less than 50 percent coverage of exited operations.

The results of the change in course can be seen in figure 1. Since 1994, project performance has maintained a steady upward trend, with projects judged satisfactory rising to 76 percent in 1998, surpassing the target of 75 percent established by the Bank's Strategic Compact—an ambitious renewal plan adopted by the Bank to promote more effective efforts toward poverty reduction. When viewed through the lens of the development effectiveness index (see box 1), a measure piloted by OED for this review, the trend remains positive, although less dramatic.

Performance across sectors and regions

All regions except East Asia and the Pacific have shown improvement in fiscal 1997–98 compared with the long-term averages for fiscal 1990–96. Improvements in project outcomes were greatest in Africa, with a gain of 14 percentage points, and Latin America and the Caribbean, with a gain of 15 points.

Improvements in project performance were noticeable in most sectors. The most rapid improvements were seen in public sector management and finance (gains of over 10 percentage points); agriculture; urban development; transportation; and population, health, and nutrition.

There has also been a convergence in performance across regions and sectors, the result of major advances in two sectors that have been plagued by chronically poor performance—finance and public sector management—as well as in Africa, where agriculture, which has been following an action plan emphasizing simpler models of delivery and greater sector coherence, has been the outstanding performer. Better borrower performance, more realistic project design, and better portfolio management account for much of the improvement. But sustainability and institutional development impact remain considerably below the levels achieved in project performance (see figure 1).

Box 1. The Development Effectiveness Index

THIS MEASURE INTEGRATES EXISTING OED measures of outcome, sustainability, and institutional development. The index is computed by assigning cardinal weights to the ratings in each of the three areas, and then combining them in a straightforward manner. Ratings range from 2 (for a project with a highly unsatisfactory outcome, which is also unlikely to be sustainable and is of negligible institutional impact) to 10 (high achievements in all three measures are realized).

The index improves the presentation of performance trends in three ways. First, it uses the full spectrum of outcome assessments made by OED, rather than the more rudimentary assignment of a tag of satisfactory or unsatisfactory. Second, it qualifies a project's outcome judgment by rewarding the robustness of achievement into the future, in some cases recognizing lasting benefits of significant achievements that fall short of expectations. Third, institutional development impact is given special emphasis.

Lending type

Adjustment loans continue to have higher average outcomes and sustainability than investment loans, although the gap has narrowed. The share of satisfactory outcomes for adjustment loans rose from 74 percent in fiscal 1990–96 to 82 percent in fiscal 1997–98, compared with a rise from 66 to 76 percent for investment loans. IDA and blend-financed projects have also shown improved performance.

The conclusions of the 1998 ARDE are based on evaluations of 298 Bank projects and 17 Bank country assistance strategies, as well as a process review of the Bank's grant programs and sectoral and thematic reviews such as assistance to financial sector reform, post-conflict reconstruction, and the role of NGOs in Bank-supported projects.

A global challenge

As the world community attempts to deal with the causes and the consequences of severe economic downturns and devastating natural disasters, the ARDE points decisively to approaches that can help.

Developing countries have shown a sudden and significant deterioration in country risk, highlighting the growing power of external factors in determining the outcome of development efforts and the need to balance unregulated movements of private capital against the risks.

This extraordinary period of global stress has brought into stark relief several lessons that development

practitioners—and those who evaluate development performance—must assimilate and utilize.

Stable economic fundamentals are not enough

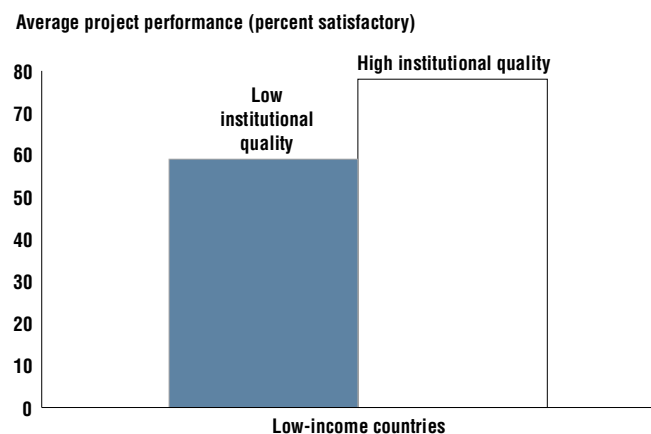
Good macroeconomic fundamentals are necessary but not sufficient to sustain stable and sustainable growth. The current economic upheaval has made this clear. Unlike the debt crisis of the 1980s, the current difficulties began in countries with relatively strong fiscal profiles, sound monetary policies, and outward-oriented trade regimes. When the crisis hit, government budgets in most of the affected countries were balanced or moving into surplus, inflation was contained, interest rates were falling, and unemployment figures were low. What, then, made these economies so vulnerable?

Institutional development

It is now clear that strong institutions are the essential anchor of economic and social stability. The events of the past year have demonstrated how costly inadequate institutions can be.

Weak economic management helped to trigger the downward spiral in East Asia. In all cases, the capital account was the primary area of vulnerability. Imbalances between short-term debt and official reserves—combined with premature financial liberalization and weak financial discipline in domestic banking systems—created opportunities for speculative pressures. In the presence of sound fundamentals, the crisis would not

FIGURE 2. INSTITUTIONS AND PROJECT PERFORMANCE IN LOW-INCOME COUNTRIES



Note: The institutional quality index is composed of three variables based on data from the *International Country Risk Guide* (ICRG), covering 1982–98. These variables are corruption, rule of law, and bureaucratic quality. Countries are assigned income groups based on classifications in *World Development Indicators 1998*. The average project performances for the country groups are based on project-level outcome data. Source: ICRG; OED, World Bank.

have spread without the failure of domestic institutions. But banking discipline was poor, and links among economic conglomerates, banks, and governments were too close. This led to excessive borrowing, disproportionate real estate booms, poor private investments, and escalating levels of private loans. The key lesson of earlier crises in Chile and Mexico—that prudential rules and surveillance are necessary safeguards for the operation of domestic financial markets—had not been heeded.

The importance of institutional development extends beyond avoidance of crisis. The 1998 ARDE found that in Bank-supported projects, the quality of institutions can have a significant influence on development effectiveness, an influence that is particularly pronounced in low-income countries (see figure 2).

Where institutions are weak, projects yield lower returns and carry greater risk, while stronger institutions bolster a country's ability to adjust, more than doubling the chances of successful development.

The role of the Bank

The World Bank can build on its project success by increasing efforts to help developing countries strengthen their institutions. There is substantial room for progress. An analysis of 41 low-income countries shows that only 1 was rated satisfactory in institutional quality. Only 40 percent of Bank-supported projects have substantial impact on institutional development; civil service reforms undertaken as components of structural adjustment loans have mixed outcomes; public sector management projects, while improving, have historically performed below the Bank average. An OED evaluation showed that Bank-supported financial sector projects had satisfactory and sustained outcomes in just 50 percent of countries. Institutional development is slow and difficult to achieve in fragile institutional environments and requires strong aid coordination and the development capacity to absorb aid and reduce the risks of overload.

Poverty reduction and the social safety net

In addition to increased institution-building, it is essential that social development be placed at center stage, both in assessing development effectiveness and in financing country assistance programs.

Employment losses on the order of 10–15 percent are estimated for Indonesia and Thailand, for example. With devaluations and the removal of subsidies, the newly unemployed across the region will suffer drastic losses in income and sharp rises in prices. The increasingly integrated global environment means that country susceptibility to shocks will continue. Much greater attention must be given to the provision of social safety

nets to insulate the poor and the near-poor from disproportionately bearing the costs of these dislocations.

Although the situation is the most dramatic in the crisis countries, they are not alone in struggling with increasing inequality. Data for 74 countries show an overwhelming increase in inequality within countries in the 1990s: 49 countries displayed increasing inequality, while only 10 showed a decrease. This underlines the importance of emphasizing inclusion, social development, and social safety nets in the design and implementation of reform strategies and development programs.

Governance and corruption

The ongoing crisis has reinforced the already strong evidence that growth in per capita income is enhanced by strong property rights, solid legal foundations, and capable civil servants—all operating in an effectively managed institutional system. Do better governance and lower corruption improve the development effectiveness of projects? Unambiguously, yes. Bank-supported projects in countries with an inadequate bureaucracy are, on average, the weakest performers. In countries with well-functioning bureaucracies, projects perform much better, with significantly lower risks than the average.

As one might assume, projects in high-corruption economies have had significantly lower returns, while carrying higher risks. The Bank has long supported efforts to improve the workings of the state. Overall project performance in public sector management is improving, but civil service reform components remain among the weakest performers in the Bank's portfolio. The central recommendation emerging from OED work in the area is that far greater priority should be given to integrating the use of performance indicators to monitor and support more effective public administration. Results-based management systems can be effectively used to focus public sector performance on outcome measures.

A country focus based on partnership

The current financial crisis adds urgency to the need to shift the focus—in evaluation, learning, and strategic thinking—to encompass the country as a whole. This approach will ensure that projects reflect country priorities and will identify vulnerabilities and critical gaps in assistance. While the Bank has shifted its focus from projects to the country, much remains to be done to enhance the quality of country assistance strategies. Country strategies must exploit complementarities across sectors and activities, tailor projects to broad institutional and social contexts, leverage partnerships, and deepen borrowers' ownership of structural reform and long-term assistance objectives.

To scale-up processes, the Bank can work in partnership with borrowers, donors, and other stakeholders to focus on maximizing development impact at the country level. Tools and methods to scale-up evaluation to the country, sectoral, and even global level must be developed. The increased emphasis on partnership and poverty alleviation stressed in the Strategic Compact is essential in sustaining performance improvements and achieving greater development impact.

The Operations Evaluation Department is an independent unit within the World Bank. It assesses what works, and what does not; how a borrower plans to run and maintain a project; and the lasting contribution of the Bank to a country's overall development. The goals of evaluation are to learn from experience, to provide an objective basis for assessing the results of the Bank's work, and to provide accountability in the achievement of its objectives. It also improves Bank work by identifying and disseminating the lessons learned from experience and by framing recommendations drawn from evaluation findings.

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