

EXECUTIVE SUMMARY

Purpose

The Annual Report on Projects in Execution (ARPE) is prepared by Management and presented to the Board of Executive Directors. It is based on the analysis of information from a variety of Bank reports and monitoring instruments that provide insight and updated data regarding portfolio quality and portfolio management practices. It outlines detailed information on the performance of the Bank's lending portfolio,^{1/} discusses trends and challenges, reports on the Bank's response to issues noted, and makes recommendations for future actions to be taken by the Bank and Borrowers to improve portfolio performance. In addition, as part of Management's self-evaluation function, the ARPE provides an opportunity to feed back operational lessons learned to improve the programming, design and execution of new operations. All of the key issues, initiatives and recommendations for future action noted in this ARPE are placed within the Bank's overall efforts to strengthen a results-based focus in its strategies, products, and systems in order to enhance the development effectiveness of its interventions.

Structure of the Report

In light of the above, the 2001 ARPE reports on portfolio performance and reporting quality and is divided into four chapters. Chapter I provides an overview of the size and composition of the portfolio as of December 31, 2001, and Chapter II highlights portfolio performance during the year. Chapter III presents key factors affecting performance quality and measures to address these issues, and Chapter IV presents conclusions and an outlook for the future.

Composition of Portfolio and Key Performance Issues and Trends

A review of the status of the 2001 portfolio and Management's efforts over the year indicates that the Bank has intensified its activities in the area of portfolio management, both internally and with respect to responding to the challenges faced by borrowing member countries. As the ARPE outlines in detail, the Bank has continued on its path to refining its products and applying lessons from its extensive experience, aimed at improving the quality of its interventions, and supporting Borrowers in the achievement of better results. But there are areas for greater attention by Management as noted in this report, and separately, in the related Portfolio Improvement Action Plan (the Plan), which outlines priority issues and specific steps to consolidate and achieve further gains in portfolio quality.

Turning to the portfolio, this report highlights that in 2001, social sector operations continued to increase, representing nearly half of projects and commitments in the portfolio^{2/}, with

^{1/} This report excludes Multilateral Investment Fund (MIF) operations which are covered in a separate portfolio reporting document, as well as Social Entrepreneurship Program (SEP) and non-reimbursable technical cooperation operations.

^{2/} Official IDB Sector Classifications: **Social:** health, education, environment, social investment, water & sanitation, urban development, and science & technology. **MOS:** financial, public sector, planning & state reform, privatization, justice, legislative, reform & modernization, and taxation and fiscal reform. **Infrastructure:** energy and transportation. **Productive:** agriculture, forestry, tourism, and microenterprises.

Modernization of the State (MOS) projects accounting for a fifth of projects and 16% of commitments. The infrastructure portfolio continued to shift lending away from public sector operations to the private sector. Country Groups C & D^{3/} accounted for the largest number of projects, while projects in Country Groups A & B represented the highest commitment values. Investment loans continued to be the Bank's primary lending instrument. Policy-based loans (PBLs) declined slightly in number but increased by nearly a third in terms of commitment values, while emergency loans completed disbursements during the year, and private sector lending remained steady.

The share of projects in the portfolio classified by Country Offices as "problematic" or unlikely to achieve their Development Objectives in the Bank's Project Performance Monitoring and Reporting System (PPMR) dropped to 9% in 2001 from 12% the previous year. Proactive measures taken by the Bank and Borrowers to solve execution problems or close operations showing little progress resulted in an overall record level of cancellations in 2001, and a decrease of 53% in terms of commitment values tied up in problem projects. The bulk of partial cancellations for ongoing projects were primarily for investment loans in the social sector. These efforts were necessary in large part due to a number of pervasive issues that continued to affect portfolio performance in Latin America and the Caribbean.

Zooming in on where specific problem areas or portfolio "hot spots" are concentrated, as noted in the report, more than eighty percent of problem project commitments in 2001 were found in the social sectors, particularly in investment loans in Group A countries (Argentina, Brazil and Venezuela). Smaller clusters of social sector problem projects were also noted in the Dominican Republic and Paraguay. The second category of problem projects in terms of commitment values was situated in the MOS sector. The location of problem status projects in these two sectors must however be seen within the perspective of their concentration in the total Bank portfolio. As a share of their respective portfolios, social and MOS problem projects represent between 8-9%, comparable to the percent of problem projects in the entire portfolio.

Approximately sixty-four percent of all problem projects and their commitments fell into the category of multiyear problem projects, that is, those rated problematic for at least two consecutive years. In terms of country clusters, they were located in Argentina, Colombia, Dominican Republic and Trinidad & Tobago, and will be the subject of intensive review by Management. In terms of sectors, multi-year problem projects were highly concentrated in social sector investment loans, but also included a smaller proportion of commitments in the MOS sector. While fruitful efforts were made by Management in 2001 to address the issue of non-performing MOS projects, pro-active portfolio management in this area is still needed, since eight out of the nine MOS problem projects (as of December 31, 2001) have been problematic for several years, and are mostly located in Group D countries.

The ARPE also points to additional issues with respect to the alert status projects. Alert status projects are classified in the Bank's Project Alert Identification System (PAIS) as those that are

^{3/} For the purpose of applying its operational policies, the Bank groups its borrowing member countries on the basis of their relative level of development within the region as follows: Group A: the more advanced countries; Group B: middle developing countries; Group C: countries with insufficient markets; and Group D: the least-developed countries. See Appendix 5A for a complete list of countries in each group.

likely to achieve their Development Objectives, but have underlying factors that put them *on alert* of possibly becoming problem projects in the future^{4/}. The number and commitments of alert projects increased slightly from 2000 to 2001, and like problem projects, they were concentrated in social sector projects in terms of numbers and commitments. Over half of the commitments of alert status projects was tied up in Group A countries. They were also prevalent in the infrastructure and MOS sectors, signaling the need for Management to focus attention on country and sector (even sub-sector) levels in order to achieve improvements. With respect to multi-year projects, the analysis indicated that these were mainly located in Argentina, Colombia, Costa Rica, Guyana and Nicaragua.

Given the status of the portfolio, the question arises as to the key issues impacting portfolio performance in 2001. Some relate to broader factors; others are more project related. Factors—beyond the project level—included worsening macroeconomic and fiscal environments, coupled with elections and shifts in governments in many countries, often resulting in changes in national priorities. In 2001, new approvals exceeded disbursements, which declined for a second year as Borrowers faced restrictions in counterpart resources needed to execute investment projects. At the project level, these issues were reflected in implementation delays, and the re-dimensioning or cancellation of projects commensurate with the changing dynamics. As a result of these factors and the normal completion of other projects, as of December 31, 2001, the Bank's active portfolio was 8% smaller in terms of volume compared to the previous year, even though the number of projects remained nearly at 2000 levels.

Furthermore, weaknesses in overall country legal and regulatory frameworks affected the timely passage of reforms in various sectors and specific project timetables. These bottlenecks were particularly significant, given the sector breakdown of the Bank's portfolio, which is concentrated in the social, MOS and infrastructure sectors, sectors that often require adjustments in policy and sectoral environments. Commitment values for MOS projects, for example, declined by 5%, in part resulting from measures taken by the Bank and Borrowers to cancel a number of MOS policy-based loans experiencing poor project performance. Management's Portfolio Improvement Action Plan outlines specific areas to tackle some of the problems identified in this area.

In 2001, institutional capacity limitations at the national level continued to be a major bottleneck to achieving and maintaining portfolio quality. In some countries, the lack of a career civil service, systemic governance problems, and high levels of staff turnover at various levels of the public sector, exacerbated by changes in government were noted as key factors affecting absorptive capacity and project implementation.

Unevenness of monitoring and evaluation frameworks, and results-based performance systems at the national, and provincial levels also constrained the Borrower's capacity to manage, measure

^{4/} Alert Status projects are comprised of 3 groups: unsatisfactory projects that are not problematic; non-problem projects with low assumptions ratings, and normal projects that have 2 or more complementary indicators such as low levels of disbursements, delays in contract ratification, or extensions of last disbursement dates. Of note is *that projects placed on alert status may not necessarily become problem projects; rather, they have a greater than average propensity to become problematic in the future, if pro-active measures are not taken to address execution issues in a timely manner* (see Appendices 7 and 7B).

and monitor outcomes, which was also mirrored at the project level. For example, project performance reports indicated that in 2001, 21% of Borrowers were not maintaining adequate information on project performance indicators. Problems with reliable data collection are issues to be addressed both by the Borrower and the Bank. In terms of the Bank, greater effort is required up front to adequately assess current systems operating at the national and project level, and to render support for the establishment of verifiable baseline data and performance metrics, as well as to boost its own quality assurance efforts on the monitoring front.

The 2001 portfolio analysis also shows how institutional weaknesses at the national level are linked to varying degrees of capabilities at the level of executing agencies. Noted were shortcomings in technical and project management expertise, as well as inter-agency coordination and some degree of institutional overload, particularly in countries with incipient institutional development and large numbers of lenders and donors. Insufficient budgetary allocations to executing agencies along with institutional bottlenecks affected the length of time for a loan contract to reach effectiveness, the project to achieve eligibility for first disbursement, and the entire implementation period.

On average, the time period of an IDB project from approval to eligibility is still too long (slightly over a year), in spite of a number of measures taken during 2001. In effect, the time to reach contract effectiveness in countries requiring ratification increased slightly from 2000. Tardiness in project start-up is an important factor in extending project execution periods, since catching up with the original plan is not always feasible. Other possible effects are increased lending costs for Borrowers, and delays in beneficiaries' receipt of project benefits. Management's new guidelines (approved in 2002) to tighten extensions of ratification periods and final disbursement dates are expected to help address this situation.

The report and the quality assurance reviews carried out within this exercise also point to the need for improvement in the Bank's own operational work in a number of areas. Of importance is the need to strengthen the results framework from the programming process onwards and throughout the entire project cycle, as well as the articulation of the linkages between national, sectoral and project level interventions.

Management has taken on this challenge by developing new country strategy guidelines that emphasize country level performance indicators to better measure results obtained during a specific programming period. In addition, new sector strategies in preparation will also contain sector performance indicators, which will enhance the consistency of monitoring and measuring results across lending instruments and Regional Departments. At the project level, the analysis within this ARPE has shown that improvements are also warranted in strengthening performance reporting systems and the evenness of their application; and in improving portfolio monitoring and management practices to enable corrective action and better tracking of progress towards outcomes. Both the ARPE and the Portfolio Improvement Action Plan outline specific activities to address these areas in a holistic manner.

The ARPE also indicates that certain aspects of project design need strengthening: the sharpening of project objectives (clarity of purpose); improvements in the use of the logical

framework and stakeholder analysis; more in-depth institutional analysis; realistic dimensioning and estimation of extension periods; clearer understanding of reform and implementation complexities; and greater simplification and flexibility of design, including fewer conditions prior to first disbursement. The design and implementation phases are bound together by how well the results framework is defined ex ante to enable solid project monitoring later in the cycle, and how well and how pro-actively the monitoring tools are applied by staff.

As part of the ARPE exercise, the review of the quality of performance reporting during project implementation and at the completion stage indicates that improvements have steadily occurred in identifying and addressing ongoing project difficulties, since the system was put in place. Certain aspects need to be reinforced. At the execution stage, these include: closer monitoring of assumptions and greater realism in reporting; the anticipation and management of specific portfolio problem areas before they become chronic; the improvement of monitoring instruments and the enhancement of feedback mechanisms (within the Bank and with the Borrower) to better close the loop between evaluation and new programming and design. At the project completion stage, ROS/PMP's quality review of all Project Completion Reports (PCRs) received in 2001 showed modest improvements in compliance rates and enhancements of overall quality, including Regional Departments' intensified review of CRGs at Headquarters. But the review also highlighted the need for a better focus on identifying project outcomes, key lessons learned and interactive dialogue with Executing Agencies on the project execution experience.

Within this context, Management is engaged in a significant revamping of its monitoring and project completion reporting systems which are expected to enhance the tracking of progress, and the sharing of information and ongoing dialogue with Borrowers/executing agencies on portfolio quality issues and results. In parallel, Management will also improve the performance reporting system related to private sector projects, addressing the confidentiality considerations of these operations and incorporating MDB/Evaluation Coordination Group standards for private sector project completion reports.

Key Recommendations for Improving the Quality of the Portfolio

Based on the analysis of the status of the portfolio, and the findings of this report, the following key recommendations emerge:

- Management will focus greater attention to portfolio quality enhancement in line with the key issues and priority areas for action identified in this report. Management's Portfolio Improvement Action Plan outlines the details of such actions aimed at addressing shortcomings noted, as well as quality assurance and portfolio performance enhancements. Building on key initiatives underway, and those contained in Chapters 3, 4, and 5 of the 2000 ARPE, this Plan will address priority areas such as: portfolio "hot spots"; governance and institutional weaknesses at the national and project levels; project start-up and execution delays; design issues; and shortcomings in Bank and Borrower results-based frameworks.
- As part of the increased focus on results management, Management, as requested by the Board, will put in place and track the validity of a new portfolio quality index- the *proactivity index*, developed in consultation with OVE- aimed at measuring Management's

responsiveness to addressing problem and unsatisfactory projects over a twelve month period. As described in the Plan, Management will monitor the proactivity index, establish a baseline, and review how it interacts with portfolio quality.

In addition, Management will also examine the variables associated with the development of another index –the *realism index*- to measure realism in performance reporting; assess the appropriateness of establishing targets for portfolio improvement; and explore similarities, differences and comparability in the IDB and World Bank/LAC portfolios, related to the issue of benchmarking, paying particular attention to co- and parallel-financed projects, lending modalities and portfolio composition, and performance reporting methodologies and approaches. Progress on these areas will be reported on in the next ARPE.

- IDB support to Borrowers, and the Bank's flexibility and responsiveness to client needs will remain a top priority, as the initiatives noted in the ARPE and those contained in the Portfolio Improvement Action Plan move forward to enhance design, portfolio management and evaluation systems and practices, and overall portfolio quality. Dialogue and partnership with Borrowers continues to be essential, and represents the cornerstone of efforts to achieve the goals set forth in the Bank's Institutional Strategy, and to respond to the more recent Millennium Development Goals elaborated in 2002. Parallel to strengthening its own results culture and incentive frameworks, the Bank will play a key role in promoting the dialogue on development effectiveness in the region, and in supporting specific initiatives of borrowing member countries. Given the importance of this topic, the IDB will also need to coordinate with other MDBs, bilateral and regional institutions working on these issues.