

**REPORT TO THE BOARD FROM THE
BUDGET COMMITTEE
AND THE
COMMITTEE ON DEVELOPMENT EFFECTIVENESS**

Shifts and Trade-Offs to Fund Plans and Priorities

(Meeting of January 8, 2007)

Informal Board Meeting: Tuesday, January 16, 2007

1. A joint meeting of the Budget Committee and the Committee on Development Effectiveness discussed management's paper on *Shifts and Trade-Offs to Fund Plans and Priorities* (SecM2006-0531). An Informal Board Meeting was scheduled for January 16, 2007.
2. **Conclusions and Next Steps.** The committees welcomed the opportunity provided by the discussion and also commended staff for their effort in putting forward this paper. Nevertheless, many members pointed out that the content of the paper did not meet their expectations in properly setting forth the strategic context for the second stage of the budget cycle. They were not satisfied by the listing and categorization of priorities in the paper. In this regard, they noted an absence of any criteria for determining strategic priorities, a medium-term (5-10 year) framework to assess choices or expected results, and of a methodology to link trade-offs with their budgetary implications. In this regard, speakers appreciated the note prepared by IEG, which pointed to ways the Bank could maximize development impact. Relatedly, speakers questioned or even disagreed with the notion of competitive advantage suggesting that comparative advantage or core competences were preferable concepts for formulating the World Bank's corporate strategy.
3. Some speakers noted and expressed their appreciation for some new and very useful information disclosed to the Board for the first time, especially the redeployment of 15% of the Bank's resources over the next three years. This could be a powerful positive signal for external as well as internal audiences but it was also a delicate matter with serious implications for staff morale. Accordingly, it was very important to have a credible and careful deliberative process.
4. In the absence of an adequately articulated strategic framework, speakers found it difficult to understand or assess budgetary implications. Some requested further information (a paper) to complete the second stage of the budget cycle while others felt a "real strategy" paper was needed before the MTSF and certainly before the start of IDA 15 negotiations.
5. With regard to specific budgeting aspects including the questions listed in the Chairpersons' Issues Note, members sought more information on a number of topics including: flat budget prospects; productivity tax; implications of further decentralization; impact of organizational changes; effect of realizing greater synergies with IFC and MIGA; greater boldness with priority initiatives such as the Africa Action Plan; deployment of the contingencies states of the SPCs which had been presented as a resource allocation mechanism in June; consistency of cuts with the Bank's actual cost drivers including travel costs, consultants, etc.
6. The Chairman concluded with respect to the next steps that the Board would be required via the Green Sheet to consider two options: delay the next phase of the budget process until the paper is redone, or try to reduce the information gap by the time of the MTSF.

7. The main topics discussed were as follows:

8. **Articulation of Strategy.** A number of speakers felt that the paper simply provided a list of priority items without articulating criteria (other than immediate vs. long-term budget impact) or a rationale for their selection. In addition, speakers felt management had not outlined a “vision” for the Bank linked to both a medium- and long-term outlook as well as negotiation of IDA 15 replenishment. Management clarified that the current paper built on the paper discussed at an Informal Meeting of the Board in October¹ at which the key priorities that had emerged from the Annual Meetings were broadly agreed. Management stated that the broad strategic direction of the Bank remains unchanged. Members also voiced concern that the paper sent a different message from the one presented in October, which may be confusing: specifically, the earlier paper had not viewed “other activities to be scaled-up” as being of secondary importance. Management explained that there had been no intent to establish a hierarchy among the priorities: the intended distinction was that the other activities to be scaled-up would have no or minimal impact on the FY07 budget.

9. Some discussion followed, centering on the view that existing and emerging priorities should be clarified well before the budget discussion in June to avoid the budget document becoming a “fait accompli”. Speakers stressed the need for priorities to be consistent with a results agenda and inquired at which stage the Board could influence the final outcome. Management explained that, in November, the VPUs had reached a consensus that resources would need to be shifted to priority areas in the approximate total amount of \$150-225 million over the next three years. Management is developing a framework to accomplish this objective: as an initial step, each VPU has been asked for a submission detailing activities it can undertake to support priorities. The framework also contemplates achieving increased cost efficiencies by line item cuts and the imposition of a differentiated productivity tax (reflecting performance); by better balancing corporate support units and operational activities; and by redeploying resources from activities that are not yielding comparable development impact. In this regard, management noted the additional task of defining what it is the Bank wants to do less of. Management also noted that some principles are being kept in mind, namely that there are limits to the amount that a line item can be cut, and reasonable time periods need to be allotted for VPUs to make shifts or even to downsize. Management stated that additional detail regarding progress under the framework will be provided in the MTSF and budget papers: however, the work required to get full detail on the redeployments over the coming three years will likely extend into the coming fiscal year.

10. **Link to Budget.** A number of speakers felt that, while the paper represented a positive step in process terms, it fell short of its objective to establish a link between strategic priorities and budget allocation, particularly for FY07 and FY08. In particular, the absence of a coherent outline of implications and tradeoffs was noted. Speakers expressed the view that tradeoff decisions should be made at the time the budget is formulated, and not while it is being implemented. In this regard, a few speakers felt the paper was a “lost opportunity”. Others were of the view that it was simply not possible to meaningfully discuss the budget without a goal-oriented strategy. Nevertheless, members noted that the document had provided some useful information regarding how budget decisions are reached, and how programs might be adjusted. A member also reminded that setting strategic priorities is not the responsibility of the Finance Complex but of top management as a whole. Some members noted the paper’s statements that increased budget did not signal greater development effectiveness.

11. Management stated that this year it was not “business as usual” – namely, the process was much more complicated than simply imposing an across-the-board uniform productivity tax of 2%. Had that been the case, then it might have been possible to present much more detail on the link between strategic

¹ *Key Priorities: Taking Stock after the Annual Meetings (SecM2006-0435)*. The current paper is a mid-point between the post Annual Meetings stocktaking and the Medium-Term Strategy and Finance Paper (February-March 2007).

priorities and the budget. Management underscored that the process being undertaken is difficult since the scale of the shifts requires a more thorough analysis of the implications (including HR). Even after the VPUs have made their submissions, a number of assessments enter into the picture, including issues of comparative advantage, development impact, past performance and future monitoring. Management stressed that decisions of this nature must be grounded in consensus and the analytics supporting them of the highest professional quality – otherwise the entire process will lose credibility.

12. **Board/Management Engagement on Strategy.** Speakers expressed the strong sentiment that the second phase of the Board/management engagement on strategy had not been completed. They requested more information (perhaps in the form of an additional paper) or an opportunity for further dialogue be provided before the MTSF. A member suggested that perhaps another vehicle for delivering and discussing such information might be considered.

13. While management appeared to understand the frustration expressed by some members, it stated that even in March of this year, it may not have information rising to a level that would satisfy their expectations. The reason is that the process is complex and difficult: while it may be possible by March to know with a greater degree of specificity the amount of a certain line item, information on detailed programs will take longer to obtain.

14. **Competitive vs. Comparative Advantage.** A number of speakers questioned or disagreed with the notion of “competitive advantage” as a guiding principle for setting priorities; in their opinion “comparative advantage” or “core competences” would have provided a more relevant framework to enable clearer choices of priority activities and operational objectives. Management clarified that its intent was to target areas where the Bank can differentiate itself from other players in the aid arena – *i.e.* where the Bank can bring something to the poverty alleviation table that some of its competitors cannot.

15. **Staff Morale.** Management shared to the large extent the concern of a number of speakers that changes in budget allocations could have a negative impact on staff morale. It agreed that having a clear sense of direction combined with a reallocation of resources toward priority areas could help reinvigorate those areas with the full support of staff. Management listened to suggestions from speakers that it articulate suitable “mitigation” strategies in this regard, increase transparency and refine communication strategies.

16. **IEG.** Several members felt that the Statement by the Director-General, Operations (DGC) was helpful, thought-provoking, and a source of valuable guidance for ways to increase development impact.

17. **Zero Real Increase Assumption.** A speaker sought clarity regarding the assumptions behind the continuation of a zero real growth budget, while a member wondered if this still made sense in light of the Bank’s expanding mandate. Management noted that the President had reaffirmed his commitment to a flat budget, and suggested that this issue might be most appropriately taken up by the Board as a whole.

18. **Redeployments.** Members would have liked the paper to have presented more estimates for redeployments and efficiency gains – particularly the expected impact of the approx. 5 % annual redeployment in the next three years. The question was asked whether they were consistent with the Bank’s main cost drivers. Speakers felt it was important for management to provide estimates of cost pressures. Management responded that the cost savings were indeed consistent with cost drivers, such as information technology, travel, and the use of consultants.

19. **Organizational Changes/Decentralization.** More information was sought on the cost and effect of organizational changes, network mergers, and increased decentralization on the budget. One speaker sought additional information on how the creation by merger of the Financial and Private Sector

Development network would affect resources devoted to the Bank's strategy for work in the financial sector. Management noted that the network mergers had intended to be budget neutral.

20. **2% Productivity "tax".** One member expressed the view that the productivity "tax" was not sustainable in the long term, while another noted that in comparable governmental organizations, productivity "taxes" had been successfully sustained for much longer than they had been applied so far in the World Bank. Others speakers questioned how the proposed differentiated tax would work in practice. In response, management explained that the productivity "tax", in the context of "resizing" and as applied to individual VPUs, is intended to be reasonable, reflect the VPU's performance, and also reflect efforts that the VPU has undertaken to reduce its expenses. Management clarified that the productivity tax exercise is different from the "allocation to priority areas" one: in short, even if a unit is in a priority area and receives more budget, it will not be automatically exempted from the productivity tax. Because a number of factors enter into the process, management believes that it may be unable even in March to commit to the exact amount of the productivity savings.

21. **Contingency Funds.** A member asked where the requests for deploying contingency funds came from and how they would be met. Another member suggested that guidelines be established for their use. Management noted that the mechanism for discussing that with the Board is the quarterly discussion: presently the recommendation is to allocate approximately \$19 million out of \$34 million. Requests are carefully reviewed and then approved by the CFO, the Managing Directors, and the President.

22. **Efficiency Gains.** Questions were asked whether additional efficiency gains could be achieved particularly by greater simplification in lending, as well as the extent to which they could be used as additional resources. A member cautioned that efficiency gains alone cannot fund long term priorities. It was also noted that some savings (travel) were independent of the priority setting.

23. **Corporate Services/Line Items.** A member suggested that corporate services be benchmarked where appropriate. It was also suggested that further synergies with other WBG institutions be explored, including consolidation of back office functions. Management noted generally that the issue of WBG synergies was being examined by the WBG CFO, and was expected to move forward once IFC had formally installed its new VP for Finance and Risk Management. A speaker felt that it was important to look at the nature of expenditures (*e.g.* communications), independently from the way in which they were reported by VPUs.

24. **Strategic Performance Contracts.** A speaker asked about the status of the SPCs. It was also noted that the paper did not discuss the budget reform initiative. Management responded that the work on the SPCs is ongoing to simplify them and make them more useful for Unit managers.

25. **Africa/Fragile States.** Some members sought more specific information on the Bank's strategy in Africa. Others noted the need to look at integrated and complex issues (*e.g.* fragile states, LICUS) or global public goods (clean energy). Reflecting on Africa's top priority status, a speaker wondered why IDA lending in the first half of FY07 was lower than in the same period in FY06.

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