

POLICY-BASED LENDING IN SUPPORT OF REFORMS AND STRUCTURAL TRANSFORMATION IN DEVELOPING COUNTRIES

JOANNE ASQUITH, SHAHROKH FARDOUST, MARK SUNDBERG (Eds.)

Lessons Learned from
Independent Evaluations of
Lending Operations by Selected
Multilateral Development Banks
and the European Union

2005–2019

**Policy-Based Lending in Support of Reforms and Structural
Transformation in Developing Countries**

*Lessons Learned from Independent Evaluations of Lending Operations by Selected
Multilateral Development Banks and the European Union, 2005–2019*

Edited by

Joanne Asquith, Shahrokh Fardoust, Mark Sundberg

Evaluation Cooperation Group

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ISBN number 978-1-3999-7342-7

ATTRIBUTION Please cite the report as: Joanne Asquith, Shahrokh Fardoust, and Mark Sundberg (Eds.). Evaluation Cooperation Group 2023. Policy-Based Lending in Support of Reforms and Structural Transformation in Developing Countries --Lessons Learned from Independent Evaluations of Lending Operations by Selected Multilateral Development Banks and the European Union, 2005–2019. Website <https://www.ecgnet.org/pbl-book>

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Edited by Joanne Asquith, Shahrokh Fardoust, and Mark Sundberg. Published by the Evaluation Cooperation Group.

Evaluation Cooperation Group

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Foreword

Multiple threats emanating from financial instability, the COVID-19 pandemic, and geopolitical uncertainty are undermining the global economy and the prospects for developing countries, pushing the Sustainable Development Goals further out of reach for many countries. Growth in advanced and developing economies is plunging, inflation has reached its highest level in decades, and rising interest rates in advanced economies have triggered massive capital outflows from developing countries, deepening the debt crisis. Falling real per capita incomes have severely set back efforts to end extreme poverty. To arrest the downward slide and prevent further hardship developing countries, particularly the most vulnerable among them, will need a sharp increase in the level of financial and technical support. Currently, though, the development system is not mobilizing financing at scale or channeling funding to the countries and sectors that need it most.

These challenges have led to calls for a new vision for international financial institutions (IFIs) to expand their capital base and ramp up emergency financing. At the 2022 Annual Meetings of the International Monetary Fund and World Bank Group, the Group of 7, Group of 20, Group of 24, and the United States Treasury Secretary called for bolder, more innovative steps to mobilize finances and support economic resilience in the face of multiple ongoing threats. Given the urgency and scale of financial need, many have called for *rapidly disbursing emergency and programmatic support* to stanch the fiscal crisis and reinforce resilience, in other words, for budget support to help build resilience and to advance key institutional and policy reforms.

This volume on policy-based finance (PBF), also known as budget support, is therefore timely and has grown in importance since the 2020 conference on which the work is based. The conference, organized by the Asian Development Bank, brought together the evaluation agencies of six major IFIs to examine evidence on the design and implementation of PBF over the past decade. For the first time the independent evaluation departments of the Asian Development Bank, the African Development Bank, the European Union, the Inter-American Development Bank, and the Caribbean Investment Bank met to discuss evidence on the design, use, and performance of their PBF instruments based on their evaluations.

This volume also illuminates the difficulty of evaluating the development effectiveness of PBF and the challenges evaluators face in attributing outcomes to the use of this instrument, given the fungibility of its financing and the difficulty of constructing a counterfactual. In this context, again for the first time, the volume distinguishes the methodological approaches to measuring PBF performance and the characteristic strengths and weaknesses of each. The agencies vary in their focus and depth of analysis in evaluating PBF, recognizing there is more work to be done, particularly in those institutions that have not yet undertaken a comprehensive evaluation of their PBF instruments.

The evaluations covered by the volume revealed important aspects of PBF that governments, policy makers, and development agencies should bear in mind when considering the future uses of PBF and whether limitations still need to be placed on their total portfolio shares. First, it is notable that all the IFIs saw a surge in demand and use of PBF during the economic crises of the past decade. They have proven to be an effective instrument for rapid delivery of financial

support during emergencies, when project assistance is slow and tied to laborious procurement rules. Second, evidence based on evaluation agency ratings suggests that the performance of PBF on objectives equals or even exceeds that of conventional project aid, although the depth of reform measures and their durability require more scrutiny. Third, the evaluations reveal the multifaceted nature of the instrument, which IFIs have tailored in to fit the range of economic circumstances confronting developing countries. Apart from the crisis finance PBF that most IFIs provide, the instrument can also be configured for longer-term programmatic reform, as policy-based guarantees that leverage private financing for countries that have difficulty accessing private credit markets, as insurance options to draw down during emergencies, or for sector support targeting special development programs. Disbursement rules also differ across the IFIs, and in the design and use of prior actions (conditionality), design elements that call for deeper evaluation. The instrument has evolved in different directions and will continue to do so as new needs arise, highlighting its flexibility.

This volume offers rich evidence on the contribution of PBF to development finance and to the support for national programs of reform. It also leaves unanswered questions that development practitioners would find valuable to explore further. How can the design of conditions governing PBF most effectively sustain progress and support incentives toward transformative reform? What innovative uses of guarantees and blended finance can leverage long-term private capital for development needs? How can PBF best be used to foster global and regional public goods to tackle the urgent challenges of climate change, contain future pandemics, or arrest global financial contagion following major shocks. Experience with PBF will surely continue to expand, offering more and different experience to fuel future evaluation and refine our understanding of the instrument.

Emmanuel Jimenez

Marvin Taylor-Dormond

November 2022

Acknowledgments

This volume is the result of a shared vision by the three editors, Joanne Asquith, Shahrokh Fardoust, and Mark Sundberg, and the Director General of the Asian Development Bank's Independent Evaluation Department, Marvin Taylor-Dormond, to gather evaluative evidence on the important but often poorly understood and under-evaluated policy-based lending development finance instrument used by many development institutions. We are grateful to the several senior evaluators in the independent evaluation departments of the Asian Development Bank, the African Development Bank (AsDB), the Caribbean Development Bank, the Europe Commission, the Inter-American Development Bank, and the World Bank who worked to bring to the evidence from each of their institutions together. We are also grateful to Dr. Emmanuel Jimenez, the current Director-General of Evaluation at the Asian Development Bank, who has supported work bringing the volume to closure.

The comparative work was initiated at a virtual conference in November 2020, organized by the Asian Development Bank (IED), which brought together for the first time the independent evaluation department of the above mentioned six major multilateral development financial institutions to examine evidence on the design and implementation, use and performance of their of policy- based budget support financing instruments over the preceding decade.

An important contribution to the volume has been made by six experts in development economics who were invited to prepare and shared their comments on each chapter: Shanta Devarajan, Alan Gelb, Cheryl Gray, Homi Kharas, Ali Khadr, and Augusto de la Torre. We are very grateful for their expert contributions.

Many Asian Development Bank staff in the Independent Evaluation Department contributed valuable time to this effort. We would like to thank in particular Saleha Waseem, Yurendra Basnett, and Sergio Villena for their help and suggestions at various stages of the project. The team is also grateful to Al Dingwall, ADB Publication Department, and William Hurlbut for their highly professional editorial support.

Finally, we would like to thank ASSYST International Pvt. Ltd. for their hard work in preparing the digital version of the volume in a highly professional and timely manner.

Joanne Asquith, Shahrokh Fardoust, Mark Sundberg,
September, 2023

Abbreviations

AfDB	African Development Bank
ADB	Asian Development Bank
BMCs	Borrowing member countries
CARTAC	Caribbean Regional Technical Assistance Centre
CDB	Caribbean Development Bank
CDF	Comprehensive Development Framework (World Bank)
CERDI	Research Center on International Development, University of Clermont Ferrand.
CPIA	Country Policy and Institutional Assessment by the World Bank. It rates countries against a set of 16 criteria grouped in four clusters: (i) economic management; (ii) structural policies; (iii) policies for social inclusion and equity; and (iv) public sector management and institution.

DAC	Development Assistance Committee—of the Organization for Economic Co-operation and Development (OECD).
DDO	Deferred drawdown option: a budget support operation with a contingent credit line that allows the borrower to rapidly meet its financing requirements following a shortfall in resources caused by adverse economic events..
DFID	The UK’s former Department for International Development.
DPF	Development policy financing
DPO	Development Policy Operation
DRM	Domestic resource mobilization
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EIB	European Investment Bank
EU	The European Union
EU MFA	The European Union provides macro financial assistance by disbursing directly to treasury with some structural reforms.
FCV	Fragility, conflict, and violence

FDI	Foreign direct investment
GDP	Gross domestic product
GEF	The Global Environment Facility
GNI	Gross national income
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IDB	Inter-American Development Bank
IED	Independent Evaluation Department, Asian Development Bank
IEG	Independent Evaluation Group, World Bank Group
IFIs	International Financial Institutions
IMF	International Monetary Fund
LICs	Low-income countries
MCC	Millennium Challenge Corporation
MDB	Multilateral development banks
MDGs	Millennium Development Goals
MfDR	Management for development results
MICs	Middle-income countries

MIGA	Multilateral Investment Guarantee Agency
ODA	Official Development Assistance
OECD-DAC	Organization for Economic Co- operation and Development/Development Assistance Committee
OIE	Office of Independent Evaluation, Caribbean Development Bank
OVE	The IDB's Office of Evaluation and Oversight
PBC	Performance based conditionality
PBF	Policy based finance
PBG	Policy based guarantee
PBL	Policy based lending
PBO	Policy based operations
PBPs	Programmatic policy-based loans
PEFA	Public Expenditure and Financial Accountability
PFM	Public financial management
PforR or P4R	Program for Results. Disbursement of funds to the Treasury that is conditioned on achieving targets of key indicators in a results framework rather than policy reform.

PRSC	Poverty Reduction Support Credit (World Bank)
SALs	Structural Adjustment Loans
SDGs	Sustainable Development Goals
SECALs	Sector Adjustment Loans
SMART	Specific, measurable, achievable, relevant, and time-bound
UNCTAD	United Nations Conference on Trade and Development

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Overview and Summary

Joanne Asquith, Shahrokh Fardoust, Mark Sundberg

This volume is the first global collection of evaluative material and key conclusions on policy-based operations (PBOs), also known as budget support, by international financial institutions over the past decade. It is based on conference papers, a workshop, and commentary organized by the Independent Evaluation Department of the Asian Development Bank. The aim is to assess the role and efficacy of PBOs based on existing independent evaluations published during 2014–19. Five evaluations were conducted by multilateral development banks (MDBs) and one by the European Union (EU).¹ Together these organizations account for about 85 percent of budget support operations globally. An assessment of this work is overdue, given the importance and, many would argue, increased need for budget support.

The motivation for this work is that while budget support is an important instrument of international development support, it is not well understood and is difficult to evaluate, and therefore has not been thoroughly evaluated.² Each of the six development finance agencies represented here provides PBOs to developing countries, totaling about \$400 billion in real terms between 2006 and 2021.³ This is small relative to total net private equity inflows in developing countries (about \$8 trillion) during the same period, but it has been a major source of financing for many developing countries. PBOs are a key instrument for the development agencies, especially during crisis years, including throughout the COVID-19 pandemic. Yet evaluative findings have been relatively scarce and, for some agencies, decades have passed without a systematic evaluation of PBO lending instruments. This volume aims to help address this glaring gap in understanding the contribution, performance, lessons, and challenges of providing and evaluating budget support to low-income countries (LICs) through consultation and dialogue on the key reforms required to boost growth and avoid crises.

Budget support has the potential to advance achievement of the Sustainable Development Goals (SDGs) and, some argue, it is the right instrument, efficiently providing support and emphasizing country ownership with reforms based on shared analysis and dialogue. But it is deployed at far too limited a scale.⁴ In Asia or Sub-Saharan Africa, for example, transition toward green and

¹ The participating MDBs' independent evaluation departments are the Independent Development Evaluation (IDEV) at the African Development Bank (AfDB), the Independent Evaluation Department (IED) at the Asian Development Bank (ADB), the Office of Independent Evaluation (OIE) at the Caribbean Development Bank (CDG), the Office of Evaluation and Oversight (OVE) at the Inter-American Development Bank (IDB), and the Independent Evaluation Group (IEG) at the World Bank Group.

² PBF and PBO are being used as generic terms throughout this volume while recognizing that different organizations use different terms and acronyms for their budget support instruments. For example, the World Bank uses the terms development policy finance (DPF) and development policy operations (DPOs), while most other MDBs use the terms policy-based finance (PBF) and policy-based operations (PBOs), as well as the term “budget support.”

³ On commitment basis and in 2019 US dollars.

⁴ In 2015, the Sustainable Development Goals replaced the Millennium Development Goals. These 17 ambitious goals provide a more comprehensive vision as well as a framework for ramping up financial support and global action. Before the COVID-19 pandemic, the \$2.5 trillion annual SDG financing gap corresponded to about \$500

inclusive economies will require a major effort, but the MDBs lack the mandate and resources to play a transformative role. MDBs can use PBOs in parallel with project finance to advance investments in sustainable infrastructure, environmental conservation, digital transformation, human capital formation, and social assistance.⁵ A word of caution is advisable, however: scaling up PBOs will face the issue of debt distress and the need to generate preferred creditor loans for countries that may have difficulty accessing private capital markets.

Demand for budget support typically surges during global economic crises, from both middle- and lower-income countries. The support aims to help countries facing sudden fiscal crisis, often to help sustain critical social spending and to meet recurrent fiscal requirements. The second main source of demand is during noncrisis times, principally from LICs pursuing medium-term reform programs, or fragile and post-conflict countries under fiscal stress and searching for economic and institutional stability. Each MDB has developed multiple types of PBOs to address different country circumstances.

Budget support is much debated as a tool for development finance. Unlike conventional project assistance, which leaves a physical asset in place, PBOs go into the government treasury to finance recurrent or capital expenditures. It is not separate or distinct from other fiscal resources. Some view this as critical to country ownership and the foundation for effective policy dialogue and technical assistance. Others view it as risky and potentially wasteful. This volume aims to shed light on these issues and anticipate future challenges.

While there are several reasons to expect that PBOs will remain a critical tool of development support, much can be learned from policy-based financing (PBF) that has not met its objectives or has had unsatisfactory results. Lack of country ownership, excessive conditionality, weak technical capacity on the recipient side, insufficient or poor policy dialogue, and inadequate or delayed technical assistance are among the common factors that account for the bulk of the 20 to 40 percent less-than-satisfactory development outcome ratings of PBOs whose evaluations, along with examples of success and failure, are reported in this volume. The evaluations reflect areas of concern and recommendations for future improvement as agencies look toward strengthening deployment of scarce public capital to improve development outcomes, including opportunities to leverage private capital for development purposes.

One conclusion of these evaluations is that, despite the main findings reported here, robust evidence on *attribution* of PBF impact remains elusive, posing a challenge to measures for strengthening evaluation methodology. The relative merits of the two principal evaluation methodologies used by the international development agencies are debated, but there is

billion for low-income countries and \$2 trillion for other developing countries (15 percent and 4 percent of GDP of additional spending per year, respectively). The magnitude of the investments needed made it clear that official development assistance alone, at less than \$200 billion a year, is insufficient and that domestic resources and private sector flows are needed to expand the pool of financial resources available to developing countries. New estimates that reflect the COVID-19 pandemic suggest that the gap has increased to \$3.7 billion, because of shortfalls in private finance (foreign direct investment, portfolio flows, and others); export revenues (including from international tourism); and domestic tax revenues, as well as the emergency public spending response to the pandemic.

⁵ The G-20 Eminent Persons Group recommended piloting country platforms to coordinate national and sectoral investment programs among various financial institutions (including long-term domestic investors, such as national development banks and insurance and pension funds).

concurrence that PBF evaluation is difficult and further methodological refinement is needed, preferably through collaborative efforts.

This overview is in two parts: the first part sets the context and role of budget support against the landscape of evolving global finance, while summarizing the main cross-cutting messages of the volume. The second part summarizes each of the agency papers prepared for the volume, alongside the invited commentaries from prominent development economists.

Part I: Motivation, Context, and Main Findings

The international aid architecture has undergone major changes, especially since the global financial crisis of 2008–09.⁶ Fragmentation of development cooperation aid; periodic regional and global financial crises; and the massive shocks caused by natural disasters, climate change, and pandemics are affecting the mix of policy instruments and development strategies taking an increasing share of limited resources.

Over the past two decades capital markets have become more integrated and the dominance of private financial flows has grown, particularly non-debt-creating inflows. Private capital flows (such as export receipts, foreign direct investment, portfolio equity investment, bank loans, bond issuance, and personal remittances) have become increasingly important financing sources. But bilateral and multilateral official development finance has also been critical for low- and lower-middle-income countries, supporting key economic and social development needs. While declining as a share of total financial flows, official development finance has been important in periods of financial crisis, when the countercyclical character of PBOs has been an important source of support as private financing suddenly dried up.

The six evaluation reports cover a tumultuous period in the global economy, including the food and fuel crisis (2006–07), the global financial crisis (2008–09), and the collapse of commodity prices (2014–15), and briefly discuss the initial response to the COVID-19 pandemic. These back-to-back crises, which buffeted economic growth and increased fiscal and balance of payments pressures in developing countries, have created significantly greater demand for countercyclical financial support from MDBs than in the preceding decade.

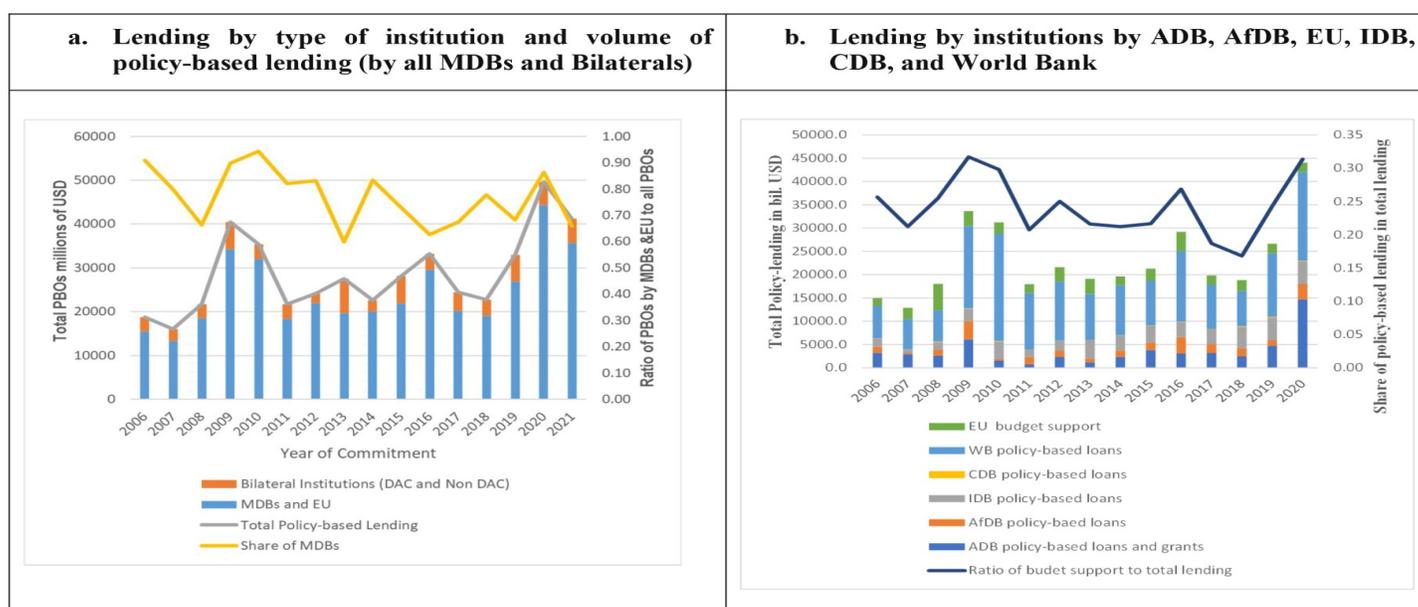
The countercyclical role of MDB financing distinguishes it from private financial flows. Private financial, equity, and debt-related flows to developing countries exceed foreign aid and official lending by a substantial margin. Foreign direct investment and worker remittances are important in many developing countries. However, most of these inflows steeply decline in crisis years. Unlike private flows, official flows, particularly budget support, have been countercyclical—they are ramped up when other sources of finance decline. Both the volume of PBOs and their share in total lending (including project lending) has increased sharply during and right after crises (in 2008–10, 2015–16, 2020–21), approaching 30 percent of MDB total lending and for some agencies exceeding it. Budget support commitments by MDBs during crises show their important countercyclical nature, rising to \$30–\$45 billion a year (Figure 1, Panel b).

⁶ World Bank. 2021. *A Changing Landscape: Trends in Official Financial Flows and the Aid Architecture*. Development Finance Vice Presidency, Washington DC. <https://thedocs.worldbank.org/en/doc/9eb18daf0e574a0f106a6c74d7a1439e-0060012021/original/A-Changing-Landscape-Trends-in-Official-Financial-Flows-and-the-Aid-Architecture-November-2021.pdf>.

Despite the explosion of private capital flows since the early 2000s, both PBOs by official institutions and public-private partnership financing remain large and important. The prolonged aftereffects of the COVID-19 pandemic, the need to respond to climate change and step up financing for the SDGs suggests that the demand for PBF is likely to remain high over the medium-term future.

The next section summarizes the main findings and cross-cutting issues that emerge from the evaluations. In most cases evaluated, PBOs were designed to help provide an enabling policy environment by promoting core public sector reforms and stable macroeconomic conditions, to allow implementation of investment projects. They aimed to help with implementation of needed public sector reforms and enable high-priority sectoral investments. Successful implementation of PBOs and investment projects has often been associated with improved growth performance and greater resilience to future shocks. However, what component of these outcomes can be attributed to PBOs is difficult to determine given the wide range of factors that contribute to improved growth performance in each country.

Figure 1: Policy-Based Lending Increases During Crisis Years



Notes: ADB = AfDB = African Development Bank, Asian Development Bank, CDB = Caribbean Development Bank, DAC = Development Assistance Committee of the OECD, EU = European Union, IDB = Inter-American Development Bank, MDB = multilateral development bank, PBO = policy-based operation, WB = World Bank
Source: Authors, based on the datasets on PBOs provided by participating institutions and OECD-DAC statistics.

Major Findings and Emerging Issues

PBOs have two main purposes: to disburse loans quickly to meet development finance needs in both crisis and noncrisis years, and to support policy reform efforts that strengthen public services and crowd in private investment. Complex reforms usually include support through

conditional policy adjustments by government to address development constraints, analytical work, technical assistance, and policy dialogue in coordination with other donors.

The evaluations presented in this volume indicate that, while evidence is inconclusive, policy-based lending (PBL) has played an important supportive role in addressing global, regional, and country-level macroeconomic, structural, and sectoral challenges since the early 2000s. The instrument has helped to support efforts by low- and middle-income countries to sustain public service delivery, respond to the pandemic, and reduce the poverty impact of crises.

Over the period covered, the evaluative evidence reveals that budget support was generally effective. Although PBL performance has varied across recipients and providers of budget support, it has improved over time thanks to changes in operational design and policy dialogue and increased country ownership of reforms.⁷ On balance, the evidence points to an increasingly important role for PBOs in providing financing for development during crises. There is also evidence that programmatic PBOs are advancing policy reforms and institutional capacity building.

The evaluations indicate these necessary ingredients for effective PBL:

- Active policy dialogue based on strong analytics
- Country ownership of reforms
- A robust learning agenda and high-quality and relevant technical assistance
- Agility by development institutions in response to changing circumstances and shocks
- A common framework for private and public sector collaboration and coordination.

The evaluation results and commentaries by experts yield ideas that can help enhance the relevance and development effectiveness of PBL as developing countries strive to meet the development challenges of the 21st century. Several common lessons and findings are summarized below.

i. Across MDBs, PBOs are associated with positive outcomes, particularly with programmatic support. However, attribution of progress to the instrument is not straightforward.⁸

Most MDBs have shifted to using prior actions in their budget support operations.⁹ In programmatic PBOs, policy conditions provide key programmatic steps and need to evolve to reflect changing circumstances, while policy actions are undertaken before loan approval, in which case and under the programmatic approach, PBL can be considered successful on approval of each tranche release.¹⁰

⁷ For example, evaluation of PBOs at ADB indicates that the performance of PBL supporting public sector reforms markedly increased over the evaluation period, with the success rate rising from 37 percent in 1999–2007 to 88 percent in 2008–17. Other MDBs reported either continuation of favorable outcomes or improvements.

⁸ The European Union does not rate its PBOs. It does report positive results based on the three-step methodology it uses to assess the effectiveness of its operations. See chapter 3 and the annex on methodology in this volume.

⁹ Prior actions are policy and institutional actions deemed critical to achieving the objectives of a program supported by the PBO. These present the legal terms defined in the financing agreement. These conditions must be met prior to the presentation of the loan, credit, or grant to the board of directors for approval.

¹⁰ The European Union mixes guaranteed and performance-based instruments. Under its approach, countries bear more risk than they do in the MDB approach, which disburses funds once prior actions are fulfilled. In his

According to independently validated project completion reports, performance by MDBs, particularly the Asian Development Bank (ADB) and the World Bank, improved over time. ADB's evaluations indicate that the performance of PBLs improved sharply over the evaluation period. From a low of 37 percent in 1999–2007, ADB's PBO performance climbed to 88 percent in 2008–17. This change coincided with greater use of programmatic PBL. Similarly, the World Bank's Independent Evaluation Group (IEG) evaluated 484 operations that closed between FY11 and FY21. Seventy-four percent of the operations (82 percent of commitment amount) were rated satisfactory (moderate or higher). The positive results may reflect the fact that reforms are increasingly taken as prior actions, that is, before loan approval. If the outcome indicators are achieved, and the quality of policy actions at completion is not assessed, it can be difficult for the evaluator to call a PBO less than successful even if the prior actions on their own were not strong enough to achieve the expected outcome (IDB). Hence, some MDB evaluation methods are now giving greater weight to the quality of PBO design, including the criticality and depth of prior actions.

ii. Policy reform should be supported through conditionality or prior actions, technical assistance, and analytical work or the transfer of knowledge.

MDBs are increasingly using prior actions in their budget support operations, while most of them have been moving away from a focus on productive sectors toward a focus on reforming public financial management (PFM) and domestic resource mobilization (DRM). Evaluation of PBOs in several MDBs and the EU indicate that, in general, technical assistance usefully complemented budget support in backing public finance reforms, including reinforcing capacities in PFM, audit, and statistics in a majority of successful cases. Where sector budget support was provided alongside general budget support, sector capacities (e.g., in health, water, and sanitation) also benefited from technical assistance. A key evaluative finding for several institutions was that good policy making must be well-informed, supported by credible, evidence-based analytical work and diagnostics. PBLs should also come with technical assistance if policy reform is to be achieved.

A key conclusion of evaluating the ADB's PBOs is that positive development outcomes are more likely if the PBL design is strong, including good-quality analytical work underpinning the reform content, strong policy actions critical to intended outcomes, good-quality technical assistance, and a clear monitoring and evaluation framework against which results can be assessed.

The evaluation of AfDB's PBOs found that technical advice and capacity support were important complementary inputs supporting PBOs. Also, in most cases supported by the EU, technical assistance was instrumental in strengthening government capacities and producing tools and systems that were important to advance the reforms. Nearly all evaluations recommended improvements to the way technical assistance needs are identified, and where relevant, this should be done jointly with other development partners. Many evaluations also recommended increased attention to strengthening local, and not just central, governance capacities. Weak

commentary on chapter 3, Shanta Devarajan suggests that both donors and recipients want money to move, so they may fudge conditions to make projects deliverable. Lenders also have the option of not fully disbursing, as ADB often did before shifting to programmatic PBL. Only when policy actions were designed to be completed before loan approval could loans be fully disbursed; otherwise, the process could take many years, causing loans to not be disbursed or to be cancelled.

implementation capacities at the local level were often a major constraint on the effectiveness of policy implementation.

iii. Policy dialogue is critical to the development effectiveness of PBOs. It must take place at a high level and across critical areas of development, including macroeconomic management, and include broader aspects of civil society.

All MDBs acknowledge the importance of policy dialogue, but they did not systematically evaluate its contribution to their portfolios or to engagement on cross-cutting issues, or its relevance for cross-conditionality with investment lending (an important aspect of PBOs that evaluations in this volume do not address in any detail). While policy dialogue is considered important, the extent to which MDBs *influenced* policy is not assessed in either self- or independent evaluation.

Institutions able to establish credible and impactful policy dialogue at the highest level of government prepared high-quality, relevant analytical work to support the policy dialogue. Among the MDBs evaluated, the World Bank (and more recently IDB) established stronger records on good-quality and relevant analytics than other MDBs.¹¹ Other MDBs draw from this work but also need to strengthen the quality and relevance of their own country-level analytical work.

Several specific country-level assessments need to be undertaken by development partners before their high-level policy dialogue with country clients. These include macroeconomic assessments that underpin the use of budget support, public expenditure and revenue assessments, business climate assessments, gender and poverty assessments, and climate change assessments. The PBO focus on policy reform requires good-quality analytical work in each of these areas, as well as technical assistance to help build technical and analytical capacity in the country client but this work could be divided among participating partners more routinely.

Good political economy analysis is also important for sound loan design. The ADB evaluation found that while PBL designs drew on available political economy analysis, such work was rarely undertaken in designing PBL operations. The political feasibility and associated risks with specific PBL-supported measures tended not to receive sufficient focus, although political economy analysis is more prevalent in the EU and the World Bank.¹²

iv. Financing for development needs to be timely, agile, available at higher levels, and distinguish between crisis finance and regular programmatic PBOs.

All six institutions report on the critical role of PBOs during crises, or in more vulnerable and fragile states. Large, quickly disbursed loans have been vital in support of social safety nets and

¹¹ See <https://www.brookings.edu/blog/future-development/2020/05/19/what-makes-the-world-bank-so-influential-its-money-or-its-ideas/>.

¹² A study by the World Bank's Independent Evaluation Group (IEG) found that while many analytical products, as well as project or program documents in the World Bank, contain political economy analysis relevant for PBOs (DPOs). Stand-alone reports on political economy analysis were "rarely commissioned for DPOs." As a result, the operations largely drew on political economy analysis on "country-level and cross-sectoral issues that are typically found in studies, such as institutional and governance reviews, country economic memoranda, poverty and social impact assessments, and public expenditure reviews." See IEG. 2016. The Role of Political Economy Analysis in Development Policy Operations, IEG Learning Product, June 28, 2016. <https://documents1.worldbank.org/curated/fr/898111481742045464/pdf/The-role-of-political-economy-analysis-in-development-policy-operations.pdf>

balance-of-payment financing requirements. The MDBs, and to a lesser extent the EU, ramped up PBO lending and credit operations to support rising financing needs of developing countries both in 2020–21 and in response to the global financial crisis in 2008–09.

Some MDBs have moved more quickly than others in response to the pandemic (as was the case during the global financial crisis of 2008–09), adjusting or recalibrating their loan conditions or focusing on health sector needs. Others have been more constrained by their emphasis on conditionality, as noted in the United Nations report on financing for development in reference to the World Bank’s initial response to the pandemic.¹³ One proposal is that MDBs should dedicate budget support without conditionality during global crisis response, as developed by ADB. Crises should not be used to push new reforms unrelated to the crisis when speed is critical, capacity is strained, and risks of weak country ownership are high.

Programmatic lending poses different challenges compared to stand-alone (single tranche) PBOs and pure budget support. The general need for development finance and greater flexibility drives demand for programmatic lending by low-income and some lower middle-income countries. Nevertheless, the use of programmatic PBOs has increased in nearly all MDBs during their evaluation periods and accounted for 30 to 40 percent of PBOs toward the end of this period.

Moreover, programmatic PBOs allow for more sustained engagement and, if policy measures become deeper as a programmatic series progresses, they can be useful to support reform programs, while also helping borrowers meet financing needs. However, over one-third of IDB’s programmatic PBL series approved since 2005 were truncated before reaching their most consequential reform steps, raising questions of ownership of the underlying reform programs. Truncation, however, was more pronounced for countries that did not seek technical assistance to go along with the underlying reform programs. The fact that programs supported by technical cooperation grants had a lower truncation rate indicates a need for continuous engagement and technical cooperation to support borrowing countries in their reform efforts. It also suggests that PBLs need to come with sustained policy dialogue and technical support.

v. Spurring private sector development should remain a central objective of PBOs.¹⁴

A significant component of many PBOs has been improvement of the private sector environment, through financial sector reforms, capital market deregulation, and measures to strengthen public-private partnerships. Even reforms driven by fiscal concerns in sectors such as transport, energy, and water may include elements that improve the private sector environment.

Investment climate reform and economic diversification represented one-quarter to one-third of overall PBL value in World Bank PBOs. The share was larger in middle-income countries than in LICs. At IDB, the private and financial cluster (one of five clusters) averaged 17 percent of PBL commitments over 2005–19. At AfDB, diversification and industrialization, mainly through private sector environment reforms, were the leading PBO objectives across the issues identified in its strategies and action plans (under the “High 5s” explained in the AfDB chapter). Of the 16 operations given in-depth assessments, 9 related to the private sector environment. The budget support operations of the EU also include areas that affect the private sector environment and business confidence, such as DRM and trade.

¹³ United Nations UN.2022. Financing for Sustainable Development 2022. New York.

¹⁴ This section draws on evaluations and commentary by Alan Gelb summarized in Part II.

Improving the private sector environment is a slow process. A 2019 assessment of World Bank development policy operation (DPO) support to Jamaica under an Economic Stabilization and Foundations for Growth loan found an unrealistically short period for the implementation of the business environment measures. The lag in the private sector response to even successful reforms, particularly when legislation is required, tends to lengthen the required time horizon. The ability to see the full outcome of policy reforms in the short term further complicates evaluation.

vi. Strengthening the macroeconomic framework, including agency coordination, is important for effective PBO support for growth and poverty reduction strategies.¹⁵

MDBs need to coordinate with the International Monetary Fund (IMF), especially in large emergency financing packages, and evaluations of PBOs should examine the extent to which the supported policy reforms incorporate structural benchmarks in IMF-supported programs. However, the stance taken on this differs across the MDBs. It is useful to show not only PBL disbursements (flows) but also PBL stocks. Doing so can reveal whether PBL activity is essentially refinancing (disbursements that compensate for amortizations falling due) rather than increasing exposure, and how consistent it is with debt sustainability assessments. Why some MDBs focus so much on disbursement flows and pay little attention to exposure (stocks) requires more attention. Moreover, budget financing needs rather than balance of payments needs increasingly dominate PBL demand for most MDBs. This deserves assessment as it seems to challenge the view of MDB lending as a means to close a country's external financing gap through burden-sharing with the IMF.

In general, the MDBs rely heavily on the IMF for macroeconomic assessments and in some institutions this is accepted with little further examination. ADB, for example, does not independently consider the adequacy of the macroeconomic framework at project completion, and the appropriateness of budget support is taken as given when supported by an IMF assessment letter. ADB's Independent Evaluation Department challenges this, arguing that ADB must independently bear the risk implied by IMF assessments.

Staff members of the Caribbean Development Bank (CDB) are required to assess the adequacy of the macroeconomic framework for the conduct of a PBO, and the views of the IMF or the existence of an IMF program are critical ingredients in the appraisal. However, independent evaluation of the CDB's stance recommended that greater collaboration with the IMF, World Bank, and IDB is needed for designing and implementing PBOs. Moreover, the evaluation recommended that PBOs not be provided to borrowing members without either an IMF stand-by arrangement or an IMF opinion on the adequacy of a home-grown program of adjustment.

AfDB officially aligns itself with G-20 principles for coordination, working with other agencies and following the IMF assessments and World Bank analyses for countries facing macroeconomic vulnerability. The evaluation concludes that in four-fifths of cases AfDB coordination with other institutions on macro management is satisfactory. Such close coordination with other agencies also characterizes EU support through PBOs, but decisions on new budget support programs and payments are not bound by IMF positions. The EU has signed a partnership program with the IMF on the global architecture and policy agenda for PFM, domestic revenue mobilization (DRM), and transparency.

¹⁵ This section draws evaluations and on commentary by Augusto del la Torre in this volume.

By contrast, since the mid-2000s, IDB has gradually expanded its analysis of countries' macroeconomic frameworks and reduced its dependence on the IMF's views. IDB required its regional departments (supported by IDB's Research Department) to produce a macroeconomic assessment at the time of approval and disbursement of PBOs. In 2014, IDB took further action to decouple its PBL lending from the IMF's assessment of macroeconomic conditions by no longer making PBL lending conditional on an on-track IMF program, Article IV consultations report, or macroeconomic update.¹⁶ IDB's Office of Evaluation and Oversight has not evaluated the impact of the independence of macroeconomic assessment on PBO performance.

Finally, an independent IEG assessment of the quality of World Bank macro-fiscal frameworks in PBOs found they were internally consistent and had improved over time. In many cases, quality was related to the alignment of the macro-fiscal analytical work of the IMF and the World Bank. PBFs and IMF programs were complementary, supporting a sound macroeconomic framework, particularly fiscal and debt reforms. Coordinated support with development partners, particularly the IMF, helped support reform implementation, including inviting IMF inputs, especially during crises. During the COVID-19 crisis there has been close coordination, with the IMF providing emergency funding by doubling two rapid financing facilities, and the World Bank approved over \$10 billion in operations to support vaccine rollout in 78 countries alongside large PBO commitments. Complementarity with IMF programs was associated with stronger outcomes for fiscal and debt-related operations. The analytical underpinnings of fiscal and debt-related PBFs influence the quality of their design. Debt and fiscal sustainability reforms are typically informed by Debt Sustainability Analyses; Debt Management Performance Assessments; Public Expenditure Reviews; and various technical assistance products.

At the same time, an independent evaluation of World Bank lending found weaknesses in three areas: (a) the ambition of macro-fiscal frameworks in some stand-alone operations and in the links between objectives and fiscal measures; (b) the credibility of the framework in view of the government's record, political economy factors, treatment of risks, or institutional fiscal rules; and (c) the robustness of the debt sustainability analysis.

vii. Small island developing states and post-conflict and fragile states face challenges that require PBO assistance targeting their specific development needs.¹⁷

The CDB is unique among MDBs in that its clients consist overwhelmingly of small states, defined as countries with fewer than 1.5 million inhabitants. Of the CDB's 19 borrowing member countries, 17 are small states (or dependencies). Of the latter, most are islands or archipelagos. Similarly, ADB provides support to 14 Pacific island countries, most of which are small island developing states, with populations well below 250,000. The small states, especially island states, share some unique characteristics and challenges:

- High fixed costs of operations
- High levels of public expenditure, including public sector wage bills as a share of gross domestic product (GDP)
- High trade costs

¹⁶ When an MDB considers a budget support loan for a member country, IMF is requested to provide the MDB's board of directors with convincing evidence, based on a recent IMF assessment, that the country has a sound macroeconomic policy framework in place.

¹⁷ This section is based on evaluations and commentary by Shanta Devarajan and Ali Khadr in this volume.

- Extreme vulnerability to natural disasters and the effects of climate change
- Very concentrated exports (tourism, a few commodities), which leave them particularly vulnerable to trade shocks and contagion from downturns in trading partners
- The small absolute (though not relative) size of their public sectors limits their institutional capacity for policy making and service delivery.

CDB has raised its prudential limit to 38 percent to create lending headroom to counter the fallout from COVID-19 and offered exogenous shock response PBOs as a distinct instrument variant. The financing of emergency priority spending has helped preserve stability in CDB member countries. Future evaluations of PBOs can yield lessons on how effectively such operations have supported small states, built resilience, and helped mitigate shocks.

Regarding post-conflict and fragile states, the EU recently introduced a budget support instrument, the State and Resilience-Building Contract (SRBC), to address the complex and volatile environments fragile states face. They constitute about 10 percent of EU budget support contracts and proved very effective in the Ebola crisis and the COVID-19 pandemic. The requirements for access to SRBCs are less demanding than those of other EU instruments, letting fragile states qualify.

Given the condition of governments and their weak capacity in fragile settings and conflict-affected states, the focus on budget resource transfers directly to the government treasury, together with policy dialogue aimed at strengthening government capacity, is viewed by some as misplaced. More attention by development partners to addressing needs of the private sector in fragile states is needed to help strengthen markets, particularly where many basic services are delivered by nonstate actors.

There were many examples of how AfDB coordinated with other development partners, notably during the identification and appraisal periods, investing upfront work with other development partners. However, the in-depth assessment illustrated how difficult AfDB had found it to sustain these initial high levels of coordination throughout the implementation phase. Moreover, following the adoption of the G-20 Principles for Effective Coordination between the IMF and MDBs on PBL in 2017, the MDBs need to align behind the IMF in countries facing macroeconomic vulnerability.

The use of PBL by ADB in the Pacific region appears to be linked to crisis years—the Asian financial crisis (1997), the dot-com bubble (2001), and the global financial crisis (2007–09). Recently, ADB has used PBL to provide contingent financing operations in some Pacific islands,¹⁸ which have been used to build disaster resilience during noncrisis times and to release funds immediately following a natural disaster. Still, given the scale of ADB investment in the development of infrastructure in the energy, water, and transport sectors in Asia and the Pacific, there is a notable lack of PBL-supported reforms in these sectors, even though infrastructure gaps were identified as key constraints on growth and poverty reduction in ADB’s long-term strategic framework.

In the EU (under its SRBC program), technical assistance was often used but was not the main driver in its programs. Most programs planned for technical assistance to strengthen governments’ weak institutional capacities, but with little coordination among development

¹⁸ These included Cook Islands, Samoa, Tonga, and Tuvalu.

partners and only a weak connection with the programs, the technical assistance was merely able to provide limited knowledge transfer or follow-up actions. Several evaluations made the point that the EU and other development partners need new types of partnerships with countries, using cooperation modalities and tools in a different manner.

In sum, some low-income states and many fragile states are caught in a “fragility trap,” for which incremental solutions based on the principles used for higher income and non-fragile states are unlikely to be sufficient to help them escape. To manage such an escape, some of these countries will need much more aid than projected based on standard macroeconomic formulas. They will also need strong, continuous technical assistance to underpin and strengthen the policy dialogue.

viii. PBOs widely embrace improving governance and institutions, especially for public financial management, but performance depends on committed country counterparts.¹⁹

In recent decades, PBOs increasingly have recognized the importance of governance and robust institutions for development outcomes. This has been evident in prior actions related to governance, most notably on PFM. This reflects a key concern that PBO funds are being used appropriately for development purposes given the fungibility of aid. Programmatic PBOs are often built around medium-term expenditure frameworks focused on budget formulation, execution, and audit and less focused on advancing infrastructure or removing major constraints to growth. This is consistent with thematic evaluations at the World Bank, which emphasized the prevalence of prior actions related to PFM.

Managing public finances is an important and powerful responsibility of government that affects the distribution of resources and the effectiveness of public programs. But other areas of governance reform, such as election systems, public employment, direct anticorruption efforts, may be as or more important for development outcomes. They have been more difficult for the MDBs to address given the challenging political environments that often prevail, limiting the kinds of program design and prior actions that are possible in PBOs. This underscores the overwhelming importance of committed country counterparts for achieving outcomes and is consistent with the World Bank finding that PBOs are significantly and positively correlated with the quality of social policies and institutions.

The Future of Policy-Based Operations by Multilateral Development Banks

MDBs have had a leading role in supporting developing countries and in setting the global development agenda. However, since the financial crisis in 2008–09, the global economic and social situation has weakened considerably as new global challenges arose—climate change, the pandemic, new technologies—placing new pressures on development agencies to maintain their relevance and effectiveness. Responses to future global crises must be collaborative and coordinated, which the MDBs are well designed to do but still have limited experience.

PBOs in their various forms present MDBs with a versatile instrument for financing or cofinancing that can help facilitate collaboration and coordinated responses. PBOs provide predictable, low-cost financial support for LICs, and they provide countercyclical financing during economic crises offsetting private financial downswings. Together these fill gaps in

¹⁹ This section is based on evaluations and commentary by Cheryl Gray in this volume.

access to financial markets at more favorable costs, while adding support for institutional reform and sometimes helping to catalyze private investment flows.

Complementary private investment and direct support for public goods, both local and global, will be increasingly necessary in the future, as will increased innovation that is inclusive and builds human capital and labor mobility to respond with agility to shifting needs. Investments with large externalities—pandemic relief, adapting to climate change, preventing natural disasters—will be more urgent and require more resources in the interest of both developing countries and rich countries. These need to be envisioned and integrated as central tasks of the development banks, in coordination with the IMF.²⁰

The international agency response to the economic shock of the COVID-19 pandemic has not yet been independently evaluated.²¹ Based on preliminary information, some MDBs responded differently to the turbulence caused by the pandemic than they did during the global financial crisis of 2008–09. Moreover, the G-20 did not call for an increase in capital for the MDBs, as it had done in response to the 2008–09 crisis. The extent of the MDBs’ responses has been limited by their capital constraints.²²

While some MDBs, including ADB and AfDB, have prioritized infrastructure financing, their programs have focused on middle-income countries. The World Bank and IDB have prioritized social spending (health, education, and social protection), much of it through PBOs, as well as conditional cash transfers and Program-for-Results (PforR at the World Bank). Based on lessons learned and emerging challenges, the MDBs need to reprioritize portfolio allocation to substantially expand support for sustainable infrastructure to low-income and fragile and post-conflict countries. While the MDBs have increased their support for climate change mitigation and adaptation and clean energy, the scale of financing is still far from meeting the \$100 billion annual commitment set under the Paris Agreement.²³

Continuing cooperation and coordination of support to developing countries on global challenges, such as climate change and pandemics, will be crucial. Coordination should cover lending, technical assistance, research, and analytical work among MDBs, the European Union, and the IMF (and between them and national development banks). Despite its importance, no systematic evaluation of cooperation or coordination has been conducted. Greater cooperation and coordination among MDBs will likely result in more efficient operations and in scaling up their financial support.

²⁰ As recommended by the G-20 report of 2017. See <https://www.imf.org/external/np/g20/pdf/2018/082918.pdf>.

²¹ Independent evaluations are under way in some MDBs, such as ADB <https://www.adb.org/sites/default/files/evaluation-document/652326/files/eap-rte-adb-response-covid-19-pandemic.pdf>; and the World Bank https://ieg.worldbankgroup.org/sites/default/files/Data/reports/ap_covid19economicimplications.pdf. An early assessment of the response by ADB was undertaken by the Center for Global Development <https://www.cgdev.org/sites/default/files/how-effectively-asian-development-bank-responding-covid-19-early-assessment.pdf>.

²² The World Bank was recapitalized in 2018 and AfDB in 2019, leaving them in a stronger position to respond than other MDBs (the most recent capital increase for ADB was in 2009 and for IDB in 2010). The continuing impacts of COVID-19 and the massive shock of the Russian invasion of Ukraine in 2022 suggests that demand for large PBOs remains very high.

²³ Under the Paris Agreement, MDBs pledged to mobilize \$100 billion a year from advanced countries by 2020 to support developing countries’ adaptation to climate change and mitigation of further rises in temperature.

Support for capacity building and institutional reforms, as well as humanitarian assistance, for fragile and conflict-affected states (FCSs) will also benefit from greater coordination. While ADB has not widely used PBOs in FCS countries (but has in small islands countries), AfDB, the EU, and World Bank have.²⁴ Their experience, based on recently conducted evaluation results, will be valuable.

Evaluation evidence offers eight takeaways and propositions that should inform future PBOs:

- MDBs are expected to continue using PBOs as a countercyclical instrument during crises, such as the COVID-19 pandemic and the food and fuel crisis caused by the Russian Federation's invasion of Ukraine, to mitigate the adverse effects on developing economies and their growth prospects.
- Consecutive crises and their prolonged aftereffects are likely to reduce MDB's lending capacity and their ability to respond.
- Economic recovery needs to be supported by policies aligned with the SDGs and aligned with the investment goals of developing countries, to the extent possible, to help their economies recover; to bring poverty reduction back on track; and support greater resilience to future pandemics, climate change, and financial crises.
- MDBs can operate more as an interconnected and cooperative financial and development system, including in operational knowledge creation and policy research and analytical work. The complementarity of their activities is important, given the complexity of issues and the diversity of regional priorities and clients.
- Given the urgency of development challenges facing both emerging economies and LICs, the MDBs should prioritize collaboration with other relevant global funds, financing efforts to adapt to and mitigate climate change, respond to pandemics, and conduct research, and analytical work on key issues concerning regional and global public goods.
- MDBs to enhance their deployment of guarantees and other credit enhancements to mobilize private funds (through policy-based guarantees and de-risking through blended finance, for example). Common definitions and methodologies will be critical for improving coordination and collaboration and reducing confusion and duplication of effort.
- MDBs need to consider the implications of the G-20-sponsored independent review of their capital adequacy and the recommendations for increasing their lending headroom, which may affect their leverage ratios and credit ratings.
- All MDBs need to evaluate their response to the recent crisis through their use of the PBO instrument. Evaluation departments should together explore new and different ways of assessing PBL. Work in this area has not progressed much since the development of

²⁴ Jeff Chelsky and Mees van der Werf. 2022. A closer look at World Bank Development Policy Financing in fragile states: Reevaluating what "good" looks like in volatile and uncertain situations to promote more informed risk-taking. March 9. <https://ieg.worldbankgroup.org/blog/closer-look-world-bank-development-policy-financing-fragile-states>

the “three-step approach” by OECD.²⁵ New work in this area could be undertaken jointly by MDBs’ evaluation departments and the OECD.

C. The Challenge of Evaluating Policy-Based Operations

PBOs aim to support implementation of a government’s overall growth and poverty reduction strategy, entailing multidimensional and complex aspects of public policy and action. Evaluating them is far more challenging than evaluating conventional “bricks and mortar” investment projects, which benefit from more clarity of measurement metrics and greater availability of data tied to specific investments and fiduciary requirements. By contrast, PBOs involve building state capacity, creating legal and regulatory frameworks, improving the quality of public institutions and policies, or deploying new technologies and approaches. Metrics for these are not well established, are more difficult to standardize across sectors and countries, and involve long-term behavioral changes that may be difficult to observe.

The fungibility of budget support compounds the difficulty of evaluating PBOs (also true of investment projects) because it creates fiscal space for any public expenditure, including those development partners may not support (such as defense outlays or untargeted transfers). Notably, the amount of financing rarely is related to estimated costs of reform objectives, except in rare cases such as recapitalization of public sector banks.

Policy dialogue aims to provide a sharper and shared focus on development outcomes—that it is a source of external discipline exercised through agreed reforms and that capacity development and related measures fill the capacity gap prioritized by both the MDB and country. Policies and institutions are contextual, differing across regions and countries, as is the interpretation of practices that build on different policy frameworks or have a cultural dimension. Funding, policy dialogue, and capacity development normally associated with PBOs are assumed to reinforce one another alongside contextual factors. Development partners cofinancing PBOs often need to agree on what policy and institutional functionality looks like, on what are considered acceptable budget management practices, even though they may disagree on priority reforms, specific policy objectives, or the appropriate measurement of results.

The theory of change underpinning PBL is based on an intervention logic that describes how budget support helps to enhance implementation of the supported development strategies to achieve established targets. Detailed requirements on how the inputs provided should be deployed are rare, although there are often rigid requirements on reporting and accounting procedures. This flexibility is particularly important during economic crises when quick-disbursing and untied financing can be critical.

²⁵ Step one is assessment of the inputs, direct outputs, and induced outputs of budget support (levels 1, 2, and 3 of the Comprehensive Evaluation Framework (CEF), including analysis of the causal relations between these three levels. Step two is assessment of the outcomes and impact of the government’s policies, strategies, and spending actions that donors supported and promoted with budget support, and identification of the main determining factors of those outcomes and impact (levels 4 and 5 of the CEF), through policy impact evaluation techniques. Step three explores the contribution of budget support to the government’s policies, strategies, and spending actions, which have produced the outcomes and impact identified in step two, to be carried out by combining and comparing the results of steps one and two. See OECD. 2012. *Evaluating Budget Support*. Paris.

Attributing Outcomes to Policy-Based Lending

A common criticism of PBL evaluations concerns the difficulty of attributing country outcomes to the use of PBOs, including the policy actions they support and the fast-disbursing financial support they provide. Most evaluations—for the ADB, IDB, and World Bank—discuss the attribution problem, particularly with multiple donors (joint funding) or simultaneous budget support and absent a well-defined counterfactual. High-level outcomes—GDP growth, levels of private sector investment, employment creation, and poverty reduction, are influenced by many exogenous factors, so claims on attribution call for modesty. Recognizing that outcomes can never be directly attributable to budget support, the World Bank evaluation notes that “it is an important finding in today’s world that the World Bank can contribute to development by recognizing and supporting committed and effective leaders without having to prove that its actions led to that commitment.”²⁶

While rigorous attribution is difficult, the CDB argues it is often possible to establish “plausible likelihood of contribution” provided PBOs have results frameworks of reasonable quality. They propose a “reverse causal chain” analysis using the PBO’s results framework that involves several sequential steps, starting from outcomes and the associated indicators to the logic of the results chain drawing on core elements of the PBO. The EU uses a different method (described below) to assess impact. Briefly, change can be traced to outputs generated by the interplay between funding—together with policy and institutional effects emerging from dialogue, technical assistance, and capacity building—and the domestic processes of policy making, budget formulation, and budget execution. Analysis that combines these data streams lets the evaluator assess the contribution of budget support to the success or failure of the recipient governments’ policies and strategies.

Principal Evaluation Methodologies

The evaluations of the MDBs and the EU follow two main methodological approaches: an objectives-based method and the three-step approach of the OECD-DAC.²⁷ Details are in Annex A. Most MDBs use an objectives-based method, which evaluates against specific program objectives of individual PBOs as stated in legal documents. The evaluation examines the relevance of policy actions and measures proposed and implemented under the program and weighs the robustness of evidence to the specific country outcomes they are meant to achieve. This approach is built on qualitative and quantitative evidence on the inputs, outputs, and outcomes expected to be delivered through specified actions or policy interventions at sectoral or regional levels that underpin the program supported by the PBO. Evaluators ultimately rank performance, judging the rigor and quality of evidence, at the intervention, program, and instrumental levels.

The EU uses a three-step approach that works at an aggregated level. It examines total budget support from all development partners, usually over a decade. The first step assesses the effects of combined budget support on policies, services, and induced outputs. The second step assesses social and economic outcomes targeted by these public policies and induced outputs. The third step

²⁶ Cheryl Gray.2022, Comments on “Policy-Based Financing at the World Bank: Evolution, Performance, and Reform” in this volume.

²⁷ Methodological details of the three-step approach are presented in OECD (2012).

relates the results of the causal analysis of the first two steps, through the links established between budget support inputs and the related policy changes, to infer the contribution of budget support.

The two evaluation approaches differ in several ways. The approach used by MDBs is objectives-based and includes performance ratings (on a six-point scale from highly unsatisfactory to highly satisfactory).²⁸ It follows standard, pre-set evaluation criteria, which include relevance, efficacy, effectiveness, impact, risks, government and MDB performance.²⁹ The ratings cover the dimensions of assessment, including the overall rating for the budget support series. The approach is suited to assessing accountability of individual operations and extracting lessons and recommending improvements in future operations. It also supports quantitative comparison of different operations.

The OECD-DAC's three-step approach does not include pre-set evaluative questions, although it follows a clear analytical framework (see Annex A). Evaluative questions vary depending on the operational focus and donor interests. The evaluations focus on learning and provide no ratings, although they include an element of accountability assessment with regular reporting. Moreover, comparisons across operations focus on total country budget support and provide qualitative and country-oriented lessons rather than quantitative comparisons. Both methodologies require evaluator judgment of the quality and weight of the evidence. More robust, quantitative methods and development of the counterfactual to permit attribution by donor or instrument are more difficult to implement in PBOs than in investment projects. By devising appropriate triangulation of evaluative data from various sources, however, carefully designed evaluations may establish whether the evaluative results obtained can be attributed to the intervention being evaluated.

Limitations of Evaluations

All the reports identify limitations of the evaluation work, as examples from four agencies show:

- **ADB.** No attempt was made to assess the impact of PBL on macroeconomic conditions or on growth and poverty reduction. Rather, the evaluators used the plausible contribution of ADB's PBL to outputs and outcomes in the areas indicated in the theory of change. The evaluation was also constrained by limited evidence in the validated program completion reports, which were informed by ADB self-assessments.
- **AfDB.** The evaluation team limited the extent to which the overarching question on results would be addressed, constraining how far up the results chain the evaluation could go. Focus was placed on collection of primary performance data in only a few sectors and data was limited. The quality of analytic work varies across countries, but use of other sources helps to mitigate the effects of the variability.
- **IDB.** Findings are not based on comprehensively evaluating PBOs as an instrument or the achievement of the outcomes, which was considered beyond the scope of the exercise.

²⁸ ADB uses a four-point scale in its ratings of project outcomes: highly successful, successful, less than successful, and unsuccessful.

²⁹ To improve the operational relevance of its work, the World Bank's Independent Evaluation Group (IEG) has modified the structure and content of its evaluations and validations of PBOs, partly in response to changes in the self-evaluation the World Bank adopted (see chapter 6 of this volume). The new IEG framework better reflects the characteristics of Development Policy Financing (DFP). The main changes relate to the assessment of relevance, results indicators, and the World Bank's performance. Instead of rating the relevance of objectives, IEG now rates the relevance of the prior actions supported by the operation (although the relevance of objectives is still discussed).

However, the chapter is an important steppingstone to a more in-depth future evaluation of PBOs. Findings of the Office of Evaluation and Oversight’s work invite questions, such as the extent to which PBL financing complements or substitutes for funding from financial markets and whether IDB-supported policy measures are complementary to or overlap those of other institutions.

- **World Bank.** IEG has not done a recent comprehensive evaluation of PBOs, but it maintains a large repository of DPO performance ratings since 2005 that is an important evaluative database. IEG’s assessment of DPOs instead draws on thematic evaluations and learning products, as well as on the World Bank’s DPO retrospectives.³⁰

This overview of the evaluation and conference findings has reviewed the context for PBF against an evolving global financial landscape and presented the main findings of the six agency evaluations and expert commentaries. Performance of PBF was generally strong, usually meeting its principal objectives. The overview also sounds a cautionary note, recognizing the challenges of evaluating budget support and attributing country-level outcomes to the augmented fiscal resources which PBF provides. A major contribution of the instrument is provision of countercyclical financing during crises when access to private financing is sharply limited. Another contribution central to PBF success is providing technical assistance and expert policy dialogue to support reforms aimed at improving PFM, service delivery, and the business environment. The overview also looks toward future challenges and the need for aid to developing countries, not only to improve their own welfare and economic performance but also to support vital global public goods related to addressing climate change, arresting the spread of pandemics, or preventing financial crises. These all point to the expectation that developing country need and demand for PBF will increase and could play a central role in ramping up financial commitments in support of the SDGs.

Part II of the overview summarizes each agency’s evaluation report. Each report draws on evidence and evaluations of PBF from the five MDBs and the European Union. Part II also summarizes comments from development experts on the agency reports.

Part II. Summary of Agency PBL Evaluations of Policy-Based Lending

Part II of the overview summarizes the independent evaluation reports on DPF for each agency and includes commentaries by development experts on the reports.

II.1 Asian Development Bank, 2008-20 (Joanne Asquith and Walter Kolkma)

The Independent Evaluation Department (IED) of the Asian Development Bank (ADB) evaluated the use of policy-based lending (PBL) by ADB between 2008 and 2017. The design and reform focus of ADB PBL fundamentally changed over this period, and the success rates—as judged by project completion reports validated by IED—more than doubled (from about 33 percent to over 80 percent), a trend also experienced by other multilateral development banks (MDBs). Improved performance appears to have coincided with the growing use of single

³⁰ World Bank Group. 2022. *2021 Development Policy Financing Retrospective: Facing Crisis, Fostering Recovery*, Operations Policy and Country Services, March 16, Washington, DC. These are prepared by and for World Bank management and not by the independent evaluation group.

tranche PBL and, with it, the use of prior actions (actions completed before loan approval). These changes substantially reduced disbursement risks and increased the capacity of MDBs to provide more predictable and reliable budget support in response to country financing needs, the primary objective of the instrument.

A key issue is whether the need to respond efficiently to country financing needs has encouraged support for less critical reforms. Over time, PBL reform topics seem to have shifted from more politically sensitive reforms (such as reform of state-owned banks) to more technical reforms connected with public financial management (PFM). PBL modalities also changed as the second tranches of loans, which often contained more difficult policy actions, were no longer part of PBL design. The policy actions in second tranches often required waivers or loan cancellations contributing to poor performance ratings. There appears to have been a trade-off between the emphasis on efficient, rapidly disbursing modalities to meet country financing needs and the emphasis on policy reform, suggesting that the two objectives are not always automatically compatible.

PBL performance dramatically improved over the evaluation period, but the evaluation identified several design issues. For example, PBL tended to be used in the region's more developed economies (Pakistan is an exception) with greater capacity for reform. It rarely focused on policy reform in areas of infrastructure development, ADB's main comparative advantage. Moreover, it was difficult to reconcile the high success rates in PBL project completion reports validated by IED with the evaluation's finding of design shortcomings. A key reason for this discrepancy is that although PBL performance significantly improved over the evaluation period, the causal chain from policy actions to country-level results was often difficult to discern. Where there is doubt about whether a PBL outcome resulted directly from the policy actions taken, the responsibility often falls on the evaluator to prove the connection by, for example, constructing a counterfactual to show whether the result would have been achieved without the PBL. In practice, however, if outcome indicators are achieved, the PBL is usually rated successful even if causality between ADB-supported policy actions and the reform outcome is tenuous.

PBL remains an efficient modality for supporting country clients through crisis periods. Its usefulness was shown by ADB's rapid response to the global economic and financial crisis in 2007–09 and the COVID-19 pandemic in 2020. The use of PBL spiked during crisis years, breaking through the 20 percent ceiling imposed on this type of lending in the sovereign loan portfolio. The increase in PBL use beyond the ceiling was made possible only through the introduction of “reform-free” and rapidly disbursing budget support modalities to finance developing member countries' (DMC) countercyclical public expenditure programs to mitigate the effects of the crisis.

PBL has played several roles in the region. It supported countries through difficult periods, including economic downturns, natural disasters, and pandemics, and it supported broad public sector management and macroeconomic stability through noncrisis years. Other budget support mechanisms are also emerging, including results-based lending, which is more effective than PBL at directly improving service delivery.

The evaluation published in 2018 made several recommendations, some strategic and others related to PBL design. At the strategic level, it recommended ADB make greater use of PBL to

support policy reforms in sectors where significant project investments are also undertaken, to forge more integrated and sustainable solutions to public policy problems in these areas. Although ADB management accepted this recommendation, it is unlikely to be implemented in the short term, mainly because of the COVID-19 pandemic, which led to higher use of non-reform-based budget support responses in 2020. If such support continues, the opportunity to use PBL to support infrastructure-related policy reform is likely to be limited in the immediate term.

The evaluation's recommendation that ADB develop an operational plan on the scope, objectives, and articulation of public sector management interventions was not accepted formally, but ADB has moved in this direction. An operational priority plan for governance and institutional capacity has since been developed as part of ADB's Strategy 2030. This plan provides corporate guidance on the conditions under which PFM loans should be provided.³¹

The evaluation recommendations that concessional assistance-only countries (Group A) be granted access to a countercyclical facility and that the use of contingent disaster financing be formalized were accepted. Since the outbreak of the pandemic, countercyclical support has been expanded to include Group A and non-OCR-eligible countries³² (Group B) as part of ADB's pandemic response, which includes using both Asian Development Fund grant resources and ADB concessional loan resources. ADB formally approved contingent disaster financing soon after the evaluation was issued.

ADB did not agree to the evaluation's recommendation that in the rare cases where a regional department's view on the macroeconomic situation of a country diverges from that of the IMF the risks involved be assessed independently of the regional department. Still, it has since strengthened the capacity of the Strategy, Policy, and Partnerships Department (SPD) to oversee PBL design before board approval. SPD has revised the PBL provisions of the Operations Manual and the relevant staff instructions, which now include a specific loan approval template and a design and monitoring framework better suited to PBL. ADB's relationship with the IMF has been clarified and ADB's capacity to produce a clear macroeconomic assessment strengthened, helping it support the overall quality assurance mechanism for PBL. ADB management decided against the recommendation of a separate three-year PBL operational review like the one the World Bank produces.³³

ADB has strengthened PBL design, although the evaluation recommended ADB limit the use of process-oriented actions and articulate policy actions as substantive outputs. It recommended tailoring the design and monitoring framework (DMF)³⁴ so policy actions, outputs, and outcomes are more clearly linked and the analytical work underpinning PBL design and policy actions clearly referenced. These recommendations are part of the revised Operations Manual and staff instructions, but the outbreak of COVID-19 and the need to respond quickly to DMC financing needs during the pandemic has meant that implementation of these changes was initially deferred.

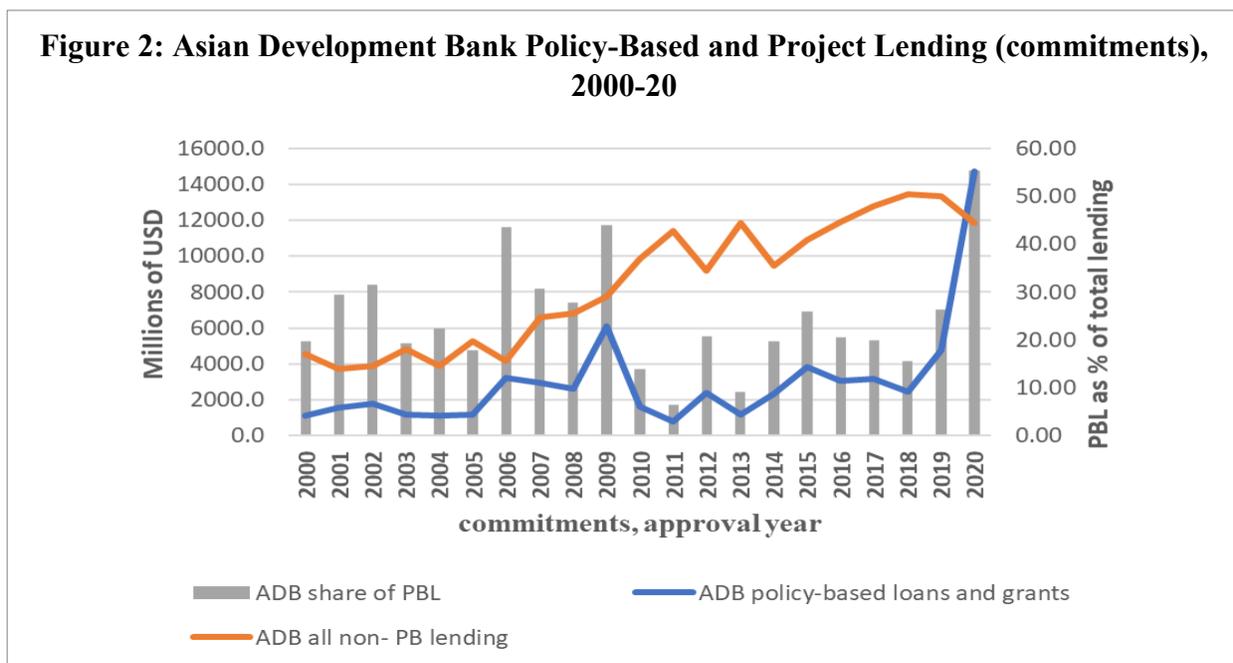
³¹ Asian Development Bank. 2019. Strategy 2030. Operational Plan for Priority 6. Strengthening Governance and Institutional Capacity 2019–2024. Manila.

³² OCR refers to Ordinary Capital Resources, which are market-based resources.

³³ World Bank Group. 2022. *2021 Development Policy Financing Retrospective: Facing Crisis, Fostering Recovery*. Operations Policy and Country Services, March 16, Washington, DC.

³⁴ Initial information about the project, results chain, performance indicators, data sources, and risks.

ADB needs to strengthen its assessment of PBL design at program completion. It also needs to focus more sharply on the role and quality of technical assistance, given its central role in the preparation and implementation of PBL. As PBL requires its own template and DMF, new approaches for assessing PBL performance need to be introduced to make sure the success rating given to completed PBLs is based on a robust evidence-based assessment of the design, especially the relevance and criticality of policy actions to development outcomes. In a single tranche PBL, policy actions have been carried out at the time of board loan approval but their relevance and criticality to the outcome should still be assessed at completion. ADB’s policy-based and project lending (on commitment bases) for the period 2000–20 is shown in Figure 2. Although non-PBO lending fell slightly during 2019–20, PBO lending increased sharply in 2020, making ADB lending highly countercyclical compared to other MDBs and the EU.



Note: PBL = policy-based lending
Source: ADB-IED.

Comments by Homi Kharas. He posed three questions: What issues affect the development effectiveness of PBL? Does the chapter capture the issues well? How is PBL linked with the Sustainable Development Goals (SDGs), which all member countries of ADB have signed on to?

PBL provides rapid financing to governments along with support for a policy reform process. The chapter describes the trade-offs involved in this process well. Financial support sometimes needs to be large and rapidly disbursed to have impact, especially during a crisis. By contrast, policy reform is often a long, slow process of incremental change and institution building. Over time, PBL has tended to address the finance objective more than the policy reform objective, as evident in the greater reliance on prior reforms; the shift to public sector management reforms within control of the ministry of finance (which, in contrast to sectoral ministries, has an incentive to deliver on reforms, as it also gets to allocate PBL resources); and the delinking of loan volume from the difficulty or cost of reform implementation.

This evolution of PBL may be positive, but it also changes the nature of the instrument. The recent trend in ADB is positive for several reasons. First, it puts countries firmly in the driver's seat on the pace of reforms. As a development partner, it is appropriate for ADB to comment on and advise counterparts on the nature, pace, and sequencing of a reform program. It is not appropriate to use financing to bolster ADB's own views over those of elected officials, unless there is a risk that the government program is so weak that a default could occur, or the economic context is so distorted that the loan could be immiserizing.

The chapter suggests that ADB should pay more attention to transport, energy, and water infrastructure reforms, to align with areas in which ADB has significant sectoral expertise. ADB has expertise in these areas it can and should share with governments, but it is not clear that using PBL as an instrument to force such reforms is appropriate. Adjustment loans are about providing liquidity, not forcing (or, more politely put, encouraging) specific policy reforms. Of course, a series of PBL operations can be used to structure reform incentives in the right way, but structuring the operation in a certain way is more about the pace, sequencing, and difficulty of reforms rather than the selection of one sector over another.

Second, one lesson of crisis management is that “too little, too late” has long-lasting harmful consequences. But how much is “too little”? It would be useful to have had some discussion of whether ADB's PBLs always complemented International Monetary Fund (IMF) programs. The chapter has a brief discussion of the need for ADB to have in-house capacity to perform its own macroeconomic assessments. This recommendation may be correct, but a strong partnership, including shared analytical assessments, with other crisis lenders is possibly more important. Has ADB ever moved ahead absent an IMF program or an IMF letter of comfort on the macroeconomic front? How often is an ADB PBL part of a financing package to a government that also includes other development partners, notably the World Bank?

Data from the International Aid Transparency Initiative indicate that ADB has one of the best records of disbursement against commitments of PBL operations in response to COVID-19 of all MDBs. That is a strong testament to the value of tilting toward finance.

The chapter correctly notes it is difficult, if not impossible, to develop a strong causal link between PBL operations and actual results, given so many other factors also affect the results. PBL is likely to become even more important than it is now, partly because it provides a unique source of affordable, flexible, countercyclical, long-term development finance. The form may change toward greater pooled funding, including through country platforms (it would have been useful had the paper commented on the ongoing pilots, which will probably be supported by sector development program loans), but the sharp focus on public finance will surely remain.

II.2. African Development Bank, 2005–20 (Chapter 2)

Clement Bansé and Stephanie Yoboué. The Independent Development Evaluation at the African Development Bank Group (AfDB) carried out two major independent evaluations of the policy-based operation (PBO) instrument. In 2011, it conducted an evaluation that covered 1999–2009; in 2018, it conducted an evaluation that covered 2012–17. The chapter draws on both evaluations, supplemented by recent data.

PBOs are fast-disbursing financing instruments AfDB provides to countries as loans or grants. They address the actual, planned, or unexpected development financing requirements of AfDB's Regional Member Countries.

The evaluation found that PBOs remained a relevant and useful instrument for AfDB and its clients, although PBOs were challenging to design and manage effectively. It found the relevance of the PBOs in AfDB's portfolio to be broadly satisfactory, based on their programming, design, and broad adherence to AfDB's policy and guidelines as well as international good practice. As for the achievement of reform objectives, the overall picture was also satisfactory.

It was much harder to find evidence of AfDB's influence on reform direction and speed. Even in the presence of strong ownership, concerns about the institutional and financial dimensions of sustainability meant that the outlook for sustainability in the sectors examined was unsatisfactory.

AfDB deployed UA7.2 billion (about \$10.8 billion) in PBOs in 2012–17, but it did not invest in its own institutional infrastructure to obtain maximum value from the instrument. As reflected in its 2012 policy, PBOs were expected to form part of a “package of support,” to ensure that they influenced and supported reform agendas while providing important funding. This package included analytical work to inform technical input, policy dialogue, and capacity support. In practice, AfDB underperformed with policy dialogue, despite its strong position as a trusted partner, partly because of its institutional arrangements; the lack of clarity about who was responsible for policy dialogue; the way the dialogue was conducted, reported, and coordinated; and a lack of investment in human resources to conduct it. In addition, AfDB underperformed in providing timely and adequate capacity support and specialized technical advice, partly because of the limited menu of instruments available with which to do so. These shortcomings had implications for how well AfDB influenced or added value to country reform paths.

The evaluation examined a range of programming issues. Although the overall picture was assessed to be broadly satisfactory, the evaluation identified areas that could be strengthened. First, use of most of the PBOs reviewed was envisaged in either the relevant country strategy paper or the midterm review, in line with the policy. However, assessment against the eligibility criteria usually was made for the first time during the PBO preparation phase. The justification for the type of PBO chosen could also have been stronger, especially when the PBO did not use the recommended programmatic approach.

Second, in two-thirds of the operations reviewed, the analytical underpinnings used were listed and relatively complete. However, exactly how this work informed or underpinned the design of the operation was not clear.

Third, although risk assessment was assessed as satisfactory in two-thirds of the operations reviewed, reputational risk was rarely explicitly considered. The risk mitigation measures, such as future capacity support to address current risks, were generally not convincing within the time frame of a PBO.

The evaluation cites many good examples of how AfDB coordinated with other development partners, notably during the identification and appraisal periods. AfDB staff took coordination seriously and invested in upfront work with other development partners. However, the in-depth assessment illustrated how difficult it was to sustain these initial high levels of coordination throughout the implementation phase. Moreover, following adoption of the G-20 Principles for Effective Coordination between the IMF and MDBs on Policy-Based Lending in 2017, in countries facing macroeconomic vulnerability MDBs needed to align with the IMF.

Although two-thirds of the PBO appraisal reports examined stated that complementary inputs could play an important role, only a handful explained how they were to do so. All PBO results frameworks defined baselines, targets, and means of verification, and integrated prior actions and triggers. However, over one-third were less than satisfactory because of (a) weaknesses in presenting a convincing results chain; (b) the large share of process- and action-based indicators; and (c) a lack of realism, particularly for single-year operations. The use of conditions was suitably selective; in programmatic operations they linked from one phase to the next to plot a medium-term path and were linked to broader dialogue frameworks.

PBOs were broadly disbursed and implemented promptly, although some receiving countries reported that disbursement was unpredictable. In line with expectations for the PBO instrument, the evaluation found that AfDB had disbursed funds fully and, compared with investment projects, quickly. In addition, implementation progress was rarely identified as a cause for concern. Nine of the 10 in-depth assessments were considered efficient in terms of transactions costs and the time taken to disburse the funds. Perceptions of timeliness and transactions costs varied among both staff and borrowers' officials, however.

Perceptions of the efficiency and transactions costs of technical assistance or institutional support provided to support PBOs were negative. When it was provided, such support was slow and tended to arrive toward the end rather than at the beginning of a PBO series, partly because capacity support tended to be designed in parallel with PBOs rather than in advance and partly because of the limited set of instruments AfDB had available to provide small pieces of technical assistance, all of which operated like full projects rather than as rapidly deployable expertise.

AfDB did not use policy dialogue sufficiently or make best use of its “African voice” to ensure PBO results. This finding echoes that of the 2011 evaluation, which described AfDB as “punching below its weight” with policy dialogue. Only 3 of the 10 in-depth assessments had satisfactory frameworks for policy dialogue in the targeted sectors.

Some of AfDB's practices were out of line with both its own policy and the practices of the World Bank and the European Union. First, PBO design and management remained somewhat centralized, led by either the Governance and Public Financial Management Coordination Office (ECGF) or sector departments. The extent to which country offices took up ownership varied significantly. Second, no centralized unit provided specialized support to PBO teams. ECGF staff task-managed most of AfDB's general budget support. This lack of a central support unit, and the limited guidance and training provided to staff, starkly contrasted with the support available at the World Bank and the European Union.

Overall, the assessment of PBO effectiveness, which focused on energy, private sector environment (PSE), and PFM, was broadly satisfactory. The evaluation highlighted areas in which AfDB could focus to strengthen results, indicating how it could contribute to the direction and pace of reforms. Data from project completion reports and country strategy and program evaluations by the Independent Development Evaluation indicated that satisfactory assessment was likely to reflect the effectiveness of the broader portfolio. All but 1 of the 10 cases achieved or partially achieved all or most of the reform actions in the results framework (in one case, 25 percent of outputs were assessed as not having been achieved). No sector performed notably better than any other. In 7 of the 10 countries covered by the in-depth studies, the overall effectiveness in terms of achievement of the objectives stated in the Results Measurement Framework was considered satisfactory.

Across the 21 individually assessed components, two-thirds were assessed satisfactory in terms of achievement of “landmark policy changes.”³⁵ In one-third of the components, AfDB’s influence on either the direction or pace of reforms was evident and was usually achieved, through analytical work, technical inputs, and policy dialogue. But AfDB staff respondents to the survey supported the view that AfDB’s influence was limited and strongest at the appraisal stage.

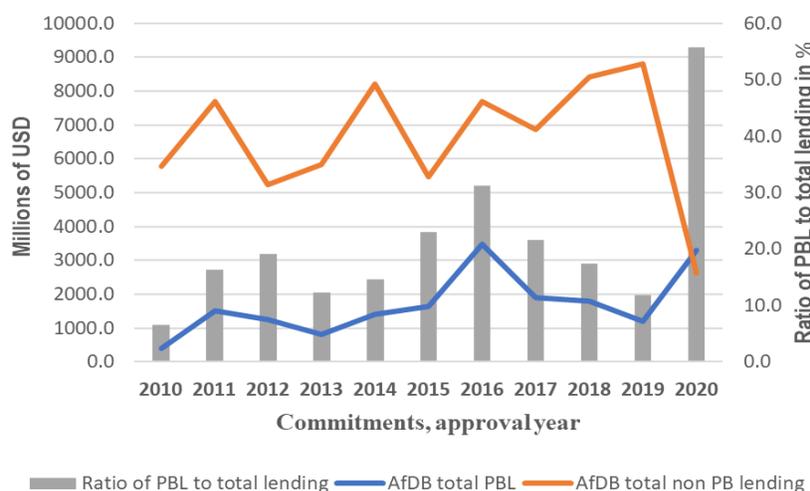
The sustainability of PBOs in energy, PSE, and PFM was assessed as unsatisfactory, particularly in relation to the institutional and financial dimensions of sustainability. Only 4 of the 10 in-depth assessments had good prospects for sustainability. Almost all 10 had laid strong foundations for sustainability in terms of government ownership and leadership, which should be at the core of the decision to proceed with a PBO. However, weak institutional and financial sustainability undermined the positive assessments of ownership. This trend was clear for energy, PSE, and PFM; it cannot be generalized across the whole PBO portfolio.

The evaluation evidence from AfDB and other institutions providing budget support in Africa indicates that the most often identified factors relating to country context were ownership, country capacity, and having a champion for reforms; the country’s socioeconomic status; and country systems. The most frequent factors relating to the budget support mechanism were the quality of design, programming, development partner coordination, and monitoring and the choice of indicators. The most often cited enabling factor was the quality of design. In terms of hindering performance, the most often cited factors were insufficient policy dialogue, high inefficiency and transactions costs, the poor choice of indicators, weak monitoring, and poor predictability.

The most significant factors associated with achievement of landmark policy changes were programming, design, and efficiency factors; technical assistance; inclusion of the operation as part of a series; and the existence of a country office. These factors were even more important than the country’s socioeconomic status. AfDB’s policy-based and project lending (on commitment bases) for 2000–20 is shown in Figure 3. Although PBO lending increased during 2019–20, non-PBO lending fell sharply in 2020.

³⁵ Landmark policy changes are budgetary or institutional changes of substance and influence targeted by PBOs within the set of intermediate outcomes (induced outputs) identified in the theory of change.

Figure 3: African Development Bank Policy-Based and Project Lending (commitments), 2000-20



Note: PBL = policy-based lending

Source Independent Evaluation Department, African Development Bank.

Comments by Alan Gelb. The chapter provides a useful overview of the evolution of PBOs at AfDB, which are described in terms of their evolving portfolio share, country distribution, variants, and focus. The chapter stimulates thinking on the evaluation of PBOs and on the institutional requirements needed to help with AfDB’s transition from a project-based to a policy-based bank.

These policy packages were contentious. Many saw them as impinging on national sovereignty—a sensitive issue, especially for newly independent countries. There were also genuine differences of view on what constituted an appropriate trade policy for African developing countries, some of which lacked a strong indigenous business sector, and on the role of the state in facilitating economic transformation. Still (and despite many critical views of the Washington Consensus), countries that stayed on track with macroeconomic and structural reform programs generally fared better than those that did not do so. Analysis based on the World Bank’s Country Policy and Institutional Assessment (CPIA) index suggested that countries with stronger macroeconomic and structural policies as well as more efficient resource allocations fared better than others. These findings suggest that many basic elements of economic management in these early PBOs were important, even if they were not sufficient, for a resumption of growth.

Given the increasing emphasis on PFM and economic governance, PBOs have shifted toward areas on which there is more consensus. Experts may debate the appropriate degree of trade protection, but it is rare to find arguments against more accountable public spending. This trend may not translate into easier implementation, however, because PFM reforms often confront strong entrenched interests and political opposition. They have a mixed record and, in some countries, governments have bypassed the reformed systems. As illustrated in the chapter, the third stage in the evolution of PBOs has been increasing the emphasis on sector policy

components across a wide range of critical areas, although most PBOs have kept a strong focus on PFM.

The chapter suggests that PBOs tend to be provided mostly to middle-income countries (MICs), although the degree of concentration is difficult to assess without comparative data on the relative size of MIC economies in Africa or the cross-country distribution of the overall portfolio. As MICs generally have stronger PFM and likely greater policy stability, PBOs might seem more suitable in such countries, especially as programmatic operations or programmatic tranching. Offsetting this tendency, the chapter notes the use of the crisis window to provide quick-disbursing funds during the Ebola crisis and the COVID-19 pandemic, both of which had both health and economic crises. The chapter confirms the importance of having a mechanism available to combine policy, technical advice, and financial support at relatively short notice to countries beset by exogenous shocks.

Two-thirds of the assessed operations appear to have achieved landmark policy changes; where they did not, reasons were advanced to help explain why. But defining a results framework for PBOs against a clear counterfactual remains a challenge.

How can impact be assessed? Attribution is a fraught area for PBOs, especially where there are multiple development partners and operations are designed to support reform measures with strong country ownership and be well coordinated with programs of other partners. PBOs are intended to provide quick-disbursing support for the budget and to encourage policy and institutional reforms. The balance between these objectives varies, and the compatibility of these twin goals cannot be taken for granted. When financing needs are pressing, policy elements may take a back seat. It is also possible that the policy reforms required by an operation may be measures that the country would have undertaken anyway.

In these circumstances, it is probably best to recognize the problem and rest content with observing whether the operation came with the expected landmark policy changes, preferably ones set out in advance as part of a well-defined programmatic or tranching operation. One-third of AfDB PBOs do not fall into one of these categories, and the share of PBOs with full programmatic tranching is modest (less than one-quarter). As loan triggers tend to become more substantive in the later years of a program, more such operations will likely be truncated, with disbursement rates above zero but less than 100 percent.

To be effective PBO partners, funding institutions need to have the capacity to engage in policy dialogue at a high level and across critical areas, including macroeconomic management (to complement the work of the IMF, public sector and budget management, and sector policy). The chapter paints a picture of the evolution of AfDB, from project lending to an institution balanced between projects and policy and program engagement. Acquiring and sustaining capacity requires a strong analytical focus, through economic and sector work, together with research and analytical support. Doing so is challenging for any institution; as the chapter notes, for AfDB that work is still incomplete. The resource requirements of achieving this analytical basis across the full range of development sectors and policies may mean a degree of operational selectivity focused on areas of traditional strength. Substantial and continuing investment in capacity seems to be essential for AfDB to exploit its “African voice” in policy dialogue, even though it is not necessarily the major player in the region. A policy-based bank that functions well will also need

the expertise and flexibility to offer complementary and timely packages of technical cooperation, a shortcoming identified in the chapter.

If policy dialogue and reform, rather than quick-disbursing funding, is to be the driver of non-project lending, it may be useful to consider other modalities to complement, or even replace, traditional PBOs, especially considering the shift toward a larger component of sector reforms. Results-based lending, such as the World Bank's Program-for-Results (PforR) instrument is one possibility. Like PBOs, PforR financing is provided to the government treasury, disbursed using country systems, and not necessarily tied to program costs. The multiyear nature of PforR operations allows countries sufficient time to move beyond immediate outputs and toward measures of outcomes and impacts, allowing for a more substantive results framework than those of many PBOs. Experience with this new instrument is still limited, but it could become a successor to sector-based PBOs.

II.3. European Union, 2005-2015 (Chapter 3)

Karolyn Thunnissen. The European Commission first introduced budget support in the 1990s. The approach evolved in the context of conditionality reform and in response to the evolution of the aid effectiveness agenda. The current approach has been implemented since the beginning of the 2000s. The period was marked by a gradual shift from using only project aid, whose effectiveness was often undermined by weak policy and governance contexts. The form in which EU budget support was implemented evolved to reflect changing policy contexts and to act on recommendations by external evaluations and by the European Court of Auditors.

Unlike projects, budget support addresses the partner country's overall conditions for economic and social development. EU budget support has always been provided exclusively as grants. It is consistent with and complementary to other EU aid implementation modalities, including projects, technical assistance, delegated cooperation, cofinancing, blending, and guarantees for investment loans by financial institutions, humanitarian aid, and emergency assistance.

The latest EU budget support policy was adopted in 2012. Its guidelines were revised in 2017 to take into account the new European Consensus on Development that followed the international adoption of the UN 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda. This policy notably introduced a new type of budget support, known as State and Resilience-Building Contract, to help countries in situations of fragility or facing the consequences of crisis and natural disasters. This type of budget support has increasingly been used and has proved instrumental in supporting countries during the COVID-19 pandemic lately.³⁶

The EU's approach to budget support has always involved four interrelated components acting together in support of partner countries' policy implementation:

- policy dialogue with a partner country to reach agreement on the policies and reforms to which budget support can contribute

³⁶ European Commission. 2017. *Budget Support Guidelines*. Brussels. https://ec.europa.eu/international-partnerships/system/files/budget-support-guidelines-2017_en.pdf.

- performance assessment to achieve consensus on expected results and to measure progress achieved
- financial transfers to the treasury account of the partner country once those results have been achieved and according to their degree of achievement
- capacity development to enable countries to implement reforms successfully and to sustain results.

EU budget support is thus a performance-based modality that provides a package of grant funding, capacity development, and a platform for dialogue to partner countries in support of the implementation of their policies. Funding is fungible: Budget support is used by the partner country's government based on domestic budgetary planning, execution, and oversight processes and using domestic PFM systems. EU budget support grants can thus be used for both recurrent and investment expenditure.

Policy dialogue is a fundamental component of EU budget support. The general conditions (regarding public policy, macroeconomic stability, PFM, and since 2012, budget transparency and oversight) provide the overall framework for dialogue with the government and other stakeholders; variable tranche indicators enable a more in-depth discussion on key reforms and policy results. Because funds are transferred to the budget, the EU can discuss general PFM issues, overall budget allocations, and sector spending as well as its results with the partner countries' authorities and other stakeholders. Because of the grant nature of the funding, the EU is particularly concerned that budget support should not be considered a substitute for efforts to raise revenues. Domestic resource mobilization is systematically raised in policy dialogue and often supported through capacity strengthening or the use of performance indicators. Monitoring of general policy outcomes and sector-level policy processes, activities, outputs, and most important, outcomes are an essential input into the overall dialogue.

Although external experts hired for technical cooperation can never be responsible for achieving the targets set for the agreed performance indicators, the capacity building most often associated with budget support is used to enhance the government's capacity to design, implement, monitor, and evaluate policies and to deliver public services. As EU budget support relies on the monitoring of performance indicators, preferably outcome indicators, the strengthening of national monitoring frameworks and associated statistical systems is a priority. Attention is also systematically paid to promoting the active engagement of nongovernment stakeholders in these monitoring frameworks.

Independent evaluation teams have undertaken 17 general and sector budget support evaluations applying the universally accepted OECD-DAC methodology for budget support evaluations (the so-called "three-step approach") since 2010.³⁷ They were managed by evaluation management groups made up of representatives of partner countries and funding agencies, under Commission's coordination. Of the 17 evaluations undertaken, 11 were multidonor evaluations assessing the joint effects of all the general and sector budget support operations financed by different development partners. Evaluation periods differed slightly across the evaluations, which stretched from 1996 to 2018.

³⁷ Independent evaluations of budget support using only steps 1 and 2 of the OECD-DAC methodology are more systematically undertaken at program level. See OECD. 2012. Evaluating Budget Support, Paris.

The period being evaluated (roughly 2005–2015, although seven of the eight evaluations concentrated on 2005–10) was a period of high and increasing official development assistance (ODA), with budget support the preferred aid modality of the EU and multilateral development partners. Budget support provided a significant and predictable source of funding for recipient governments and created fiscal space for them to undertake discretionary expenditure. The scale of budget support in relation to public expenditure was significant in all countries. Budget support annual disbursements represented as much as 25 percent of public expenditure in Uganda in the first half of the period; 15 percent of public expenditure in Burkina Faso; over 10 percent in Mali, Mozambique, and Tanzania; 8 percent in Ghana; and 6.5 percent in Zambia. Even in Tunisia, where it represented only 1.4 percent of public expenditure, budget support was an important source of funding for discretionary expenditure.

The predictability of the amounts of budget support was high, with disbursements close to planned amounts in most cases, even though failure to meet eligibility conditions triggered temporary suspensions of budget support by the EU and other development partners in five of the eight countries during the evaluation period. In three cases, temporary suspension was linked to the government's breach of principles (major corruption and fraud cases came to light in Tanzania in 2007 and 2008; Zambia in 2009; and Mozambique in 2009, 2011, and 2012). The EU's general budget support was not yet explicitly linked to respect for fundamental values but only to the eligibility criteria, which continued to be satisfied. While corrective measures were discussed and then implemented, the EU continued to disburse funds, which eased the effect of these suspensions on the government's treasury tensions. In two other cases, Uganda (2012) and Ghana (2013 and 2014), underperformance on results, a deteriorating macroeconomic situation, and serious concerns regarding PFM triggered all development partners, including the EU, to suspend budget support, because the key conditions were no longer being met.

With these temporary suspensions and deferred disbursements of budget support because of countries' breach of mutual accountability, the predictability of disbursement timing could not be maintained. In Mali, Uganda, and Zambia, public expenditure was delayed and the government had to seek temporary domestic borrowing.

In most EU budget support operations, capacity development complements funding, policy dialogue, and performance monitoring. Technical assistance is used to strengthen the country's policy and PFM systems, improve the accountability of the government toward its citizens, and strengthen key institutions and policy making processes. Typical areas of support include external oversight; monitoring and evaluation; underlying statistical data systems and processes; PFM, including gender budgeting and monitoring; and the active engagement of stakeholders in policy design, implementation, and monitoring.

Technical assistance usefully complemented budget support in backing governance reforms and reinforcing capacities in PFM, audit, and statistics in six of the eight countries. Where sector budget support was provided alongside general budget support, sector capacities also benefited from technical assistance. In Ghana, major efforts were made to strengthen the capacities of civil society organizations and to enhance their role in policy processes. Overall, technical assistance remained a minor component of the budget support package; in many instances, evaluators estimated that more could have been done with better planning and a more flexible response to strengthen capacities at the subnational level, where policy implementation takes place.

In every result identified in all eight evaluations as a direct or indirect effect of budget support, policy dialogue featured as a central element. Dialogue related to budget support was invariably a crucial factor in improving policies, governance, and policy decision making. Through their policy dialogue, development partners were able to put and keep specific issues on the government's priority agenda, draw attention to governance matters, and propose and discuss policy options. Development partners also used performance monitoring and the variable tranche indicators to discuss results of policy implementation, corrective measures, and implementation challenges.

Strong coordination of budget support donors within a structured framework increased the effectiveness of policy dialogue, facilitating harmonization, alignment, and the delivery of joint messages. During the period, temporary suspensions of budget support disbursements led to a severe deterioration of relations between the government and development partners in several countries. The overall positive assessment of budget support policy dialogue was tempered in several cases by a perceived lack of government ownership and leadership of the policy dialogue as well as by extending budget support areas of interest to ever wider governance and sector issues for which reform capacities were insufficient.

General budget support was found to have induced and sometimes helped to trigger positive and mostly lasting changes in four main areas: policy formulation and implementation, the composition of public spending, PFM, and transparency and external oversight. Also, general budget support accompanied improvement in policies in several areas, depending on the objectives pursued and the weaknesses to be addressed.

Improvements in sector policies and delivery processes were substantial when general budget support was paired with sector budget support. In several countries, budget support contributed to strengthening of sector policies, adoption of a sector-wide approach, and implementing sector policies.

Discretionary funding enabled by budget support helped governments to significantly increase their social and pro-poor expenditure, in particular in the low-income countries (LICs), which led to expanded access and delivery of services in these priority sectors. The gains in social outcomes were momentous, but not always equitable. PFM, supported by policy dialogue, technical assistance, and the monitoring of PFM performance indicators, also improved in all countries except one as shown by repeated Public Expenditure and Financial Accountability reports. Evidence of strengthened transparency and external oversight as well as sector governance was also found in most countries receiving budget support. However, in fragile countries, where budget support contributed to fiscal stabilization and strengthening the capacities of vital state institutions, the strengthening of the institutions responsible for security, justice, peace, and democratic governance has been slower than expected.

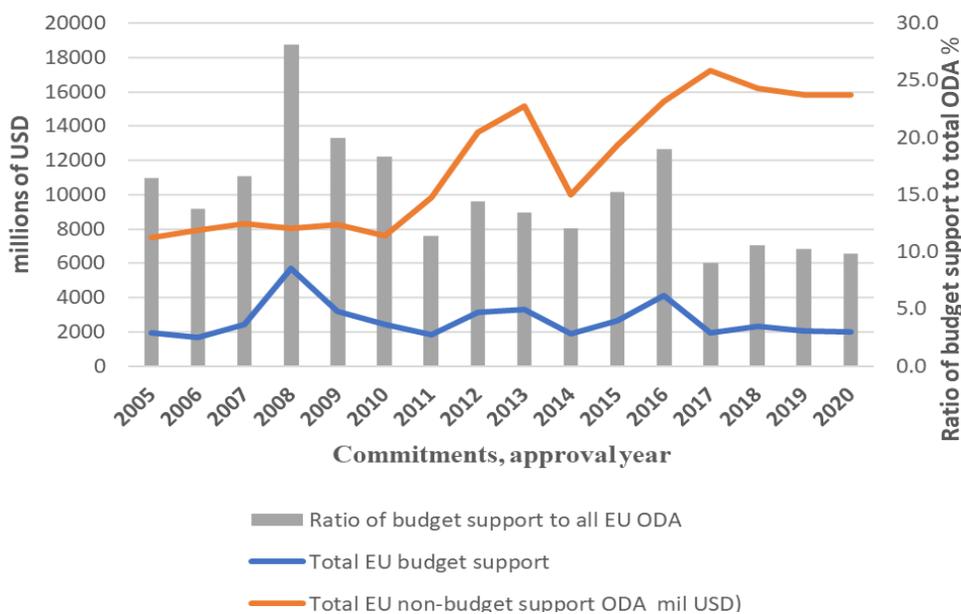
The evaluation findings summarized here should be considered in their context. This synthesis was based on evaluations undertaken in 2011–20 of budget support programs implemented during 1996–2018. Looking across the 17 evaluations and with the benefit of hindsight, some of the progress to which budget support contributed was short-lived, especially when countries experienced drastic sociopolitical, economic, or security shocks. The risk of losing progress never disappears; it therefore needs to be monitored closely during budget support

implementation. This finding may also indicate the need for deeper consideration of the factors that would help ensure the sustainability of outputs and induced outputs when designing budget support and evaluating its effectiveness.

Each of the 17 evaluations made recommendations to improve the use of budget support in the country concerned and, sometimes, to improve the specific programs, policies, and institutions supported. Recommendations that were less context-specific and could be applied to the management and use of budget support included: (a) establish new types of partnerships with partner countries, using cooperation modalities and tools differently; (b) use budget support as a complement to other aid modalities; (c) strengthen policy dialogue; (d) carefully consider the choice and use of performance indicators for the variable tranches; (e) improve technical assistance.

EU’s policy-based and project lending (on commitment bases) for 2005–20 is shown in Figure 4. Although non-PBO lending remained at high level in 2019–20, PBOs were not countercyclical as they had been during the previous crisis.

Figure 4: The European Union Budget Support and Other Lending (commitments), 2005-20



Note: ODA = official development assistance
Source: European Union.

Comments by Shanta Devarajan. This chapter is a useful description of the European Union’s budget support instrument and synthesis of the 17 independent evaluations of budget support operations. The EU’s budget support programs have many distinctive aspects, some of which the

chapter highlight. The synthesis of the evaluations paints a generally favorable view of EU budget support, although without a counterfactual analysis of the true impact cannot be discerned.

The two main distinguishing characteristics of EU budget support are that it is provided exclusively as grants rather than loans and is disbursed based on observable and monitorable indicators of performance, such as progress in implementing PFM reforms. EU budget support differs from budget support operations of the World Bank or AfDB, which mainly provide loans (some of which are concessional) and disburse based on prior policy actions rather than results.

The fact that the EU provides grants has implications for the definition of the appropriate macroeconomic framework. While everyone agrees that budget support should be provided only in a stable macroeconomic environment (hence the EU's collaboration with the IMF), the definition of "a stable macroeconomic environment" may be somewhat different if the country does not have to repay a loan. Hence, the macroeconomic framework for EU budget support may not necessarily be the same as the frameworks of the IMF or World Bank.

Disbursement of EU budget support is based on progress in meeting certain benchmarks agreed upon at the beginning of the program. The disbursement is made of a fixed component (which requires general conditions to be met and whose amount do not vary) and a variable component, which serves as a performance top-up and is disbursed proportionally to a set of additional and specific performance indicators (provided the general conditions are met). The disbursement can therefore be full (fixed tranche and the totality of the variable tranche), partial (fixed tranche and part of variable tranche, if progress was only partial), or nil (one of the general conditions is not met). This system of disbursement contrasts with the approach taken by the MDBs, whose budget support is disbursed based on policies undertaken (prior actions) rather than on results. To the extent that there is a difference between ex ante policies and ex post performance, one wonders how countries can coordinate across their budget support donors.

Performance-based conditionality (PBC) raises three issues of its own. First, because development is a risky business—whether a given policy reform will yield the expected outcome is not known—PBC puts more of the risk on the recipient.

Second, other attempts at PBC, such as the World Bank's Program-for-Results (PforR) financing, have found a tendency to "dilute" the performance criteria (in order not to risk failing to disburse) to the point where they resemble ex ante policy conditions.³⁸ The reality is that both the donor and the recipient have an interest in seeing the operation disburse and therefore may, even subconsciously, nudge conditions in that direction. It is possible that this is happening with EU budget support as well.

Third, the chapter notes approvingly, in addition to budget support, the EU provides technical assistance to countries to further progress on key areas such as PFM. Although it is desirable that EU technical assistance, budget support conditions, and policy dialogue all pull in the same direction, there may also be problems here. If the EU is providing technical assistance in an area that is also a performance criterion for tranche release, at least two things could happen. If the country fails to meet the performance criterion, it could blame it on the technical assistance, or

³⁸ Alan Gelb, Anna Diofasi, and Hannah Postel. 2016. "Program for Results: The First 35 Operations." CGD Working Paper, 430. Washington, DC: Center for Global Development.

the organization providing the assistance could try to influence the EU into certifying that the country had met the criterion, lest its own performance be judged as mediocre. Even if the technical assistance and budget support operation are kept independent, as both being provided by the same institution, it is difficult for the country to not perceive them as linked.

The independent evaluations synthesized in the chapter all follow the same three-step framework. First, the effects of the budget support operation on policies and institutions are analyzed. Second, the outcomes and outputs in a country are related to policy and institutional changes. Third, the results of the first two steps are combined to provide a narrative of how the budget support operation, through its contribution to policy and institutional change, helped achieve outcomes and impacts.

There is an attempt to specify a counterfactual in some of the individual steps, but the overall narrative does not include one. One way of constructing a counterfactual is to compare one country with another with similar characteristics that did not receive a budget support operation from the EU. This cross-country analysis has been used in other evaluations of budget support operations.³⁹ Another is to compare the same country's performance in two periods, one in which there was a budget support operation and one in which there was not. Such an analysis would need to adjust for other factors, such as a terms-of-trade shock, that may have affected the economy during the budget support phase but were unrelated to the operation. If, for instance, a country experienced a favorable terms-of-trade shock during the period of the operation, the success of the operation may have been because of the shock rather than the operation.

The value of having a counterfactual goes beyond just having a better estimate of the project's impact. It also helps disentangle the different components of budget support. As the synthesis notes, budget support operations have three components: the transfer of resources, technical assistance, and dialogue on policy reforms aimed at achieving the targets of the operation. What is the relative importance of each?

The chapter notes that many evaluations discussed the relative contributions of the financial transfer (flow of funds), technical assistance, and policy dialogue, but this seems to be based on the relative magnitude of the financial transfer and the intensity of technical assistance and policy dialogue rather than on a model of the combined effect of the three on outcomes. Nevertheless, the chapter finds that the flow of funds played a greater role in the general budget support operations than in sector budget support. The reason could be that the sector budget support operations were concentrated in MICs, including some upper-middle-income countries; the financial transfer represented a tiny part of the government's budget (0.6 percent as opposed to 15 percent for general budget support). In addition to their relative contributions, one needs to understand the interaction between financial and knowledge assistance.

The bundling of finance and policy dialogue into budget support raises the broader question of why they should be bundled. If these policy reforms benefit the country, why do they not implement them anyway? Why is it necessary to incentivize them with funding?

³⁹ William Easterly. 2003. "IMF and World Bank Structural Adjustment Programs and Poverty." In *Managing Currency Crises in Emerging Markets*, ed. Michael P. Dooley and Jeffrey A. Frankel. Chicago: University of Chicago Press.

One answer is that the financial transfer acts as an encouragement for the government to undertake the reforms, suggesting that the reforms are not collectively owned by the whole of government. The financial transfer helps fix a fundamental political economy problem in the country (usually on a temporary basis). It is not clear that such solutions are sustainable. It is also not clear that external actors, such as the European Union or World Bank, can or should select reform champions in the country.

The financial transfer associated with budget support can have two other effects that may not be conducive to better development outcomes. The synthesis in the chapter hints at some of them but does not develop their implications. The first is the fungibility of aid resources, which the chapter mentions. As the financial transfer goes directly to the government's budget, it could in principle be used for any expenditure. Several evaluations speak favorably of the fact that pro-poor expenditures—on, for example, health, education, and social protection—rose during a budget support operation. But if the country was planning on increasing spending in these sectors anyway, then the EU's funds were being used to finance other expenditures, about which little is known. This possibility is not just theoretical. There is evidence on the fungibility of aid in general. The second problem with the financial transfer links back to the political economy problem mentioned earlier.

Most of the evaluations seem to equate increased public spending on health and education with improved health and education outcomes. Evidence for this link is weak at best because the delivery of basic services in health and education is poorly targeted and often ineffective (often because of absentee teachers or doctors). The chapter notes this discrepancy by pointing out that the gains were momentous but not always equitable... and gains in access have not always been accompanied by better quality of services.

II.4. Inter-American Development Bank, 2005–19 (Chapter 4)

Monika Huppi and Gunnar Gotz. The Inter-American Development Bank (IDB) offers three broad lending categories among its sovereign-guaranteed loans: investment lending, policy-based lending (PBL), and lending for financial emergencies during macroeconomic crisis (called special development lending). PBL provides fast-disbursing financial assistance or country budget support conditional on the borrowing country fulfilling a set of agreed upon policy and institutional reforms. Investment lending disburses against specific predefined project expenditures. Special development lending also provides fast-disbursing support but is conditional on a country having been struck by a macroeconomic crisis, being supported by an active International Monetary Fund (IMF) program, and the special development lending being part of an international support package.

IDB introduced PBL in 1989, in response to the Latin American and Caribbean debt crisis. The instrument has evolved over time, leading to a decoupling from IMF support, the introduction of a programmatic variant and of a deferred draw-down option. The programmatic version consists of a series of single tranche operations set in a medium-term framework of reforms. The first operation identifies the policy conditions for the disbursement of that operation as well as indicative triggers for the subsequent loans in the series. Since the triggers can be revisited at the time of loan approval, programmatic PBL allows for conditions to be adjusted as circumstances change.

PBL has historically been subject to a lending limit which has changed over the years. In 2005–19, PBL accounted for about 28 percent of IDB’s sovereign-guaranteed approvals and amounted to \$42.6 billion. About 80 percent of these resources were approved as programmatic operations supporting 124 programs, with the remaining 20 percent as individual single- or multi-tranche policy-based operations. All IDB borrowing member countries except one used PBL to varying degrees in the period. IDB’s PBL is rarely co-financed by other institutions and IDB tends to support reform processes in areas in which it has accumulated experience and knowledge. Emergency budget support has been provided through separate budget support instruments (currently called special development lending) that have also evolved. This form of support accounted for only 2 percent of sovereign-guaranteed approvals in 2005–19. During the first half of 2020, in response to the COVID-19 pandemic, policy-based and special development lending have spiked.

IDB’s Office of Evaluation and Oversight (OVE) has looked at PBL in several contexts, but a full-fledged evaluation of IDB’s PBL has yet to be undertaken. OVE routinely reviews the performance of PBL in its country program evaluations. It also reviews and validates IDB’s self-evaluations of completed programs and operations and assigns a performance rating to each completed PBL program or freestanding PBL operation. In addition, OVE undertook a thorough review of the design and use of PBL in 2015, which is summarized in the chapter.

The OVE review of the design and use of PBL found that although countries used PBL for various reasons, the predominant use was for budget support in time of need. While countries valued the policy dialogue and technical expertise that came with IDB PBL, the policy elements were usually secondary to the primacy of budget support. Although PBL provided important financial support, its ability to play a countercyclical role overall was limited because of the cap on PBL, the limited size of PBL operations compared to the economy in all but small countries, and because PBL could not be disbursed if borrowers did not have a positive macroeconomic assessment.

The extent to which PBL is complementary to or a substitute for market financing has not been systematically assessed by OVE’s review. In some instances, OVE’s country program evaluations show that countries with ample access to financial markets used PBL as a liquidity management tool to complement market financing and fill short-term liquidity needs, particularly outside an economic crisis.

In its 2015 review, OVE assessed the depth of the policy measures supported by PBL and found that while they were generally relevant to the objectives of the reform programs they aimed to support, most policy conditions did not have enough depth to set in motion reforms that could by themselves bring lasting changes. Policy conditions were of higher depth in programs in the financial and energy sectors and during times of crisis.

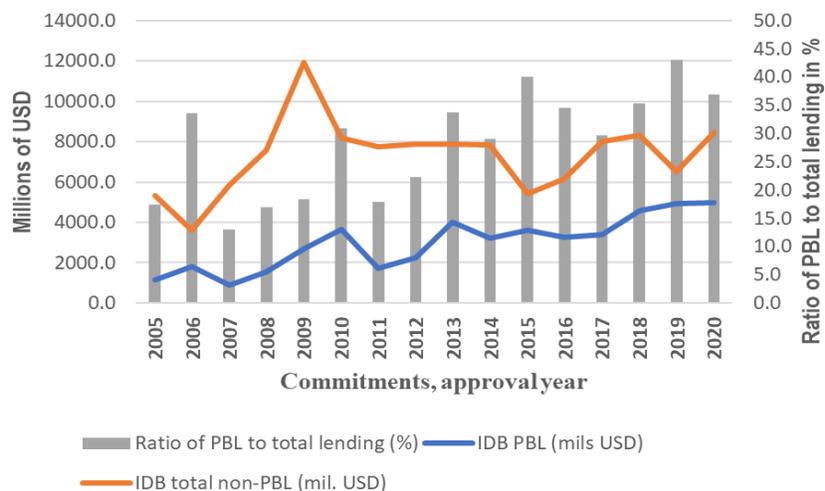
Programmatic policy-based loans were found to allow for more sustained engagement. To the extent that policy measures became deeper as a programmatic series progressed, they were a useful tool to support reform programs while also helping borrowers meet financing needs. However, over one-third of programmatic PBL series active between 2005–19 were truncated before they reached their most consequential reform steps, raising questions about the ownership of the underlying reform programs that such lending sought to support. Truncation was more pronounced for PBL series in countries that resorted mostly to PBL to meet financing needs and did not seek technical assistance to accompany the underlying reform programs. That programs supported by

technical cooperation grants had a lower truncation rate suggests the need for continuous engagement and technical cooperation to support borrowing countries in their reform efforts.

The findings of OVE’s work undertaken so far invite questions. To what extent does PBL complement or substitute for funding from financial markets? Are IDB-supported policy measures complementary to, or do they overlap with those of other institutions providing budget support? What nonfinancial additionality does PBL provide? What results have PBL operations helped achieve and how sustainable will those results prove to be? OVE plans to undertake a full-fledged evaluation of PBL at IDB to try to answer some of these questions.

IDB’s policy-based and project lending (on commitment bases) for the period 2005–20 is shown in Figure 5. Both PBO and non-PBO lending increased in 2020, though the ratio of policy-based lending to total lending fell slightly below IDB’s 40 percent cap.

Figure 5: Inter-American Development Bank Policy-Based and Project Lending (commitments), 2005-20



Note: PBL = policy-based lending

Source: Office of Evaluation and Oversight, Inter-American Development Bank.

Comments by Augusto de la Torre. The chapter is divided into two sections. The first neatly summarizes the evolution of PBL and its use by borrowing countries since its introduction at IDB in 1989. The second assesses PBL along several dimensions (based on well-focused findings), including the reasons countries demand PBL, complementarities between PBL and other IDB operations, and issues in design and implementation of PBL operations. The analysis part of the chapter is strong when it comes to findings; it falls short when interpreting the implications of such findings for IDB and borrowing countries. The observations of this commentator elaborate on these questions and issues and raise a few others.

The chapter provides significant evidence that borrowing countries' predominant use of PBL was to fill their budget financing needs, with policy elements usually being secondary to the primacy of budget support. This suggests that MDBs recognize that financing needs are at the heart of the demand for PBL but point to policies and reforms as a key reason for offering PBL. Efforts to align these two motivations drive PBL preparation and design. These efforts succeed at times but not always.

Not surprisingly, using a creative analytical approach, the OVE review found that most conditions in PBL were of low to medium depth. They tended to involve one-off and often reversible policy measures, to be process oriented, or to have good policy intentions that could not be implemented at the time. by themselves effect lasting change. The OVE review stressed that conditionality in PBL was generally relevant to the programs' objectives but probably insufficient to attain the expected outcomes. The commentator concludes that the findings of the OVE report should lead MDBs to adjust expectations toward more realistic levels. PBL operations do not simply "buy" reforms, as is often believed. At best, they provide needed budgetary financing while recognizing—and helping fine-tune and strengthen the technical aspects of—reforms that would have been attempted by the country with or without the PBL.

Still, the commentator finds that the rise in programmatic policy-based loans (PBPs) can be interpreted as a major step toward greater realism and frankness in PBL. PBPs have accounted for the lion's share of IDB-originated PBL since 2005. He concludes that wisely, PBPs do not pretend to "buy reforms." Instead, each single tranche loan in the program recognizes and gives credit to the country for policy actions and reforms that have happened before loan disbursement. Future reforms appear only as indicative guides for future operations under the multiyear program.

As a result, PBPs avoid the time-inconsistency trap of traditional multi-tranche PBL operations, in which countries under duress may agree to conditions (reforms) with a low probability of being met (because the incentives to stick to the conditions diminish after the PBL is approved and the first disbursement comes in).

Related to the question of ownership is the crucial question of whether PBL or PBPs can realistically be expected to generate policy additionality. Given the difficulties in identifying a counterfactual, it is difficult to attribute policy reforms to PBL or, equivalently, to reject the hypothesis that those policy reforms would have taken place even absent PBL. This calls for modesty by MDBs, whose role is not so much to tell countries what to do but to partner with countries in their quest for social and economic progress, including in design, implementation, and evaluation of reform.

To mitigate the risks of low-depth reforms and truncation, a premium must be put on a continued and robust technical engagement and policy dialogue between the MDB and the country client. Doing so is particularly important considering several important findings in the OVE evaluation, including that "IDB tends to support policy reforms in sectors in which it had previously worked (usually through technical cooperation grants and investment loans) and thus has some country-level expertise that allows it to sustain a policy dialogue and provide relevant technical advice" and that "there was a significant positive relationship between technical cooperation support and

the likelihood of a PBP series being completed.”⁴⁰This point also argues for not evaluating PBL—or any particular financial product offered by an MDB—in isolation, but in context—that is, considering the entire portfolio of services the MDB offers to its country clients, including financial services, knowledge services, and convening services.

The findings in the chapter raise questions about the complementarity and substitutability of PBL and market-based finance, an issue the chapter does not address but should. One hypothesis is that in countries with strong macro-financial policy frameworks, PBL is complementary to market-based finance—that is, these countries use PBL as part of their prudent management of the portfolio of public sector liabilities. In countries with weaker macro-financial policy frameworks, the hypothesis would imply that PBL is a substitute for market-based finance—that is, these countries resort to PBL because they lack access to market-based finance. The chapter should have explored this hypothesis and elaborated on the implications of what it found.

II.5. Caribbean Development Bank, 2005-2020 (Chapter 5)

James Melanson and Jason Cotton. The mandate of the Caribbean Development Bank (CDB) is to reduce poverty and transform lives by contributing to the sustainable, resilient, and inclusive development of its Borrowing Member Countries (BMCs). PBOs are financing instruments—loans, grants, and guarantees—that are used to incentivize the implementation of country-owned policy reforms and institutional changes aimed at advancing sustainable development goals. PBL provides fast-disbursing budget support to finance priority expenditures while helping to strengthen the effectiveness of public policy frameworks. It is disbursed following compliance with agreed policy actions and supports the process of good policy making and governance while reducing transactions costs and providing timely resources to national budgets. PBL is complementary to investment lending, as it helps establish an enabling environment for enhancing resilience, achieving economic growth, and reducing poverty. It is an important CDB intervention modality to enhance development effectiveness and responsiveness to the changing needs of members.

CDB PBOs can take several forms:

- Macroeconomic PBOs address external or internal economic imbalances.
- Sector PBOs support reforms that help address critical sector issues and strengthen progress toward overall economic development.
- Exogenous shock response PBOs provide resources in crisis situations to assist with the fallout from a shock; they can support reforms to enhance resilience.
- Regional public goods PBOs help embed the policy and institutional frameworks necessary to advance regional cooperation and integration.
- PBO guarantees guarantee a portion of debt service on a borrowing or bond issue by a BMC in support of country-owned policy reforms.

PBL can be an important component of country financing strategies. At the country level, the size of the loan is related to development financing requirements, defined in terms of balance of payments, fiscal, sector, or other economic funding needs.

⁴⁰ Chapter 4 in this volume.

CDB began participating in PBL operations in the late 1980s, with operations to support macroeconomic adjustment executed in collaboration with the IMF, World Bank, and IDB. These operations addressed complex development problems, made more acute by the increased frequency of natural disasters and the impacts of climate change, external shocks, relatively low growth, and high debt in Latin American and Caribbean states.

In 2005, CDB formally introduced PBOs into its lending toolkit. Since then, it has sought to gradually strengthen the PBO instrument and the policy governing its use. Five external reviews or evaluations, as well as internal assessments by staff, have guided these efforts. Over time, they have revealed scope for improving the administration of PBOs, particularly in their design, supervision, and reporting, and the need to develop a more comprehensive and structured policy framework and guidelines. CDB has also experienced internal capacity building in results-based management, country fiscal diagnostics, and debt sustainability analysis.

In 2013, a significant revision to the 2005 framework was undertaken to provide greater clarity on the principles, procedures, and guidelines for administering PBOs and to anchor them within CDB's overall risk management and control framework. The new framework provided for an increase in the PBL limit from 20 percent of total loans and guarantees outstanding to 30 percent and subsequently, subject to further approval, to 33 percent. It also introduced risk-based and policy-lending allocation limits (from a credit risk, use, concentration, and capital adequacy standpoint) at the country level that align with, and preserve, the prudential soundness of CDB. Following a comprehensive review of operations and the establishment of a centralized Office of Risk Management in May 2013, the PBL limit rose to 33 percent in December 2015.

In March 2020, CDB's board approved an increase in the prudential limit to 38 percent, creating headroom for lending in response to the fallout from the COVID-19 pandemic. The increase is expected to be temporary, with a return to 33 percent by the end of 2023.

The PBL framework encourages collaboration with development partners when they have PBOs that pursue similar expected outcomes to those of CDB. CDB seeks to harmonize appraisal, supervision, and monitoring using a common policy matrix. When CDB resources will not be able to close the financing gap, staff either appraise a PBO request as part of a joint operation with other development partners or consult closely with strategic partners to help mobilize resources. Staff must assess the adequacy of the macroeconomic framework for the conduct of a PBO. The views of the IMF and the existence of an IMF program or an Article IV assessment are important ingredients in the appraisal. Absent an IMF program or Article IV assessment in the preceding 18 months, an assessment letter of the macroeconomic framework is requested. For overseas territories of the United Kingdom, a letter of approval from the requisite authority in the United Kingdom is sought.

Between 2005 and September 2020, CDB undertook 27 operations, amounting to \$944.7 million. In 2019, PBL represented 42 percent of CDB's total loan approvals and 54 percent of its loan disbursements. PBL has financed emergency priority spending and helped preserve stability in BMCs, which are highly vulnerable to external shocks and natural disasters. This vulnerability derives from inherent structural characteristics, such as lack of economies of

scale or economic diversification, export concentration; remoteness from global markets; dependence on external financing; and exposure to natural hazards and climate change.⁴¹

During 2006–20,⁴² PBL activity correlated closely with periods of economic and natural hazard shocks. In 2008, on the heels of the global financial crisis, CDB approved nine PBOs, totaling about \$340 million (36 percent of the PBL portfolio). Given the increasing frequency and intensity of hurricanes in the region, PBL demand has remained strong since 2015, peaking in the 2017 and 2019 hurricane seasons. Since the introduction of PBL, practice has evolved, reflecting CDB’s learning and experience in managing the instrument and its observation of experience at other MDBs.

The findings and conclusions of a 2017 evaluation conducted by CDB’s Office of Independent Evaluation, based on evidence from document review, case studies, and a wide range of interviews, suggests that several key factors increased the likelihood of PBL operations achieving their desired results. These included (a) clear objectives and results logic, with indicators and targets that can be measured and verified; (b) a selective focus on a manageable number of expected reform outcomes; (c) agreement on a small number of prior actions clearly linked to those outcomes; (d) good understanding of external risks and elaboration of mitigation strategies; (e) an engagement process with BMCs that engenders ownership and commitment by borrowers; (f) a menu of PBL options that offers the right instrument calibrated to borrowers’ reform readiness; (g) an understanding of national capacity constraints and, where needed, provision of affordable technical assistance to address them; (h) designation of an identified champion in the national public service with responsibility and authority for achieving reform results; and (i) consistent monitoring to identify when conditions are met, and the degree of progress toward reform outcomes.

Although the evaluation found that CDB’s PBL was increasingly taking these factors into account, it offered several recommendations to encourage further progress:

- CDB should review its practice of management for development results (MfDR) in the PBL program, making sure its design processes respect good MfDR practice, with clearly stated expected outcomes and indicators that are specific, measurable, achievable, relevant, and time-bound (SMART).
- A corollary of more carefully stated results frameworks would be more tailored risk mitigation strategies. To date, such strategies have tended to be generic across PBOs. They should be more closely matched to the specific circumstances of the national context and reform program.
- CDB’s PBLs should focus on a small number of key outcomes, with prior actions that are causally linked to them. The choice of outcomes should take account of the limited size of CDB’s PBL loans, BMC priorities and CDB’s own country strategy, and an agreed longer-term reform program.
- This focus should be maintained over time, with prior actions in successive PBOs building incrementally on one another.

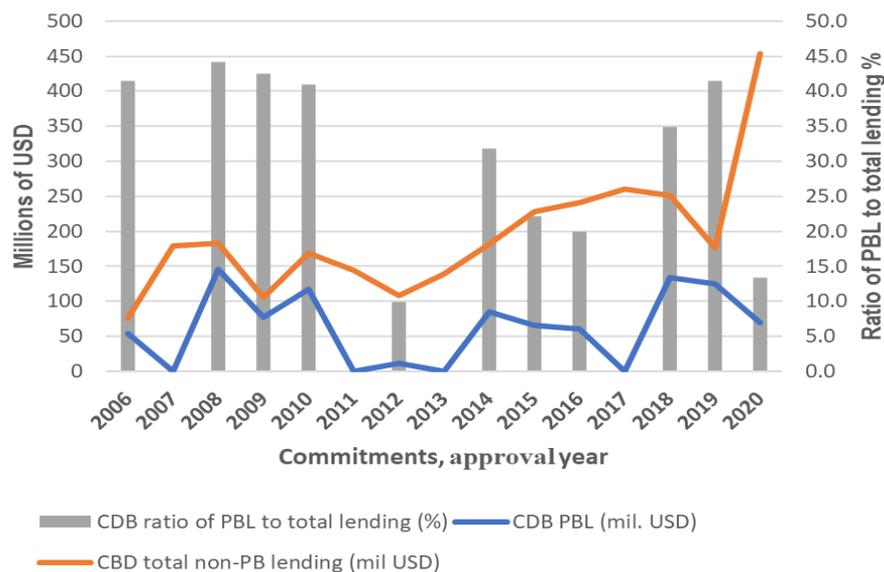
⁴¹ Caribbean countries are seven times more likely than other countries to be affected by a natural hazard and to suffer damage that is six times greater. See Sebastian Acevedo Mejia. 2016. “Gone with the Wind: Estimating Hurricane Climate Costs in the Caribbean.” IMF Working Paper WP/16/199. Washington, DC: IMF.

⁴² Data for 2020 cover the months January–September.

- National ownership and leadership are indispensable to the success of development reform programs. CDB should facilitate these to the greatest extent possible through collegial engagement with BMCs in PBL design and implementation. Doing so will require consultations with a sufficient breadth of national stakeholders, at both leadership and implementation levels, to gain commitment and follow through on reform objectives and prior actions. A good practice to be encouraged is the designation of a “champion” from the BMC’s public sector for implementation of targeted reforms. Small economies experience serious capacity constraints to implement reform programs. These constraints need to be anticipated and responded to as part of an effective PBL program. Relative to other MDBs, CDB has a more intimate understanding of the contexts and constraints of its BMCs, but it has carried out only limited needs analysis and there has been limited uptake of CDB technical assistance in connection with its PBL loans. CDB should investigate the reasons for this and make sure potential technical assistance requirements are well analyzed at the design stage and that flexibility is shown when such assistance is implemented.

CDB’s policy-based and project lending (on commitment bases) for the period 2006–20 is shown in Figure 6. While non-PBO lending rose sharply in 2020, PBO lending fell and the ratio of policy-based lending to total lending fell well below CDB’s temporary cap of 38 percent. For CDB the lending pattern has become increasingly reflective of the financing needs arising from natural disasters than global events.

Figure 6: Caribbean Development Bank Policy-Based and Project Lending (commitments), 2005-20



Note: PBL = policy-based lending

Source: Office of Independent Evaluation Office, the Caribbean Development Bank.

Comments by Ali Khadr. The chapter provides an informative overview of the findings of five assessments, including two Office of Independent Evaluation (OIE) evaluations of CDB PBOs. Among many other findings, it conveys how the institution’s practice of PBL, as well as the associated framework and guidance, has evolved over the roughly 15 years since it was initiated. Even with the favorable evolution of CDB’s PBL practice, there is room for further improvement.

Like other MDBs, CDB has moved over time toward the body of good practice identified in an ever-growing PBL literature. Among the key elements of this emerging body of good practice are (a) more frequent use of the more adaptable programmatic PBL instrument variant rather than the more rigid multi-tranche variant; (b) a focus on fewer, “deeper”⁴³ prior actions in PBOs; (c) use of results frameworks with a tighter logic linking a small number of prior actions to a manageable number of key outcomes sought, as well as associated use of specific, measurable, achievable, relevant, and time-bound (SMART) results indicators; (d) greater country ownership of proposed measures and outcomes sought, bolstered by broad prior consultation; (e) identification of capacity constraints to reform implementation and provision of parallel technical assistance as needed; and (f) identification and mitigation of risks adequately tailored to the specific operation. These elements raise questions about (a) the use of PBOs in small states and the shocks to which they are often subject; (b) the use of PBOs to strengthen fiscal management; (c) the analytical underpinnings of PBOs; (d) the quality of the results framework, including the depth of prior actions; and (e) establishment of attribution or contribution.

CDB is unique among MDBs in that its clients consist overwhelmingly of small states (formally defined as countries with fewer than 1.5 million inhabitants). Of the CDB’s 19 BMCs, 17 are small states (or dependencies), most of them islands or archipelagos.

As extensively documented in a burgeoning literature, small states as a group, especially small island states share several intrinsic characteristics and challenges. They include higher fixed costs (for instance, larger public expenditure, including public sector wage bills, as a share of GDP). The locations of these states also commonly entail high trade costs as well as extreme vulnerability to natural disasters and the deleterious effects of climate change. In addition, their exports tend to be very concentrated (usually in tourism and a few commodities), which makes them particularly vulnerable to trade shocks and contagion from trading partner downturns, including the downturn induced by the COVID-19 pandemic.

These intrinsic characteristics and challenges—particularly the exposure to repeated economic and natural shocks that are large relative to GDP—have resulted in a greater volatility of growth in small states compared with larger ones. Together with the inherent stresses on public finances and limited borrowing opportunities, these repeated shocks have often entailed fiscal distress and rapid debt accumulation, making effective fiscal and debt management imperative.

Given the shock-intensive country client context, PBL from MDBs has a clear role to play in CDB BMCs. It is especially encouraging to see that CDB has raised the prudential limit to 38 percent to create lending headroom to counter COVID-19-related fallout and offering exogenous

⁴³ The concept of depth, used in several evaluations of PBL, can be traced back to the measure of “structural depth” developed and applied in Independent Evaluation Office. 2007. *Structural Conditionality in IMF-Supported Programs*, Washington, DC: International Monetary Fund.

shock response PBOs as a distinct instrument variant. Future evaluations of CDB PBOs can yield valuable lessons on how effectively such operations have supported small states, especially in helping mitigate the shocks to which they are subject and building resilience.

In many small states drawing on PBOs, fiscal management is likely to be—or at least should be—a central component. One area of focus in future PBL evaluation work by CDB could therefore be the quality of PBOs’ macro-fiscal frameworks, given recent findings in the evaluation literature to that it is positively associated with loan outcomes.

In an earlier study, the Independent Evaluation Group (IEG) of the World Bank Group examined the quality of macro-fiscal frameworks in 390 World Bank PBOs completed during fiscal years 2005–13. It found that certain aspects of the quality of PBO macro-fiscal framework design were positively correlated with loan outcome ratings. Two aspects of the quality of the PBO framework showed a statistically significant association with loan outcome ratings: the credibility of the PBO framework given the country’s fiscal record and adequate coverage of quasi-fiscal risks (risks the government might need to devote public spending to off-budget items, such as an underfunded public pension system or state-owned enterprises in distress).

There is emerging, although not conclusive, evidence that strong analytical foundations can be an important determinant of PBO effectiveness. IEG found generally solid links between World Bank PBL design and integrative analytical work on public expenditure, as well as continuity in policy dialogue from the latter to the former. However, it was difficult to establish a clear association between such links and PBO outcome ratings, although PBOs informed by analytical work on public expenditures showed slightly better outcome ratings over 2009–12.

The depth of prior actions in CDB PBOs increased over time. Depth—the extent to which the reform measure on its own can bring about lasting change in the institutional and policy environment—is a key ingredient in the quality of the results framework. Noncritical, shallow, and process-related measures should be avoided.

A common complaint in PBL evaluations concerns the difficulty of attributing medium-term country outcomes to the use of PBOs, including the prior actions they support and the financing they provide. The difficulty is compounded when several development partners deliver PBL simultaneously. It is therefore not surprising to read in the chapter that “it was not feasible for the evaluation to gather a sufficient amount of directly attributable evidence to support statements of causal linkage between CDB’s PBL support and higher-level medium-term outcomes.”⁴⁴

Given the concentration of CDB clients in small states, CDB PBL evaluation work can yield valuable lessons about how CDB PBOs support small states in dealing with shocks, particularly whether PBOs adequately cover the multiple drivers of fiscal and debt sustainability and foster systemic, rather than incremental, changes in disaster and climate resilience by targeting incentives and behaviors. Other issues on which future CDB evaluation work could usefully focus include the quality of CDB PBOs’ macro-fiscal frameworks and analytical underpinnings, the quality of PBO results frameworks (including depth of prior actions supported), and establishment of the plausible likelihood of PBOs contributing to country outcomes.

⁴⁴ Chapter 5 in this volume.

II.6. World Bank, 2006–19 (Chapter 6)

Zeljko Bogetic and Jeff Chelsky. International financial institutions use different names for policy-based financing (PBF) and PBOs/PBLs. The World Bank generally refers to this type of support as development policy financing (DPF), delivered through different types of the DPF instrument, depending on the nature of the financing provided. A development policy loan or development policy operation is the most common type. If the financing is a grant (typically provided to low-income country recipients), the PBF will usually be a development policy grant.

Development policy financing can also be a guarantee, for which a policy-based guarantee (PBG) is used,⁴⁵ or as financing contingent on the activation of an indicative trigger related to, for example, natural disasters or health crises. DPF can be provided through a single, stand-alone operation or through a programmatic series of operations, linked by indicative triggers. DPF is provided to sovereign national governments of World Bank member states and, sometimes, to subnational governments.

The World Bank’s policy on DPF states that “DPF is aimed at helping a Member Country address actual or anticipated development financing requirements that have domestic or external origins. The [World] Bank may provide a Bank Loan to a Member Country or to one of its Political Subdivisions; and it may provide a Bank Guarantee of debt incurred by a Member Country or by one of its Political Subdivisions.”⁴⁶ DPF aims to help the borrower achieve sustainable poverty reduction through a program of policy and institutional actions. These may include, for example, strengthening PFM, improving the investment climate, addressing bottlenecks to improve service delivery, or diversifying the economy. DPF provides general budget support, meaning that the funds are disbursed into the general budget of the client government and are not earmarked for specific purposes.

Approval by the Board of Executive Directors and implementation of a set of policy and institutional actions (prior actions) are required before financing can be disbursed. Prior actions are expected to advance, catalyze, or signal meaningful movement along the results chain toward the achievement of clearly specified objectives. The objectives of each development policy operation are expected to be consistent with the recipient’s national development goals and the World Bank–supported strategy for the country. Well-defined results indicators, with clear baselines and time-bound targets, monitor progress toward objectives along a credible results chain (or theory of change) that links prior actions, complementary other activities, and reforms to targeted outcomes. The policy framework underpinning a DPO is developed through a dialogue between the World Bank and the recipient government.

Over the past decade and a half, DPF operations have accounted for one-quarter to one-third of World Bank financing commitments. The use of DPF increased during the global financial crisis in 2007–09, when it was used to provide countercyclical financing to many developing country recipients. It has also increased during regional crises and most recently, in response to the COVID-19 pandemic.

⁴⁵ In a PBG, instead of providing financing directly to the client government, the World Bank provides a guarantee for a portion of the principal or interest on a loan, or both, which is provided by commercial creditors, or the client government issues an international bond.

⁴⁶ **Chapter 6 in this volume.**

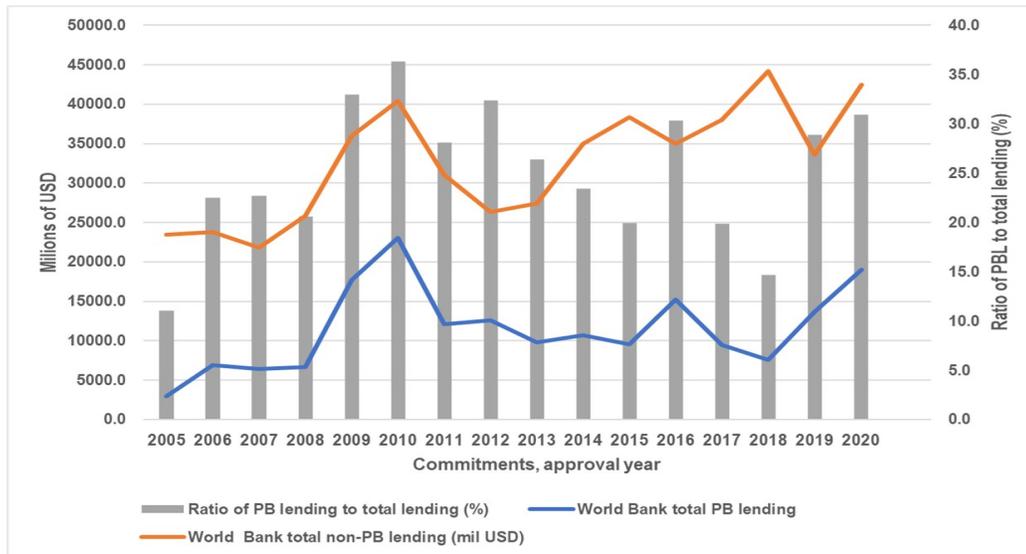
This chapter reviews the evolution in DPF at the World Bank and provides evidence on the performance of the instrument between 2005 and 2019, as reflected in the recent literature and IEG evaluations. It also describes recent changes to IEG’s evaluation framework for PBF operations. The principal findings are:

- Policy-based lending has been an important financing instrument of the World Bank, accounting for about one-quarter of its total financing during 2005–19 but increasing to about 40 percent in times of crises. It often plays an important countercyclical role in developing countries. Budget support operations have supported short-term and longer-term policy and institutional reforms geared toward poverty reduction and shared prosperity.
- The World Bank uses DPF as a key instrument in supporting country clients in crisis. During crises such as the global financial crisis, the focus on fiscal management, effectiveness of public expenditures, and targeted social programs supported countercyclical policies.
- Several types of budget support are in use, including standard, stand-alone operations; programmatic series of operations; and PBGs and deferred draw-down options. This variety makes DPF a versatile financing instrument that can be deployed in a wide variety of contexts to support short-term goals (such as macroeconomic stabilization, natural disaster emergency, post-conflict budget financing support, and arrears clearance) and long-term goals (such as poverty reduction and shared prosperity). For this reason, governments have often requested this instrument, especially in times of crises, when national budgets are under stress and quick-disbursing financing, combined with corrective policy actions, is an economic and social imperative.
- The COVID-19 crisis and its unprecedented global health, economic, and social impact prompted the World Bank to rapidly scale up its financing to developing country recipients to cushion impact. At the start of the pandemic, it committed to deliver \$160 billion in overall financial support by the end of June 2021. In the event, \$157 billion was delivered, including \$28 billion in DPF.
- IEG evaluations have generally assessed World Bank DPOs positively, with the overall outcomes of about four-fifths of operations rated moderately satisfactory or higher. However, within this, the share of operations rated satisfactory has declined while the share rated moderately satisfactory has risen.

The framework for evaluating DPF at the World Bank was recently revised to produce more operationally relevant findings and lessons better tailored to this instrument. IEG has similarly revised its validation framework for evaluations of DPF operations to give greater attention to World Bank performance more generally, including the relevance and quality of prior actions, appropriateness of results indicators, and the adequacy of the ex ante assessment of risks to the achievement of objectives. IEG began using this new framework in late 2020.

World Bank policy-based and project lending (on commitment bases) for 2005-20 is shown in Figure 7. While both PBO (DPF) and non-PBO lending rose sharply in 2020, the ratio of policy-based lending to total lending at about 30 percent fell well below the World Bank’s ratios during earlier crisis (e.g., 2008–10) when ratio rose to 35 percent.

Figure 7: World Bank (IBRD & IDA) - Policy-based and Project Lending (Commitments), 2005-20



Note: PBL = policy-based lending
 Source: IEG, the World Bank.

Comments by Cheryl Gray. This chapter provides a useful, concise, and well-written summary of the evolution of the World Bank’s approach to PBF and methods to evaluate it. It shows the careful thinking undertaken by the World Bank as it has struggled to deliver effective support to countries, often in complex and difficult settings.

As the chapter illustrates, PBF has long been a major instrument of international development support, valued in the hundreds of billions of dollars annually across development agencies. Its breadth and complexity have made it exceedingly difficult to study, and evidence of its results remains elusive. This chapter sheds light on what is known, although for perhaps unavoidable reasons the picture is still incomplete.

The first point worth stressing is the practicality and value-added of the World Bank’s evaluation architecture. Over more than three decades the World Bank has designed, implemented, and continuously improved a cohesive structure to document results from all its operations—both investment and PBOs—in a practical and cost-effective manner. The process begins with a self-evaluation, using standard criteria applicable in all similar operations, by the task team, whose members know the operation best. IEG then reviews and assesses that self-evaluation.

The fact that 100 percent of self-evaluations are assessed by IEG creates an incentive for task teams to report accurately while also producing a complete database of operation-level reviews across the institution. IEG sometimes follows up with more in-depth evaluations or broader sector or thematic evaluations, adding further context and evidence on results. The entire evaluation architecture is oriented toward documenting activities and outcomes, creating opportunities for learning through self-evaluation and analysis.

These routine World Bank evaluations are not in-depth impact evaluations with rigorous causal inference. They do not compare performance against counterfactuals to identify and measure cause and effect. Occasionally, it is possible to apply impact evaluation techniques to specific interventions in specific settings, but it is not possible to do so across the board, given the breadth and complexity of most World Bank operations, particularly PBF.

The chapter describes the criteria for self-evaluation and validation of DPF (the World Bank's term for PBF). These criteria have changed over time to reflect changes in the design of PBF. When policy-based lending began at the World Bank, in the 1990s, loans were disbursed in several tranches triggered by successful completion of policy reforms and institutional milestones. Today, DPFs provide all the financing upfront, upon completion of a small number of key prior actions. This policy differs from the policy lending of the EU, which includes a performance element and disburses in part based on the achievement of results.

The World Bank's approach puts a heavy weight on a small number of upfront policy and institutional changes it considers key to the country's success. Having a small number of prior actions simplifies the lending process and focuses the World Bank's oversight, but it runs the risk that the assumptions regarding the impact of reforms may be wrong.

Recently, the World Bank moved from rating the relevance of a DPF operation's objectives (the standard approach in evaluations of investment operations) to rating the relevance of the prior actions, the only conditions for the operation directly within the World Bank's control. The World Bank is also putting greater weight on evaluating the relevance and quality of the operation's results indicators, World Bank performance, and the treatment of risk. These judgments are largely qualitative. To ensure these ratings are robust, it would help to track whether guidelines, dialogue, and practice are converging in reasonably common standards across operations and over time.

An important aspect of DPF operations missed by the World Bank's evaluation approach is the impact of the resource transfers themselves—that is, the impact of transferring hundreds of millions of dollars to recipient countries through DPF. Some have argued that the increased availability of funds for governments to spend may be the biggest impact of PBL, greater than the support to policy and institutional reforms provided by the loans.

The chapter reviews the data on the results of DPF operations over time, highlighting several academic studies and thematic evaluations that have tried to draw conclusions from these data. In addition to the inherent limitations on results measurement noted above, a few points stand out. First, there is a high prevalence of “moderately satisfactory” ratings for outcomes and World Bank performance.

Second, thematic evaluations emphasize the prevalence and salience of DPF prior actions related to PFM. Managing public finances is an important and powerful responsibility of government that strongly influences the distribution of resources and effectiveness of public programs. It is

an area that the World Bank has focused on and influences relatively effectively through its operations. The World Bank can bring expertise and resources to the technical aspect of PFM, such as budgeting processes, computer systems, and auditing. Other areas of governance reform, such as election systems, public employment, or direct anticorruption efforts, may be as (or even more) important for development outcomes. They have been more difficult for the World Bank to address in the political environments in which it works. These sensitivities put limitations on what kinds of prior actions are feasible in DPF operations, limiting their potential development impact.

Third, one of the academic studies cited concludes that the level of macroeconomic stability is positively associated with the success of DPF operations.⁴⁷ As noted in the chapter, it is impossible to untangle causation (whether the World Bank's operation influenced the country's policies or good policies made it possible for the World Bank to lend). The fact that government ownership is also key to achieving outcomes and that "the World Bank's policy lending is significantly and positively correlated with the quality of social policies and institutions"⁴⁸ reinforce the overwhelming importance of committed country counterparts.

Attributing causal impact to DPF operations themselves is not likely to be supported by the evaluation techniques available. But the evidence strongly supports the finding that enlightened leadership, pro-development policies, and effective World Bank support go hand in hand.

⁴⁷ Lodewijk Smets and Stephen Knack. 2014. "World Bank Lending and the Quality of Economic Policy." World Bank Policy Research Paper 6924, Washington, DC.

⁴⁸ Željko Bogetić and Lodewijk Smets. 2017. "Association of World Bank Policy Lending with Social Development Policies and Institutions." World Bank Policy Research Paper 8263, Washington, DC.

Chapter 1

Asian Development Bank Policy-Based Lending: Performance, Results, and Issues of Design

Joanne Asquith and Walter Kolkma

1. Introduction

Policy-based lending (PBL) offered by ADB provides ADB developing member countries (DMCs) with fast-disbursing and untied financial resources. These loans are conditional on reforms agreed by the government and are designed to help meet budget financing needs, including the cost of the reforms.⁴⁹ Initially known as program lending, the modality was first introduced by ADB in 1978, although its purpose and design has changed significantly since then.⁵⁰ PBL initially provided liquidity (in a foreign currency) for countries in balance of payments distress, so its initial purpose was wholly crisis-related. The emphasis was on rapidly disbursing financial support to enable countries to purchase essential imports and to support macroeconomic stability, with little or no policy reform mentioned.⁵¹ However, conditions were soon added and, in 1983, PBL disbursement in ADB became explicitly linked to policy reforms, in line with the approach followed by other multilateral development banks (MDBs).⁵² Thus, in addition to crisis periods, PBL was increasingly used in non-crisis periods to respond to the financing needs of countries' development programs with funds disbursed against policy reforms.⁵³

Change in Focus

Over time, PBL evolved to provide budget financing for development and its policy focus changed significantly. The focus during the 1980s on structural adjustment, reforms to trade and state-owned enterprises (SOEs), and the removal of relative price distortions and subsidies

⁴⁹ The term "financing" in this context encompasses grants and concessional loans in addition to non-concessional loans.

⁵⁰ ADB. 1978. *Program Lending*. Manila.

⁵¹ Funds were disbursed against a positive list of imports; in ADB's case, against the importation of agricultural inputs. However, as money is fungible, this practice was replaced over time by disbursing financial support against an agreed list of policy reforms.

⁵² ADB. 1983. *A Review of Program Lending Policies*. Manila. ADB reformulated its program lending to explicitly support policy reforms in this document. The reformulation included adding a policy matrix of required reform actions and a development policy letter that set out the country's intended reform program.

⁵³ The link between the program size and the policy reform adjustment cost was, however, formally dropped in 2011, when it was decided to mainstream programmatic budget support "through determining the overall loan size based on the development financing needs of a country, with reference to specific elements of the development expenditure programs supported by the budget support (that may not include the costs of adjustment directly related to implementation of the envisaged reforms) and, where relevant, support provided by other development partners." ADB. 2011. *Review of Policy-Based Lending*. Manila.

resulted in second-generation reforms designed to deal with long-run social and institutional issues, e.g., expanding access to essential public services and reducing poverty. In short, a more developmental approach was followed. This period also saw a move away from development-partner-driven reform agendas to an approach whereby development partners aligned their programs with country-driven development strategies and harmonized their practices with country systems, with governments firmly in the driving seat. Toward the end of the 1990s, reforms in public sector management, private sector development, and the social sectors began to emerge and this moved the focus away from structural adjustment and from industry, energy, and agriculture policies. This reflected a shift in countries' agendas, as well as a growing realization on the part of the development community that social, political, and economic institutions are critical for the sustained implementation of sound policies and for growth and poverty reduction.

Programmatic Policy-Based Lending

The most significant change in PBL design was the progressive replacement of *ex ante* conditions by “prior actions”, i.e., policy reforms undertaken before loan approval. In the early days, PBL was limited to a single loan (a “stand-alone” loan) typically arranged into two or three tranches, with tranche release conditions specified up front. The stand-alone modality was increasingly replaced by programmatic PBL—a series of distinct loans (“subprograms”), each supporting reforms sequenced in time but linked by a common results framework. Programmatic PBL was introduced by ADB in 1999 but caught on relatively slowly. However, since 2008 it has increasingly become the norm. Under programmatic PBL, each successive PBL operation is approved only when the country has fulfilled certain prior actions. Policy reforms are completed before loan approval, and disbursement follows immediately. The introduction of programmatic PBL in ADB and other MDBs was mainly in response to the implementation problems associated with stand-alone operations with several tranches, a disproportionate number of which experienced significant delays to the disbursement of their final tranches. Policy reform waivers were often requested to ensure these final tranches could be disbursed, or the final tranche was cancelled, resulting in unfulfilled reform objectives. As a result, stand-alone PBL was not effective at meeting country financing needs or at supporting policy reforms.⁵⁴

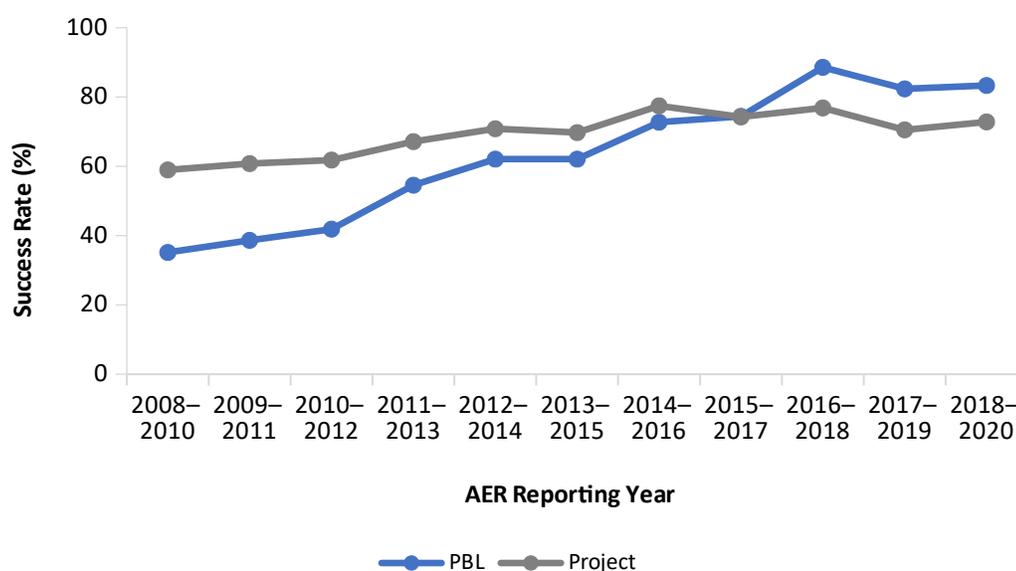
The progressive use of programmatic PBL by ADB was followed by a significant improvement in PBL success rates, a trend also experienced by other multilateral development banks.⁵⁵ The ADB PBL average success rate in 2017–2020 was 83%, compared with 35% in 2008–2010.⁵⁶ From 2016 to 2020, PBL success rates have outperformed those of ADB investment projects by a wide margin (Figure 1.1).

⁵⁴ Operations Evaluation Department (OED). 2001. *Special Evaluation Study on Program Lending*. Manila: ADB.

⁵⁵ PBL performance is assessed against the core evaluation criteria of relevance, effectiveness, efficiency, and sustainability. All of these contribute to the overall project success rating (IED. 2016. *Guidelines for the Evaluation of Public Sector Operations*. Manila: ADB).

⁵⁶ Independent Evaluation Department. 2020. *Annual Evaluation Review*. Manila: ADB.

Figure 1.1: Performance of Policy-Based Lending and Project Sovereign Operations, 2010-2020



AER=Annual Evaluation Review

Note: Based on updated PBL ratings database

Source: Asian Development Bank (Independent Evaluation Department) database

Methodology

This chapter examines the various factors that have contributed to this remarkable turnaround in performance. To do this, it draws on an evaluation of PBL carried out by the ADB Independent Evaluation Department in 2018 (“the evaluation”),⁵⁷ which aimed to assess PBL effectiveness by finding answers to three questions. (i) How responsive has PBL been to both country financing and policy reform needs? (ii) What development results have been achieved? (iii) How well has ADB designed, monitored, and measured policy reform outcomes? The rest of this chapter is structured around these three questions and the answers to them. Section 1 outlines trends in PBL use in the Asia and Pacific region over the evaluation period 2008–2017 as well as the types of PBL used by ADB and the policy reforms supported. It also covers ADB’s response to the coronavirus disease (COVID-19) pandemic in 2020 and 2021, which has far exceeded ADB’s response to the global financial crisis of 2007–2009 and the food crisis of 2007–2008. ADB’s COVID response has drawn attention to the utility of PBL as a leading crisis response instrument.⁵⁸ Section 2 considers trends in PBL performance, including the increased use of single-tranche loans and the shift in policy focus from reforming the financial sector to public sector management, which has had a major impact on PBL success rates in validated project completion reports. Section 3 looks in detail at PBL design issues, especially the shortcomings in

⁵⁷ IED. 2018. *Policy Based Lending 2008-2017: Performance, Results, and Issues of Design*. Manila: ADB.

⁵⁸ IED. 2012. *Real-Time Evaluation of Asian Development Bank’s Response to the Global Economic Crisis of 2008–2009*. Manila: ADB.

monitoring and evaluation frameworks which have made it difficult to assess what PBL has contributed to, or what difference the completion of prior actions made to achieving development outcomes. Section 4 draws conclusions and ends with the evaluation's recommendations for ADB.

2. How Responsive is Policy-Based Lending to Country Financing and Policy Reform Needs?

PBL has two objectives: to respond to country financing needs, generally indicated by a fiscal deficit, and to support policy reforms. In practice, however, the balance between these objectives is not automatic. In crisis periods, for instance, the balance tips toward financing because the short-term need for fast-disbursing liquidity (in a foreign currency) to support macroeconomic stability trumps the long-term need for policy reform, as demonstrated by the recent response to COVID-19, which so far has been largely budget support.

This section argues that meeting country financing needs has been the primary objective of ADB PBL even in non-crisis periods, and that policy reform is the secondary objective. Policy reform is definitely an important objective, but for PBL to be effective in the policy arena it requires other inputs, including policy diagnostics and technical assistance, which go beyond budget support. These have not always been provided. Crisis periods have prompted ADB to introduce reform-free PBL variants.⁵⁹ For instance, in response to the global financial crisis of 2007–2009, the food crisis of 2007–2008 and more recently the COVID-19 pandemic, ADB has used reform-free modalities that support an increase in public expenditure as a countercyclical response to an economic downturn. The switch to single-tranche PBL over the evaluation period also signaled that more predictable and reliable financing was in fact the primary objective of PBL and that there may be a trade-off between financing and reform. ADB also engages in policy reform without the use of PBL, e.g., through covenants attached to investment project loans or stand-alone technical assistance.

Policy-Based Lending During Crisis Periods

Growth in demand for PBL was initially driven by economic crises. PBL approvals surged in response to the 1990 oil price shock, spiked again during the Asian financial crisis in 1997–1998, and increased significantly in response to the global financial crisis in 2007–2009 (Figure 1.2). Nearly half of all PBL (225 loans and grants, worth about \$27.1 billion) was approved in the 10 years from 2008 to 2017, with peak lending occurring around the time of the global financial crisis.⁶⁰ ADB's response to COVID-19 in 2020, over 90% of which consisted of budget support, has been the largest single spike in demand on record.⁶¹ However, as ADB sets a ceiling on PBL use at around 20% of overall sovereign lending, the other way it can respond to major crises is through the introduction of loans that are exempt from this ceiling and that do not necessarily contain policy reforms.⁶² In crisis periods, the share of these modalities in ADB sovereign

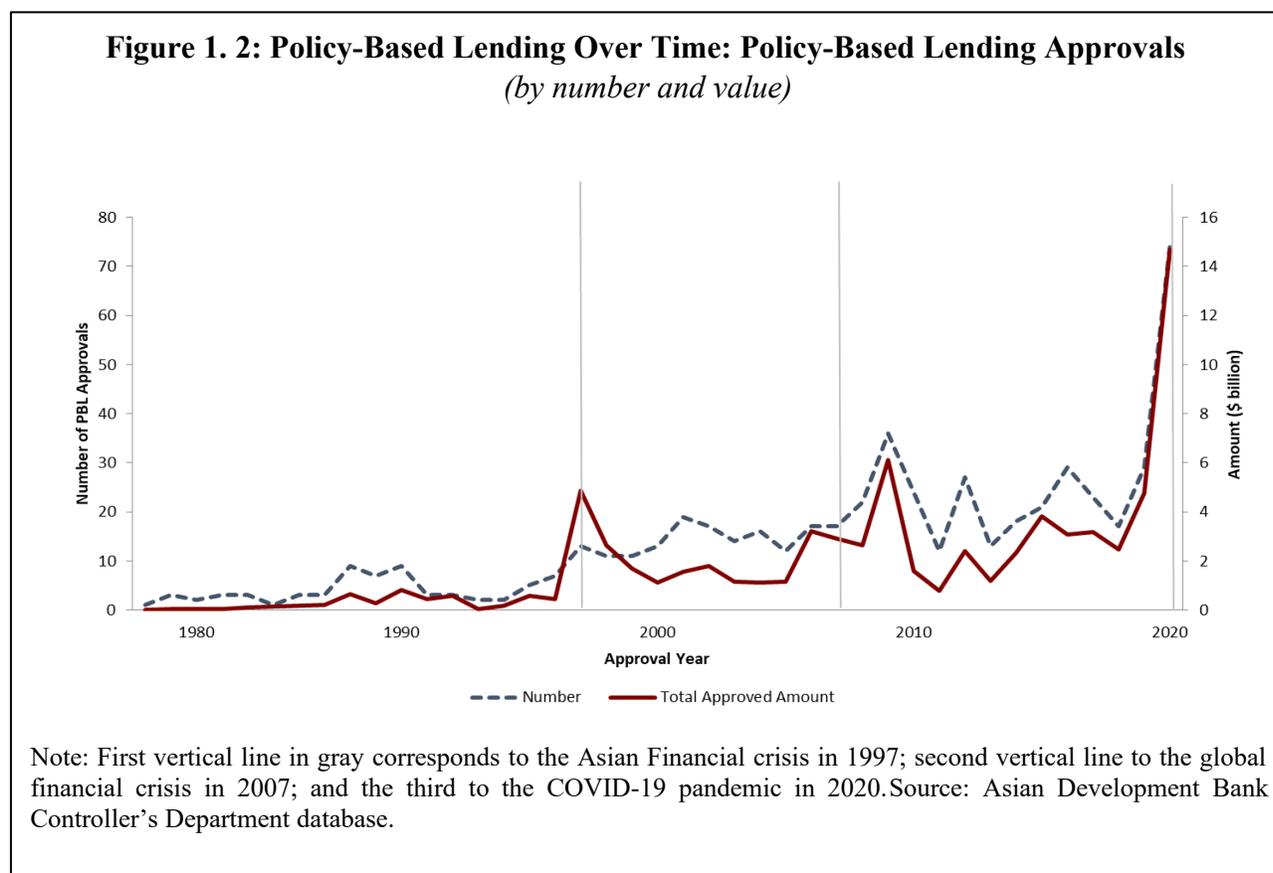
⁵⁹ In these PBL operations, reforms are substituted for countercyclical budget expenditures, which is also a policy response (a fiscal policy response).

⁶⁰ From 1978 to the end of 2017 ADB approved 451 PBL loans and grants worth approximately \$55 billion.

⁶¹ PBL accounted for 55% of total ADB sovereign approvals in 2020.

⁶² In line with other multilateral development banks (MDBs), which limit PBL use either formally or informally, ADB sets a ceiling on PBL use as a share of total sovereign borrowing. Except for its specific crisis response instruments, ADB currently limits PBL use to 20% of total sovereign lending on a 3-year rolling average basis.

approvals has increased sharply, showing that this type of lending modality primarily responds to country financing needs, which intensify during crisis periods, a finding common to other MDBs providing similar products.⁶³



Policy-Based Lending in Non-Crisis Periods

Some countries have used PBL consistently and extensively since its introduction and have grown to rely on it as a source of budget financing even in non-crisis years. Consultations with country officials have suggested that demand for PBL is expanding, and in some countries it is the preferred lending modality. Indonesia, Pakistan, the Philippines, and Viet Nam have consistently accounted for nearly 59% of all PBL approved by value since 1978. These countries continue to be the largest, most frequent, and most consistent PBL users. Apart from Pakistan, where there is a strong poverty argument to justify the use of PBL, the evaluation found that PBL is mostly used by larger, more capable, and more developed countries. In terms of the number of PBL operations, Pakistan has been the largest PBL recipient, followed by Indonesia. In 2008–

ADB's PBL ceiling for concessional resources is an explicit constraint. While the introduction of crisis instruments in 2009 allowed ordinary capital resources (OCR) countries to borrow outside the ceiling, special dispensation was needed for countries eligible for concessional finance to do so because there was no such instrument for these countries. The policy does not set limits at the individual country level.

⁶³ For instance, in response to the global financial crisis, development policy financing (DPF) by the World Bank increased to about 40% of commitments and disbursements over 2009–2010.

2017, PBL accounted for 71% of ADB’s sovereign lending portfolio in Indonesia and 57% in the Philippines. In terms of ADB regions, Southeast Asia has been the largest and most consistent user of PBL since 1978, accounting for nearly 40% of approvals by number each year and almost 50% by value. Central and West Asia accounted for 25% of total approvals, and South Asia for only 16% by value, despite its large reform agenda. The use of PBL in the Pacific region appears to be linked to crisis years: the Asian financial crisis (1997), the stock market crisis in the US triggered by the bursting of the dot-com bubble (2001), and the global financial crisis (2007–2009). Recently, ADB has used PBL to provide contingent financing operations in Cook Islands, Samoa, Tonga, and Tuvalu which have been used to build disaster resilience during non-crisis times and to release funds immediately following a natural disaster.⁶⁴

The evaluation found that PBL is positively correlated with the size of fiscal deficits, and negatively correlated with GDP growth, suggesting that finance is the primary objective of countries requesting PBL, rather than policy reform,⁶⁵ even if the key motivation of ADB is policy reform. Frequent PBL recipients, including Indonesia and the Philippines, base their requests for PBL on their budget financing needs (this was confirmed during consultations with ministry of finance officials in both countries). In the Philippines, for example, the Treasury divides financing of the budget deficit between domestic currency (80%) and foreign currency (20%) financing. Foreign currency financing includes financing by MDBs, so the larger the deficit the higher the demand for PBL. In general, ADB PBL approvals have increased after countries experienced large fiscal deficits. Policy reform is an important motivating factor as well (certainly for ADB) but the size of PBL operations is not necessarily determined by the size or cost of a government’s reform agenda and nor are such operations systematically triggered by the desire for reform. In the absence of a fiscal deficit, it would be difficult to justify PBL use, and policy reform would be better supported using other financing modalities.⁶⁶

Despite growth in PBL use in crisis and non-crisis periods, the size of PBL in relation to gross domestic product (GDP) and as a share of budget financing has decreased since the 1980s. Asia has experienced rapid growth and poverty reduction over the last three decades and the significance of development assistance relative to GDP has fallen across the region, although less so in the Pacific. As a result, the average size of a PBL operation relative to a country’s GDP has declined more than threefold since the late 1980s, reducing the potential effectiveness of PBL as a countercyclical device during a crisis, although some of the value of PBL as a market confidence building device may have remained. The capacity of PBL in high-growth economies

⁶⁴ PBL has been used to clear debt arrears, for example, in the re-engagement of development partner support for Myanmar see. ADB. 2012. *Proposed Policy-Based Loan Republic of the Union of Myanmar: Support for Myanmar Reforms for Inclusive Growth Program*. Manila.

⁶⁵ Two panel fixed-effects models were estimated by the evaluation. Model 1: $PBL_GDP_{it} = c_i + \beta_1 Res_Imp_{it} - 1 + \epsilon_{it}$ and Model 2: $PBL_GDP_{it} = c_i + \beta_1 FiscalDeficit_{it} - 1 + \epsilon_{it}$ where i indicates country and t indicates year. The dependent variable, PBL_GDP , is policy-based lending (PBL) as a percentage of GDP. Res_Imp indicates total reserves in months of imports. c_i is the country-specific effect. The sample period is 1990–2016. The regression analysis shows that PBL is negatively correlated with total reserves in months of imports and positively correlated with fiscal deficits. The results suggest that the use and the amount of PBL is determined by countries’ financing needs at the macroeconomic level.

⁶⁶ There is a view that higher demand for PBL in these countries also coincided with sharpened procurement and safeguard conditions attached to ADB investment loans, particularly in the first decade of the 2000s, and that some countries had negative experiences with the introduction and grade of these conditions, and therefore lowered their demand for infrastructure investment lending. Thus their demand for policy-based lending increased by default. However, the evaluation did not assess this view fully.

to act as an incentive for policy reform may therefore also have diminished. Moreover, finance (the provision of liquidity) alone cannot achieve policy reform.⁶⁷ Good policy making must be well-informed, supported by evidence-based analytical work, diagnostics, and continuous dialogue with stakeholders to build traction for reform. Hence, PBL should also come with technical assistance (TA) if policy reform is to be achieved, and ADB has learned to increasingly deploy TA alongside its PBL, on grant basis.⁶⁸

3. Types of Policy-Based Lending

ADB uses four PBL types: stand-alone, programmatic, countercyclical, and special.⁶⁹ Within this group, there are also sector programs, which combine investment projects with PBL. Stand-alone PBL is a single loan usually configured into two or more tranches.⁷⁰ Programmatic PBL is a series of single-tranche loans, each supporting policy reforms that are sequenced over time but linked by a common, longer-term development objective. While both these PBL types can support reforms over the longer term, in practice they are very different loans, and this is discussed in more detail below. In contrast, the Countercyclical Support Facility (CSF) and special PBL (SPBL) are crisis-response instruments. Following a crisis, CSF helps finance a fiscal stimulus that aims to protect the most vulnerable during an externally triggered economic downturn. The newly introduced COVID-19 pandemic response option (CPRO) also supports a fiscal stimulus to help countries tackle the economic and social impact of the COVID-19 pandemic.⁷¹ SPBL is used to support a country during a balance of payments crisis and until recently had never been used, despite being introduced nearly 3 decades ago.⁷² In addition to these different PBL types, ADB also uses PBL as a precautionary instrument in case an economic or disaster-related crisis may occur. In this case, policy reforms are directly related to reducing risks, e.g., building disaster resilience, which may include strengthening economic and fiscal resilience, providing social safety nets, and carrying out disaster preparedness. The use of PBL as a precautionary instrument that can respond rapidly in the aftermath of a disaster was formalized by ADB in August 2019.⁷³ Precautionary PBL that anticipates the onset of a future economic crisis has not yet been widely used.

Stand-alone and programmatic PBL have inherently different approaches to loan conditionality. Stand-alone PBL with several tranches is approved on the condition that the borrower undertakes policy reforms in the future, against which the loan is disbursed.⁷⁴ It creates more uncertainty than single-tranche PBL since borrowers need to carry out the policy reforms attached to the loan after it has been approved, which can make timing and disbursement of

⁶⁷ The Tinbergen Rule states that achieving multiple targets (or objectives) requires an equal number of instruments. Hence, the two objectives of providing finance and supporting policy reform requires two modalities: finance and technical assistance.

⁶⁸ For instance, from 2008 to 2017, 45% of all PBL had at least one TA project, 26% had two, 12% had between three and seven, but 17% had no TA.

⁶⁹ New PBL types have also recently been established to respond to COVID-19.

⁷⁰ Stand-alone can also be designed as a single tranche.

⁷¹ ADB. 2020. *ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila

⁷² SPBL was used for the first time in 2019, as part of an international financial package to provide balance of payments support for Pakistan.

⁷³ Available: <https://www.adb.org/news/adb-introduces-contingent-disaster-financing-natural-disasters>

⁷⁴ Although the first tranche in multitranche PBL is disbursed against policy actions already undertaken. Conditions in the second tranche are undertaken in the future.

subsequent tranches uncertain. The further into the future the reforms are, the greater the risk, which reduces the capacity of the PBL to provide timely financial support. Previous evaluations have noted that stand-alone operations have often resulted in significant delays to disbursements, or that waivers have been sought when tranche release conditions were not met. Evaluations of ADB PBL in 2001 (footnote 6) and 2007⁷⁵ described how overloading the second and subsequent tranches with complex and numerous conditions had led to severe disbursement delays, waivers, and cancellations, which was also experienced by other MDBs (Box 1.1).

Box 1.1: Before 2008, Most Policy-Based Lending Disbursement Was Significantly Delayed

In 2001, an evaluation of Asian Development Bank (ADB) policy-based lending (PBL) found that nearly three-quarters of all PBL operations (which at that time were all stand-alone PBL with several tranches) experienced delayed disbursement, and 11% of the final tranches were cancelled, which limited the PBL's efficiency, and reduced the likelihood, and hence the effectiveness, of the ultimate reform objective being pursued. To allow governments to comply with loan conditions, the implementation periods of stand-alone loans with several tranches were often extended or conditions were waived. For example, the India Rural Cooperative Credit Restructuring and Development Program (2006) was extended twice, delaying the program by 3 years.^a In Indonesia, the Industrial Competitiveness and Small and Medium Enterprise Development Program (2000) closed 4 years and 9 months after program approval, with cancellation of the final tranche.^b The Banking Sector Reform Program in Lao People's Democratic Republic (2002) took 6 years instead of 3 to complete.^c The Governance Reform Program in Nepal (2001) was delayed by 3 years and the last tranche cancelled.^d The final tranche of the Bangladesh Good Governance Program (2007) was finally disbursed in 2018, some 7 years later than initially planned.^e Delays, followed by cancellations, were particularly common in Pakistan. A major restructuring of the Pakistan portfolio in 2007–2009 also contributed to PBL cancellations. Among the factors that contributed to the poor performance of stand-alone loans before 2008 was that the more complex policy conditions were backloaded into second and subsequent tranches, increasing the uncertainty of those tranches being disbursed. Nevertheless, in the case of the Bangladesh Good Governance Program, while some conditions were waived and disbursements were significantly delayed, the project was regarded as a success by ADB. Gradually stand-alone PBL with several tranches was replaced by single-tranche operations. This meant the completion of policy actions was now no longer in doubt and hence the success rate of PBL improved.

^a IED. 2015. *Validation Report: Rural Cooperative Credit Restructuring and Development Program in India*. Manila: ADB.

^b IED. 2010. *Validation Report: Industrial Competitiveness and Small and Medium Enterprise Development Program in Indonesia*. Manila: ADB.

^c IED. 2011. *Validation Report: Banking Sector Reform Program in Lao People's Democratic Republic*. Manila: ADB.

^d IED. 2010. *Validation Report: Governance Reform Program in Nepal*. Manila: ADB.

^e ADB. 2021. *Validation Report: Good Governance Program in the People's Republic of Bangladesh*. Manila: ADB.

Source: Asian Development Bank (Independent Evaluation Department)

⁷⁵ OED. 2007. *Policy-Based Lending: Emerging Practices in Supporting Reforms in Developing Member Countries*. Manila: ADB.

To overcome the difficulties with stand-alone PBL with several tranches, around the turn of the century MDBs began making increasing use of single-tranche operations, either on their own or as part of a series of single-tranche loans in a programmatic series. ADB introduced programmatic PBL in 1999 and began to use it more frequently from the mid-2000s.⁷⁶ Policy actions in single-tranche PBL operations are completed before loan approval, eliminating the delays and cancellations associated with stand-alone operations, and increasing the likelihood of the PBL being successful. The share of stand-alone PBL in the ADB portfolio declined significantly over the evaluation period.⁷⁷ The shift to single-tranche PBL meant that loans could now disburse with certainty because policy reforms had been completed in advance. At the same time, the type of reforms supported also changed, and perhaps their ambition has also diminished. This is discussed in more detail below.

4. Types of Policy Reforms Supported

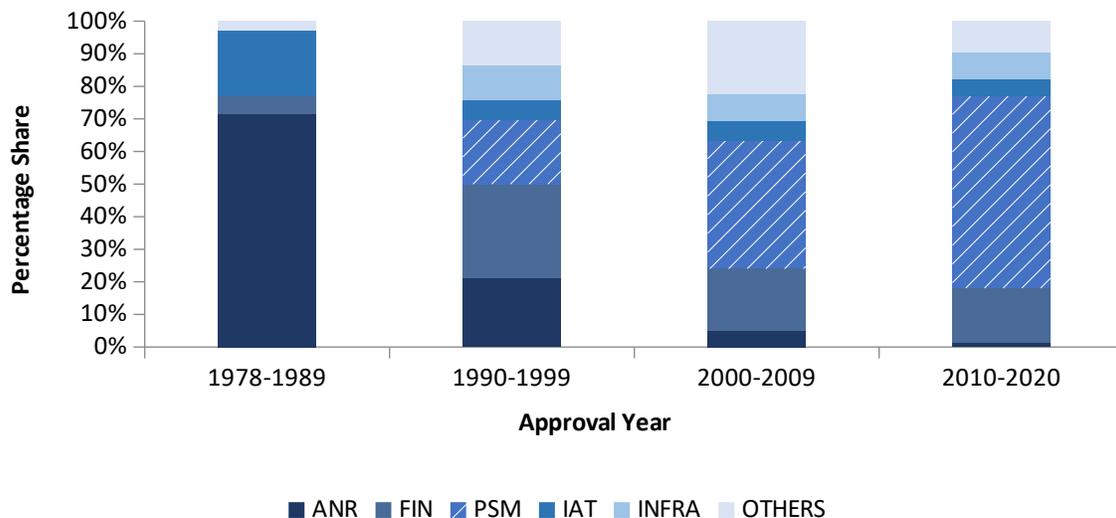
PBL has supported reforms across a broad range of sectors and policy areas in a variety of countries, from upper middle-income countries to fragile states emerging from conflict, countries impacted by natural disasters, and countries hit by the coronavirus pandemic. Over the last two decades, however, the focus of reform, in nearly all country categories, has shifted away from agriculture, natural resources, and rural development (ANR) to public sector management (PSM)—Figure 1.3. Before the late 1990s, on average 61% of the total number of approvals per year supported ANR, but lending for policy reform in agriculture has sharply declined since those days. In the period leading up to the Asian financial crisis, PBL support shifted to financial sector reforms⁷⁸ and, since the mid-1990s, ADB has used PBL mainly to support broad public sector management (PSM) reforms in such areas as public expenditure and fiscal management, public administration, economic affairs management, decentralization, state-owned enterprises, law and judiciary, and social protection. The number of PSM operations escalated in response to the global financial crisis, as it did at other MDBs. PSM accounted for nearly two-thirds of all PBL approved over the evaluation period, peaking in 2008 (78%) and 2009 (87%) and PSM continued to be the focus of over 60% of PBL in 2010–2020 (Figure 1.3). In the first half of 2020, PSM accounted for 73% of all PBL approvals.

⁷⁶ ADB. 1999. *Review of ADB's Program Lending Policies*. Manila.

⁷⁷ In the post 2008 cohort of validated project completion reports, the number of multitranches PBL operations fell by two-thirds from 61 to 22, while the number of single-tranche operations increased by the same proportion from 9 to 27.

⁷⁸ Financial sector reforms often overlap with PSM as the focus of reform is about developing appropriate financial market regulation, removing the state from bank ownership, or introducing appropriate policies for financial market development and competition.

Figure 1:3: Reforms Supported by ADB Policy-Based Lending by Sector, 1978–2020



ANR = agriculture, natural resources and rural development; FIN = finance; PSM = public sector management; IAT = industry and trade; INFRA = energy, transport, and water and other urban services; OTHERS = education, health, information and communication technology, and multisector.

Source: Asian Development Bank (Controller's Department) database.

Surprisingly few PBL operations are to be found in ADB's key areas of investment—transport, energy, and water infrastructure—the areas in which ADB has most expertise.⁷⁹ PBL operations in energy and the financial sector increased only in the last 3 years of the evaluation period 2008-2017. Recent approvals in the financial sector have focused on capital market development and improving the environment for private sector investment, rather than on the areas that appeared before 2008, such as privatization of state-owned banks or the appropriate policy and institutional structure for developing rural financial services. However, it is the relevant and changing role of the state in public service management and the delivery of essential services that is the focus of attention in policy reform and hence the areas of investment may be less important than arriving at a clearer understanding of why particular reforms are selected for PBL support. For instance, ADB selected capital market development as the focus for PBL support in Bangladesh, not transport or energy development, despite the fact that reforms were needed for longer-term investment sustainability in these areas.⁸⁰ ADB also selected capital market development in Sri Lanka, despite the fact that energy sector pricing was well below the cost of production and the tax ratio to GDP was among the lowest in the world.⁸¹

⁷⁹ This is not to say that ADB does not support sector reforms but, rather, that these are often supported through project interventions and not necessarily through PBL.

⁸⁰ IED. Forthcoming. *Country Assistance Program Evaluation: Bangladesh, 2010-2020*. Manila: ADB.

⁸¹ IED. 2016. *Country Assistance Program Evaluation: Sri Lanka, 2006-2015*. Manila: ADB.

In a limited number of cases, PBL is packaged alongside investment lending and TA into a sector development program. However, the use of this type of program, combining all three instruments in a single intervention, has declined since the early 2000s. Nevertheless, there are still examples of investment projects and PBL being used in parallel to help improve the policy context for investment projects. However, these are generally not packaged as an SDP. For instance, in Indonesia, ADB supports energy sector reform through a PBL operation without an explicit link to its energy sector projects.

Nevertheless, as mentioned above, given the scale of ADB investment in the development of infrastructure in the energy, water, and transport sectors in Asia and the Pacific, there is a notable lack of PBL-supported reforms in these sectors, even though infrastructure gaps were identified as key constraints on growth and poverty reduction in ADB's long-term strategic framework, *Strategy 2020*.⁸² These are also areas where ADB has significant expertise and capacity to influence reform agendas and, given the scale of its infrastructure investments, one expects to see ADB capitalizing on its long-term engagement in these sectors. While ADB can address specific sectoral issues through covenants in investment loan agreements and through technical assistance, this may not be sufficient to remove binding constraints on growth in areas where political economy issues are deeply entrenched and go beyond the concerned sector. For example, the removal of consumer subsidies for energy, water, and transport requires broader engagement with central government agencies and other stakeholders.

5. What Results Have Been Achieved?

This section discusses the performance and results of ADB PBL, especially in those countries that have used PBL the most. Measures of PBL performance were drawn from project completion reports that have been validated by the Independent Evaluation Department (PVRs) while the broader focus on development results draws from evidence of achievements at the country level. The performance of PBL operations since 2008—as measured by the success ratings assigned by PVRs—has improved sharply compared with those approved before 2008.⁸³ Other MDBs have witnessed similar improvements. While several factors have contributed to the dramatic turnaround in ADB, two stand out: (i) the increasing use of single-tranche PBL since 2008, and (ii) the shift in the reform focus to public sector management, particularly public finance management.⁸⁴ Nevertheless, while the performance of PBL improved over the evaluation period, attributing country development outcomes to ADB-supported policy reforms is not straightforward, as is discussed in more detail below.

Shift to Public Sector Management Reforms

⁸² ADB. 2008. *Strategy 2020. The Long-Term Strategic Framework of the Asian Development Bank, 2008–2020*. Manila.

⁸³ The evaluation portfolio is all policy-based loans approved and evaluated since 2008. Policy-based loans evaluated post 2008 are included in the sample even if they were approved before the period. The validated project completion reports of 49 PBL operations approved since the beginning of 2008 found that 80% were rated *successful*, almost twice that for the 70 PBL operations approved before 2008.

⁸⁴ The evaluation referred to five factors: including the high proportion of regular PBL in the portfolio that responded to the 2008–2009 global financial crisis, 93% of which were rated *successful*; the reduction in the number of policy actions; and a reduction in the share of Pakistan operations in the portfolio, a higher number of which were rated *unsuccessful*. These factors were trends in ADB performance data rather than structural changes in PBL design and reform focus.

As ADB began to use single-tranche operations, the PBL policy focus shifted to public sector management (PSM), as it did at other MDBs.⁸⁵ Nearly two-thirds of PBL operations by value approved from 2008 to 2017 supported PSM reforms, and nearly half of all evaluated PBL since 2008 supported PSM reforms. Hence, PSM became the dominant sector supported by PBL.⁸⁶

The performance of PBL supporting PSM reforms increased sharply over the evaluation period. From a success rate of 37% in 1999–2007, PBL-supported PSM reforms climbed to 88% in 2008–2017. One explanation for this is that those PBL operations that supported PSM concentrated on public expenditure and financial management (PEFM) with policy actions that were within the direct control of finance ministries, the major stakeholder in the PBL design. Of the 49 PVRs, 26 supported PEFM, whereas in the previous cohort only seven were PEFM-related. Furthermore, the types of reforms supported, while important for longer-term growth and development, became less politically controversial because they focused on technical areas that were within finance ministries' scope of work, e.g., reforms concerning budget preparation, the introduction of medium-term fiscal frameworks, and treasury management, which match the existing functions of finance ministries. PBL that supports the restructuring of state-owned enterprises, reductions in subsidies, or the adjustment of tariffs in energy or water are generally more politically charged and difficult to achieve, with the locus of action being in ministries or units outside the finance ministry's scope of influence.

Country Results

Despite the improvement in PBL performance, assessing results at the country level and linking these with ADB PBL interventions is not straightforward. This section looks at country results related to public sector management, particularly public financial management, which was the primary focus of PBL-supported reforms over the evaluation period. The majority of PSM reforms for which a PVR was available were in Pakistan (7); Indonesia (6); Viet Nam (4); India, Mongolia, Nepal, the Philippines, and Tuvalu (3 each); and Armenia, Georgia, and Samoa (2 each) while 14 further countries had 1 PSM-related PVR each.

Public sector management. ADB PBL interventions in India, Indonesia, Nepal, Pakistan, the Philippines, and Viet Nam aimed to improve public financial management systems at national and subnational levels, on both the expenditure and revenue sides. Reform areas included debt management, strengthening audit capacity, fiscal consolidation, and budget management. The objective was often to build resilience to future economic shocks, improve public finance management, and strengthen overall macroeconomic management. A common feature of PSM-related reforms supported by ADB in India, Indonesia, Nepal, Pakistan, and the Philippines was decentralization and strengthening of state-level public finance management, e.g., in West Bengal and Assam in India, Sindh Province in Pakistan, and broader decentralization processes in Indonesia and the Philippines. ADB also supported initial efforts to strengthen local capacity in Nepal. Decentralization was a common element of reform efforts in the PSM sector in these countries but less so in the countries that had limited PBL and for which only one evaluation report was available, making an assessment of performance in these countries more difficult to make. Further evidence of country results was found in IED country assistance program

⁸⁵ The use of single-tranche loans was recommended by IED in its 2001 evaluation (footnote 6). These were first used in Viet Nam in a programmatic series to support a World Bank poverty reduction credit support series.

⁸⁶ Its share of PBL approvals doubled from one-third of PBL approvals in 2000–2007 by value (30% by number) to nearly two-thirds from 2008–2017 (57% by number).

evaluations (CAPEs), Public Expenditure and Financial Accountability (PEFA) reports, and ADB country performance assessments.⁸⁷

India. Project and country field evaluation evidence indicated that PSM support was closely linked to country priorities and strong government ownership. The program aimed to tackle fiscal imbalances, which had led to underinvestment in infrastructure and the social sectors and poor basic services. The India CAPE in 2017 regarded ADB’s support as having been effective, as the major reform objectives and fiscal targets supported by the programs had largely been achieved.⁸⁸ However, several years after completion, some indicators, including capital expenditure levels, had regressed. The CAPE concluded that, given the state government’s commitment to achieving fiscal consolidation, the results of the West Bengal PSM program were likely to be sustained. However, it was too early to assess the likelihood of longer-term results, such as the impact that public financial management (PFM) reforms would have on improvements to service delivery. A similar PBL operation in the Indian state of Mizoram did not have the same impact. The PVR for this program noted that the targets were ambitious and the capacity to implement the agreed reforms may have been overestimated.⁸⁹

Philippines. The most recent IED assessment of the program in the Philippines found that ADB had directly contributed to major policy and institutional reforms, improved PSM, and laid the foundations for more business investment.⁹⁰ PSM support contributed to the government’s policy reform agenda and helped build capacity in revenue and public expenditure management, decentralization, and public–private partnerships (PPPs). The institutional strengthening for PPP was particularly evident, with a PPP center established, 80 improvements made to the legal framework, and a pipeline of PPPs established, which led to the implementation of infrastructure initiatives. ADB also supported a review of the Local Government Code, and at the time of the evaluation two bills focusing on local government revenue generation were before Congress. However, ADB’s support for the judiciary and court administration had not been sustained. This long-standing support had stagnated compared with the early 2000s.

Indonesia. PBL supported the strengthening of audit functions, decentralization, public financial management, and public service delivery. ADB has been extensively involved in Indonesia’s decentralization reforms, with a focus on financial management systems in regional governments. Although over half of public expenditure in Indonesia is now undertaken at the subnational level, the process of decentralization has produced variable results in terms of increasing citizens’ access to local services. While there has been a general improvement and regional convergence in access to services, the quality remains poor and regional disparity is widening. Further reforms are needed to raise quality.⁹¹ The World Bank’s 2011 PEFA⁹² assessment noted steady progress in strengthening the quality of PFM systems in Indonesia

⁸⁷ The Public Expenditure and Financial Accountability (PEFA) program was initiated in 2001 by the European Commission, International Monetary Fund, World Bank, and the governments of France, Norway, Switzerland, and the United Kingdom. PEFA established a standard methodology for PFM diagnostic assessments, which report on the strengths and weaknesses of public financial management (PFM). PEFA provides a snapshot of PFM performance at specific points in time using a methodology that can be replicated in successive assessments, giving a summary of changes over time.

⁸⁸ IED. 2017. *Country Assistance Program Evaluation: India, 2007–2015*. Manila: ADB.

⁸⁹ IED. 2017. *Validation Report: Mizoram Public Resource Management Program in India*. Manila: ADB.

⁹⁰ IED. 2016. *Validation Report: Country Partnership Strategy Final Review in the Philippines, 2011–2016*. Manila: ADB.

⁹¹ World Bank. 2017. *Indonesia Economic Quarterly: Decentralization that Delivers, December*. Jakarta.

between 2007 and 2011, with some reforms in progress supported by ADB, the World Bank and other development partners.

Viet Nam. ADB's PSM efforts were largely focused on restructuring state-owned enterprises and improving the business environment. ADB targeted financial restructuring and equitization of several of the country's general corporations, which required substantial changes to laws, decrees, and regulations. These reform efforts have been largely successful.⁹³ In 2017, the Ministry of Planning and Investment finalized a list of 375 state-owned enterprises to be wholly or partially divested by 2020.⁹⁴

Nepal. Initial PBL support for PSM reforms before 2012 was found to "have had modest results."⁹⁵ However, a 2014 PEFA assessment suggested that Nepal had subsequently made substantial progress in deepening the structures and processes of PFM, particularly in the use of information technology. Investment efficiency gains had been achieved, despite a political transition period (2006–2010) during which reform was not a high priority.⁹⁶ This finding demonstrates that reform results may not be immediately visible, so longer-term monitoring outside the PBL timeframe is necessary.

Pakistan. PBL operations in Pakistan at federal and provincial levels were also weighted toward reforms in public sector management. There were few lasting or major results, however, because of the difficult reform context. The PEFA report showed that there had been positive improvements but only in some areas.⁹⁷ Consultations with government officials revealed that they saw the results of PBL more positively than the ADB evaluations, which had recorded very low success rates for all completed PBL operations over the evaluation period.⁹⁸ These officials felt that the incremental nature of the reforms that had arisen from numerous PBL operations was to be expected. The slow progress was at least partly the result of some sector reforms not being supported strongly enough by the government and its development partners. This was particularly the case for civil service reform and anticorruption initiatives, which were not directly tackled by PBL operations, or by national institutions. In this fraught political context, officials regarded incremental progress as sufficient justification for the programs. Overall, the PEFA showed that country systems for public financial management were improving, bearing in mind that improving PFM can take years, and that improvements to systems are not the same as improvements to public service delivery.

Number of PBL operations. ADB country performance assessments (CPAs) provide some evidence to suggest that, where ADB has provided five or more PBL operations, PSM and public finance management in countries eligible for concessional financing is improving. Scores for the

⁹² World Bank. 2012. *Indonesia: Repeat Public Expenditure and Financial Accountability (PEFA) Report and Performance Indicators*. Washington, DC.

⁹³ IED. 2016. *Validation Report: Viet Nam Country Partnership Strategy Final Review Validation, 2012–2015, Linked Document. Assessment of Public Sector Management*. Manila: ADB.

⁹⁴ E. Cook. 2017. Vietnam Gears up to Divest State Owned Enterprises in 2018. *The Diplomat*. Asia.

⁹⁵ IED. 2013. *Validation Report: Country Partnership Strategy Final Review in Nepal, 2010–2012*. Manila: ADB.

⁹⁶ World Bank. 2015. *Public Expenditure and Financial Accountability (PEFA) Assessment: Nepal PFM Second Performance Assessment as of FY2013-14 (English)*. Washington, DC: World Bank Group. <http://documents.worldbank.org/curated/en/483831467998500044/Public-expenditure-and-financial-accountability-PEFA-assessment-Nepal-PFM-second-performance-assessment-as-of-FY2013-14>

⁹⁷ SPBL was used for the first time in 2019, as part of an international financial package to provide balance of payments support for Pakistan.

⁹⁸ Pakistan Federal Government. 2012. *Public Financial Management and Accountability Assessment*. Islamabad.

country performance assessment (CPA) component (which measures the quality of governance and PSM) had improved in most countries eligible for concessional financing.⁹⁹ The largest gains were in countries that had started from a relatively low base and received five or more PBL operations over the period, e.g., Cambodia and Lao People’s Democratic Republic. While reforms may be less effective once the quality of PSM has reached a certain level, countries with relatively well-developed systems that have received more PBL, e.g., Bhutan and Viet Nam, also achieved sizable positive changes. However, the evaluation found no relationship between PBL use and the overall CPA score, because there are other factors that influence this result which are exogenous to PBL.

Capital market development. Countries that received significant support for capital market development had also achieved positive results. ADB has been a major partner of the government of Indonesia in the development of the financial sector that has taken place since the late 1990s. ADB programs contributed to results mainly in government bond markets, the Islamic capital market (*sukuk*), and the insurance sector. Similar results were found for Bangladesh, where ADB has supported capital market development since the late 1980s. In both cases, technical assistance also played a major role and it is difficult to determine whether reforms would have been undertaken in its absence. Nevertheless, since 2016, the capital market in Bangladesh has not developed to the extent envisaged and more reforms, including strengthening the market regulator, are needed to generate the desired longer-term development impact.

Transport, energy, and water. The PBL evaluation found less progress in PBL operations that supported reforms in transport, energy, and water—areas of significant ADB project investments. PBL supported energy sector reforms in the state of Assam in India,¹⁰⁰ Pakistan,¹⁰¹ the Philippines,¹⁰² and Sri Lanka,¹⁰³ all of which have closed and been evaluated since 2008. Common issues included energy sector financing and political interference in pricing and supply. For example, the India country assistance program evaluation (CAPE) in 2017 found that, despite success in supporting the national electricity transmission and distribution network through project investments, cost recovery remained a concern (footnote 40). Support for energy sector reforms in Pakistan resulted in incremental improvements in the architecture, roles, and capacity of institutions, but the twin reforms of unbundling and privatization were incomplete.¹⁰⁴

⁹⁹ A country performance assessment assesses a country’s policy and institutional framework for promoting poverty reduction, sustainable growth, and how effectively it uses concessional assistance. Each country’s performance is based on a composite score constructed from the following: (i) an assessment of the quality of its macroeconomic management, (ii) the coherence of its structural policies, (iii) the degree to which its policies and institutions promote equity and inclusion, (iv) the quality of its governance and public sector management, and (v) performance of its concessional assistance project portfolio.

¹⁰⁰ ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Loans and Technical Assistance Grant to India for the Assam Power Sector Development Program*. Manila.

¹⁰¹ ADB. 2000. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to the Islamic Republic of Pakistan for the Energy Sector Restructuring Program*. Manila.

¹⁰² ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster and Program Loan to the Republic of the Philippines for the Power Sector Development Program*. Manila.

¹⁰³ ADB. 2002. *Report and Recommendation of the President to the Board of Directors: Proposed Loans to Sri Lanka for the Power Sector Development Program*. Manila.

¹⁰⁴ ADB. 2015. *Country Partnership Strategy: Pakistan, 2015–2019*. Manila.

Substantial progress was made in the Philippines in privatizing power generation and introducing wholesale competition, which reduced unsustainable subsidies to the sector.¹⁰⁵

Macroeconomic stability. Overall, country-level evidence suggests that PBL has contributed to macroeconomic stability and improved public financial management. It has helped reinforce macroeconomic performance and fiscal discipline, especially in crisis-affected countries. Budget support helped focus attention on public finance management and accountability processes, and more generally on broader PSM and governance issues. In most cases, significant progress was made in public financial management, as noted in PEFA assessments. There is also evidence that PBL provides a useful instrument around which development partner support can be better coordinated. However, the evaluation found less evidence to suggest that improvements were being carried through to improvements in human well-being, better service delivery and use of public goods and services, stronger governance, increased business confidence, or higher levels of investment and competitiveness, economic growth, and poverty reduction. This could be related to the weak theories of change that underlay PBL in PSM: ADB has not spelled out the relationship between the interventions and their impacts on the economy and society, nor are such impacts often recorded in PCRs. This could be because development outcomes are long-term and may not be observable at the time of program completion. These complexities apart, the fact is that, overall, assessing the results of PBL in ADB is constrained by design issues, such as a lack of baselines and the absence of counterfactuals (i.e., what would have happened without the policy reform?), as well as by constraints on collecting country data and developing statistical systems. The fact that many policy reforms are now completed before loan approval raises issues about the value added by PBL and how its results can be evaluated. More emphasis needs to be placed on design features, which explains why recent MDB evaluations have focused on this aspect. Strengthening the design of PBL will not only help improve its impact but also support the collection of evidence to document intended and unintended results, enabling ADB's contribution to be better understood. For instance, PBL design depends on strong analytical foundations, the identification of quantifiable outcomes and indicators, and the selection of policy actions that are critical to the achievement of the development outcome. To measure the results of these policy actions, the PBL design needs to include a clear results framework that links policy actions with their intended results. The findings of this evaluation on design and monitoring issues are presented in the next section.

6. How Well has ADB Designed, Monitored, and Measured Policy Reform Outcomes?

The notable increase in PBL performance since 2008, as judged by the high success rate in project completion reports validated by IED, should indicate that these loans are very well-designed, especially in relation to policy reform. Nevertheless, because PBL is presented to the Board in the same format as an investment loan and, in turn, is assessed at project completion as if it were an investment loan, this has raised several design issues.

Macroeconomic assessment. First, like other MDBs, ADB relies too much on the IMF for its macroeconomic assessments, yet this assessment is rarely presented in the approval documentation because the investment loan template does not require it.¹⁰⁶ In Indonesia, for

¹⁰⁵IED. 2012. *Validation Report: Power Sector Development Program in the Philippines*. Manila: ADB.

¹⁰⁶An IMF assessment letter no more than 6 months old attached as a linked document to the approval documentation (RRP) is generally considered to be adequate.

instance, none of the reports and recommendations of the president (RRPs)—the ADB approval documents—for PBL that were reviewed as part of the evaluation adequately assessed the macroeconomic framework or contained tables presenting key macroeconomic indicators or forecasts. In the Philippines, RRP for PBL typically discussed the size of the budget deficit and how an operation would help close the financing gap, but this was rarely linked to a macroeconomic assessment. In Bangladesh, PBL designs seldom contained a judgment on whether the macroeconomic policy framework provided a satisfactory backdrop for PBL use. Staff guidance on what constitutes essential aspects of the macroeconomic framework is not clearly set out in the ADB Operations Manual. None of the minutes of the management review meetings for PBL approved in 2016 for example, raised any issues in connection with the macroeconomic framework. Nor was the adequacy of the macroeconomic framework considered at project completion. The appropriateness of injecting liquidity (in a foreign currency) into the macroeconomic framework of a DMC is taken as a given at approval, supported by an attached IMF assessment letter, and completion. The evaluation found only one case where ADB’s decision to proceed with a PBL was contrary to the IMF’s position. This implies that ADB itself should maintain a robust capacity to evaluate the views of the IMF on the macroeconomic conditions of the country as part of PBL design. The IMF assessment letter cannot be definitive, as the decision to proceed with the PBL lies with ADB. The risk implied by the IMF assessment, including the reputational and precedent-setting risks of acting contrary to the IMF views, must be fully assessed, and borne, by ADB.

Political economy analysis. While a macroeconomic assessment should underpin the use of budget support, the policy reform side of a PBL also requires good analytical work and technical assistance. Good political economy analysis is also important for sound loan design. The evaluation found that, while PBL designs drew on available political economy analysis, such work was rarely undertaken specifically in designing PBL operations. As a result, the political feasibility of, and risks associated with, specific PBL-supported measures tended not to receive much focus. RRP for PBL operations in Bangladesh, the Philippines, and Viet Nam did not feature any significant political economy analysis, despite the substantial political risks involved. Similarly, in Indonesia, substantive political economy analysis was seldom part of the preparation for PBL, although interviews suggested that some analysis was done informally. Several programs in Pakistan would have benefited from political economy analysis. The sector analysis that was prepared for several ADB PBL-supported programs fell noticeably short of adequately assessing the economic and political dynamics that would be crucial determinants of ownership and commitment. Starting in the early 2000s, ADB built up significant PBL support to help shape local government systems and service delivery. The devolved social services programs (DSSPs) in Sindh,¹⁰⁷ Punjab,¹⁰⁸ and Balochistan,¹⁰⁹ for example, sought to develop formula-based, performance-oriented grants to district governments, despite providing little evidence to show that the provincial governments were genuinely interested in reducing their

¹⁰⁷ ADB. 2003. *Report and Recommendation of the President to the Board of Directors: Proposed Program and Technical Assistance Loans to the Islamic Republic of Pakistan for the Sindh Devolved Social Sector Program*. Manila.

¹⁰⁸ ADB. 2004. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loans and Technical Assistance Grant to the Islamic Republic of Pakistan for the Punjab Devolved Social Sector Program*. Manila.

¹⁰⁹ ADB. 2005. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loans, Technical Assistance Loan, and Asian Development Fund Grant to the Islamic Republic of Pakistan for the Balochistan Devolved Social Sector Program*. Manila.

discretion over the financing of local governments (one provincial government later went so far as to claim that the DSSP was developed over its objections). Similar problems plagued the implementation of many other provincial PBL operations. In hindsight, the design of ADB support for the devolution process in Pakistan was based on an insufficient understanding of the political economy risks involved and this was a key reason why the PBL operations from that time were rated less than successful.

Analytical work. The evaluation found that, while the majority of PBL appeared to be informed by analytical work, it was difficult to find clear references or links to the work that had been undertaken. Generally, the key conclusions of such analysis were not described in the RRP and in most cases references to the analysis that provided the rationale for the PBL were unclear. One reason why this information was missing is that the RRP template introduced in 2010 was not tailored to the PBL modality. In Bangladesh, for example, two of the five PBL programs (on urban public health and regional trade facilitation) did not appear to be based on detailed diagnostic work. The sector assessments underlying several of the PBL operations were very general and often did not point to specific policy actions or reforms. Without clear analytical underpinnings, it was often unclear how policy actions were derived or why they were selected. In several cases, there was too little prior analysis to adequately inform PBL preparation. This was particularly the case in Pakistan. It was therefore often difficult to assess how specific policy actions would help to address policy issues and constraints.

Quality of the results framework. The ability to evaluate the policy reform side of PBL ultimately depends on the quality of the results framework in the design document. In ADB this is known as the design and monitoring framework (DMF), which is an appendix to the RRP, and includes the logic (or theory of change) linking program inputs with outputs and outcomes and the results indicators selected. In some MDBs, the policy matrix itself (i.e., the list of policy actions to be undertaken), has gradually also become the results matrix. In ADB, the policy matrix and the results matrix (the DMF) are separated, so linking policy actions, the first step on the results ladder, with results (outputs and outcomes in the DMF) is not as straightforward as it could be.

The evaluation found several issues with the quality of the DMFs. Some of these related to basic attribution problems, which is a challenge for all MDBs. The use of very high-level outcomes in the DMF—e.g., GDP growth, levels of private sector investment, employment creation, and poverty reduction—which are influenced by many other factors exogenous to PBL reforms, limits any possibility of attributing significant changes in these areas to ADB-supported policy actions. Conversely, setting results that are too output-oriented, and which are identical or similar to policy actions, as some PBL operations do, is also a problem because it confuses inputs with intended changes generated by the policy actions, and may mislead the assessment of PBL results. Nor should the output and outcome statement be the same.

Assessing the quality of the DMF for PBL is complex. Finding clear links between the policy actions supported and the outputs and outcomes stated in the DMF is often difficult, especially when there are numerous, often overly process-oriented policy actions, with results that are unclear or difficult to measure in practice. Such policy actions can include the approval of a document, the submission of a document to cabinet, the approval of an institution's organization chart, and staff training. The evaluation found that over 50% of policy actions were overly process-oriented, with results that were not measurable or only distantly related to the outcome. Moreover, the number of policy actions was correlated with loan size, suggesting that the ADB

Board of Directors expected to see a greater quantity of reform effort with larger loans. However, the size of the loan is determined by country financing needs, not by the cost of policy reforms. Moreover, this approach indicates shortcomings in PBL design. Other MDBs have set a limit to the number of policy actions, usually 10 or fewer. The average for ADB PBL operations over the evaluation period was 23.

The evaluation also found that many policy actions had become outputs in the DMF or were listed as indicators for outputs. However, the problem with presenting policy actions as outputs in the DMF or as indicators of the output is that the result of the policy action is the policy action itself, which greatly reduces the credibility of achieving it. This can be seen in Table 1.1, where each indicator for the output is worded the same way as the policy action that was undertaken prior to loan approval. The result of all these actions, moreover, is not adequately captured in the output, which simply states that policies and actions are in place. The output and outcome statements are also similar. Even where the indicator for the outcome is achieved, it is difficult to attribute this entirely to the policy actions or to understand what the connection is. DMF outputs are achieved simultaneously with policy actions, making PBL successful on approval. A review of 49 PVRs of PBL approved since 2008 found that 20 contained policy actions that were used as equivalent to outputs in the DMF.

Table 1.1: Example of a Results Chain and Performance Indicators for Policy-Based Lending

<p>Outcome: Framework for incremental policy and investment actions to improve air quality in the region strengthened</p>	<p>Fund disbursement rates for air pollution control measures increased to 80% for the central and provincial government and 90% for municipal governments (2014 base line: 71% for central government and 65% for provincial government)</p>
<p>Outputs: Policies and actions to reduce air pollution from key sectors issued and approved</p>	<p>1a. Natural gas network expansion plan with time-bound investment approach to accelerate implementation issued by the provincial government</p> <p>1b. Enabling regulation to encourage capture of synthetic natural gas from coke oven flue gas and allow its injection into the natural gas distribution network issued by the provincial government.</p> <p>1c. Action plan for accelerated decommissioning of decentralized heat-only boilers and substitution with centralized combined heat and power plants with enhanced emission reduction measures issued the provincial government.</p> <p>1d. Policy on quantitative targets for raw coal reduction and promotion of centralized and non-coal-fired heating service adopted by all 11 municipalities.</p> <p>1e. Analysis of financial and market-based incentive schemes for urban and rural heating service from low-carbon and low-emission cleaner energy sources started by the engaged institute.</p>

Source: ADB reports and recommendations of the President to the Board of Directors

Role of technical assistance. PBL design and implementation was widely, although not universally, supported by grant-financed technical assistance, which undertook analysis and supported the implementation of policy actions prior to loan approval. So, while the loan is absorbed into the countries' budget, TA is provided to the implementing agency to help implement policy actions. As some interviews suggested, provision of TA can provide an important incentive for line ministries to undertake reforms. In the Philippines, for example, TA was delivered as an integral part of PBL during 2008–2011, although more recent PBL implementation has tended to rely on existing or stand-alone TA. In the Kyrgyz Republic, a system support grant attached to the Investment Climate Improvement Program¹¹⁰ in 2008 helped set up an electronic single window for pre-customs clearance of imports and exports, clearly demonstrating how TA can help improve PBL design and implementation.

Slow delivery and underuse of TA undermined operational effectiveness in some cases. In Bangladesh, for example, the PCR for the Public Expenditure Support Facility and the CSF Program suggested that the failure to provide TA had undermined the achievement of some of the desired outputs.¹¹¹ The Viet Nam countercyclical support loan also did not draw on TA, which may help to explain the stop-go character of the government's stimulus program. In several of the Viet Nam programs, including the Third Financial Sector Program in 2007 and the Small and Medium- Sized Enterprise Program in 2010, TA came late or was ineffective.

Many of the available PCRs noted that a significant portion of TA funds—as much as 40% in some cases—remained undisbursed. In Pakistan, TA was provided in some form for all the PBL approved during 2008–2016 but was often marked by low use of designated funds. Where TA was provided to assess the impact of crisis support on households, for example in Armenia (2009), Georgia (2009), and Kazakhstan (2009), it was cancelled, which was a missed opportunity for learning. A comprehensive report on the overall impact of the Economic Recovery Support Program on vulnerable groups in Cook Islands was not undertaken, largely due to a lack of household survey data. Similar TA provided to support the government with state-owned enterprise reforms was cancelled in the Maldives (2009). Other PBL operations had to add more TA to help reform objectives to be achieved. In the Marshall Islands, for instance, while the TA was fully utilized, its outputs were not fully achieved. Tax revenue increased but the approval of tax legislation (prepared with TA consultant support) remained pending in Parliament, so the reforms could not be fully implemented. Similarly, debt management and implementation of state-owned enterprise (SOE) reforms were also delayed pending approval of the SOE and fiscal responsibility legislation. The envisaged TA outcome of fiscal sustainability was not achieved because of continuing fiscal deficits. These reform objectives therefore had to be completed by additional TA even once the initial budget support had been completed.

The part played by TA in facilitating the achievement of policy actions is often not fully presented in project completion reports. A key issue is the extent to which the policy reforms that were undertaken could have been implemented with TA alone, i.e., without budget support. In Bangladesh, for instance, there were suggestions that TA was effective in supporting the Third Capital Market Development Program and reforms would likely have occurred without the need

¹¹⁰ ADB. 2008. *Report and Recommendation of the President to the Board of Directors: Proposed Program Cluster, Grant for Subprogram 1, and Grant Assistance to the Kyrgyz Republic for the Investment Climate Improvement Program*. Manila.

¹¹¹ ADB. 2012. *Completion Report: Public Expenditure Support Facility Program and Countercyclical Support Facility Program in Bangladesh*. Manila.

for, or incentive of, budget support. In nearly all cases, budget support is rarely undertaken without TA, further illustrating that finance and policy reform have separate purposes and require separate modalities. Moreover, policy reform is unlikely to occur with budget support alone; it also requires TA for good analytical work, diagnostics, and reform implementation.

7. Conclusions

IED evaluated the use of PBL by ADB over the period 2008–2017. The design and reform focus of ADB PBL fundamentally changed over this period and success rates—as judged by project completion reports validated by IED—more than doubled, a trend also experienced in other MDBs. Improved performance appears to have coincided with the growing use of single-tranche PBL and, with this, the use of prior actions that are completed before loan approval. These changes have substantially reduced disbursement risks and increased the capacity of MDBs to provide more predictable and reliable budget support in response to country financing needs, the primary objective of the instrument. A key issue, however, is whether the need to respond efficiently to country financing needs has encouraged support for less critical reforms. Certainly, over time, PBL reform topics appear to have shifted from more politically sensitive reforms such as reform of state-owned banks, to more technical reforms connected with public financial management. PBL modalities also changed as the second tranche of a single loan, often containing more difficult policy actions, had generally required waivers or had been cancelled. These were no longer part of PBL design. So there appears to have been a trade-off between efficient, rapidly disbursing modalities to meet country financing needs and policy reform, which suggests that the two objectives of finance and policy reform are not automatically compatible.

While PBL performance dramatically improved over the evaluation period, the evaluation identified several issues. For example, except for Pakistan, PBL tended to be used in the region's more developed economies and was rarely focused on reform areas concerned with infrastructure development, ADB's main comparative advantage. Moreover, it was difficult to reconcile the high success rates in project completion reports validated by IED with the evaluation's finding that there were shortcomings in the quality of PBL design. A key reason for this is that, while PBL performance significantly improved over the evaluation period, assessing country-level results, such as improved service delivery, better governance, greater business confidence, and poverty reduction, and linking these with ADB PBL interventions was not as straightforward. If there is doubt about attribution (e.g., whether the PBL outcome was the direct result of the policy actions taken), the responsibility often falls on the evaluator to prove this (e.g., by constructing a counterfactual to show whether the result would have been achieved with or without the PBL). In practice, if the outcome indicators were achieved, the PBL will usually be rated successful, giving the role of PBL the benefit of the doubt.

Where budget support is delivered concurrently by several development partners, unambiguous attribution of outcomes to a specific donor or PBL operation can be almost impossible to establish. An alternative is to assess the additionality of the operation or its contribution to generating outcomes. In other words, the focus of evaluation should be on the quality of the whole of ADB's contribution, including TA, policy analytical work, and ongoing policy dialogue and other design matters. While attributing PBL's contribution to broader development outcomes is difficult, it is clear that positive outcomes are more likely if there is strong PBL design,

including good quality analytical work underpinning the PBL's reform content, strong policy actions critical to intended outcomes, good quality technical assistance, and a clear monitoring and evaluation framework against which results can be assessed.

PBL remains an efficient modality for supporting DMCs through crisis periods. This was demonstrated by ADB's rapid response to the global economic and financial crisis in 2007–2009, and by the COVID-19 pandemic in 2020. ADB's use of PBL has spiked during crisis years and broken through the 20% ceiling imposed on this type of lending in the sovereign loan portfolio. The increase in PBL use was only possible through the introduction of reform-free and rapidly disbursing budget support modalities to finance DMC countercyclical public expenditure programs to mitigate the extent of the crisis. PBL played several different roles over the evaluation period. It supported countries through difficult periods, including economic downturns, natural disasters, and pandemics, and it supported broad public sector management and macroeconomic stability through non-crisis years. Other budget support mechanisms are also emerging, including results-based lending, which is more relevant to improving service delivery than PBL.

It remains difficult to attribute the economic growth and reductions in income poverty that has been observed in several countries in the Asia and Pacific region to budget support. This is partly due to a paucity of data, weak country statistical systems, problems establishing a causal chain, and difficulties establishing an appropriate timescale; the difficulty in attributing results to PBL does not mean budget support had no poverty impact or had less poverty impact than that of other forms of MDB support. More country-specific knowledge is needed on the links between budget support, policy reform (especially in public sector management), and growth and poverty reduction. ADB needs to strengthen its efforts to strengthen the quality of its design and monitoring frameworks and to better articulate the link between policy actions (the first rung on the results ladder) and development policy outcomes. A PBL operation needs to be founded on a strong results framework in which a small number of critical reforms are more clearly linked to desired outcomes to foster effective monitoring and evaluation. In the past, ADB may have been given the benefit of the doubt in success ratings where outcomes in DMFs are achieved, but the link to policy actions has not always been clear.

The evaluation published in 2018 made several recommendations, some strategic and others related to PBL design. At the strategic level, it recommended that ADB should make greater use of PBL to support policy reforms in sectors where significant project investments were also undertaken. This would enable ADB to help countries achieve more integrated and sustainable solutions to public policy problems in these areas. Although this recommendation was accepted by Management, in practice it is unlikely to materialize mainly due to the COVID-19 pandemic, which in 2020 led to higher use of the non-reform-based countercyclical support facility. If this continues, the opportunity to use PBL to support infrastructure-related policy reform is likely to be limited in the immediate term.

The evaluation's recommendation that ADB should develop an operational plan on the scope, objectives, and articulation of public sector management interventions was not accepted formally, but in practice ADB has made moves in this direction. An operational priority plan for governance and institutional capacity has since been developed as part of ADB's Strategy 2030.

This plan provides corporate guidance on the conditions under which public financial management loans should be provided.¹¹²

The evaluation recommendations that (i) concessional assistance-only countries (Group A) should have access to a countercyclical facility, and (ii) the use of contingent disaster financing be formalized were accepted. Since the outbreak of COVID-19, countercyclical support has been expanded to include Group A and non-OCR eligible countries (Group B) as part of ADB's response to the COVID-19 pandemic.¹¹³ The response includes using both Asian Development Fund (ADF) grant resources and ADB concessional loan resources as part of its COVID response. It is not clear whether this arrangement will continue after the current crisis period. Contingent disaster financing was formally approved by ADB soon after the evaluation was issued.¹¹⁴

ADB did not agree to the evaluation's recommendation that, in rare cases where a regional department's view on the macroeconomic situation of a country diverges from that of the IMF, the risks involved be assessed independently of the regional department. Nevertheless, ADB has since strengthened the capacity of the Strategy, Policy, and Partnerships Department (SPD) to oversee PBL design prior to Board approval. SPD has revised the PBL provisions of the Operations Manual and the relevant staff instructions, which now include a specific loan approval template and a design and monitoring framework better suited to PBL. ADB's relationship with the IMF has been clarified and ADB's capacity to produce a clear macroeconomic assessment has been strengthened, helping to support the overall quality assurance mechanism for PBL. ADB Management decided against the recommendation of a separate 3-year PBL operational review such as the one produced by the World Bank, which may have helped to ensure a greater focus on results.¹¹⁵

ADB has taken steps to strengthen PBL design. The evaluation recommended that ADB limit the use of process-oriented actions and articulate policy actions as substantive outputs. It recommended tailoring the DMF so that policy actions, outputs, and outcomes are more clearly linked, and that the analytical work underpinning PBL design and policy actions is clearly referenced. While these recommendations are part of the revised Operations Manual and staff instructions, the outbreak of COVID-19 and the need to respond quickly to DMC financing needs during the pandemic has meant that implementation of these changes has been deferred.

In due course, ADB needs to strengthen its assessment of PBL design at program completion. This assessment should cover: the justification for the use of PBL, the relevance of the policy reforms supported, and their significance to the development outcome. There should also be a greater focus on the role and quality of TA, given its central role in the preparation of a lot of PBL and its implementation. Just as PBL requires its own template and DMF, new approaches for assessing PBL performance need to be introduced to ensure that the success rating given to completed PBL is based on a robust evidence-based assessment of the design, especially with regard to the relevance and criticality of policy actions to development outcomes. In single-

¹¹²ADB. 2019. *Strategy 2030. Operational Plan for Priority 6. Strengthening Governance and Institutional Capacity 2019-2014*. Manila.

¹¹³ADB. 2020. *ADB's Comprehensive Response to the COVID-19 Pandemic*. Manila.

¹¹⁴ADB. 2019. *Contingent Disaster Financing under Policy-Based Lending in Response to Natural Hazards*. Manila.

¹¹⁵World Bank Group. 2015. *Development Policy Financing Retrospective. Results and Sustainability*. Washington DC.

tranche PBL, policy actions have already been carried out at the time of the approval of the loan by the ADB Board, but their relevance and criticality to the outcome should still be assessed at completion.

This chapter regards ADB management's response to IED's recommendations as generally positive. Several initiatives to strengthen PBL design are underway. SPD, which oversees PBL quality and design, has strengthened its procedures. A separate PBL loan template, and a new results framework, linking policy actions with their intended results, have been developed. The COVID-19 outbreak in early 2020 led to a surge in countercyclical budget support in the first half of that year and the introduction of a new type of PBL to enable ADB to respond quickly to those countries most severely affected by the pandemic. A revised project completion template which more closely examines design issues is yet to be developed.

Comment on Asian Development Bank Policy-Based Lending: Performance, Results, and Issues of Design

Comment by: Homi Kharas

This comment focuses on three questions. (i) What are the issues affecting the development effectiveness of policy-based lending (PBL)? (ii) Does the chapter capture the issues well? (iii) What does PBL have to do with the Sustainable Development Goals (SDGs), which all member countries of ADB have signed up to?

1. What are the Issues Affecting the Development Effectiveness of Policy-Based Lending?

PBL provides rapid financing to governments along with support for a policy reform process. The chapter describes the trade-offs involved in this process very well. Financial support sometimes needs to be fast and large to have an impact, especially at a time of crisis. By contrast, policy reform is often a long slow process of incremental change and institution building. The two do not always co-exist comfortably. Over time, PBL has tended to address the finance objective more than the policy reform objective, as laid out in the chapter and evident in a greater reliance on prior reforms, shifting to PSM reforms within control of the ministry of finance (which has an incentive to deliver on reforms as it also gets to control the PBL money, as opposed to sectoral ministries), de-linking the loan volume from the difficulty or cost of implementation of the reform program.

This evolution of PBL may be positive, but it does change its nature. I believe the recent trend is positive for several reasons. First, it puts countries firmly in the driver's seat on the pace of reforms. As a development partner, it is appropriate for ADB to comment on and provide advice to counterparts on the nature, pace and sequencing of a reform program. It is not appropriate, in my view, to use financing to bolster ADB's own views over those of elected officials unless (i) there is a risk that the government program is so weak that a default could occur; or (ii) the economic context is so distorted that the loan could be "immiserizing".¹¹⁶

The chapter suggests that ADB should pay more attention to transport, energy and water infrastructure reforms, to align with areas where ADB has significant sectoral expertise. I am convinced ADB does have expertise in these areas that it can and should share with governments, but I would be reluctant to use the PBL as an instrument to force this. I subscribe to Martin Feldstein's critique of IMF operations during the Asian financial crisis, that the IMF strayed too far into structural reform territory during that time.¹¹⁷ Adjustment loans are about providing liquidity, not an instrument for forcing, or, more politely put, encouraging, specific policy reforms. Of course, a series of PBL operations can be used to structure reform incentives in the right way, but that is more about the pace, sequencing and degree of difficulty of reforms, rather than about choosing one sector over another.

¹¹⁶ Tariffs, foreign capital and immiserizing growth
Richard Brecher and *Carlos F. Diaz Alejandro*
Journal of International Economics, 1977, vol. 7, issue 4, 317-322.

¹¹⁷ Martin Feldstein. 1998. Refocusing the IMF. *Foreign Affairs*. March/April.

The second reason for supporting the tilt of PBL toward the provision of finance is that one lesson of crisis management is that “too little, too late” has long-lasting harmful consequences. What would be “too little”? That’s a question not really addressed in the paper. It would be useful to have had some discussion of whether ADB PBL always complemented IMF programs, although the chapter does contain a cryptic discussion of the need for ADB to have its own macroeconomic assessment capabilities. This may be correct, but a strong partnership, including shared analytical assessments, with other crisis lenders is possibly more important. Has ADB ever moved ahead in the absence of an IMF program or an IMF letter of comfort on the macroeconomic front? How often is ADB PBL part of a financing package to a government that also includes other development partners, notably the World Bank?

The chapter is correct in saying that the IMF is not the fount of all wisdom on macroeconomic matters, but developing an alternative capability, as the World Bank’s rather mixed experience shows, will not be easy nor necessarily uniform across a large institution like ADB.

Data from International Aid Transparency Initiative indicates that ADB has one of the best track records of disbursement against commitments of PBL operations in response to COVID-19 among all the multilateral development banks (MDBs). That is a strong testament to the value of tilting towards finance.

The chapter correctly notes that it is hard, if not impossible, to develop a strong causal link between PBL operations and actual results, given that so many other factors also affect the results. I can only agree. One intermediate approach that some bilateral agencies follow in their multilateral assessments might provide guidance. Imagine a diagram where all ADB developing member countries are ranked along an X-axis in terms of the degree to which their policies and institutions in place align with ADB’s strategic priorities (the seven operational priorities of Strategy 2030, for example), and a Y-axis that measures government effectiveness in implementation. It could be argued that PBL should be concentrated in the upper right quadrant (effective government, aligned policies). This could provide a framework for how to think about the allocation of PBL. It would also link PBL to issues such as climate change, the SDG agenda, and Strategy 2030 in a way that currently seems absent.

An approach like this offers some potential for cross-country differentiation. For example, there may be countries well suited to PBL, where finance remains important alongside country dialogue in a context where there is strong alignment between ADB management and government officials. Conversely, there may be countries where either the alignment or effectiveness is so poor that PBL should not be considered.

In future, I would anticipate that PBL will become even more important, partly because it provides a unique source of affordable, flexible, counter-cyclical, long-term development finance. The form may change towards greater pooled funding, including through country platforms (it would have been useful if the paper could have commented on the on-going pilots which will probably be supported by sector development program loans), but the strong focus on public finance will surely remain intact.

2. Does the Chapter Capture the Issues Well?

I found the chapter very well written and informative. My one comment is that more country differentiation would have been very useful. The paper is silent on, for example, the use of PBL in small island countries, a country grouping where ADB is trying to expand its operations and where issues of debt are very pertinent. It is also silent on the use of PBL in fragile and conflict-

affected situations, another area where ADB lending activities are set to expand. The trade-offs that arise in these different contexts might be quite different from those discussed above.

3. What does PBL have to Do With the Sustainable Development Goals?

This is where the chapter is weakest. In fact, it does not address the SDGs directly at all. To link PBL with SDGs requires judgments on three questions: (i) the scale and ambition of ADB activities, (ii) creditworthiness assessments, and (iii) partnerships and country platforms.

Scale and Ambition of ADB Activities

PBL is the right instrument for tackling SDG-related issues, but it is currently deployed at too limited a scale. Achieving the SDGs will require a major effort in Asian countries if they are to transition toward green and inclusive economies, but ADB does not yet have the mandate or resources to play a transformative role, even in partnership with other MDBs.

In future, it would be ideal if ADB and other MDBs could use instruments like PBL to advance investments in sustainable infrastructure, digital transformations, human capital provision, social assistance, biodiversity, and conservation. To do this, ADB may have to identify ways of identifying SDG-related expenditures that could be supported by a PBL. This will provide some comfort both to ADB and to citizens in developing member countries that PBL funds are being well spent.

Creditworthiness Assessments

If PBL operations are used in this way, they will have to confront the issue of debt distress and appropriate volumes of preferred creditor loans, especially for countries that may have difficulty in accessing private capital markets. Of course, this will need to be done in a manner consistent with maintaining ADB's AAA rating, but many analysts believe that, even within these constraints, there are many opportunities for stretching balance sheets.¹¹⁸¹¹⁹

Partnerships and Country Platforms

Unlike project lending, PBL is almost always undertaken in partnership with other financial institutions. The G20 Eminent Persons Group recommended piloting a number of country platforms, with the idea of coordinating national investment programs (sometimes sectoral) among various financial institutions (including in many instances domestic long-term investors such as national development banks and insurance and pension funds). These platforms would go well beyond donor coordination to include: transparency; high environmental, social, and governance (ESG) standards; and standardized project preparation, documentation and templates. They would be designed and oriented toward specific SDG investments, probably on a sectoral basis to permit the development of critical expertise.

¹¹⁸ See, for example, Chris Humphrey and Annalisa Prizzon, 2020, "**Scaling up multilateral bank finance for the Covid-19 recovery.**" Overseas Development Institute, London;

¹¹⁹ R. Settimo, 2019, "**Higher multilateral development bank lending, unchanged capital resources and triple-a rating. A possible trinity after all?**" Banca d'Italia Occasional Papers, No. 488

Chapter 2

Program-Based Operations at the African Development Bank, 2005–2020: An Overview

Clément Bansé and Stephanie Yoboué

1. Introduction

The objective of the chapter is to pool the results of recent evaluations of program-based operations (PBOs) during the period 2005–2019. Over the period 2005–2019, Independent Development Evaluation at the African Development Bank Group (AfDB) carried out two major independent evaluations of the PBO instrument: (i) in 2011, an Evaluation of Policy-Based Operations in the African Development Bank, which covered the period 1999–2009;¹²⁰ and (ii) in 2018, an Independent Evaluation of African Development Bank Program-Based Operations, which covered the period 2012–2017.¹²¹ The chapter draws on these two evaluation reports, supplemented by recent data on certain aspects.

Section 2 describes the historical development and use of policy-based lending, 2005–2019. Section 3 covers PBO performance over the period 2005–2019. Section 4 concludes the chapter.

2. Historical Development and Use of Policy-Based Lending by the African Development Bank, 2005–2019

Definition

PBOs are fast-disbursing financing instruments, which the AfDB provides to countries in the form of loans or grants. They address the actual, planned or unexpected development financing requirements of AfDB's regional member countries (RMCs).¹²²

PBOs are intended to support nationally owned policy and institutional reforms in RMCs, and to make available predictable medium-term finance to support priority spending to meet medium- and long-term development goals. They provide funds to the country's Treasury, to be executed using the national financial management system. PBOs are fungible and are provided together with associated policy dialogue and economic as well as sector work, all in support of nationally driven policy and institutional reforms.

Following in the footsteps of the World Bank (which first created structural adjustment loans to provide balance of payment finance to countries in return for policy and institutional reforms), the PBO instrument, formerly known as policy-based lending (PBL), was introduced in 1988

¹²⁰ Operations Evaluation Department. 2011. *Evaluation of Policy-Based Operations in the African Development Bank, 1999-2009*. Abidjan: AfDB.

¹²¹ Independent Development Evaluation. 2018. *Evaluation of Program-Based Operations in the African Development Bank, 2012-2017*. Abidjan: AfDB.

¹²² African Development Bank. 2012. *Policy on Program-Based Operations*. Abidjan.

through the Bank Group Policy on Structural and Adjustment Lending.¹²³ The same year, AfDB also introduced Policy-Based Lending Operations: Supplementary Guidelines and Procedures¹²⁴ to provide guidance on the use of the instrument. Until then, lending had focused exclusively on investment projects. In 2004, AfDB adopted Guidelines on Development Budget Support Lending¹²⁵ and Guidelines for Policy-Based Lending on Governance,¹²⁶ complemented by a Legal Note on Sector Budget Support Operations¹²⁷ in 2005.

The Governance, Economic and Financial Management Department was established in 2006 to lead AfDB's work on PBOs. In 2008, AfDB's Governance Strategic Directions and Action Plan, 2008–2012 (GAP I),¹²⁸ was adopted to guide AfDB's governance work in its RMCs. Using a combination of PBOs, institutional support projects (ISPs), technical assistance, economic and sector work (ESW), policy dialogue, and advisory services, AfDB has emphasized economic and financial governance in its RMCs. In 2010, after an independent evaluation, a commitment was made as part of the African Development Fund (AfDF)¹²⁹ replenishment negotiations that a comprehensive new policy would be prepared to consolidate existing good practices and streamline requirements for policy-based operations. Consequently, in 2011, the Program-Based Operations Policy, 2012–2017 (henceforth “the 2012 policy”) was adopted. The subsequent guidelines, which were finalized in March 2014, complemented the 2012 policy by providing additional practical guidance on the design and implementation of PBOs in AfDB, while re-establishing good practice in aid effectiveness in relation to predictability, country ownership, donor coordination, policy dialogue, and reporting.

Different Types of Program-Based Operations

There are four types of PBOs: general budget support (GBS), sector budget support (SBS), crisis response budget support (CRBS), and import support. The fourth category is markedly different from the others, which provide funds directly to the national treasury. Import support goes to the central bank. Fiduciary and audit standards are also different for import support.

- **General budget support (GBS).** A loan or grant that provides non-earmarked financial transfers to the national budget in support of policy and institutional reforms that are established in the country's national development plan or national poverty reduction strategy and are included in the country's budget priorities. This financing is accompanied by policy dialogue to support on-going government-led policy reforms in multiple sectors as well as other complementary instruments, where appropriate.
- **Sector budget support (SBS).** A loan or grant that involves policy and institutional reforms in a particular sector of AfDB's operational priorities, supported by unallocated financial transfers to the national budget. This financing is accompanied by policy

¹²³ African Development Bank. 1988. *Policy on Structural and Adjustment Lending*. Abidjan.

¹²⁴ African Development Bank. 1988. *Policy-Based Lending Operations: Supplementary Guidelines and Procedures*. Abidjan.

¹²⁵ African Development Bank. 2004. *Guidelines on Development Budget Support Lending*. Abidjan.

¹²⁶ African Development Bank. 2004. *Guidelines for Policy-Based Lending on Governance*. Abidjan.

¹²⁷ African Development Bank. 2005. *Legal Note on Sector Budget Support Operations*. Abidjan.

¹²⁸ African Development Bank. 2008. *Governance Strategic Directions and Action Plan: GAP 2008–2012*. Abidjan.

¹²⁹ The standard abbreviation for the African Development Fund is ADF. However, to avoid possible confusion with the Asian Development Fund, which uses the same abbreviation, in this book the abbreviation AfDF has been used to signify the African Development Fund.

dialogue in support of a particular sector and other complementary instruments, where appropriate.

- **Crisis response budget support (CRBS).** A fast-disbursing loan or grant to mitigate the adverse impact of a crisis or shocks. CRBS is available to the full range of RMCs: middle-income countries (MICs), low-income countries (LICs), and Transition states¹³⁰ (for which a risk assessment must be carried out). The crisis may be political, economic, or humanitarian. CRBS appraisal reports need to justify the decision to use the instrument based on the nature of the crisis. There is limited scope for policy dialogue at times of crisis, but the instrument can be used to open the door for future policy dialogue. AfDB streamlines its processes to fast-track the preparation and disbursement of PBOs as part of CRBS operations.
- **Import support.** A loan or grant that involves the transfer of financial resources to the central bank or is used to boost reserves in the case of a balance of payment deficit. Import support is not the strategic focus of AfDB. The instrument is to be used only in exceptional cases as part of a coordinated donor action (e.g., with the International Monetary Fund) to mitigate short-term macroeconomic instability in any RMC.

The 2012 policy makes clear that budget support can be provided either as a stand-alone operation or as programmatic support. The policy highlights the usefulness of a programmatic approach for supporting medium-term policy reforms, while maintaining stand-alone operations as an option.

- **Stand-alone operations.** A single disbursement against the fulfillment of prior actions during the year of approval. Policy dialogue is limited to a 1-year period.
- **Programmatic operations.** A series of single-year operations in a multi-year framework. This involves a series of single-tranche operations that are sequentially presented to the AfDB Board of Directors, within a medium-term framework specified at the outset. Indicative triggers are included in an overall multiple-year appraisal report and are adapted to changing circumstances at each phase of the program. At the end of each phase, a streamlined appraisal document is prepared, indicating the prior actions taken in advance of the next loan or grant as well as the triggers for subsequent operations in the series.
- **Programmatic tranching.** Single loan operations with a series of tranches set within a multi-year framework, all approved upfront in one appraisal report. Under this model, the conditions precedent for the disbursement of each tranche are identified and approved by the Board at the time of approval. This requires a high degree of certainty on reform actions and timing but has the advantage of reducing transaction costs for both AfDB and the RMC.

At the AfDB, PBO resources are not subject to earmarking and are not related to the cost of the reforms supported, but rather to country financing requirements and AfDB's available lending envelope. From 2009 to 2019, PBOs constituted 17%–21% of overall annual approvals.

Within that timeframe, GBS represented 65% of AfDB operations. Following the adoption of the 2012 policy, the share of SBS increased to 26.4%. The CRBS instrument was introduced in 2012 by the policy and represented 8.7% of all PBOs approved during 2012–2017.

¹³⁰ Transition States are countries where the main development challenge is fragility

Despite AfDB's stated preference for programmatic operations, single-standing operations (SSOs), still account for a third of approved projects. Programmatic models are the preferred option for AfDB (as in other multilateral development banks), because: (i) reforms are medium-term in nature, and (ii) they allow development partners more leverage to support reforms. Since 2012, 42% of PBOs have been designed as programmatic operations or programmatic tranching (24%).

The coronavirus disease (COVID-19) pandemic has disrupted African countries' economies and the livelihoods of millions of people. In response, AfDB has introduced initiatives to support the governments of its RMCs as they take measures to mitigate the human and economic impact of the pandemic. As part of its response, AfDB has used CRBS to respond quickly to crises. This is not the first time AfDB has faced such a major emergency, in 2014 it responded to the Ebola crisis affecting Guinea, Liberia, and Sierra Leone using the PBO instrument to strengthen the countries' health systems so that they could tackle the outbreak. The use of CRBS is guided by AfDB's 2014 operational guidelines on the programming, design and management of PBOs and by simplification measures introduced by the \$10 billion COVID-19 Rapid Response Facility (CRF)¹³¹ AfDB launched in April 2020.

In addition to the CRF, a number of measures have been launched as part of the COVID-19 outbreak and its economic consequences, including a \$3 billion Fight COVID-19¹³² social bond, and \$2 million in emergency assistance to support measures led by the World Health Organization¹³³ to curb the spread of the disease. Since the approval of the CRF, 28 CRBS operations have been prepared and approved for the benefit of 40 RMCs. Specifically, 26 AfDF countries received support with a total of \$1,244 million and 14 African Development Bank countries for a total of \$2,364 million.¹³⁴

The focus of CRBS operations has been on supporting emergency responses to the health, social, and economic crises brought about by COVID-19. AfDB's policy dialogue with governments has centered on the formulation and content of COVID-19 response plans, in particular on ensuring that these plans cover not only the health dimensions of the crisis, but also respond to the social and economic fallout. AfDB has accorded high priority to safeguarding the transparency and accountability of COVID-19 expenditures and programs, and has taken the lead in addressing this as part of its policy dialogue with RMCs. In the medium term, the focus of the dialogue will shift to increasing AfDB's engagement on the reforms required for recovery and on building economic resilience, which can be pursued once the crisis is over.

¹³¹ COVID-19 Response Facility. <https://www.afdb.org/en/news-and-events/press-releases/african-development-bank-group-unveils-10-billion-response-facility-curb-covid-19-35174>

¹³² The Fight Covid-19 Social Bond. <https://www.afdb.org/en/news-and-events/press-releases/african-development-bank-launches-record-breaking-3-billion-fight-covid-19-social-bond-34982>

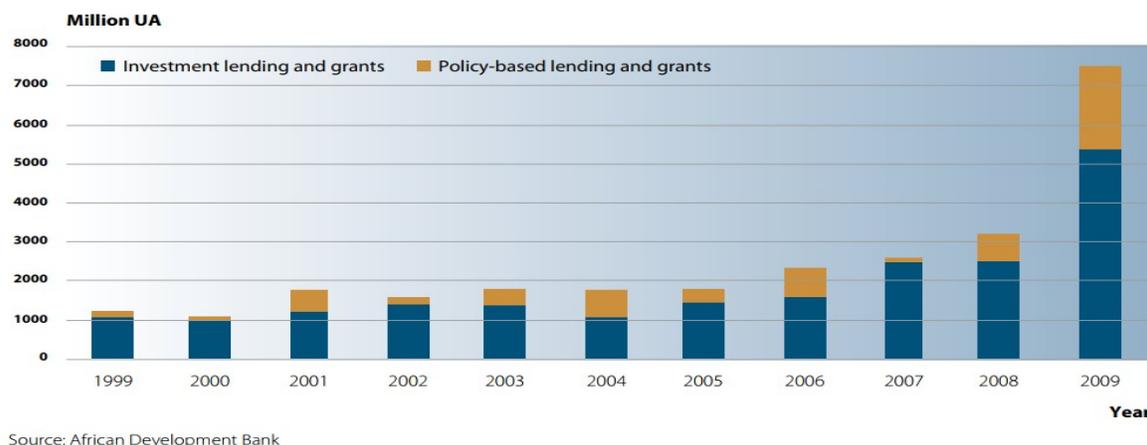
¹³³ The emergency assistance for the World Health Organization (WHO) to reinforce its capacity to help African countries contain the COVID-19 pandemic and mitigate its impacts. <https://www.afdb.org/en/news-and-events/press-releases/african-development-bank-approves-2-million-emergency-assistance-who-led-measures-curb-covid-19-africa-35054>

¹³⁴ AfDB. *First Quarterly Progress Report Implementation of the COVID-19 Response Facility (2021)*. The unit of account (UA) is the currency for AfDB projects.

Use of Program-Based Operations

There has been a substantial increase in AfDB’s use of PBOs in terms of the number and amount of approvals since 2005. Between 2005 and 2008, AfDB’s total operations grew steadily before a spectacular increase in 2009, in response to the global financial crisis.¹³⁵ Total PBO approvals over the 2005–2009 period amounted to UA6.1 billion, comprising UA3.6 billion in AfDB loans (21 operations), UA1.8 billion in AfDF loans (68 operations), and UA0.7 billion in AfDF grants (31 operations). A third of AfDB PBOs over the period were approved in 2009, accounting for 49%, by value, of the total AfDB PBOs approved during 2005–2009. One operation (Botswana Economic Diversification Support Loan) dominated the approvals, with a value of just over UA1 billion. The top five users of PBOs, by value, during the 2001–2009 period, were all MIC countries (Morocco, Botswana, Tunisia, Mauritius, and Egypt). Within active AfDF countries, more than half (20 out of 36) had PBOs, which accounted for over 20% of their total operations. In eight countries, PBOs represented 10%–20% of their operations, but in eight others less than 5% of their total AfDF financing was provided as PBOs. The largest AfDF users of PBOs, in terms of total finance provided, were Ethiopia, Tanzania, Ghana, and Mozambique, all of which received more than UA200 million over the 1999–2009 evaluation period. The AfDF countries with the largest number of separate operations were Tanzania, Burkina Faso, and Cape Verde (each with six); and Ethiopia, Mali, Zambia, Benin and Lesotho (each with five).

Figure 2.1: Total African Development Bank Group Loans and Grants, 1999–2009



AfDB has approved 91 PBOs during the 2012–2017 period)¹³⁶ with an approval value of UA7.2 billion.¹³⁷ Of the 91 approved operations during 2012–2017, 68% were part of a series of

¹³⁵ Operations Evaluation Department. 2011. *Evaluation of Policy-Based Operations in the African Development Bank, 1999–2009*. Abidjan: AfDB.

¹³⁶ Independent Development Evaluation. 2018. *Evaluation of Program-Based Operations in the African Development Bank, 2012–2017*. Abidjan: AfDB.

¹³⁷ Operations Evaluation Department. 2011. *Evaluation of Policy-Based Operations in the African Development Bank, 1999–2009*. Abidjan: AfDB.

operations. This represents an increase on the period covered in the previous evaluation (1999–2009) in terms of both average annual approval volumes¹³⁸ and the average number of operations approved per year.¹³⁹ The PBO share of AfDB financing increased to 78% compared to 59% in the earlier period. For 2012–2017, disbursement stood at 95% of approvals at the time of writing. The remaining undisbursed funds were related to 2017 approvals.

Since the approval of the 2012 policy, there was a steady increase in the number of operations approved until 2016 (Figure 2.2)¹⁴⁰ when approval volumes spiked¹⁴¹. As a result, in 2017 the Board and Senior Management agreed to introduce a ceiling of 15% for AfDB operations for PBOs, which led to some PBOs planned for approval in 2017 being delayed or reconsidered and a decrease in approvals in 2017. The AfDF countries had a 25% PBO ceiling in place for the full evaluation period. The ceiling applies to the AfDF 3-year cycle, meaning that annual approvals fluctuate. In terms of other key portfolio trends as they relate to the direction pushed by the 2012 policy, there has been an increase in the proportion of PBOs which support sector governance, as opposed to only core public finance management (PFM) issues. Programmatic or multi-year operations now make up the majority of operations approved since 2012 (66%), with the remainder being SSOs.

Over three-quarters (by amount) of PBOs approved since 2012 have been for operations in MICs, although this translates to about one third in terms of the number of operations. The average size of PBOs is larger in MICs than in either LICs or transition states and larger in 2012–2017 than in 2010–2011. Over the same period, the average size of PBOs in LICs and transition states showed a slight decrease. The volume of PBOs provided as grants has also decreased and they accounted for just 6.1% in 2012–2017. In total, AfDB provided PBOs to 34 countries in Africa between 2012 and 2017. Of these, Morocco made the most use of AfDB’s PBO instrument, with 10 operations during that period.

Each country category was associated with a specific type of PBO. CRBS was predominant in transition states (75% of the total number), while GBS was most often used in LICs (68% of the total number). About half of SBS was directed at MICs (46% of the total number).

More recently, AfDB approved 33 PBOs in 24 countries between 2018 and 2020, amounting to more than UA1.9 billion. Reflecting previous trends, the largest amounts of PBOs were directed at MICs, including Morocco, Egypt, and Angola.

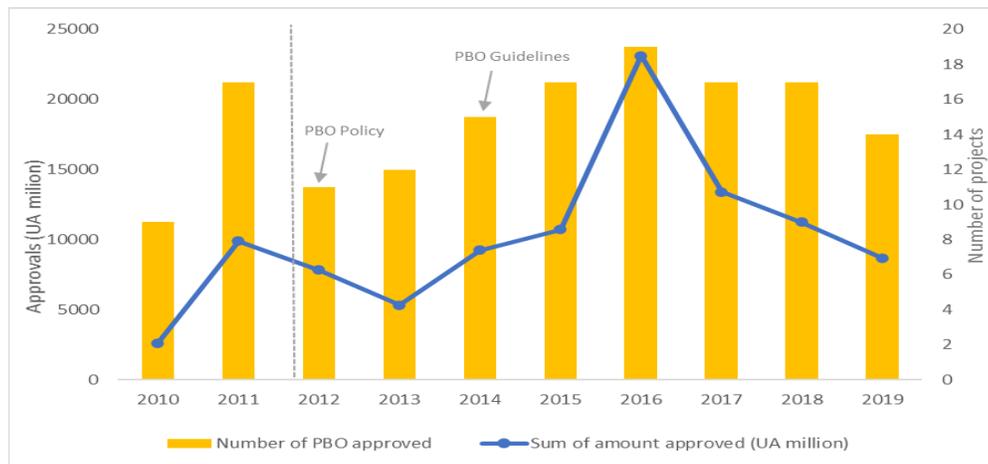
¹³⁸ AfDB, Operations Evaluation Department (2011).

¹³⁹ Ibid.

¹⁴⁰ The 2011 evaluation included data only up to 2009, so data for 2010 and 2011 are also included to ensure there is no gap in longer-term approval data.

¹⁴¹ Three specific large approvals contributed to this spike: Algeria, Egypt, Nigeria

Figure 2.2: Evolution of the PBO Portfolio, 2010-2019



PBO = program-based operations, UA = unit of account (the currency for AfDB projects).

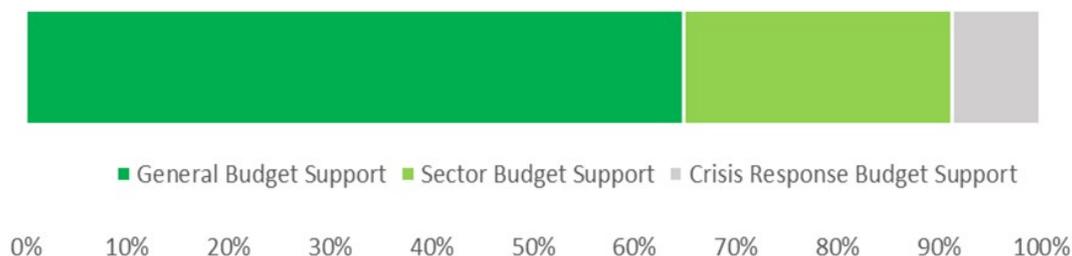
Note: The evaluation period is 2012–2017. The previous periods (2010–2011 and 2018–2019) were added for context and to complete the story of the evolution of the portfolio since the 2011 evaluation, which covered 1999–2009 approvals.

Policy Reform

Over the period 1999–2009, out of a total of 102 PBOs, only seven supported reforms in the energy, agriculture, social and financial sectors. Most PBOs were focused on PFM and on improving the business climate.

In line with the spirit of the 2012 policy, AfDB is making greater use of PBOs to support governance reforms in the health, energy, transport, and agriculture sectors in addition to its core work in economic and financial governance. Although about 65% of PBOs during the period were officially listed as GBS (Figure 2.3), the proportion of SBS increased over previous years. In addition, a closer look at the content of the PBOs reveals that 59% (whether listed as GBS, SBS or CRBS) included a focus on sector governance rather than concentrating on core economic governance areas such as PFM. This compares with 31% for the 2 years preceding the policy. At the same time, 75% of PBOs in the 2012–2017 period also included PFM components.

Figure 2.3: Share of Operations Classed as General Budget Support, Sector Budget Support, or Crisis Response Budget Support, 2012–2017



Notably, all PBOs can be mapped to at least one of AfDB’s “High 5s,”¹⁴² as identified in the Ten-Year Strategy and the Governance Strategy and Action Plan II (2014–2018), or supported governance issues which cut across them. The three High 5s that received the most support during the period were: (i) Industrialize Africa (mainly through private sector environment reforms);

(ii) Quality of Life (including education and social protection); and, (iii) Light up and Power Africa (the fastest growing area with almost all PBOs approved in the last 3 years). AfDB’s New Deal on Energy in Africa highlights the importance of addressing deficiencies in country policy and regulatory frameworks. PBOs with a focus on helping governments to provide an environment conducive to doing business is relevant to AfDB’s existing governance and private sector development strategies as well as to the “Industrialize Africa” High 5.

During the Ebola outbreak of 2014, which was responsible for the deaths of 11,325 people in West Africa, the three countries most affected by the crisis (Guinea, Liberia and Sierra Leone) were characterized by weak links between government and society, inadequate governance, continued insecurity, and weak institutional capacity. Strengthening their recovery and response capacity was seen as vital to ensure early detection and avoid the outbreak expanding beyond the affected countries. The last case of Ebola was recorded in Guinea in June 2016. AfDB used the SBS instrument and was able to learn from its experience in managing a crisis, which subsequently enabled it to respond quickly and efficiently to the COVID-19 pandemic. Several lessons were drawn from the evaluation of the two projects, which made up part of AfDB’s response to the Ebola crisis:¹⁴³

- Active community consultation, engagement, social mobilization and proper analysis of the social environment contribute to good project design.
- Including government officials as members of the project implementation units for large and complex projects is important.

¹⁴² Building on its existing 2013–2022 strategy, AfDB outlined five development priorities: Light up and Power Africa; Feed Africa; Industrialize Africa; Integrate Africa; and Improve the Quality of Life for the People of Africa.

¹⁴³ AfDB. 2015. *Technical Assistance to Support Countries (Guinea, Sierra Leone and Liberia)*. Abidjan; and AfDB. 2014. *Strengthening West African Health Systems*. Abidjan.

- Operational flexibility in the design and implementation of the project can be helpful in meeting project objectives.
- Country ownership and empowerment of local organizations through community engagement and social mobilization are key for the success of any project that operates in the community.
- The lack of a unified regulatory framework is likely to hamper the deployment of volunteer health workers and other support mechanisms.
- Embedding capacity building as part of an emergency or crisis response that faces severe restrictions on movement and personal contacts does not work.
- The lack of a monitoring and evaluation officer for a project of this magnitude adversely affects smooth and efficient project delivery.

Debt Relief

The 2012-2017 evaluation did not find out whether PBOs took place in conjunction with debt reduction or relief support programs by other donors. Instead, it assessed the relevance of PBOs within AfDB's portfolio and the extent to which they adhered to its own policy and guidelines as well as international good practices. Macroeconomic stability is one of the conditions for PBO eligibility, as AfDB needs to consider debt sustainability. The aim is to ensure that loan conditions do not compromise the debt sustainability of recipient countries.

Cooperation with Multilateral Development Banks and the International Monetary Fund

AfDB has made substantial progress in its use of PBOs. In 1999, it was heavily dependent on the World Bank and to a lesser extent the IMF for the analysis and design of its PBOs. The only instruments available to AfDB were structural and sectoral adjustment operations, which often encountered implementation difficulties and delays resulting from weak country ownership and unsuccessful attempts to leverage policy change using complex conditionalities.

The evaluation of PBOs in 2018 highlighted how AfDB had coordinated with other development partners, most notably in the identification and appraisal periods. AfDB staff give high importance to coordination and invest in upfront work with other development partners. However, the evaluation also found that AfDB had found it difficult to sustain these initial high levels of coordination throughout the implementation phase. AfDB's approach was in line with the G20 Principles for Effective Coordination between the IMF and MDBs on Policy-Based Lending in 2017, which proposed that all MDBs align behind the IMF with regard to countries facing macroeconomic vulnerability.

Harmonization with other development partners was one of the 2012 policy's five PBO eligibility criteria and is also considered core to international good practice. Nevertheless, the guidelines make it clear that "the criterion of harmonization does not prevent AfDB from providing PBOs when no other development partner is doing so. Indeed, in such cases, teams are expected to consider the potential of the PBO to leverage other support and influence. With regards to coordination with the IMF in particular, expectations have recently changed."

At the identification and appraisal stages, AfDB's efforts to coordinate with other development partners were rated satisfactory in 82% of cases. Such coordination was clearest in the 23% of

PBOs which made use of joint performance assessment frameworks (PAFs). Where PAFs did not exist, and even in cases where AfDB was the only partner to provide assistance in the form of budget support, sound justifications and evidence of coordination were found. For example, in Chad, AfDB worked closely with the European Union and the World Bank, including through joint missions during the first Public Finance Reform Support Programme, although the practice was not fully sustained under the second. In Ghana, the joint budget support framework had broken down by the time the Public Financial Management and Private Sector Competitiveness Support Programme (PFMPSC) was appraised; however, AfDB's decision to provide a PBO and to work closely with IMF and the World Bank was well justified.

In the context of in-depth PBO assessments, a consistent theme on coordination emerged. Coordination was strong during the identification and appraisal stage where the concerned government took up its leadership role, but was not always maintained throughout implementation. Around two-thirds of survey respondents had a positive view of AfDB's coordination with other development partners, although views were slightly more positive among AfDB staff than among RMC officials. Egypt provides an example of good practice in terms of coordination between the AfDB and the World Bank, since the coordination that began at identification and appraisal continued into implementation.¹⁴⁴ Although the IMF program was not in place by the time AfDB approved the first a series of PBOs, it followed soon after and there was regular liaison between the three institutions during the planning stages. In the Seychelles, appraisal for the first in a series of PBOs for both the AfDB and the World Bank was closely linked to the IMF's assessment, and the government took the lead in bringing the development partners together to support related reform programs, but this coordination was not sustained in later years.

There have been cases where AfDB has proceeded with a PBO in the absence of an on-track IMF program before the G20 principles were adopted. These included three countries that did not have an IMF program: two are MICs (Angola and Nigeria) and one is a transition state (Comoros, although the PBO was not CRBS).¹⁴⁵ In addition to the in-depth PBO assessments, the desk review highlighted that in Algeria, Comoros, and Mauritania, IMF programs were not on track but an IMF letter of comfort and/or notes on the country's relationship with IMF through Article IV consultation were included in the appraisal package.

¹⁴⁴ With the exception that, for the third phase, the two institutions are now running on different schedules, since AfDB faced some delays, which reduced the extent to which it has been possible to conduct missions jointly.

¹⁴⁵ This figure does not include Egypt since the IMF program was agreed shortly after PBO approval.

3. Evaluation of the Performance of Program-Based Operations, 2005–2019

Evaluation of African Development Bank Policy-Based Operations, 1999–2009

The first independent evaluation of PBOs was undertaken in 2011 and assessed AfDB's use of PBOs over the period 1999–2009 (footnote 71). The evaluation examined how effectively AfDB had used PBOs to support national development objectives, with a focus on AfDB's policies and procedures for PBOs. It was based on: (i) a review of the literature and comparative experience with PBOs in other development agencies, (ii) a review of AfDB's institutional and policy framework, (iii) six country case studies, and (iv) four case studies of other significant operations.

The evaluation concluded that AfDB had made substantial progress in its use of PBOs. In 1999, AfDB was heavily dependent on the IMF and the World Bank for the analysis and design of its engagement in structural and sectoral adjustment operations. As of 2011, AfDB operated as a significant partner in joint donor budget support arrangements, and the record of its engagement, as shown by the country case studies, was largely one of success. AfDB had developed a cadre of staff with strong experience in the design and management of budget support. The establishment of country offices had significantly improved AfDB's ability to engage in national policy and budget processes and had strengthened its monitoring and supervision of PBOs (even though decentralization progressed far more slowly than planned).

AfDB had strengthened its organizational capacity and structure for the design, appraisal, management, and monitoring of PBOs, although some aspects still required further development. It had proved highly responsive to the international economic and financial instability that affected RMCs during 2008 and 2009. AfDB was able to design and implement operations to meet the urgent financial requirements of its clients and these operations provided a platform from which longer-term structural reforms could be addressed. It also made important contributions to the development of budget support arrangements under the Fragile States Facility; in Liberia, for instance, AfDB played a leading role in moving other development partners toward budget support.

The evaluation found that, while AfDB had succeeded in engaging effectively in joint budget support arrangements and in mobilizing rapid responses for fragile and crisis-affected countries, there were some shortcomings in its policies and practices. Its numerous policies and guidelines were not being consolidated or updated. Project procedures were not being fully documented, and were designed for investment operations rather than specifically tailored to PBOs. There was a lack of clarity about how results should be defined and measured for PBOs, information systems were weak, and audit and fiduciary risk issues needed to be addressed.

Independent Evaluation of African Development Bank Program-Based Operations, 2012–2017

The evaluation was based on seventeen background reports, as well as on a series of focus groups and reference group discussions (footnote 72). The evaluation scope covered the 91¹⁴⁶ PBOs approved between 2012 and 2017, with a collective approval value of UA7.2 billion.

The evaluation was designed to: (i) identify factors which had enabled or hindered good performance, (ii) draw lessons for AfDB, and (iii) identify specific recommendations to help AfDB to optimize the effective use of the PBO instrument in future. Specifically, the objectives of the evaluation were to provide credible evidence on: (i) how AfDB was programming, designing and managing its PBOs in accordance with the 2012 policy and other elements of good practice;¹⁴⁷

(ii) the performance of PBOs in specific areas; (iii) the factors that had enabled or hindered achievement of PBO objectives; and (iv) lessons that could inform AfDB's future use of PBOs to ensure consistent good practice and to support achievement of the High 5s.

The evaluation addressed three overarching questions.

- (i) To what extent is AfDB appropriately programming, designing, and managing its PBOs?
- (ii) What is the evidence regarding PBO performance, particularly for AfDB in the priority areas of energy and the private sector environment (PSE)?
- (iii) Looking forward, how can AfDB ensure it optimizes its use of PBOs, including helping it to achieve the High 5s?

These three questions were broken down into eight sub-questions, addressed through over 40 criteria.

Methodology

A generic theory of change for AfDB PBOs was constructed based on AfDB documents, consultations with internal stakeholders, and the methodology endorsed by the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD-DAC) for evaluating budget support operations. The theory of change helped to refine the evaluation questions. Individual theories of change were also developed for each of the 10 in-depth country studies based on the generic version.

The evaluation had seven components and each used different sources of data and analytical techniques. In addition, the evaluation was based on a thorough inception phase which included two staff focus groups and interviews with 42 internal stakeholders, including eight executive directors and 12 members of senior management.

¹⁴⁶ Sixty of these relate to programmatic operations, where two or three separate operations together are considered a series, but each phase in the series is approved as an individual operation. The number of single PBOs plus PBO series is 51.

¹⁴⁷ There are various sources of advice on “good practice.” The most relevant for AfDB is OECD-DAC. 2006. *Harmonising Donor Practices for Effective Aid Delivery. Volume II*. Paris: OECD, which laid out a set of principles for the provision of budget support consistent with the 2005 Paris Declaration.

For the 10 in-depth studies, a cluster approach was used. This allowed strong evidence to be collected within specific areas but limited the extent to which the findings could be generalized across the full portfolio. The two focus areas of energy and the private sector enabling environment (PSE) were identified early in the design stage following analysis of: (i) the recent use of PBO funds, (ii) the availability of evidence, and (iii) the pertinence of these areas to future directions for AfDB, particularly in support of the High 5s. In addition to evaluating these two focus areas, the evaluation also examined the PFM components of the PBOs (present in nine of the 10 countries). It is important to note that, for the two general budget support (GBS) cases that included a broad range of targeted sectors in addition to energy, PSE, and PFM, those other sectors were not the focus of in-depth analysis, although the delivery of all reforms was assessed.

Within these two focus areas of energy and the private sector enabling environment, cases were selected according to the following considerations.

- **Evaluability.** The sample included countries with PBOs that were at a reasonably mature stage of implementation (least 12 months since approval) so some influence could be expected on intermediate outcomes (known as “induced outputs,” see Table 2). All 2017 approvals were therefore excluded.
- **Contemporary relevance.** The sample covered countries with relatively recent PBOs, whose design and implementation should reflect the 2012 policy, and where the process of implementation could still be recalled by those interviewed. This meant most of the cases came from the 2014–2016 period.
- **Diversity in types of PBOs.** In selecting the cases, the goal was to include examples of SBS, GBS, single-standing operations, programmatic operations, and programmatic tranching.
- **Diversity in country contexts.** The sample covered: (i) MICs, LICs, and transition countries; (ii) countries in at least four of the five sub-regions in which AfDB operates; and (iii) anglophone, francophone, and lusophone countries.
- **Diversity in size of PBOs.** The sample included some of the largest and most important PBOs, intermediate PBOs, and small PBOs.

Ten countries and 16 operations were covered by the in-depth studies (Table 2.1). Collectively, they accounted for UA2,155,040 in approvals and 36% of PBO approvals by amount in 2012–2016. The assessments covered energy, PSE, and PFM¹⁴⁸. However, the sample was not designed to be generalizable across the full portfolio. In particular, PBOs with a focus on social sectors—which have also been an important part of the portfolio and are managed by a different department—were not covered.

Table 2.1: Program-Based Operations Covered by the In-Depth Assessments

Country	PBO Operations	Approval Date	PBO Type	Disbursement	Net Loan Amount (UA million)
Energy Cluster					

¹⁴⁸ PFM is a cross cutting area and most PBOs (Energy and PSE) have a PFM component.

Country	PBO Operations	Approval Date	PBO Type	Disbursement	Net Loan Amount (UA million)
Angola MIC Lusophone Southern Africa	Power Sector Reform Support Programme	2014	SBS	100%	705
Comoros Transition Francophone East Africa	Energy Sector Support Programme	2014	SBS	100%	4
	Energy Sector Reform and Financial Governance support Programme	2012	GBS	100%	2
Burkina Faso LIC Francophone West Africa	Energy Sector Budget Support Programme	2015	SBS	100%	20
Nigeria MIC Anglophone West Africa	Economic Governance, Diversification and Competitiveness Support Programme	2016	GBS	100%	445.6
Tanzania LIC Anglophone East Africa	Power Sector Reform and Governance Support program	2016	SBS	100%	37.4
	Power Sector Reform and Governance Support Program	2015	SBS	100%	35.5
Private Sector Environment Cluster					
Egypt MIC Arabic and Anglophone North Africa	Economic Governance and Energy Support Program Phase II	2016	GBS	100%	371.3
	Economic Governance and Energy Support Program Phase I	2015	GBS	100%	371.3
Mali Transition Francophone West Africa	Programme d'appui aux réformes de la gouvernance économique Phase II	2016	GBS	0%	23.2
	Programme d'appui aux réformes de la gouvernance économique Phase I	2015	GBS	100%	15

Country	PBO Operations	Approval Date	PBO Type	Disbursement	Net Loan Amount (UA million)
Morocco MIC Francophone North Africa	Morocco Economic Competitiveness Support Programme	2015	GBS	100%	83.5
Ghana LIC Anglophone and Francophone West Africa	Public Financial Management and Private Sector Competitiveness Support Programme Phase II	2016	GBS	100%	35
	Public Financial Management and Private Sector Competitiveness Support Programme Phase I	2015	GBS	100%	40
Seychelles HIC Anglophone	Inclusive Private Sector Development and Competitiveness Programme Phase II	2015	GBS	100%	7.4
	Inclusive Private Sector Development and Competitiveness Programme Phase I	2013	GBS	100%	14.9

GBS = general budget support, HIC = high-income country, LIC = low-income country, MIC = middle-income country, PBO = program-based operations, SBS = sector budget support.

Source: AfDB

The evaluation was subject to a number of limitations. Each of these was taken into account in how the evaluation was designed and reported.

First, at the design stage, the evaluation team explicitly limited the extent to which the overarching question (ii), on results, would be addressed.¹⁴⁹ This limitation related both to how far up the results chain the evaluation could go in assessing AfDB's contribution to results. Additionally, the decision to focus primary data collection on performance within the two sectors and PFM covered by the two clusters of in-depth assessments allowed to give strong internal validity. Other data were used to establish whether the observed patterns had validity beyond those sectors.

Second, secondary data were not always available. For example, in some cases project completion reports, validations, and implementation progress and results reports (IPRs) were not available. In addition, AfDB does not systematically record its policy dialogue with countries. These constraints were mitigated by using other data sources where possible.

Third, given resource constraints, the balance between depth and breadth was based on stakeholder information needs. The 10 in-depth cases were chosen to maximize learning in the specific areas of energy and PSE, nine of the 10 cases also included PFM. The survey sought to bring in broader staff and RMC views, as did focus groups for staff. The project portfolio

¹⁴⁹ AfDB. *IDEV Approach Paper, IDEV Information Note to the Board, Final Inception Report*(2017).

documentation review used a representative stratified sample. It did not include an assessment of the quality of analytical work.

Fourth, recent cases (from early 2018) were included to ensure that the evidence was contemporary, which also helped with the availability of informed staff and stakeholders. However, since many reforms are medium-term in nature, this meant that fewer results were available.

Fifth, to understand how PBOs had contributed to results, the in-depth assessments followed a uniform methodology designed to reflect the specificity of the PBO instrument and to maximize the learning potential for AfDB. Four different assessments were conducted (Table 2) to arrive at the overall assessment. The overall assessment was satisfactory, and the weakest area was AfDB’s contribution to the direction or the pace of achieving landmark policy changes. In order to mitigate risks when it came to evaluating the results of PBOs, the evaluation compared the results with those of other internal and external evaluations of AfDB operations to validate them.

Table 2.2: Assessing the Effectiveness of Program-Based Operations and Their Contribution to Landmark Policy Changes

Country’s Achievement of RMF Indicators	AfDB Contribution to Landmark Policy Changes^a
Induced output ^b execution ratio	Achievement of landmark changes ^c
Overall assessment of effectiveness by country, including induced outputs and final outcomes	Evidence of PBO influence on landmark changes

AfDB = African Development Bank, PBO = program-based operations, RMF = results measurement framework.

^a Defined in Box 1.

^b The term induced outputs is aligned with international methodological standards on evaluating PBOs developed by OECD. However, induced results may also be considered to be an intermediate outcome. The theory of change in Annex 2 of the evaluation report outlines the kind of results anticipated at this level.

^c Landmark policy changes constitute (i) changes introduced as a result of decisions made at senior levels of government, and (ii) substantive changes, with a clear link to a desired final outcome. Thus, the mere adoption of a plan of action for reform would not be a landmark policy change, but the implementation of legislative or regulatory reforms as a result of that plan would constitute a landmark policy change.

Key Findings

The evaluation found that PBOs remained a relevant and useful instrument for AfDB and its clients, although they were challenging to design and manage effectively. The evaluation found the relevance of the PBOs in AfDB’s portfolio to be broadly satisfactory, based on their programming and design and their broad adherence to AfDB’s own policy and guidelines and to international good practice. With regard to the achievement of reform objectives, the overall picture was also satisfactory. However, it was much harder to find evidence of AfDB’s influence on reform direction and speed. Regarding sustainability, even in the presence of strong ownership, concerns about the institutional and financial dimensions of sustainability meant that the overall outlook for sustainability in the sectors examined was unsatisfactory.

Despite having deployed UA7.2 billion as PBOs 2012–2017, AfDB had failed to invest in its own institutional infrastructure to obtain maximum value for money from the instrument. As was well reflected in the 2012 policy, PBOs were expected to form part of a “package of support” in order to ensure that they influenced and supported reform agendas, while also providing important funding. This package included analytical work to inform technical input, policy dialogue and capacity support. In practice, while there was some variation across countries, overall AfDB had underperformed when it came to policy dialogue, despite its strong position as a trusted partner. This was partly due to its institutional arrangements; a lack of clarity about who was responsible for policy dialogue; the structure of how the dialogue should be conducted, reported, and coordinated; and a lack of investment in human resources to conduct it. In addition, AfDB had underperformed in providing timely and adequate capacity support and specialized technical advice, partly due to the limited menu of instruments available to do so. These shortcomings had implications for how well AfDB was able to influence or add value to country reform paths.

Programming issues. A range of programming issues were examined and, while the overall picture was assessed to be broadly satisfactory, the evaluation identified areas that could be strengthened. First, for the large majority of the PBOs reviewed (94%, excluding CRBS), their use was envisaged in either the relevant country strategy paper (CSP) or the midterm review (MTR), in line with the policy. However, in the majority of cases, the assessment against the eligibility criteria was made for the first time during the PBO preparation phase. In terms of the type of PBO, the justification for the type chosen could have been stronger, especially when the PBO did not use the recommended programmatic approach. Second, in approximately two-thirds of the operations reviewed, the analytical underpinnings used were clearly listed and relatively complete. However, exactly how this work informed or underpinned the design of the operation was not clear. Third, while risk assessment was assessed as satisfactory in two-thirds of the operations reviewed, reputational risk was rarely explicitly considered. The risk mitigation measures, such as future capacity support to address current risks, were generally not convincing within the timeframe of a PBO.

Alignment with country and AfDB priorities. This was assessed positively on the basis of the document review and in terms of stakeholder perceptions. All the PBOs could be mapped to at least one of the High 5s or supported crucial governance issues which cut across them. AfDB had also succeeded in expanding use of the instrument to support sector reforms in addition to economic and financial governance. Nearly 80% of survey respondents had positive views on the alignment of PBOs with country policy frameworks.

Coordination. There were many good examples of how AfDB had coordinated with other development partners, notably during the identification and appraisal periods. AfDB staff had taken coordination seriously and had invested in upfront work with other development partners. However, the in-depth assessment illustrated how difficult AfDB had found it to sustain these initial high levels of coordination throughout the implementation phase. Moreover, following the adoption of the G20 Principles for Effective Coordination between the IMF and MDBs on Policy-Based Lending in 2017, in countries facing macroeconomic vulnerability MDBs needed to align behind the IMF.

Designing PBOs for results. The overall picture was satisfactory, although some shortcomings were identified. Although two-thirds of the PBO appraisal reports examined stated there was an important role to be played by complementary inputs, only a handful explained how this was to

be achieved. All PBO results frameworks defined baselines, targets and means of verification, and integrated prior actions and triggers. However, over a third were less than satisfactory because of: (i) weaknesses in presenting a convincing results chain; (ii) high proportions of process- and action-based indicators; and (iii) a lack of realism, particularly for single-year operations. The use of conditions was suitably selective; in programmatic operations these linked from one phase to the next in order to plot a medium-term path, and they were linked to broader dialogue frameworks. However, weaknesses were noted when the number of prior actions was high, opportunities for identifying triggers were missed, or the level of ambition for prior actions was not appropriate.

Gender and environment. The evaluation found that AfDB had missed valuable opportunities provided by the PBOs to address gender equality and environmental reform issues at the policy level. Just over a third of the PBO project appraisal reports (PARs) that were assessed included gender-related indicators and 7% included environmental or climate-sensitive indicators. The opportunity to push gender equality and environmental concerns varied according to the type of PBO. However, particularly in the energy sector, PBOs can provide valuable opportunities to shift national policies in support of AfDB's ambitions of inclusive and green growth.

Efficiency. Broadly speaking, PBOs were broadly disbursed and implemented in a timely way, although some receiving countries said that disbursement was unpredictable. In line with expectations for the PBO instrument, the evaluation found that AfDB had disbursed the funds fully and, compared with investment projects, quickly. In addition, implementation progress was very rarely identified as a cause for concern. Nine of the 10 in-depth assessments were efficient in terms of transaction costs and the time taken to disburse the funds. However, perceptions of timeliness and transaction costs varied among both staff and RMC officials.

Technical assistance. Perceptions of the efficiency and transaction costs of technical assistance or institutional support provided to support PBOs was negative. Such support, when it was provided, was slow and tended to arrive toward the end rather than beginning of a PBO series. This was partly because capacity support tended to be designed in parallel with PBOs rather than in advance, and partly because of the limited set of instruments AfDB had available to provide small items of technical assistance, all of which operated like full projects rather than as rapidly deployable expertise.

Policy dialogue. AfDB did not use policy dialogue sufficiently or make best use of its "African Voice" to ensure PBO results. This finding is not dissimilar to that of the 2011 evaluation which described AfDB as "punching below its weight" when it came to policy dialogue. Only three of the 10 in-depth assessments had satisfactory frameworks for policy dialogue in the targeted sectors. The deficiencies that emerged in relation to policy dialogue can be broadly categorized as: (i) lack of clarity over who is leading and responsible for policy dialogue, especially after approval;

(ii) limited capacity to engage in in-depth technical dialogue in some areas; (iii) lack of structured planning or reporting for policy dialogue efforts, including through AfDB's normal supervision channels; and (iv) lack of a medium-term strategy to capitalize on doors that may be opened by a PBO after formal completion. In the survey, fewer than a third of respondents were clearly positive when asked about the extent to which AfDB mobilizes appropriate resources for policy dialogue. In the 10 countries investigated, only five had a satisfactory framework for policy dialogue.

Policy guidance. The existence of the 2012 policy helped AfDB to improve its approach to PBOs and to make it more consistent; however, there were areas where implementation was wanting. The policy provided clarity on the authorizing environment and on a range of important issues, including the type of instrument, when it should be employed, on what basis and with what objectives. The policy was broadly aligned with good practices. Although it clearly set out activities or changes that needed to take place in order to facilitate implementation, not all aspects of implementation have gone as planned. For example, there have been delays in producing the supporting guidelines, a glaring lack of training, and unfinished business in ensuring an enhanced role for country offices. The guidelines, which are described as a living document, have not been updated and there has been no additional guidance on new reform areas, such as energy. The guidelines have not been following the adoption of the G20 principles. The survey and focus groups both also revealed staff demand for more guidance in areas such as policy dialogue, working in post-conflict contexts, and results measurement.

Institutional arrangements. Some of AfDB's practices were out of line with both its own policy and the practices at the World Bank and the European Union. First, PBO design and management remained somewhat centralized and led by either the Governance and Public Financial Management Coordination Office (ECGF) or by sector departments. The extent to which country offices had taken up ownership varied significantly. Second, in practice, there was no centralized unit that provided specialized support to PBO teams. ECGF staff had been task-managing most of AfDB's GBS. This lack of a central support unit, and the limited guidance and training provided to staff, was in stark contrast to the support available at the World Bank and the European Union.

Effectiveness. Overall, the assessment of PBO effectiveness, which focused on energy, PSE, and PFM, was broadly satisfactory. The evaluation highlighted areas where AfDB could focus attention in order to strengthen results and specifically how it could contribute to the direction and pace of reforms. Data from project completion reports and country strategy and program evaluations by the Independent Development Evaluation indicated that the satisfactory assessment was likely to reflect the effectiveness of the broader portfolio.

- All of the 10 cases achieved or partially achieved all, or the majority, of the reform actions listed in the results framework. In only one case were 25% of outputs considered to have been not achieved. In all other cases, at least 75% of the reforms were assessed to have been either fully achieved, partially achieved, or achieved with significant delay. With regard to the achievement ratios by sector covered, no clear pattern emerged. No sector performed notably better than any other. At an aggregate level, in seven of the 10 countries covered by the in-depth studies the overall effectiveness in terms of the achievement of the objectives stated in the results measurement framework (RMF) was considered satisfactory.

- Across the 21¹⁵⁰ individually assessed components, two-thirds were assessed satisfactory in terms of the achievement of “landmark policy changes.” Within a PBO RMF, some actions can be much more important than others, although an RMF can include a large number of “tick-box” type items alongside more fundamental issues that have the potential to drive change and contribute to transformative outcomes. Such indicators were identified as “landmark policy changes.” Where these were not achieved, it is worth noting that the sample included a transition state (Comoros); two cases where the principal focus of the PBO was in another area (Tanzania and Seychelles); and one where the second part of the planned series never took place (Nigeria).
- AfDB’s influence on the achievement of landmark policy changes was not always evident. In one third of the components, AfDB’s influence on either the direction or pace of reforms was evident and was usually achieved through analytical work, technical inputs, and policy dialogue. AfDB staff respondents to the survey supported the view that AfDB’s influence was limited, and strongest at the appraisal stage.

Sustainability. The sustainability of PBOs in energy, PSE and PFM was assessed to have been unsatisfactory, particularly in relation to the institutional and financial dimensions of sustainability. Only four of the 10 in-depth assessments had good prospects for sustainability. Almost all of the 10 had laid strong foundations for sustainability in terms of government ownership and leadership, which should be at the core of the decision to proceed with a PBO. However, the weak institutional and financial sustainability undermined the positive assessments in terms of ownership. While this trend was clear for energy, PSE and PFM, it cannot be generalized across the whole PBO portfolio.

Contextual, design, and management factors. The evaluation evidence from AfDB and from other institutions providing budget support in Africa indicates that the most frequently identified factors relating to country context were: (i) ownership, country capacity, having a “champion” for reforms; (ii) the country’s socioeconomic status; and (iii) country systems. The most frequent factors relating to the budget support mechanism were: (i) quality of design, programming, development partner coordination; and (ii) quality of monitoring and choice of indicators. The single most frequently cited enabling factor was the quality of design. In terms of hindering performance, the most frequently highlighted were: insufficient policy dialogue, high efficiency and transaction costs, poor choice of indicators, weak monitoring, and poor predictability.

The most significant factors associated with achievement of landmark policy changes,¹⁵¹ stronger even than the country’s socioeconomic status, were: programming, design, and efficiency factors; technical assistance; the operation being part of a series; and the existence of a country office.

Recommendations

Updating the guidance framework. Changes in the international context, calls for more internal guidance, and shortcomings in design and implementation indicate that the 2014 guidelines on implementing the 2012 policy need to be updated. The analysis indicates that a strong

¹⁵⁰ Separate assessments were made for each of the relevant sectors: PFM, energy, and PSE. The total number of assessments was 21. Where the PBO was part of a series, the assessment was for all parts of the series completed or well underway.

¹⁵¹ Budgetary or institutional changes of substance and influence targeted by PBOs within the set of intermediate outcomes (induced outputs) identified in the theory of change.

relationship between the government and the development partners and the presence of an ongoing IMF program are fundamental to the achievement of reforms.

Recommendation 1: Update or complement the PBO guidelines

- Reflect AfDB’s response to the 2017 G20 principles on coordination with the IMF.
- Provide detailed guidance to staff on the most challenging areas of the results frameworks, including: conducting effective policy dialogue, post-conflict concerns, and promoting reforms in support of gender equality and environment and climate change.

Enforcing compliance. Although the assessment of programming and design was satisfactory (most of the PBOs in the sample were assessed to have been satisfactory against selected criteria), AfDB aims for every PBO to be satisfactory, especially in relation to 100% compliance with the provisions of AfDB’s own policy and guidelines.

Recommendation 2: Fully enforce the provisions of the 2012 policy

- Use of non-programmatic operations or operations that are not already programmed in the country strategy paper (CSP) or CSP midterm review (MTR) should be done only on an exceptional basis as per the 2012 policy. Such operations should have a convincing rationale and should be based on sound analysis, including an evaluation of the alternative options.
- Conduct fiduciary risk assessments when the decision is first made to use a PBO. The assessment should be updated at appraisal, and the proposed risk mitigation measures should be adequate to address the identified risks within the timeframe of the planned PBO.

Focusing PBO ambitions. Some PBOs were spread over a broad range of reform areas. Moreover, analysis was not always undertaken to identify where AfDB could add most value, including through the expertise it could provide, or which reform actions would pave the way to “landmark policy changes.”

Recommendation 3: Design all future PBOs with a focus on a limited number of medium-term reform areas from within broader government reform plans

- Assess which reforms have the potential to pave the way to landmark policy changes.
- Evaluate AfDB’s complementarity with other development partners and with its wider portfolio.
- Judge the ability of AfDB to add value in these areas, especially in terms of analytical work, expertise, and policy dialogue.

A tight focus should be combined with a strengthening of the medium-term dimension in the design, i.e., programmatic PBOs should follow a clearly defined multi-year reform path, as well as paying attention to how AfDB might accompany reform processes over the medium term over one or more PBOs.

Prioritizing policy dialogue. Policy dialogue is a central part of how PBOs achieve results and how AfDB adds value to reform processes. Yet there was a lack of clarity and insufficient prioritization of policy dialogue in AfDB PBOs.

Recommendation 4: Reflect the vital role of policy dialogue in PBOs in practice

- Make unequivocally clear at the design stage what policy dialogue will entail, what mechanisms will be used, what the priorities will be, how policy dialogue will be underscored by relevant technical expertise, and who will be responsible for conducting and reporting it. This can be done by including a standard annex on policy dialogue priorities and responsibilities in the PBO's project appraisal report. This would provide a starting point that could be adapted over time to respond to new policy needs as they arise.
- Align practices with plans in the 2012 policy and the development and business delivery model (DBDM) by more clearly allocating responsibility for PBO design and management to country offices and regions. Ensure country offices and regions have sufficient resources and the necessary reporting structures to take up this responsibility, and provide strong technical support from headquarters teams. (Alternatively, if AfDB prefers to operate a centralized model, the policy and DBDM documents should be adjusted to reflect this approach to remove any confusion).
- Ensure that budget lines for PBO appraisal and supervision take account of the need to involve the appropriate range of expertise in the case of PBOs that cover a range of areas.

Using technical assistance more efficiently. The other complementary input supporting PBOs was technical advice and capacity support. AfDB has tied its hands by relying on a limited menu of instruments on which it can call to provide this support, and some of these do not provide support in a timely or efficient manner.

Recommendation 5: Provide PBOs with appropriate and timely expertise and capacity support

- Examine how to refine and expand AfDB's menu of options when it comes to providing expertise and technical assistance. This should include: (i) reviewing how to make the MIC Trust Fund and other trust funds more flexible so as to improve their relevance; (ii) investigating other instruments, including short-term options, such as framework contracts with specialist companies that can provide quick and high-quality technical expertise that is not available internally; and (iii) providing longer-term solutions such as a fast-track technical assistance scheme.
- Require clear justification if relevant capacity support or expertise is not already in place or at least planned by the time approval for any PBO is sought.

Investing in supporting institutional infrastructure for PBOs. AfDB has not appropriately invested in its most important tool for making PBOs an effective and value-for-money instrument: its people. It has no central support team charged with supporting the instrument at a technical level or for cross-learning purposes. It has established only minor differences between quality at entry and processes for PBOs as compared with those for investment projects.

Recommendation 6: Invest in the supporting infrastructure for PBOs

- Invest in continuous training for staff involved in PBO design and implementation. Such training could take the form of an accreditation scheme and draw on the rich experience that has been gained internally, while also drawing on lessons from elsewhere.

- Invest in upfront analytical work to support PBO design and the focus of policy dialogue and capacity support, which will require forward planning and resources to allow teams to conduct or commission it. Review the extent to which AfDB's quality assurance processes are appropriate for PBOs, in particular the readiness review. Strengthen supervision and reporting of supervision.

Overview of Management Response to the Independent Evaluation of Program-Based Evaluation, 2012–2017

Management welcomes the Independent Evaluation of AfDB PBOs 2012-2017 and agrees with the findings and recommendations of the evaluation, which it considers to be useful in further improving the Bank's important work in providing PBOs. The Bank and its clients consider PBOs to be effective instruments to support macro-fiscal stability and advance wide-ranging policy reforms in RMCs. The evaluation comes at a time when there is a great deal of interest in and debate around the use of the PBO instrument. Overall, management

The use of the PBO instrument by AfDB increased significantly over the period 2005–2019, leading to calls for caution. In response to these concerns and in order not to compromise its financial stability, AfDB introduced unbreachable limits of 25% of allocations from the AfDF window and 15% of the allocations from the AfDB window, in terms of volume.

The instrument has demonstrated its relevance, particularly during crisis situations and in support of structural reforms in the PFM, energy, transport, and health sectors.

Although the performance of the instrument was rated generally satisfactory by two independent evaluations, these evaluations also found that AfDB was still not able to realize the instrument's full potential. PBOs need to be used as a package of support, combining budget support, policy dialogue, and technical assistance.

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Annex

AfDB Management Response to the Independent Evaluation of Program-Based Evaluation, 2012–2017

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Management of PBOs

The evaluation finds a broadly positive picture of the Bank's time efficiency in disbursing and implementing PBOs. However, this efficiency was jeopardised when technical assistance (TA) was required to support the implementation of reforms, but the Bank was unable to provide it in a timely manner. Management agrees that the Bank's lack of flexibility to respond quickly in providing TA or other expertise affects the Bank's ability to always engage effectively, and it will look into how to enhance/expedite responsive TA provision.

The evaluation examines the Bank's engagement in policy dialogue and concludes that the Bank is not fully using its comparative advantage to ensure PBO results through policy dialogue. Issues affecting the quality of policy dialogue included lack of clarity on responsibility for policy dialogue, what policy dialogue entails, and how it is planned and reported. Management takes note of these findings and fully agrees with the recommendations put forward to strengthen the central role of policy dialogue in PBOs.

Supervision and reporting compliance are other issues raised by the evaluation. While supervision and monitoring are taking place, the evaluation noted as an issue the lack of systematic documentation on these key activities. Management shares the concern that lack of documentation undermines internal knowledge sharing and reporting and will monitor compliance with the Bank's standard reporting requirements.

The evaluation also examines the institutional framework for the management of PBOs, contrasting the level of support, guidance and training provided to Bank staff managing PBOs with that provided to colleagues in two peer organisations. It points out that the responsibility for PBOs has remained relatively centralised although the PBO Policy and DBDM envisage a stronger role for country offices. It highlights the important role of country offices in ensuring smooth dialogue, while noting that the extent to which country offices have actually taken up ownership of the dialogue varies significantly. The evaluation emphasises the need for a strong technical team to provide guidance, support and qualitative input during PBO preparation. Bearing in mind the need for urgency in effective High 5s implementation, management sees that the Bank needs to invest more resources to support technical staff development; hence it plans to develop an accreditation scheme/training programme to begin addressing the shortfalls in staff capacity.

Performance of PBOs

The evaluation concludes that PBO effectiveness in PFM, PSE and energy is broadly satisfactory, especially in terms of achieving “landmark reforms”. However, it also highlights the difficulty of determining the Bank’s influence, noting that the degree of influence varies by sector and area of focus and providing positive examples from the energy sector. Management takes note of these findings, which support its view that PBOs are relevant instruments to effectively support critical reforms, including for the High 5 areas. Management also agrees with the lesson on the importance of carefully identifying the appropriate areas of focus of the operation and ensuring active engagement with countries and partners.

The evaluation examines the sustainability of the reforms PBOs supported in energy, PSE and PFM, and found that it was assured in just 40% of the cases. Management takes particular note of this finding. Sustainability is critical, and achieving it is a perennial challenge faced not only by the Bank, but also by its peer MDBs that provide PBOs. It requires, first and foremost, strong and long-term country commitment to reform implementation. To address this issue, Management agrees with the evaluation recommendation—that increased use of the programmatic approach is beneficial not only to achieving reforms, but also to sustaining them. Management is also of the view that sustainability is an issue that should feature regularly in development partners’ in-country consultations. It considers the lessons provided in this regard to be pertinent and useful.

Conclusion

This is a timely evaluation that provides useful lessons and recommendations for Management’s consideration and implementation. The evaluation reinforces management’s position that PBOs should continue to constitute an integral part of the services available to Bank clients. It also points out some of the areas where there is need for improvement.

Management broadly agrees with the recommendations, and it proposes response actions in the attached Management Action Record.

4. Dissemination of Evaluation Findings

After the evaluation findings were presented to the Development Effectiveness Committee (CODE) on 2 October 2018, the evaluation summary report was published on the Independent Development Evaluation website and a brief presentation of the key findings were made available online and in print. The reports of the two clusters, together with the 10-case study reports, were also published on the website.

In addition, the evaluation findings were shared at the following events:

- African Development Fund F-14 Mid-Term Review Meeting on 26 October 2018 in Kigali, Rwanda.
- The African Evaluation Association 9th Biennial International Conference on 14 March 2019 in Abidjan, Cote d’Ivoire.
- Workshops on “Proceeding of Optimizing the AfDB’s PBOs as Package of Support” on 21 May 2019 in Pretoria, South Africa; on 28 May 2019 in Nairobi, Kenya; and on 26 June in Abidjan, Cote d’Ivoire.

- Private sector development learning session on 30 October 2019, in Abidjan, Cote d'Ivoire.

5. Emerging issues

In 2017, AfDB approved a new lending instrument: results-based financing (RBF). RBF supports government-owned sector programs and links disbursements directly to the achievement of program results. However, due to its recent approval and implementation, this instrument has not yet been evaluated.

Since the presentation of the findings of the evaluation to the CODE in October 2018, AfDB has taken several actions to implement the main recommendations.

- **Staff training**
 - AfDB staff received training in February 2020 on how to plan and effectively conduct policy dialogue, and on the design of results frameworks for PBOs.
 - AfDB is developing e-courses for task managers, which will include a module on program-based operations.
- **Preparation of guides to enhance the quality and effectiveness of PBOs**
 - A guide on policy dialogue in the context of PBOs has been prepared and is currently under review and clearance by AfDB's top management. However, AfDB adopted and implemented during the last quarter of 2020 the Policy Reform Dialogue Matrix (PRDM) which is an innovative instrument that allows to systematically plan, budget, implement and monitor results of the Bank's dialogue on key policy reforms in each RMC, while promoting linkages with the Bank's lending and nonlending activities.
- **Commitments.** within the framework of the negotiations for the 7th general capital increase, AfDB undertook to implement all of the recommendations of the PBO evaluation.
- **Preparation of a new governance strategy.** A new governance strategy is being prepared and this will incorporate the lessons learned from the latest PBO evaluation, as PBOs remain an important way for AfDB to deliver governance interventions.
- **Preparation of a note compiling relevant findings and lessons from evaluations of PBOs.** This will be used to inform AfDB's support to its RMCs in mitigating the economic and social consequences of COVID-19.

6. Conclusion

The use of the PBO instrument by AfDB increased significantly over the period 2005–2019, leading to calls for caution. In response to these concerns and in order not to compromise its financial stability, AfDB introduced unbreachable limits of 25% of allocations from the AfDF window and 15% of the allocations from the AfDB window, in terms of volume.

The instrument has demonstrated its relevance, particularly during crisis situations and in support of structural reforms in the PFM, energy, transport, and health sectors.

Although the performance of the instrument was rated generally satisfactory by two independent evaluations, these evaluations also found that AfDB was still not able realize the instrument's

full potential. PBOs need to be used as a package of support, combining budget support, policy dialogue, and technical assistance.

Nevertheless, AfDB's management response to the findings and recommendations of the 2018 evaluation, as well as the actions that have already been taken, should mean that PBOs are used more effectively to meet the needs of AfDB RMCs.

Comments on “Program-Based Operations at the African Development Bank, 2005–2020: An Overview”

Comment by: Alan Gelb

The chapter provides a useful overview of the evolution of program-based operations (PBOs) at the African Development Bank (AfDB). These are described in terms of their evolving portfolio share, country distribution, variants, and focus. The chapter stimulates thinking on the evaluation of PBOs and on the institutional requirements if AfDB is to transition from a project-based bank to a policy-based bank.

1. Evolution of Program-Based Operations

While each multilateral development bank (MDB) is distinctive, many of the trends noted in the paper have broad parallels in other institutions. At their inception, structural adjustment programs, as they were then termed, usually included a strong focus on “stroke of the pen” reforms, such as trade liberalization, budget spending cuts and the privatization of state-owned enterprises. These policy packages were contentious. Many saw them as impinging on national sovereignty, a sensitive issue, especially for newly independent countries. There were also genuine differences of view on what constituted an appropriate trade policy for African developing countries, some of which were without a strong indigenous business sector, and on the role of the state in facilitating economic transformation. Nevertheless, (and despite many critical views on the “Washington Consensus”), countries that managed to stay on track with macroeconomic and structural reform programs generally fared better than those that failed to do so.¹⁵² Similarly, analysis based on the World Bank’s Country Policy and Institutional Assessment (CPIA) index suggested that countries with stronger macroeconomic and structural policies as well as more efficient resource allocations fared better than others. This suggests that many basic elements of economic management included in these early PBOs have been important, even if they were not sufficient, for a resumption of growth.

Given the increasing emphasis on public financial management (PFM) and economic governance, PBOs have shifted toward areas where there is more consensus. Experts may debate the appropriate degree of trade protection, but it is rare to find open arguments against more accountable public spending. However, this trend may not translate into easier implementation, because PFM reforms often confront strong entrenched interests and political opposition. They have a mixed record and, in some countries, governments have by-passed the reformed systems. As illustrated in the chapter, the third stage in the evolution of PBOs has been toward a greater weight of sector policy components, across quite a wide range of critical areas, although most PBOs have retained a strong focus on public financial management.

Do PBOs tend to be provided mostly to middle-income countries (MICs)? The chapter suggests this may be the case for AfDB, although the degree of concentration is not easy to assess without comparative data on the relative size of MIC economies in Africa or the cross-country distribution of the overall portfolio. Since MICs generally have stronger PFM and likely greater

¹⁵² Independent Assessment of the Special Program of Assistance for Africa, as cited in: Alan H. Gelb. 2000. *Can Africa Claim the 21st Century*. Washington, DC: World Bank. p. 35. Nevertheless, it is difficult to separate out the impact of operations from their initial conditions; countries and development partners are more likely to resort to PBOs in times of crisis.

policy stability, PBOs might seem more suitable in such countries, especially in the form of programmatic operations or programmatic tranching. An analysis by the Inter-American Development Bank (IDB) found that World Bank PBOs were also concentrated on MICs but that its own PBOs were not, although this could be because IDB has a more homogenous client base with a larger share of MICs.¹⁵³ Offsetting this tendency, the chapter also notes the use of the crisis window to provide quick-disbursing funds during the Ebola crisis and, more recently, during the coronavirus disease (COVID-19) pandemic. These included elements of both health and economic crises, and the paper confirms the importance of having an available mechanism to provide a combination of policy, technical advice and financial support at relatively short notice to countries beset by exogenous shocks.

2. Evaluability and Results

Defining a results framework for PBOs against a clear counterfactual remains a challenge, and the chapter presents a less than conclusive picture. At the output level, it notes that PBOs tend to include a considerable number of process indicators and far fewer “landmark policy changes.”¹⁵⁴ It would be preferable to base an output-level assessment on the landmark policy changes, rather than simply on the number of indicators achieved; the attention the chapter pays to this issue is one of its strengths. Two-thirds of the assessed operations appear to have achieved landmark policy changes and in cases where they did not particular reasons were advanced to help explain why.

As the chapter finds, the questions are then: how can impact can be assessed and how can the influence of AfDB’s program on the achievement of such changes be judged? Attribution is a particularly fraught area for PBOs, especially in settings where there are multiple development partners and operations are designed to support reform measures with strong country ownership and are well-coordinated with programs of other partners. It has long been recognized that there is a twofold motivation for PBOs: to provide quick-disbursing support for the budget and to encourage policy and institutional reforms. The balance between these objectives varies, and the compatibility of these twin goals cannot be taken for granted. Thus, when financing needs are pressing, policy elements may take second place. It is also possible that the policy reforms required by the operation may be measures that the country would have undertaken anyway.¹⁵⁵ Similarly, with well-coordinated policy dialogue and funding from a range of development partners, it becomes harder to separate out the impact of any one partner. The problem of specifying the counterfactual also exists for projects, but is even more difficult for PBOs where there is no relationship between the budgetary costs of a reform and the size of the financing.

In these circumstances, it is probably best to recognize the problem and rest content with observing whether the operation has, in fact, been accompanied by the expected landmark policy

¹⁵³ OVE Annual Report 2015. <https://publications.iadb.org/publications/english/document/OVE-Annual-Report-2015-Technical-Note-Design-and-Use-of-Policy-Based-Loans-at-the-IDB.pdf>

¹⁵⁴ This seems to be true for other MDBs also; for example, an assessment for the Inter-American Development Bank (IDB) concluded that only 15% of the multitude of triggers were “high-depth.”

¹⁵⁵ IEG assessments for International Development Association (IDA) countries suggest that the added benefits of programmatic policy-based operations are higher when commitment amounts are lower as a share of government expenditures. The reason that has been advanced for this paradoxical result is that World Bank teams are less concerned about the potentially disruptive effects on client countries when they are faced with the option of responding to low reform performance by delaying or canceling operations in programmatic series. This renders the operations more credible, helping to maintain reform momentum. <https://ieg.worldbankgroup.org/sites/default/files/Data/reports/meso-devpolfinancing.pdf>

changes, preferably ones set out in advance as part of a well-defined programmatic or tranching operation. While most AfDB PBOs fall into one of these categories, one third do not, and the share of PBOs with full programmatic tranching is modest (less than one quarter). Since loan triggers tend to become more substantive in the later years of a program, it is likely that more such operations will be truncated, with disbursement rates above zero but less than 100%. Indeed, the review for IDB found that the rate of truncation for a series of PBOs was 44% and that it tended to be higher for series with three planned operations than for those with only two.

It is therefore surprising to see disbursement ratios of 100% in all but one of the 16 in-depth assessments covered in the chapter, with the exception being 0% disbursement. The reason for this pattern is not clear, but it may be partly explained by the fact that few of these cases involved programmatic tranching (so policy actions were a condition for loan approval), or that the focus on relatively recent programs did not give enough time for multi-year programmatic tranching to play out so that reforms could be both implemented and consolidated. It would be useful to understand more about this longer-run dimension of African PBOs, especially as it relates to the important question of sustainability raised in the paper. For example, what has been the longer-run outcome of power sector reform in Angola or Tanzania, following their apparently successful operations in 2014 and 2015? Have landmark policy changes been sustained?

It is a pity that the chapter was not able to go beyond the evaluations to form such assessments, using perhaps indicators of sector policy and performance, such as Public Expenditure and Financial Accountability (PEFA) reports in operations with a strong focus on PFM or perhaps indicators from the World Bank's annual Country Policy and Institutional Assessment (CPIA). This could be a project for the future. It would also help us to understand better the tension between supposedly high political ownership on the one hand and apparently limited financial and institutional sustainability on the other.

3. Toward a Policy-Based Bank

To be effective PBO partners, funding institutions need to have the capacity to engage in policy dialogue at a high level and across critical areas, including macroeconomic management (to complement the work of the International Monetary Fund, public sector and budget management, and sector policy). The chapter paints a picture of the evolution of AfDB, from project lending to an institution balanced between projects and policy and program engagement. Acquiring and sustaining capacity requires a strong analytical focus, in particular economic and sector work, together with associated research and analytical support. This is a challenge for any institution and, as noted in the chapter, in the case of AfDB the work is still incomplete. The resource requirements of achieving this analytical basis across the full range of development sectors and policies may mean a degree of operational selectivity focused on areas of traditional strength. In any event, a substantial and continuing investment in capacity appears to be essential for AfDB to be able to fully exploit its "African voice" in policy dialogue, even though it is not necessarily the major player in the region.¹⁵⁶ Management's response to the evaluations appears to be generally encouraging, but the experience of other organizations confirms the challenge. There is no simple organizational fix: the World Bank initiated measures to centralize and strengthen expertise in "global practices" but this policy has been partly reversed. A policy-based bank that

¹⁵⁶ For observations on the relative size of the AfDB and other MDBs see:
<https://www.cgdev.org/publication/dilemma-afdb-does-governance-matter-long-run-financing-mdbs>

functions well will also need the expertise and flexibility to be able to offer complementary and timely packages of technical cooperation, a shortcoming identified in the chapter.¹⁵⁷

4. Toward a Stronger Focus on Results

If policy dialogue and reform, rather than quick-disbursing funding, is really to be the driver of non-project lending, it might be useful to consider other modalities to complement, or even replace, traditional PBOs, especially considering the shift toward a larger component of sector reforms. Results-based lending is one possibility, as in the program-for-results instrument of the World Bank. Since the creation of program-for-results lending in 2012, there has been a steady increase in its use: as of 30 September 2020, there were 113 active operations totaling \$33.1 billion in commitments.¹⁵⁸ Like PBOs, program-for-results financing is provided to the Treasury, disbursed using country systems, and not necessarily tied to program costs. Some program-for-results operations are framed as an alternative to project loans with a high share of “output-type” disbursement-linked indicators (DLIs), but others are closer to policy-based operations, with a high proportion of institutional or “action” DLI benchmarks.¹⁵⁹ Tight linkage of disbursements to such indicators increases the importance of having a coherent results chain—a concern with PBOs noted in the chapter—and timely monitoring of progress. Moreover, the multi-year nature of program-for-results operations allows enough time to move beyond immediate outputs and towards measures of outcomes and impacts, allowing for a more substantive results framework than those of many PBOs. Experience with this new instrument is still limited but it could come to be a successor to sector-based PBOs.

5. Overview of Private Sector Development Components

Improving the environment for the private sector environment (PSE) has been a significant component of many PBOs, including through financial sector reforms, capital market deregulation, and measures to strengthen public private partnerships (PPPs). Even if reforms are driven by fiscal concerns, in such major sectors as transport, energy and water, the reforms may include PSE-related elements. For the World Bank, the area of investment climate and economic diversification represented between a quarter and a third of overall policy-based lending (PBL) value, with a higher tendency in MICs than in low-income countries (LICs). For IDB, the private and financial cluster (which is one of five such clusters) averaged 17% of PBL commitments over 2005–2019. For AfDB, diversification and industrialization, mainly through private sector environment reforms, were the leading PBO objectives across the “High 5’s” strategic issues identified in its strategies and action plans. Of the 16 operations selected for in-

¹⁵⁷ Assessments by the Inter-American Development Bank found that the average number of technical cooperation projects accompanying a reform sequence was 2.3 per series, and that these provided around \$1.3 million of additional financial assistance. This was especially relevant because, while PBO resources flow to a country’s Treasury, parallel technical cooperation provides direct support for the line ministries in charge of the reforms. The study found a significant positive relationship between technical cooperation support and the likelihood of completing a PBO series.

<https://publications.iadb.org/publications/english/document/OVE-Annual-Report-2015-Technical-Note-Design-and-Use-of-Policy-Based-Loans-at-the-IDB.pdf> An IEG assessment for the World Bank confirms the importance of timely provision of technical cooperation operations

<https://ieg.worldbankgroup.org/sites/default/files/Data/reports/meso-devpol/financing.pdf>

¹⁵⁸ Program-for-Results Financing. <https://www.worldbank.org/en/programs/program-for-results-financing>

¹⁵⁹ For an analysis of the first 35 operations with classification of disbursement-linked indicators (DLIs) into categories, see <https://www.cgdev.org/sites/default/files/program-results-first-35-operations-working-paper430.pdf>

depth assessments, nine were classified as PSE. The budget support operations of the European Union tend to be more focused on governance and service delivery, but they also include areas such as domestic resource mobilization and trade; reforms in such areas, as well as the macro and fiscal impact of additional financing, can also affect the PSE and business confidence. The assessments do not separate out the performance of PSE-focused PBL operations from others.

While there is some evidence that better scores on the World Bank Doing Business ranking may increase foreign direct investment (FDI) flows,¹⁶⁰ there are large gaps between *de jure* (yet actionable) measures and the *de facto* business climate as expressed by firms in enterprise surveys. Another uncertainty relates to weighting: the performance indicators of a PBO might not address the most critical factors constraining business, including the government's credibility and commitment to the private sector. This may be an issue for a government that agrees to reforms as a condition of quick-disbursing funding rather than in response to a strong national business constituency.

Some insight can be gleaned from the evaluations of important operations referred to in the chapter. Responding to a fiscal crisis caused by plummeting diamond revenues, the Botswana Economic Diversification Support Loan¹⁶¹ was the largest operation identified in the AfDB chapter. It targeted multiple Doing Business indicators, as well as financial sector development. The program completion report (PCR) rated the policies it supported as relevant and the outputs satisfactory, but the outcomes were rated unsatisfactory. Measurable progress toward economic diversification could not reasonably be realized within the 2-year duration of the project. A comparison from the Caribbean may be relevant here. The Jamaica Economic Stabilization and Foundations for Growth development policy loan (DPL) was approved by the World Bank in 2013. A project performance assessment report (PPAR), completed in 2019¹⁶² found that the project had allowed an unrealistically short time for the implementation of PSE measures, particularly when they involved legal reforms. But looking back 6 years after approval of the loan, it found substantial achievement of objectives. Reforms had been sustained and, especially considering the potential for sovereign default at the time the loan was approved, it had made an effective contribution. Debt ratios had fallen, investment climate indexes had improved, and levels of FDI had risen. However, the PPAR also noted that World Bank oversight had extended well beyond the implementation period of the operation because of the link with a subsequent DPL series. The Jamaica example, makes it clear that PSE and related operations need to be approached with a longer-term horizon. Reforms may take time, especially when legislation is required, while the lag in the private sector response to even successful reforms increases the necessary time horizon as outputs shade into outcomes.

¹⁶⁰ https://www.researchgate.net/publication/241767916_Foreign_Direct_Investment_and_The_Ease_of_Doing_Business

¹⁶¹ AfDB. 2009. Appraisal Report: Economic Diversification Support Loan: Botswana. Abidjan: AfDB. https://www.afdb.org/fileadmin/uploads/afdb/Documents/Project-and-Operations/Botswana_-_Economic_Diversification_Support_Loan_-_Appraisal_Report.pdf

¹⁶² World Bank. 2019. *Project Performance Assessment Report: Jamaica. Economic Stabilization and Foundations for Growth Development Policy Loan*. Washington, DC: World Bank. https://ieg.worldbank.org/sites/default/files/Data/reports/ppar_jamaica_dpl.pdf

Chapter 3

Budget Support by the European Union: What Do the External Evaluations Tell Us?

Karolyn Thunnissen

1. Historical Development and Use of Budget Support by the European Union

The European Commission (EC)¹⁶³ first introduced budget support in the 1990s. The approach evolved in the context of conditionality reform and in response to the evolution of the aid effectiveness agenda. The current approach has been implemented since the beginning of the 2000s. The 1980s were marked by a gradual shift from using only project aid, whose effectiveness was often found to be limited by unfavourable policy and governance contexts, to the introduction of sector-wide approaches and structural adjustment programs. Sector-wide approaches enabled projects to be aligned with partner countries' sector policies and enabled discussions about sector policies and sector governance. Sometimes these projects were implemented using the beneficiary country's budgetary processes.¹⁶⁴ At the same time, structural adjustment programs started providing direct budgetary support against prior conditions regarding major reform measures to be taken by the partner country. This support was accompanied by policy and governance discussions that aimed to improve the overall context for development and aid effectiveness. At the end of the 1990s, when evaluations of the effectiveness of structural adjustment programs implemented during the 1980s showed that using aid conditionalities did not generate sustainable policy reforms, budget support replaced structural adjustment programs: budget support was no longer triggered by the implementation of reform measures but was provided to eligible countries in support of their reform policies.

The form in which European Union (EU) budget support is implemented has evolved over time to reflect changing policy contexts and to take into account recommendations by external evaluations and by the European Court of Auditors. Unlike projects, budget support addresses the partner country's overall conditions for economic and social development. EU budget support has always been provided exclusively in the form of grants. It is coherent and complementary with other EU aid implementation modalities, including projects, technical assistance, delegated cooperation, co-financing, blending, humanitarian aid, and emergency assistance.

¹⁶³ The European Commission is the executive body of the EU and in charge of implementing the EU budget.

¹⁶⁴ Program estimates are a form of on-budget support whereby the institution responsible for the budget and activities is assessed beforehand.

The latest EU budget support policy was adopted in 2012¹⁶⁵. Its guidelines were revised in 2017¹⁶⁶ to take into account the new European Consensus on Development that followed the international adoption of the UN 2030 Agenda for Sustainable Development and the Addis Ababa Action Agenda.

The EU's approach to budget support has always involved four interrelated components acting together in support of partner countries' policy implementation:

- (i) **policy dialogue** with a partner country in order to reach agreement on the policies and reforms to which budget support can contribute;
- (ii) **performance assessment** to achieve consensus on expected results and to measure progress achieved;
- (iii) **financial transfers** to the Treasury account of the partner country once those results have been achieved and according to their degree of achievement; and
- (iv) **capacity development** to enable countries to implement reforms successfully and to sustain results.

EU budget support is thus a performance-based modality, which provides a package of unconditional grant funding, capacity development and a platform for dialogue to partner countries in support of the implementation of their policies. Funding is totally fungible: it is an additional resource to domestic revenues and is used by the partner country's government according to domestic budgetary planning, execution and oversight processes and using domestic public finance management (PFM) systems. EU budget support grants can thus be used for both recurrent and investment expenditure.

Policy dialogue is a fundamental component of EU budget support. The general conditions (regarding public policy, macroeconomic stability, public finance management and, since 2012, budget transparency and oversight) provide the overall framework for dialogue with the government and other stakeholders, while variable tranche indicators enable a more in-depth discussion on key reforms and policy results. Because funds are transferred to the budget, the EU is able to discuss general PFM issues, overall budget allocations and sector spending as well as its results with the partner countries' authorities and other stakeholders. Due to the grant nature of the funding, the EU is particularly concerned that budget support should not be considered a substitute for efforts to raise revenues. Domestic resource mobilization is systematically raised in policy dialogue and is often supported through capacity strengthening and/or through the use of performance indicators. Monitoring of general policy outcomes and of sector-level policy processes, activities, outputs and, most importantly, outcomes are an essential input into the overall dialogue.

Although external experts hired in the context of technical cooperation can never be responsible for achieving the targets set for the agreed performance indicators,¹⁶⁷ the capacity building most often associated with budget support is used to enhance the government's capacity to design,

¹⁶⁵ The policy direction is set out in the 2011 Budget Support Communication 'The Future Approach to EU Budget Support to Third Countries', and corresponding Council Conclusions COM(2011) 638; 13 October 2011; 3166th Foreign Affairs Council meeting, Brussels, 14 May 2012 (http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/EN/foraff/130241.pdf).

¹⁶⁶ See European Commission. 2017. *Budget Support Guidelines*. Brussels. https://ec.europa.eu/international-partnerships/system/files/budget-support-guidelines-2017_en.pdf

implement, monitor, and evaluate policies and to deliver public services. Since EU budget support relies on the monitoring of performance indicators, preferably outcome indicators, strengthening of national monitoring frameworks and associated statistical systems is a priority. Attention is also systematically paid to promoting the active engagement of nongovernment stakeholders in these monitoring frameworks.

2. Eligibility for European Union Budget Support

EU budget support has always been subject to the satisfaction of eligibility criteria.¹⁶⁷ These criteria need to be met before a program is approved and throughout implementation, in particular before disbursements. Although these eligibility criteria have evolved over the past 20 years, they have stayed faithful to the same underlying principles: budget support is performance-based and uses a dynamic approach to assess eligibility, looking at the country's past and recent performance in public policy, macroeconomics, public finance management (PFM), and budget transparency and oversight, against reform commitments. A stable macroeconomic environment, an established PFM system (including a budget and functioning external oversight) and a credible and relevant public policy are essential to achieving economic development and are thus crucial to the effectiveness of budget support.

The eligibility criteria for budget support are listed in Table 3.1.

Table 3.1: EU Eligibility Criteria for Budget Support at Approval and During Implementation

Criteria at Program Approval	Criteria During Implementation
<p>Public policy. Existence of a credible and relevant national and/or sector policy in place</p> <p>Macroeconomics. Existence of a credible and relevant program to restore and/or maintain macroeconomic stability</p> <p>Public financial management. Existence of a credible and relevant program to improve public financial management, including domestic revenue mobilization</p> <p>Budget transparency and oversight. The government has published either the executive's proposal or the enacted budget within the previous or current budget cycle.</p>	<p>Public policy. Satisfactory progress in the implementation of the policy or strategy and continued credibility and relevance of that or any successor strategy</p> <p>Macroeconomics. Maintenance of a credible and relevant stability-oriented macroeconomic policy or progress made towards restoring key balances</p> <p>Public financial management. Satisfactory progress in implementation of reforms to improve public financial management, including domestic revenue mobilization, and continued relevance and credibility of the reform program</p> <p>Budget transparency and oversight. Satisfactory progress with regard to the public availability of accessible, timely, comprehensive and sound budgetary information.</p>

While the first three criteria have always been linked to the provision of EU budget support, the inclusion of budget transparency and oversight as a stand-alone criterion resulted from the

¹⁶⁷ Box 'Ten aspects to consider when assessing a performance indicator', in Annex 8 of the Budget Support Guidelines, op.cit., page 139.

¹⁶⁸ The eligibility criteria stem from EU financial regulations (see the 2018 EU Financial Regulation currently in force, Article 236).

revised 2012 budget support policy. This revision also introduced the partner country's commitment to EU fundamental values of human rights, democracy and rule of law as a precondition to the provision of general budget support. The explicit reference to domestic revenue mobilization was added when the guidelines were updated in 2017 in order to take into account the Addis Ababa Action Agenda of 2015.

Both an in-depth analysis of each of these eligibility criteria and an accompanying dialogue are undertaken prior to the formulation of a budget support program. This ensures that conditions for budget support effectiveness are in place, that the government is committed to the reforms the EU supports, and that it has the capacity and political back-up to implement them.

When the eligibility criteria are satisfied, the EU can provide budget support by transferring funds directly to the central bank of the partner country. These funds are then converted to the national currency, paid into the Treasury, and used to support national policy implementation using domestic systems, processes, and procedures. Funds cannot be used to build up foreign exchange reserves.¹⁶⁹ Responsibility for the management of these transferred resources rests with the partner government. These funds, like any other public monies, are subject to oversight by the national supreme audit institution and the parliament and subject to public scrutiny. In particular, the EU promotes the involvement of civil society organizations in order to foster domestic accountability.

The peculiarity of EU budget support lies in the disbursement of funds in a combination of fixed tranches, paid in full (or not at all) and variable tranches. Their payment is proportional to the progress in meeting benchmarks, as agreed at the beginning of the program. On average, the split of funds delivered through fixed and variable tranches is 50%.¹⁷⁰ The disbursement of each tranche is subject to the eligibility criteria mentioned above. Variable tranches provide an incentive for performance and allow focused discussions on key reforms and results to be held. They give the EU an effective and predictable way to adjust payment levels to the country's achievements and to discuss issues around under-performance without having to entirely stop program implementation.

In its mechanics, the EU's definition of budget support is exactly the same as that of the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD-DAC), but with the additional aspect that disbursements take place only when eligibility criteria are satisfied and targets are met. EU budget support is therefore strongly focused on results: it relies on a qualitative assessment of the progress made in the four areas of eligibility (macroeconomic policies, PFM reform, sector policy implementation, and budget transparency and oversight) as well as on specific performance indicators (preferably outcome indicators) which measure the progress in the uptake of services delivered to the population. The performance indicators and their targets are drawn from partner countries' own policy monitoring matrixes, are agreed upfront at the beginning of a program, and can only be changed under exceptional circumstances.¹⁷¹ Funds are released once progress is demonstrated, both on

¹⁶⁹ A specific clause in a budget support contract requires the partner country to provide documentary evidence that the Treasury account has been credited by the amount equivalent to the foreign exchange transfer at the exchange rate prevailing on the day funds were received. Budget support funds must be accounted as government revenues and included in the state budget.

¹⁷⁰ However, great variation can be seen across countries; some programs provide only fixed tranches or only variable tranches in a given year.

¹⁷¹ In addition, changes to indicators or their targets have to be agreed no later than the end of the first quarter of the implementing year to which the result targets refer. In practice, as results of year N-1 are most often

overall policies (fixed tranches) and on the specific performance indicators (variable tranches). The average disbursement rate of the 199 EU budget support programs approved and implemented between 2014 and 2019 was 83%. Most of the non-disbursed 17% came from the partial disbursement of variable tranches (when not all performance indicators reached their agreed targets). The remainder stems from fixed tranches not being disbursed (when program implementation was severely disrupted or eligibility to budget support not met any longer).

3. Types of Budget Support

Whereas previous EU budget support had been implemented as general or sector budget support, the 2012 policy introduced a further differentiation of the types of budget support and strengthened its contractual aspects. The EU now offers three types of budget support contracts:

- **Sustainable Development Goals contracts (SDG-Cs).**¹⁷² These are provided at the macroeconomic level to support implementation of the overall national development strategy. A contract covers several SDGs and the approach is comprehensive and crosscutting. The partner country's commitment to the respect of the EU's fundamental values is a precondition for this type of support. The SDG-Cs call for stability and confidence in the overall policy stance and democratic governance of the partner country. This type of contract has an average duration of 4 years but can run from 3 to 6 years.
- **Support for fragile and transition countries.** This contract was introduced in 2012 and takes the form of a state and resilience building contract (SRBC).¹⁷³ The contract offers general budget support in the case of political transitions, post-disaster situations, and crises (such as the COVID-19 pandemic). Eligibility for this type of support includes a forward-looking approach, based on the partner country's political commitment to reform and to fundamental values. SRBCs can last from 1 year (for countries recovering from a crisis) to 3 years (in cases of more structural fragility). The average duration of SRBCs is 2.5 years.
- **Support for sector policies and reforms.** This is provided through sector reform performance contracts (SRPC), which account for the largest share of EU budget support (about 80%). SRPCs are more narrowly focused than the other two types of contracts and concentrate on one or a few closely related SDGs. They aim to improve governance and service delivery in a specific sector or a set of interlinked sectors. The average duration of SRPCs is 4 years.

4. Significance of European Union Budget Support

Over the period 2000–2019, new budget support commitments amounted to an average of €1.84 billion per year. This varied from €1.1 billion per year on average during 2000–2006, to €2.3 billion per year on average during 2007–2013 and €2.2 billion per year on average over 2014–2019.

assessed mid-year N when outcome data become available, it is often too late to agree changes for subsequent years if data reveal weaknesses and/or deviations from expected outcomes. This rule ensures, first, that adequate attention is brought to the choice and definition of performance indicators used for variable tranches and, second, that there is a joint EU-partner commitment to reach the agreed targets.

¹⁷² Previously known as good governance and development contracts (2012–2017).

¹⁷³ Previously known as state building contracts (2012–2017). The resilience dimension was added in 2017.

Over the period 2000–2019, the EU provided budget support to about 100 countries.¹⁷⁴ As of 2015, EU sector budget support started being implemented in the Western Balkans for candidates and potential candidates for EU membership. In the most recent period, 2014–2019, just over €13 billion was committed to 231 budget support programs in 94 countries. The average value of a budget support contract was €56.4 million (equivalent to €15.4 million per contract per year on average). General budget support is at the high end of the scale, with an average amount of €99.4 million per SDG-C, equivalent to €25.5 million per year per contract, and €80 million on average per SRBC, which is equivalent to €32.5 million per contract per year. Sector budget support contracts are the most common type of contract and have the lowest average values. Over the period, 179 SRPCs were provided for an average value of €12.3 million per contract per year.

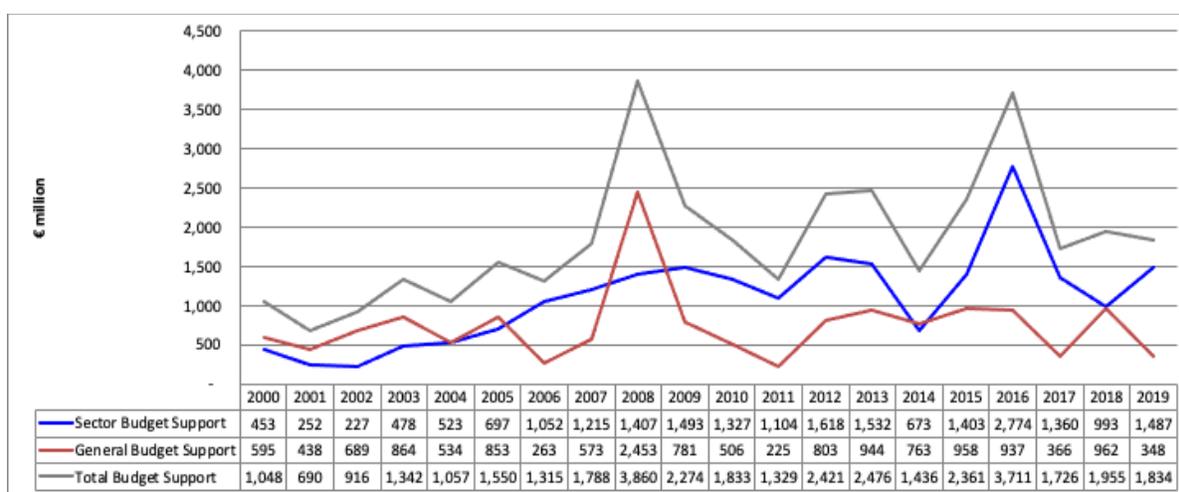
On average, the European Commission estimates that budget support amounts to 35%–40% of its country programmable aid, a very significant part of its portfolio of direct cooperation with partner countries.

5. Beneficiaries of EU Budget Support

Evolution of General and Sector Budget Support

EU budget support is provided as sector budget support (SRPCs) and as general budget support (which includes both SDG-Cs and SRBCs). Between 2000 and 2005, general budget support was the main type of budget support provided by the EU, representing 60% of the total budget support value (Figure 3.1). Over time, sector budget support has increased its share.

Figure 3.1: European Union Budget Support Commitments, 2000–2019 (€ million)



Source: European Commission, Unit E1 ‘Macro-economic Analysis, Fiscal Policies and Budget Support’

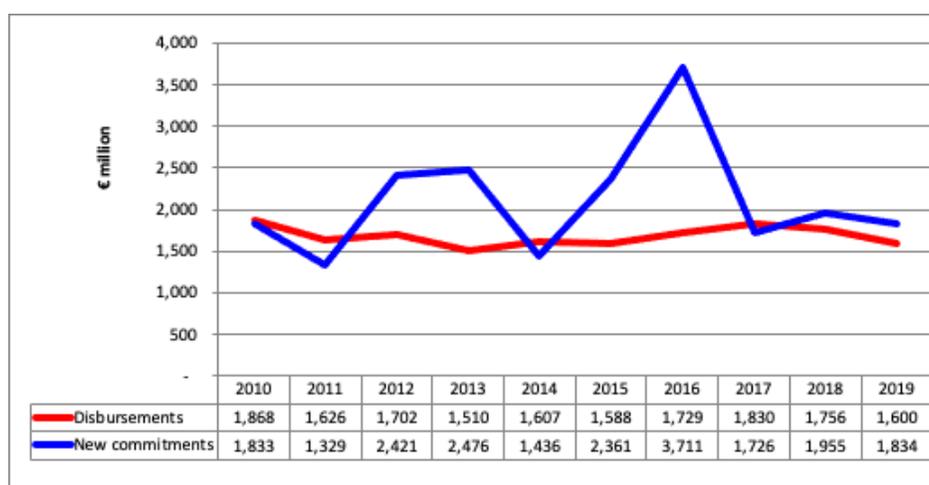
Sector budget support has been increasingly used by the EU since 2006, due both to the decreased use of general budget support (linked to the requirement that countries commit to fundamental values to be eligible for such support introduced in 2012), and to the introduction of sector budget support to the Western Balkans in 2015. Sector budget support represented 67% of

¹⁷⁴ This includes EU overseas countries and territories.

all budget support provided over the period 2014–2019. In 2020, the EU increased its use of state resilience and building contracts in response to the COVID-19 pandemic, including in the Western Balkans, where hitherto only sector budget support could be provided.

Budget support is an effective and flexible instrument for many situations, including emergencies, which require a fast-track response to help stabilise a situation and to ensure the crisis does not deteriorate further at the expense of the population. New budget support commitments amounted to €3.86 billion in 2008 and remained well above average in 2009 and 2010. This partly reflects the EU’s programming cycle (preparations for new budget support programs launched in 2007 started being approved by the end of 2008 and the beginning of 2009); partly the introduction of a few very large Millennium Development Goals contracts (the precursor of SDG-Cs); and partly the EU’s reaction to the 2007–2009 global financial crisis, which resulted in the provision of budget support to countries suffering from economic collapse and/or soaring food prices.

Figure 3.2. Budget Support Disbursements (€ million)



EU budget support disbursements (Figure 3.2) represented, on average, €1.68 billion a year over the period 2010–2019; 15% of EU total official development assistance (ODA) per year, or an estimated average of 29% of country programmable aid disbursements per year.

Since 2012, a new type of fast-track contract, the state building contract (SBC) has been used to support countries facing a crisis, including natural disasters or health pandemics. This type of support to countries in a situation of fragility or transition has overtaken SDG-Cs as general budget support. SBCs were introduced in 2012 and amounted to €180 million in commitments, or 21% of general budget support in 2012. Since 2017, they have been known as state and resilience building contracts (SRBCs). By 2019 they represented 88% of all new general budget support. Since 2012, just under €4 billion has been provided to fragile states in the form of SBCs or SRBCs.

Budget Support Beneficiaries by Income Status Group

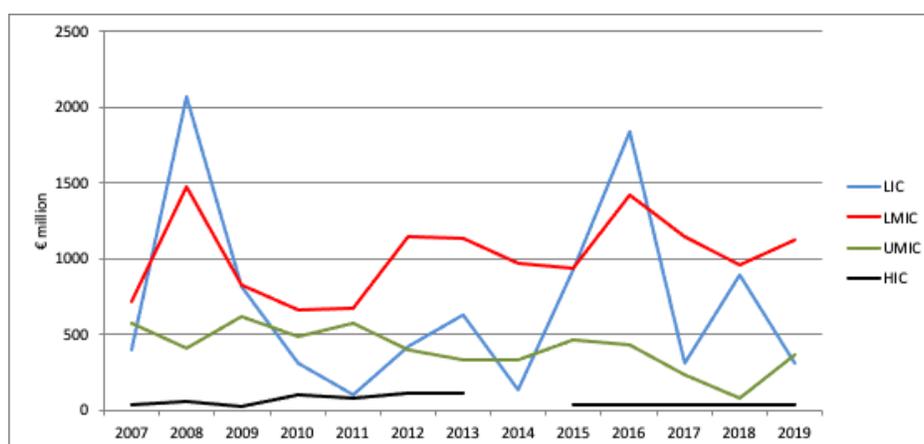
Low-income countries (LIC) and lower middle-income countries (LMIC) are the primary beneficiaries of EU budget support, accounting for 81% of total commitments during 2007–2019. During 2007–2013, 23 LICs benefited from a total amount of €4.75 billion through budget support, with the largest amounts going to Burkina Faso, Tanzania, and Mozambique. During 2014–2019, 18 LICs received €4.4 billion, with the largest recipients being Burkina Faso,

Afghanistan and Niger (each receiving €450–€500 million). As seen above and in Figure 3.2, countries in a fragile or crisis context have been increasingly important recipients of budget support since 2012.

Since a number of LICs have moved to LMICs status, the group benefiting the most from EU budget support has changed over time. During 2007–2013, 33 LMICS received budget support, of which Morocco, South Africa and Egypt received the highest amounts (between €500 million and €1.3 billion each over 2007–2014). During 2014–2019, 63 LMICs received budget support, with the highest amounts provided to Morocco, Tunisia and Ukraine.

Upper middle-income (UMIC) and high-income countries (HIC) were minor recipients of budget support. Most of the 36 UMICs and HICs benefiting from budget support during 2007–2013 were small-island states receiving budget support at the end of their trade protocol with the EU, which protected sugar production. During the more recent period 2014–2019, 14 HICs received budget support, with 70% of the amounts going to Eastern European states.

Figure 3.3: European Union Budget Support Commitments by Income Status (€ million)



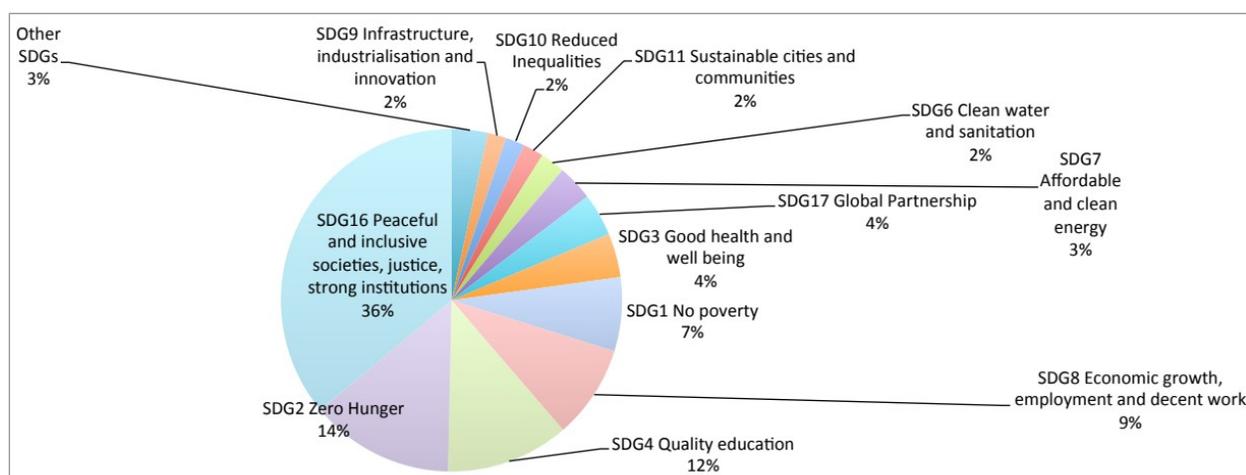
In terms of geographical areas, Africa remains the largest recipient of EU budget support, accounting for 60.4% of all budget support funding during 2014–2019 (€7.86 billion), followed by Asia and Eastern Europe (14% each) and Latin America (5%). The remaining 6% is accounted for by overseas countries and territories, and Caribbean and Pacific islands.

6. Policy Reforms Supported by European Union Budget Support, 2014–2019

The EU budget support portfolio directly or indirectly contributes to improvements in macroeconomic management, PFM, domestic revenue mobilization (DRM), budget transparency and oversight, and sector policies, through the in-depth analysis and policy dialogue of budget support eligibility criteria. In many cases, improvement in these areas also benefit from complementary technical assistance and specific budget support programs in support of SDG 16.

In addition, EU budget support supports reforms across a wide range of sectors and sub-sectors, with a dominant focus on governance issues (SDG 16), poverty reduction (SDG 1) and basic services (SDGs 3, 4, and 6)—**Figure 3.4**. Gender (SDG 5) and the fight against inequality (SDG 10) were supported as major cross-cutting issues. Gender was supported in 41.6% of budget support program amounts and the fight against inequality 13.2%, of budget support amounts over the period 2014–2019.

Figure 3.4: Policy Reforms Supported by the European Union during 2014–2019, by Main Sustainable Development Goal, Total Amounts Committed (Percentage Share of Total Commitments)



The EU used its fast-disbursing SRBCs¹⁷⁵ to provide much needed support to health expenditure in countries hit by Ebola (Guinea, Liberia, and Sierra Leone). This support either facilitated the maintenance of health expenditure (Guinea) or increased it quite dramatically. For instance, in Sierra Leone, Ebola-related fixed-tranche disbursement helped to increase the share of recurrent spending of the health sector from 13.3% of GDP in 2011 to 19.7% in 2014, 20% in 2015, and 16.5% in 2016¹⁷⁶. In the same way, the EU provided SRBCs to Nepal following the earthquake in 2015, Fiji and Dominica for post-cyclone recovery in 2016, and Dominica following hurricane Maria in 2018.

Where required, existing budget support operations can be amended to release larger amounts more quickly than originally planned. This was the case at the beginning of 2020, in the context of the COVID-19 pandemic, when some amounts planned for variable tranches in existing contracts were converted to fixed tranches and disbursed ahead of their planned schedule, in order to help governments fund COVID-19 preventive measures at very short notice. Some 2021 tranches have also been frontloaded to increase the EU’s global response to the crisis. Where undisbursed funds from previous tranches were available, they were used to top-up existing programs.

7. Cooperation Between the European Union and the International Monetary Fund

The EU cooperates closely with the International Monetary Fund (IMF). First, IMF assessments are essential to inform EU decisions regarding eligibility for budget support (for the macroeconomic policies, but also when relevant for the assessment of PFM, DRM, and transparency reforms and for the financing of development or sector policy). This takes place in the context of Article IV consultations. IMF assessments are equally important for informing payment decisions. Nevertheless, in line with the EU’s policy and regulatory framework, EU

¹⁷⁵ SRBCs can be prepared and disbursed very rapidly (in a matter of weeks rather than years) compared to other types of budget support.

¹⁷⁶ Source: Evaluation of EU State Building Contracts (2012-2018), Main report, page 58.

https://ec.europa.eu/international-partnerships/system/files/state-building-contracts-2012-2018-eval-dec-2020-main-report_en.pdf

decisions on new budget support programs or budget support payments are not bound by IMF positions.

Second, the EU has signed a PFM Partnership Program with the IMF on the global architecture and policy agenda for PFM, DRM, and transparency. This program complements funding granted to the IMF regional technical assistance centres. The EU has been the top funder of the IMF in the field of capacity development in the period 2018-2020. At the country level, IMF technical review or support missions complement technical assistance and capacity development projects that are funded and implemented directly by the EU.

8. Evaluations of EU Budget Support, 2010–2019

Since 2010, independent evaluation teams have undertaken 17 general and sector budget support evaluations. These were managed by evaluation management groups, comprising representatives of partner countries and funding agencies, under European Commission management. As shown in Table 3.2, of the total 17 evaluations undertaken, 11 were multi-donor evaluations assessing the joint effects of all the general and sector budget support operations financed by different development partners. Evaluation periods differed slightly across all 17 evaluations, which stretched from 1996 to 2018.

Table 3.2: Budget Support Evaluations Since 2010a

Type of Budget Support Evaluated ^b	Country Income Status ^c	Country and Completion Year of the Evaluation	Multi-Donor Budget Support and Evaluation	Period Covered
General budget support, SDG-Cs	LMIC	1. Tunisia (2011)	Yes	1996–2008
	LIC	2. Mali (2011)	Yes	2003–2009
	LIC	3. Zambia (2011)	Yes	2005–2010
	LIC	4. Tanzania (2013)	Yes	2004–2011
	LIC	5. Mozambique (2014)	Yes	2005–2012
	LIC	6. Uganda (2015)	Yes	2004–2013
	LIC	7. Burkina Faso (2016)	Yes	2009–2014
	LMIC	8. Ghana (2017)	Yes	2005–2015
General budget support, SRBCs	LIC	9. Sierra Leone (2016)	Yes	2002–2015
	LIC	10. Burundi (2015)	Yes	2005–2013
	LIC	11. All SRBCs, 23 countries (2020) ^d	No	2012–2018
Sector budget support, SRPCs	LMIC	12. South Africa (2013)	No	2000–2011
	LMIC	13. Morocco (2014)	Yes	2005–2012
	UMIC	14. Paraguay (2016)	No	2006–2014
	UMIC	15. Peru (2017)	No	2009–2016
	LMIC	16. Cambodia (2018)	No	2011–2016
	LMIC	17. El Salvador (2019)	No	2010–2017

LIC = low-income country, LMIC = lower middle-income country, SDG-C = Sustainable Development Goals contract, SRBC = state and resilience building contract, SRPC = sector reform performance contract, UMIC = upper middle-income country

^a The evaluations can be found on https://ec.europa.eu/international-partnerships/strategic-evaluation-reports_en.

- ^b The terminology used is that of the European Commission's 2017 [Budget Support Guidelines](https://ec.europa.eu/international-partnerships/system/files/budget-support-guidelines-2017_en.pdf).
https://ec.europa.eu/international-partnerships/system/files/budget-support-guidelines-2017_en.pdf
- ^c Country income status during the period of budget support provided (indicated in the last column of the table).
- ^d This evaluation assessed the use of the SRBC instrument in the 23 countries where it had hitherto been provided. See https://ec.europa.eu/international-partnerships/evaluation-eu-state-building-contracts-2012-2018_en.

Methodology

The OECD-DAC methodological approach¹⁷⁷ to evaluating budget support, sometimes known as the three-step approach, was used in all the evaluations listed in Table 3.2. This approach acknowledges that budget support cannot deliver outcomes and impacts by itself, as it can only contribute to the outcomes and impacts that are achieved through the implementation of governmental policies and public spending. EU budget support focuses on the results and, in particular, on the outcomes of the policies it supports. It leaves the partner country to take full ownership of its policy process and full responsibility for the accountability of its results, while supporting it with discussions, advice, funding, capacity development, and results monitoring. Because of this approach, the EU cannot claim to have directly delivered any of the achieved outcomes but, since it has supported governments in reaching these results, it can claim that it has (or has not) contributed to the achievement of these results.

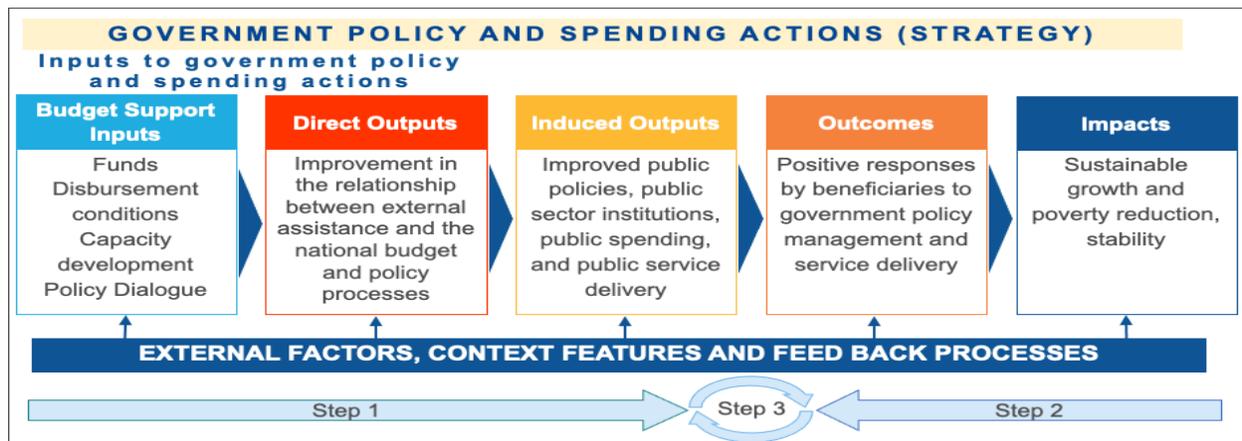
The OECD–DAC methodology is particularly well suited to evaluating EU budget support because it unravels and assesses the paths through which budget support inputs may have contributed to the improvement of public policies and institutions and also the extent to which these improved public policies and spending actions have caused changes in social and economic development.

In many cases, the EU is not the only development partner to have provided support for government policies. When evaluating budget support, the combined effects of all budget support operations in a given period of time in a country are considered. Given the influence of external factors, budget support evaluation cannot rely on a causality analysis and needs to differentiate between: the budget support's direct outputs (which can be expected to be produced directly by the budget support's inputs, e.g., funds, policy dialogue, technical assistance and performance measurement); and its induced outputs (which are situated at the level of public policy, institutional and spending changes, and which result from budget support direct outputs influencing and interacting with government processes).

To accommodate this complexity, the OECD–DAC approach to budget support evaluation is undertaken in three steps (Figure 3.5).

¹⁷⁷ See Evaluating Budget Support: <https://www.oecd.org/dac/evaluation/evaluatingbudgetsupport.htm>.

Figure 3.5: OECD–DAC Budget Support Comprehensive Evaluation Framework



Source: Adapted from <https://www.oecd.org/dac/evaluation/evaluatingbudgetsupport.htm>

Each step follows a very distinct logic:

- **Step 1.** Identifies the combined effects of all budget support provided to the country on aid, policy and institutional processes. The causal relationships between the budget support provided and changes in public policies, institutions, services delivery, and spending are analysed, recognizing that these changes are determined by the government and its policies beyond the budget support package. This step analyses the contribution of budget support inputs to outputs and induced outputs.
- **Step 2.** Identifies changes observed in outcomes and impacts as regards social and economic development which were targeted by the government policies supported (e.g, use of public services, business confidence and other sector outcomes) and analyses the factors determining these changes. These determining factors include public policy actions and also factors outside the government’s control (e.g., private sector and civil society initiatives, other aid programs, and external factors). Step 2 links changes observed at outcome and impact levels to their explanatory factors. It usually involves an econometric regression analysis of change in two or more sectors supported by budget support.
- **Step 3.** Combines the results of step 1 and step 2. The analysis teases out the extent to which budget support, through its contribution to government policies and spending actions, may have contributed to the outcomes and impacts identified.

This evaluation framework assumes that there are two main driving forces which generate most of the changes in induced outputs and outcomes:

- the flow-of-funds effects resulting from the provision of the budget funds; and
- the policy and institutional effects resulting from the interplay of budget support funding, policy dialogue, capacity building and disbursement conditions (performance indicators) with domestic processes of policy making, budget formulation and budget execution.

Both streams of effects can be traced up to the induced output level, while also recognizing that other factors are at play. The contribution analysis of step 1, when confronted with the results of the attribution analysis undertaken in step 2, allows the evaluator to assess the contribution of budget support to the successes and/or failures of the government policies and strategies, in relation to the outcomes and impact that the budget support programs intended to promote. This last step 3 analysis is a qualitative contribution analysis.

Key Questions and Issues

Evaluation questions are country- and sector-specific and follow a similar pattern. An evaluation generally has no more than 12 questions. The first questions concern the relevance of the budget support and assess the extent to which the support responded to the institutional, political, economic, and social context of the country or sector and was coherent with government priorities. Subsequent questions analyse the direct effects of budget support inputs on aid processes, macroeconomic management, public finance management, the level and composition of public spending, policy formulation and implementation processes, and governance. Answers to these questions allow for the completion of step 1 of the evaluation methodology.

The scope of the budget support being evaluated (general and/or sector budget support) usually determines the number of questions asked under step 2 of the evaluation, with usually one question per theme or sector. These questions investigate the effectiveness and impact of the policies being supported. They start by identifying the changes in the competitive nature of the economy, in areas pursued by the budget support programs, in income and non-income poverty, in the use and quality of public services and their impact on the livelihood of the population. Once these changes are identified, the extent to which they are related to changes in macroeconomic management, PFM systems, sector policy or policy processes, and/or to other factors, is assessed. The scope of step 2 and the focus of the questions depends on the data available and may be limited due to the evaluation's budget and time constraints.

Step 3 is a conclusive evaluation question, which assesses the extent to which budget support has contributed to the policy and institutional changes that were found to be important factors in reaching the observed outcomes and impacts at sector and country levels. This question provides a qualitative assessment of the efficiency, effectiveness, and sustainability of the budget support provided.

Limitations of the Evaluation Approach and Recommendations for Improvement

This three-step evaluation methodology was tested several times before being adopted by the OECD-DAC network on development evaluation in 2012.¹⁷⁸ It was re-assessed in 2014 when the EU commissioned a synthesis of seven evaluations undertaken since 2010, looking at the strengths and weaknesses of the three-step approach.¹⁷⁹ The specific tools and evaluation techniques used by each evaluation team were compared and assessed in order to develop recommendations on possible improvements. The recommendations covered methodological aspects as well as managerial and process issues.

¹⁷⁸ The methodology was tested in evaluations of budget supports in Mali, Zambia, and Tunisia in 2011. See <https://www.oecd.org/countries/zambia/evaluatingbudgetsupport.htm>.

¹⁷⁹ In addition to the three pre-cited evaluations of 2011, the synthesis included the evaluations of budget support in Tanzania (2013), Mozambique (2014), South Africa (2013) and Morocco (2014). See <https://www.oecd.org/dac/evaluation/Evaluation-Insights-Evaluating-the-Impact-of-BS-note-FINAL.pdf>

- A contextual analysis should be included in each evaluation.
- Step 2 analysis should consider the possibility of using secondary rather than primary data analysis¹⁸⁰ and/or more qualitative approaches (such as benefit–incidence surveys or perception surveys).
- Development partners’ management responses to evaluation recommendations need to be strengthened.
- Evaluation reporting formats should be simplified.
- The classification and presentation of evidence collected should be simplified to facilitate comparability across evaluations.

In addition, the study noted that the evaluation approach could become an integral part of the domestic policy processes if it was led by the country rather than by the development partners.

These recommendations were based on seven evaluations. Looking across the 17 evaluations examined in this chapter, it is clear that the application of the methodology provided more robust results at the step 1 level for sector budget support than for general budget support.¹⁸¹ This was not due to the type of budget support but to the fact that, by coincidence, in five of the six sector budget supports evaluated, recipient governments chose to earmark EU funds to specific (and narrowly defined) spending programs. This made the effects of budget support more traceable and allowed for a counterfactual approach to be taken for step 1. At the same time, these five countries stood out for their poor monitoring of policy actions and outcomes, making it more difficult to undertake the step 2 analysis. To assess policy and budget support effectiveness, the 17 evaluations confirmed that strengthening partner countries’ statistical institutions, statistical and monitoring systems, and accountability systems through improved and regular policy impact analysis needs to remain a priority.

Findings and Recommendations

Table 3.2 lists the 17 evaluations undertaken to date under EU management. Their findings and recommendations are presented in this chapter in three sections, one for each of the three types of budget support provided by the EU. The focus of the evaluations reflects the objectives of the three types of contracts: high-level strategic objectives requiring a cross-cutting approach for SDG-Cs; sector-level policies, reforms and governance for SRPCs; and transition to recovery, development and democratic governance and societal and state resilience for SRBCs. Correspondingly, the evaluations focused on the role of budget support in contributing to: global policy and governance achievements (SDG-Cs); sector or sub-sector outcomes and sector governance improvements (SRPCs); and consolidation of vital state functions, including the delivery of basic services to the population (SRBCs). The evaluations also differed in scope, with SRPC and SRBC evaluations looking, to a large extent, at EU budget support only; whereas SDG-Cs evaluations systematically considered the budget support being provided by all

¹⁸⁰ Most of the evaluations relied on the analysis of secondary data sourced from existing administrative or survey data. Primary data collection was mostly limited to information gained through focus group discussions and structured interviews. The synthesis discussed the possibility of undertaking specific survey work to provide primary data for a more precise and focused analysis.

¹⁸¹ The evaluations can be found on https://ec.europa.eu/international-partnerships/strategic-evaluation-reports_en

development partners to the country. SRBCs need to be examined separately from the other type of general budget support (SGC-Cs) because of the particularities of the countries and type of support provided.

The next three sections present evaluation findings related to SDG-Cs, SRPCs, and SRBC evaluation findings. A last section presents an overview of the main recommendations made across all 17 evaluations.

9. Evaluation Findings: General Budget Support

Eight multi-donor evaluations of general budget support have been undertaken since 2010 (Table 3.2).

These captured the interactions and combined effects of all budget support provided by all development partners in each of the eight countries¹⁸² between 1996 and 2015. The countries included six low-income countries (LICs) with very high poverty levels, poor social indicators, deficiencies in their political framework, weaknesses in governance, and high levels of aid dependency (Burkina Faso, Mali, Mozambique, Tanzania, Uganda, and Zambia) and two lower middle-income countries (Ghana, which had high economic growth rates, low poverty, but high aid dependency, and Tunisia, which had higher per capita income and social indicators, very limited aid dependency but relatively high poverty rates and unemployment). The original evaluations contained in-depth analyses of the country contexts.¹⁸³

Budget Support as a Package of Funds, Technical Assistance, Dialogue and Performance Measurement

The period being evaluated (roughly 2005–2015, although seven of the eight evaluations concentrated on the period 2005–2010) was a period of high and increasing ODA levels, with budget support being the EU’s and multilateral development partners’ preferred aid modality. Overall, budget support provided a significant and predictable source of funding for recipient governments and created fiscal space for them to undertake discretionary expenditure. The scale of budget support in relation to public expenditure was significant in all countries. Budget support annual disbursements represented as much as 25% of public expenditure in Uganda in the first half of the period; 15% of public expenditure in Burkina Faso; more than 10% in Mali, Mozambique and Tanzania; 8% in Ghana; and 6.5% in Zambia. Even in Tunisia, where it represented only 1.4% of public expenditure, budget support was an important source of funding for discretionary expenditure.

The predictability of the amounts of budget support was high, with disbursements close to planned amounts in most cases. This was true even though a lack of mutual accountability triggered temporary suspensions of budget support by the EU and other development partners in five of the eight countries during the evaluation period. In three cases, temporary suspension was linked to the government’s breach of principles (major corruption and fraud cases had been brought to light in Tanzania in 2007 and 2008; Zambia in 2009; and Mozambique in 2009, 2011,

¹⁸² The Tunisia evaluation considered only the EU’s budget support programs, which were provided in a joint framework with the African Development Bank and the World Bank.

¹⁸³ The evaluations can be found on https://ec.europa.eu/international-partnerships/strategic-evaluation-reports_en

and 2012). At the time, the EU's general budget support was not yet linked to respect for fundamental values, but only to the eligibility criteria, which continued to be satisfied. While corrective measures were discussed and then implemented, the EU continued to disburse funds, which eased the effect of these suspensions on the government's Treasury tensions. In the two other cases, Uganda (2012) and Ghana (2013 and 2014), underperformance on results, a deteriorating macroeconomic situation and serious concerns regarding PFM triggered all development partners, including the EU, to suspend budget support since the key conditions were no longer being met.

With these temporary suspensions and deferred disbursements of budget support due to the countries' breach of mutual accountability, the predictability of disbursement timing could not be maintained: in Mali, Uganda, and Zambia public expenditure was delayed and the government had to seek temporary domestic borrowing.

In almost all EU budget support, capacity development complements funding, policy dialogue, and performance monitoring. Technical assistance is used to strengthen the country's policy and PFM systems, to improve the accountability of the government toward its citizens, and to strengthen key institutions and policy-making processes. Typical areas of support include external oversight, monitoring and evaluation, underlying statistical data systems and processes, PFM, including gender budgeting and monitoring, and the active engagement of stakeholders in policy design, implementation and monitoring.

Technical assistance usefully complemented budget support in backing governance reforms and reinforcing capacities in PFM, audit, and statistics in six of the eight countries. Where sector budget support was provided alongside general budget support, sector capacities (e.g., in health, water, and sanitation) also benefited from technical assistance. In Ghana, major efforts were made to strengthen the capacities of civil society organizations and to enhance their role in policy processes. Overall, technical assistance remained a minor component of the budget support package and in many instances, evaluators estimated that more could have been done with better planning and a more flexible response to strengthen capacities at the subnational level where policy implementation takes place.

In every result identified in all eight evaluations as a direct or indirect effect of budget support, policy dialogue featured as a central element. Dialogue related to budget support was invariably a crucial factor in improving policies, governance, and policy decision making. Through their policy dialogue, development partners were able to put and keep specific issues on the government's priority agenda, draw attention to governance matters, and propose and discuss policy options. The development partners also used performance monitoring and the variable tranche indicators to discuss results of policy implementation, corrective measures, and implementation challenges.

The effectiveness of policy dialogue was helped by the strong coordination of budget support donors within a structured framework (Box 3.1). This facilitated harmonization, alignment, and the delivery of joint messages. During the period, temporary suspensions of budget support disbursements led to a severe deterioration of government–development partner relations in five countries. The overall positive assessment of budget support policy dialogue was tempered in several cases by a perceived lack of government ownership and leadership of the policy dialogue (this was not the case in Ghana) as well as by extending budget support areas of interest to ever wider governance and sector issues for which reform capacities were insufficient.

Box 3.1: Development Partner Harmonization and Alignment

All countries had strong formal budget support management structures and national monitoring frameworks. Budget support was managed in a harmonized manner despite the differences in the design and management of each development partner's budget support. During the periods evaluated, the number of active development partners in both general and sector budget support provision ranged from three (where there was only general budget support) to 19 (in Mozambique). Sector budget support was mostly directed toward social service delivery (health, education, roads, water and sanitation), technical and vocational training (Tunisia), PFM (Mali and Zambia) and decentralization (Zambia). These management structures helped align the development partners with government policy priorities and with the use of national monitoring frameworks and systems and common delivery mechanisms. Their use considerably reduced transaction costs, making budget support a more efficient modality than projects or basket funds. EU budget support variable tranche triggers were drawn from these common performance assessment frameworks.

Budget Support Contributions to Improving Public Governance

General budget support was found to have induced and sometimes been instrumental in triggering positive and mostly lasting changes in four main areas: policy formulation and implementation, the composition of public spending, public finance management (PFM), and transparency and external oversight.

General budget support accompanied improvement in policies in several areas, depending on the objectives pursued and the weaknesses to be addressed. For example, budget support's focus on outcomes was instrumental in improving policy monitoring in Uganda and in institutionalizing government annual performance reports. These monitoring reports provided timely information to policy makers and implementers on previous performance and challenges, and thus significantly improved policy making. Strong gains were made in the water and sanitation sector, where policy processes and the quality of policies gradually improved, thanks to the consultative processes nourished by these performance assessments. In other sectors, data reliability did not improve, and policy changes remained based on uninformed political decision making. In Tunisia, budget support contributed to discrete improvements in specific areas of reform, including trade tariffs, business environment regulations, and the tax system.

Improvements in sector policies and delivery processes were particularly substantial when general budget support was paired with sector budget support. In several countries, budget support contributed to the strengthening of sector policies, the adoption of a sector-wide approach and the implementation of sector policies, e.g., for the health and water and sanitation sectors in Burkina Faso. However, sometimes the contributions of budget support were positive but insufficient, by themselves, to improve service delivery. This was the case in Ghana, where budget support played a positive role in improving policy formulation, enhancing intrasectoral coordination (in environment and decentralization), and in strengthening the capacities of key public institutions. It also improved legislation and tariff adjustments designed to benefit natural resource management. However, while budget support helped to maintain the pace of reform and

improve the quality of policies in Ghana, it could not overcome the barriers to effective policy implementation.

In the six LICs, the discretionary funding enabled by budget support helped governments to significantly increase their social and pro-poor expenditure (health, education, social protection, water and sanitation, roads, and agriculture).

- In Mali, budget support provision was associated with an increase in expenditure on priority sectors from 39% of total public expenditure in 2003 to 54% in 2009.
- In Uganda, a trebling of poverty reduction expenditure was facilitated at the beginning of the 2004–2013 period when budget support funds came onstream. Budget support made it possible for these expenditures to remain protected from budget cuts during the entire period, but their importance in per capita terms fell drastically after 2004–2005 as the government's priority spending turned to infrastructure and defence, and basic service expansion stalled.
- Even in countries where priority sectors already absorbed the largest share of public spending, this trend was clearly visible. In Mozambique, for example, the share of public expenditure on priority sectors rose from 61% to 67% during 2005–2012. This increase in spending would not have been possible without budget support.
- In Ghana, the government ring-fenced budget support funding for pro-poor sectors, private sector development, natural resources, energy and oil. Despite this, pro-poor spending and public investment decreased in relative terms over the evaluation period.

In the LICs and Ghana, additional funding benefited spending on wages (higher salaries and more health staff and teachers), non-salary recurrent expenditure (mainly in Ghana), and a higher share of domestic funding of public investments. In addition, the implementation of PFM reform programs improved domestic revenue mobilization in all countries except Uganda and Burkina Faso and was associated with stronger budget planning and budget execution capacity (see below), thus increasing the efficiency of spending and providing an additional window of opportunity to increase amounts available for discretionary expenditure.

In turn, greater expenditure in social and priority sectors expanded access and delivery of services in these sectors. In education, the number of schools, teachers, and textbooks increased; in health infrastructure, essential drugs availability and personnel improved; and in water services, access was expanded. In all countries, budget support directly contributed to an increased provision of health, education, and other basic services.

In all countries, except Burkina Faso (Box 3.2), PFM vastly improved, as evidenced by repeated Public Expenditure and Financial Accountability (PEFA)¹⁸⁴ assessments. Budget support played an important role in these improvements through the provision of technical assistance (on issues such as integrated financial information systems, budget management, audit, and the legislative framework), the monitoring of the performance indicators contained in the performance assessments frameworks and in the variable tranches, and the close attention paid to PFM in policy dialogue. In most countries (Box 3.3), budget support was linked to wide PFM

¹⁸⁴ The Public Expenditure and Financial Accountability (PEFA) program was launched in 2001 by seven international development partners: The European Commission, International Monetary Fund, World Bank, and the governments of France, Norway, Switzerland, and the United Kingdom. See <https://www.pefa.org/>.

improvements at both central and local government levels, except in Tunisia, where the focus on PFM was limited to support for the development of the medium-term expenditure framework. In exceptional cases, such as Ghana, progress in PFM reforms was real but very limited: technical assistance and dialogue brought PFM issues to the fore and contributed to legislative improvements but remained largely ineffective as they were not backed by a prioritized and sequenced reform strategy. Since the reforms applied to only part of the budget, the limited progress made did little to improve the general management of government finances.

Box 3.2: Missed Opportunity to Improve Public Financial Management in Burkina Faso

In Burkina Faso, the PFM priority during 2009–2014 was the introduction of medium-term expenditure planning, and its associated budget program approach; some limited measures for improving budget execution (procurement and procurement control, simplification of expenditure chain); and the first attempts in favour of fiscal deconcentration (the delegation of some fiscal functions from the ministry of finance to line ministries or to sub-national administrative levels) and decentralization (the transfer of responsibility for revenue collection and expenditure management to sub-national levels of government). The role of budget support providers in these endeavours was very muted: they monitored developments, shared their concerns and recommendations with the government, and were occasionally solicited by the government to provide expertise for specific tasks. The slow progress of PFM reforms was not sanctioned by the development partners, who remained almost at the periphery of PFM efforts, possibly recognizing that many other priority issues needed to be addressed (notably the weakness of existing policies and corruption) for PFM reforms to improve expenditure effectiveness.

PFM = public financial management

Box 3.3: Technical Assistance for Public Financial Management in Uganda

Over the period 2004–2013, PFM in Uganda made huge strides at both central and local government levels, gains that were strongly associated with budget support, which helped catalyze these changes. Budget support brought substantial technical assistance, capacity building activities, and analytical services, which both strengthened PFM systems and provided budget support donors with leverage to push PFM issues in policy dialogue. A specific technical assistance support unit facilitated a coordinated effort, the production of common analytical materials (such as the relationship between fiscal decentralization, fiscal incentives, and decentralized services), and the common development and monitoring of PFM indicators and actions. Without budget support funding flowing through domestic PFM systems and the attention focused by development partners on PFM improvements, progress in PFM reforms would have been more limited.

PFM = public financial management

Contributions to Transparency and External Oversight were also made by budget support. Although they recognized the effectiveness of budget support, many EU Member States returned to project aid after 2010 (mainly because their constituents questioned the value of budget support). However, Member States entrust the European Commission to continue implementing budget support as the most effective way of promoting systemic changes, sustainable results, and domestic accountability. They are working closely with the European Commission in policy dialogue, capacity development, and performance monitoring, often through joint actions. To ensure the accountability of its actions to European taxpayers, the European Commission added budget transparency and external oversight as the fourth criterion for budget support eligibility. Within its budget support operations, the European Union prioritizes support for strengthening the functioning of supreme audit institutions (SAIs) and encourages the publication of budgets and budget accounts in a timely fashion. It also supports civil society participation in external oversight through the strengthening of the capacity of parliamentary committees and research bodies to scrutinize the budget. It also supports grassroots initiatives to enable populations to hold a government accountable for its spending actions (both budget management and service delivery).

In the two LMICs, budget support did not specifically target improved public accountability. In the six LICs, the evaluations confirmed that the EU's dynamic approach to transparency and oversight had paid off, often paving the way for improved governance over the periods considered (all before 2015). Transparency and external oversight improved, as did the control of corruption in a range of countries: Mozambique (improved budget documentation and legislative and institutional framework for the control of corruption); Tanzania (quality, timeliness and scope of audits, external scrutiny and the legal framework for corruption); Zambia (external auditing); Burkina Faso (external oversight, Box 3.2); Uganda (legal framework and strengthening of capacities of accountability institutions, Box 3.3). In Tanzania, corruption cases prosecuted more than doubled between 2010 and 2014. In all cases, improvements were linked to increased operating budgets for the relevant institutions (facilitated by the additional discretionary funding), technical assistance and increased attention within policy dialogue, all linked to the provision of budget support. In Uganda, it took the temporary suspension of budget support to bring the government's attention to corruption and governance issues.

Box 3.4: Improvement of External Oversight in Burkina Faso

Before 2014, the role of civil society in external scrutiny of public finance management and of the fight against corruption was strengthened through budget support. External oversight was an important part of the policy dialogue between the group of development partners providing budget support and the government. Discussions took place from the Prime Minister's Office to the technical level. Several development partners used performance indicators in the areas of external oversight and corruption as triggers for disbursement, reinforcing the significance they placed on these issues. To complement budget support, capacity strengthening support for the SAI, civil society, and other control institutions enabled them to be more effective. Although the dialogue did not produce the anticipated corruption and external oversight laws, the development partners' initiatives enabled civil society to make progress on other fronts, thus creating an improved environment for external oversight, which facilitated the subsequent

adoption of an anticorruption law under the transitional government.

SAI = supreme audit institution.

Contributions to Improved Social Outcomes

The main objective of all EU budget support is poverty eradication and inequality reduction. General budget support should be used to support the attainment of the Sustainable Development Goals (SDGs). In most of the eight countries examined in this chapter, the provision of budget support coincided with a period when social indicators significantly improved. Regression analysis found these improvements to have been directly linked to the expanded delivery of key public services as a result of increased social and pro-poor spending. Budget support contributed, sometimes very significantly, to this higher spending. Improved outcomes were achieved in education (higher enrolment rates in primary education, higher transition rates from primary to secondary schools, and lower drop-out and repetition rates) and in health (greater use of health facilities, higher immunization rates, lower child and maternal mortality indicators, and lower incidence of diseases).

The gains were momentous, but not always equitable. Generally speaking, rural areas have lagged behind, regional differences have remained widespread, and gains in access have not always been accompanied by better quality of services. For example, greater education access was achieved in Ghana, Tunisia, and Zambia (Box 3.5), but the quality did not follow suit. In Burkina Faso, access to basic services such as education, health, and water and sanitation improved but their quality and infrastructure remained poor. In addition, in some countries, including Ghana and Uganda, the government's fiscal position strongly deteriorated at the end of the evaluated period and the lack of resources for non-salary recurrent expenditures and investments have seriously weakened the service delivery systems. Finally, service delivery at local government level has not always received adequate attention.

Box 3.5: Expansion of Coverage of Key Social Services in Zambia

The evaluation of budget support in Zambia noted that, in the education sector: “The budget increases have enabled the Ministry to invest more in teachers, classrooms and books. The number of basic schools increased from 7,600 in 2005 to 8,400 in 2010, the number of teachers from 50,000 to 63,000 and the number of primary school pupils from 2.9 million to 3.4 million. The enrolment of girls improved and gender parity was almost achieved at the lower and middle basic levels. The number of Grade 9 examination candidates increased from 190,000 in 2005 to 280,000 in 2010 (with an increase of female candidates from 89,000 to 133,000). Partly as a result of a lack of resources, the quality of education remained low. However, it must be noted that improved access among underprivileged groups changed the composition of classrooms in primary schools, which had an impact on average examination results.” (page 18, Synthesis report).

Contributions to Higher Economic Growth and Reductions in Income and Non-Income Poverty

In Tunisia, the reforms supported by budget support contributed directly to the country's opening to international trade and coincided with a period of economic growth and stability. Budget support contributed to tax reforms and tariff dismantling as well as to the improvement of economic governance and the business environment, which was essential to improve Tunisia's international competitiveness (Box 3.6). It clearly also contributed to the Tunisian government's wider strategic agenda.

Box 3.6: Contribution of Budget Support to the Liberalization of the Tunisian Economy

Budget support in Tunisia supported a set of reforms aimed at liberalizing the domestic market, strengthening the competitiveness of the economy, reform secondary and technical education with a view to reduce youth unemployment. During the period of budget support, macroeconomic growth accelerated, the trade volume with the EU more than doubled in real terms between 1995 and 2006, the trade deficit decreased to near zero by 2008, private investment grew an average by 7.5% a year, labour productivity increased, and the number of apprentices in vocational training and higher education graduates increased dramatically, although they could only partially be absorbed in the labor market where high levels of unemployment persisted.

In the other seven countries, budget support represented a significant share of public expenditure. In tandem with support provided by the IMF, budget support was instrumental in providing essential resources for the maintenance of macroeconomic stability, strengthening the capacity to manage external shocks, and to ensure high economic growth rates. The evaluations confirmed that the eight countries had improved their macroeconomic performance, attaining generally higher growth rates than neighbouring countries that did not receive budget support (although Ghana's performance declined strongly over the evaluation period). The main reasons for these positive trends were the governments' overall prudent macroeconomic management and national and sector policies, as well as a number of favourable external factors, including debt relief. Within this conducive context, budget support helped stabilize the fiscal deficit and allowed higher spending without governments having to tap into domestic savings. This spending was often used for public investments, including public infrastructure, helping to stimulate domestic activity and productivity. In Ghana, when development partners stopped providing budget support in 2013–2014 this was an important factor in the government's decision to accept an IMF stabilization program.

Macroeconomic gains were particularly strong in countries that successfully managed to raise domestic revenues (a priority concern for the EU) and to increase social expenditure. Apart from Uganda, in all of the countries evaluated, domestic revenue mobilization (DRM) increased during the periods of EU budget support. By contrast, in Uganda DRM remained low, and, at the end of the evaluated period (i.e., after 2010) when budget support contributions declined, the government was unable to provide sufficient funding for public services and could no longer sustain social services. The Uganda evaluation suggested that the sheer volumes of budget support received probably crowded out local revenue mobilization. With a low DRM, the sustainability of gains was seriously compromised. In Mozambique and Tanzania, extensive

revenue reforms to trigger higher DRM were implemented during periods of budget support provision.

With the improvement of social performance indicators, non-income poverty also decreased significantly in all eight countries over the period. The Human Development Index increased by 11%–14% between 2004 and 2010 in Mali, Mozambique, Tanzania, and Zambia. The period of budget support coincided with a sharp drop in poverty rates in some countries. Significant reductions in income poverty were achieved in Mali (from 61% of the population in 2000 to 51% in 2005) and Ghana (from 17% in 2006 to 8% in 2013). Moderate poverty reduction was seen in Tanzania and Mozambique, but reductions were limited to the cities in Zambia.

The contribution of budget support to these improvements is not quantifiable and none of the gains made can be directly attributable to budget support. However, most evaluations found indirect positive links between budget support and poverty reduction.

10. Evaluation Findings: Sector Budget Support

While sector reform performance contracts (SRPCs) share the general objectives of budget support, they focus more narrowly on supporting sector policies and reforms and on improving governance and service delivery in a specific sector or in a set of closely interlinked sectors. In line with the Sustainable Development Agenda 2030's pledge not to leave anyone behind, SRPCs emphasize equitable access to, and the quality of, public service delivery, particularly for poor and vulnerable populations, and the promotion of gender equality and children's rights.

The EU has undertaken six sector budget support evaluations since 2010 in Cambodia, El Salvador, Morocco, Peru, Paraguay, and South Africa. The evaluated periods for each country were different but all fell within the 2000–2017 timeframe. These evaluations covered only EU support, except in Morocco where the evaluation encompassed budget support provided by four multilateral and three bilateral development partners. The number of SRPCs in each country varied widely, from 54 programs in Morocco to two in Cambodia.

The evaluated SRPCs were provided to support poverty reduction, macroeconomic policy implementation, good governance (public administration, PFM, and fiscal reform), social sector policies (education, health, social protection, social development), and sub-sector policies or programs (development of a national quality control system, promotion of the environment and trade, and the fight against drugs).

Policy Dialogue, Technical Assistance, and Performance Measurement

In contrast to general budget support (where funding was essential to the results achieved), in SRPCs, technical assistance, policy dialogue and performance measurement were the main drivers of effectiveness, with funding taking a second, even if strategic, place.

Of the six countries evaluated, Cambodia, El Salvador, Morocco, and South Africa were lower middle-income countries (LMICs), whereas Paraguay and Peru were upper middle-income countries (UMICs). Budget support represented the main, and often the only, aid delivery method for the EU in these countries and the volume of funding remained minor relative to total public funding. As opposed to general budget support, where funds could represent 15% or more of public expenditure, depending on the year considered, the countries considered here were not aid-dependent and SRPCs represented, at most, 0.6% of annual public expenditure.

However, this is not necessarily a general characteristic of SRPCs, but rather a particularity of those in this small sample of LMICs and UMICs. For example, the eight countries considered in the previous section on general budget support also benefited from sector budget support, which was found to be as essential as policy dialogue and technical assistance in contributing to observed results.

In the six cases of sector budget support evaluated, actual disbursements were close to planned disbursements, and SRPCS were more predictable than any other aid modality, both in amounts and in delivery timing. Some in-year unpredictability of timing occurred but it was well-managed by the authorities, leaving government budget and Treasury plans unaffected.

The technical assistance provided in the context of SRPCs was crucial to improving sector conditions for effective policy implementation in complementarity with budget support funding. Technical assistance nourished strategic dialogue on policy design and technical discussions on specific policy areas. It provided tools or outputs crucial for reforms to be pushed forward. It strengthened the capacities of the institutions responsible for policy implementation and provided preparatory inputs for the monitoring of disbursement conditions.

When the needs expressed by the recipient countries and the technical assistance provided by the EU were in harmony, and coordination between development partners was good, the support provided tended to be more effective (Box 3.7).

Box 3.7: Joint Pool for Technical Assistance in Cambodia

The EU set up a joint pool fund for technical assistance in Cambodia. This significantly improved the response to government capacity strengthening needs and priorities and aligned the support of the various development partners. The EU's technical assistance was instrumental in easing the massive institutional and human resource constraints on implementing important reforms in education and public finance management. It also contributed to improved budget efficiency through the tools it developed.

The role of policy dialogue is key in budget support, both in reaching agreement on the reforms to be supported and in monitoring progress in policy implementation. In the six countries, the depth and scope of the dialogue and its effects on policy decisions varied from strategic policy advice to technical and operational discussions. In Morocco, within the wider policy dialogue framework taking place under the EU–Morocco Association Agreement signed in 2000, policy dialogue focused on the operational requirements for implementing a set of reforms to liberalize the economy, promote trade integration and modernize the regulatory framework. In Paraguay, policy dialogue and performance indicators influenced the design and implementation of policies in education, social protection, and public finance management. In El Salvador and Peru, discussions were focused more on the technical issues that arose within the sectors supported.

Unlike general budget support, the delivery of SRPCs did not involve joint management structures with other providers of budget support. This was partly because the majority of SRPCs evaluated were designed to provide support for a specific reform within a sector or a subsector, rather than to support a sector-wide approach. When an SRPC supported a whole sector (for

example, education in Cambodia, El Salvador, Morocco, and Paraguay), policy dialogue would take place within existing multi-donor sector policy dialogue structures. Where established dialogue mechanisms already existed, the dialogue was more strategic and more effective. For example, the dialogue with development partners in the education sector in Cambodia led to a strategic decision by the government to increase budget transfers to schools for their operating budgets.

Where SRPCs were provided as stand-alone operations, targeting very specific programs, sub-sectors or regions, the conditions for joint development partner dialogue were more limited. The EU was often the only development partner providing budget support in these areas (or, as in South Africa, the only development partner providing budget support at all). Development partners providing loans (e.g., multilateral lenders providing policy-based lending) were often leading a separate dialogue from those providing grants (e.g., the EU and bilateral development partners); this was more marked in LMICs and UMICs than in LICs. In the case of the SRPCs evaluated, dialogue was limited to the scope of the sub-sector or program supported, harmonization was less advanced, and there was less inclination to align disbursement triggers and positions on policy dialogue issues (El Salvador, Paraguay, and Peru).

In all cases, the use of variable tranches and of performance indicators provided an opportunity for discussing sector or subsector issues and finding solutions to identified problems. In some cases (e.g., Morocco) EU budget support was instrumental in setting up monitoring frameworks with actions and targets to be achieved. Dialogue on performance indicators sometimes led to strategic policy discussions and the monitoring of wider sector objectives. More often, the scope remained tightly linked to the variable tranche indicators, with the strategic dimension of policy design and implementation staying firmly with the government. Where the choices of performance indicators spanned several different areas of a sector policy or different sector policies, budget support overcame the internal fragmentation of management structures within and between beneficiary ministries by nurturing intra- and inter-institutional dialogue and coordination. The strengthening of the inter-institutional dialogue within government was a benefit of EU budget support, as noted in both Morocco and Paraguay.

Contribution to Improvements in Public Governance

In contrast to general budget support, which generated important gains in overall governance issues such as PFM, transparency and oversight, SRPCs focussed more narrowly on sector governance issues.

Dialogue in the context of SRPCs was more about operational matters and the discussion of performance at program and subsector level than about wider strategic objectives. However, where budget support was used to support new programs, such as Peru's fight against drugs or the creation of the Salvadoran National Quality Control System, the EU delegation and the technical assistance provided policy advice to the government at a crucial time while these new policies were being developed. In South Africa, such advice was very limited. In Morocco, the EU's technical advice on PFM led to progress on two highly sensitive areas in terms of defining strategic policy directions, namely the estimation and publication of tax expenditure and tax rationalisation (Box 3.8).

Tax reform, which began in Morocco in the mid-1980s, achieved positive results until the late 1990s, when progress slowed. A new wave of reforms was undertaken from the late 1990s and was accompanied and supported by the EU and other development partners from 2005 onwards with budget support. This led to the simplification, rationalization, and harmonization of taxes, the development of a new Public Finance Law, and, importantly, since 2007 made it possible to report on tax expenditures in the Finance Act.

In the field of taxation, budget support was instrumental, not for launching reforms (which were initiated by the government), but for influencing their orientation on such critical issues as value-added tax (VAT), corporate tax, tax neutrality, rationalization of tax expenditure in order to align with good practices, particularly those underway in the EU. The intensity of the policy dialogue, the technical assistance and analytical work provided during the preparation phases, and the choice of disbursement conditions (performance indicators) were instrumental in advancing the reforms.

In most cases, technical assistance played an instrumental role in strengthening government capacities and producing tools and systems which were important to advance the reforms. In Morocco, technical assistance was particularly effective in supporting regulatory and institutional changes to modernize the Moroccan economy and facilitate its entry into the world economy. In Cambodia, El Salvador, and Peru, technical assistance played a key role in improving sector governance and in particular public finance management. Technical assistants exchanged ideas and provided analysis and policy proposals to nourish institutional strategies and policy development, produced management and technical tools, and delivered training in areas such as sector planning, budget management, financial management and results-based management reforms.

Great strides forward were identified in results-based planning and budgeting (Cambodia and Peru), in monitoring capacities (Cambodia), in strengthening inter-ministerial relationships and in the technical capacities of the institutions supported. This improved governance was recognized as key to sustainable and systemic improvements in policies and delivery that would lead to better sector outcomes. All such sector-level improvements were linked to technical assistance.

Even though the volume of funding provided by budget support was small relative to total public spending, budget support funds were essential in maintaining or even increasing spending in selected areas. In the six countries examined, the fiscal space created by budget support was used by the governments to ensure funding of specific programs, or to increase funding of existing programs.

- **Cambodia.** EU budget support helped reverse an increasing trend of underfunding non-salary expenditure in education by convincing authorities to increase school operating budgets and by enabling continued funding of some specific education initiatives, such as scholarships and multilingual education, which had been successfully piloted by other development partners.

- **El Salvador.** In 2010, EU macroeconomic support to El Salvador helped relieve the pressure on the national treasury in the aftermath of the global financial crisis of 2007–2009, when the government sought to implement an anti-crisis plan and increase social spending.
- **El Salvador, Paraguay, and Peru.** EU budget support allowed governments to increase funding of specific spending programs, including: the Salvadoran Quality Systems Programme; the very limited capital budget and the purchase of books and stationery in the education sector in Paraguay; and social protection for vulnerable people and nutritional programs in three regions in Peru.
- **Morocco.** Although aggregate budget spending remained stable, the budgets allocated to non-formal education and adult literacy were boosted by the attention given to these areas in the policy dialogue and indicators that accompanied EU budget support.
- **South Africa.** Budget support funds were used by the government to top up the budgets for innovative spending in service delivery processes in different areas (water and sanitation, health, justice, education, employment, private sector development, and the provincial legislative assemblies). In cases where public spending was verified to have reduced poverty and inequality levels, corresponding programs were mainstreamed into policy, scaled up, and funded domestically through the budget.

In all cases, EU funding enabled the respective governments to increase the scope of services delivered to the population. In Paraguay, Peru, and South Africa, this was easily identifiable as funds were channelled by the government to specific spending programs and regions, increasing coverage and efficiency in specific policy areas (education, social protection, and health). In other budget support programs, the link between EU funding and the increased access to public services was more indirect.

Evaluations also noted that, although EU budget support had contributed to an expansion in services, it was not always successful in increasing the quality of those services (e.g., education in Cambodia) or in addressing persistent inequalities in access to services.

Contribution to Improved Social Outcomes, Higher Economic Growth, and Reduction of Income and Non-Income Poverty

In the six countries, the evaluations found that budget support had made genuine and positive contributions to better sector governance, improved institutional capacities, and more efficient and higher spending. This enabled the governments to deliver more services to the population. These policy results, in turn, were either verified to have contributed to improved macroeconomic and social outcomes or were inferred to have contributed to these outcomes

- **El Salvador.** Funding, technical assistance to strengthen fiscal management, and dialogue about performance indicators targeting subsidy levels and social spending contributed to the country's progress towards an improved fiscal balance. Tax revenues increased and more funds were allocated to social spending. Overall, budget support programs in El Salvador were found to have contributed to improved education enrolment, grades, and coverage; access to water, sanitation, and electricity; pensions and other social transfers; and the promotion of a culture of quality.

- **Peru.** Budget support funds were directed by the government at specific programs and regions. It was found that regions that received the funds performed better than other regions in terms of the prevalence of chronic infant malnutrition, reductions in coca cultivation, and increases in the cultivation of industrial crops.
- **Paraguay.** The government directed EU budget support funding at child nutrition, teacher training, and the purchase of textbooks. These programs were considered by stakeholders to have increased education enrolment and to have improved the territorial distribution of education services.
- **South Africa.** The funding of innovative processes successfully increased access to and use of water and sanitation, primary health care, justice, and democratic participation by the poorest and most marginalized population groups.
- **Morocco.** Lower rates of morbidity and mortality, in particular maternal mortality, were achieved through the wider adoption of health insurance and increased use of health services, supported by budget support. An increase in the adult literacy rate from 52% in 2004 to 67% in 2011 and reduced drop-out rates and improved progression rates were attained, helped by the EU's budget support to education. More broadly, SRPCs supported legal and regulatory changes, which reinforced a wider liberalization of the domestic market.

However, budget support did little to reduce regional or urban–rural disparities in access and delivery of services. Moreover, some of the improvements linked to EU budget support were not linked to the improvement of sector outcomes and impacts, or at least the results could not be clearly seen. This was the case for the EU's budget support to education in Cambodia. The EU strongly contributed to increased and more efficient recurrent spending, but this did not lead to better or more uniform education outcomes (primary and secondary enrolment rates, and repetition rates) over the period. For example, the evaluation found that the provision of EU scholarships and better school governance, which the EU support emphasized, did not play a significant role in the positive changes observed in drop-out rates and early childhood enrolment rates. Other factors, including correct school entry age, access to drinking water, and the location of schools or school spaces were more important. However, in this specific case, it was also noted that by the time the evaluation was carried out, the improved sector policy implementation might not yet have had enough time to lead to the expected outcomes.

11. Evaluation Findings: State and Resilience Building Contracts

State and resilience building contracts (SRBCs) are provided by the EU in situations of fragility or transition. They address immediate needs by providing additional fiscal space and supporting key actions to help countries to ensure vital state functions and to deliver basic services to the population. They also aim at tackling the structural causes of fragility and at building up the state's economic resilience. Since SRBCs were introduced in 2012, individual evaluations of them have been undertaken in Burundi (2015) and Sierra Leone (2016). A thematic evaluation of the instrument was undertaken in 2019, covering the 23 countries that had received SRBCs since 2012. Between 2012 and 2019, 42 SRBCs were implemented in those 23 countries, with a disbursed amount of €3.9 billion.

Characteristics and Importance of the EU's SRBCs

SRBCs offered a rapid funding response in a high-risk environment. All SRBC recipient countries were characterized by social vulnerability, macroeconomic fragility, political instability, weak institutions and governance, lack of state legitimacy, volatile aid, and substantial and increasing risk levels. All countries displayed an urgent need for a large volume of funding. Most often, these situations arose in structurally fragile countries hit by a health, economic, political, climate and/or security crisis. Sometimes, situations of fragility were exacerbated by political change, natural or climate catastrophes, or external shocks (e.g., a drop in commodity prices). In these contexts, the EU's response has been to provide a rapid response in an emergency context, with budget support funding discussed with the IMF, to close an existing financing gap. On average, SRBCs represented 5% of domestic revenues.

SRBCs were usually prepared very rapidly, and conditions for disbursement could be adapted during implementation. Although the eligibility criteria were the same as for Sustainable Development Goals contracts (SDG-Cs) and sector reform performance contracts (SRPCs), they were interpreted more flexibly for SRBCs and their results were assessed through policy commitment and intent, rather than the policy track record. Flexibility was also shown in the way variable tranche performance indicators could be revised, the length and amounts of the contract could be adapted, and additional tranches could be provided in response to specific unexpected challenges.

This flexibility did not undermine the important role of the variable tranches as an incentive to reach specific targets: overall, only 75% of the planned value of variable tranches were disbursed. However, it was found to have diminished their potential role in stimulating the adoption of pro-stability and pro-growth policies.

Policy dialogue was key to all SRBCs, given that eligibility criteria were assessed on the basis of policy intent and political commitment, and disbursement conditions could be re-assessed rapidly in reaction to changes in the situation. The dynamic interpretation of disbursement conditions required intense and continuous discussions, focusing mostly on budget and fiscal issues, PFM, and fundamental values. Policy dialogue was most often undertaken bilaterally, but it was often undermined by a lack of political backing or consensus, weak institutional capacities, and the overbearing weight of the ministry of finance in discussions that concerned line ministries.

Technical dialogue was based on the performance indicators, which usually targeted the government actions (input and process indicators) that are essential for state functioning: economic and financial governance, social sectors (education, health, food security), and democratic governance. A characteristic of the EU's dialogue has been the concept of "proximity." The EU's presence on the ground, and the direct management of the SRBCs by the EU delegations (with headquarters support), facilitated these technical discussions, which often evolved into a more structured dialogue (through the setting up of monitoring platforms or committees), and facilitated dialogue between the ministry of finance, the services responsible for the actions covered by the performance indicators, the EU delegations, and technical assistants. In several cases, proximity and the rapid mobilization of funds through the SRBC also provided an opportunity for the policy dialogue to open the door to political dialogue in complex situations (e.g., in Afghanistan, Burundi before 2016, and The Gambia).

Technical assistance was often used but was not a driver in these programs. Most programs planned for technical assistance to strengthen governments' weak institutional capacities, but with little coordination among development partners and only a weak connection with the programs, the technical assistance was merely able to provide limited knowledge transfer and/or follow-up actions.

Contribution to Improved Public Governance

SRBCs targeted the strengthening of government capacities in:

- macroeconomic and fiscal stabilization and PFM systems, with an important focus on domestic revenue mobilization (DRM);
- provision of basic social services; and
- democracy and the rule of law.

Macroeconomic and fiscal stabilization policies are the IMF's mandate. The IMF provides partner countries with incentives to follow a macroeconomic stabilization policy. It is often backed up by EU budget support, first through the budget support eligibility criteria, which require the partner country to pursue a macroeconomic stabilization policy, and second by the EU's direct contribution to stabilization via the injection of large amounts of funding into national Treasury accounts right after the shock. The EU's role in supporting macroeconomic stabilization was particularly significant in fragile countries with a high security risk. Indeed, the large influx of EU funding and the EU's presence as a frontrunner in providing budget support has often provided a strong signal for other development partners to follow suit and provide support in a high-risk environment (Box 3.9).

Box 3.9: Support for the Central African Republic

In 2014–2015, the EU's SRBC was the only budget support provided to the Central African Republic. Equivalent to 15% of total revenues in 2014 and 12% in 2015, it covered as much as 36% of civil servants' salaries during and just after the peak of civil war violence. In 2016, the IMF, World Bank, African Development Bank, and France joined to assist and cover the gap on the balance of payments and state budget, in the form of budget support. In this manner, the relative weight of the EU SRBC gradually declined over the period. These various budget supports helped to relieve some of the pressure on public finances, but with domestic resources mobilization only increasing from 5% of GDP in 2014 to 9% of GDP in 2018, the country's Treasury remained extremely stressed during that period.

An increase in foreign direct investment has been observed in countries where the EU provided SRBCs, with the influx of foreign currency having a positive effect. The resumption of external debt interest payments and the availability of essential imports provided the wider public with more confidence in the government: during the periods of SRBC provision, the cost of domestic borrowing decreased, further easing the fiscal situation.

Fiscal stabilization was also enhanced by the EU's focus on domestic revenue mobilization (DRM). This was usually achieved through policy dialogue, the performance indicators of

variable tranches and complementary technical assistance. In most cases, this focus on increased DRM paid off, with positive results obtained through better tax administration (including tax exemptions and the taxing of extractive industries), improving the sustainability of fiscal stabilization.

Public financial management (PFM), supported by the EU and other development partners, made good progress. Since vast amounts of grant funding were passing through domestic systems, PFM improvement and more rigorous treasury management were amongst the most important objectives of policy dialogue between the EU and the government. As a result, about half of the variable tranche performance indicators were linked to targets in the areas of PFM, including DRM, external audit, and transparency and anticorruption. PFM was a major focus of policy dialogue and technical assistance support. Although not all these efforts appeared to have paid off, improvements were noted, especially in treasury management, budget planning and procurement, and in democratic participation of budget programming. Transparency in budget execution and external oversight did not improve.

SRBCs enabled an increase in government recurrent spending on basic social services, mostly for salaries, in a general context of fiscal restraint. The additional space for discretionary spending allowed by EU SRBCs was found to have been crucial to protecting recurrent expenditures during the evaluation period. Capital expenditures did not increase. The allocation of the discretionary expenditure to social spending was, at least partly, influenced by the accompanying policy dialogue and use of performance indicators.

In line with the focus of early SRBCs, which was on stabilization rather than growth, the SRBCs did not seek to influence public policies other than macroeconomic and fiscal management. Nevertheless, EU SRBCs were instrumental in preserving and even increasing social services, despite the very difficult contexts. EU funding, coupled with an insistent dialogue on the need to protect social sector budget allocations and to fully execute available budget lines, as well as the inclusion of performance indicators targeting the protection of these budget allocations, enabled the maintenance of spending on social services and an increase in health spending. As a result of SRBCs, social services in fragile countries continued to be delivered. Health services, including drug availability, improved in all countries and especially so in those countries suffering from the Ebola pandemic. In some cases (Côte d'Ivoire, Madagascar), SRBCs also supported a better distribution of services over the territory.

In turn, the protection of basic services delivery was recognized in the evaluation to have contributed, alongside other international technical and financial support, to the attainment of SDGs, in particular to positive effects on health and education outcomes, such as lower infant mortality and improved maternal health. However, no evidence was found that the quality of services or the food security situation of the population improved as a result of EU SRBCs.

With regards to democracy and the rule of law, the strengthening of the institutions responsible for security, justice, peace and democratic governance has been slower than expected. The accent has been on policy reforms and legislation, which did not yet result in improved public governance over the period evaluated. About one-third of SRBCs specifically targeted the reinforcement of democracy and the rule of law through the use of performance indicators (on budget allocations, the creation of institutions, the reinforcement of institutional processes, the strengthening of institutional capacities). SRBCs were found to have been instrumental in triggering reforms in the fields of justice, internal security, decentralization, the fight against

corruption, and citizen participation. Despite this good progress, the effect upon improved governance is not yet visible. In Niger, for example, the first two SRBCs supported reforms to justice and internal security. The EU, the United Nations Development Programme, and the EU Capacity-Building Mission (EUCAP) Sahel supported the government to prepare a national strategy for internal security and its action plan, which was adopted in 2017. Its implementation continued to be supported by the EU through a third SRBC during 2019.

Countries with an on-going political transition provided a favourable context for SRBCs, which could accompany a peace consolidation process by supporting stabilization and the strengthening of state functions, leading to stronger public governance. In others, efforts made were undermined by the difficult context, marked by persistent political and security fragility, continued macroeconomic risks, political resistance, and insufficient capacity to implement difficult reforms addressing structural bottlenecks. These problems were exacerbated by a lack of popular trust in state institutions and state legitimacy. In these cases, the SRBCs' efforts to improve governance were not successful.

Contribution of SRBCs to Economic Growth and Social Outcomes

The SRBC evaluation found that SRBCs had a positive and proven track record of contributing to macroeconomic and fiscal stabilization and strengthened PFM systems in contexts of fragility and risk. The flow of funds effect on social spending was also important.

However, the evaluation found that the early SRBCs paid insufficient attention to the structural causes of fragility and did not sufficiently integrate considerations about resilience. They did not seek to support structural reforms that could address fragility and the risk factors affecting longer-term economic growth. Nor were they able to have a positive impact upon population poverty and vulnerability. SRBCs rarely had an exit strategy, which could have defined the manner in which gains made could be consolidated and the follow-up programmes that the EU could have offered after emergency support had been delivered.

The SRBCs were found to be extremely valuable in responding to the specific and immediate needs of countries in crisis and/or countries in a situation of fragility or transition or in need of reconstruction. In these contexts, SRBCs brought opportune support that enabled countries to avoid further disintegration of the state's basic functions and allowed the government to resume delivery of basic public services to the population. SRBCs are the EU's only instrument capable of mobilizing, at very short notice, financial resources to be used for recurrent expenditure (usually salary payments) and continued state functioning, as well as providing technical resources to help strengthen the capacities of vital state institutions. These two effects combined have allowed populations to be protected from a total state collapse and to be provided with a minimum level of services.

Although not covered by the evaluation, the current COVID-19 crisis illustrates how SRBCs can rapidly disburse funds to the Treasury to enable it to channel more resources to the health sector and tackle the extra strain on health services at a time of pandemic. This allows for more support to be given to vulnerable populations and/or for resources to become available at a time when domestic resource mobilization may be squeezed by negative effects of the crisis on the economy.

12. Summary of Findings for the Three Types of Budget Support

The evaluation findings for the three types of budget support are summarized in Figure 3.6. This provides a quick overview of the characteristics of, and the evaluation findings for, the three types of budget support. It includes their foci, inputs, induced outputs, and contributions to outcomes and impacts, as well as the external factors at play. It also qualifies, at the level of inputs, their relative contribution to the effectiveness of the budget support outputs and the induced outputs achieved.

The evaluation findings summarized here should be considered in their context. This synthesis was based on evaluations undertaken over the period 2011–2020 of budget support programs implemented during the period 1996–2018. Looking across the 17 evaluations and with the benefit of hindsight, it is clear that some of the progress to which budget support contributed was short-lived, especially when countries experienced drastic socio-political, economic, or security shocks. The risk of losing progress never disappears and it needs, therefore, to be monitored closely during budget support implementation. However, this finding may also indicate the need for a more in-depth consideration of the factors that would help ensure the sustainability of outputs and induced outputs when designing budget support and when evaluating its effectiveness.

CSO = civil society organization, DRM = domestic revenue mobilization, PFM = public financial management, SRPC = sector reform performance contracts, SDG-C = Sustainable Development Goals contract, SRBC = state and resilience building contract.

Key:

- + minor contribution (accompanied change)
- ++ important contribution (change was facilitated but might have happened anyway)
- +++ critical contribution (change would probably not have happened within the time frame and to the extent observed)

13. Recommendations of the Evaluations

Each of the 17 evaluations made a number of recommendations to improve the use of budget support in the country concerned and, sometimes, to improve the specific programs, policies and institutions supported. Below are those recommendations that were less context-specific and can be applied to the management and use of budget support in general.

- **The EU and other development partners need to establish new types of partnerships with partner countries, using cooperation modalities and tools in a different manner.** This point was made by several evaluations. Several different directions were recommended. For example, the evaluation of operations in Ghana proposed that the EU should use technical assistance and policy dialogue in a more balanced manner, focusing support on policy innovation and integration of cross-cutting issues. At the time Ghana was a country in transition between being a low-income country (LIC) and a lower middle-income country (LMIC).¹⁸⁵ The evaluations of budget support to El Salvador, Peru and South Africa, illustrated how these governments used EU budget support precisely in this manner, creating fiscal space that allowed them to fund non-essential new pilot programs and risk-taking initiatives that could later, if successful, be mainstreamed into policies.
- **Budget support should be focused on the areas of highest need and impact.** This recommendation was made by one evaluation. Future partnerships should be less ambitious but should concentrate on a few key areas, including mobilizing domestic revenue; reversing the underfunding of social service delivery; and strengthening governance institutions, accountability and enforcement. In short, to ensure that budget support is more strategic, a mix of funding, technical assistance, dialogue, and performance monitoring should be adapted to fit the specific weaknesses and/or opportunities in the specific country context. This would require both a thorough context analysis (including of inequalities, stakeholders, and the political economy) and a more careful understanding of the budget support's logical framework, so that outcomes and impacts potentially influenced by budget support can be defined and monitored.
- **Budget support needs to complement other aid modalities.** This point was made in several evaluations, which suggested that sector approaches that aligned a broader mix of external support instruments would offer a more flexible response to specific problems. Similarly, the use of mutually reinforcing support, such as sector support alongside

¹⁸⁵ Ghana passed from LIC to LMIC in 2011.

governance support, was recommended wherever possible. Where several budget support programs coexist, they should be designed to foster complementarity and steered toward the achievement of common objectives. With regard to situations of fragility, EU budget support should be coordinated with EU humanitarian aid, as well as with the IMF and other development partners to provide synergies through complementary funding and technical support.

- **The EU should strengthen its policy dialogue.** All evaluations had at least one recommendation regarding this issue. Invariably, evaluations found that policy dialogue required strengthening at both central and local levels. Dialogue can begin with the discussion of performance indicators, and then extend to a dialogue on policy directions, based on the monitoring of progress in achieving sector and country outcomes and framed in a medium- to long-term perspective. For this, EU staff need to be equipped with adequate skills. Some evaluations recognized that the human resource needs for policy dialogue go beyond what the EU can realistically provide: the shortage of specifically qualified staff in charge of policy dialogue was particularly acute for the implementation of state and resilience building contracts (SRBCs). Guidance on policy dialogue and training for EU staff were recommended.
- **The EU needs to carefully consider the choice and use of performance indicators for the variable tranches.** This recommendation concerned mostly programs that had been designed before the 2012 budget support policy and its revised guidelines, which included much more detailed guidance on the definition, choice, and use of performance indicators. These guidelines provide detailed information on best practices in the choice and use of performance indicators.
- **EU technical assistance needs to improve.** Technical assistance was recognized to be an often essential component of budget support. Evaluations almost unanimously recommended improvements to the way technical assistance needs are identified, and, where relevant, this should be done jointly with other development partners. The assistance needs to be better planned, deployed more strategically, and carried out in a more flexible manner. The recruitment procedures for technical assistants should be more flexible. The increased effectiveness of harmonized and coordinated technical assistance was underlined, and, in that context, the advantages of providing technical assistance through a pool fund were highlighted. Many evaluations also recommended increased attention be paid to strengthening local, and not just central, governance capacities. Weak implementation capacities at the local level were often identified as a major constraint on the effectiveness of policy implementation.
- **The EU should do more to strengthen the role of civil society, its participation in policy decision making and its capacity to act as an external check of accountability on public actions.** The participation of civil society should be encouraged and reinforced so citizens can take part in monitoring, public policy discussions, and external oversight. Almost all evaluations stressed this issue, arguing that it would lead to better ownership of the budget support programs, more effective policies, improved external oversight, and more transparent results.
- **The EU and other development partners should extend the duration of their support to particular sectors or themes so that gains can be consolidated.** This recommendation was

made by several evaluations, sometimes in the context of PFM and macroeconomic stabilization in LMICs. This was also one of the main recommendations of the SRBC evaluation. Reforms take a long time to be implemented and to deliver results and years may pass before gains can be consolidated and results be deemed sustainable. Budget support design needs to be adapted accordingly, follow-on programs have to remain coherent, and an exit strategy should be devised. The EU has moved in this direction in recent years, and it is now increasingly approving 3-year SRBCs, instead of successive 1-year programs.

Comments on “Budget Support by the European Union: What Do the External Evaluations Tell Us?”

Comment by: Shanta Devarajan

This paper is a useful description of the European Union’s budget support instrument and a faithful synthesis of the 17 independent evaluations of budget support operations. There are many distinctive aspects of the EU’s budget support programs, some of which are highlighted in the chapter. The synthesis of the evaluations paints a generally favorable view of EU budget support although, as acknowledged in the chapter, without a counterfactual analysis the true impact cannot be discerned. In my comments, I look first at the implications of the distinctive characteristics of EU budget support for development effectiveness more generally, as well as for the evaluations themselves. Next, I raise some issues from the evaluation synthesis. Finally, I offer some comments on the budget support instrument aimed at fragile states, the state and resilience building contract (SRBC).

1. Characteristics of the European Union Budget Support Instrument

The two main distinguishing characteristics of EU budget support are that: (i) it is provided exclusively in the form of grants rather than loans, and (ii) it is disbursed based on observable and monitorable indicators of performance, such as progress in implementing public financial management reforms or restoring macroeconomic balance. These make EU budget support different from, say, budget support operations of the World Bank or the African Development Bank, which mainly provide loans (some of which are concessional) and disburse based on prior policy actions rather than results.

Grants, Not Loans

The fact that the EU provides grants has implications for the definition of the appropriate macroeconomic framework. While everyone agrees that you should give budget support only in a stable macroeconomic environment (hence the EU’s collaboration with the IMF), the definition of “a stable macroeconomic environment” may be somewhat different if the country does not have to repay a loan. For instance, there may be countries in debt distress who would not be eligible for World Bank loans but who could still use the resources productively if they were provided as grants. Hence, the macroeconomic framework for EU budget support may not necessarily be the same as those of the IMF or World Bank. There is also a question of whether countries that are not in debt distress should spend the grants for current expenditure (as they seem to have done) or to use them to leverage greater financing for investment projects. The latter may be the best use of EU budget support, especially in countries with huge infrastructure deficits, but it may not be common practice and may even be prohibited because of the restriction that EU budget support cannot be used to build up foreign exchange reserves.

Performance-Based Disbursements

Disbursement of EU budget support is based on progress in meeting certain benchmarks that are agreed upon at the beginning of the program. The disbursement can be full (fixed-tranche) or partial (variable-tranche) if the progress itself was only partial. This is in contrast to the approach taken by the multilateral development banks, whose budget support is disbursed based on policies undertaken (“prior actions”) rather than on results. To the extent that there is a difference between *ex ante* policies and *ex post* performance, one wonders how countries are able to coordinate across their budget support donors. For instance, if a country failed to undertake some prior actions but still met the performance criteria, the World Bank would not disburse but the EU would release its tranche. Conversely, if a country met its prior actions but missed the performance criteria, the World Bank would disburse but the EU may not. These situations have implications for the multi-donor evaluations conducted for about 11 countries. In fact, the cases where these discrepancies occurred could teach us a lot about the effectiveness of the two different disbursement criteria.

Furthermore, performance-based conditionality (PBC) raises three issues of its own. First, inasmuch as development is a risky business—we often do not know if a certain policy reform will yield the expected outcome—PBC puts all the risk onto the recipient. If the policy reform fails, the EU does not disburse. With conditionality based on *ex ante* policies, the donor and recipient are sharing the risk: if the policy reform fails, the donor also loses because they have already disbursed the money. To be sure, the reason behind PBC is to increase the results focus of recipient governments and to increase the incentives to undertake the necessary reforms. However, these benefits should be weighed against the risk-sharing aspects of PBC, which are clearly biased against the recipient. It appears that the EU recognized this when it decided to introduce variable tranches, so as not to risk all the disbursement on one set of performance criteria being met.

Second, other attempts at performance-based conditionality, such as the World Bank’s Program for Results, have found that there is a tendency to “dilute” the performance criteria (so as not to risk failing to disburse) to the point where they resemble *ex ante* policy conditions.¹⁸⁶ The reality is that both the donor and recipient have an interest in seeing the operation disburse and therefore may, even subconsciously, nudge the conditions in that direction. It is possible that this is happening with EU budget support as well. Some of the examples cited, such as public financial management reforms or budget transparency, are quite similar to the policy conditions in World Bank budget support operations. The fact that the 199 budget support programs between 2014 and 2019 had an average disbursement rate of 83% also suggests that the conditions may have been close to having been met when they were selected.

Third, the chapter notes, approvingly, that in addition to budget support, the EU provides technical assistance (TA) to countries to further progress on key areas such as public financial management. While it is desirable that EU TA, budget support conditions, and policy dialogue are all pulling in the same direction, there may also be some problems here. If the EU is providing technical assistance in an area that is also a performance criterion for tranche release, at least two things could happen. If the country fails to meet the performance criterion, it could

¹⁸⁶ Alan Gelb, Anna Diofasi, and Hannah Postel. 2016. Program for Results: The First 35 Operations. *Center for Global Development Working Paper No. 430*. Washington, DC: Center for Global Development.

blame it on the TA; or the organization providing the TA could try to influence the EU into certifying that the country had met the criterion, lest its own performance be judged as mediocre. Even if the TA and budget support operation are kept independent, since both are being provided by the same institution, it is difficult for the country to not perceive them as linked. Moreover, there is a cost to aligning the TA too closely to the performance benchmarks in that the country may benefit from technical assistance in addressing some longer-term reform issues (e.g., energy subsidies, and anti-trust laws) which, being politically sensitive, may not be included in a budget support operation.

2. Synthesis of Evaluations

The independent evaluations that are synthesized in the chapter all follow a particular, three-step framework. First, the effects of the budget support operation on policies and institutions are analyzed. Next, the outcomes and outputs in a country are related to policy and institutional changes. Finally, the results of the first two steps are combined to provide a narrative of how the budget support operation, through its contribution to policy and institutional change, helped achieve outcomes and impacts.

What is the Counterfactual?

While the chapter notes that in some of the individual steps there is an attempt to specify a counterfactual, the overall narrative does not have one. Yet, without a well-specified counterfactual, it is difficult to interpret the evaluations. We do not know how the economy would have evolved in the absence of the budget support operation. For instance, if Mali increased priority-sector spending in the period of the EU budget support, by how much would they have increased it in the absence of such support? If Burkina Faso's public financial management improved during its budget support period, by how much would it have improved without budget support? These questions are important not just for gauging the effectiveness of the budget support instrument but also for understanding how budget support can help a country.

One way of constructing a counterfactual is to compare a country with another country with similar characteristics that did not receive a budget support operation from the EU. This cross-country analysis has been used in other evaluations of budget support operations.¹⁸⁷ Another is to compare the same country's performance in two periods of time, one where there was a budget support operation and one where there was not. Here, you would need to adjust for other factors, such as a terms-of-trade shock, that may have affected the economy during the budget support phase but were unrelated to the operation. For instance, if a country experienced a favorable terms-of-trade shock during the period of the operation, the success of the operation may have been due to the shock and not to the operation.

¹⁸⁷ William Easterly. 2003. IMF and World Bank Structural Adjustment Programs and Poverty. In Michael P. Dooley and Jeffrey A. Frankel, eds. *Managing Currency Crises in Emerging Markets*. Chicago: University of Chicago Press.

Bundling of Financial and Knowledge Assistance

The value of having a counterfactual goes beyond just having a better estimate of the project's impact. It also helps us disentangle the different components of budget support. As the synthesis notes, budget support operations have three components: a transfer of resources, technical assistance, and a dialogue on policy reforms aimed at achieving the targets of the operation. What is the relative importance of each? For instance, in Mali, Uganda, Zambia, and other low-income countries, the evaluations found that the financial transfer created fiscal space for these countries to increase priority expenditures (or at least not cut them during a period of austerity). What role did the policy dialogue play in these instances? Would they not have increased spending on priority sectors in the absence of dialogue (but with the financial transfer)? After all, these sectors were included in the government's priorities. Meanwhile, the Burkina Faso evaluation concluded that policy dialogue led to significant improvements in the country's public financial management. These reforms did not cost the country very much. Would Burkina Faso have carried them out without the financial transfer?

The chapter notes that many of the evaluations discussed the relative contributions of the financial transfer ("flow of funds"), technical assistance, and policy dialogue, but this seems to be based on the relative magnitude of the financial transfer and the intensity of TA and policy dialogue, rather than on a model of the combined effect of the three on outcomes. Nevertheless, it is worth noting that the chapter finds that the flow of funds played a greater role in the general budget support operations than in sector budget support. The reason could be that the sector budget support operations were concentrated on middle-income countries, including some upper middle-income countries, whereas the financial transfer represented a tiny portion of the government's budget (0.6% as opposed to 15% for general budget support).

In addition to their relative contributions, we need to know the interaction between financial and knowledge assistance. For example, when in 2010, many EU member states stopped providing budget support because of questions about the use of aid funds, they were clearly concerned about the financial transfer. If there was a way to reduce the size of the financial transfer and intensify the policy dialogue, it may have been possible to address these concerns.¹⁸⁸

The bundling of finance and policy dialogue into budget support raises the broader question of why they should be bundled. If these policy reforms benefit the country, why do they not do them anyway? Why is it necessary to accompany them with money? One answer is that the financial transfer acts as an encouragement for the government to undertake the reforms. But this implies that the government was not sufficiently committed to reforms in the absence of the transfer, which suggests that the reforms are not genuinely owned by the government. Another possible answer is that the additional resources enable the reformist elements in government to convince the non-reformists that the reforms are worth doing. Again, this suggests that the reforms are not collectively owned by the whole of government. Then the financial transfer is helping to fix (usually on a temporary basis) a fundamental political-economy problem in the country. It is not clear that such solutions are sustainable. It is also not clear that external actors such as the EU or World Bank can or should be selecting reform champions in the country. In

¹⁸⁸ At the World Bank, we once explored the possibility of a "zero-dollar budget support operation" to a country that wanted the operation because of the discipline it would provide in maintaining a reform agenda but whose corruption indices were so high that a financial transfer to the budget would not have been approved by the Board. The project did not go ahead because of concerns that it would be seen as mocking the Board's objections to financial transfers to the country.

Zambia in 1991, a new finance minister convinced the World Bank and IMF that the government was serious about reform and signed a series of budget support operations that involved, inter alia, maize price reforms. It turned out that the finance minister had not consulted with the agriculture minister, who was responsible for maize prices. The agriculture minister refused to sign off on the reform and the operation was cancelled.¹⁸⁹

Problems with Financial Transfers

The financial transfer associated with budget support can have two other effects that may not be conducive to better development outcomes. The synthesis in the chapter hints at some of them but does not develop their implications. The first is the fungibility of aid resources, which is mentioned in the chapter. Since the financial transfer goes directly to the government's budget, it could in principle be used for any expenditure. Several of the evaluations speak favorably of the fact that pro-poor expenditures on, for example, health, education, and social protection rose during a budget support operation. But if the country was planning on increasing spending in these sectors anyway, then the EU's finance was being used to finance some other expenditures, about which we know very little. This is not just a theoretical possibility. There is evidence on the fungibility of aid in general.¹⁹⁰

The second problem with the financial transfer links back to the political-economy problem mentioned earlier. If the reason why the policy reform was not implemented before was that there was not a political consensus in government in favor of the reform, then does a financial transfer help or hurt? The typical answer is that it helps "grease the wheels," permitting reformists to bring non-reformers on board. But there is evidence that financial transfers may have the opposite effect, namely, they give governments the breathing room to postpone, or even avoid, reforms. The World Bank gave three budget support operations in a row to Kenya for the same maize price reform.¹⁹¹ In fact, in 1992, the one year that donors withdrew their support to Kenya, the country implemented a series of sweeping reforms, including a tax reform that has given Kenya one of the highest tax-to-GDP ratios in Africa. As Michael Bruno, the chief economist of the World Bank at the time, put it, "We did more for Kenya in that one year than we did during the previous thirty years." In short, the bundling of finance and policy dialogue, which is a hallmark of budget support operations, may not be the best way of achieving results when the underlying problem is domestic politics.¹⁹²

Effectiveness of Public Expenditures

Most of the evaluations seem to equate increased public spending on health and education with improved health and education outcomes. Unfortunately, the evidence for this link is weak at best.¹⁹³ The reason is that the delivery of basic services in health and education is poorly targeted

¹⁸⁹ Lise Rakner, Nicholas van de Walle, and Dominic Mulaisho. 2001. Zambia. In S. Devarajan, D. Dollar, and T. Holmgren, eds. *Aid and Reform in Africa*. World Bank.

¹⁹⁰ Tarhan Feyzioglu, Vinaya Swaroop, and Min Zhu. 1998. A Panel Data Analysis of the Fungibility of Foreign Aid. *The World Bank Economic Review*. Vol. 12. No.1. pp. 29-58.

¹⁹¹ F. Stephen O'Brien and Terry Ryan. 2001. Kenya. In S. Devarajan, D. Dollar and T. Holmgren, eds. *Aid and Reform in Africa*. Washington, DC: World Bank.

¹⁹² Shantayanan Devarajan and Stuti Khemani. 2018. If Politics is the Problem, How Can External Actors be Part of the Solution? In K. Basu and T. Cordella, eds. *Institutions, Governance and the Control of Corruption*. Cham, UK: Palgrave Macmillan.

¹⁹³ World Bank. 2003. *World Development Report 2004: Making Services Work for Poor People*. Washington, DC: World Bank.

and often ineffective (often because of absentee teachers or doctors). In fact, the chapter notes this discrepancy by pointing out that the “gains were momentous but not always equitable...and gains in access have not always been accompanied by better quality of services.” The evaluations should have been more circumspect in claiming that, since the budget support operations were associated with increased spending in these sectors, they contributed to better outcomes in those sectors. Indeed, the observation that “the provision of budget support coincided with a period when social indicators significantly improved...” says more about economic growth during this period (it was a time of high commodity prices) than about increased spending.

Country Context

The country evaluations seem to have been narrowly focused on the EU budget support operation, its performance indicators, and the observed outcomes. There is little mention in the synthesis about the overall context in those countries. Sometimes, that context calls into question the validity of the evaluation. For example, the synthesis speaks favorably about Mozambique’s “improved budget documentation and legislative and institutional framework for the control of corruption.” Yet this is the same country that had a huge scandal because it hid its debt; and the former finance minister is facing extradition from South Africa for corruption charges. Similarly, budget support to Tunisia “contributed directly to the country’s opening to international trade and coincided with a period of economic growth and stability.” But this period was followed by the Arab Spring when President Ben Ali was thrown out of power. Furthermore, there is evidence that the period of Tunisia’s opening to international trade was also one of elite capture when certain industries (e.g., transport, telecommunications, and banking) received protection from foreign competition because firms in these sectors were owned by members of the Ben Ali family.¹⁹⁴

3. Budget Support to Fragile States

The third instrument, the state and resilience building contract (SRBC) is a welcome addition to the EU’s budget support instruments and has already proved to be extremely useful in disasters such as the Ebola crisis and more recently the coronavirus disease (COVID-19) pandemic.¹⁹⁵ The fact that the eligibility criteria of SRBCs are different from those of other EU instruments is key. If SRBCs applied the eligibility criteria of the SDG-Cs, most of these fragile states would not qualify. That said, the essential feature of fragile states is that the government no longer has a monopoly on violence. But most of the actions associated with the instrument seem to be exclusively with the government. The budget support goes directly to government and the policy dialogue is aimed at strengthening “government capacities.” If the government is incapable of protecting its citizens with its security and other basic services, it is unlikely to be able to build these capacities in the short run. There should be more thinking about how development partners

¹⁹⁴ B. Rijkers, C. Freund, and A. Nucifora. 2017. All in the Family: State Capture in Tunisia. *Journal of Development Economics*. Vol. 124, Issue C, pp. 41-59.

¹⁹⁵ There is some ambiguity as to whether the SRBC, which is seen as an instrument for emergency support in pandemics, earthquakes, and other disasters, is restricted to fragile states. For instance, the SRBC was used in Nepal after the 2015 earthquake. Similarly, there are plans to use it for countries hit by the Covid-19 pandemic, most of which are not fragile states.

can to help the private sector in these fragile states, since they are the only source of growth. Many of the basic services in these fragile countries are delivered by the non-state sector, which may be able to scale up faster at short notice than the government.

Second, there should be consideration of the fact that many of these countries are caught in a “fragility trap”, in which case, incremental solutions based on the principles used for non-fragile states are unlikely to help them escape that trap.¹⁹⁶ Specifically, the macroeconomic analysis, including that conducted by the IMF, does not take into account the possibility of a low-level equilibrium trap.¹⁹⁷ In some cases, these countries will need a large amount of aid, much larger than that yielded by the standard macroeconomic formulae, in order to escape the fragility trap.

Third, the discussion on domestic resource mobilization in these countries should be strengthened. Taxation is not just a way of generating revenue for government. It is also a means of building solidarity among an often fragmented population around the common good.

¹⁹⁶ Paul Collier, Timothy Besley, and Adnan Khan. 2018. *Escaping the Fragility Trap*. London: International Growth Centre.

¹⁹⁷ N. Andrimihaja, M. Cinyabuguma, and S. Devarajan. 2011. Avoiding the Fragility Trap in Africa. *World Bank Policy Research Working Paper*. Washington: World Bank.

Chapter 4

Policy-Based Lending at the Inter-American Development Bank, 2005–2019

Monika Huppi and Gunnar Gotz¹⁹⁸

1. Historical Development and Use of Policy-Based Lending, 2005–2019

Summary

The Inter-American Development Bank (IDB) introduced policy-based lending (PBL) in 1989, in response to the Latin American and Caribbean debt crisis. The instrument has evolved over time, leading to a decoupling from International Monetary Fund (IMF) support, and the introduction of a programmatic variant (consisting of a series of single-tranche loans in support of a reform program) and of a deferred draw-down option. Policy-based lending has historically been subject to a lending limit which has changed over the years. In 2005–2019, policy-based lending accounted for about 28% of IDB’s sovereign-guaranteed approvals, with the share increasing over the period. All borrowing member countries except one used policy-based loans to varying degrees in the period. IDB’s policy-based loans are rarely co-financed by other institutions and IDB tends to support reform processes in areas in which it has accumulated experience and knowledge. Emergency budget support has been provided through separate budget support instruments that have also evolved over time. This form of support accounted for only 2% of sovereign-guaranteed approvals in 2005–2019. During the first half of 2020, in response to the coronavirus disease (COVID-19) pandemic, policy-based, and emergency budget support lending have spiked.

Background

IDB offers three broad lending categories among its sovereign-guaranteed loans. Investment lending (INV), policy-based lending (PBL), and lending for financial emergencies during macroeconomic crisis, called special development lending (SDL). In addition, IDB can also guarantee loans made by private financiers for public sector projects. PBL provides fast-disbursing financial assistance or country budget support that is conditional on the borrowing country fulfilling a set of agreed upon policy and institutional reforms, while investment loans disburse against specific predefined project expenditures. SDLs also provide fast-disbursing support and are conditional on a country having been struck by a macroeconomic crisis, being supported by an active IMF program, and the SDL being part of an international support package.

IDB introduced PBL at the time of its seventh capital replenishment in 1989, in response to the Latin American and Caribbean (LAC) debt crisis of the 1980s. It was based on the model of conditional budget support created by the World Bank almost a decade earlier. Originally called

¹⁹⁸ The authors are Principal Advisor and Senior Associate, respectively, at the Interamerican Development Bank Office of Evaluation and Oversight (OVE). The chapter draws heavily on a technical paper authored by Agustina Schijman, former Senior Specialist at OVE. See IDB Office of Evaluation and Oversight, *Design and Use of Policy-Based Loans at the IDB*. Document RE-485-6. Washington, DC: IDB. <https://publications.iadb.org/en/ove-annual-report-2015-technical-note-design-and-use-policy-based-loans-idb>.

sector loans, IDB's PBL was intended to support the twin objectives of promoting policy or institutional reform and helping countries meet their financing needs. PBL was introduced to help countries pursue macroeconomic adjustment programs while supporting structural reforms. PBL was to be disbursed in several tranches and was conditioned on the maintenance of a sustainable macroeconomic policy framework and compliance with a set of agreed-upon conditions defined in a policy matrix. PBL processes required a country policy memo to ensure that the conditions were being complied with and relied on IMF-supported programs for macroeconomic assessments. Policy-based lending was capped at a maximum of 25% of IDB's 1990–1993 overall lending program. By the time of its eighth capital replenishment in 1994, IDB concluded that the need for major macroeconomic adjustment in the Latin America and Caribbean region had declined and that PBL should place greater emphasis on social sector policy and the efficiency of service delivery. To reflect this, the term sector loans was changed to policy-based loans and the cap was reduced from 25% to 15% of the lending program. The effects of the Asian financial crisis in 1997–1998 made adhering to the new cap difficult and led to the introduction of a transitory emergency variant of PBL, which was subject to a separate limit. The emergency program ended in the early 2000s, but demand for PBL continued to exceed the 15% limit. This led to three modifications in 2002: the 15% ceiling was replaced by an absolute figure of \$4.5 billion for 2002–2004 (meaning that PBL lending became independent from the level of investment lending);¹⁹⁹ a new emergency lending category, now separate from PBL, was introduced; and a minimum disbursement period of 18 months across tranches was established for PBL, mostly to avoid crowding out the new emergency instrument. Moreover, IDB started to supplement the traditional policy matrix with a matrix of results in its PBL loan documents.

By the mid-2000s, as borrowing countries were experiencing higher growth, increased institutional capacity, and better access to capital markets, IDB introduced three main changes to PBL. First, IDB made a progressive move to expand its own analysis of the adequacy of countries' macroeconomic frameworks and reduce its dependence on the IMF's views. This led to the creation of the "independent macroeconomic assessment," which required the regional departments (supported by the Research Department) to produce a macroeconomic assessment at the time of approval and disbursement of PBL. In practice, however, IMF views continued to be a key input to IDB's assessment.²⁰⁰ Second, the 18-month minimum disbursement period for PBL was removed. Finally, a programmatic variant of PBL, called programmatic policy-based loan, was introduced. The programmatic version consists of a series of single-tranche operations set in a medium-term framework of reforms. The first operation identifies the policy conditions for that operation as well as indicative triggers for the subsequent loans in the series. Since the triggers can be revisited at the time of loan approval, programmatic PBLs allow for conditions to be adjusted as circumstances change. With these changes, IDB also approved guidelines for the preparation and implementation of PBL, thus consolidating existing policies and practices for the first time.

¹⁹⁹ Three years later that limit was increased to \$9.8 billion for 2005–2008, and for the first time a cap was established on disbursements—\$7.6 billion for the 4-year period. A ceiling on concessional PBL from the Fund for Special Operations (FSO) was also established (\$100 million for the 4-year period).

²⁰⁰ An IMF on-track program or Article IV (issued within the last 6 months) were de facto requirements to approve and disburse a PBL operation. If an Article IV was more than 6 months old, or if the country had no IMF program or Article IV in place, a letter of comfort from the IMF was usually required.

Source: Based on IDB Office of Evaluation and Oversight (OVE). *Design and Use of Policy-Based Loans at the IDB*. Document RE-485-6. Washington, DC: IDB. <https://publications.iadb.org/en/ove-annual-report-2015-technical-note-design-and-use-policy-based-loans-idb>

More recently, PBL lending limits have been raised further and a deferred draw-down option has been added. The dollar-denominated cap on PBL established for 2005–2008 was initially extended for 2009–2012, but in 2011 the ceiling for PBL was changed to 30% of total approved lending. More recently, to facilitate IDB’s response to the COVID-19 crisis, the ceiling has been temporarily increased to 40% of total lending through 2022.²⁰¹ In 2012, IDB also introduced a deferred draw-down option (DDO) to synchronize proceeds with countries’ financing needs. The DDO allows countries, on payment of an up-front premium, to draw on the resources of PBL when they require these funds. During the drawdown period, the borrower must maintain policy conditions and sustainable macroeconomic policies. In 2014, further actions were taken to decouple IDB’s PBL lending from the IMF’s assessment of macroeconomic conditions. IDB decided to strengthen its own macroeconomic assessment capacity and no longer make PBL lending conditional on an on-track IMF program, Article IV, or IMF letter of comfort.

On the emergency lending side, a temporary emergency lending facility was replaced by a consecutive series of emergency lending instruments. The initial temporary emergency facility established in response to the 1997–1998 financial crisis was replaced by a permanent emergency lending category in 2002. It was capped at \$6 billion and was in turn replaced by a development sustainability credit line in 2012. This was a contingent credit line whose funds could be withdrawn at a time of a crisis, but it had to be approved before the crisis. It was geared toward providing liquidity during financial distress, while protecting expenditures for programs directed at the poor. It expired in 2015 and was replaced by the special development lending (SDL) instrument in 2017. While the SDL does not require an IDB-specific independent macroeconomic

²⁰¹ The PBL lending cap of 30% of total lending applies to lending from IDB’s ordinary capital over consecutive four-year periods. For concessional lending from the FSO the cap is applied on a biannual basis. The temporary increase of the cap to 40% of total lending from the IDB’s ordinary capital applies to the 4-year period ending in December 2022. For FSO resources, the increased PBL cap of 40% applies to lending for 2021–2022.

assessment, it is conditional on a country experiencing a macroeconomic crisis and being supported by an existing IMF program. SDL lending cannot exceed \$500 million or 2% of a country's GDP if supported by fresh funds. It can be funded through a reallocation of uncommitted loan balances, provided at least 60% of the remaining uncommitted loan balances are investment loans.

Evolution of Policy-Based Lending Portfolio

Between 2005 and 2019, policy-based operations accounted for 28% of IDB's sovereign-guaranteed approvals²⁰², with the share increasing over time. In this period, IDB approved 266 policy-based operations totaling almost \$42.6 billion. About 80% of these resources were approved as programmatic operations supporting 124 programs, with the remaining 20% as individual single- or multitranches policy-based operations. Since 2007, programmatic PBLs have consistently accounted for at least three-quarters of all approved policy-based operations. Policy-based operations' share of total sovereign guaranteed approvals increased from 19% in 2005–2009 to 36% in 2015–2019 (Table 4.2). The 2007–2009 global financial crisis led to a significant increase in the number and amounts of policy-based operations. IDB approved 61 policy-based operations for \$7.9 billion in 2008–2010, compared with only 31 such operations for \$3.8 billion during the previous 3 years. After falling somewhat in relative importance in 2011–2012, policy-based operations rose again in 2013 and since then IDB has averaged around 19 policy-based operations totaling almost \$3.9 billion per year (Figure 4.2).



Source: IDB Office of Evaluation and Oversight (OVE), based on data from IDB databases.

Emergency lending accounted for 2% of sovereign-guaranteed approvals between 2005 and 2019. Emergency lending to provide financial support during a macroeconomic crisis was primarily used during the 2007–2009 financial crisis. Five countries used this option, but three of the loans never

²⁰² Sovereign guaranteed approvals in this context includes all SG loan and guarantee operations regardless of funding source.

disbursed and two disbursed only partially. Three countries also made use of emergency lending after the financial crisis to weather country specific crises (Table 4.1). Overall, IDB approved \$3.5 billion in emergency lending between 2005–2019, of which 71% was approved in 2008–09.

Table 4.1: Emergency Lending, 2005–2019 (\$ million)

Year	Bahamas	Costa Rica	Dominica	Ecuador	El Salvador	Jamaica	Panama	Total
2008		500			400			900
2009			800			300	500	1,600
2013					100			100
2014				300				300
2018	100							100
2019				500				500

Source: IDB Office of Evaluation and Oversight (OVE), based on data from IDB databases.

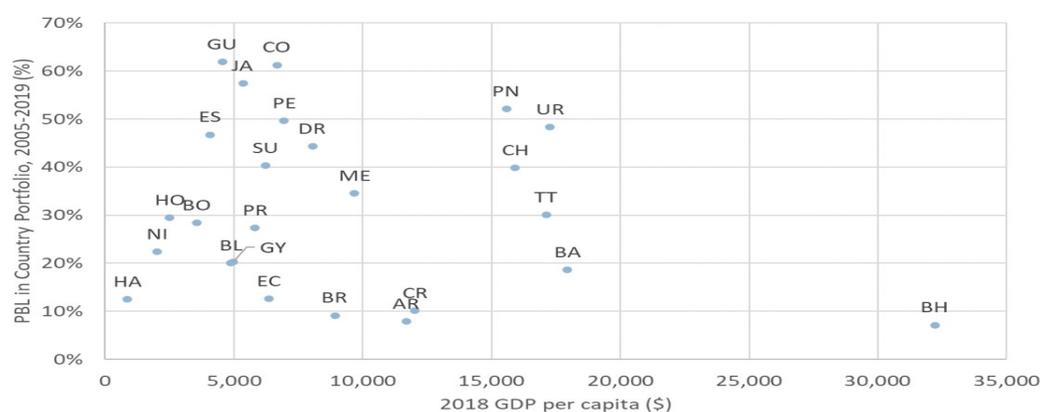
IDB’s PBL and emergency approvals spiked during the first half of 2020, in response to the COVID-19 pandemic and its economic effects. To facilitate timely approval of operations to help its borrowing member countries respond to the COVID-19 pandemic and related social and economic effects, IDB developed several prototype operations, including one for PBL in support of fiscal and economic management to help cushion the effects of the economic crisis. The PBL prototype sets out a menu of policy measures geared towards timely availability of resources to respond to the public health crisis, temporary expansion of social protection programs, provision of essential services, efficient public expenditure management and formulation of a program for economic recovery. Individual operations then draw on a menu of these measures for speedy preparation and approval. The prototype also includes a pro forma results matrix. During the first 7 months of 2020, IDB approved 14 PBL operations amounting to \$4.18 billion, of which \$1.2 billion went to five prototype operations. In addition, it approved five special development lending operations in the amount of \$1.2 billion.

Cofinancing of IDB PBL has been minimal since the mid-2000s. Most of IDB’s PBL cofinancing occurred in the early days of PBL, especially in the first 2 years of the instrument’s existence when partnership with the World Bank was mandatory. Cofinancing remained important until the mid-2000s but since then IDB has financed almost all PBL on its own. Similarly, in the early years of PBL, operations used to be approved when the borrowing country had an IMF-supported program in place: 90% of the PBL approvals between 1995 and 2003 were granted to countries with an IMF program. This proportion has decreased substantially since then, both because of the decreasing presence of IMF-supported programs in Latin America and the Caribbean, and because of IDB’s progressive move to expand its own assessment of the adequacy of countries’ macroeconomic frameworks and reduce its dependence on the IMF’s views. There are, nevertheless, instances where IDB has continued to support PBL in the context of an IMF program, including for example \$1 billion of PBL support to Argentina in 2018–2019.

Apart from Venezuela, all borrowing member countries made use of PBL over 2005–2019, but the relative importance of PBL in country portfolios varied. The share of PBL in overall sovereign-guaranteed approvals increased for all country income groups and was not significantly correlated with country income level (Figure 4.3 and Annex, Figure 4.A2). In terms of overall importance, a

few countries have dominated, both in the number and amounts of PBL received. Peru received 36 PBL operations and Colombia 25, reflecting their strong preference for the instrument. In terms of overall volume, Colombia and Mexico together accounted for almost 40% of the approved PBL volume over this time period (Table 4.2). Five countries (Colombia, Guatemala, Jamaica, Panama, and Peru) borrowed at least half of their sovereign-guaranteed envelope in the form of PBL in 2005–2019, and in the last 5 years eight countries did so (Chile, Colombia, Dominican Republic, El Salvador, Jamaica, Mexico, Panama, and Uruguay). Only two countries (Peru and Uruguay) have made use of the deferred draw-down option, with Uruguay using it as an important instrument for fiscal and foreign exchange management.

Figure 4.3: Gross Domestic Product Per Capita and Share of Policy-Based Lending by Sovereign-Guaranteed Lending by Country, 2005–2019



GDP = gross domestic product, PBL = policy-based lending.

AR=Argentina; BH=Bahamas; BA=Barbados; BL=Belize; BO=Bolivia; BR=Brazil; CH=Chile; CO=Colombia; CR=Costa Rica; DR=Dominican Republic; EC=Ecuador; ES=El Salvador; GU=Guatemala; GY=Guyana; HA=Haiti; HO=Honduras; JA=Jamaica; ME=Mexico; NI=Nicaragua; PN=Panama; PR=Paraguay; PE=Peru; SU=Suriname; TT=Trinidad and Tobago; UR=Uruguay.

Source: IDB Office of Evaluation and Oversight (OVE), based on data from IDB databases.

Table 4.2: Policy-Based Lending Approvals by Country, 2005–2019

Country	Number of PBL Approvals			Total PBL Amount (\$ million)			PBL as a Percentage of Sovereign-Guaranteed Approvals		
	2005-2009	2010-2014	2015-2019	2005-2009	2010-2014	2015-2019	2005-2009	2010-2014	2015-2019
Argentina	1	0	5	500	0	1,200	6%	0%	15%
Bahamas	0	1	0	0	48	0	0%	19%	0%
Barbados	0	2	0	0	115	0	0%	51%	0%
Belize	2	0	0	40	0	0	52%	0%	0%

Bolivia	1	6	8	15	402	844	3%	27%	35%
Brazil	1	6	0	409	1,834	0	6%	16%	0%
Chile	0	1	8	0	10	705	0%	5%	65%
Colombia	7	9	9	1,750	2,270	3,900	43%	61%	76%
Costa Rica	0	0	1	0	0	350	0%	0%	34%
Dominican Republic	2	5	4	210	1,060	1,250	17%	49%	55%
Ecuador	1	0	3	50	0	900	4%	0%	26%
El Salvador	3	3	2	500	500	550	45%	37%	65%
Guatemala	4	3	1	800	734	250	60%	89%	35%
Guyana	5	2	2	55	22	29	25%	11%	30%
Haiti	5	8	1	100	176	27	22%	16%	3%
Honduras	2	5	8	58	296	459	13%	27%	38%
Jamaica	3	10	6	120	850	465	22%	72%	60%
Mexico	3	4	7	1,200	3,000	4,250	18%	31%	51%
Nicaragua	3	5	3	91	223	195	17%	25%	23%
Panama	2	6	9	200	1,250	1,750	16%	76%	54%
Paraguay	2	1	4	130	100	790	19%	11%	37%
Peru	11	21	4	1,155	670	750	65%	47%	38%
Suriname	0	9	1	0	255	70	0%	62%	23%
Trinidad and Tobago	0	5	0	0	335	0	0%	35%	0%
Uruguay	4	2	4	660	670	997	52%	39%	54%
Venezuela	0	0	0	0	0	0	0%	0%	0%
Grand Total	62	114	90	8,042	14,819	19,731	19%	27%	36%

Notes: PBL = policy-based lending. Includes PBL funding from all sources.

Source: IDB Office of Evaluation and Oversight (OVE), based on data from IDB databases.

IDB classifies its loans based on their main sector focus. Based on this classification, this chapter has grouped the PBL approvals in 2005–2019 into five thematic areas:

- (i) public sector governance and economic management;
- (ii) financial sector reform and private sector development (with the latter mostly supporting measures to improve competitiveness);
- (iii) social sectors (health, education, social protection and gender);
- (iv) infrastructure and utilities (transport, energy, water and sanitation, housing and municipal infrastructure); and
- (v) environment, natural resource, territorial and disaster risk management, and agriculture.

Both in terms of number of operations (30% of the total) and approval volumes (38% of the total), PBL in the area of public sector governance and economic management has dominated.²⁰³ The importance of reforms supported in this area grew considerably in the face of the 2007–2009 global financial crisis. However, an analysis by the IDB Office of Evaluation and Oversight (OVE) found that the content of policy conditions did not change much compared with similar PBL operations approved before the crisis. Programs initiated in pre-crisis years (2005–2007) and crisis years (2008–2010) included similar conditions, which were usually oriented toward such areas as establishing fiscal rules, increasing government revenues or improving spending, and developing frameworks and systematic macroeconomic forecasting for budgeting.²⁰⁴

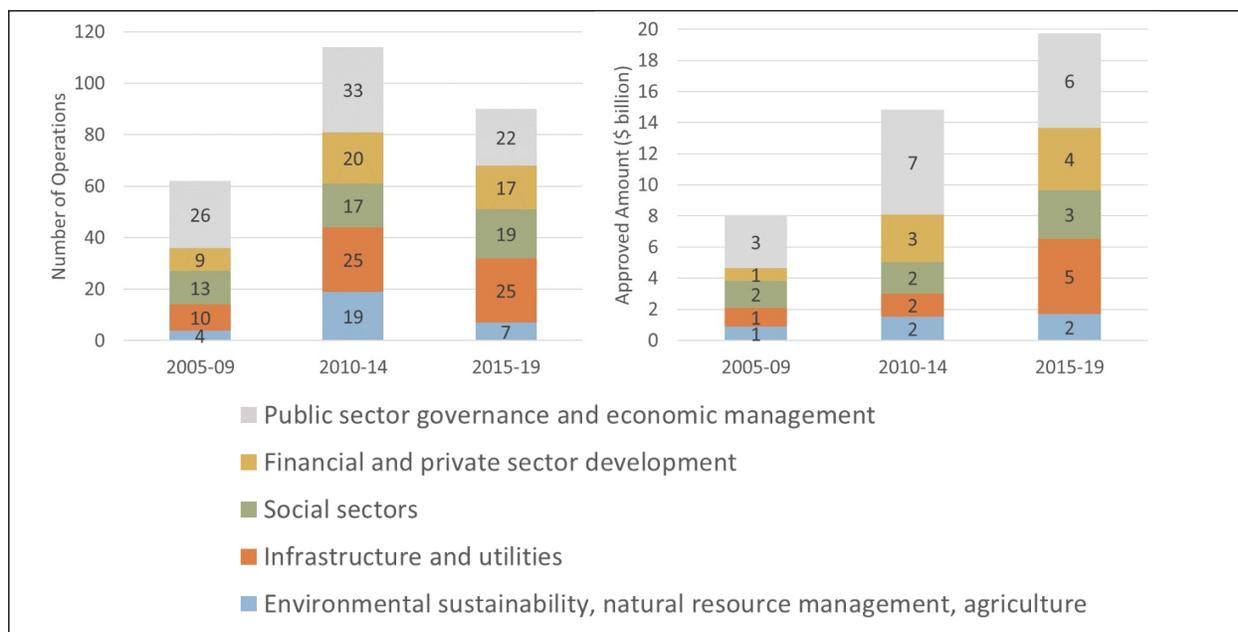
The second most important group contained PBL in support of infrastructure, with a particular focus on utility reforms, which accounted for 23% of operations and 18% of lending volume. This group grew considerably in importance over the review period, from only ten operations approved in 2005–2009 to 25 operations in 2015–2019, driven by support for energy sector reforms.

A more in-depth analysis of PBL by OVE suggests that IDB usually supports reform processes in areas in which it has accumulated experience and knowledge. In its 2015 review of the design and use of PBL at IDB, OVE mapped the interaction between PBL and a set of broader but related operations in each country, using social network analysis. The results suggested that IDB tended to support policy reforms in sectors in which it had previously worked (usually through technical cooperation grants or investment loans) and thus where it had some country-level expertise that allowed it to sustain policy dialogue and provide relevant technical advice. This finding is also compatible with the hypothesis that when countries need quick financial support, IDB turns to sectors where it has expertise so it can respond more quickly.

²⁰³ Some PBL operations support reforms in multiple sectors. When assigning a sector code to an operation, IDB goes by the number of policy measures in a given sector and does not account for the fact that operations may cover several sectors. Hence the figures presented here may not give a full picture of all reforms supported in a given area.

²⁰⁴ IDB Office of Evaluation and Oversight, *Design and Use of Policy-Based Loans at the IDB*. Document **RE-485-6**. Washington, DC: <https://publications.iadb.org/en/ove-annual-report-2015-technical-note-design-and-use-policy-based-loans-idbIDB>

Figure 4.4: Distribution of Policy-Based Lending by Focus Area, 2005–2019
(left graph shows number of operations; right graph shows approved amounts in \$ billion)



Source: IDB Office of Evaluation and Oversight (OVE), based on data from IDB database.

2. Evaluation of Inter-American Development Bank Policy-Based Lending

Summary

In 2015, the IDB Office of Evaluation and Oversight undertook an analysis of the design and use of policy-based lending at IDB. Although it found countries used PBL for various reasons, the predominant use was for budget support in time of need. While countries valued the policy dialogue and technical expertise that came with IDB PBL, the policy elements were usually secondary to the primacy of budget support. Although PBL provided important financial support, its ability to play a countercyclical role overall was limited because of the cap on PBL and because PBL could not be disbursed if borrowers did not have a positive macroeconomic assessment. The review assessed the depth of the policy conditions and found that most were of low- or medium-depth, meaning they helped set in motion policy reforms but could not by themselves effect lasting changes. Conditions tended to gain in depth in the second and third loan of a programmatic series, as the underlying reform program progressed. However, over one third of programmatic PBL programs active in 2005–2019 were interrupted, affecting the depth of supported programs. Policy conditions were of higher depth in programs in the financial and energy sectors and during times of crisis. Neither the number of conditions in a program nor the loan size were correlated with program depth.

Background

OVE has looked at PBL in several contexts, but a full-fledged evaluation of IDB’s policy-based lending has not been undertaken to date. OVE routinely reviews the performance of PBL in the context of its country program evaluations. OVE also reviews and validates IDB’s self-evaluations

of completed programs and operations and assigns a performance rating to each completed PBL program or freestanding PBL operation. In addition, OVE undertook a thorough review of the design and use of PBL in 2015.²⁰⁵ This section will briefly discuss the performance ratings of PBL based on OVE’s validations of self-evaluations and then present key findings of OVE’s 2015 review of the design and use of PBL.

IDB’s current self-evaluation system was adopted relatively recently. Project teams are required to prepare a project completion report for a programmatic PBL series when the program has been completed or interrupted or, in the case of freestanding PBL operations, at the time of completion of the operation. These self-evaluations are then validated by OVE which assigns an outcome rating to each program or freestanding PBL operation. In the case of programmatic PBL series, the program as a whole is evaluated against a results matrix for the entire program rather than for each loan. In the case of a freestanding PBL, the operation is assessed against the results matrix for that particular operation. The assessment covers three dimensions: relevance, effectiveness, and sustainability. An overall performance rating is assigned based on a weighted average of the ratings achieved on each of these three dimensions.²⁰⁶ As this system has evolved over time, comparable performance ratings are available for only 4 years; for operations or programs that were validated by OVE in 2017–2020. A total of 26 programs, comprising 48 loans have been rated thus far. Four of these consisted of hybrid operations with a PBL and an investment lending component. Of the 26 validated programs, 15 (58%) achieved an overall outcome rating of partly successful or higher. Excluding the hybrid operations, 14 of the 22 programs (64%) achieved a rating of partly successful or higher (compared with 57% of investment loans).

Findings of the Review

Among the key questions that OVE’s 2015 review of the design and use of PBL explored were how the design and implementation of PBL operations changed over time and why countries demand PBL. The following sections will briefly summarize the review’s findings in this respect. OVE’s 2015 analysis did not seek to evaluate the achievements of the outcomes to which the PBL sought to contribute. It covered the period 1989–2014, with an emphasis on the last decade of the period.

Why did Countries Demand Policy-Based Lending?

To explore what drives countries’ demand for PBL, OVE looked at four dimensions: (i) the frequency and intensity of PBL use; (ii) the correlation between PBL borrowing and growth rates, fiscal deficits, and gross financing requirements; (iii) countries’ reliance on parallel technical cooperation grants; and (iv) countries’ tendencies to fully complete or interrupt (“truncate”) programmatic PBL series. OVE analyzed these dimensions by reviewing all relevant lending documents and country economic data, carrying out an econometric analysis of lending, and interviewing IDB staff and officials from borrowing countries. Through this analysis, OVE identified four main categories of PBL users (Box 4.1).

²⁰⁵ IDB Office of Evaluation and Oversight, *Design and Use of Policy-Based Loans at the IDB*. Document RE-485-6. Washington, DC: IDB <https://publications.iadb.org/en/ove-annual-report-2015-technical-note-design-and-use-policy-based-loans-idb>

²⁰⁶ Relevance, effectiveness and sustainability are each rated on a four-point scale. The overall performance rating is a weighted average of the scores on each of these three dimensions, with relevance and sustainability being given a weight of 20% each and effectiveness 60%. The overall performance rating uses a six-point scale ranging from highly successful to highly unsuccessful.

- **Mostly as budget support.** This category included countries that resorted to PBL mainly in a countercyclical fashion (for example, to deal with a crisis that had suddenly halted capital inflows) or as a swift source of liquidity to handle short-term needs, such as debt servicing. In general, these countries exhibited a negative correlation between policy-based lending and GDP growth rates, and a positive correlation between policy-based lending and fiscal deficits or gross financing requirements. Their programmatic PBL series exhibited relatively high rates of interruption. They did not rely much on parallel IDB technical cooperation grants to accompany the reform programs. Since their demand for PBL depended on economic needs, these countries were not among the most regular users of PBL. In the decade leading up to 2015, examples in this category included Dominican Republic, Honduras, and Jamaica.
- **Mostly as seal of approval for reforms and to benefit from IDB’s technical advice.** This group comprised countries that tended to resort regularly to PBL and did so mostly to help legitimize their policy reform process by getting a “seal of approval” from IDB and to benefit from technical discussions between country officials and IDB specialists. Their PBL operations tended to be relatively small, and the demand for PBL tended not to be correlated with growth, fiscal deficits, or gross financing requirements. Moreover, programmatic PBL series in these countries had low truncation rates (a reflection of reform program implementation over a more extended time period and arguably higher ownership of the underlying reform program). They relied significantly on parallel technical cooperation grants provided by IDB to support the PBL programs. Peru and Bolivia were examples of this country grouping.
- **Mixed.** These countries sometimes relied on PBL to cover financing needs and sometimes used them to benefit from IDB’s validation and technical inputs. Examples in the decade leading up to 2015 included Brazil, Colombia, Mexico, El Salvador, Nicaragua, and Panama.
- **Preventive.** Uruguay has used policy-based lending as part of the government’s precautionary borrowing strategy with multilateral development banks (MDBs). Since 2008, Uruguay has frequently postponed disbursements of approved PBL and used the proceeds only when it faced large financing needs. This practice was institutionalized with IDB’s introduction of the DDO modality in 2012. Recently, Uruguay resorted to drawing down resources from several DDO PBL operations to rapidly cover its financing needs to counter the COVID-19 pandemic and its associated social and economic effects.

Jamaica and the need for budget support. More than half of Inter-American Development Bank (IDB) support for Jamaica in the decade leading up to 2015 was in the form of PBL, which helped the country advance public financial management and social reforms in the context of two IMF adjustment programs. Disbursements to Jamaica in 2010 in support of the first of those IMF programs (about \$600 million) were among the largest IDB had provided to a borrowing country in a single year, both in per capita terms and as a share of GDP.

Peru’s regular use of PBL and IDB’s “seal of approval.” Peru stood out as the most regular user of PBL: it had 43 PBLs between 1990 and 2014, and 32 of them were approved in the decade leading up to 2015. Uniquely among IDB borrowers, Peru had at least one PBL approved every year between

2000 and 2015. The 32 PBL operations approved between 2005 and 2014 were arranged in 11 programmatic series. Most were long series (three or four loans each), supported by several technical cooperation grants, and all of them were completed—another feature that distinguishes Peru from many other IDB borrowers. However, each loan was relatively small. Peru used PBL to legitimize institutional reforms and obtain technical expertise through strong parallel technical cooperation grants, in a context of favorable fiscal results.

Colombia’s flexible use of programmatic PBL series. Colombia stood out for its heavy use of PBL, with 22 such operations approved between 1990 and 2014. Sixteen of these were approved between 2005 and 2014, accounting for more than half of the sovereign-guaranteed lending approved for the country over the period. The intensive use of PBL was the result of Colombia’s demand for funds to meet its annual fiscal and debt commitments, and to stimulate the economy when needed. This might help explain why Colombia’s programmatic PBL series were frequently interrupted. That said, Colombia also used PBL because it valued IDB’s technical support and it was a frequent user of parallel technical cooperation grants, which usually provided strategic inputs for the reform processes.

Panama’s recurrent shift in program focus. As in Peru and Colombia, IDB’s engagement with Panama pivoted on PBL: in the decade leading up to 2015, over 40% of all sovereign-guaranteed lending, and over 70% during the second half of the decade, was PBL. These operations were instrumental in providing policy advice to support Panama in building a strong macroeconomic policy framework, but PBL also became a regular (and reliable) source of government funding. As in Colombia, this might help explain why the programmatic PBL series in Panama were frequently interrupted. Successive changes in the focus of IDB’s programmatic lending prompted the truncation of most of Panama’s series in 2010–2014. As a consequence, five of 11 planned operations did not materialize, thus diminishing the relevance of the proposed lending series.

Support for subnational fiscal consolidation in Brazil. Until the early 2000s, Brazil hardly used PBL. Six of eight Brazilian PBL operations approved through 2014 were approved between 2012 and 2014. All of them supported reforms at the subnational level. Brazil’s use of PBL at the subnational level is unique among IDB borrowers.

Uruguay’s preventive use of PBL. Uruguay made use of a limited number of relatively large PBL operations as a liquidity management tool. Even before IDB introduced a deferred draw down option (DDO) in 2012, Uruguay opted to delay drawing down the proceeds of two PBL operations until December 2008 and January 2009, after the collapse of Lehman Brothers, when the external cost of financing in the market had substantially increased. Since the introduction of the DDO in 2012, Uruguay has made frequent use of this option.

DDO = deferred draw down option, IDB = Inter-American Development Bank, PBL = policy-based lending.

Source: Based on IDB Office of Evaluation and Oversight (OVE). *Design and Use of Policy-Based Loans at the IDB*. Document RE-485-6. Washington, DC: IDB. <https://publications.iadb.org/en/ove-annual-report-2015-technical-note-design-and-use-policy-based-loans-idb>

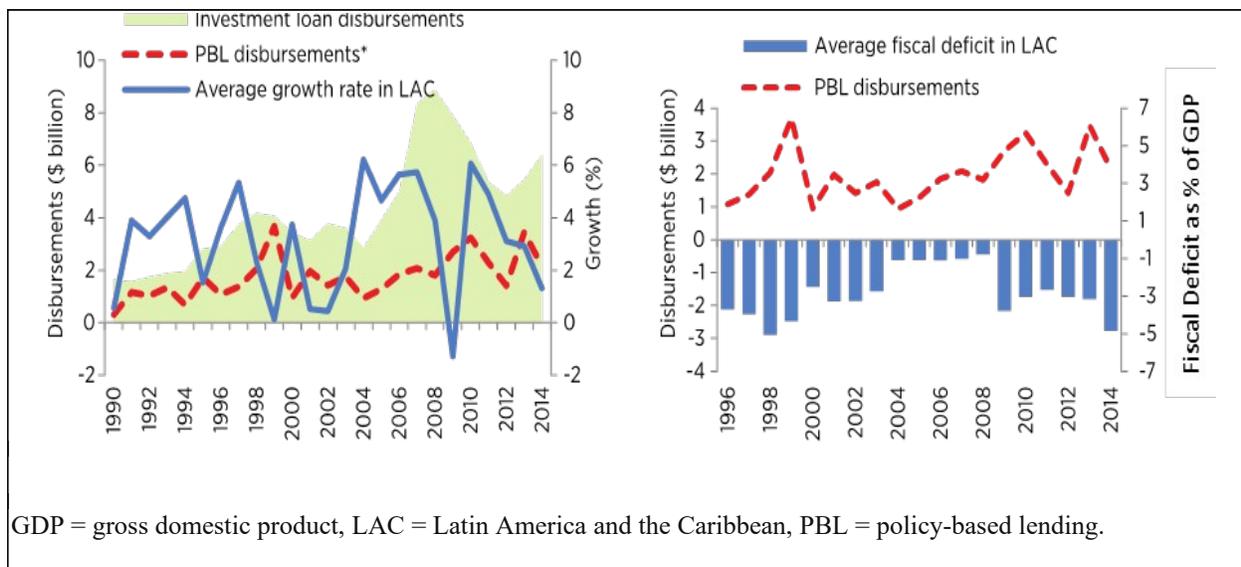
Overall, OVE concluded that, despite the range of reasons for using PBL across countries, the predominant use was for budget support in time of need. Its review found that, while countries valued the policy dialogue and technical expertise that came with IDB PBL, the policy elements were usually secondary to the primacy of budget support. Econometric analysis found that policy-based lending was negatively correlated with a country's growth rate, and positively correlated with the size of fiscal deficits and gross financing needs (Figure 4.5, Figure 4.6). Drawing on the literature on early warning signals for economic and financial crises, OVE estimated fixed-effects panel regression models using PBL disbursements as a percentage of GDP as the dependent variable. The results confirmed that countries' financing objectives were a key motivation for the use of PBL, both to handle short-term financing needs and to face contingent shocks. The use of PBL for budget support purposes was found to be particularly pertinent for small economies, which tended to be more vulnerable to external economic shocks and for which IDB financing could be decisive in helping them to weather a storm. While larger countries also made use of PBL for fiscal and liquidity management purposes, the instrument's ability to affect macroeconomic conditions in these countries was limited by the small size of the loans in relation to their overall economies. While PBL played a major financing role, its countercyclical role overall was limited in most countries by the overall cap on PBL and the fact that PBL could not be disbursed if borrowers did not have a positive macroeconomic assessment.

An analysis of the extent to which PBL funding is complementary or a substitute for market financing was beyond the scope of OVE's 2015 review and therefore remains an open question. OVE country program evaluations suggest that some countries with ample access to international financial markets tend to use PBL as a debt and liquidity management tool to complement market financing, particularly when borrowing during good economic times. A Colombia country program evaluation, for example, found that, as the country gained increased access to financial markets, PBL remained an attractive instrument because its large and predictable disbursements facilitated the Ministry of Finance's financial planning, given that Colombia tended to issue bonds in January and September. Similarly, a recent evaluation of Mexico's country program found that the Ministry of Finance sought regular and predictable disbursements for debt management purposes.²⁰⁷

²⁰⁷ IDB Office of Evaluation and Oversight (OVE). 2015. *Country Program Evaluation: Colombia 2011-2014*. Washington, DC: IDB. <https://publications.iadb.org/en/country-program-evaluation-colombia-2011-2014>; IDB Office of Evaluation and Oversight (OVE). 2019. *Country Program Evaluation: Colombia 2015-2018*. Washington, DC: IDB <https://publications.iadb.org/en/country-program-evaluation-colombia-2015-2018>; IDB Office of Evaluation and Oversight (OVE). 2019. *Country Program Evaluation: Mexico 2013-2018*. Washington, DC: IDB <https://publications.iadb.org/en/country-program-evaluation-mexico-2013-2018>

Figure 4.5: Countercyclical Role of PBL Lending

Figure 4.6: Latin America and the Caribbean’s Fiscal Balance and PBL Disbursements



Source: IDB Office of Evaluation and Oversight (OVE). *Design and Use of Policy-Based Loans at the IDB*. Document RE-485-6. Washington, DC: IDB. <https://publications.iadb.org/en/ove-annual-report-2015-technical-note-design-and-use-policy-based-loans-idb>

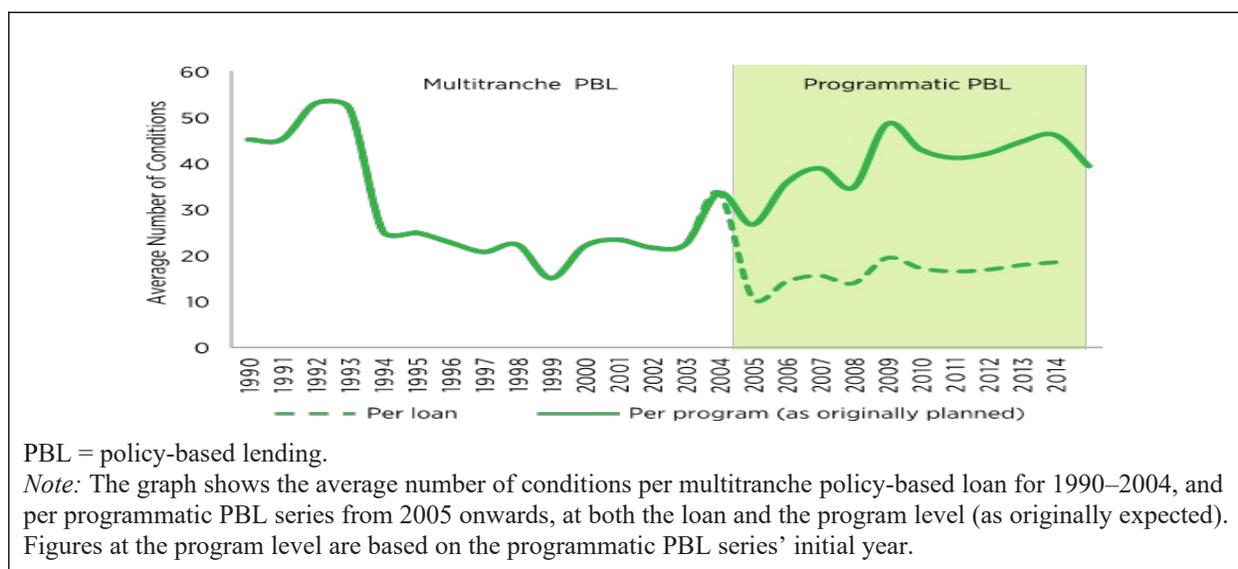
How did the Design and Implementation of Policy-Based Lending Change over Time?

OVE’s analysis of the design of PBL focused on the evolution and nature of policy conditions, the vertical logic of the programs, and the extent to which PBL was accompanied by other IDB support. When looking at the evolution of policy conditions, OVE considered all PBL operations approved between 1990 and 2014, in order to gain a longer-term perspective. For a more in-depth analysis of the nature of policy conditions, and the complementarity between PBL and parallel IDB support, OVE focused on PBL operations approved in the decade leading up to 2015. In order to conduct this analysis, OVE drew a stratified random sample of 40 policy-based programs from the universe of PBL operations approved between 2005 and 2014 in four thematic areas: public sector and economic management, social sectors, financial sector, and energy. The sample encompassed 70 multitranche and programmatic loans in 18 countries and covered 34% of all programs approved over the time period. Analysis of policy matrices was supplemented by information from pertinent OVE country program evaluations and interviews with IDB staff and country stakeholders. To review the complementarity between PBL and parallel IDB support through technical cooperation grants or investment loans, OVE focused on all 82 programmatic PBL series (equivalent to 144 PBL operations) approved between 2005 and 2014.

The number of conditions at the program level increased over time. In the early 1990s, the average number of conditions per loan was roughly 50, and that figure fell by half between the mid-1990s and 2004. In line with the Organisation for Economic Co-operation and Development

(OECD) Paris Declaration in 2005, the introduction of the programmatic modality further streamlined conditionality at the loan level (Figure 4.7). However, at the program level, the average number of conditions increased after 2005, offsetting the streamlining gained at the loan level²⁰⁸. There were no significant differences in the number of conditions across thematic areas or regions.

Figure 4.7: Average Number of Conditions Per Policy-Based Operation



Source: IDB Office of Evaluation and Oversight (OVE). *Design and Use of Policy-Based Loans at the IDB.* Document RE-485-6. Washington, DC: IDB. <https://publications.iadb.org/en/ove-annual-report-2015-technical-note-design-and-use-policy-based-loans-idb>

To determine to what extent PBL-supported policy conditions had sufficient depth to trigger long-lasting policy and institutional changes, OVE’s analysis reviewed the content of each policy condition and assigned one of three categories to it:

- **Low-depth.** Conditions that would not, by themselves, bring about any meaningful changes. Low-depth conditions are usually process-oriented and often involve the preparation of action plans or strategies and the announcement of intentions.
- **Medium-depth.** Conditions that can have an immediate but not a lasting impact. These include conditions calling for one-off measures that can be expected to have an immediate and possibly significant effect, but that would need to be followed by other measures for this to be lasting. Submission of draft legislation to Congress, reaching a target or benchmarks, and organizational changes are examples of medium-depth conditions.
- **High-depth.** Conditions that could, by themselves, trigger long-lasting changes in the institutional or policy environment. Conditions in this category include legislative changes, government decrees, or lower-level actions that complete a critical reform process. High-depth conditions also include measures that require that certain

²⁰⁸ For multitranche PBLs, the average number of conditions per loan was found to have increased from 23 to 32.

fiduciary measures be taken regularly or permanently, even when legislation is not needed.

This analysis was supplemented by an assessment of the programs' overall vertical logic and coherence. OVE evaluated the sequencing of the conditions across PBL tranches or across individual loans in a programmatic PBL series by looking at the extent to which the policy conditions included in each tranche of a multitranche PBL, or in each loan of a programmatic PBL series, followed a logical sequence over time by supporting different stages of the reform process cycle (i.e., formulation or design, adoption or approval, implementation, monitoring and evaluation). OVE also assessed the program's vertical logic: the coherence between conditions and the reform program objectives and expected results. While OVE's analysis of the depth of policy conditions and their sequencing allowed it to gauge the progress of the reform program supported by PBL, the methodology did not measure IDB's technical additionality to the reform program or the extent to which the impetus for reforms could be traced to IDB actions.

Most conditions involved policy or regulatory measures, while a small proportion focused on organizational changes at public agencies. OVE found that almost 80% of conditions in the sample supported policy reforms, ranging from the design of a new payment scheme for a social program to the approval of fiscal responsibility legislation. The rest promoted changes in the structure, responsibility chain, and/or institutional capacity of public agencies, such as the creation of a public health unit in the Ministry of Health or the formulation of a code to define the structure and processes for a public agency.

Most conditions were low- or medium-depth; they helped set in motion policy reforms but could not by themselves effect lasting changes. Almost a third of conditions in both the multitranche PBL and the programmatic series reviewed were low-depth, calling for basic one-off measures or simply expressing intentions. For example, a condition would commit a line agency to an independent operational audit of a feeding subsidy or call on an agency to prepare terms of reference for the design of a methodology to analyze the outcomes of a national investment plan. It is questionable whether such measures are in line with IDB's guidelines, which stipulate that PBL conditions should be essential for the achievement of expected results. Only 15% of the conditions in the sample were high-depth, for example the elimination of government budget support for state-controlled enterprises or the adoption of revised targeting mechanisms for a school feeding program. No major differences in the depth level of conditions were found between multitranche PBL and programmatic PBL series.

Sequencing of PBL conditions followed the stages of reform cycles and tended to gain in depth as the reform process advanced, but the monitoring and evaluation (M&E) stage was seldom included. OVE classified the conditions in each operation according to the milestones in a policy reform cycle (formulation, adoption, implementation, M&E) that they supported. Not surprisingly, conditions in the first tranche or loan tended to focus on earlier stages of a policy reform process, while a larger proportion of conditions in subsequent tranches or loans tended to focus on implementation (Figure 4.8). Conditions gained in depth as the program advanced. For example, 43% of conditions in the first loans of programmatic PBL series were low-depth, while this proportion decreased to 30% in the second loan and to 16% in the third (Figure 4.9). According to OVE's analysis, the reviewed conditions were generally relevant to the programs' objectives, although they were probably insufficient to attain the expected outcomes. Less than 6% of the conditions reviewed included provisions linked to the last stage of a reform process—M&E.

Programs in the social sectors were more likely to include M&E conditions, especially when compared with those in the financial sector (0.8% of conditions).

Figure 4.8: Policy Conditions and Stage in the Policy-Making Cycle (Programmatic PBL Series)

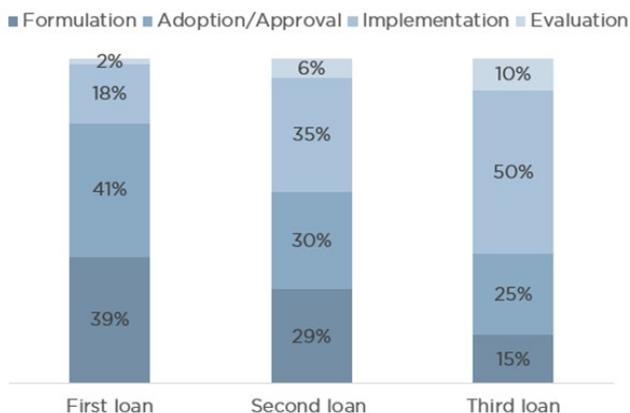
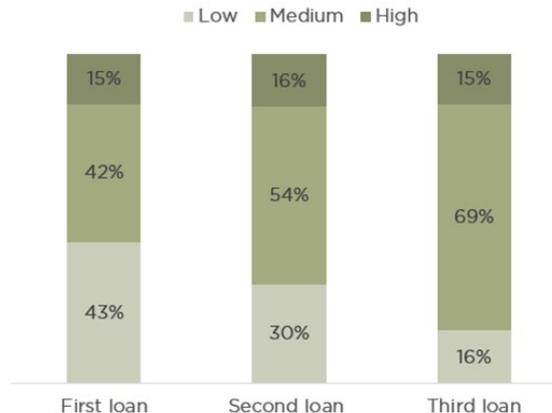


Figure 4.9: Depth and Loan Order (Programmatic PBL Series)



Source: IDB Office of Evaluation and Oversight (OVE). *Design and Use of Policy-Based Loans at the IDB*. Document RE-485-6. Washington, DC: IDB. <https://publications.iadb.org/en/ove-annual-report-2015-technical-note-design-and-use-policy-based-loans-idb>

Programs with a larger number of conditions tended to have a greater share of low-depth conditions. This suggests that IDB could in many cases have been more parsimonious with policy conditions and focused on measures that were critical to achieving the desired results. Similarly, OVE found no correlation between loan amount per capita and how ambitious the reform program was, nor did it find any correlation between loan size and the number of policy conditions. For example, the first loan of a program to strengthen the public finance system in Mexico in the amount of \$800 million had 15 policy conditions, while the second loan in support of a water resources reform program in Peru in the amount of \$10 million had roughly the same number. These findings are consistent with IDB’s policy-based lending guidelines, which state that the size of the loan is not necessarily related to the cost of the policy reforms or institutional changes supported by the PBL, but rather to development financing requirements.

The depth level of reform programs varied across and within countries; in general, programs in the financial and energy sectors tended to have more depth. When analyzing differences in the depth level, sharp differences across countries were detected. For example, about 22% of the conditions in Peru had high depth, compared with 9% in Colombia programs and less than 5% in Bolivia programs. Moreover, there were substantial differences across programs within countries. In Peru, for example, fewer than 8% of the conditions in a social sector reform program were high-depth conditions, compared with almost 30% in the energy program. The most consistent differences appeared to be at the thematic level: almost a quarter of the conditions in programs in the financial and energy sectors were high-depth, compared with slightly above a tenth in the social and public sector and economic management clusters.

Programmatic PBLs in countries whose reform processes were further advanced at the outset tended to have higher depth conditions. For example, energy sector reforms in Surinam were only modestly advanced when IDB approved a programmatic PBL to help the country develop a framework for the energy sector. Most of the conditions consisted of one-off measures to help set building blocks, such as the preparation of diagnostic assessments and draft guidelines for future legal frameworks. In contrast, a programmatic PBL to support energy sector reforms in Nicaragua supported a reform process that was already advanced and in which the country already had experience. Although it had almost the same number of conditions as Suriname's, Nicaragua's PBL had a higher depth level, with conditions that included devising and implementing a new energy tariff structure.

Reforms supported at times of crisis were slightly deeper than those supported outside crisis periods. OVE examined whether PBL programs initiated in times of crisis (which tended to provide countercyclical funding) supported more ambitious reforms than programs started during less adverse economic times. When comparing the depth of the reform programs that were initiated during the global financial crisis (that is, programs for which the first loan was approved during 2008, 2009, or 2010) with those initiated either before or after, OVE found that, on average, programs initiated in times of crisis had slightly higher depth.

Complementarity with other Inter-American Development Bank Operations

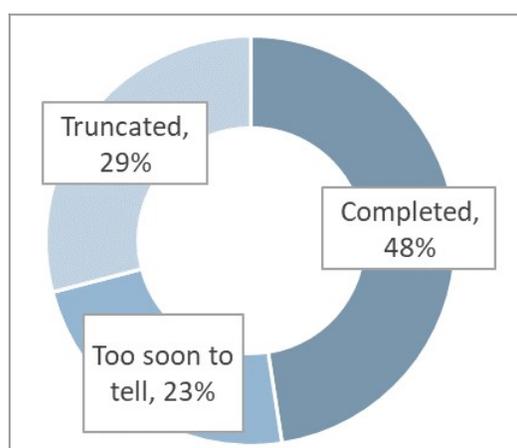
Over 80% of programmatic PBL series approved between 2005 and 2014 were accompanied by parallel technical cooperation grants. The grants supported policy dialogue, diagnostic work, and compliance with disbursement conditions and averaged \$1.3 million per series. While the resources from a PBL go to the country's Treasury, parallel technical cooperation grants provide direct support for the line ministries in charge of the reforms and can thus help incentivize them to proceed with reform implementation. While PBL programs supported by technical cooperation grants were not found to have deeper conditions than those without such support, OVE found that there was a significant positive relationship between technical cooperation support and the likelihood of a programmatic PBL series being completed, pointing to the importance of sustained dialogue and technical support by IDB to accompany countries' reform efforts. The presence of technical cooperation grants was neither correlated with a country's institutional capacity, nor with income per capita. Less frequently (in 15 of the 82 programmatic series), investment loans accompanied programmatic PBL series, with the PBLs either continuing a line of work initiated by previously approved investment loans or preparing the ground for subsequent investment operations.

Implementation of Policy-Based Lending

Over one third of programmatic PBL series approved since 2005 have been truncated. OVE's 2015 review of the design and implementation of PBL operations at IDB found that 32% of active programmatic PBL series between 2005 and 2014 had been interrupted, while 40% had been completed and the remainder were still active, resulting in a truncation rate of 44% (truncated series as a share of completed plus truncated series). An OVE update of this analysis to cover PBL programs approved through 2019 showed only marginal improvement in series completion. Of the 124 programs active between 2005 and 2019, 59 have been completed, 36 have been interrupted and 29 are still ongoing (Figure 4.10, Table 4.3), resulting in a truncation rate of 38%. The truncation rate increases with the number of operations in a series: it is 33% for series with two operations, but 43% for series with three or more operations.

There are significant variations in truncations across countries. For example, Colombia had 16 series between 2005 and 2019 and a truncation rate of over 54%, while Peru with a similar number (15) of programs had a truncation rate of 8%. OVE country program evaluations showed that, in countries with high numbers of truncated series (e.g., Colombia and Panama), IDB often engaged in a new series in a different sector after a series has been truncated. Since medium- and high-depth conditions tend to be concentrated in the second and third loans of a series, the truncation of a series impairs the program’s depth. OVE’s 2015 review of the design and use of PBL found that the truncation rate was higher when there was a change in government, yet almost 20% of programs had been started within a year of elections and over 40% had been started within 2 years of elections, raising questions about IDB’s timing of programs.

Figure 4.10: Status of Programmatic PBL Series, 2005–2019 Approvals



Series by Program Size, 2005–2019 Approvals

Number of Planned Operations in Series	Completed	Too Soon to Tell	Truncated	Total
2	34	22	17	73
3	24	7	18	49
4	1	0	1	2
Total	59	29	36	124

Table 4.3: Status of Programmatic PBL

Source: IDB Office of Evaluation and Oversight (OVE), based on data from IDB databases.

In a programmatic PBL series the policy matrix of each operation outlines the conditions applicable to the loan in question, as well as indicative conditions (called triggers) for subsequent loans in the program. In its review, OVE compared the actual policy conditions in second and third loans in a sample of 28 programmatic PBL series to the most up-to-date indicative triggers and found that about half of the triggers had changed during implementation, reflecting the flexibility of the programmatic instrument (Table 4.4). In terms of policy and institutional depth, for about 14% of the triggers in the second loans, and 19% in the third loan, the depth was found to have been reduced when the loan was approved. Conversely, the depth of conditions rarely increased.

Table 4.4: Changes to Disbursement Triggers and Policy Conditions in 28 Programmatic PBL Series

Changes	Loan 2	Loan 3
---------	--------	--------

Condition unchanged	54.5%	33.6%
Condition changed but same depth	13.2%	21.2%
Condition added	12.9%	21.2%
Depth decreased	14.1%	18.6%
Depth increased	5.7%	5.3%
Number of policy conditions	335	120

Source: Based on IDB Office of Evaluation and Oversight (OVE). *Design and Use of Policy-Based Loans at the IDB*. Document RE-485-6. Washington, DC: IDB. <https://publications.iadb.org/en/ove-annual-report-2015-technical-note-design-and-use-policy-based-loans-idb>

2. Recent Developments

Requirements pertaining to policy-based lending at IDB have not changed significantly since OVE’s 2015 review. The main change since the review was a temporary increase in the PBL lending cap from 30% to 40% of overall sovereign-guaranteed lending to accommodate higher demand for budget support in response to the COVID-19 crisis. Before then, IDB introduced loans based on results (LBR) as a new modality under its investment lending instruments in 2016. Under LBRs, the disbursement of funds is linked to the achievement of predefined results rather than against incurred expenditures. LBRs have been used in only six countries and they accounted for only 1% of sovereign-guaranteed lending between 2016–2019. Given the limited experience of the modality thus far, no evaluation of LBRs has been carried out yet.

3. Conclusions

Policy-based lending was an important IDB instrument during the review period 2005–2019, accounting for about 28% of sovereign-guaranteed approvals and amounting to \$42.6 billion. The reasons countries had for using PBL varied, but the predominant use was to help meet financing needs. Policy elements of PBL were usually secondary to the primacy of budget support. This points to a tension between IDB’s dual PBL objectives of supporting borrowing countries’ reforms and helping them meet financing gaps. Many borrowers see PBL primarily as a tool to help meet financing needs.

While OVE’s work found that policy measures supported by PBL were generally relevant to the objectives of the reform programs which they aimed to support, most conditions did not have sufficient depth to set in motion reforms that could by themselves bring lasting changes. Programmatic policy-based loans allow for more sustained engagement and if policy measures become deeper as a programmatic series progresses, they can be a useful tool to support reform programs, while also helping borrowers meet financing needs. However, over one third of programmatic PBL series approved since 2005 were truncated before they reached their most consequential reform steps, raising questions of ownership of the underlying reform programs which such lending sought to support. Truncation was more pronounced for countries that resorted mostly to PBL to meet financing needs and did not seek technical assistance to accompany the underlying reform programs. The fact that programs which were supported by technical cooperation grants had a lower truncation rate indicates there is a need for continuous engagement and technical cooperation to support borrowing countries in their reform efforts. It

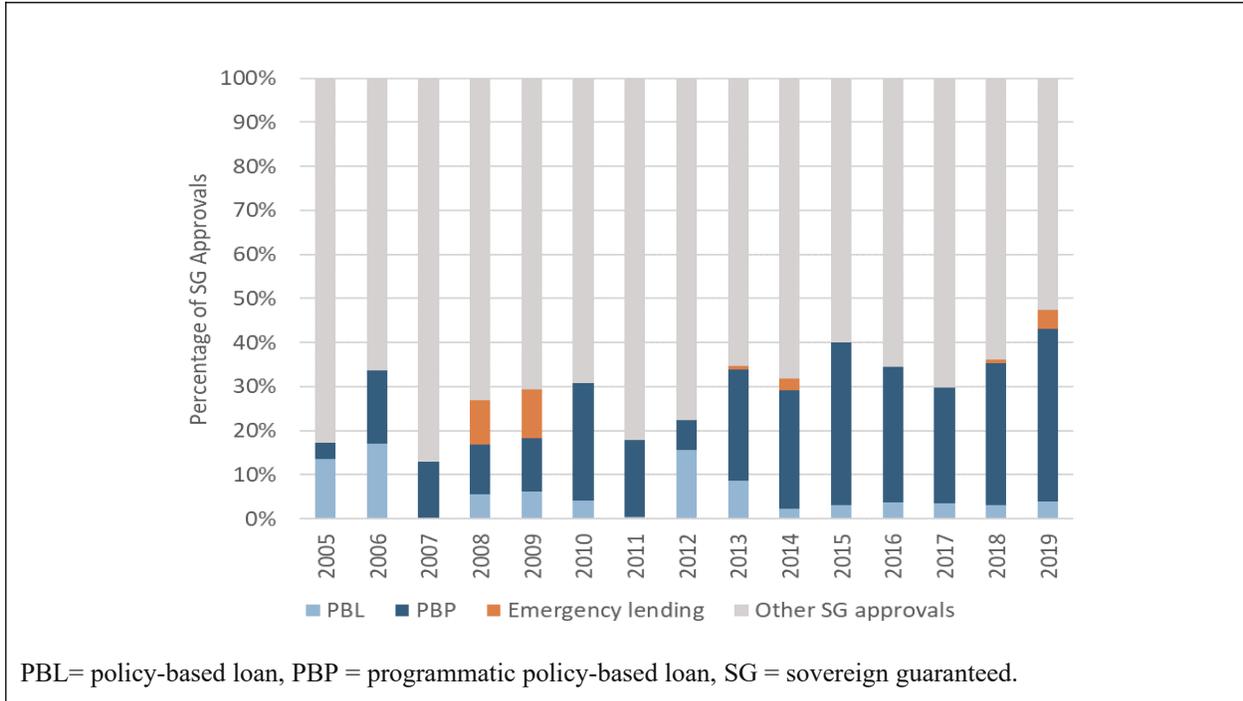
also suggests that evaluations of PBL should not be undertaken in a vacuum; they need to consider the extent to which the PBL was accompanied by sustained policy dialogue and technical support.

PBL as a financial instrument can either complement or substitute for financing from the financial market. While OVE's review did not look at this aspect systematically, some of OVE's country program evaluations show that countries with ample access to financial markets used PBL as a liquidity management tool to complement market financing and fill short-term liquidity needs, particularly outside an economic crisis. While many countries make use of PBL during times of crisis, the countercyclical role which such instruments can play is limited by a cap on overall PBL lending and the limited size of PBL operations compared to the economy in all but small countries.

The findings of OVE's work undertaken to date invite further questions. To what extent does PBL financing complement or substitute for funding from financial markets? Are IDB-supported policy measures complementary to, or do they overlap with those of other institutions providing budget support? What non-financial additionality does PBL provide? What results have PBL operations helped achieve and how sustainable will those results prove to be? OVE plans to undertake a full-fledged evaluation of policy-based lending at IDB to try to answer some of these questions.

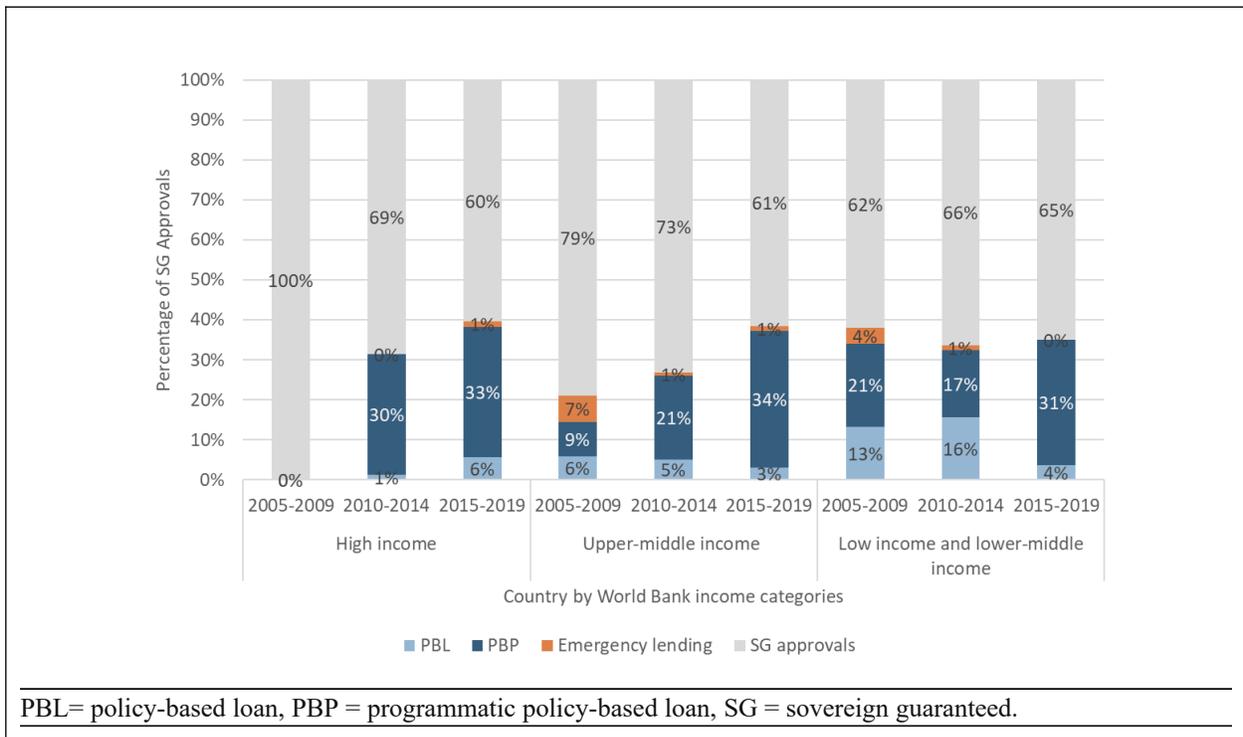
ANNEX

Figure 4.A1: IDB Policy-Based Operations in Latin America and the Caribbean, 2005–2019



Source: IDB Office of Evaluation and Oversight (OVE), based on data from IDB databases.

Figure 4 A.2: Relative Importance of Policy-Based Operations by Country Income Groups



Source: IDB Office of Evaluation and Oversight (OVE), based on data from IDB databases.

Comments on Policy-Based Lending at the Inter-American Development Bank, 2005–2019

Comment by: Augusto de la Torre

The Office of Evaluation and Oversight (OVE) at the Inter-American Development Bank (IDB) has produced a crisp, candid, and well-structured evaluation of IDB’s policy-based lending (PBL). The report presents many carefully drawn out, relevant, and interesting results. The authors deserve congratulations.

The chapter, which largely reflects the findings of a review of PBL that OVE undertook in 2015, is divided into two sections. The first neatly summarizes facts regarding the evolution of PBL and its use by borrowing countries since its introduction at IDB in 1989. The second assesses PBL along several dimensions (based on well-focused findings), including the reasons why countries demand PBL; complementarities between PBL and other IDB operations; and issues in design and implementation of PBL operations. The chapter provides recommendations for possible amendments to IDB policy-based lending.

The analysis part of the chapter is strong when it comes to findings, but it falls short when interpreting the implications of such findings for IDB and borrowing countries. These comments will therefore elaborate on these and raise a few other questions and issues.

1. Main Comments

The chapter should from the outset have more frankly recognized that there are potential tensions between the reasons why countries demand PBL, on the one hand, and what multilateral development banks (MDBs) expect to obtain by offering PBL, on the other.

The chapter provides significant evidence that borrowing countries’ use PBL mainly to fill their budget financing needs rather than to intensify high-impact reforms. MDBs do recognize that financing needs are at the heart of the demand for PBL but point to policies and reforms as the main rationale for offering PBL. Reforms are highlighted by MDB staff when justifying a PBL before their Boards of Directors. Efforts to align these two motivations drive PBL preparation and design. These efforts succeed at times, but not always.

It is not surprising that, using a creative analytical approach, the OVE evaluation found that most conditions in PBL were of low- to medium-depth, i.e., they tended to involve one-off and easily reversible policy measures, to be process-oriented, or to contain good policy intentions that are not operationalized for implementation. The OVE evaluation stressed that conditionality in PBL “was generally relevant to the programs’ objectives” yet it clarified that such conditionality “was probably insufficient to attain the expected outcomes.” Or, to put it differently, “most conditions ... helped set in motion policy reforms but could not by themselves effect lasting institutional changes.” These findings have important implications, which are discussed below.

Adjusting Multilateral Development Bank Expectations for Policy-Based Lending

The findings of the OVE report should lead MDBs to adjust expectations downward, toward more realistic levels. PBL operations do not simply “buy” reforms, as is often believed. At best, PBL provides needed budgetary financing while recognizing (and helping fine-tune and

strengthen the technical aspects of) reforms that would have been attempted by the country *with or without the PBL*. At worst, PBL operations over-sell and exaggerate the importance and depth of the conditions (reforms) on which they are based.

Nevertheless, the rise in policy-based program loans (PBPs) can be interpreted as a major step towards greater realism and frankness in policy-based lending. PBPs have accounted for the lion's share of IDB-originated PBL since 2005 (see Figure 2.2 in the IDB OVE's chapter). Wisely, PBPs do not pretend to "buy reforms." Instead, they move away from "conditionality" in that each single-tranche loan in the program recognizes and gives credit to the country for policy actions and reforms that have already happened.²⁰⁹ Future reforms appear only as indicative guides for future tranches under the multi-year program but do not condition the big upfront disbursement associated with the single-tranche in question.

As a result, PBPs address the tricky question of "ownership" (a key issue that is not discussed in the chapter but should have been) while avoiding the time inconsistency trap of traditional PBL operations, where countries under duress agree to conditions (reforms) that have a low probability of being met (because the incentives to stick to the conditions diminish after the PBL is approved and the first disbursement comes in). However, PBPs can lead to marginal or low-depth reforms, cooked up in a hurry by country authorities under the stress of large financing needs, and thus are quite vulnerable to being truncated after the first single-tranche loan has been disbursed. The OVE evaluation found that 38% of PBPs approved since 2005 had been interrupted, with a higher incidence of truncations where loans are approved during times of changes of government.

Related to the question of ownership is the crucial question of whether PBL or PBPs can realistically be expected to generate policy additionality. Given the difficulties in identifying a counterfactual, it is difficult to attribute policy reforms to PBL or, equivalently, to reject the hypothesis that those policy reforms would have taken place even in the absence of PBL. This calls for modesty on the part of MDBs, whose role is not so much to tell countries what to do, but to partner with countries in their quest for social and economic progress, which includes partnering in the process of reform design, implementation, and evaluation. In any case, the chapter should have discussed more fully whether, how, and to what extent PBL promotes country ownership of reforms. This is crucial to avoid situations where a country engages in reforms without conviction but only to get the loan. The chapter should have tried to tease out from the data the counterfactual of whether reforms would have been adopted in the absence of PBL.

In any case, to mitigate the mentioned downsides (low-depth reforms and truncation) of PBPs, a premium must be put on a continued and robust technical engagement and policy dialogue between the MDB and the client country. This is particularly important considering a number of important findings in the OVE evaluation, including that: (i) "IDB tends to support policy reforms in sectors in which it had previously worked (usually through technical cooperation grants and investment loans) and thus has some country-level expertise that allows it to sustain a policy dialogue and provide relevant technical advice;" and (ii) "there was a significant positive relationship between technical cooperation support and the likelihood of a PBP series being completed."

²⁰⁹ **IDB can put some pressure on a country to achieve certain reform milestones as a prior condition for approval of the single-tranche disbursement.**

In other words, the reform impact and non-truncation of PBPs hinge directly on the quality of the policy dialogue that an MDB maintains with client countries and the quality of knowledge services the MDB provides. This is a point that is insufficiently highlighted in the chapter.

This point also argues in favor of not evaluating PBL (or any particular financial product offered by an MDB) in isolation, but in context, i.e., taking into account the entire portfolio of services the MDB offers to its client countries (including financial services, knowledge services, and convening services). The chapter could have been enhanced by relying on such a more contextualized or portfolio approach to the analysis of PBL. In the end, evaluating PBL in isolation may lead to biases in the assessment of MDB value added to development. It should be rather argued that the whole of an MDB engagement in a country (via a portfolio of financial services, technical assistance services, policy dialogue, and convening services) is likely to be larger than the sum of its parts.

PBL and Market-Based Finance

The findings in the chapter raise questions about the complementarity and substitutability of PBL and market-based finance. This is an issue that the chapter does not address but should have. One hypothesis is that, in countries with strong macro-financial policy frameworks, PBL is complementary to market-based finance—that is, these countries use PBL as part of their prudent management of the portfolio of public sector liabilities. In countries with weaker macro-financial policy frameworks, the hypothesis would imply that PBL is a substitute to market-based finance—that is, these countries resort to PBL because they do not have access to market-based finance. The chapter should have explored this hypothesis and elaborated on the implications of what it finds in this regard.

Limits to the Countercyclical Role of Policy-Based Lending

The findings in the chapter invite a richer discussion of the limits to the countercyclical and systemic liquidity functions of PBL. The chapter finds a mild countercyclical pattern: PBL has been negatively correlated with GDP growth. However, it quickly clarifies that “the instrument’s ability to affect macroeconomic conditions in these countries was limited by the small size of the loans in relation to their overall economies.” The leverage limits faced by MDBs (and the associated need for MDBs to retain their high ratings) lead to caps on lending to individual countries. Hence, the chapter should have more frankly recognized that MDBs are not set up to act as international lenders of last resort. That is a function left to the International Monetary Fund (IMF). This should dampen down the wrong, yet widely held, expectation that MDBs can be major players in countercyclical lending and emergency (systemic) liquidity assistance.

The limits to countercyclical lending by MDBs do not, of course, invalidate the prescription (which the evaluation should have highlighted) that MDBs must avoid unduly procyclical lending. In other words, MDBs need to avoid the tendency to join markets in lending copiously and euphorically in good times, which is necessary for MDBs to keep firepower available to provide considerable budget support (via PBL) in bad times. At the same time, the fact that bad times can facilitate a push to reform may play in favor of MDBs in times of crises, even if their countercyclical impact is limited.

2. Other Comments

The chapter notes the intriguing fact that, starting around 2005, IDB policy-based lending ceased to formally depend on the IMF's assessment of a country's macroeconomic viability and can now rely solely on the views of IDB's own Independent Macroeconomic Assessment Unit within the Research Department. This move is interesting considering that the World Bank tried a similar route but then abandoned it, after a bad experience in Argentina. Have there been specific situations of tension in IDB PBL operations, where the Research Department's assessment of macroeconomic viability was at odds with that of the IMF? If so, how were those tensions managed? In any case, strengthening an MDB's capacity to conduct systematic macroeconomic viability assessments—independently or in coordination with the IMF—is particularly relevant given the coronavirus disease (COVID)-induced surge in debt across the world.

Given the need for MDBs to cooperate with the IMF, especially in large, emergency financing packages, the chapter should also have examined the extent to which the policy reforms featured in PBL are incorporated as structural benchmarks in IMF-supported programs.

The chapter should have shown not only PBL disbursements (flows), but also PBL stocks. This would have helped shed light on the relevant question of whether much of the PBL activity is essentially refinancing (disbursements that compensate for amortizations falling due) rather than increases in exposure. In fact, one wonders why MDBs tend to focus so much on disbursement flows and to pay little attention to exposure (stocks). This question deserved at least a footnote in the chapter.

Do burden-sharing and bailing-in considerations play any role in PBL? I assume that IDB is not indifferent to situations where its loans are used by a country mainly to pay (or bail out) private or bilateral external creditors in times of sudden stops or reversals in capital flows. Are there any IDB policy guidelines in this respect? If not, shouldn't such guidelines be developed?

The fact that budget financing needs, rather than balance of payments needs, are the dominant driver of PBL demand deserves further assessment. This seems to invalidate the traditional view of MDB lending as a means to close a country's external financing gap. The chapter should have offered a well thought out discussion of why the external financing motive for MDB lending seems to have vanished, at least in normal times. A likely answer would point in the direction of the rising international financial integration of emerging economies.

Chapter 5

Caribbean Development Bank: Policy-Based Lending and its Evaluation

James Melanson²¹⁰ and Jason Cotton²¹¹

1. Historical Development and Use of Policy-Based Operations, 2005–2020

Instrument Definition

The mandate of the Caribbean Development Bank (CDB) is to reduce poverty and transform lives by contributing to the sustainable, resilient, and inclusive development of its borrowing member countries (BMCs). Policy-based operations (PBOs) are financing instruments²¹² used to incentivize the implementation of country-owned policy reforms and institutional changes aimed at advancing sustainable development goals. The policy-based lending (PBL) instrument, while helping to strengthen the effectiveness of public policy frameworks, provides fast-disbursing budget support to finance priority expenditures, and is disbursed following compliance with agreed policy actions. In a broad sense, therefore, the PBL product is a lending modality that supports the process of good policy making and governance, while reducing transaction costs and providing timely resources to national budgets. PBL is complementary to investment lending as it helps to establish an appropriate enabling environment for enhancing resilience, achieving economic growth, and reducing poverty. It is an important component of CDB's intervention modalities to enhance development effectiveness and responsiveness to the changing needs of members.

CDB offers four types of PBL:

- macroeconomic,
- sector,
- exogenous shock response, and
- regional public goods.

Macroeconomic PBOs address external and/or internal economic imbalances. Sector PBOs support reforms that help address critical sector issues and strengthen the progress toward overall economic development. Exogenous shock response PBOs provide resources in crisis situations to assist with the fallout from a shock and they can be used to support reforms to enhance

²¹⁰ Office of Independent Evaluation.

²¹¹ Christine Dawson and Donna Kaidou-Jeffrey also contributed.

²¹² Inclusive of loans, grants and guarantees.

resilience. Regional public goods PBOs help to embed the policy and institutional frameworks necessary to advance regional cooperation and integration. PBO guarantees may be used to guarantee a portion of debt service on a borrowing or bond issue by a BMC in support of country-owned policy reforms.

PBL can form an important component of country financing strategies. At the country level, the size of the loan is related to development financing requirements defined in terms of balance of payments, fiscal, sector, or other economic funding needs.

Evolution of the Policy Framework

CDB began participating in PBL operations in the late 1980s, with operations to support macroeconomic adjustment executed in collaboration with the International Monetary Fund (IMF), the World Bank, and the Inter-American Development Bank (IDB). These addressed complex development problems, made more acute by the increased frequency of natural disasters and the impacts of climate change, external shocks, relatively low growth and high debt. In 2005, CDB formally introduced PBOs into its lending toolkit, which had traditionally focused on expanding productive infrastructural and institutional capacity. The new instrument was guided by a Board-approved policy paper²¹³, outlining the development challenges in the region; the rationale, definition, and objectives of policy-based lending; design considerations; quality at entry standards; organizational and implementation arrangements; and prudential limits.²¹⁴ This introduced a more appropriate model to support the type of policy and institutional reforms required to address the structural, social and institutional development challenges being faced, and the far-reaching policy and institutional adjustments required to facilitate stronger development pathways.

Since 2005, CDB has sought to gradually strengthen the PBO instrument and the policy governing its use. This has been guided by five external reviews or evaluations, as well as by internal assessments by staff. Over time, these have revealed scope for improving the administration of PBOs, particularly in their design, supervision, and reporting; and the need to develop more a comprehensive and structured policy framework and guidelines. There has also been internal capacity building in results-based management, country fiscal diagnostics, and debt sustainability analysis.

In 2013, a significant revision to the 2005 framework was undertaken²¹⁵ to provide greater clarity on the principles, procedures, and guidelines for administering PBOs and to anchor them within CDB's overall risk management and control framework. The changes included:

(i) broadening PBOs beyond loans to include grants and guarantees; (ii) clarifying the rationale and purpose for the use of PBOs; (iii) establishing guiding principles for donor coordination; (iv) broadening the types of PBOs to include sector, exogenous shock response, and public goods PBOs, and multitranche, single-tranche and programmatic²¹⁶ operations; and (v) clarifying how

²¹³ Caribbean Development Bank: 2005. *Policy Paper: A Framework for Policy Based Lending*, BD 72/05.

²¹⁴ The IDB played an advisory role in preparation of the paper.

²¹⁵ ⁴ Caribbean Development Bank. 2013. *Policy Paper: Framework for Policy-Based Operations - Revised Paper*. BD 72/05 Add. 5

²¹⁶ A programmatic PBL is a series of single-tranche loans designed to support policy and institutional reforms in a medium-term framework. A multitranche PBL is a single loan consisting of two or more tranches.

requests for waivers and the deferral of disbursement conditions, partial disbursements, supplementary financing, and revisions of scope should be handled. These were issues that were not addressed in the 2005 policy paper.

The 2013 framework provided for an increase in the PBL limit from 20% of total loans and guarantees outstanding to 30%, and subsequently, subject to further approval, to 33%. It also introduced risk-based and policy-lending allocation limits (from a credit risk, utilization, concentration and capital adequacy standpoint) at the country level that align with, and preserve, the prudential soundness of CDB. Following a comprehensive review of operations and the establishment of a centralized Office of Risk Management (ORM) in May 2013, the PBL limit rose to 33% in December 2015.

In March 2020, the Board gave approval to an increase in the prudential limit to 38%, creating headroom for lending in response to the fallout from the coronavirus disease (COVID) pandemic. This is expected to be temporary, with a return to 33% by the end of 2023. The move has enabled support to the Bahamas (\$40 million) and Saint Lucia (\$30 million), with the expectation of lending for economic recovery and resilience to additional pandemic-affected BMCs.

Cooperation with Development Partners

The PBL framework encourages collaboration with development partners when they have PBOs that pursue similar expected outcomes to those of CDB. CDB seeks to harmonize appraisal, supervision and monitoring around a common policy matrix. In circumstances where CDB resources will not be sufficient to close the financing gap, staff will either appraise a PBO request as part of a joint operation with other development partners or consult closely with strategic partners to help mobilize resources. Staff are required to assess the adequacy of the macroeconomic framework for the conduct of a PBO. The views of the IMF, the existence of an IMF program, or an Article IV assessment, are important ingredients in the appraisal. In the absence of an IMF program or Article IV assessment in the preceding 18 months, an assessment letter of the macroeconomic framework is requested. In the case of the UK Overseas Territories, a letter of approval from the requisite United Kingdom (UK) authority is sought.

Policy-Based Lending Activity

Over the past 14 years, CDB undertook 27 operations (as of September 2020) amounting to \$944.7 million. In 2019, PBL represented 42% of CDB's total loan approvals and 54% of its loan disbursements. PBL has financed emergency priority spending and helped preserve stability in BMCs, which are highly vulnerable to external shocks and natural disasters. This vulnerability²¹⁷ derives from inherent structural characteristics such as lack of economies of scale, export concentration, remoteness from global markets, lack of economic diversification, dependence on external financing, and exposure to natural hazards and climate change. Acevedo

²¹⁷ A CDB working paper argued that its borrowing member countries (BMCs) are, on average, medium to highly vulnerable countries. CDB. 2019. Measuring Vulnerability: A Multidimensional Vulnerability Index for the Caribbean. *CDB Working Paper 2109/01*. <https://www.caribank.org/publications-and-resources/resource-library/working-papers/measuring-vulnerability-multidimensional-vulnerability-index-caribbean>

Mejia²¹⁸ notes that Caribbean countries are seven times more likely than other countries to be affected by a natural hazard, and to suffer damage that is six times greater.

CDB’s PBL activity can be separated into two distinct periods. The first generation of lending was prepared under the original 2005 policy framework. PBL activity rose sharply in 2008–2010 coinciding with the adverse social and economic fallout from the global financial crisis of 2007–2010. Multitranche PBL provided urgently needed financing, supported the restoration of macroeconomic and fiscal stability, and strengthened debt dynamics in the wake of the crisis. The second generation of PBL operations was based on the revised policy framework introduced in 2013, with a high proportion being crisis-response PBL.

During the period 2006–2020,²¹⁹ PBL activity correlated closely with periods of economic and natural hazard shocks (Figure 5.1). CDB approved nine PBOs totaling approximately \$340 million (36% of the PBL portfolio) on the heels of the global financial crisis in 2008. Given the increasing frequency and intensity of hurricanes in the region, PBL demand has remained strong since 2015, peaking in the 2017 and 2019 hurricane seasons. The extensive damage from hurricanes Irma and Maria to Dominica and Anguilla in 2017 contributed, in part, to some of the PBL lending in 2018. CDB also supported the government of Bahamas in 2019 with an exogenous shock response programmatic PBL (\$50 million) to address the fallout related to Hurricane Dorian.

Figure 5.1: Evolution of Policy-Based Lending Activity (number of operations and \$ million)



COVID = coronavirus disease, PBO = policy-based operations.

Source: Caribbean Development Bank.

CDB’s ordinary capital resources (OCR) provide 86% of the resources for PBL, with concessionary resources from the Special Development Fund (SDF) (Unified) providing 10%

²¹⁸ Sebastian Acevedo Mejia. 2016. *Gone with the Wind: Estimating Hurricane Climate Costs in the Caribbean*. IMF Working Paper WP/16/199. Washington, DC: IMF.

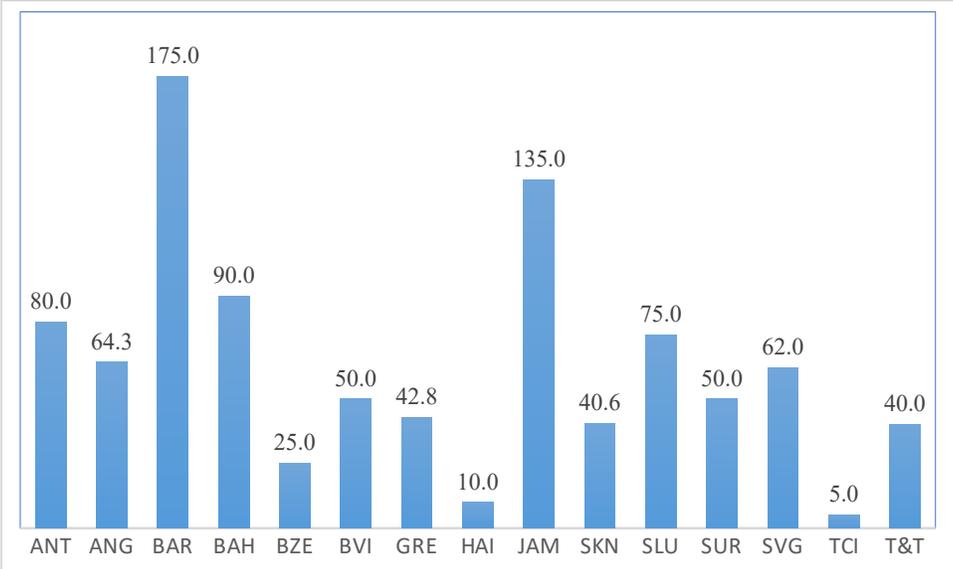
²¹⁹ Data for the year 2020 cover the months January–September.

and Ordinary Special Funds 4%. Lending rates and tenors for concessional resources have been determined differently for different country groups, according to levels of gross domestic product (GDP) per capita. Higher lending rates combined with shorter tenors and therefore lower degrees of concessionality have been targeted at higher-income countries which have traditionally had greater market access for financing. Conversely, lower-income countries have accessed SDF resources blended with OCR for greater concessionality of lending.

Borrowers and Beneficiaries

The largest beneficiaries of PBO lending have been the smaller and less developed members of CDB, in keeping with its charter. Approximately 53% of PBL (\$454.1 million) was disbursed to smaller and less developed BMCs, with the remaining 47% allocated to more developed BMCs (Barbados, Jamaica, Bahamas, and Trinidad and Tobago). The single largest country beneficiaries were Barbados, with accumulated borrowing of \$175 million, and Jamaica, with \$135 million (Figure 5.2). Barbados received three PBO operations (in 2010, 2018 and 2019), while Jamaica received two (in 2008 and 2012). PBOs are supported by policy dialogue with the country and, if necessary, technical assistance (TA) to address bottlenecks in implementation and delays in disbursement.

Figure 5.2: Policy-Based Lending by Country, 2006–2020 (\$ million)



ANG = Anguilla, ANT = Antigua and Barbuda, BAH = The Bahamas, BAR = Barbados, BZE = Belize, BVI = British Virgin Islands, GRE = Grenada, HAI = Haiti, JAM = Jamaica, SKN = St Kitts and Nevis, SLU = Saint Lucia, SUR = Suriname, SVG = St. Vincent and the Grenadines, TCI = Turks and Caicos Islands, T&T= Trinidad and Tobago.

Source: Caribbean Development Bank.

Macroeconomic Policy-Based Operations

Macroeconomic PBOs represent the largest proportion (59%) of the CDB policy-based lending portfolio. They are intended to combat the low and volatile growth, fiscal imbalances, and high debt in many BMCs (Table 4.1). During 2010–2019, economic performance in the region, although positive, was slower than the global average and lagged significantly behind that of other small island developing states. During this time, real gross domestic product (GDP) growth averaged 1.5% per annum compared with 4% in other small states. Meanwhile, the average debt to GDP ratio in the region remained high and averaged 63% of GDP at the end of 2019, above the 60% sustainability threshold recommended by many economists.

Table 5.1: Types of Policy-Based Operations, 2006–2020

Type	Number of Operations	Amount (\$ million)	Percentage of Portfolio	Country	Year of Approval
Macroeconomic	15	557.8	59%	BZE, SKN, SLU, ANT, GRE, SVG, ANG, BVI, BAR, BAH, JAM, TCI, TT	All PBO years
Sector	4	177	19%	SVG, T&T, ANT, SUR	2010, 2014, 2015, 2016
Exogenous shock response	4	179.3	19%	ANG, BVI, BAH, SLU	2018, 2018, 2019, 2020
Guarantee	2	20.6	2%	SKN	2006, 2012
Grant	1	10	1%	HAI	2009

ANG = Anguilla, ANT = Antigua and Barbuda, BAH = The Bahamas, BAR = Barbados, BZE = Belize, BVI = British Virgin Islands, GRE = Grenada, HAI = Haiti, JAM = Jamaica, PBO = policy-based operation, SKN = St Kitts and Nevis, SLU = Saint Lucia, SUR = Surinam, SVG = St. Vincent and the Grenadines, TCI = Turks and Caicos Islands, T&T= Trinidad and Tobago, VI = Virgin Islands.

Source: Caribbean Development Bank.

PBL was mainly geared toward fostering macroeconomic stability, reducing rising debt levels, and resolving internal imbalances. The reform milestones were particularly concentrated on fiscal policy in the areas of revenue and expenditure and supported by important institutional reforms to strengthen the framework for revenue collection and the management of state-owned enterprises. Examples of institutional reforms include: the implementation and strengthening of value-added tax (VAT) legislation, introduction of the United Nations Conference on Trade and Development (UNCTAD) automated system for customs data (ASYCUDA), and reviews of state-owned enterprise tariffs and fees.

Macroeconomic PBL also focused on public financial management (PFM) and audit and improved debt management. The public financial management and audit reforms were geared toward strengthening PFM and audit legislation, conducting public sector institutional

assessments and expenditure reviews, supporting the transition from cash to accrual accounting, and improving government financial information government systems, among others.

The efforts to improve debt management and processes focused on milestones that aimed to reduce the stock of arrears and avoid new arrears, introduce debt management strategies, establish debt units, put in place debt advisory committees, and review institutional debt management frameworks.

Exogenous Shock Response Policy-Based Operations

From 2017-2020 there was a sharp increase in the number and size of exogenous shock response PBOs to address the adverse impacts of natural hazard events. The exogenous shock response PBL is intended to ensure that economic and social gains from the country's reform program are protected as the country recovers from a crisis. In addition, the instrument seeks to ensure that macroeconomic stability is maintained, and long-term fiscal and debt sustainability is preserved. Hence, some of the reforms in exogenous shock response PBOs focus on establishing a sound macroeconomic framework prior to the crisis. The first exogenous shock response PBO was approved in 2018 in the aftermath of hurricanes Irma and Maria.

The reform agendas supported by the exogenous shock response PBOs have broadly resembled those of the macroeconomic PBOs but have also included reforms concerned with disaster management and resilience building. Some of the key reforms supported in the four exogenous shock response PBOs thus far have focused on disaster risk insurance (in the case of Anguilla, Bahamas, and the Virgin Islands) as well as the legislative and institutional framework for disaster planning and response. Reforms connected with social protection and social resilience were evident in the PBL to Saint Lucia (in response to COVID-19), and in the PBOs to the British Virgin Islands and Anguilla. For example, the Saint Lucia PBO supported proxy means testing to improve targeting of poor households so social assistance for immediate COVID-19 relief could be scaled up. As for the macroeconomic PBOs, debt sustainability is an important consideration in the appraisal of an exogenous shock response PBO. This is evident in the PBOs for Anguilla, The Bahamas, and Saint Lucia, where the instrument incentivized primary balance targets, revenue and expenditure reforms as well as policy frameworks such as fiscal rules (Saint Lucia).

Sector Policy-Based Operations

Sectoral interventions have focused primarily on the financial and energy sectors. In the financial sector, the 2015 PBO to Antigua and Barbuda supported a resolution of ABI Bank in order to avoid a disorderly adjustment, which would probably have had severe economic and social repercussions. A disorderly resolution in Antigua and Barbuda would have had an impact on other Eastern Caribbean Central Bank (ECCB) member countries, with possible runs on banks in the currency union, and adverse consequences for their capital base and capital adequacy.

The PBO therefore supported the decision of the Eastern Caribbean Currency Union Monetary Council to try to achieve a resolution of the bank, along with reforms to the banking system and a new Banking Act, 2015. It also included reform actions on fiscal and debt sustainability to help stabilize the macroeconomic situation.

Energy sector PBOs in Trinidad and Tobago and Suriname supported key reforms such as reducing fuel subsidies and CO₂ emissions and strengthening the regulatory framework in power generation and renewable energy. It should be noted that sectoral reforms have not been restricted to sector PBOs; in a number of macroeconomic PBOs, specific pillars have focused on pertinent sectoral issues in areas such as doing business and trade facilitation.

2. Evaluations of Policy-Based Lending

There have been five reviews of policy-based lending (PBL) at CDB since use of the instrument was approved by its Board in late 2005. Three occurred between 2010 and 2012, before CDB had a fully independent evaluation function, with each review being conducted by an individual expert. The Office of Independent Evaluation (OIE), which was created in 2012, then oversaw a comprehensive PBL evaluation (2006–2016), using a theory-based approach with four in-depth case studies, reporting in December 2017. In the following year, as part of an OIE cluster country strategy and program evaluation (CSPE) of the Organisation of Eastern Caribbean States, a review of PBL experience with relatively small borrowers was undertaken.

Together, the five studies document the evolution in CDB’s guidance for, and practice of, policy-based lending. Two generations of policy-based lending are discernible. The first (2006–2010) was on average characterized by ambitious numbers of prior actions, widely scoped, with a sometimes enuous connection to expected reform outcomes. Delays in implementation and condition waivers were relatively frequent. The second generation (post-2010) featured fewer prior actions with a clearer causal connection to outcomes. There was also a progression from multitranche loans to either single-tranche loans or a programmatic series. The degree of national ownership of prior actions and reform programs tended to increase over the period.

The evaluations identified opportunities for continued improvement in CDB’s PBL practice. In particular, CDB could: take a longer view of reform outcome monitoring, not ceasing at loan disbursement but tracking through successive country strategy exercises; document capacity constraints and TA requirements associated with reforms more explicitly; and provide greater analysis of the quality and depth of prior actions at the time of appraisal.

*First Assessment of Caribbean Development Bank Policy-Based Lending, March 2010*²²⁰

Background and Terms of Reference

Following CDB’s adoption of the PBL instrument in 2005, multitranche policy-based loans were made to Antigua and Barbuda, Belize, Grenada, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines over the period 2006–2009, with an approved total of \$242.8 million. In 2010 CDB’s Evaluation and Oversight Division²²¹ commissioned a review of experience with the PBL instrument to date. The overall objective was to assess:

- (i) design and inputs, consistency with other operations, validity of underlying assumptions, and whether it addressed the relevant development constraints;

²²⁰ Caribbean Development Bank (Michael DaCosta, consultant). 2010. *Policy-based Loans by the Caribbean Development Bank, 2006 – 2009: An Assessment*.

²²¹ The Evaluation and Oversight Division (EOV) was until 2011 a unit reporting to the Vice President of Operations. A new Evaluation Policy converted it into the Office of Independent Evaluation, reporting to the Board, beginning in 2012.

- (ii) ownership and the extent to which governments were fully committed to, directly involved in, and accountable for the program of policy reforms;
- (iii) conditionalities and the ability of the country to meet loan conditions within the time frame specified;
- (iv) the effectiveness of monitoring and supervision by CDB;
- (v) the effectiveness in achieving the results when there is failure to meet conditionalities;
- (vi) the level of consultation and partnership in design and implementation; and
- (vii) the role of CDB and the rationale for PBL financing in relation to the activities of the World Bank, the Inter-American Development Bank (IDB), the International Monetary Fund (IMF) or other relevant international financial institutions operating in the BMCs.

The terms of reference did not mention the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD-DAC) evaluation criteria or require a rating of performance, but rather they focused on lesson learning and recommendations for improved implementation. An individual consultant with a background in public finance, fiscal policy, and banking systems was engaged. The consultant conducted a document review, interviews with Board members and staff, and country visits to meet with senior officials and heads of agencies charged with implementing PBL prior actions.

Review Findings

Context and analytic framework. The review observed that PBOs over the 2006 to 2009 period were transacted in part due to imminent fiscal crisis, and in part out of national political will for a longer-term reform and social protection. The main influencing conditions were:

- the emergence of fiscal pressures as expenditure and debt commitments outstripped revenue by amounts in excess of available financing on prudent terms;
- an assessment that the financing gap was not quickly reversible and that measures being taken to address it would take time to yield results;
- a judgment that financial support already finalized or being discussed with other lenders and donors would not be delivered in time to avert a potential payments crisis; and
- a conviction that a PBL would ease the immediate fiscal pressures, forestall a potential budget crisis, and allow time for the country to implement policies that would provide lasting stability and improved growth potential.

CDB's analytical basis for its PBL lending at the time, shared by other multilateral development banks (MDBs), recognized the pervasive role of the public sector in economic development in small developing countries, and particularly the way in which government policies affect private behavior, investment, and growth. Since these policies were implemented through the national budget and the activities of government-controlled entities, fiscal policy could have a profound influence on growth and the pace of development.

At the same time, it was recognized that a focus on fiscal policy, public sector management and reform, and debt sustainability, while necessary, was not sufficient to achieve lasting stability and growth, particularly in the 2–3-year timeframes of PBOs. Other factors, including good governance and credible institutions governing law and order and property rights, can be equally important.

Design process. Typically, a cross-sectoral team of CDB staff visited the country in question for one week. It reviewed the economic situation and policies, focusing on public finances, debt, and the government’s program of adjustment and reform. The macro-fiscal framework and projections were developed, often with inputs from the work of other institutions, including the Eastern Caribbean Central Bank (ECCB), the World Bank, the IMF, and other development partners. In addition, TA needs for diagnostic work or program implementation were assessed, taking into account TA from other providers, including the Caribbean Regional Technical Assistance Center (CARTAC).

The review found that staff had collaborated closely with country officials and staff of other MDBs, the IMF, and the ECCB on program design, including the macroeconomic framework; projections over the medium term; debt sustainability analyses; and appropriate policies or actions to be incorporated in PBL conditions. It stated that analytical work on topics relevant to the objectives of the PBOs, such as the impact of debt restructuring and the effects of the global financial crisis had been noteworthy.²²² The staff analysis of the likely impact of PBL on poverty and the social sectors was frank and well informed.

All or most of the policy actions included in a loan proposal were expected to have originated from the country’s own economic reform program, with explicit consideration of the likely impact on social conditions and poverty. In cases where other lenders were present (usually the World Bank or IDB) disbursement conditions were to have been calibrated to achieve consistency across institutions and avoid “conditionality arbitrage.”

However, two areas in program design needed attention: (i) the specification of PBL objectives and likely outcomes; and (ii) the treatment of assumptions and macroeconomic projections. Since clarity was essential for program design, conditionality, and monitoring and evaluation, there was a need for a clearer explanation PBL objectives, creating a stronger basis for the assessment of performance. Furthermore, further refinement of the techniques for macroeconomic and fiscal projection, including explanations of the basis for key assumptions and projections, was also needed to sharpen the analysis and bolster the credibility of the PBL instrument.

²²² CDB’s analytical work on debt dynamics in Jamaica, for example, helped catalyze contributions from the IDB and World Bank in this area.

Conditionality. The review summarized the guidance on conditionality from various CDB documents:

- (i) Dialogue with a wide cross-section of country officials was critical to identifying and designing conditions that reflected a strong commitment to reform, and that could be achieved during the implementation phase
- (ii) Structural changes and institutional strengthening take time, and a PBL should reflect this. The activities to be undertaken during the disbursement period should be within the implementation capacity of the borrower and should be capable of being monitored
- (iii) The conditions and associated activities need to be clearly defined and time-bound
- (iv) Conditions should consist only of actions critical for achieving program objectives.

The seven PBOs to 2009 were multitranche operations. Most conditions (about 80%) related to fiscal policy, public financial management (PFM), and debt management, with measures in other areas (economic management, investment and growth, and the social sector) accounting for an average of about 6% each (Table 5.2). Under the fiscal and debt umbrella, most types of conditions were in the revenue category followed by measures covering PFM, debt management, and expenditure.

The average number of conditions for disbursement of the first tranche of PBL operations was 10, with the figure rising from five in the first PBL to Belize in 2006 to 15 in the case of Grenada in 2009. With regard to total conditions (covering first- and second-tranche disbursements), these increased from nine for Belize to an average of 30 for St. Lucia and Grenada, with a pronounced backloading of conditions, particularly in the case of St. Lucia. A large number of conditions were included in some of the PBOs.²²³ In small countries with limited capacity, the requirements were viewed as overly burdensome.

²²³ By comparison, a \$450 million development policy loan by the World Bank to El Salvador for public finance and social sector reform, approved in January 2009, contained a total of 14 disbursement conditions for two tranches.

Table 5.2: Conditions in Caribbean Development Bank Policy-Based Loans, 2006–2009

Policy Area	Belize	St. Kitts and Nevis	St. Lucia	Jamaica ^a	St. Vincent and the Grenadines	Grenada	Antigua & Barbuda
Economic Management							
Maintain stable macroeconomic framework				√			
Set up or strengthen institutions for economic management			√			√	√
Training in economic forecasting and management						√	
Financial Sector							
Limit activities of the government owned development bank	√						
Investment and Growth							
Legislation for investment promotion						√	
Update tourism legislation and update sector strategy			√				
Establish tourism authority					√		
Complete implementation plan for an export strategy			√				
Social Sector							
Preparation or completion of poverty assessment or reduction strategy			√		√		√
Review of ministry responsible for social sector matters			√				
Ensure full staffing of social policy unit							√
Totals	7	12	11	10	16	10	13

^{a/} First tranche condition only as listed in Board documents

Country performance on conditions. Compliance with first-tranche loan conditions during 2006–2009 was mixed. Three of the six borrowing countries (Belize, Grenada, and St. Vincent and the Grenadines) met all their conditions without waivers, postponements, or adjustments and were able to draw down their first-tranche disbursements within about 2 months of the date of the loan agreement. Jamaica also secured a rapid disbursement after adjustments to its initial policy matrix, in part, to ensure consistency with the conditions of the World Bank’s development policy loan. Of the remaining countries, St. Lucia’s first-tranche disbursement took place following CDB’s agreement to re-program five conditions to the list of second-tranche conditions. In St. Kitts and Nevis, after a delay of more than 1 year from the signing of the loan agreement, the first-tranche disbursement took place following a waiver of one of the conditions.

Observations on loan conditions. An important contribution of the review was to gauge the depth of “ownership” of PBL conditions and reforms, as expressed by senior national officials. Some key messages emerged:

- (i) The collaborative manner in which CDB staff arrived at a consensus on loan conditions with national officials and other MDBs was appreciated
- (ii) Loan conditions helped mobilize domestic support for key reforms. However, PBL conditions sometimes incorporated policy commitments which were not yet fully developed, or for which a domestic consensus had not yet been achieved, which adversely affected ownership

- (iii) There was a tendency to overestimate domestic capacity as well as the speed of TA delivery and government processes, including Cabinet decision-making and the drafting and approval of legislation. A smaller number of disbursement conditions would have been preferred. Policy actions requiring TA delivery should have been excluded until the arrangements for the funding and delivery of the TA had been finalized.
- (iv) Given uncertainties in reform progression, more flexibility in applying second-tranche conditions was needed.

The evaluator added some summary reflections regarding CDB's use of conditionality:

- (i) Rather than multitranche operations, CDB should consider designing single-tranche PBL, with subsequent operations and disbursements being consistent with an agreed medium-term strategy (this was later to be called the "programmatic approach").
- (ii) Caution should be exercised when requiring legislation as part of loan conditions. While legislation often needs to be updated or introduced as part of the process of reform, it is important to avoid a drift toward treating legislation alone (or action plans) as substitutes for real progress
- (iii) Given the high incidence of poverty and inequality in the Caribbean and the importance of poverty reduction and social progress in CDB's objectives and strategies, greater efforts should be made to include conditions aimed at achieving social objectives or mitigating adverse effects from adjustment and reform measures.
- (iv)

Monitoring and supervision. Overall, the assessment found that CDB's procedures for monitoring and supervising its policy-based loans had not kept pace with PBL operations. Procedures were built on pre-existing systems for investment lending and had been insufficiently adapted to the PBL instrument. Reporting by staff to senior levels in CDB was ad hoc. Reporting required of borrowers in loan agreements (on macroeconomic indicators every quarter for 5 years) was viewed by countries as burdensome and therefore not regularly submitted.

Conclusions and Lessons

The review noted that loans had facilitated improvements in frameworks for macroeconomic management, fiscal policy, debt management, and overall public financial administration. Also, revenue systems had been modernized and debt restructuring facilitated. In addition, through their TA components, PBOs had helped strengthen capacity in areas, including macroeconomic forecasting, budgeting, and debt management.

The review observed that PBOs require careful consideration of feasible policy options, and analytical skills that can mold these into credible loan operations. They also require clear objectives and focused conditions, with specific, measurable goals, particularly in PBOs which are part of joint policy support operations with other MDBs. Goals need to be clear, realistic, and modest with greater consultation in setting loan conditions that are few in number and well defined. A series of discrete, well-defined steps toward reform, supported by a single-tranche PBL, might be more effective than a multitranche loan based on a hopeful set of longer-term commitments. A development bank with a commitment to improving social conditions should not shy away from incorporating social sector conditionality in its policy work.

Recommendations

The review offered four main recommendations:

- (i) Focus PBL operations on public sector reform or social sector priorities which are not already covered by policy loans from other MDBs.
- (ii) Specify the objectives of the PBL more clearly and pursue analytical work that can support improved program design and conditionality.
- (iii) Adhere to the principles of parsimony and sharper the focus on disbursement conditions. The requirement for legislation as part of loan conditions should be used sparingly.
- (iv) Develop guidelines specific to the monitoring and supervision of PBL.

Second Assessment of CDB Policy-Based Lending, May 2011²²⁴

Only one year after the first assessment of policy-based lending, the Evaluation and Oversight Division commissioned a second one. However, rather than review operational experience as had been done previously, this second exercise was tasked with examining CDB's overall framework for PBL operations, as a prelude to updating it.

The same individual consultant who had performed the first assessment undertook the second, employing the same methodology of document review and key informant interviews, but this time adding a survey.

Terms of Reference

The consultant's terms of reference were as follows:

- (a) Assess the appropriateness of CDB's framework for PBL, with attention to:
 - (i) the existing prudential limit of 20% of total loans outstanding,
 - (ii) the interest rate structure,
 - (iii) the use of concessional Special Development Fund (SDF) resources to fund this product and adherence to the SDF strategic objectives,
 - (iv) the scheduling and role of TA in the design of the PBL and in supporting capacity building and institutional strengthening to achieve the desired results of the PBL
 - (v) the adequacy of institutional arrangements at CDB for policy-based lending.
- (b) Make recommendations for changes, if necessary, to the framework.

Background and Regional Context

²²⁴ Caribbean Development Bank (Michael DaCosta, consultant). 2011. *A Review of the Framework for Future Policy Based Lending*. BD 43/11.

By the end of 2010, the global financial crisis was taking firm hold in the Caribbean region:

- Low or negative rates of GDP growth had characterized many of CDB's BMCs since the early 1990s, and in 2010 the region as a whole was estimated to have registered a contraction.
- A heavy debt burden derived from several years of weak fiscal performance continued to constrain growth and poverty reduction.
- Weak or declining growth had led to rising unemployment, social pressures exacerbated by rising food and fuel prices, and worsening poverty and social indices.
- Growth was projected to be sluggish until tourism could rebound and was therefore anchored in a recovery in the United States and Europe that remained uncertain for 2011–2012.

It was against this backdrop that the demand for policy-based lending was framed, to both stave off fiscal crisis and facilitate growth-oriented reforms.

Three new loans had been approved since the previous review, two being single-tranche operations (Table 5.3).

Table 5.3: PBLs by the CDB 2006 -2010: Basic Data

Country	Board Approval	Loan Amount ^{a/}	Tranches	Funding Source	Interest Rate ^{c/}	Loan Agreement	IFI Participation	1st Tranche Release	2nd Tranche Release ^{d/}	3rd Tranche Release ^{d/}	Original Completion Date ^{e/}
Belize	12/2006	25.0	2	OCR/SFR (15/10)	6.25/2.5	6/2007	1DB	8/2007	2/2009	...	12/2008
St. Kitts & Nevis Revision in Scope	2/2007 7/2010	20.0	2	OCR/SFR (12/8)	6.25/2.5	5/2007		7/2008	9/2010	...	12/2008
St. Lucia Revision in Scope	5/2008 5/2010	30.0 15.0	2 1	OCR/SFR (18/12) OCR/SFR (9/6)	5.9/2.5 5.9/2.5	10/2008 6/2010		3/2009 ...	6/2010 ...	... 3/2012	12/2009 3/2012
Jamaica ^{b/}	12/2008	100.0	3	OCR/SFR (70/30)	5.4/2.5	2/2009	WB/IDB/IMF	2/2009	3/2010	4/2011	3/2011
St. Vincent and the Grenadines Revision in Scope	5/2009 10/2010	25.0	2	OCR/SFR (16/9)	5.4/2.5	7/2009		9/2009	9/2010	...	9/2010
Grenada Revision in Scope	10/2009 12/2010	12.8	2	OCR/SFR (4.8/8.0)	5.3/2.0	11/2009	IMF/WB	12/2009	12/2010	6/2011	12/2010
Antigua & Barbuda ^{b/} Revision in Scope	12/2009 12/2010	30.0	3	OCR	4.8	6/2010	IMF	9/2010	6/2011	6/2012	3/2012
Anguilla	7/2010	55.0	1	OCR	4.5	8/2010		9/2010	...	...	9/2010
St. Vincent and the Grenadines Financial Sector Stabilization	7/2010	37.0	1	OCR	4.5	8/2010		12/2010	...	...	4/2011
Barbados	10/2010	25.0	1	OCR	4.5	12/2010		12/2010	...	...	12/2010

Source: CDB

^{a/} In millions of US dollars

^{b/} Indicates loans comprising three equal tranches

^{c/} Two interest rates are quoted. One for OCR and one for SFR

^{d/} Actual date or latest estimate

^{e/} Original date by which loan was expected to be fully disbursed. In the case of Jamaica the date refers to the second tranche disbursement

... = not applicable, CDB = Caribbean Development Bank, IDB = Inter-American Development Bank, IFI = international financial institution, IMF = International Monetary Fund, OCR = ordinary capital resources, SFR = Special Funds Resources, WB = World Bank.

Of the 10 PBOs listed in Table 4.3, several experienced delays and performed below expectations. There was an average delay of 6 months between Board approval and the signing of loan agreements. Implementation of loan conditions was delayed because of weak capacity in the BMCs, and unclear objectives and design issues (including, particularly in the earlier PBL operations, an excessive number of conditions in multitranche loans and in situations of rapidly changing economic circumstances). Timely implementation and disbursement were observed in only two of the seven multitranche loans. Disbursements of the remaining five loans were hampered by problems of implementation, with a need for adjustments, waivers, postponements or deferrals, or revisions of scope. By contrast, single-tranche loans were disbursed in a timely manner, without the need for waivers, shortly after finalization of the loan agreements.

Review Findings

Institutional and management arrangements. The review assessed the evolution of CDB's arrangements to manage PBL and found a number of issues that needed to be addressed:

- The “prudential limit” on policy-based lending of 20% of total loan disbursements had been reached by the end of 2010. CDB either had to severely restrict further lending or raise the limit.
- CDB needed to clarify the role of the IMF and other MDBs if they were to be involved.
- CDB should clarify operating rules for the funding of PBL by OCR or a blend of OCR and concessional resources (a blend of funding should occur only where there was a social sector or poverty reduction component).
- CDB should establish criteria for recommendations to the Board for the approval of waivers, partial disbursements, and revisions of scope.
- Separate and specifically adapted documentation should be prepared for the appraisal, supervision, and review of PBL (rather than relying on existing investment loan procedures).
- The role of CDB in financial sector restructuring needs to be clarified. Experience with bank rescues in two BMCs suggested that restructuring only be done in coordination with other lenders and TA providers.
- Revised guidelines for sectoral PBL operations are needed, including the extent to which, like IDB, CDB plans to develop them to tackle the many challenges in the social sector.
- An appropriate balance needs to be struck between supporting home-grown reforms and undertaking lending operations in which the contribution of CDB is clearly identified.

Conclusions and Recommendations

The review concluded that there was a pressing need for CDB to change its processes given the economic crisis facing the region at the time, and the fact that CDB had reached the 20% PBL lending limit set under the 2005 policy.

After 5 years, important gaps had surfaced in CDB’s framework, indicating that it was no longer adequate to address recent developments in PBL activity or to serve as a comprehensive guide to future PBL operations. There was a need for greater clarity on key aspects, including the review and supervision of PBOs, loan terms, waivers, TA, and the role of partner institutions, such as the IMF and World Bank. Given the uneven performance of PBOs over the first 5 years (as measured by disbursement delays and the incidence of requests for waivers and revisions of scope), the framework needed to be strengthened by updating the policy and operational guidelines.

The review made the following recommendations:

1. *Prudential limit and terms*

- (a) Increase the limit on PBL from 20% to one third of total loans outstanding, with the numerator and denominator measured as a 3-year moving average. Clarify the definition of the limit in the PBL operational guidelines.
- (b) Clarify the principles that determine the funding of PBL, and, in particular, the blending of OCR with SDF and OSF.
- (c) Apply OCR terms to macro-type PBL operations, and a blend of OCR and concessional funding for PBL operations with a clear poverty-related, social sector, or TA focus.
- (d) Given the interest expressed by some BMCs, explore the feasibility of giving borrowers the option of fixed or floating interest rates.²²⁵

2. *PBL design and review*

- (a) Specify, document, and distribute to directors, BMCs, and CDB staff appraisal standards, supervision and management review practices, and evaluation criteria that are specific to PBL operations, including those, such as the recent PBL for Barbados, that are based on an assessment by the CDB of the quality of policies and actions which are fully implemented by BMCs before completion of the appraisal.
- (b) Extend the period between loan approval and the signing of the PBL agreement beyond the current maximum limit (60 days) only in cases where the Loans Committee is satisfied that an extension would not result in a substantively changed macroeconomic framework or outlook for the BMC than that discussed at the time of board approval.
- (c) Document the procedures and review criteria used by the Loans Committee in the conduct of its assessment and approval of PBL proposals from the staff.
- (d) On the completion of each PBL operation, prepare completion reports to facilitate institutional learning and adequate evaluation.
- (e) Include a quantitative assessment of the impact of each PBL on the borrower's debt in the PBL documents sent for approval to the Loans Committee and the Board.

3. *Variations of PBL*

- (a) Since macro-type and sectoral PBL operations were contemplated in the policy approved by CDB's Board, but no sectoral loan has been developed, clarify the operational differences between macro-type and sectoral PBL, with examples of what would constitute a sectoral PBL, and how such a PBL would be managed—including for operations in the public, financial, and social sectors.
- (b) Clarify the policy and practice regarding the role of the IMF, World Bank, and IDB as partners in PBL operations.

²²⁵ IDB allows borrowers to select one of two interest rate options: (i) a pool-based adjustable lending rate, which is tied to the average cost of a pool of medium- to long-term borrowing, or (ii) a London Interbank Offered Rate (LIBOR)-based lending rate.

4. *Waivers, revisions in scope, and disbursements*

- (a) Incorporate into the PBL guidelines the policies and practices regarding waivers, deferrals, and revisions of scope, including a clarification of the roles of the Board, the President, and the Loans Committee.
- (b) Set out guidelines governing partial disbursements and supplementary financing.
- (c) Include in the operational guidelines the process for communicating to BMCs CDB's decisions on tranche disbursements.

5. *TA and coordination with other lenders and donors*

- (a) Revise the guidelines to require: (i) early consultation with other lenders and donors on ongoing and planned PBL operations and related TA issues; and (ii) a summary of these discussions in the appraisal document.
- (b) Specify more clearly in loan proposals to the Board an assessment of the TA (if any) needed to achieve the objectives of each PBL, the scheduling and delivery of such TA by institution, and the specific contribution of the CDB, including through TA loans or grants.

*Third Assessment of Policy-Based Lending, September 2012*²²⁶

Notwithstanding the guardedly positive assessments of the 2010 and 2011 reviews, some CDB Board members still questioned the effectiveness of PBL and the extent to which outputs and outcomes were being achieved. This concern was prompted in part by the waivers sought and granted to certain BMCs, as well as questions about whether the conditions attached to the PBOs had been commensurate with the gravity of the fiscal, debts and broader macroeconomic situations.

Terms of Reference

A study was commissioned, again with an individual expert, with the following terms of reference:

- Review the rationale and considerations underpinning the current policy-based lending framework.
- Assess the effectiveness of CDB's policy-based interventions (loans and TA) in support of policy reforms and institutional changes in its BMCs.
- Assess the institutional capacity of CDB to design and supervise effective policy-based interventions.
- Identify lessons learned and opportunities for improvement in policy-based operations and recommend other instruments CDB should consider in support of

²²⁶ Caribbean Development Bank (Dr. Terrence Farrell, Consultant). 2012. *Assessment of the Effectiveness of The Policy-Based Lending Instrument*.

fiscal and debt management in its BMCs if policy-based interventions are not considered the most effective instrument.

The assessment was based on key informant interviews (CDB staff and members of the Board of Directors), a document review, and a comparison between the PBL policies at CDB and those at other MDBs.

Conclusions and Recommendations

The review concluded that there was both demand- and supply-side appetite for further policy-based lending. However, improvements were needed in supervision and monitoring, and questions had been raised as to whether in, certain situations, PBOs had delayed necessary IMF-supported adjustment by BMCs and/or whether the reform agendas as designed and implemented had been sufficiently robust, given the regression that appeared to have occurred in certain cases.

The review recommended that:

- (i) The limit on PBL be raised to 33% of loans outstanding (from 20%), with the tenor on individual loans reduced to 10 years (which was a better match with the time period of reform completion).
- (ii) The operational guidelines be revised to specify conditions under which the Board could be asked to approve waivers, deferrals, and scope revision of PBL conditions.
- (iii) PBL not be offered to borrowing members in the absence of either an IMF Stand-By Arrangement, or an IMF opinion on the adequacy of a “home grown” program of adjustment. More generally, ensure greater collaboration with the IMF, World Bank, and IDB in design, supervision, and monitoring of PBL operations.

Findings

The assessment summarized CDB PBL operations (Table 5.4).

Table 5.4: Summary of Caribbean Development Bank Policy-Based Lending Operations

Country	Policy-Based Lending	Comment
Anguilla (2010)	\$55 million (OCR 100%); for debt restructuring	PBL objectives achieved; strong political commitment via governor of the territory
Antigua and Barbuda (2009)	\$30 million (OCR 100%) in three tranches (one tranche undisbursed at July 2012)	In progress; high completion rate of conditions; effected in conjunction with IMF Stand-By Arrangement (SBA)
Barbados (2010)	\$25 million (OCR 100%) single tranche to “ease fiscal strain” and protect social gains	This was an <i>ex post</i> PBL (conditions already fulfilled); no conditions related to foreign exchange outlook given debt profile; rating downgrade in July 2012; concerns remain
Belize (2006)	\$25 million (OCR 60%, SFR 40%) in two tranches to close fiscal financing gap and facilitate debt restructuring	Policy conditions set by CDB were achieved, but the country has since regressed and another debt restructuring is imminent
Grenada (2009)	\$12.8 million in three (originally two) tranches (OCR 37.5%, SFR 62.5%) to strengthen economic management and social policy frameworks	In progress at June 2012; most conditions were marked “achieved” with minor delays in some instances, but the fiscal situation has deteriorated; this has been attributed to adverse external factors; waiver granted
Jamaica (2008)	\$100 million (OCR 70%; SFR 30%) in three tranches as part of a program with other MDBs to improve “debt dynamics” and economic management	Loan conditions were marked “achieved;” however, Jamaica has since regressed and is reportedly engaging with the IMF for a new SBA
St Kitts and Nevis (2006)	\$20 million (OCR 60%, SFR 40%) to improve “debt dynamics” by replacing high-cost debt	Some reforms achieved, but PBL objectives not fully realized owing to global crisis; full disbursement, although three conditions remain unmet
St Lucia (2008)	\$45 million (OCR 60%, SFR 40%) in three tranches to build institutional capacity and expand fiscal space	Most conditions not satisfied but in an advanced stage of completion; waivers approved
St Vincent and the Grenadines (2009)	\$25 million in two tranches (OCR 64%, SFR 36%) to preserve fiscal and debt sustainability	Three conditions outstanding at June 2012
St Vincent and Grenadines (2010)	\$37 million, single tranche (OCR 100%); sector PBL to restructure and divest the National Commercial Bank of SVG and maintain domestic financial stability	Conditions achieved

CDB = Caribbean Development Bank, IMF = International Monetary Fund, MDB = multilateral development bank, OCR = ordinary capital resources, PBL = policy-based lending, SBA = Stand-By Arrangement, SFR = Special Funds Resources, SVG = the Bank of Saint Vincent & the Grenadines was formerly known as the National Commercial Bank (SVG),

Source: CDB, *SDF-8 A Framework for the Continuation of Resources to Address Fiscal Distress*,

Annex, *SDF 8/3 –NM-2-1*

*Review of Policy-Based Lending in States of the Organisation of Eastern Caribbean States, 2006–2018*²²⁷

²²⁷ Caribbean Development Bank (Office of Independent Evaluation) and Universal Management Group, 2019. *Cluster Country Strategy and Programme Evaluation of OECS and ODT Borrowers (2010-18); Volume III - Review of the Caribbean Development Bank’s Policy-Based Lending to the OECS.*

As part of a cluster evaluation of CDB's country strategies and programs in the Organisation of Eastern Caribbean States (OECS), the Office of Independent Evaluation (OIE) undertook a review of PBL experience in these six countries, and three overseas territories of the United Kingdom. The review drew heavily on the 2017 OIE evaluation of all CDB PBL (presented below) and distinguished between first- and second-generation loans. First-generation loans were characterized by more numerous and diverse prior actions, while second generation loans were more focused on their reform expectations.

The OECS borrowers are among the smallest and most vulnerable of CDB's members, with some in debt distress and others at moderate to high risk of becoming so. Over the review period, five OECS members received 10 PBL operations totalling \$319 million. The loans supported reforms in PFM; public debt restructuring and management; macroeconomic planning; public sector reform; social sector reform; sector reform (banking and finance, tourism, food safety, energy regulation); and trade facilitation.

As with other studies, this review confirmed the demand for the instrument in facilitating debt restructuring and averting banking crises in the Eastern Caribbean Currency Union, as well as in supporting "home-grown" reforms. The review probed some important design issues. Apart from noting the incidence of wide and unfocused reform plans in some early PBOs, it assessed the "quality" of prior actions across all 10 PBOs.

To do this, it applied the IDB classification of low-, medium-, and high-depth prior actions, according to the likelihood a given prior action would trigger lasting policy or institutional change. On this basis it found 25% were low-depth, 48% medium-depth, and 27% high-depth. In programmatic series, high-depth prior actions were observed in the later loans, evidence of good sequencing. As CDB had not at that time undertaken such an explicit analysis of prior action depth, the OES review suggested that it begin doing so.

The review found evidence that PBOs had facilitated bank resolutions in three members following the 2008 financial crisis, heading off potential contagion in the Eastern Caribbean Currency Area. Orderly debt restructuring and avoidance of default had also been accomplished in one of the smaller members.

The outcome of targeted reforms in PFM, public debt management, tourism, trade facilitation, disaster management (legislation, building standards and codes), and social safety nets was documented. However, there were numerous implementation delays across the portfolio, often as a result of insufficiently anticipated gaps in national capacity.

The review made a number of suggestions for improved PBL planning. CDB should:

- (i) adopt and apply a conceptual framework for explicit definition of the quality of prior actions;
- (ii) improve documentation, for the sake of transparency, of how prior actions were arrived at and the extent to which they are attributable to policy discussion between CDB and the borrower;
- (iii) document the needs for TA associated with PBL reforms, and what plans exist for its provision; and
- (iv) consider making greater use of PBL to build *ex ante* resilience, including, for example, fiscal buffers and better physical planning and building codes.

*Independent Evaluation of Policy-Based Operations (2006–2016)*²²⁸

This was the first fully independent overall evaluation of CDB PBL, carried out by its Office of Independent Evaluation (OIE). It assessed the nearly \$550 million in PBL to 12 borrowing members approved over the period 2006–2016, employing a significantly higher level of effort than the three earlier reviews of 2010–2012.

Objectives of the Evaluation

The evaluation's objectives as stated in its terms of reference were to assess:

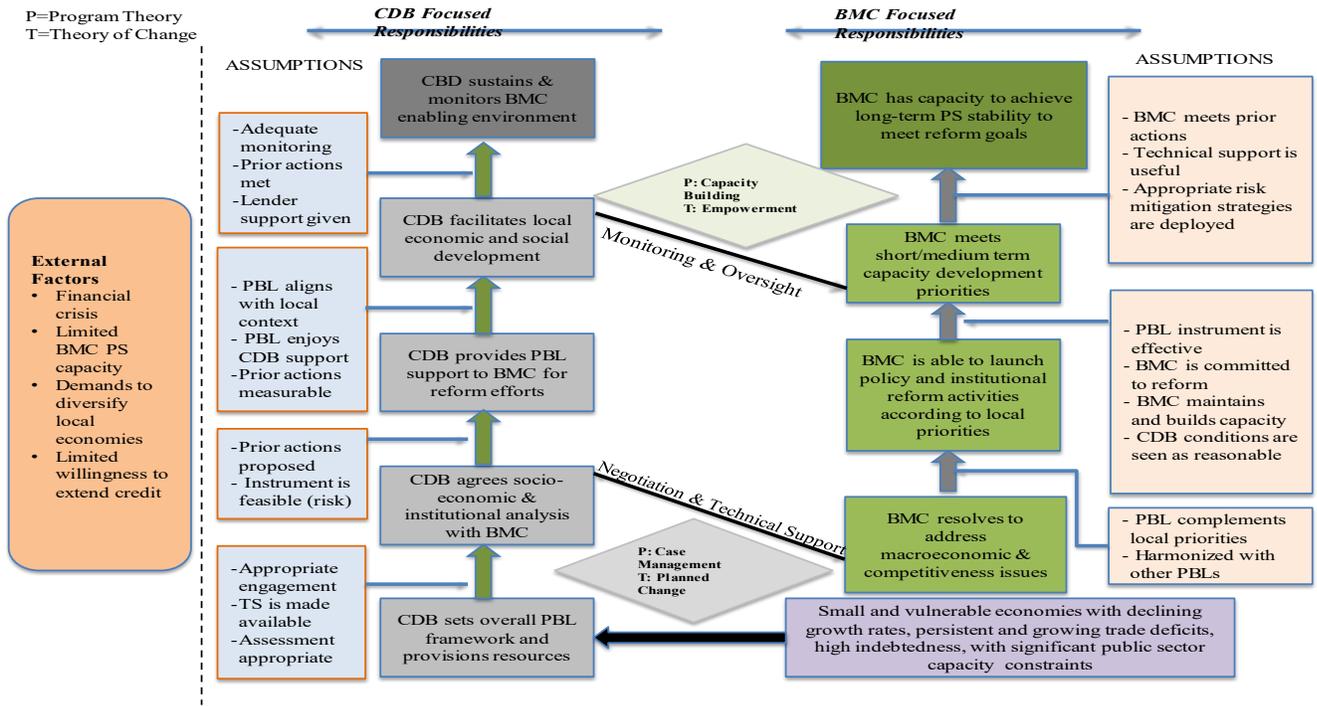
- the need for the PBL program,
- the relevance of the PBL program to BMCs,
- the achievement of results for BMCs,
- the design and implementation of the PBL program,
- the extent to which the PBL compares with international experience, and
- ways in which the program can be improved to support CDB's strategic objectives.

Evaluation Approach and Methodology

This was a theory-based evaluation, with a reconstructed theory of change for the PBL program (Figure 5.3), validated with stakeholders. It tested numerous assumptions that underlay the program.

²²⁸ Caribbean Development Bank (Office of Independent Evaluation) and Carleton University, 2017 *Evaluation of Policy-Based Operations (2006-2016)*

Figure 5.3: Theory of Change: Caribbean Development Bank Policy-Based Lending Program



BMC = borrowing member country, CDB = Caribbean Development Bank, PBL = policy-based lending, PS=public sector, TS=technical support

Figure 5.3 suggests that the logic of CDB’s PBL program has two parts: (i) the conditions set by CDB, and (ii) the conditions actually implemented by BMCs. CDB created the PBL initiative to enable BMC governance reforms that would not otherwise occur. Specifically, PBL was intended to assist “small and vulnerable economies with declining growth rates, persistent and growing trade deficits, high indebtedness, with significant public-sector capacity constraints.”²²⁹ To support such economies, CDB prepared funding contracts with conditions negotiated with borrowers to address policy-based reforms. CDB assessed whether BMCs were carrying out the conditions of these contracts through regular monitoring and oversight as shown by the cross arrows between the two causal pathways in the figure. For their part, BMCs accepted the conditions contained in those contracts with the long-term objective of ensuring macroeconomic stability and public capacity to meet their development goals.

In program theory literature, the change theory that best explains whether CDB can create such conditions is called “planned behaviour.” This theoretical framework suggests that if CDB creates appropriate application, review, and implementation processes for its PBL program, and there is a clearly stated need and rationale for the PBL intervention, then borrowers will utilize

²²⁹ Caribbean Development Bank. 2013. *Policy Paper: Framework for Policy-Based Operations - Revised Paper. BD_72/05 Add. 5*

the program to buttress their own reform efforts and prevent breakdowns or crises in their local governance systems. For their part, BMCs will not successfully effect the reforms unless conditions are built that maximize their room or flexibility for programs of reform based on their own identification of needs. Such flexibility provides the local confidence and commitment needed to respect PBL agreements.

Extensive evidence was gathered to test the assumptions in the theory of change (Table 5.5). This included in-depth case studies of PBL operations in Barbados, Jamaica, Grenada, and St. Vincent and the Grenadines; a meta-analysis of PBL experience at other MDBs; extensive interviews with BMC and CDB officials; and analysis of secondary (mostly macroeconomic) data.

Table 5.5: Assumptions Tests by Evaluation Criterion

Assumptions Tests	
1: Relevance of the PBL program	<ol style="list-style-type: none"> 1. Does the CDB PBL program support country objectives for reform? 2. Is the design of the CDB PBL program appropriate? 3. Is the CDB PBL program relevant, given alternative programs available to BMCs?
<i>If the first set of assumptions holds, examine the next questions.</i>	
2: Appropriateness of the conditions	<ol style="list-style-type: none"> 1. Is there an appropriate match between the conditions outlined in the PBOs, and the priorities of BMCs? 2. Are the conditions calibrated to the capacity limitations of the BMCs? 3. Does the benefit of implementing the conditions outweigh the costs of using the PBL? 4. Is technical support offered and is it appropriate?
<i>If the first and second sets of assumptions hold, examine the next questions.</i>	
3: Observable effects	<ol style="list-style-type: none"> 1. Is there an appropriate monitoring strategy for the program? 2. Are there observable effects that can be attributed to the program? 3. Are there improvements that can be made to the program?

PBL = policy-based lending, PBL = policy-based operation.

Findings and Conclusions

Need, relevance, and rationale. It is beyond dispute that MDB lending has been important to BMCs, enabling them to address fiscal pressure and debt management, as well as to encourage economic and social sector reforms. However, different parties emphasized different aspects of the instrument. Borrowers tended to be driven by short-term fiscal pressures, particularly in the aftermath of the 2007–2009 financial crisis. PBL support played a role in helping some of them through that period, and at times they agreed to reform programs that they did not entirely buy into. For their part, lenders (including CDB), while recognizing fiscal exigencies, understood the PBL to be primarily an instrument that provided incentives to implement reforms. At times they required large numbers of “prior actions” from BMCs as conditions of PBL support.

To some extent this difference in perspective had to do with sequencing: in one view relieving fiscal pressure first to allow the space to eventually undertake reforms; and, in the other, adopting reforms that will eventually help open fiscal space. While these views could co-exist in the broad space of acknowledged need for PBL lending, their differences did have implications for the expectations and approach to PBL negotiations by the respective parties.

A number of MDBs and other partner organizations—including the World Bank, IMF and IDB—brought significant funding to policy-based lending in the region. Respondents had clearly reflected on the appropriate role and value added of CDB among these larger players. They alluded to CDB’s more detailed understanding of BMC contexts, its closer working relationships with governments, and the potential for brokering harmonized reform packages that included non-economic governance elements.

Planning and design. The quality of the process by which borrowers and lenders came to an agreement on the design of an intended reform program was an important predictor of eventual success. The evaluation observed that in the first generation of PBL operations there was a perceived imbalance in negotiating leverage between CDB and borrowers (favouring CDB). As a result, the ownership of the prior actions by the BMCs and their commitment to expected reform outcomes were sometimes less than complete. This was compounded in cases where CDB’s consultation did not involve a sufficient range of stakeholders, particularly those who would either have a role in implementing reforms or would be affected by them. Not hearing these views at the outset came at the cost of lack of buy-in or even resistance to intended reforms during implementation. More recent PBL design processes had performed better in this regard.

Apart from the process of arriving at a design, the actual nature and number of prior actions and expected reform outcomes were important determinants of effectiveness. Again, it was observed that there was an evolution from earlier to more recent PBOs. Pre-2013 PBOs tended to require larger numbers of prior actions across multiple sectors, and these often lacked a clear causal linkage to the higher-level expected reform outcomes. BMCs felt that prior actions did not always reflect national reform priorities, and that the cost of delivering on them sometimes exceeded the value of the PBL on offer. More recently, there have been examples of PBOs with streamlined prior actions in fewer areas. These actions have been better calibrated to the scale of assistance being offered, and more likely to be achieved. There has also been some evidence of successive PBOs building on earlier efforts, with prior actions requiring incremental progress from earlier to later loans.

Assessing at the outset whether borrowers had the capacity to implement intended reforms was a necessary element of good PBL planning. Providing TA responsively during implementation to address bottlenecks was also important. To date, this has not been an area of strength for CDB.

Harmonization of CDB PBOs with those of other MDBs became stronger over the evaluation period. However, an unanticipated consequence of this harmonization has been that closely synchronising CDB's prior actions with those of other lenders has somewhat limited CDB's flexibility to tailor its own offerings. Such tailoring could grow out of CDB's particular understanding of BMC context, or its interest in promoting reforms focused on non-economic areas.

Implementation. The timeliness of fund disbursement under the PBL mechanism was efficient. That said, there were some instances of tranche payment in the absence of all prior actions being met (which is likely to have been related to earlier findings regarding numerous conditions and national capacity constraints). CDB's monitoring of PBOs was inconsistent. Project supervision and completion reports were sometimes missing, and monitoring was more oriented toward verifying completion of prior actions than to assessing progress towards reform outcomes. Evidence was not always available to corroborate project completion report statements.

The quality of PBL results frameworks was not optimal. The link between prior actions (outputs), and economic, sectoral, and institutional reforms (outcomes) was not always clear. Proposed indicators and targets were not necessarily good measures of the outcomes with which they were (or should have been) associated. BMCs lacked the capacity to report on the range of expected results. Statements of risk tended to be generic across PBOs, missing the need for mitigation strategies specific to each PBO's expected outcomes and national contexts.

The revised framework document of October 2013 placed renewed emphasis on the longer-term reform orientation of policy-based lending, and the value of programmatic PBL. At the same time, there are varying stages of readiness for reform implementation across the region, and a menu of PBL instruments, including multitranche PBOs, may be needed to respond to different situations.

Results achievement. Completion of PBO prior actions for three of the four case study countries (Barbados, Jamaica, and Grenada) was verified. This totaled 113 prior actions across five PBOs. In the fourth case study country (Saint Vincent and the Grenadines), completion of 19 out of 23 originally planned prior actions was verified; the other four were waived with Board approval to allow a second-tranche disbursement.²³⁰ Among the short-term outcomes of the PBL operations were:

- debt management improved;

²³⁰ In view of the challenging economic circumstances at the time, and the otherwise positive reform trajectory, the CDB Board authorized disbursement of the second tranche of the 2009 PBL, notwithstanding delays in completion of four prior actions. A separate 2010 PBL operation for St. Vincent and the Grenadines used an unusual formulation involving six prior actions and seven post-disbursement conditions or indicators. Completion of the prior actions was verified at the time of the evaluation, along with four of the post-disbursement conditions.

- fiscal space created that allowed BMCs to bolster social program reforms or reduce economic stress on individuals and families;
- conditions for investment improved to bolster key industries (such as tourism, by reducing wait times at border crossings, which could be attributed in part to PBL); and
- critical management systems such as audit, budgeting and planning improved, contributing to increased public sector management efficiency.

Because of the number of causal factors in play, including support from other PBL lenders and global economic events, it was difficult to attribute medium-term outcomes directly to CDB lending. Nonetheless, BMC officials across all case studies indicated that a coordinated, targeted, and ongoing program of reform supported by lenders such as CDB had ensured momentum, leading to improved economic and social program performance. For example, Jamaican respondents indicated that its 2008 PBL was, “a critically important intervention in Jamaica, and with the support of other MDBs helped to identify first generation structural reforms on which the recent fiscal gains have been premised.”

Generally, however, it was not feasible for the evaluation to gather a sufficient amount of directly attributable evidence to support statements of causal linkage between CDB’s PBL support and higher-level medium-term outcomes. This is a common difficulty in PBL assessment across MDBs, although as mentioned above an improvement in CDB’s specifications, measurement, monitoring, and reporting on results would help.

Summary Comments and Recommendations

Over the 10 years since the introduction of PBL at CDB, there had been an evolution in practice that reflects CDB’s learning and experience in managing the instrument, and its observation of how other MDBs also manage PBL. The loans addressed an evident need among BMCs.

The findings and conclusions of this evaluation, based on evidence generated from the document review, documented case studies, and a wide range of interviews, suggested that several key factors increased the likelihood of PBL operations achieving their desired results. These were:

- clear objectives and results logic, with indicators and targets that can be measured and verified;
- a selective focus on a manageable number of expected reform outcomes;
- agreement on a limited number of prior actions that are clearly linked to those outcomes;
- good understanding of external risks, and elaboration of mitigation strategies;
- an engagement process with BMCs that engenders ownership and commitment on the part of borrowers;
- a menu of PBL options that offers the right instrument calibrated to borrowers’ reform readiness;
- an understanding of national capacity constraints and, where needed, provision of affordable TA to address them;

- designation of an identified champion in the national public service with responsibility and authority for achieving reform results; and
- consistent monitoring to identify when conditions are met, and the degree of progress towards reform outcomes.

Although the evaluation found that CDB's PBL was increasingly taking account of these factors, it offered the following recommendations to encourage further progress.

- (i) CDB should review its practice of management for development results (MfDR) in the PBL program. It should ensure that its design process respects good MfDR practice, with clearly stated expected outcomes and indicators that are specific, measurable, achievable, relevant, and time-bound (SMART). The robustness of the results framework should be the primary criterion for quality at entry. Where necessary, staff responsible for PBL design and monitoring should have access to training in MfDR techniques, as well as occasional expert advice from a results specialist.
- (ii) CDB should develop more tailored risk mitigation strategies. To date, such strategies have tended to be generic across PBOs. Instead, they should be more closely matched to the specific circumstances of the national context and reform program.
- (iii) CDB's policy-based lending should focus on a limited number of key outcomes, with prior actions that are causally linked to them. The selection of outcomes should take account of: (a) the limited size of CDB's PBL loans, (b) BMC priorities and CDB's own country strategy, and (c) an agreed longer-term reform program in mind. This focus should ideally be maintained over time, with prior actions in successive PBOs building incrementally on one another.
- (iv) National ownership and leadership are indispensable to the success of development reform programs. CDB should facilitate these to the greatest extent possible through collegial engagement with BMCs in PBL design and implementation. This will require consultation with a sufficient breadth of national stakeholders, at both leadership and implementation levels, to gain commitment and follow through on reform objectives and prior actions. A good practice to be encouraged is the designation of a "champion" from the BMC's public sector for implementation of targeted reforms.
- (v) Small economies experience serious capacity constraints in attempting to implement reform programs. These need to be anticipated and responded to as part of an effective PBL program. Relative to other MDBs, CDB has an intimate understanding of the contexts and constraints of its BMCs. Yet it has carried out only limited needs analysis or uptake of CDB TA in connection with its PBL loans. CDB should investigate the reasons for this, ensure that potential TA requirements are well analyzed at the design stage, and that flexibility is shown when they are offered during implementation.
- (vi) Different countries find themselves at different stages of readiness for PBL-supported reform programs. Although the 2013 revised framework for PBL lending emphasized placing loans within a longer-term reform context (through a programmatic series approach), some BMC stakeholders contend that multitranche PBL may continue to be well suited to BMCs requiring more structured and predictable prior actions. CDB should ensure that the right PBL instrument is matched to each reform context.
- (vii) Monitoring and completion reports are important parts of the effective implementation and accountability of the PBL program. CDB should ensure that these tasks are

consistently carried out, and that they have a results focus, for all PBL. This should go beyond verifying that prior conditions have been met, and should assess the extent to which these actions are contributing to reform outcomes. CDB should also consider extending monitoring efforts beyond the timeframe of PBL disbursements. The outcomes of interest are, after all, medium- and longer-term reforms, and CDB will wish to track these as part of its overall country strategy process.

Management Response

Management expressed general agreement with the findings, conclusions, and recommendations of the OIE evaluation, with one area of exception. It felt that evaluators had underappreciated the extent of staff engagement with borrowers in arriving at agreed prior actions and reforms, and thus also understated the degree of national ownership of PBL-facilitated reform programs. It acknowledged, however, that consultation processes could have been better documented, that results frameworks should have more clearly established the logic of the links between prior actions and reforms, and that monitoring could be improved.

Management accepted all recommendations and provided a time-bound action plan for their implementation. The Oversight and Assurance Committee, a subcommittee of the Board of Directors, annually monitors completion of these actions.

3. Emerging Issues

In the period since OIE last examined policy-based lending, use of the instrument has if anything become more prominent in CDB's overall lending program, and PBL has been the subject of considerable Board discussion. In response to the impacts of several category 5 hurricanes, CDB has deployed exogenous shock response PBOs, which were contemplated in the 2013 policy framework but had not previously been used. This has prompted thinking on how policy-based lending could better incentivize policy and institutional actions that would build *ex ante* resilience to natural hazards. CDB's recently approved Disaster Management Policy and operational guidelines in fact suggest that a specific "resilience PBL" instrument be prepared. Deferred draw-down approaches have also been discussed.

The global pandemic is having an enormous impact on the Caribbean's tourism-dependent economies and their fiscal and debt balances. CDB has responded with both a debt moratorium on outstanding OCR loans (to selected countries), and new PBL aimed at preserving macroeconomic stability. Elevated lending has in turn revived discussion of the allowable upper limit for total policy-based lending. Given the circumstances, the Board has granted an increase to 38% of outstanding balances, but only until 2023. At the same time, it has asked Management to further review of experience with the instrument and its guiding framework.

Annex

Summary of Reform Milestones

Type of Reform	Fiscal policy	Public Enterprise	PFM and audit	Debt management	Economic Management	Financial sector	Investment and growth	Social sector	Doing business reform	Energy reform	Resilience	Number of reforms
Belize, 2006	3	1	1	1	-	1	-	-	-	-	-	7
St. Kitts and Nevis, 2006	6	2	2	2	-	-	-	-	-	-	-	12
Jamaica, 2008	5	1	2	1	1	-	-	-	-	-	-	10
St. Lucia, 2008	4	-	1	1	1	-	2	2	-	-	-	11
St. Vincent and the Grenadines, 2009	9	1	2	2	-	-	1	1	-	-	-	16
Grenada, 2009	3	-	2	2	2	-	1	-	-	-	-	10
Antigua and Barbuda, 2009	6	-	1	3	1	-	-	2	-	-	-	13
Barbados, 2010	7	-	3	3	1	-	-	3	1	-	-	18
St. Vincent and the Grenadines, 2010	5	-	1	2	-	-	2	1	-	-	-	11
Anguilla, 2010	5	-	1	2	1	-	-	2	1	-	-	12
St. Kitts and Nevis, 2012	-	1	-	2	-	-	-	-	-	-	-	3
Jamaica, 2012	3	-	1	-	2	1	-	4	3	-	-	14
Trinidad and Tobago, 2014	2	-	-	-	-	-	-	-	-	7	-	9
Grenada, 2014/15/16	2	1	2	-	3	1	2	3	3	1	2	20
Antigua, 2015	7	-	-	1	-	6	-	-	1	-	-	15
Suriname, 2016	1	-	-	1	-	-	2	-	-	6	-	10
Turks and Caicos Islands, 2016	1	-	-	-	1	-	1	-	1	-	1	5
British Virgin Islands, 2018	1	-	-	-	-	-	-	-	-	-	5	6
Barbados, 2018	10	1	1	4	2	1	-	1	-	-	-	20
Anguilla, 2018	5	1	2	1	1	-	-	2	-	1	2	15
Barbados, 2019	2	2	1	4	2	-	1	3	4	-	-	19
The Bahamas, 2019	2	-	1	-	-	-	-	-	-	-	9	12
Total Reform Measures	89	11	24	32	18	10	12	24	14	15	19	268

Comments on “Caribbean Development Bank: Policy-Based Lending and its Evaluation”

Comment by: Ali Khadr

The chapter provides an informative overview of the findings of five assessments, including two Office of Independent Evaluation (OIE) evaluations, of Caribbean Development Bank (CDB) policy-based operations (PBOs). Among many other findings, it conveys clearly how the institution’s practice of policy-based lending (PBL), as well as the associated framework and guidance, has evolved over the roughly 15 years since it was officially initiated. Like other multilateral development banks (MDBs), CDB has moved over time toward the body of good practice identified in an ever-growing PBL literature. As expected, the favorable evolution of CDB’s PBL practice notwithstanding, there is room for further improvement.

Among the key elements of this emerging body of good practice are: (i) more frequent use of the more adaptable programmatic PBL instrument variant compared with the more rigid multitranches variant; (ii) a focus on fewer, “deeper”²³¹ prior actions in PBOs; (iii) use of results frameworks with a tighter logic linking a limited number of prior actions to a manageable number of key outcomes sought, as well as associated use of specific, measurable, achievable, relevant, and time-bound (SMART) results indicators; (iv) greater country ownership of proposed measures and outcomes sought, bolstered by broad prior consultation; (v) identification of capacity constraints to reform implementation and provision of parallel technical assistance as needed; and (vi) identification and mitigation of risks that are adequately tailored to the specific operation.

There is little I can find to disagree with in the chapter’s chronicling of the findings and recommendations of the successive reviews and evaluations of CDB policy-based lending. There is also little I find counter-intuitive in the findings. I propose therefore to focus this commentary on a few questions that future CDB evaluation work on PBL might usefully look at in greater depth (existing OIE work has already examined them to some extent). These questions concern: (i) the use of PBOs specifically as they relate to small states and the shocks to which they are frequently subject; (ii) the use of PBOs to strengthen fiscal management; (iii) analytical underpinnings of PBOs; (iv) results framework quality, including depth of prior actions; and (v) establishment of attribution or contribution.

²³¹ The concept of depth, which has been used in several evaluations of policy-based lending, can be traced back to the measure of “structural depth” developed and applied in IEO (Independent Evaluation Office), 2007. *Structural Conditionality in IMF-supported Programs*, Washington, D.C.: International Monetary Fund.

1. Policy-Based Operations and Small States

CDB is unique among MDBs in that its clients consist overwhelmingly of small states, formally defined as countries with fewer than 1.5 million inhabitants. Of the CDB's 19 borrowing member countries (BMCs), 17 are small states (or dependencies). Of the latter, most are islands or archipelagos.

As has been extensively documented in a burgeoning literature, small states as a group, and especially small island states—despite the heterogeneity of their specific characteristics and needs—share several intrinsic characteristics and challenges compared with larger states.²³² These include fixed costs in the public and private sector that are typically high relative to the small scale of operations, entailing high unit costs (and, for instance, larger public expenditure, including public sector wage bills, as a share of GDP). The locations of these states also commonly entail high trade costs as well as extreme vulnerability to natural disasters and the deleterious effects of climate change. In addition, their exports tend to be very concentrated (e.g., in tourism and a few commodities), which makes them particularly vulnerable to trade shocks and contagion from trading partner downturns, including the downturn that the coronavirus disease (COVID-19) pandemic has induced. In addition, the small absolute (though not relative) size of their public sectors limits their institutional capacity for policy making and service delivery.

These intrinsic characteristics and challenges, particularly the exposure to repeated economic and natural shocks that are large relative to GDP, have resulted in a greater volatility of growth in small states compared with larger states. Together with the inherent stresses on public finances and limited borrowing opportunities, these repeated shocks have often entailed fiscal distress and rapid debt accumulation, making effective fiscal and debt management an imperative.

Given the shock-intensive client country context, policy-based lending from multinational development banks has a clear role to play in CDB BMCs. It is especially encouraging to see that CDB has stepped up to the plate, *inter alia* raising the prudential limit to 38% to create lending headroom to counter COVID-19-related fallout and offering exogenous shock response policy-based operations (PBOs) as a distinct instrument variant. Future evaluations of CDB PBOs can yield valuable lessons on how effectively such operations have supported small states, especially in helping to mitigate the shocks to which they are subject and to build resilience. In particular, it may be worth examining whether: (i) in seeking to strengthen fiscal resilience, the PBOs have been sufficiently broad in scope, adequately addressing the multiple drivers of fiscal and debt sustainability; and (ii) in seeking to enhance natural disaster and climate change resilience, the

²³² See, for example, Independent Evaluation Group. 2016. *World Bank Group Engagement in Small States: The Cases of the OECS, PICs, Cabo Verde, Djibouti, Mauritius, and the Seychelles*. World Bank Group: Washington, DC. IEG's cluster country program evaluation of World Bank Group support to small states found a repeated two-pillar pattern of country program support in these countries: (i) for strengthening resilience (macro-fiscal, disaster risk and climate, and social); and (ii) for enhancing competitiveness (trade facilitation, financial sector strengthening, infrastructure expansion and management, and leading sectors (e.g., tourism, fisheries, and agriculture) support). The evaluation assessed the World Bank Group programs in the six independent Organisation of Eastern Caribbean States (OECS) countries and nine Pacific island countries, and more selectively the programs in four African small states: Cabo Verde, Djibouti, Mauritius, and Seychelles. It covered the period 2006–2014.

PBOs have gone beyond direct support for resilience-building and focused on measures that can foster wholesale changes in public and private incentives and behavior as well as on the long-term risks of climate change (including whether they have facilitated countries' access to climate financing).

2. Policy-Based Operations and Fiscal Management

In keeping with the findings of IEG (footnote 179) and those reported in the chapter, it is likely that in many small states drawing on PBOs, fiscal management will be—or at least should be—a central component. This observation suggests that one area of focus in future PBL evaluation work by CDB could usefully be the quality of PBOs' macro-fiscal frameworks, given recent findings in the evaluation literature to the effect that it is positively associated with loan outcomes.

In an earlier study, IEG examined the quality of macro-fiscal frameworks in 390 World Bank PBOs completed during fiscal years 2005–2013 and found that certain aspects of the quality of PBO macro-fiscal framework design were positively correlated with loan outcome ratings.²³³ Specifically, two aspects of the quality of the PBO framework showed a statistically significant association with loan outcome ratings: (i) the credibility of the PBO framework given the country's fiscal track record; and (ii) adequate coverage of quasi-fiscal risks (i.e., risks that the government might need to devote public spending to off-budget items, such as an underfunded public pension system or state-owned enterprises in distress). Once PBO implementation quality—as measured by the deviation between the macro-fiscal targets under the PBO and actual outcomes—was factored in, the overall quality of macro-fiscal framework design was also statistically significantly associated with loan outcome ratings. The quality of framework design was also positively correlated with PBO implementation. Moreover, in-depth case studies suggested that close collaboration with the IMF in PBO preparation increased the likelihood of a well-designed macro-fiscal framework.

In this regard, I was not entirely clear from the CDB chapter whether the OIE evaluation of PBOs examined the quality of collaboration with the IMF in developing and monitoring the associated macro-fiscal frameworks. Given the requirements under the 2013 framework, intuition suggests at least some level of collaboration, but future evaluation work could usefully assess the depth of such collaboration, and whether it correlates to PBO effectiveness.

²³³ Independent Evaluation Group. 2015. *Quality of Macro-Fiscal Frameworks in Development Policy Operations*. Washington, DC: World Bank.

3. Analytical Underpinnings of Policy-Based Operations

There is emerging, although not entirely conclusive, evidence that strong analytical foundations can be an important determinant of PBO effectiveness. For instance, IEG found generally solid links between World Bank PBL design and integrative analytical work on public expenditure, as well as continuity in policy dialogue from the latter to the former.²³⁴ However, it was difficult to establish a clear association between such links and PBO outcome ratings, although PBOs informed by analytical work on public expenditures showed slightly better outcome ratings over 2009–2012. Nevertheless, case studies did provide illustrations (e.g., a programmatic PBL series in Peru) where timely, high-quality analytical work informed loan design, including the choice of prior actions and the specification of robust links between actions and anticipated outcomes in the results framework, resulting in good loan outcomes.²³⁵ Findings regarding the importance of sound analytics are also reflected in earlier evaluation work, notably an evaluation at the Asian Development Bank in 2007, which found that insufficient consideration of macroeconomic and/or sector policies tended to detract from desirable loan outcomes.²³⁶ In this regard, I was not entirely clear from the CDB chapter whether the OIE evaluation had systematically assessed whether PBOs were adequately underpinned by analytical work, although this would be a worthwhile topic for future CDB evaluation work to examine.

4. Policy-Based Operations Results Framework Quality and Depth of Measures

It is encouraging to note from the chapter that the depth of prior actions in CDB PBOs has increased over time. Depth of a prior action—the extent to which the reform measure on its own can bring about lasting change in the institutional and policy environment—is a key ingredient in the quality of the results framework.²³⁷ In other words, non-critical, shallow, and process-related measures should be avoided. Another key ingredient in quality of the results framework is the consistency of the policy matrix—the extent to which there is a clear “line of sight” between PBO conditions, program objectives, and the intended results or outcome indicators. In other

²³⁴ Independent Evaluation Group. 2015. *How does Knowledge on Public Expenditures Integrate with the Design of Development Policy Operations?* Washington, DC: World Bank.

²³⁵ Case studies also pointed to instances of missed opportunities where available knowledge was not adequately drawn upon and loan outcomes were compromised.

²³⁶ Operations Evaluation Department. 2007. *Policy-Based Lending: Emerging Practices in Supporting Reforms in Developing Member Countries*. Manila: Asian Development Bank.

²³⁷ Independent Evaluation Group. 2015. *The Quality of Results Frameworks in Development Policy Operations*. Washington, DC: World Bank. OIE’s evaluation of PBOs in the Organisation of Eastern Caribbean States (OECS) countries in the CDB chapter found 25% to be low-depth, 48 medium-depth, and 27% high-depth, and in programmatic series, high-depth prior actions were observed in the later loans. IEO (Independent Evaluation Office), 2007, *Structural Conditionality in IMF-supported Programs*, Washington, D.C.: International Monetary Fund, found that depth was often lacking in IMF structural conditionality. Similarly, the Inter-American Development Bank, OVE (Office of Evaluation and Oversight. 2016. *Design and Use of Policy-Based Loans at the IDB*. Office of Evaluation and Oversight Technical Note to the 2015 Annual Report, Washington, DC: Inter-American Development Bank) found that most reform measures in a sample of IDB PBOs were low- or medium-depth, although the depth of the reforms tended to increase in later operations in a programmatic series (which also implied that truncation of series, frequently observed, missed out on the more worthwhile reforms). IED (Independent Evaluation Department, 2018) *Policy-Based Lending 2008–2017: Performance, Results, and Issues of Design*, Asian Development Bank, Manila, also documented the frequent absence of depth in ADB PBO-supported measures.

words, there should be a strong logic linking inputs, outputs, and outcomes, including in the results indicators selected.²³⁸

Because there is some empirical evidence that these two aspects of the quality of the PBO results framework matter to loan outcomes, they would be worthwhile areas of focus in future PBL CDB evaluation work. Moll et al. used regression analysis to examine the correlates of the outcomes of World Bank PBOs.²³⁹ They focused on two variables, both constructed through desk reviews of the PBO documentation. The first was the fraction of “weaker” prior actions that focused largely on process-oriented steps—in other words, that lacked depth. The second variable measured the extent to which the results framework embodied a clear link between PBO conditions, program objectives, and the intended results, including the use of specific, measurable, achievable, relevant, and time-bound (SMART) indicators. The paper found that the second variable had a strong and statistically significant positive association with the PBO outcome rating. The first variable, the proportion of prior actions lacking in depth, was negatively associated with the PBO outcome rating, and its significance increased once the variable on policy matrix consistency was removed from the model. In summary, a clear link from reforms to outcomes and a lower proportion of conditions lacking in depth were both associated with a better outcome rating.

5. Attributing Outcomes to Policy-Based Lending

A common complaint in PBL evaluations concerns the difficulty of attributing—at least in part—medium-term country outcomes to the use of PBOs, including the prior actions they support and the financing they provide. The difficulty is compounded when several development partners deliver PBL simultaneously. It is therefore not surprising to read in the chapter that “it was not feasible for the [OIE] evaluation to gather a sufficient amount of directly attributable evidence to support statements of causal linkage between CDB’s PBL support and higher-level medium-term outcomes.”

Nevertheless, it is often possible to make some headway, perhaps toward establishing “plausible likelihood of contribution” (rather than directly attributing an outcome to a PBO), and future CDB evaluation work might usefully focus on this. The process involves—for PBOs with reasonable-quality results frameworks—referring to an evaluation framework such as that prepared by OECD.²⁴⁰ My own preference involves doing a “right-to-left” or “reverse causal chain” analysis using the PBO’s results framework, involving the following sequence of steps:

- clearly state the outcome(s) that is (are) the subject of the causal contribution analysis, including the associated outcome indicator(s);

²³⁸ This also implicitly takes account of how well the results indicators selected fulfill the SMART criteria.

²³⁹ Loan outcomes were measured by the IEG-validated performance (or outcome) ratings of 312 PBOs completed between 2004 and 2015. P. Moll, P. Geli, and P. Saavedra. 2015. Correlates of Success in World Bank Development Policy Lending. *Policy Research Working Paper 7181*. World Bank.

²⁴⁰ Organisation for Economic Co-operation and Development. 2015. *Evaluating the Impact of Budget Support: Conclusions and Recommendations Based on a Synthesis of Seven Budget Support Evaluations*. Paris: OECD.

- identify the main factors that play a role in bringing about the outcome(s) and changes, including the contributing policies, the outputs of public and private expenditures, and the supporting institution(s);
- identify the principal roles that the CDB and other development partners have played in enabling these contributing factors; and
- following the logic of the results chain, identify the concrete elements of the PBO—including the relevant prior actions, the financing provided, and any associated policy dialogue, analytical work, technical assistance, and convening activity and partnerships engagement—that have been the principal means through which the PBO has helped enable the contributing factors.

6. Conclusion

Given the concentration of CDB clients in small states, CDB PBL evaluation work can teach us valuable lessons about how CDB PBOs support small states in dealing with shocks, particularly whether PBOs adequately cover the multiple drivers of fiscal and debt sustainability and whether they foster systemic, rather than incremental, changes in disaster and climate resilience by targeting incentives and behaviors. Other questions on which future CDB evaluation work could usefully focus include: the quality of CDB PBOs' macro-fiscal frameworks and analytical underpinnings, the quality of PBO results frameworks (including depth of prior actions supported), and establishment of the plausible likelihood of PBOs contributing to country outcomes.

Chapter 6

Policy-Based Financing at the World Bank: Evolution, Performance, and Reform

Željko Bogetić and Jeffrey Allen Chelsky*

International financial institutions use different names for policy-based financing (PBF) or policy-based operations/lending (PBOs/PBLs), which refers to budget support to help promote the recipient governments' policy and institutional reforms. The World Bank generally refers to this as development policy financing (DPF), delivered through different varieties of DPF instrument depending on the nature of the financing provided. A development policy loan is a common type. If the financing is in the form of a grant (typically provided to low-income country recipients from the World Bank Group's International Development Association [IDA] resources), the PBF will usually take the form of a development policy grant.

Financial support through DPF can also take the form of a guarantee, for which a policy-based guarantee (PBG) is used,²⁴¹ or as contingent financing, depending on the activation of an indicative trigger related to natural disasters or health crises (for example, a DPF with a deferred drawdown option). Other varieties of the DPF instrument have been used over time—for example, poverty reduction support credits (PRSCs)—but are no longer used. DPF can be provided through a single, stand-alone operation or through a programmatic series of operations, linked by indicative policy triggers. DPF is provided to sovereign national governments of World Bank member states and, sometimes, to subnational governments.

1. Historical Development and Use of Policy-Based Financing, 2005–2019

The World Bank's policy on DPF states: "a DPF is aimed at helping a Member Country address actual or anticipated development financing requirements that have domestic or external origins. The [World] Bank may provide a Bank Loan to a Member Country or to one of its Political Subdivisions; and it may provide a Bank Guarantee of debt incurred by a Member Country or by one of its Political Subdivisions."²⁴² DPF aims to help the borrower achieve sustainable poverty reduction through a program of policy and institutional actions, for example, strengthening public financial management, improving the investment climate, addressing bottlenecks to improve service delivery, and diversifying the economy. DPF provides general budget support, meaning that the funds are disbursed into the general budget of the client government and are not tied to specific budget items.

²⁴¹*This chapter was prepared by staff of the Independent Evaluation Group (IEG) of the World Bank Group. The findings, interpretations, and conclusions expressed here do not necessarily reflect the views of World Bank management or the Executive Directors of the World Bank or the governments they represent.

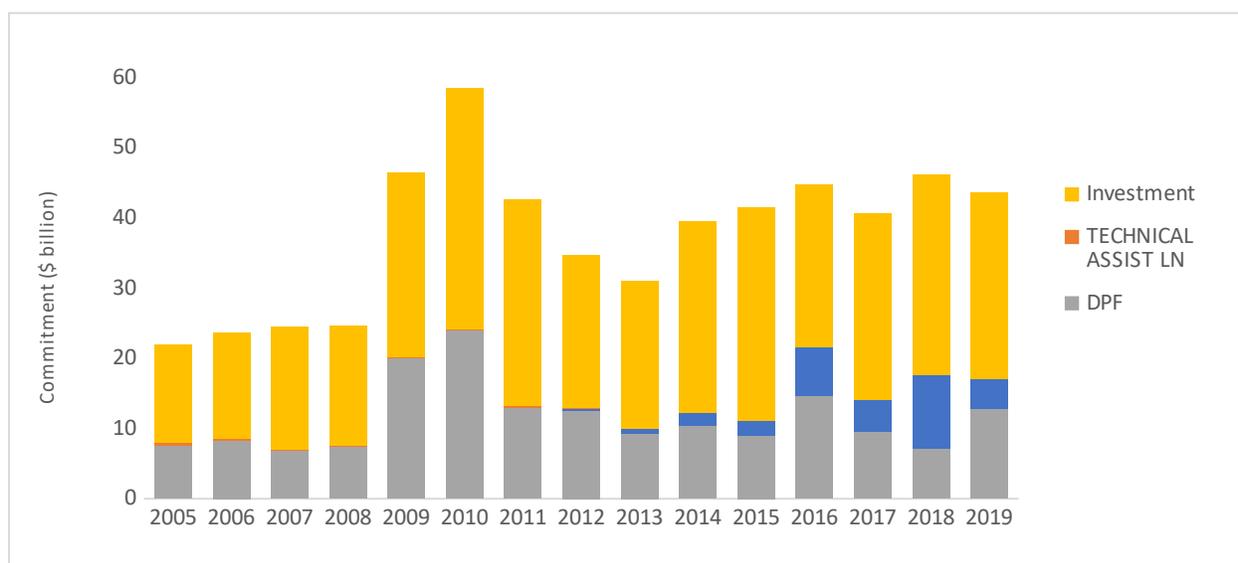
With a PBG, instead of providing financing directly to the client, the World Bank provides a guarantee for a portion of the principal and/or interest on the loan while commercial creditors provide the loan itself via direct commercial lending or via client government international bond issuance.

²⁴² World Bank. 2017. *The World Bank Operational Manual: Operations Policy OP/BP 8.60*. Washington, DC: World Bank. Section III.

DPF is provided after implementation of a set of policy and institutional actions (prior actions) that support the achievement of development policy objectives, consistent with the recipient’s national goals and strategies and the World Bank’s strategy in the country. Implementation of all prior actions is a condition for approval by the Board of Executive Directors. The purpose of the prior actions is to advance, catalyze, or signal broader reforms and demonstrate credibility and ownership necessary for their success. Well-defined results indicators, with clear baselines and time-bound targets, monitor progress toward objectives. A credible results chain (or theory of change) links objectives, prior actions, other activities, and results indicators. The policy framework is developed through a policy dialogue between the World Bank and the recipient government.

At the World Bank, over the past decade and a half, DPF operations have typically accounted for between one-quarter and one-third of World Bank financing commitments, rising during times of major crises to as high as 40% (Figure 6.1). The use of DPF escalated during the global financial crisis in 2007–2009 because it was used to provide countercyclical financing to many developing country recipients. This has also been the case during regional crises.

Figure 6.1: Evolution of World Bank Financing by Financing Instrument, 2005–2019

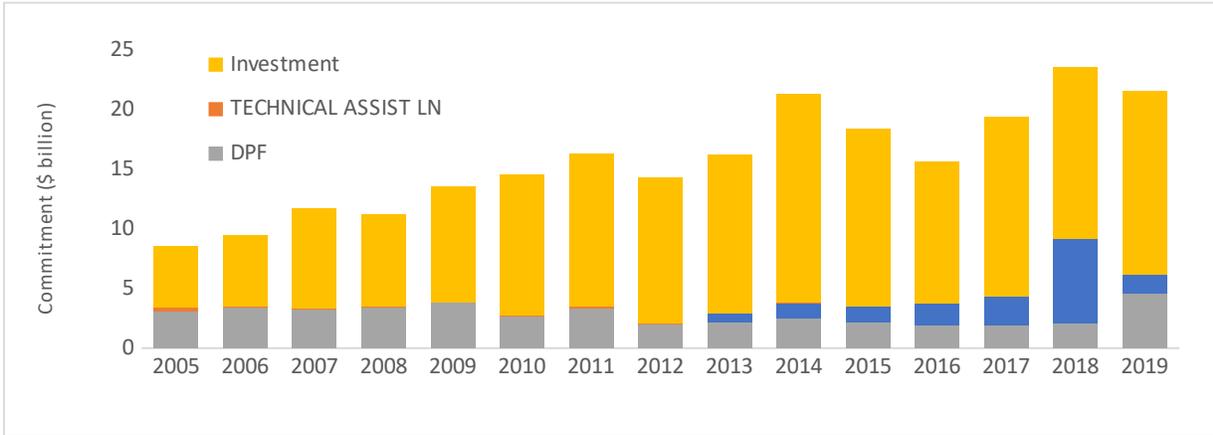


Source: Independent Evaluation Group.

Note: DPF includes development policy loans and grants, poverty reduction support credits, programmatic structural adjustment loans, sector adjustment loans, structural adjustment loans, and emergency recovery loans. P4R refers to the program-for-results financing instrument, and “investment” refers to traditional investment projects.

The World Bank has historically made relatively greater use of development policy financing (as part of overall development financing) in middle-income than to low-income countries. To some extent, this reflects the more advanced institutional and absorptive capacities and better developed systems of public expenditure management and budget planning in these countries. The global financial crisis had a disproportionate impact on middle-income countries, and, in response, the World Bank scaled-up DPF operations to middle-income country recipients during and immediately after the crisis (Figure 6.2).

Figure 6.2: Evolution of World Bank Financing to Middle-Income Country Recipients by Financing Instrument, 2005–2019

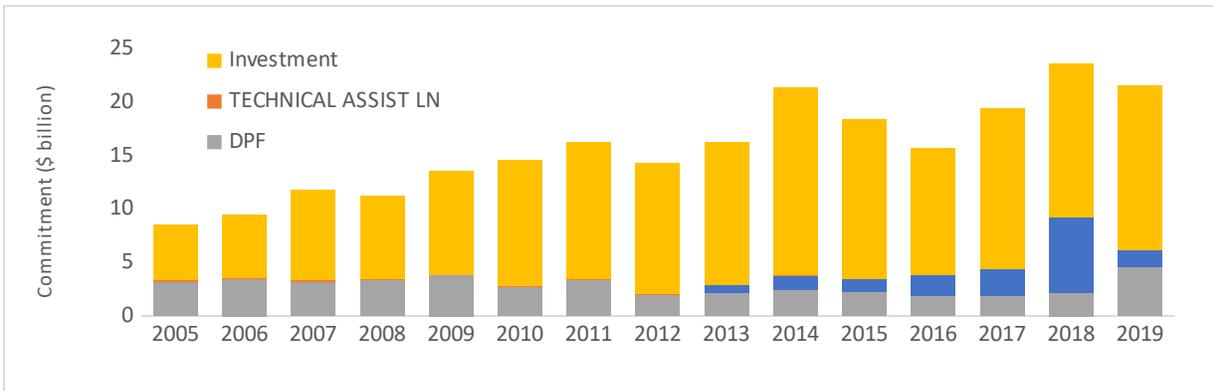


Source: Independent Evaluation Group.

Note: DPF includes development policy loans and grants, poverty reduction support credits, programmatic structural adjustment loans, sector adjustment loans, structural adjustment loans, and emergency recovery loans. P4R refers to the program-for-results financing instrument, and “investment” refers to traditional investment projects. World Bank financing to middle-income countries is extended through International Bank of Reconstruction and Development (IBRD), which is part of the World Bank Group.

Investment project financing from the World Bank is relatively more important in low-income countries. However, a growing number of low-income countries, especially in Sub-Saharan Africa, and particularly since the onset of the COVID pandemic, are now receiving budget support through DPF (Figure 6.3). The largest low-income country recipients of DPF between 2005 and 2019 were Bangladesh, Ghana, Pakistan, Viet Nam, and Tanzania.

Figure 6.3: Evolution of World Bank Financing to Low-Income Country Recipients by Financing Instrument, 2005–2019



Source: Independent Evaluation Group.

Note: World Bank financing to low-income countries is extended through International Development Association (IDA) fund. DPF includes development policy loans and grants, poverty reduction support credits, programmatic structural adjustment loans, sector adjustment loans, structural adjustment loans, and emergency recovery loans. P4R refers to the program-for-results financing instrument, and “investment” refers to traditional investment projects.

Programmatic development policy operations—a series of consecutive budget support operations in support of a common set of objectives and reforms—have become more common at the World Bank, reflecting their ability to more consistently support longer-term reforms, particularly in the context of a stable policy environment. They enable policy dialogue to continue, reforms to be monitored, and midcourse corrections to be made, as needed. By contrast, stand-alone loans may be more appropriate in the context of either short-term needs or situations of uncertainty (for example, re-engagements, crises, political uncertainty), when the World Bank needs to balance the need to support clients while maintaining flexibility regarding subsequent commitments.

2. Use of Policy-Based Financing in the World Bank’s Response to the COVID-19 Pandemic

Given the seriousness of the coronavirus (COVID-19) pandemic and the threat it poses to development gains and future progress, the World Bank has brought its full range of instruments, including DPF, to bear in support of its clients. DPF supports clients in several ways, even when operations are not tagged explicitly as part of a COVID-19 response. DPF provides countercyclical financial support to help countries to maintain critical public services, address rising health care needs, and replace revenues lost from declining economic activity. The prior actions in DPF operations support reforms that will improve the efficiency of public sector spending, thereby making better use of increasingly scarce public resources. This can include improving budget processes to ensure that resources are allocated to the most critical needs, supporting private sector development to help sustain firms during the crisis, and strengthening their eventual recovery (including by encouraging reforms that lower the costs of doing business).

At the outset of the COVID pandemic, the World Bank Group committed itself to providing up to \$160 billion, in total financing (IBRD, IDA, IFC, MIGA, and from trust funds), from April 2020 through the end of June 2021 to help countries address the health, social, and economic impacts of COVID-19, while maintaining a line of sight to their long-term development goals. This financing comes from a variety of instruments (including DPF) through new operations and restructuring existing ones to strengthen country capacity to address health, economic, and social shocks. It includes \$50 billion in IDA financing for low-income country recipients. The support is organized around four pillars: saving lives, protecting the poor and most vulnerable, ensuring sustainable business growth and job creation, and strengthening policies, institutions, and investments for rebuilding better.²⁴³ By June 2021, the Bank provided \$157 billion in overall financing support to client countries, of which \$98.9 was accounted for by IBRD financing for middle-income countries and IDA financing for low-income countries.²⁴⁴ Of this, about \$28 billion was provided in development policy financing for crisis support, \$10 billion to middle-income and \$8 billion to low-income countries²⁴⁵ This \$28 billion in DPF in support of the

²⁴³ World Bank. 2020. *Supporting Countries in Unprecedented Times: Annual Report 2020*. Washington, DC: World Bank.

²⁴⁴ The World Bank 2021. *Annual Report 2021: From Crisis to Green, Resilient and Inclusive Recovery*. World Bank. Washington D.C.

²⁴⁵ World Bank. 2021. *2021 Development Policy Financing Retrospective: Preliminary Findings*. OPCS. World Bank: Washington D.C. pp. 24-25. <https://thedocs.worldbank.org/en/doc/15a18cacdbcf0b366069d95225036969-0290032021/original/Development-Policy-Financing-DPF-2021-Retrospective-Preliminary-Findings.pdf>

COVID19 crisis response during April 2020-June 2021 compares with \$12.9 billion provided in the FY2019 as shown in Figure 6.1.

3. Independent Evaluation Group Evaluation and Validation of Development Policy Financing Operations

At the close of every World Bank DPF operation (or programmatic series of operations), the unit which prepared the operation produces a self-evaluation in the form of an implementation completion and results report (ICR). ICRs are intended to provide a candid and systematic account of the performance and results of each operation or programmatic series of operations, drawing on evidence collected during the life of the project and after completion, thereby contributing to World Bank learning and accountability. The ICR assesses the extent to which operations have achieved their relevant objectives, self-assesses World Bank performance and, until recently, rated borrower performance.

IEG conducts validations of all ICRs. The resulting report, the ICR review (ICRR), is the main operation-level assessment of operational performance. The ICRR validates the ICR's analysis and findings, providing an independent, desk-based, critical review of the evidence, results, and ratings of World Bank self-evaluation. Based on the evidence provided in the ICR and an interview with the relevant task team leader, IEG arrives at an independent rating for the operation. The ICRR may downgrade the rating of an operation from the staff self-assessment, sometimes because of shortcomings in the evidence in support of achievement. IEG reports aggregated data on the disconnect between staff and IEG ratings to the Board, which provides some degree of discipline on the objectivity of the self-assessment. IEG conducts in-depth evaluations (project performance assessment report) for a subset of operations with a completed ICRR, based on additional evidence (including field visits with extensive interviews of relevant stakeholders) to gain deeper insights into what works and what does not, serving both accountability and learning functions.

ICRs and ICRRs have traditionally taken an objectives-based approach to evaluating performance by assessing the relevance of the objectives and design and the achievement of each objective with reference to targets for pre-identified results indicators. This methodology is similar to the approach used to evaluate and validate investment projects. Recently, the World Bank and IEG reformed the approach to assessing budget support operations to better reflect the characteristics of DPF operations. This new framework, which began being implemented recently, is discussed below in the penultimate section “The Evolving Framework for the Evaluation of World Bank Development Policy Financing.”

Assessments of Relevance

Previously, ICRs and ICRRs discussed and rated the relevance of project development objectives (PDOs) and the design of the operation. They looked at the extent to which an operation's objectives, design, or implementation were consistent with the country's current development priorities, current World Bank country and sectoral assistance strategies, and corporate goals. The requirement for consistency (or alignment, as it was often called) did not explicitly require that the operation tackle the most challenging constraints to achieving development objectives (although the accompanying guidance called for the evaluation to take into account “whether the [World] Bank's implementation assistance was responsive to changing needs and that the operation remained important to achieving country, [World] Bank, and global development objectives”). Indeed, many budget support operations had high-level objectives that were almost

always relevant in developing economies (for example, strengthen public finances, promote private sector development, or improve public financial management).

The relevance of PDOs for investment project financing (IPF) tended to be defined more narrowly, considering, among other things, the primary target groups of the project and the change or response expected from this group because of the project's interventions. Investment projects also tended to focus on outcomes for which the project could reasonably be held accountable. According to the guidelines for IPF self-evaluation, a PDO "neither encompasses higher-level objectives beyond the purview of the project, nor [is it] a restatement of the project's activities or outputs."

As a result of their relatively high level, most relevance assessments for DPF objectives and design were quite favorable. Indeed, over the past 5 years, the share of DPF operations with ratings for the relevance of objectives that were "moderately satisfactory" (MS) or better was above 95%.

Assessments of Efficacy

Efficacy for DPF was defined as the extent to which the operation's objectives were achieved or were expected to be achieved, and the extent to which that achievement is attributable to the activities or actions supported by the operation. In using the operation's results indicators to assess efficacy, the evaluator implicitly assessed whether these were the right indicators to use to measure achievement of expected outcomes. However, efficacy was often determined largely by assessing the achievement of targets for the operation's results indicators alone. The efficacy rating was rarely discounted because of results indicators that either did not capture progress toward the objective or that did not reflect the impact of the prior action in question. Consideration of the adequacy of results indicators tended to appear toward the end of the evaluation in the monitoring and evaluation section of the ICRR, after efficacy had been assessed and rated.

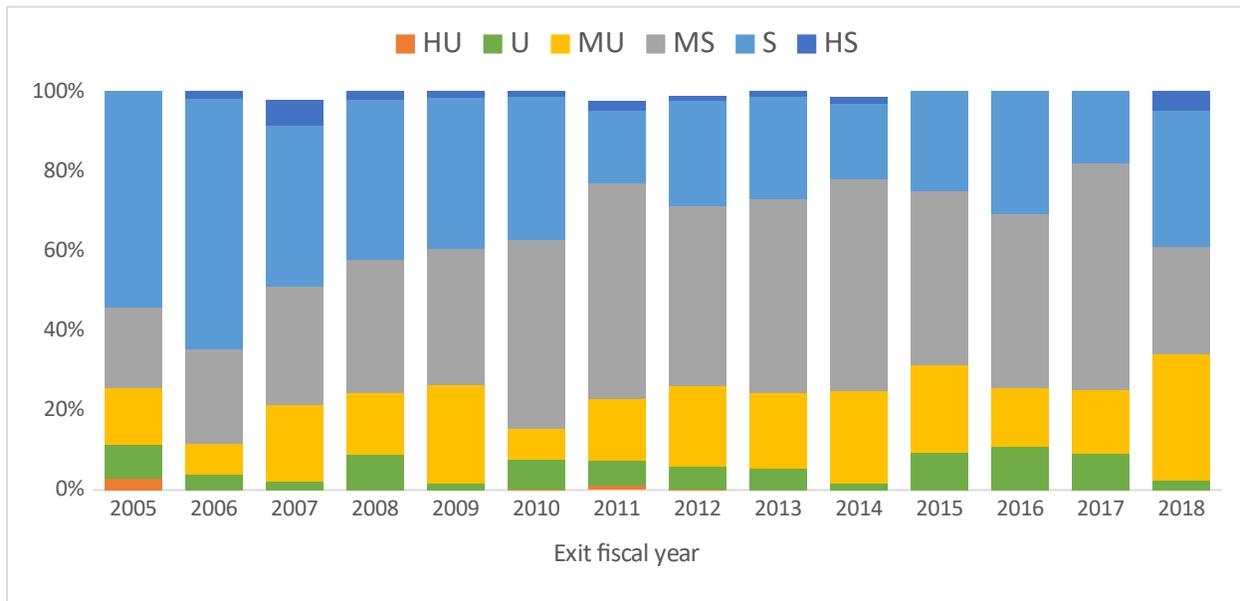
Evolution of the Performance of World Bank's Development Policy Financing Operations

In preparing this chapter, we briefly reviewed data on IEG-validated ratings for DPF operations, focusing on the ratings for overall outcome and World Bank performance. Over the period 2005–18, just over three-quarters of the World Bank's DPF operations were rated Moderately Satisfactory or higher (MS+) for overall outcome.²⁴⁶ The MS+ rating is used to track the operational performance of World Bank projects and DPF operations in the World Bank Group's Corporate Scorecard.²⁴⁷ Although this ratio has been relatively stable over the period, there has been a decline in operations rated satisfactory, largely offset by an increase in operations rated moderately satisfactory (Figure 6.4).

²⁴⁶ The rating for overall outcome is derived from subratings for the relevance of objectives and efficacy (i.e., the achievement of objectives).

²⁴⁷ For more information, visit: <https://scorecard.worldbank.org/>

Figure 6.4: Overall Outcome Ratings for DPF Operations, Shares of all Development Policy Financing, 2005–2018



Source: Independent Evaluation Group.

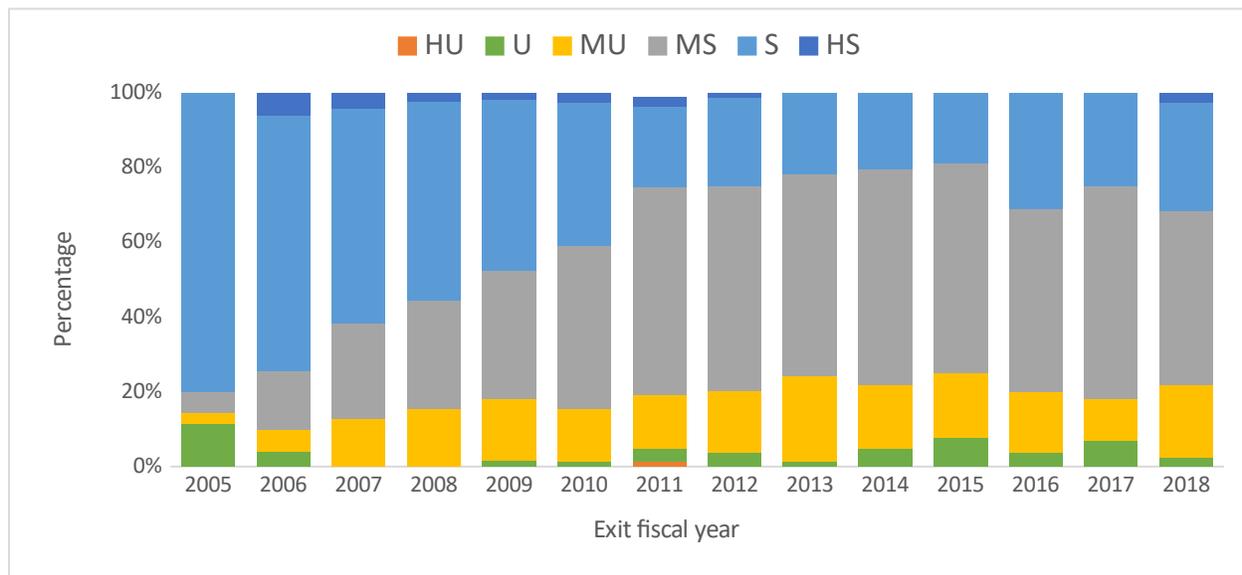
Note: HS = highly satisfactory, HU = highly unsatisfactory, MS = moderately satisfactory, MU = moderately unsatisfactory, S = satisfactory, U = unsatisfactory.

Assessing World Bank Performance in its Development Policy Financing Operations

Between 2005 and 2018, World Bank performance in evaluations of DPF operations was defined as the extent to which services provided by the World Bank ensured quality at entry of the operation and supported effective implementation through appropriate supervision. Quality at entry referred to the extent to which the World Bank identified, facilitated the preparation of, and appraised the operation so it was most likely to achieve its planned development outcomes and was consistent with the World Bank’s fiduciary role. The quality of World Bank supervision was the extent to which the World Bank proactively identified and resolved threats to the achievement of the relevant development outcome and carried out its fiduciary role.

Figure 6.5 illustrates the evolution of ratings of World Bank performance since 2005. The share of operations rated MS+ was relatively stable, averaging about four-fifths of all operations between fiscal years 2005 and 2018. As with overall outcome ratings, there was a deterioration in the share of operations with a satisfactory World Bank performance rating, offset by an increase in the share of operations with World Bank performance rated MS, suggesting a decline in average quality, although that trend has reversed in recent years.

Figure 6.5: Ratings for World Bank Performance in Development Policy Financing Operations, 2005–2018



Source: Independent Evaluation Group.

Note: HS = highly satisfactory; HU = highly unsatisfactory; MS = moderately satisfactory; MU = moderately unsatisfactory; S = satisfactory; U = unsatisfactory.

Some Empirical Findings on World Bank Development Policy Financing

Several studies have provided insights into the correlation of outcomes from World Bank DPF operations (as measured by overall outcome ratings from ICRRs) and characteristics of those operations.²⁴⁸ However, given the complexity of the results chain underpinning most policy reforms, these studies do not establish causality.

Smets and Knack²⁴⁹ explored how the World Bank’s policy-based lending has influenced the quality of economic policy, given the focus of DPF on policy reforms as immediate and intermediate objectives. Their analysis focused on the early part of the broad results chain of aid outlined by Bourguignon and Sundberg,²⁵⁰ from aid to policy making and policies, but it did not address the subsequent link between policies and country outcomes. To this end, the authors used elements of the World Bank’s Country Policy and Institutional Assessment (CPIA) ratings as the dependent variable and as a proxy for the quality of economic policy. Although past studies found only limited association between DPF operations and the macroeconomic stability component of the CPIA, the authors examined those links and focused specifically on macroeconomic and fiscal issues, in particular macroeconomic stability as measured by the

²⁴⁸ For a retrospective overview of Bank’s DPF, see World Bank 2015. *World Bank Development Policy Financing Retrospective, Results and Sustainability*. World Bank.

²⁴⁹ Lodewijk Smets and Stephen Knack. 2014. World Bank Lending and the Quality of Economic Policy. *World Bank Policy Research Paper*. No. 6924.

²⁵⁰ Francois Bourguignon and Mark Sundberg. 2007. Aid Effectiveness: Opening the Black Box. *American Economic Review*. Vol. 97, No. 2, pp. 328-21

relevant CPIA indexes. They did not find an association between DPF operations and macroeconomic stability. However, they did not address reverse causality, i.e., the possibility that the DPF operation was selected because of stable macroeconomic conditions. This is important because the World Bank requires macroeconomic stability at the time of approval.

Moll, Geli, and Saavedra²⁵¹ empirically tested whether elements of operations design (for example, prior actions, results frameworks, and task team leader skills and professional affiliation) influenced the success of World Bank DPF, as measured by IEG-validated overall outcomes for 2004–2013. They controlled for income per capita, quality of macroeconomic and governance-related policies, and force majeure as measured by natural disasters. They found that the line of sight between the policy reform supported and the results framework was critical for success, while the skills of the task team leader and a professional affiliation with the Poverty Reduction and Economic Management network of the World Bank was also associated with greater DPF success.

Bogetić and Smets²⁵² found that the World Bank’s policy lending was significantly and positively correlated with the quality of social policies and institutions. They also found that loan conditions related to social protection and environmental sustainability were associated with better social policies and institutions more than those related to the equity of public resource use, and with health and education. These findings reinforce the idea that the type and quality of World Bank conditionality matters for the design and outcomes of policy-based lending.

Findings on Development Policy Financing Performance from IEG Thematic Evaluations and Learning Products

IEG thematic evaluations and learning products (and the World Bank’s DPF retrospective) provide rich insights into various dimensions of DPF performance, especially with respect to results frameworks, policy-based guarantees, use of DPF as an anti-crisis instrument, macroeconomic frameworks, and the performance of DPF in low-income IDA countries. The findings included the following:

- Results frameworks in DPF documents have improved, but shortcomings remain in the relevance of results indicators and prior actions. In particular, prior actions were found to be lacking in many instances in the sense that their completion did not contribute critically to development objectives.²⁵³
- IEG’s review of evidence from the early policy-based guarantees (PBGs) during the 2011–2015 period found that borrowers, with World Bank support, could typically meet their financing needs during difficult market conditions. A robust macroeconomic and fiscal policy framework was essential for sustaining benefits from improved access to private finance for deficit financing. The impact of PBGs on borrowers’ credit terms varied from one program to another, but in all of the PBGs that IEG reviewed, the aggregate interest rates were lower than they would have been without guarantees; however, more evidence is

²⁵¹ Peter Moll, Patricia Geli, and Pablo Saavedra. 2015. Correlates of Success in World Bank Development Policy Lending. World Bank Policy Research Paper. No. 7181.

²⁵² Željko Bogetić and Lodewijk Smets. 2017. Association of World Bank Policy Lending with Social Development Policies and Institutions. World Bank Policy Research Paper. No. 8263.

²⁵³ World Bank. 2015. Quality of Results Frameworks in Development Policy Operations. Washington, DC: World Bank.

needed on the benefits when the implied interest rate is calculated on nonguaranteed terms and takes account of the erosion of the guarantee's value over time.²⁵⁴

- The World Bank responded to the global financial crisis, especially in middle-income countries, with 67 crisis response development policy operations focused largely on anti-crisis fiscal management. Policy frameworks focused on the timely provision of budget financing at the time of market turbulence and measures to strengthen fiscal sustainability by improving the effectiveness of public expenditures. They included improvements in the targeting of social entitlements and cuts in unproductive expenditures. At the same time, and because of their counter-cyclical focus, policy frameworks included comparatively few structural measures, which occurred in less than one-third of crisis response operations. Also, tax policy and tax administration reforms to improve revenue collection were notably less frequent.²⁵⁵
- An assessment of the degree to which knowledge on public expenditures informed the design of DPF operations found that public expenditure reviews or similar analytics informed most DPF operations in some way, but that the quality of integration of that knowledge into the DPF design varied, in part depending on the quality and length of the policy dialogue and World Bank engagement, and trust between the World Bank and the client government. The main areas that informed DPF operations were public sector governance, social development, and human development. Medium-term expenditure frameworks, budgeting, and public financial management were the most common issues.²⁵⁶
- Policy-based lending in the environment sector, which has grown significantly since 2005, was used to pursue broader sectoral and multisector goals related to climate change and the environment. It was most effective “when policy issues are the main barrier to improving environmental outcomes, rather than capacity or other issues.”²⁵⁷ Clear theories of change and well-designed results frameworks, analytical work, and technical assistance were identified as important factors influencing design and outcomes, while monitoring and evaluation frameworks were often weak.
- An IEG empirical analysis of success factors in DPF operations in low-income countries found that “improving ‘relevance of design’ is key for achieving better DPF outcomes: it requires congruence between policies supported and project development objectives pursued.” This study also found evidence of analytical underpinnings, macro policies, and government ownership affecting the success of DPF operations. Interestingly, DPF operations with development partners using joint policy assessment frameworks have not been associated with better outcomes than other DPF operations with otherwise similar characteristics.²⁵⁸

²⁵⁴ World Bank. 2016. *Findings from Evaluations of Policy-Based Guarantees*. Washington, DC: World Bank.

²⁵⁵ World Bank. 2017. *Crisis Response and Resilience to Systemic Shocks: Lessons from IEG Evaluations*. Washington DC: World Bank. See also IEG (Independent Evaluation Group). 2010. *The World Bank Group's Response to the Global Economic Crises, Phase I*. Washington, DC: World Bank; and IEG. 2012. *The World Bank Group's Response to the Global Economic Crisis, Phase II*. Washington, DC: World Bank.

²⁵⁶ World Bank. 2015. *How Does Knowledge Integrate with the Design of Development Policy Operations?* Washington, DC: World Bank.

²⁵⁷ World Bank. 2016. *Lessons from Environmental Policy Lending*. Washington, DC: World Bank. pp. x-xi.

²⁵⁸ World Bank. 2018. *Maximizing the Impact of Development Policy Financing in IDA Countries: A Stocktaking of Success Factors and Risks*. IEG meso-evaluation. Washington, DC: World Bank. p. 7.

- An independent reassessment of the quality of macro-fiscal frameworks in DPF operations found that these frameworks were largely internally consistent and credible, noting some improvement over time. In many cases, the quality appeared to be related to the alignment with the International Monetary Fund and World Bank’s analytical work in the macro-fiscal area. At the same time, the assessment found weaknesses in the following areas: (i) the ambition of macro-fiscal frameworks in some stand-alone operations and in the links between objectives and fiscal measures, (ii) the credibility of the framework in view of the government’s track record, political economy factors, treatment of risks, or institutional fiscal rules, and (iii) the robustness of the debt sustainability analysis.²⁵⁹

4. Evolving Framework for Evaluating World Bank Development Policy Financing

Until 2018, the World Bank used similar approaches for self-evaluation and validation of World Bank investment project financing (IPF) and DPF operations. The main difference was that efficiency (i.e., cost–benefit analysis) was not assessed for DPF operations because of the methodological difficulties in assigning costs, benefits, and weights to economic reforms underpinning DPF operations compared with the outputs supported by traditional investment projects. To assess the efficiency of a DPF operation, an evaluation would have to determine (i) whether more reform or more impactful reform could have been obtained for the same amount of budget support, or (ii) whether the same reforms could have been secured with less budget support. Given the nature of a budget support operation, a credible assessment of either would not have been feasible.

In September 2018, the World Bank and IEG adopted IPF-specific evaluation guidelines. Among the changes adopted, the rating for borrower performance was dropped so the assessment could be focused on how World Bank staff adapted and responded to borrower-related challenges. Self-evaluation and validation of DPF operations continued to use the preexisting guidelines.

The World Bank recognizes that budget support operations have features that require a different approach to evaluation when compared with investment project lending. For example, the specific prior actions required for DPF disbursement alone are rarely sufficient to achieve the program objectives, especially in the context of a multisector operation. Additional actions by governments and complementary support from investment projects and development partners are usually needed.

The trajectory of reforms supported by DPF are generally part of broader and longer-term policy-making efforts. This makes attribution of the development objectives to DPF operations particularly difficult. It also presents challenges in articulating a complete results chain based solely on the prior actions in the operation. Moreover, while supervision of a multi-year investment project is conceptually clear, it can be of lesser importance for a standalone DPF operation given that prior actions, by definition, are completed before approval (although monitoring of progress toward targets remains important).

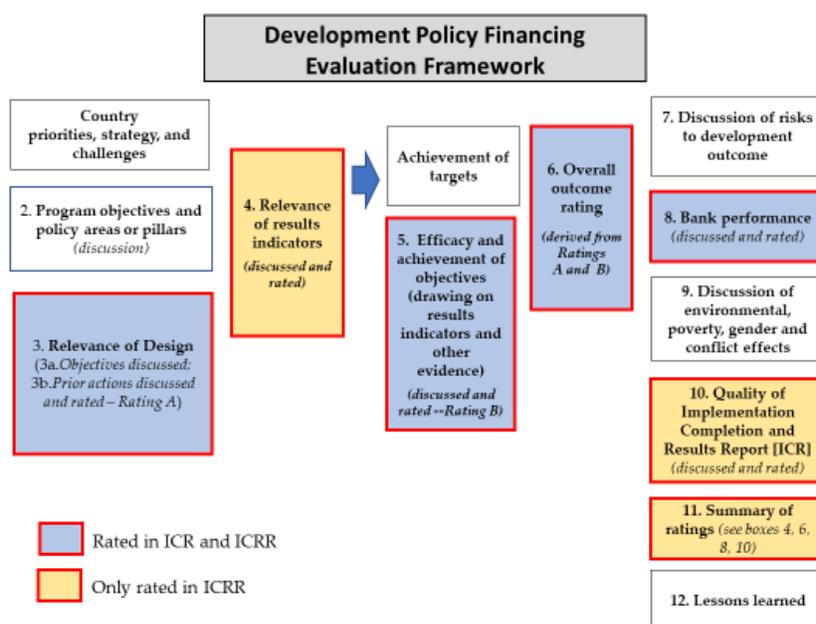
To improve the operational relevance of its work, IEG recently adopted changes to the structure and content of its evaluations and validations of DPF operations. This was in part in response to

²⁵⁹ World Bank. 2015. *Quality of Macroeconomic Frameworks in Development Policy Operations*. Washington, DC: World Bank.

changes in ICRs (self-evaluation) that the World Bank has adopted. The new IEG framework for evaluating budget support operations better reflects the characteristics of DPF. Figure 6.6 shows the main building blocks of the new DPF evaluation framework.

The main changes from the earlier framework relate to the assessment of relevance, results indicators, and World Bank performance. Instead of rating the relevance of objectives, IEG will rate the relevance of the prior actions supported by the operation (although the relevance of objectives will still be discussed).²⁶⁰

Figure 6.6: Independent Evaluation Group’s New Pilot Evaluation Framework for Development Policy Financing Operations



DPF = development policy financing, ICR = implementation completion and results report, ICRR = implementation completion and results report review.

Source: Independent Evaluation Group.

Assessing the Relevance of the Reform Actions Supported by the Operation

Prior actions are reforms that are required for Board approval of the loan and operation. They are designed to address important constraints on the achievement of the operation’s development objectives. This rating assesses the extent to which prior actions: (i) addressed meaningful

²⁶⁰ The discussion of the relevance of the objectives considers the extent to which a particular objective should be a priority for the World Bank, taking into account the overarching World Bank-supported country development strategy.

constraints or had a major impact on the achievement of the project development objectives (PDOs), and (ii) made a substantive and credible contribution to achieving those objectives. In rating the relevance of prior actions, the IEG evaluator will attempt to: (i) ascertain the clarity and credibility of the results chain linking prior actions to the achievement of the objective, taking into account the adequacy of the analytical basis linking the prior action to the PDO (and lessons learned from similar operations or experiences in the particular client country or in similar countries), and (ii) assess the importance of prior actions to the achievement of outcomes. This approach is expected to result in more operationally relevant lessons.

Evaluating the Quality of Results Indicators

The new framework also sought to put more structure and rigor into the identification of meaningful results indicators. For the first time, IEG will systematically rate the relevance and quality of indicators in the results framework. Results indicators are rated to assess the extent to which they capture the contribution of the prior actions supported by the DPF operations in achieving the program development objectives (PDOs). Beyond assessing the link between the reforms supported by the operation and the objectives of the operation, the assessment will look for clarity with respect to the definition of each results indicator, its method of calculation, and the credibility and availability of the associated data. The latter dimension was included because a conceptually appropriate indicator for which there are no reliable or available data is of little use in monitoring progress toward the achievement of the relevant development objective.

By assessing the results indicators before assessing the achievement of targets, this approach should provide a better basis for assessing the adequacy of the evidence presented for the achievement of objectives (for example, if an outcome target is achieved for an indicator that does not capture the impact of prior actions well, this would not be considered strong evidence of the achievement of a development objective). It is hoped that, over time, this approach will create a feedback loop to help World Bank teams to improve the selection and design of indicators, thereby fostering a greater outcome orientation in DPF operations.

Assessing World Bank Performance

The assessment of World Bank performance has also been adapted to include greater granularity regarding the criteria to be used for assessment (Box 6.1). These criteria are deemed more operationally relevant to budget support operations, since they better reflect how World Bank staff engage with stakeholders and the operation during both preparation and the implementation. Particular attention is given to the adequacy of the *ex ante* assessment of risks to the achievement of objectives and the articulation and implementation of mitigating measures to reduce these risks. The importance of this discussion reflects, to some extent, the fact that the prior actions supported by a DPF operation are themselves generally not sufficient for the achievement of the PDOs. The *ex ante* discussion of risks forces a closer look at the results chain, linking the prior action to the desired outcome, drawing early attention to the additional support and complementary actions that will be required. The hope is that over time, this will promote more successful and better-informed risk taking in DPF operations.

Box 6.1. Criteria for Assessing World Bank Performance

Assesses World Bank performance in the design and preparation of the operation or series, as well as during its implementation (i.e., after approval)

Key IEG Rating criteria

Design and preparation stage:

- Extent to which lessons learned from prior experience have been reflected in program design. Could be either from country in question or from similar operations or activities in other countries;
- Selection of prior actions and results indicators, including adequacy of analytical underpinnings.
- Extent to which World Bank staff identified and managed ex ante risks to achieving project development objectives
- Extent to which operation drew upon consultations with major stakeholders and development partners when necessary

Implementation stage:

- Was there evidence of ongoing monitoring of emerging risks and progress toward achievement of targets using the results framework?
- Were triggers, targets and/or results indicators adapted appropriately to lessons learned or changing circumstances?
- Were mitigating measures implemented (e.g., technical capacity constraints, ownership concerns) to address risks to achievement of PDOs identified ex ante?
- Was there stakeholder and donor coordination?

5. Concluding Remarks

This chapter has reviewed the evolution of the use of DPF at the World Bank between 2005 and 2019 and its performance as reflected in the recent literature and Independent Evaluation Group (IEG) evaluations. The chapter also described recent changes to IEG's evaluation framework for PBF operations. The principal conclusions are as follows.

- Policy-based lending has been an important financing instrument of the World Bank, accounting for about one-quarter of its total financing during 2005-19, but increasing to 40% in times of crises. It plays an important countercyclical role in developing countries. Budget support operations have supported short-term and longer-term policy and institutional reforms geared toward poverty reduction and shared prosperity (the World Bank's twin corporate goals). There are several varieties of budget support in use, from standard, stand-alone operations, and programmatic series of operations to policy-based guarantees (PBGs) and deferred draw-down options. This makes development policy financing a flexible and versatile financing instrument that can be deployed in a wide variety of country contexts to support short-term goals (e.g., macroeconomic stabilization, natural disaster emergency, post-conflict budget financing support, and arrears clearance) and long-term goals (e.g., poverty reduction and shared prosperity). As a result, governments have frequently chosen this instrument, especially in times of crises, when national budgets are under stress, and quick-disbursing financing, combined with corrective policy actions, is an economic and social imperative.
- The COVID-19 crisis and its unprecedented global health, economic, and social impact has prompted the World Bank to rapidly scale up its financing to developing country recipients to cushion impact. To that end, the World Bank committed itself at the start of the pandemic to deliver \$160 billion in overall financial support by the end of June 2021. In the event, \$157 billion was delivered, of which \$28 billion in development policy financing.

- IEG evaluations have generally assessed the World Bank's DPF positively, with about four-fifths of assessments rated moderately satisfactory or higher. However, the share of operations rated satisfactory has declined, while the share rated moderately satisfactory has risen. There is evidence that elements of design have improved over time, including the quality of macroeconomic frameworks, results frameworks, and the use of knowledge on public expenditures.
- The World Bank has used DPF as a key instrument in supporting country clients in crisis. During crises such as the global financial crisis, the focus on fiscal management, effectiveness of public expenditures, and targeted social programs has supported countercyclical policies.
- The framework for evaluating development policy financing was recently revised in order to produce more operationally relevant assessments and findings, including with respect to the assessment of World Bank performance. IEG has similarly revised its validation framework for evaluations of DPF operations to give greater attention to the relevance and quality of prior actions, better results indicators, and more informed ex ante assessment of risks. IEG began using this new framework in late 2020.

Comments on “Policy-Based Financing at the World Bank: Evolution, Performance, and Reform”

Comment by: Cheryl W. Gray

This chapter provides a useful, concise, and well-written summary of the evolution of the World Bank’s approach to policy-based financing and methods to evaluate it. It shows the careful thinking undertaken by the World Bank as it has struggled to deliver effective support to countries, often in complex and difficult settings. As the chapter illustrates, policy-based financing has long been a major instrument of international development support, valued in the hundreds of billions of dollars annually across development agencies. Yet its breadth and complexity have made it exceedingly difficult to study, and evidence of its results remains elusive. This chapter helps to shed light on what is known, although for perhaps unavoidable reasons the picture is still incomplete.

1. World Bank Evaluation Architecture

The first point worth stressing is the practicality and value-added of the World Bank’s evaluation architecture. Over more than three decades the World Bank has designed, implemented, and continuously improved a cohesive structure to document results from all its operations—both investment and policy-based operations—in a practical and cost-effective manner. The process begins with a self-evaluation by the task team, whose members know the operation best. That self-evaluation—which uses standard criteria applicable to all similar operations—is then reviewed and validated by the Independent Evaluation Group (IEG). The fact that 100% of self-evaluations are validated creates an incentive for task teams to report accurately while also producing a complete database of operation-level reviews across the institution. As noted in the paper, IEG follows up in some cases with more in-depth evaluations and/or broader sector or thematic evaluations, adding further context and evidence on results. The entire evaluation architecture is oriented toward documenting activities and outcomes, and it creates opportunities for learning through self-evaluation and analysis.

The evaluation systems of other multilateral development banks (MDBs) are similar, in part due to concerted efforts at harmonization across the MDBs. In my personal experience on both sides of this self-evaluation and validation system—as both an operational and an evaluation manager—the system is useful, practical and cost-effective.

While recognizing the positive aspects of the evaluation architecture noted above, it is also important to emphasize what the system does not do, especially in the complex area of policy-based financing. These types of routine World Bank evaluations are not in-depth impact evaluations with rigorous causal inference. They do not compare performance against counterfactuals to identify and measure cause and effect. Occasionally it is possible to apply impact evaluation techniques to specific interventions in specific settings, but this is not feasible across the board given the breadth and complexity of most World Bank operations, particularly policy-based financing. Rather, in the World Bank system, task teams and evaluators seek to define relevant objectives for World Bank operations and then determine whether those

objectives were achieved during the life of the operation, with some implicit assumptions but no rigorous analysis of causation.

2. Evaluation of Policy-Based Financing

The chapter describes in detail the criteria for self-evaluation and validation of development policy financing (DPF), which is the World Bank's name for policy-based financing. These criteria have changed over time to reflect changes in the design of policy-based financing over time. When policy-based lending began in the World Bank in the 1990s, loans were disbursed in a series of tranches that were triggered by successful completion of policy reforms and institutional milestones. In contrast, the World Bank's current DPF approach provides all the financing up-front, upon completion of a small number of key prior actions. This differs from the policy lending of the European Union, for example, which has a performance element and disburses in part on the achievement of results.

The World Bank's approach thus puts a very heavy weight on a small number of upfront policy and institutional changes that it considers key to the country's success. While having a small number of prior actions simplifies the lending process and focuses the World Bank's oversight, it runs the risk that the assumptions regarding the impact of reforms may be wrong. Indeed, over time the consensus on what constitutes good policies has to some extent shifted, and it is likely that the prior actions and results indicators of many policy loans of the 1990s would now be seen as problematic by World Bank staff and evaluators. The World Bank's heavy reliance on selected prior actions calls for an equally determined analysis of the effect of these policy and institutional changes whenever possible. Yet in practice there are few opportunities for the World Bank to follow up with careful analysis of these effects after the completion of prior actions and DPF disbursement.

Recently the World Bank has moved from rating the relevance of the DPF operation's objectives (the standard approach in evaluations of investment operations) to rating the relevance of the prior actions, which are the only conditions for the operations that are directly within the World Bank's control. The World Bank is also putting greater weight on evaluating the relevance and quality of the operation's results indicators, World Bank performance, and the treatment of risk. These judgments are largely qualitative, and one person's judgment may differ from another's. To ensure these ratings are robust, it would be helpful to track whether guidelines, dialogue, and practice are converging in reasonably common standards across operations and over time.

An important aspect of DPF operations missed by the World Bank's evaluation approach is the impact of the resource transfers themselves, i.e., the impact of spending the hundreds of millions of dollars transferred to recipient countries through development policy financing. Indeed, some have argued that the increased availability of funds for governments to spend may be the biggest impact of policy-based lending in practice, greater than the support to policy and institutional reforms provided in the loans.

Measuring the impact of the resource transfers would require knowledge of how those funds are actually spent, and this is not straightforward. DPF transfers are wholly fungible and are likely in practice to fund the "marginal expenditure" in the public budget—i.e., expenditure that could not otherwise be funded. This marginal expenditure could be in any sector—including infrastructure, social programs, defense, agriculture, and enterprise subsidies. It is by no means a foregone conclusion—nor is it even likely—that such marginal spending will be in the sectors with the policy reforms supported by the DPF. Although determining the marginal expenditure is

likely to be difficult in practice, it might be possible to get a broad sense of the overall patterns of public spending with and without the extra resources transferred through the DPF. Trying to assess such changes in public spending in at least a few large DPF operations would be a worthwhile evaluative exercise for the World Bank.

Finally, the focus of most evaluations on individual DPF operations fails to capture the overall distribution of World Bank support and resource transfers among borrowing countries, although larger thematic evaluations may help to capture this dimension. Given the political incentives facing both borrower and donor governments, as well as bureaucratic incentives within the World Bank and other development institutions, it is not surprising that many resource flows go to middle-income countries—where it is easier to lend and where absorption power and interest rates are typically higher—than to low-income countries where the need may be greater and access to alternative financing sources more limited. This is particularly true in multilateral development banks, whose income and credit ratings are dependent in part on loan proceeds, in contrast to bilateral or multilateral donors (such as the EU) whose resources come wholly from governments.

3. Findings on Development Policy Financing Effectiveness

The chapter reviews the data on the results of DPF operations over time and highlights several academic studies and thematic evaluations that have tried to draw further conclusions from these data. In addition to the inherent limitations on results measurement noted above, a few points stand out. First, there is a high prevalence of “moderately satisfactory” ratings for outcomes and World Bank performance. The difference between “moderately satisfactory” and “satisfactory” development policy financing—like the difference between “moderately satisfactory” and “moderately unsatisfactory” development policy financing—is based on the qualitative judgments of the validators, and this runs the risks of inconsistency noted earlier.

Second, thematic evaluations emphasize the prevalence and salience of DPF prior actions related to public financial management (PFM). Managing public finances is indeed an important and powerful responsibility of government that strongly influences the distribution of resources and effectiveness of public programs. It is an area that the World Bank has been able to focus on and influence relatively effectively through its operations. PFM has technocratic aspects—e.g., budgeting processes, computer systems, and auditing—to which the World Bank can bring needed expertise and resources. Other areas of governance reform, such as election systems, public employment, or direct anticorruption efforts, may be as (or even more) important for development outcomes but have been more difficult for the World Bank to address in the political environments in which it works. These sensitivities put limitations on what kinds of prior actions are feasible in DPF operations, which might also limit their potential development impact.

Third, the chapter also notes the value of the granularity gained through more in-depth evaluations of particular operations through project performance assessment reports (PPARs). Yet it is unclear to what extent operational World Bank staff read PPARs and integrate the findings into their operational work. Continued efforts to increase PPAR accessibility and impact, through both greater outreach and continued experimentation with content and process, would help to increase their usefulness. For example, in some instances comparative analyses of several similar operations may offer insights that reviews of individual projects do not. Doing

some evaluations jointly with outside experts, other development organizations, or operational staff might also increase their ownership and visibility.

Finally, one of the cited academic studies concludes that the level of macroeconomic stability is positively associated with the success of DPF operations.²⁶¹ As noted in the chapter, it is not possible to untangle causation, i.e., whether the World Bank's operation influenced the country's policies or good policies made it possible for the World Bank to lend. The fact that government ownership is also key to achieving outcomes and that "the World Bank's policy lending is significantly and positively correlated with the quality of social policies and institutions"²⁶² both reinforce the overwhelming importance of committed country counterparts.

In sum, the evidence strongly supports the finding that enlightened leadership, pro-development policies, and effective World Bank support go hand in hand, which is probably as much as can confidently be claimed. Attributing positive causal impact to the DPF operations themselves is not likely to be supported by the evaluation techniques available. But it is an important finding in today's world that the World Bank can contribute to development by recognizing and supporting committed and effective leaders without having to prove that its actions led to that commitment.

²⁶¹ Lodewijk Smets and Stephen Knack. 2014. World Bank Lending and the Quality of Economic Policy. *World Bank Policy Research Paper*. No. 6924.

²⁶² Željko Bogetić and Lodewijk Smets. 2017. Association of World Bank Policy Lending with Social Development Policies and Institutions. *World Bank Policy Research Paper*. No. 8263.

ANNEX

Methodologies for Evaluating Policy-Based Lending Operations

A comparative analysis of the main methodologies

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Introduction

This annex describes the two principal and distinct methodologies used for evaluating policy-based operations (PBOs). Understanding evaluation methods is important for interpreting and using evaluation results. The annex draws on pedagogical materials prepared by the Independent Evaluation Group (IEG) of the World Bank, which is representative of MDB practice, and by the European Commission.

Evaluation of PBOs poses challenges to evaluators beyond those commonly found in conventional investment project financing (IPF), such as infrastructure investments. First, IPF typically lends itself to greater clarity of measurement metrics and greater availability of data. Measurement of physical project outputs (e.g., kilometers of roads built) and intermediate outcomes (e.g., lower transport costs, time savings) have readily quantified metrics that can directly relate to project inputs. Policy-based lending, in contrast, involves work with building national or subnational capacity, legal and regulatory frameworks, and quality of institutions and policies for which metrics are not well established and are difficult to standardize across sectors and countries, often relying on institutional specialists. Second, IPF is normally tied to specific expenditures with fiduciary requirements that include evidence to validate project-linked expenditures in accord with the procurement standards of international financial institutions. PBOs dispense with these specific fiduciary requirements and use partner countries' own fiduciary and budget management practices.

This raises a third issue, fungibility. All foreign assistance may ease the budget constraint and allow funding to activities other than the donor's intent. However, the problem of attribution (the counterfactual) is arguably more difficult to address for PBOs, particularly in the context of country partnerships. Results can only be considered a *contribution* to what the country achieved, which is difficult to evidence and quantify.

Finally, policies and institutions are also contextual and inherently differ across regions and countries as does the interpretation of practices that build on different policy conventions, for

²⁶³ Shanta Devarajan, and Xavier Le Mounier (EU) provided helpful comments and suggestions on the differences in evaluation methodologies for PBOs between the EU and selected MDBs in the context of chapter 3 in this volume. Shahrokh Fardoust and Alan Gelb provided helpful comments on an earlier version of this annex. The author is also grateful to Željko Bogetić (IEG, World Bank) for his substantive contributions to this Annex. The editors of this volume alone are responsible for any remaining errors.

example between Anglophone and Francophone accounting practices. Donors cofinancing PBOs often largely agree on what policy and institutional functionality looks like, for example, on good budget management practices that lie behind international Public Expenditure and Financial Accountability (PEFA) ratings. However, donors also often disagree on priority reforms in support packages, specific policy objectives, or on the appropriate measurement of results.²⁶⁴ This can add further complexity to evaluating outcomes across multiple donors.

Principal Evaluation Approaches

Two main methodological approaches have been used by the MDBs to evaluate PBO program performance: (a) An **objectives-based method** (OBM) used by most of the MDBs, including the African Development Bank, Asian Development Bank, Caribbean Development Bank, Inter-American Development Bank, and the World Bank k; and (a) the OECD-DAC “**three-step approach**,”²⁶⁵ which employs three distinct steps to selectively attribute country outcomes and impacts to budget support and its induced outputs.

The design of the OBM is similar manner to evaluation of investment project operations, focusing on evaluation of the specific program objectives of individual PBOs or a series of PBOs, as stated and formalized in the legal documents of the program. Evaluators using OBM examine the institutions and measures proposed and implemented under the program and weigh the robustness of evidence as to specific country outcomes identified in the operation as reflected in the theory of change. This approach is built around qualitative and quantitative evidence on the outputs and outcomes delivered as a result of specified actions or interventions at a granular level. Based on the evidence available, the evaluator ranks performance using an established scale at the intervention, program, and instrumental levels.

The OECD-DAC’s three-step approach used by the EU works at an aggregated level taking *total* budget support received by a country to the extent possible, from all development partners providing budget support, and typically covering a decade of support. The first step aims to assess the effects of combined budget support on policies, services, and induced outputs. The second aims to assess social and economic *outcomes* that have been the target of these public policies and induced outputs. The third step relates the results of the causal analysis of step two to the links established in step one between budget support inputs and the related policy changes to infer the contribution of budget support.

PBO support presupposes that the recipient government has the necessary policy, capacity, incentives, and implementation tools to enforce agreed reforms with desired results. Importantly, it should also have in place a stability-oriented macroeconomic policy framework and fiduciary environment necessary for sustained success. The criteria for this are not detailed, leaving room for institutional judgment and potential departure from IMF macroeconomic assessments and reporting. Policy could be strengthened through the provision of technical support included in (or complementary to) the PBO package. Therefore, country systems, including the use of the general treasury account through which PBO is channeled, are evaluated by the donor *ex ante*, and must be considered adequate before support is extended. Where country systems are considered weak, programs typically include reform objectives aimed at strengthening public

²⁶⁴ Discussion of these issues with reference to public financial management is found in Matt Andrews et al. 2014.

²⁶⁵ Methodological details of three-step Approach are presented in OECD (2012).

financial management practices. PBO resources are processed through the recipient country's own financial accounting and budget systems, thus aligning with the Paris, Accra, and Busan principles on aid effectiveness regarding country ownership, donor alignment, donor harmonization, managing for results, and mutual accountability.²⁶⁶

The intended objectives of PBOs, whether from the EU or MDBs, are essentially the same. In general, PBO is intended to support the recipient government's implementation of their overall growth and poverty reduction strategy. This generally entails the following:

- Improve macroeconomic stability and growth-oriented policies to ensure an adequate resource framework for economic growth and poverty reduction.²⁶⁷
- Strengthen public financial management in all its dimensions, including transparency and accountability to improve participation and control in the budget process by the Parliaments and civil society, and in terms of strategic efficacy and expenditure efficiency to improve policy implementation.
- Improve sectoral policies and service delivery, especially in the targeted sectors, by supporting design, planning, and monitoring capacities at the central and local levels, effective coordination and inspection systems, trained staff, stakeholders' participation, gender equality, and equity, and adequate funding of sector strategies.
- Ensure a conducive regulatory framework, including support for an enabling environment for the private sector, democratic controls and basic freedoms, law enforcement and security, and gender equality.

The *theory of change* to support these outcomes is based on several assumptions. Budgetary funds are not earmarked, and funds are assumed to help create needed financial opportunities, support greater fiscal flexibility, and enhance incentives because they are not earmarked—notably the amount of financing is not related to any specified costs of reform objectives. Second, it assumes that policy dialogue provides a sharper and shared focus on development outcomes. Dialogue may help to articulate and compare various policy options and identify specific inputs to respond to the implementation needs. Third, it is a source of external discipline exercised through policy conditionality, both *ex ante* and *ex post*. A fourth assumption is that capacity development support and related measures fill the capacity gap prioritized by both the donor and country. Finally, the three inputs provided in most PBOs (funding, policy dialogue, and capacity development) are assumed to reinforce each other alongside contextual factors and other government and nongovernment interventions.

The theory of change is based on an intervention logic depicting how budget support inputs help enhance the implementation of the supported development strategies to achieve established targets. However, there are no detailed assumptions on how the inputs provided should be specifically deployed. This is particularly important during economic crises when quick-disbursing and untied financing is critical.

²⁶⁶ See <https://www.oecd.org/dac/effectiveness/45827300.pdf>

²⁶⁷ Quality of the macro-fiscal framework, in particular, has been an important building block in the design of successful budget support operations at the World Bank (World Bank 2015).

The MDBs' Objectives-Based Methodology

The OBM most MDBs use arose from the need to evaluate individual projects in accordance with the commitment to validate all programs and projects (a practice most MDBs continue to follow). The MDB normally prepares a *self-evaluation* (a “completion report”) at the close of every operation or program series, following standardized guidelines on methodology and scope.²⁶⁸ These reports are intended to provide a complete account of the performance and results of each operation, drawing on evidence collected during and after project completion. The reports assess the extent to which the projects or programs achieve their stated and documented objectives efficiently stating it as an *outcome rating* of project performance. They also rate the risk to development outcome, the MDB's own performance, and the borrower's performance, and the quality of program monitoring and evaluation (M&E).

The next stage of project evaluation is the independent *validation* of the MDB self-evaluation. The independent evaluation offices of the MDBs conduct these validations on the full agency portfolio. They are desk exercises that rely on the data and coverage in the completion report, but provide a critical review of the evidence, results, and ratings provided in relation to the operation's design documents. The independent evaluation offices thus arrive at independent ratings for the project based on the same evaluation criteria used for the completion reports.

For a purposeful sample of operations, in-depth evaluations of projects (Project Performance Reports at the World Bank), are also undertaken. These draw on additional evidence and instruments, including field visits to collect administrative data, surveys, and structured and unstructured stakeholder interviews, among other information. The purpose of these evaluations is to gain deeper insight into project performance and what works or does not work at the project level, serving both accountability and learning functions.

The validation reports and project performance evaluations employ the same objectives-based approach to assessing project performance. All elements of evaluation are related to formalized project objectives. As part of assessment and rating of project outcome, the method assesses the relevance of objectives and design as well as the achievement of each objective through the prism of target outcome indicators.

Each evaluation criterion has a specific definition and rating scale for each evaluation criterion as follows:

Outcome: The extent to which the operation's major relevant objectives were achieved, or are expected to be achieved, efficiently. The rating has three dimensions: *relevance*, *efficacy*, and *efficiency*. Relevance includes relevance of objectives and relevance of design. Relevance of objectives is the extent to which the project's objectives are consistent with the country's current development priorities and with current World Bank country and sectoral assistance strategies and corporate goals (typically as these are expressed in national Poverty Reduction Strategy Papers (or country equivalents), Country Assistance Strategies, sector strategy papers, and operational policies). Relevance of design is the extent to which the project's design is consistent with the stated objectives. Efficacy is the extent to which the project's objectives were achieved,

²⁶⁸ World Bank (2014b).

or are expected to be achieved, taking into account their relative importance. Efficiency is the extent to which the project achieved, or is expected to achieve, a return higher than the opportunity cost of capital and benefits at least cost compared with alternatives. *The efficiency dimension is not applied to development policy operations*, which provide general budget support. There are six possible ratings for outcome: highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, and highly unsatisfactory.

Risk to development outcome: The risk, at the time of evaluation, that development outcomes (or expected outcomes) will not be maintained (or realized). Possible ratings for risk to development outcome: high, significant, moderate, negligible to low, and not evaluable.

MDB performance: The extent to which services provided by the MDB ensured quality at entry of the operation and supported effective implementation through appropriate supervision (including ensuring adequate transition arrangements for regular operation of supported activities after loan or credit closing toward the achievement of development outcomes). The rating has two dimensions: quality at entry and quality of supervision. Possible ratings for MDB performance: highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, and highly unsatisfactory.

Borrower performance: The extent to which the borrower (including the government and implementing agency or agencies) ensured quality of preparation and implementation and complied with covenants and agreements toward the achievement of development outcomes. The rating has two dimensions: government performance and implementing agency(ies) performance. Possible ratings for borrower performance: highly satisfactory, satisfactory, moderately satisfactory, moderately unsatisfactory, unsatisfactory, and highly unsatisfactory.

These evaluation criteria are assessed for each program objective as identified in the program's legal documentation. The mix of quantitative and qualitative data sources used for each evaluation varies by sector, country, capacity, and resources available for the evaluation.

An Example of Both Methodologies in Practice: Budget Support to Uganda, 2004–13

In 2015, the European Commission (EC) and IEG undertook the first joint evaluation of all donor budget support to Uganda for 2004–13 (European Commission and Independent Evaluation Group 2015). The EC and the World Bank, the two largest donors, closely coordinated budget support with other bilateral donors through a budget support coordinating group. This major evaluation covered multiple sectors, including cross-cutting themes of macroeconomic and fiscal management, governance and accountability, public financial management, and gender, as well as special sector focus on education, health, and water and sanitation. It was based on intensive document analysis and fieldwork, including visits to secondary towns, stakeholder and service provider surveys, and statistical analysis. The evaluation used the standard OECD-DAC EC evaluation methodology for evaluating budget support operations.²⁶⁹

²⁶⁹ Caputo, Lawson, and van der Linde 2008.

Table A.1: Cross-Linkages between the Third Step of the OECD-DAC Approach (first column) and MDB Objectives-Based Approach (top row)

<i>MDB/IEG Objectives based criteria →</i>		<i>Relevance of objectives and design</i>	<i>Policy achievement (efficacy)</i>	<i>Short- and long-term impact</i>	<i>Risks to development results</i>	<i>Government performance</i>	<i>Donor performance</i>	<i>Lessons and recommendations</i>
<i>Ten Evaluation Questions in the OECD-DAC Three-Step Analysis (below)</i>								
EQ1: Relevance and design of budget support	✓✓				✓		✓✓	
EQ2: Direct effects of financial and nonfinancial inputs			✓		✓	✓✓	✓✓	
EQ3: Macroeconomic management			✓✓	✓	✓	✓✓	✓	
EQ4: Public financial management			✓✓		✓	✓✓	✓	
EQ5: Allocative and operational efficiency of public spending			✓✓		✓	✓✓	✓	
EQ6: Policy formulation and implementation processes			✓✓		✓	✓✓	✓	
EQ7: Governance and accountability			✓✓	✓	✓	✓✓	✓	
EQ8: Education	✓			✓✓	✓	✓	✓	
EQ9: Water	✓			✓✓	✓	✓	✓	
EQ10: Health	✓			✓✓	✓	✓	✓	
Synthesis	✓	✓	✓	✓	✓	✓	✓	✓✓
✓✓	The criterion is largely covered by the OECD-DAC EQ							
✓	The criterion is partly covered in the OECD-DAC EQ							

Source: World Bank and European Commission 2015, Volume 1. Additional two dimensions (not shown in the table for clarity reasons) are elements of both the IEG and EC-DAC methodologies: monitoring and evaluation and “unintended effects.”

In parallel the World Bank team prepared its own evaluation, following the objectives-based methodology, of the World Bank’s two series of budget support operations to Uganda, which were approved and closed during the period 2006–13 (IEG 2015b). The overarching objective of the first series was to support the implementation of the government’s third Poverty Eradication Action Plan (PEAP). The two objectives of the second series were improved access to, and greater value for money in, public services. These programs comprised a significant share of the overall, closely coordinated, EC-World Bank budget support. This allowed comparison of the performance of the World Bank across two periods and two budget support series. The first

series was found to be less successful, and the second more successful, due in part to learning from the design problems with the first series.

The joint evaluation exercise using the two methodologies offers an opportunity to compare and contrast the two methods. Table A.1 illustrates the analytical framework combined the Evaluative Questions-based approach of the OECD-DAC methodological guidelines to evaluate budget support and the objective-based approach of MDB/IEG for strategic evaluation. The table highlights the proximate relations between the two approaches in various elements of the evaluation. The first column lists the 10 evaluation questions, which are tailored to the specific country context and operation and are addressed covering all budget support operations during the evaluation period. The seven columns across the top list the evaluation criteria used by the OBM approach of the World Bank. Each cell indicates how closely these overlap between the two (largely, partly, or not at all). For example, column 1 shows that the OBM focus on “Relevance of objectives and design” is picked up in the OECD-DAC evaluation question 1, and partially reflected in the three sector evaluation questions plus the synthesis.

Three conclusions stand out from a comparison of evaluation coverage and scope in the two approaches. First, the MDB/IEG assessment is objectives-based and includes performance ratings. It follows standard, preset evaluation criteria for all such assessments: relevance, efficacy, impact, risks, government and World Bank performance, and lessons and operations. The explicit ratings cover the various dimensions of assessments, including the overall rating for the budget support series, on a six-point scale from highly unsatisfactory to highly satisfactory. As such, the MDB/IEG approach is especially suited for assessing accountability of individual operations or groups of operations in a given country. It also offers an opportunity to reflect on broader lessons and provide recommendations for improvements in future operations.

Second, the OECD-DAC approach does not have preset evaluative questions, although it follows a clear, three-step analytical framework described in the next section. Evaluative questions vary from assessment to assessment depending on the focus of the EC budget support and the interest in specific questions to be answered by the EC donors. Importantly, the EC approach does not have ratings. As such, it is geared more toward learning lessons. It also has an element of accountability assessment with regular reporting, despite the lack of explicit ratings.

Third, these differences suggest that the MDB/IEG approach, being uniform and explicit about ratings offers an opportunity for quantitative comparisons of evaluations, both cross-operational and cross-country. By contrast, comparisons of EC assessments across operations are typically focused on total country budget support and are not based on ratings. This lends itself to more qualitative and country-oriented lessons than quantitative comparisons.

It should be acknowledged that in both methodologies there is considerable need for evaluator judgement as to the quality and weight of the evidence. More robust, quantitative methods and development of the counterfactual to permit attribution by donor or instrument are generally not possible.

The OECD/DAC Three-Step Approach²⁷⁰

²⁷⁰ This section draws principally on OECD-DAC (2012) and on Bogetić, Caputo, and Sundberg (2018).

The OECD-DAC results-based method follows a three-step analytical framework aimed at discovering how the opportunities provided have been used to develop the policy process to achieve outcomes. It also aims to develop a narrative regarding how, and through which dynamics, targeted development outcomes have evolved. The three-step process logically focuses on (a) policy processes, (b) development outcomes and causal factors, and (c) a synthesis narrative of a and b aiming to identify contributing factors and broader lessons. To ascertain how and to what extent the opportunities provided by budget support have been used to strengthen government policies toward the achievement of the agreed results, the evaluation uses a contribution analysis²⁷¹ divided into two steps (step 1 and step 2) and then synthesized in step 3. Through the evidence collected, contribution analysis aims to build a body of relevant evidence and a credible story on the relationships between budget support inputs and targeted development outcomes, mediated through government policies.

In step 1, the approach aims to investigate whether the resources provided by budget support are used by the government to strengthen its development policy and institutional process in the given context (relevance). The government may be engaged in different priorities from those stated in the strategies. Country-level and general lessons may be drawn on the negotiation and design processes. Second, it investigates to what extent and how the government has used the capacities and opportunities provided by budget support to strengthen its own policy and institutional processes (efficiency and effectiveness).

In step 2, the focus is on development outcomes in the broader national context, beyond external assistance and PBF/budget support (i.e., what happened during the period under review). A statistical analysis identifies changes in development outcomes and impacts and a regression analysis captures their explanatory factors, not limited to but including policy measures. The causal analysis thus identifies the policy and institutional changes that have contributed to the achievement or nonachievement of observed results.

In step 3, the assessments carried out in steps 1 and 2 are synthesized and compared, thereby enabling the establishment of contribution links between budget support and development outcomes, through the government policies, the latter being at the same time partly influenced by budget support inputs and opportunities and partly responsible for the achievement of the targeted outcomes. Step 3 provides a narrative of budget support contributions to development change in a given country context.

The evaluation must build a credible story that accounts for specific, different features in each country, so it must uncover how these key causal links materialize (the specific mechanisms).

²⁷¹ Contribution analysis is the standard method of choice where experimental or semi-experimental approaches are not applicable, especially in cases addressing complex evaluations with multiple interactions. This method has been discussed since the mid-1990s. One of its earliest and most convincing definitions is that of Hendricks (1996), who states that the contribution analysis aims at identifying “plausible associations” between a program and the targeted development outcomes. John Mayne’s approach to contribution analysis has been discussed and adopted by various institutions, including the World Bank (IEG), the IMF, and others (World Bank 2014; Dwyer 2007). Using contribution analysis, the evaluator does not expect to rigorously measure and quantify the exact level of the program’s contribution to the targeted outcomes. Rather, it aims at building a robust story and factual and data evidence on how and to what extent the program has contributed to the achievement of the targeted outcomes.

The assessments to be carried out to build the evaluation story are different in step 1 and step 2. In the first case, the facts to be analyzed and the actors to be considered are usually accessible and close to the budget support inputs, and the relationships and links to be assessed are rather direct. In step 2, identification of the policy processes that lead to the results is underpinned by statistical analysis and/or historical methods. Finally, guided by the theory, the evaluator synthesizes the application of these assessment criteria, identifying the contributions of budget support inputs to policy (induced) outcomes.

Based on the theory of change, the formulation of the evaluative questions (EQs) must contain the various hypotheses and indicators necessary to understand how the government has used the resources provided and how the dialogue has or has not allowed facilitation of a constructive use of such resources. Instead of verifying a predefined sequence of causal links, as happens in a project evaluation, the EQs must help identify the broader context within which the cluster of budget support operations takes place, the opportunities created or missed, and how the different parties have used them. The EQs address the various levels of the intervention logic. The first set of EQs (step 1) compare planned budget support inputs and those provided (relevance, size, predictability, coordination with technical assistance, alignment with external support, and others) and the improvements in areas that are being supported. Step 2 EQs assess expected achievements in terms of development results at outcome and impact level as defined in the budget support agreements. Finally, the step 3 EQs turn to addressing the extent, and mechanisms through which, budget support contributed to the attainment of development results identified in step 2.

Future Directions

The three-step methodology was deployed several times before being adopted by the OECD-DAC Network on development evaluation in 2012. In 2014 the EU commissioned a synthesis of seven evaluations undertaken since 2010. The synthesis looked at the strengths and weaknesses of the three-step approach, among other things. The specific tools and evaluation techniques used by each evaluation team were compared and assessed to develop recommendations on possible improvements to evaluation practices. These covered methodological, managerial, and process issues.

To improve the methodological approach, the study recommended that (a) a contextual analysis be introduced systematically in each evaluation; (b) step 2 analysis considers the possibility of reliance on secondary rather than primary data analysis and/or more qualitative approaches (such as benefit-incidence surveys or perception surveys); (c) development partners management response to evaluation recommendations be strengthened; (d) evaluation reporting formats be simplified; (e) the classification and presentation of evidence collected be simplified so as to facilitate comparability across evaluations; and (f) that the evaluation approach could become an integral part of the domestic policy processes if it is led by the country rather than the donors. These recommendations were taken into account in the budget support evaluations that have followed, but the methodology has not changed since its adoption.

Regarding the MDB/IEG approach, some proposed changes to practice being rolled out by IEG are discussed by Bogetić and Chelsky in chapter 6 of this volume. In summary, they highlight the need for greater recognition of PBO as a different aid instrument from traditional project finance,

and emphasize the critical role played by the identification and selection of conditionality (prior actions), which are necessary conditions for Board approval of PBO loans by the World Bank. They argue that prior actions are key reform elements but have not received sufficient attention in past evaluations. Finally, they note some recommended changes to practice: (a) eliminate evaluation of the borrower's performance but retain evaluation of MDB performance; (b) streamline and reduce the number of ratings; (c) increase use of machine learning tools that automatically or semi-automatically help increase the efficiency of organizing and analyzing large amounts of quantitative and qualitative data.

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