36772

DEVELOPMENT POLICY LENDING RETROSPECTIVE

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ABBREVIATIONS AND ACRONYMS

AfDB	African Development Bank
AFR	Africa Region
CAS	Country Assistance Strategy
CEA	Country Environmental Analysis
CEM	Country Economic Memorandum
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Report
CPIA	Country Policy and Institutional Assessment
CSO	Civil society organization
DPL	Development policy lending/loan
DPO	Development policy operation
DPR	Development Policy Review
DSA	Debt Sustainability Analysis
DSF	Debt Sustainability Framework
EAP	East Asia and Pacific Region
ECA	Europe and Central Asia Region
FSAP	Financial Sector Assessment Program
FY	Fiscal year
GPP	Good practice principles
HIPC	Heavily Indebted Poor Country
IADB	Inter-American Development Bank
IBRD	International Bank for Reconstruction and Development
ICR	Implementation Completion and Results Report
IDA	International Development Association
IEG	Independent Evaluation Group
IMF	International Monetary Fund
LCR	Latin America and Caribbean Region
LDP	Letter of Development Policy
LIC	Low-income country
MDG	Millennium Development Goal
MDRI	Multilateral Debt Relief Initiative
MIC	Middle-income country
MNA	Middle East and North Africa Region
MOU	Memorandum of Understanding
NGO	Nongovernmental organization
OECD-DAC	Development Assistance Committee, Organisation for Economic Co-operation and Development
OP	Operational Policy (statement)
OPCS	Operations Policy and Country Services
PAF	Performance assessment framework
PEFA	Public Expenditure and Financial Accountability (Initiative)
PER	Public Expenditure Review
PFM	Public financial management
PIN	Public Information Notice
PRGF	Poverty Reduction and Growth Facility
PRS	Poverty reduction strategy
PRSC	Poverty reduction support credit
PRSP	Poverty Reduction Strategy Paper
SAR	South Asia Region
SEA	Strategic Environmental Assessment
USAID	United States Agency for International Development

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DEVELOPMENT POLICY LENDING RETROSPECTIVE

EXECUTIVE SUMMARY

1. In August 2004, Executive Directors of the World Bank adopted a new comprehensive operational policy (8.60, *Development Policy Lending*) governing all fast-disbursing policy-based lending. The new policy draws on experience with previous adjustment lending policies and reflects the evolution of the latter instrument toward increased focus on poverty reduction and sustained support for policy and institutional reform and capacity building.

2. ***Purpose.*** The development policy lending retrospective responds to a request by IDA Deputies and the Board for a systematic review of experience with the implementation of the new policy. It serves as background to the preparation of a framework to assess the readiness of countries to make productive use of development policy operations (DPOs) by the time of the IDA14 Mid-Term review. The retrospective also provides a progress report on the implementation of good practice principles on conditionality, put forward in the context of the 2005 World Bank Conditionality Review, as requested by IDA Deputies and the Board.

3. ***Methodology.*** The report builds on a desk review of lending documents, interviews with Bank staff, consultations with borrowers, internal review meetings, feedback from civil society organizations, and a series of broad analytic work on policy-based lending conducted over the past 18 months by the Bank and development partners.

4. ***Lending Trends.*** The Bankwide share of policy-based lending remained in the range of historical averages in FY06, with about 31 percent of FY06 lending commitments in policy-based operations. IBRD's share of policy-based lending commitments was 34 percent whereas that for IDA was 26 percent. The majority of policy-based operations continued to be in LCR (for IBRD) and Africa (for IDA). Policy-based commitments over the past years were concentrated in countries with better overall country policy and institutional assessment (CPIA) scores and better CPIA governance cluster scores. The quality at exit of policy-based lending remains high—95 percent of outcomes in FY05 were rated satisfactory. Moreover, the currently available evidence from CPIA scores and from quality at exit ratings by the Independent Evaluation Group for investment lending and policy-based lending suggests that the Bank's choice of lending instruments in different policy environments has been consistent with maintaining high quality.

5. ***Conditionality.*** During FY06, conditionality trends remained largely unchanged compared to those presented in the FY05 conditionality review. The average number of conditions remained at 12-13 per operation for both IDA and IBRD countries. Use of nonbinding benchmarks in policy matrices increased from 30 to 32 in IDA countries and declined from 10 to 8 in IBRD countries, compared to FY05.

6. ***Macroeconomic Analysis and Growth.*** All reviewed operations include a description of recent economic developments and the macroeconomic outlook, and identify credit risks and potential mitigating measures, drawing on available analytic work. IMF views have been conveyed consistently, including in standard annexes. However, the quality of macroeconomic analysis varies. Macroeconomic horizons are frequently focused on the short-term and tend to neglect the long-term macroeconomic and growth outlook, reflecting weaknesses identified for

macro-analytic work. Binding constraints to growth are rarely identified or linked to program actions.

7. ***Participation and Poverty and Social Impact Analysis.*** A majority of supported programs build on some type of participatory process and more than 50 percent of operations foster participatory and consultative processes under the supported program. (In addition, DPOs increasingly take advantage of work with other donors.) However, documentation of participatory processes underpinning government programs is weak and lacking in 80 percent of reviewed documents, making it difficult to gauge the breadth of participation and how participatory process may have contributed to program design. Almost all operations also include a discussion of likely distributional impacts of supported policies. However, available analytic work could be more fully utilized. PSIA work could also be better embedded in upstream processes and plans for PSIA work could be disclosed earlier.

8. ***Environmental Aspects.*** All but one reviewed operation made the required determination of likely significant effects on the environment. However, program documents could more systematically assess environmental capacity and institutions, and at times teams struggle with situations where environmental effects may be indirect and difficult to identify on the outset. The number of completed Country Environmental Analyses underpinning DPOs is below original expectations.

9. ***Fiduciary Issues and Public Financial Management Aspects of Governance.*** All reviewed operations build on prior country fiduciary analysis, typically a Country Financial Accountability Assessment, and many operations draw on several pieces of analytic work. Where fiduciary weaknesses have been identified, public financial management reform is an integral part of the government program supported under DPOs, and, if necessary, additional fiduciary arrangements such as dedicated accounts have been applied. Implementation could be improved further by better (a) assessments of the strength of the supported program; (b) tracking of progress over time; and (c) more systematic identification of residual fiduciary risks.

10. ***Customization.*** In IBRD countries most operations focus on "second-generation" sectoral reforms, and programs are frequently summarized succinctly in small policy matrices. Borrowers highly value the strong technical expertise and analytic work in support of these programs and they request low transaction costs and few conditions. In IDA countries, translating the PRS into focused action plans remains a challenge and continues to affect the management of policy matrices in frequently multisectoral operations. At the same time, harmonization in budget support settings is common and review calendars are being better aligned to increase predictability, a major concern of IDA borrowers/recipients. Recent studies also point to effectiveness of budget support in supporting poverty reduction strategies implementation and in improving allocative and operational efficiency of expenditure. DPOs have also been used selectively in fragile states/post-conflict states or turnaround cases where changing policy environments offered opportunities for quick wins, albeit at higher risks.

11. ***Options.*** The policy allows for a variety of options. Debt and debt service reduction operations and Deferred Draw-down Options appear to be unattractive and are rarely used. By contrast, subnational lending is a frequently used option in large countries with devolved responsibilities. Supplemental financing has already shown its ability to deliver additional resources quickly, as for example in the Bank's response to the earthquake in Pakistan.

12. ***Results.*** DPOs systematically include results frameworks, typically with a mix of qualitative and quantifiable indicators. Recent Implementation Completion and Results Reports also show an increasing use of outcome indicators to justify ratings of policy-based loans, and examples from six countries supported with policy-based operations over several years show progress in service delivery indicators. Teams continue to struggle to find a relevant set of monitorable and meaningful indicators and to align them with poverty reduction strategies and Country Assistance Strategies. Results frameworks need strengthening through consistent benchmarking of indicators and integrating capacity and institution building for monitoring and evaluation into the supported program.

13. ***Conditionality Review.*** Given the short time elapsed since the completion of the 2005 conditionality review, only early trends can be identified. Recent operations are broadly consistent with the good practice principles. Nonetheless, the number of nonbinding benchmarks used in IDA countries remains high as teams continue to describe the broader program in Bank documents—but there are also emerging examples that rely on country documents or joint donor frameworks rather than a full description of supported programs.

14. ***Conclusions and Follow-Up.*** The new operational policy for development policy lending has emerged as a robust and flexible framework that is adaptable to a variety of country circumstances and that incorporates a strong focus on results in supporting government-owned programs. Consistent with the policy, the Bank has been selective, using the instrument predominantly in stronger policy environments. Policy compliance has been high, guided by the mandatory corporate review process. A number of areas emerge for follow-up to strengthen policy implementation, most importantly (a) systematic description of participatory processes that underpin supported programs; (b) more strategic upstream consideration of distributional and environmental effects, better use of existing analytic work for poverty and social impact analysis, and preparation of analytic work on the environment; (c) improved assessment of the strength and timely implementation of public financial management programs, more systematic tracking of progress in public financial management (including through Public Expenditure and Financial Accountability indicators), and better analysis of residual fiduciary risks; (d) improved benchmarking of results indicators and better integration of capacity and institution building for monitoring and evaluation into the program. Implementation of suggested follow-up actions would build on (a) revisions to existing good practice notes as warranted; (b) additional focus of the corporate review process in these areas, especially as regards progress with improving PFM systems and result measurement; and (c) efforts by Regions and Networks in improving quality of some analytic work and identifying relevant analytic work upstream.

DEVELOPMENT POLICY LENDING RETROSPECTIVE

I. INTRODUCTION AND CONTEXT

1. In August 2004, the Executive Directors of the World Bank approved a new operational policy (OP) 8.60, *Development Policy Lending* (DPL).[1] The new policy replaces a host of separate adjustment lending instruments and codifies all policy-based lending in a single operational framework. This retrospective (a) takes stock of first experiences with the new operational policy, (b) highlights key lessons to further strengthen its application both from the operational policy and design perspectives, (c) discusses client and staff perceptions and feedback, and (d) describes how the good practice principles on conditionality endorsed by the Development Committee in September 2005 have been reflected in recent operations.

2. ***Justification and Objective of DPL.*** The operational policy for DPL covers all Bank operations that provide "rapidly disbursing policy-based financing to address actual or anticipated development financing needs of external or domestic origins" (para.1). The overarching objective of DPL is to support a "country's economic and sectoral policies and institutions aimed at accelerated sustainable growth and efficient resource allocation" (para. 2). To this end, development policy operations (DPOs) typically support a program of policy and institutional actions and finance the borrower's overall budget expenditures, with the exception of items on a standard negative list.[2]

3. ***Evolution of Adjustment Lending.*** The Bank's instruments for fast-disbursing lending evolved during the 1990s in response to lessons learned in the application of adjustment lending.[3] A mixed record with the focus on short-term balance-of-payment adjustment in the 1980s led to an increased focus on poverty reduction, support for sustained policy and social programs, and increased focus on capacity and institution building in Bank operations. The Bank also responded to research findings and studies suggesting that programs without sufficient ownership are less likely to succeed, highlighting the importance of adapting Bank support to a country's development priorities and implementation capacity.[4] Important milestones reflecting these lessons were the introduction of programmatic adjustment lending in 1999[5] and the launch of poverty reduction support credits (PRSCs) in 2001.[6]

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1 *From Adjustment Lending to Development Policy Lending: Update of World Bank Policy* (R2004-0135), June 25, 2004.

2 The standard negative list has remained unchanged compared with the list applied to adjustment loans, except that financing of expenditure in local currency is no longer prohibited.

3 *Adjustment Lending Retrospective* (SecM2001-0215), April 2, 2001.

4 See, for example, David Dollar and Lant Printchett, *Assessing Aid: What Works, What Doesn't and Why*, World Bank Policy Research Report (Oxford University Press, 1998) and David Dollar and Jakob Svensson, "What Explains Success or Failure of Structural Adjustment Programmes?" *The Economic Journal*, 110(466): 894-917, October 2000.

5 The programmatic approach was designed to support reforms that involve multiyear policy changes and institution building in low- or middle-income countries. It builds on (a) the existence of a strong medium-term program, (b) a phased series of single-tranche loans disbursed on the basis of completed actions, and (c) triggers (rather than legal conditions) to move from one operation to the next. For a detailed review of experiences, see *Programmatic Adjustment Lending Retrospective*, (SecM2003-0333), July 15, 2003.

6 PRSCs were designed as a separate adjustment lending instrument to support the implementation of poverty reduction strategies in low-income countries through programmatic adjustment operations. Their objective was to (a) help operationalize and finance a medium-term program to implement poverty reduction strategies, (b) improve resource predictability, and (c) provide a framework for donor harmonization. *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), May 26, 2005, reviews the Bank's experiences with this instrument.

4. ***Incorporating Lessons Learned into the New Policy.*** Building on the lessons of experience and the evolution of the adjustment lending instrument, the policy for DPL adopted in August 2004 offers a coherent framework for the Bank's approach to fast-disbursing lending. Reflecting the mixed record of adjustment lending, the policy no longer contains any policy prescriptions—such as directives for privatization and trade liberalization policies. Instead, the policy explicitly recognizes that the Bank through the DPL instrument supports the implementation of the country's own program of policy and institutional action. In this regard, decisions to extend DPOs need to rely on an assessment of a country's institutional and policy framework, the country's commitment, and its track record. Overall, reflecting key lessons on aid effectiveness, the policy highlights the importance of country ownership; donor coordination; participation; analytic underpinnings; analysis of poverty and social impacts and environmental effects of supported policies; fiduciary analysis; conditionality focused on critical actions; and focus on results, monitoring, and evaluation.

5. ***Simplification and Modernization of Policies.*** In addition to incorporating lessons learned, the policy revision contributed to the ongoing modernization and simplification of Bank operational policies and procedures. The new OP replaces the operational directives and a number of operational memoranda that were guiding the Bank's instruments for structural adjustment lending, such as structural adjustment loans (SALs), sectoral adjustment loans (SECALs) and PRSCs.[7] It thereby greatly reduces and focuses the number of applicable policy statements for fast-disbursing lending.

6. ***Objectives Associated with the New Policy.*** Overall, the adoption of the new policy had a number of broad objectives:

a) systematic incorporation of key lessons on development effectiveness into the design of all policy-based lending operations;

b) more effective customization of Bank support to country circumstances and country-level objectives;

c) better and more flexible response to clients' needs trough a simpler and streamlined policy framework;

d) enhanced focus on results, in particular in relation to countries' growth and poverty reduction agendas and on support for achieving the Millennium Development Goals (MDGs);

e) sharper distinction between Bank and borrower requirements; and

f) clearer separation of mandatory policy provisions from good practice.

7. ***Purpose and Objectives of the Retrospective.*** This development policy lending retrospective responds to a request by IDA Deputies and the Board for a systematic review of experience with the implementation of the new policy by the time of the IDA14 Mid-Term Review.[8] It also serves as background to the preparation of a framework to assess for the IDA

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7 Given its wide recognition, the PRSC label has been retained for medium-term and multisectoral support to PRSP implementation in better-performing IDA countries. However, PRSCs are no longer subject to separate policy provisions.

8 *Additions to IDA Resources: Fourteenth Replenishment. Working Together to Achieve the Millennium Development Goals.* Report from the Executive Directors of the International Development Association to the Board of Governors, March 10, 2005.

Mid-term Review the readiness of countries to make productive use of DPOs. As requested by IDA Deputies and the Board, the retrospective provides a progress report on the implementation of good practice principles on conditionality in development policy lending, put forward in the context of the 2005 World Bank Conditionality Review and endorsed by the Development Committee in September 2005.[9] The main objectives of this report are to (a) update key figures on volume, selectivity, and conditionality of policy-based lending; (b) review the consistency with which the new operational policy is being applied; (c) discuss implementation issues, particularly those related to customization of Bank support and results-focus of DPOs; and (d) identify whether and how the good practice principles on conditionality are being reflected in recently approved DPOs. In meeting these objectives, the report highlights emerging good practice and identifies areas for follow-up to strengthen design of operations.

8. ***Coverage and Limitations of the Retrospective.*** Unless otherwise indicated below, the review covers a set of 50 DPOs for 37 countries (23 IDA-only countries) approved until March 31, 2006.[10] These operations, covering both middle-income and low-income countries, offer a first overview of the application of the new policy in a variety of country circumstances. A list of these operations is attached as Annex A. However, the experience with the application of DPL is recent and limited, with most operations being approved in the second half of FY05 and FY06. Several reviewed operations also represent continuations in a series of programmatic adjustment loans, and their design was largely pre-determined by the programmatic structure. The findings of the retrospective are therefore to be seen as a snapshot on emerging experiences and lessons rather than a definite answer on the properties of the new lending instrument. Moreover, as noted above, DPL emerged from an evolution of adjustment lending. Thus, with only a limited set of experience to date, the retrospective comes too early to detect any impact of the policy change on the quality at exit of policy-based lending operations.

9. ***Methodology and Consultations.*** The report builds on a desk review of lending documents, interviews with Bank staff, consultations with borrowers, feedback and discussions during internal training events and internal review meetings, feedback from civil society organizations (CSOs), evaluation reports by the Independent Evaluation Group (IEG) and the Quality Assurance Group (QAG), and a series of broad analytic work on policy-based lending conducted over the past 18 months by the Bank and development partners.[11] Consultations and discussions with borrowers, multi- and bilateral donors, CSOs, and Bank staff on development policy lending took place during (a) a workshop on the implementation of the Paris declaration in Bamako, Mali, on March 28-29, 2006, attended by representatives of 25 North, West, and Central African governments; (b) a Forum on National Plans as Poverty Reduction Strategies in Vientiane, Lao PDR, on April 4-6, 2006, attended by representatives of 6 East Asian governments; and (c) a videoconference with borrower representatives and Bank staff in 6 countries in the Latin America and Caribbean Region on May 25, 2006. CSOs also contributed with early results of their own research on conditionality during the Spring Meetings in

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[9] *Review of World Bank Conditionality* (SecM2005-0442), August 18, 2005, and Development Committee Communiqué, September 25, 2005.

[10] These include three operations for which the policy was applied retroactively, after approval by the Managing Director, Operations. The sample excludes the Morocco Housing Sector DPL, for which a retroactive application of OP 8.60 was also granted but not originally recorded.

[11] A possible survey of borrowers was also considered. However, given the limited set of borrowers involved with DPL to date, a standard response rate of about 30 percent would have yielded no more than 10-12 responses, which would be insufficient for statistical exploitation or full Regional coverage.

Washington, and they had an opportunity to give feedback on preliminary findings on June 13, 2006. In addition to these events, the report draws on papers presented and exchanges with government and donor representatives during a World Bank-sponsored Practitioners' Forum on Budget Support on May 5-6, 2005 in Cape Town, South Africa, captured in a recently published volume.[12] Additional analytic work of relevance includes the Bank's 2005 PRSC stocktaking paper and the 2005 Poverty Reduction Strategy (PRS) Review.[13] Finally, the report draws on a joint evaluation of general budget support based on a systematic review of experiences in 8 low-income countries, piloted by the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD-DAC).[14]

10. ***Structure of the Report.*** The review is organized in six chapters. The next chapter reviews recent trends in policy-based lending as regards volumes, share of DPL in Bank operations, sectoral coverage, loan design, and conditionality. The third chapter discusses the application of the new policy as regards specific policy requirements. The fourth chapter reviews practical implementation issues, in particular as regards the customization of Bank operations and their results focus. The fifth chapter reports on the Bank's efforts and progress in disseminating and implementing the good practice principles for conditionality. The last chapter lays out proposed next steps and suggests issues for Board consideration.

II. RECENT TRENDS IN POLICY-BASED LENDING

11. The Bank periodically reports on lending trends and conditionality for policy-based operations—most extensively in two of the background papers for the 2005 Review of Conditionality.[15] This chapter provides an update on the FY05 and FY06 evolution of trends for policy-based operations. Since the new OP for DPL only applies to operations with concept reviews after September 1, 2004, the experience with DPL is too brief to identify any statistically significant changes in lending trends or number and type of conditions. Therefore, the analysis below largely focuses on overall trends for policy-based lending in recent years, with occasional references to new trends emerging for DPOs. In addition to the operations listed in Annex A, the figures below reflect 16 additional DPOs approved through end-June 2006 (see Annex B).

A. Policy-Based Lending Operations and Commitments

12. The number of policy-based lending operations approved by the Bank's Board increased from 30 during FY01 to 51 (excluding supplemental financing) during FY06 (see Table 1) alongside the overall increase in Bank lending from about $17 billion during FY01 to almost $24 billion in FY06. Although IDA countries typically receive the majority of policy-based operations, IBRD normally accounts for two-thirds or more of policy-based lending commitments. DPOs accounted for less than one-third of all policy-based lending operations in

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12 Stefan Koeberle, Zoran Stavreski, and Jan Walliser (eds.), *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons,* World Bank, April 2006.

13 *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-028), May 12, 2005, and *2005 PRS Review: Balancing Accountabilities and Scaling Up Results* (DC2005-0017), World Bank and International Monetary Fund, September 12, 2005.

14 *Evaluation of General Budget Support: Synthesis Report*, International Development Department, University of Birmingham, and Associates, May 2006.

15 *Review of World Bank Conditionality: Recent Trends and Practices* (SecM2005-090/4), July 21, 2005, and *Review of World Bank Conditionality: Content of Conditionality in World Bank Policy-Based Operations* (SecM2005-0390/5), July 11. 2005.

FY05 as the new policy was phased in, but during FY06 DPOs have almost completely replaced adjustment lending.

Table 1. Policy-Based Lending Operations and Commitments FY00-06

	FY00	FY01	FY02	FY03	FY04	FY05	FY06
IDA							
Number of Operations [a]/	9	15	23	24	23	32	30
of which: DPOs	0	0	0	0	0	9	29
Lending commitments (US$ million) [b]/	682	1,826	2,443	1,831	1,698	2,301	2,425
of which: DPOs	0	0	0	0	0	562	2,325
IBRD							
Number of Operations	14	15	21	21	18	23	21
of which: DPOs	0	0	0	0	0	9	19
Lending commitments (US$ million)	4,426	3,937	7,383	4,187	4,453	4,264	4,905
of which: DPOs	0	0	0	0	0	2,186	4,521
Total							
Number of Operations	23	30	44	45	41	55	51
of which: DPOs	0	0	0	0	0	18	48
Lending commitments (US$ million)	5,108	5,763	9,826	6,018	6,151	6,565	7,330
of which: DPOs	0	0	0	0	0	2,748	6,846

[a] / Excludes blend operations and supplemental financing operations.
[b] / Includes the IDA share of blend operations.
Source: SAP Business Warehouse.

13. ***Share of Policy-Based Lending.*** The majority of Bank operations remain investment operations. For both IDA and IBRD, policy-based operations accounted for 20 percent or less of all operations in recent fiscal years. In terms of lending commitments, the Bankwide share of development policy lending has remained close to 30 percent during FY03-06, without any discernible overall trend (see Figure 1). However, the share of policy-based lending by IBRD and IDA has fluctuated over time. IBRD's policy-based lending share spiked as a result of crisis lending during FY02, whereas IDA's share fell sharply in FY04 during a rapid acceleration of IDA investment lending. During FY06, IBRD's share of policy-based lending was 34 percent, and IDA's share stood at 26 percent. As part of the operational policy change in 2004, the prior 25 percent ceiling for the Bankwide share of policy-based lending was removed. However, Management committed to report annually in a separate paper at the same time as the Medium-Term Strategy and Finance paper and Credit Risk and Loan Provisioning paper to the Board on the anticipated share for policy-based lending commitments, giving Executive Directors an opportunity to approve a guideline for the annual share of DPL. To date, management has reported twice to the Board on projected DPL commitment shares.[16] As suggested by Executive

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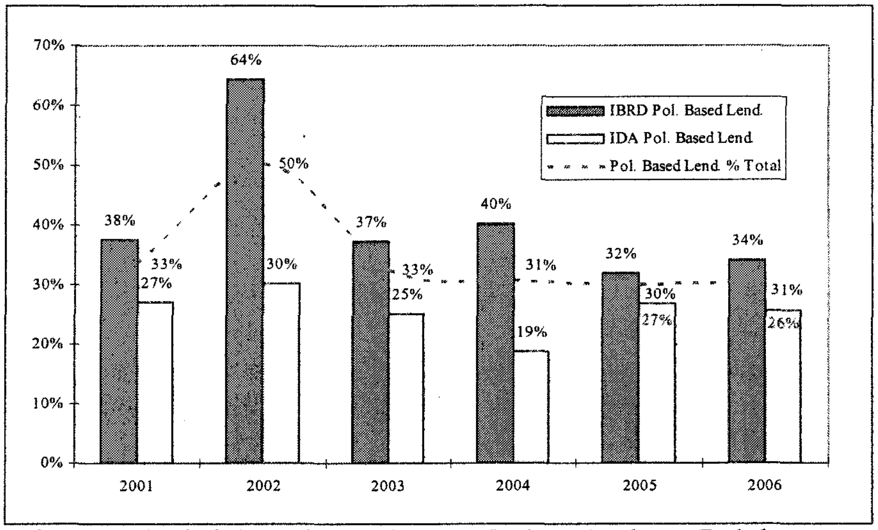
[16] *FY05-07 Outlook for the Bankwide Share of Development Policy Lending, First Annual Report* (SecM2005-128), March 17, 2005, and *FY06-08 Outlook for the Bankwide Share of Development Policy Lending, Annual Report* (SecM2006-140), April 5, 2006.

Directors, the report will in the future be annexed to the Medium-Term Strategy and Finance paper.[17]

Figure 1. Share of Policy-Based Lending in World Bank Lending



Source: Staff calculations using data from SAP Business Warehouse. Excludes guarantees.

B. Design Aspects, Regional Distribution, and Processing of Policy-Based Operations

14. Like earlier adjustment lending policies, OP 8.60 provides for a variety of options in designing operations. One important aspect is the choice between single- and multitranche designs. Single-tranche operations disburse against a set of completed actions (prior actions) whereas multitranche operations set out conditions in the legal agreement for the release of future tranches (tranche release conditions). Single-tranche operations can be part of a programmatic series of operations or be processed as stand-alone operations. However, as a matter of operational policy, stand-alone single-tranche operations must be embedded in a medium-term framework (para. 14).

15. ***Programmatic Lending Approach.*** Since their introduction in 1999, programmatic policy-based operations have become a key operational tool of the Bank. Under programmatic operations the Bank accompanies the implementation by borrowing countries of an often complex medium-term program through a phased series of single-tranche loans, each of which is disbursed on the basis of completed actions. Triggers (indicative prior actions) rather than conditions are used to evaluate progress under the program and determine the move from one operation to the next. In addition, the program, which is typically laid out in a sequenced policy matrix, may contain other policy and institutional actions, so-called benchmarks. Benchmarks are generally monitored under the program but are usually not considered to be of such critical

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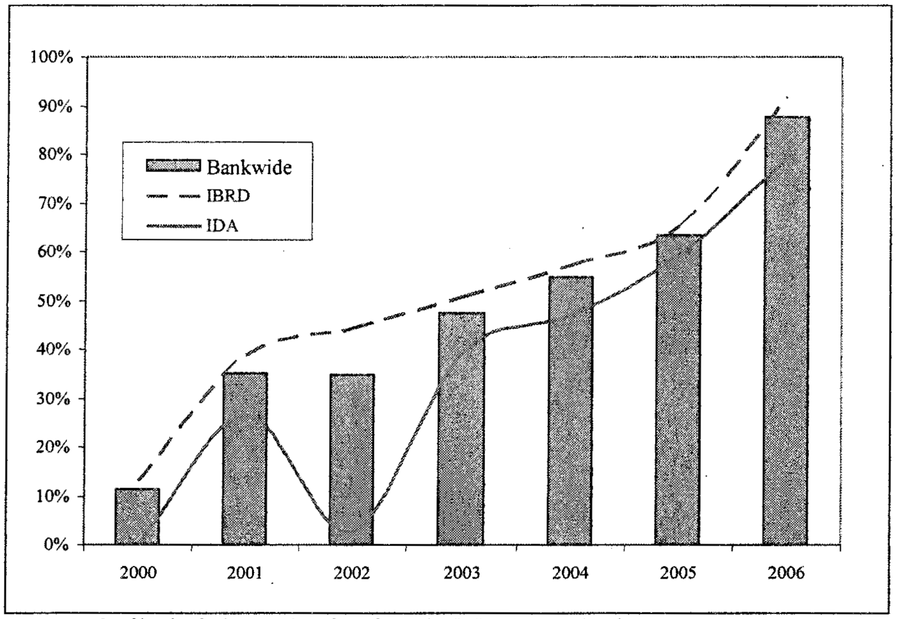
17 In addition to the Bankwide share, Management also monitors separately the anticipated share of DPL commitments by IDA. In line with commitments made during the IDA14 replenishment, Management will seek guidance from IDA Executive Directors if the projected share of IDA DPL commitments exceeds 30 percent. See *Additions to IDA Resources: Fourteenth Replenishment. Working Together to Achieve the Millennium Development Goals,* Report from the Executive Directors of the International Development Association to the Board of Governors, March 10, 2005, para 52.

nature for the success of the program that they are intended to be prior actions for future operations.

16. ***Increasing Use of Programmatic Operations.*** Reflecting the experiences under structural adjustment lending related to rigidities in multitranche settings,[18] as well as the increasing demand for Bank support of complex institutional reforms requiring a flexible step-by-step approach, the share of Bank operations and commitments for programmatic operations has risen sharply since 2000 (see Figure 2). In FY06, more than 85 percent of policy-based lending commitments for IBRD countries and more than 70 percent for IDA countries were programmatic—in IDA countries these operations typically used the PRSC label.

Figure 2. Share of Programmatic Lending Commitments in Policy-Based Lending



Source: Staff calculations using data from SAP Business Warehouse.

17. ***Declining Use of Multitranche Design.*** A corollary of the increasing use of programmatic lending approaches is the increasingly rare use of multitranche designs (see Figure 3). Since FY03, only a minority of policy-based operations have been multitranche loans. During FY05 and FY06, more than 81 percent of IBRD and 90 percent of IDA policy-based operations were single-tranche.

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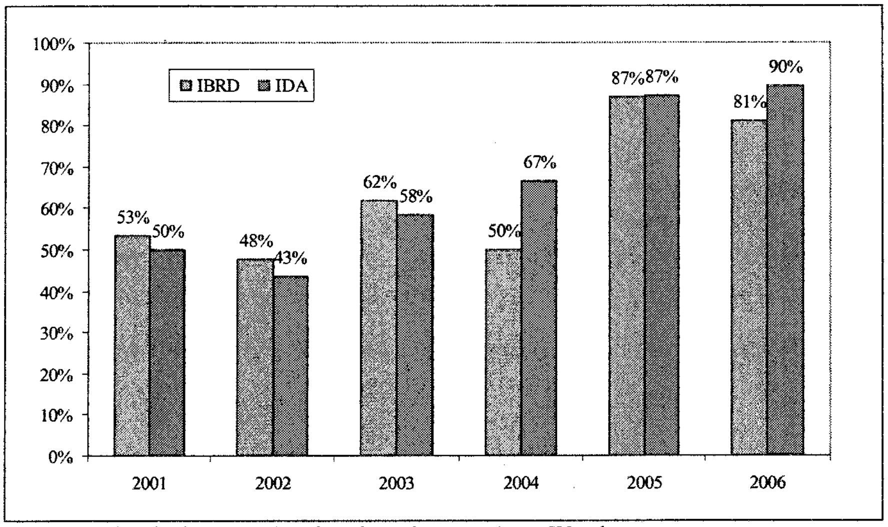
[18] *Adjustment Lending Retrospective* (SecM2001-0215), April 2, 2001.

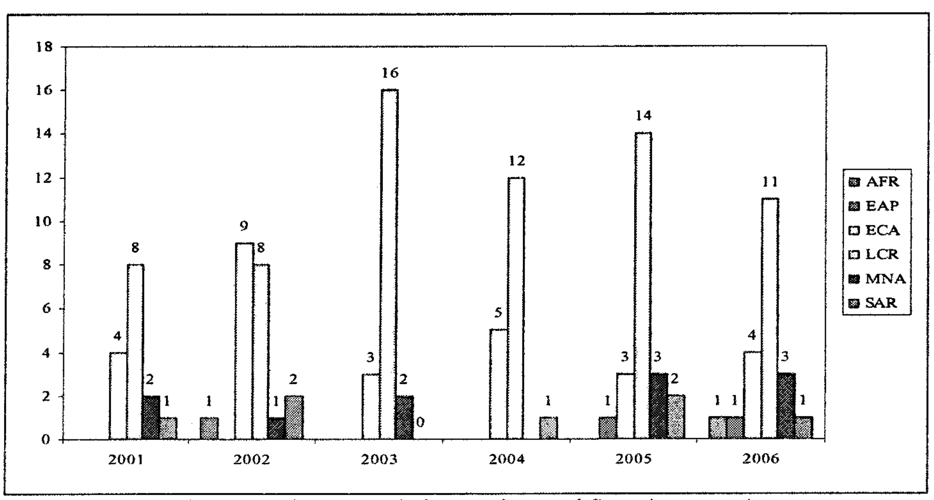
Figure 3. Share of Single-Tranche Operations in Policy-Based Lending Portfolio



Source: Staff calculations using data from SAP Business Warehouse.

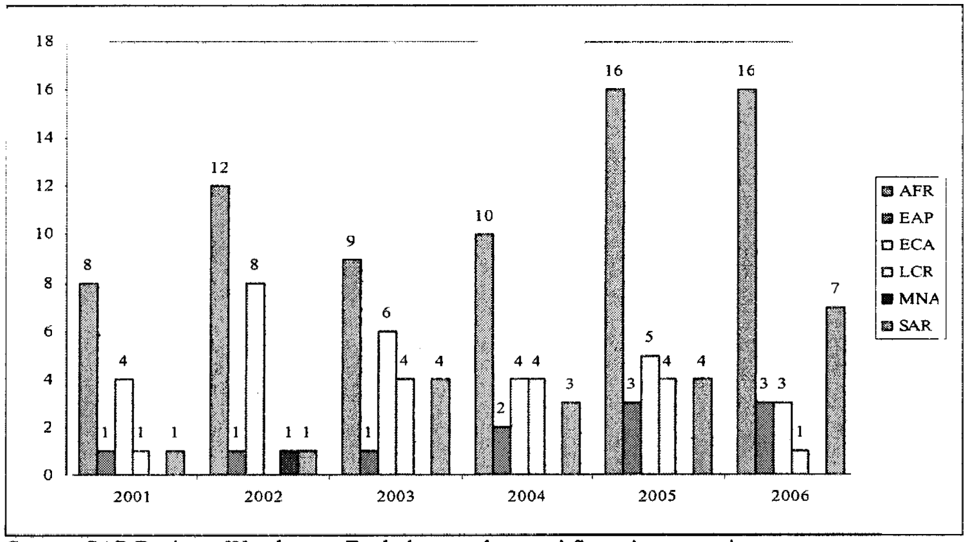
18. ***Regional Distribution of Operations.*** The distribution of policy-based lending is heavily concentrated in a few of the Bank's Regions. The Latin America and Caribbean Region (LCR) processes by far the largest number of policy-based loans on IBRD terms, followed by the European and Central Asia (ECA) and Middle East and North Africa (MNA) Regions (see Figure 4). These figures reflect the fairly large demand of middle-income countries in LCR for Bank support for "second-generation" reform programs, with many operations supporting sectoral reforms and tackling competitiveness issues. The Africa Region (AFR) processes the largest number of policy-based operations on IDA terms (see Figure 5). Many of these operations carry the PRSC label and provide recurrent broad-based support for the implementation of poverty reduction strategies (PRSs) in better-performing IDA countries. Additional interest in policy-based lending for IDA-eligible countries has also emerged in South Asia (SAR) and to some extent LCR since FY02. By contrast, the number of IDA operations in ECA has declined somewhat since FY02; this principally reflects the graduation of several ECA countries from IDA to IBRD.

Figure 4. Number of IBRD Policy-Based Operations by Region



Source: SAP Business Warehouse. Excludes supplemental financing operations.

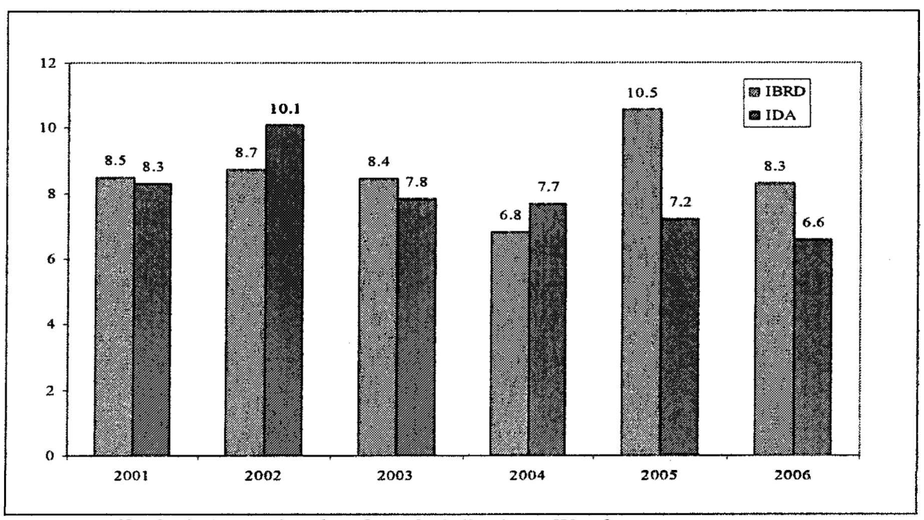
Figure 5. Number of IDA Policy-Based Operations by Region



Source: SAP Business Warehouse. Excludes supplemental financing operations.

19. ***Processing Times.*** Use of less complex loan designs, increased reliance on programmatic lending, and the streamlining of operational policy requirements appear to have yielded positive results for average preparation times of policy-based lending operation for IDA (see Figure 6). Excluding four extreme outliers, processing times between concept review and Board approval declined by more than 20 percent between FY01 and FY06 for IDA policy-based operations and but stayed roughly constant for IBRD policy-based operations.[19] Similar figures apply comparing FY06 outturns against average preparation times during FY01-06.

Figure 6. Average Processing Time between Concept Review and Board Approval by Fiscal Year (in months)



Source: Staff calculations using data from SAP Business Warehouse.

[19] These figures omit four extreme outliers: Gabon's Natural Resource Management DPL, Mexico's Urban Poverty Program, Cameroon's Forestry and Environment DPL, and Vietnam's first PRSC. All of these operations were subject to changes in the lending instrument between concept review and Board approval.

C. Selectivity

20. Experience with policy-based lending shows that selectivity is an important aspect in enhancing aid effectiveness. Policy-based lending tends to be more successful when there is government ownership of a strong program; conditionality cannot substitute for ownership.[20] Research has also highlighted the fact that the impact of aid on growth depends on the quality of a country's policies and institutions.[21] For IDA, such selectivity concerns have directly influenced the design of the IDA performance-based allocation formula, which rewards countries with higher ratings under the Country Policy and Institutional Assessment (CPIA) with more resources per capita.[22] The OP for DPL approved in 2004 also draws on these lessons by noting that "the decision to extend DPL is based on an assessment of a country's institutional and policy framework" (para. 3). The OP also states that "the Bank considers the strength of the program and the country's commitment to and ownership of the program against its track record." In addition, the policy suggests that lending design and amounts should respond to fiduciary considerations (para. 19).

21. ***Selectivity against Overall CPIA Ratings.*** Distributional analysis of CPIA ratings and commitments for policy-based lending suggest that the Bank is making selective choices in its use of policy-based lending (see Figure 7). A significantly larger share of policy-based commitments is made to countries in the upper range of the distribution of CPIA ratings. For example, Bankwide less than 7 (17) percent of commitments for policy-based lending have been made to the bottom 32 (45) percent of the CPIA distribution during FY98-06. This finding is particularly evident for IDA countries, where less than 14 percent of IDA policy-based lending commitments during FY98-06 have been made to the bottom 43 percent of the CPIA distribution for IDA countries. At the same time, some fairly limited resources (9.6 percent of total policy-based lending for IDA), including for cases to repay bridge financing used to clear arrears, have been committed for policy-based lending to countries with a CPIA below 3.0, mostly to support countries emerging from conflict or experiencing rapid changes in policy environments (turnaround cases) with opportunities to reap quick gains.

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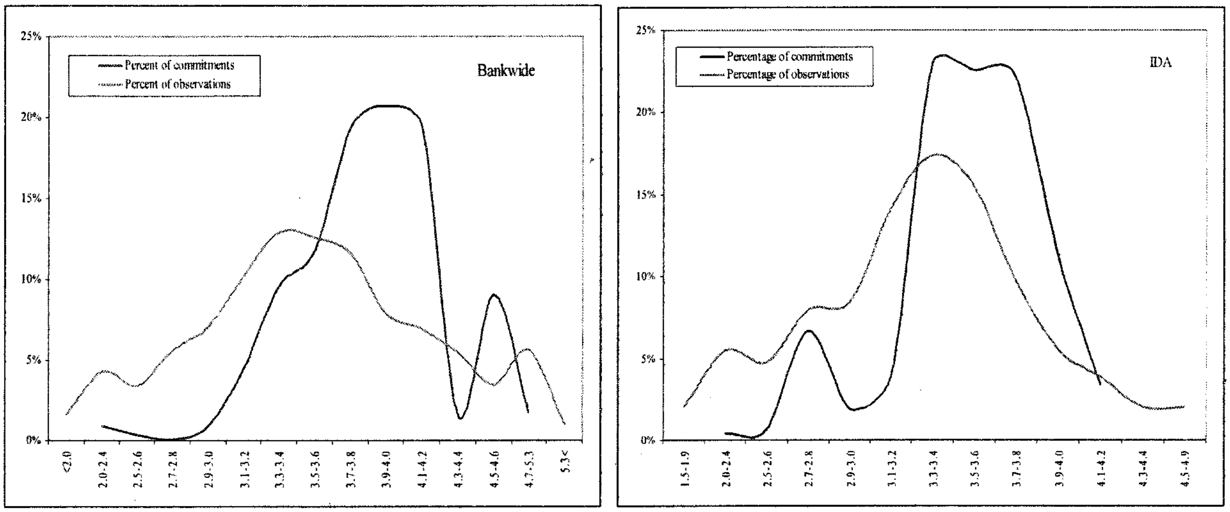
[20] The Bank's first review of structural adjustment lending in 1986 already highlighted the need to "assist countries to forge a consensus on the reforms that are to be undertaken." See *Structural Adjustment Lending: A First Review of Experience* (SecM86-1227), November 7, 1986.

[21] Craig Burnside and David Dollar, "Aid, Policies, and Growth," *American Economic Review*, 90(4), 847-868, September 2000.

[22] IDA's allocation formula also incorporates country portfolio performance measures and gives a strong weight to governance. For details, see *Additions to IDA Resources: Fourteenth Replenishment. Working Together to Achieve the Millennium Development Goals,* Report from the Executive Directors of the International Development Association to the Board of Governors, March 10, 2005, Attachment II.

Figure 7. Selectivity in Policy-Based Lending Against CPIA Ratings



Source: Staff calculations.

22. ***Selectivity against Governance Cluster and Corruption CPIA Ratings.*** DPOs support a country's development program through a direct resource transfer to the government's budget. The quality of public sector governance (including the framework to design and execute programs) and its budget and fiduciary systems are therefore of particular concern for DPOs—as discussed in more detail below—both from a selectivity and a program design perspective. Similar to findings for the overall CPIA, the Bank through the CAS process and IDA's performance-based allocation has allocated a significantly larger share of resources to countries in the upper range of the distribution for the governance cluster rating of the CPIA. Bankwide 11 (20) percent of policy-based lending commitments have been made to countries in the bottom 25 (52) percent of the governance CPIA cluster rating. For IDA, 12 (14) percent of commitments during FY98-06 have been to the bottom 26 (35) percent of the CPIA distribution for governance ratings in IDA countries (see Figure 8).[23] Additional distributional analysis for lending commitments in relation to the single CPIA corruption rating suffers somewhat from the fact that CPIA corruption ratings are heavily concentrated in the 2.5-3.5 range for IDA countries. Thus, there is less dispersion of countries that could be exploited for identifying selective choices. Bankwide the bottom 33 percent of the CPIA corruption ratings received about 20 percent of policy-based lending commitments during FY98-06. For IDA countries, the bottom half of the distribution of the CPIA corruption received less than 30 percent of policy-based lending commitments.

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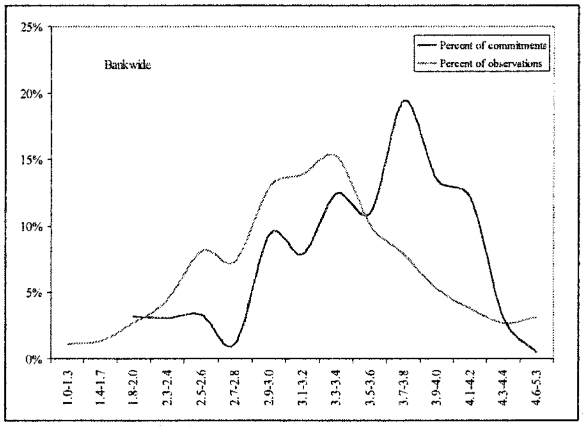
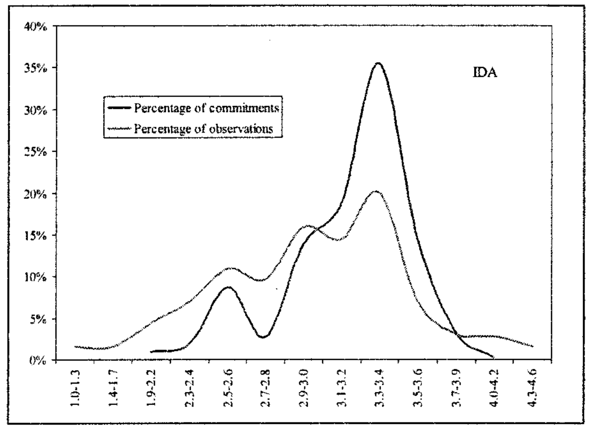
[23] Public sector management ratings refer to the last cluster of five CPIA questions. Governance ratings refer to question 20 (since 2005, question 16) of the CPIA.

Figure 8. Selectivity in Policy-Based Lending Against CPIA Governance Cluster Ratings





Source: Staff calculations.

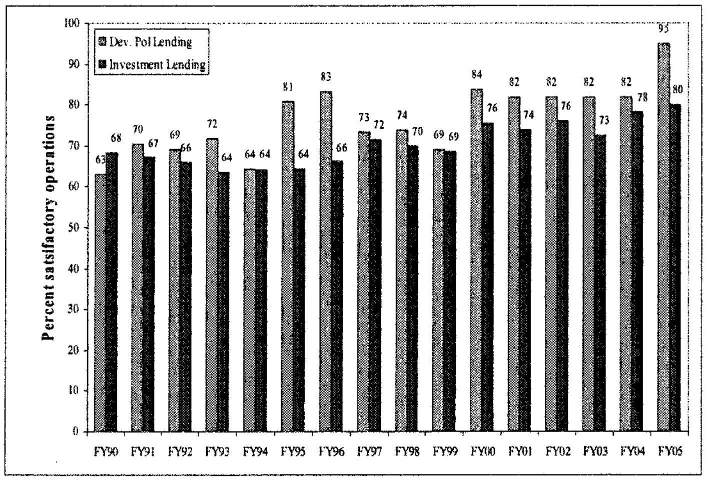
D. Quality

23. The quality of Bank lending is evaluated at exit by the Bank's Independent Evaluation Group (IEG) for development outcomes, sustainability, institutional development, and along other dimensions.[24] This section reviews the record of policy-based operations compared with trends for investment lending and against different CPIA ratings.

24. ***Recent Trends in Quality.*** Policy-based operations reached a record level of satisfactory outcome ratings in FY05. Ninety-five percent of the 42 operations evaluated in FY05 had satisfactory outcomes, against 80 percent for investment operations (see Figure 9). In line with the increased focus of programmatic operations on medium-term reforms and institution building, sustainability was rated likely for 97 percent, and substantial institutional development impact for 68 percent of the policy-based operations in FY05. This continues a rising trend over the past two decades (see Figure 10). The most recent quality-at-entry review (QEA7) by the Bank's Quality Assurance Group (QAG) found none of sampled DPOs to be of at less than moderately satisfactory quality.

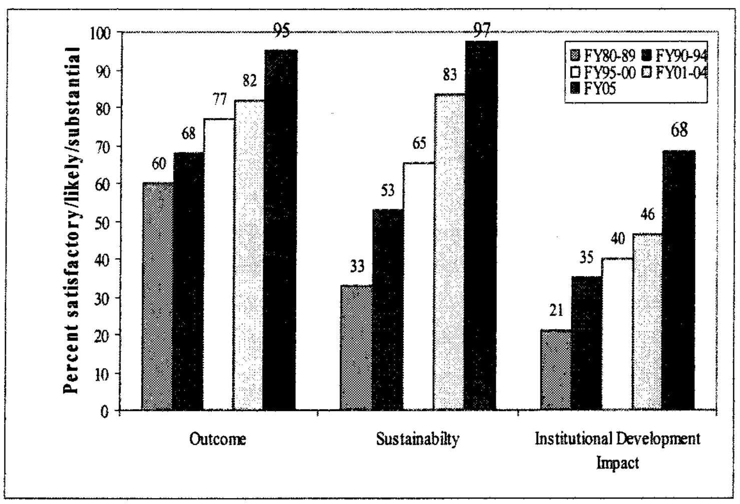
[24] The rating systems for Implementation Completion and Results Reports and for IEG will change in FY07.

Figure 9. Satisfactory Outcome Ratings for Policy-Based and Investment Operations



Source: Staff calculations using data from SAP Business Warehouse.

Figure 10. Outcome, Sustainability, and Institutional Development of Policy-Based Operations, FY80-05



Source: Staff calculations using data from SAP Business Warehouse.

25. ***Quality and CPIA Ratings.*** Operations exiting during FY01-05 show two important trends in comparison with CPIA scores (see Figure 11).[25] First, operations undertaken in countries with higher CPIA ratings are more likely to have satisfactory outcomes than those with lower CPIA ratings, and this trend is evident for both policy-based lending and investment lending.[26] Second, with the exception of the CPIA range below 2.5—a range with only two small policy-based operations over the sample period—policy-based lending outcomes are no worse than those for investment lending. These findings reconfirm that, in general, lending is more risky in weaker environments, as measured by the CPIA. They suggest that current choices of lending instruments within country lending envelopes are consistent with maintaining high quality at exit (e.g., further reducing use of DPOs in weak environments in favor of investment

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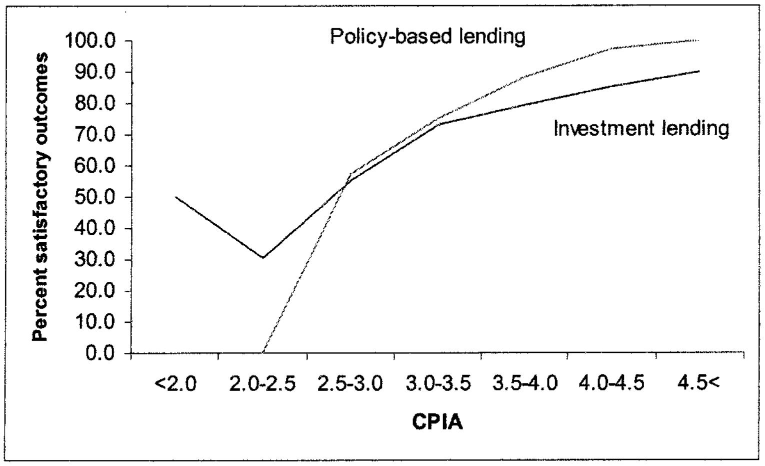
[25] CPIA ratings are used for the year an operation is evaluated by IEG to ensure internal consistency in CPIA ratings.

[26] The 7th Quality-at-Entry review also found lower satisfactory entry ratings for countries with lower CPIA ratings.

lending may not necessarily increase the quality of Bank lending). It should be noted that the analysis largely focuses on overall trends for policy-based lending in recent fiscal years and thus is not specific to the new DPO instrument. Moreover, some of the recent quality-at-exit ratings in FY04-05 result from simplified Implementation Completion and Results (ICR) Reports of programmatic operations and may be revised by IEG during the Project Performance Assessment Report (PPAR) process.

Figure 11. Quality and CPIA by Operation, FY01-05



Source: Staff calculations.

26. ***Quality and CPIA Governance and Budget Management Ratings.*** Policy-based lending relies to an important extent on the capacity of the public sector to conceive, execute, and evaluate programs financed through the budget. Public sector management capacity and budget management quality could be expected to play an important role in achieving satisfactory outcomes for DPOs. Below, CPIA ratings for the governance cluster (cluster on public sector management and institutions) and the budget management score (question 13 on quality of budgetary and financial management) are compared with the percentage of satisfactory outcomes during FY01-05. The findings are similar to those of the overall CPIA ratings, with both policy-based lending and investment lending achieving lower levels of satisfactory outcomes on average for lower CPIA scores. Policy-based lending tends to perform somewhat worse than investment lending in ranges below 3 for governance CPIA cluster, and some of the lower ranges of budget management CPIA scores. However, given the small number of policy-based operations in these lower CPIA ranges (as a result of an already selective instrument choice),[27] outcome ratings for policy-based lending at low CPIA scores tend to be more volatile and dependent on sample periods than those for investment lending.[28] These results, drawing on specific CPIA scores, therefore also offer no statistically significant evidence that the choice of lending instruments within the context of different policy environments is reducing the quality of Bank lending.

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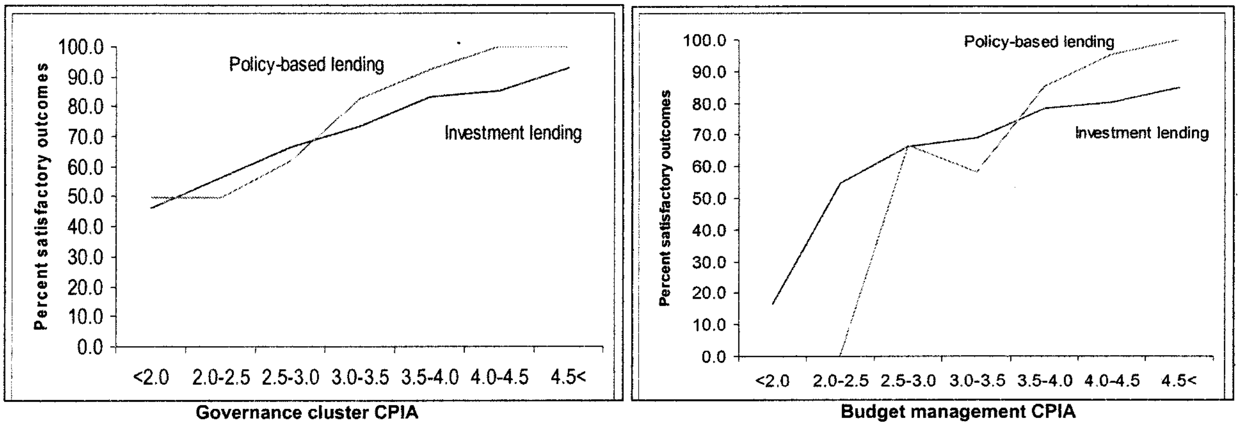
[27] There were 25 policy-based operations in countries with a governance cluster score below 3 compared to 183 investment operations, and 33 (9) policy-based operations with a budget management score below 3.5 (3.0) compared to 271 (100) investment operations.

[28] For example, excluding FY03 from the sample would boost the number of satisfactory ratings to 67 percent in the 3-3.5 CPIA budget management score.

Figure 12. Quality and Governance Cluster and Budget Management CPIA by Operation, FY01-05



Source: Staff calculations.

E. Conditionality

27. The 2005 review of conditionality provided an extensive overview over the modalities, trends, and contents of Bank conditionality for policy-based lending.[29] This section briefly summarizes a few key concepts on conditionality and gives a summary update on conditionality trends during FY06 to provide a basis for the subsequent discussion of progress against the good practice principles.

28. ***Typology of Conditionality.*** Policy-based loans are made available only when the borrower accomplishes critical policy and institutional actions, or loan conditions (see OP 8.60, para. 13). In the context of different loan designs, the Bank uses different terminology for conditionality. If actions are met before an operation is approved by the Board, these conditions are referred to as *prior actions* and are listed in a schedule to the legal agreement. All conditions for single-tranche operations are prior actions. In a multitranche operation, the borrower complies with certain conditions after Board approval and effectiveness. These conditions are in addition to any conditions the borrower must meet for the operation to be presented to the Board and are termed *tranche-release conditions*. Unless all tranche-release conditions are met, a tranche may be released only if the Board approves a waiver of the unmet condition(s).

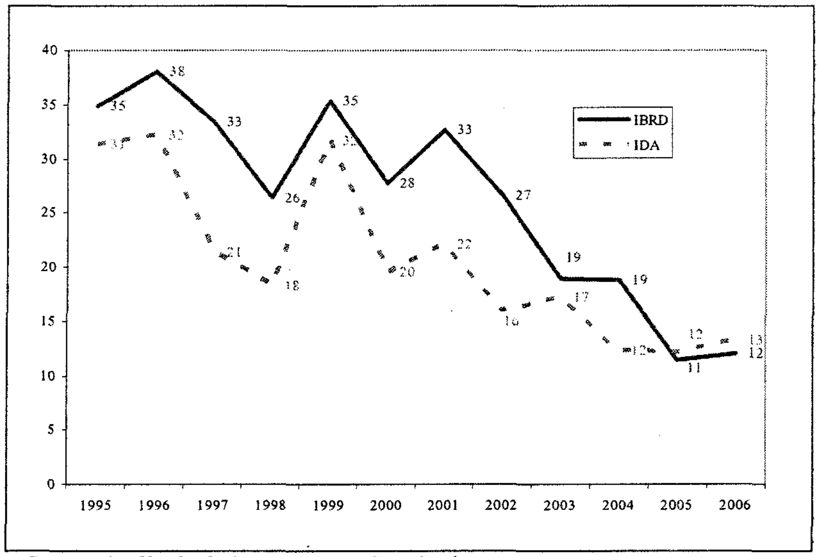
29. ***Triggers and Benchmarks.*** In addition to the critical policy and institutional actions that are recorded as prior actions or tranche-release conditions in legal agreements, the Bank uses so-called triggers and benchmarks to monitor and describe progress under programmatic series of loans. *Triggers* are indicative prior actions for future lending and represent critical actions for achieving and sustaining the results of the medium-term program. Compliance with triggers normally indicates sufficient progress to move from one operation to the next. Triggers offer greater operational flexibility than using tranche-release conditions, because triggers can be adapted more easily to a changing program environment. Bank operational documents are expected to lay out how triggers were adapted and modified to support program objectives before being converted into the prior actions of a follow-on operation. *Benchmarks* in program matrices describe the contents and results of the government's program in areas monitored by the Bank. They are frequently used to describe small steps in a reform process that represent significant, though not necessarily critical, progress markers for the implementation of the program.

29 *Review of World Bank Conditionality* (SecM2005-0442), August 18, 2005.

Although they help define an area of the Bank's policy involvement, they are not intended to be determinative of disbursements of Bank loans or grants.

30. ***Average Number of Conditions.*** By historical standards, World Bank conditionality as measured by the number of conditions continues to be low for both IDA and IBRD borrowers (see Figure 13). The average number of conditions per policy-based operation declined from above 30 in the mid-1990s to about 11-12 in FY05. It has remained at about that level for operations approved in FY06.[30] These trends also can be found in all Regions.

Figure 13. Average Number of Conditions by Fiscal Year



Source: Staff calculations using ALCID database.

31. ***Benchmarks.*** The number of benchmarks in Bank-supported policy-based operations for both IDA and IBRD countries initially rose sharply with the introduction of programmatic lending in 1999. For IDA countries, the number of benchmarks increased from 5-10 in the mid-1990s to over 30 in FY04 and has remained at that level (see Figure 8). This trend is closely associated with the emergence of large policy matrices under PRSC-supported multisectoral programs. Policy matrices were intended to summarize the government's broader agenda in implementing the PRSP—often to overcome weak prioritization in PRS documents—rather than define conditions for Bank engagement. Sometimes, however, they have raised concerns because of their complex nature and their perceived intrusiveness. Emerging practice for second-generation PRSPs and newly designed PRSC series (subsequently described in more detail) could lead to a declining use of benchmarks in future years. In contrast to IDA operations, IBRD operations use few benchmarks and the trend decline in benchmarks that began in FY04 has continued in FY06 (see Figure 14). This development largely reflects the greater ease with which teams in IBRD countries now use small policy matrices in lending documents that are focused on prior actions and triggers, leaving the description of the broader program to government documents or analytic underpinnings.

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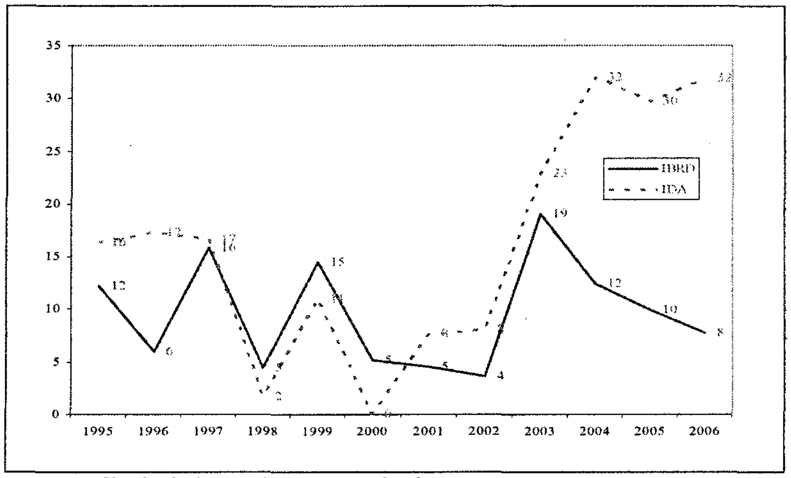
[30] Conditions include prior actions preceding Board presentation, effectiveness conditions, and conditions for tranche release, which are set out in the Bank's legal agreements. The number of conditions is not a statistic that can accurately measure the complexity of each action, which may vary greatly from condition to condition.

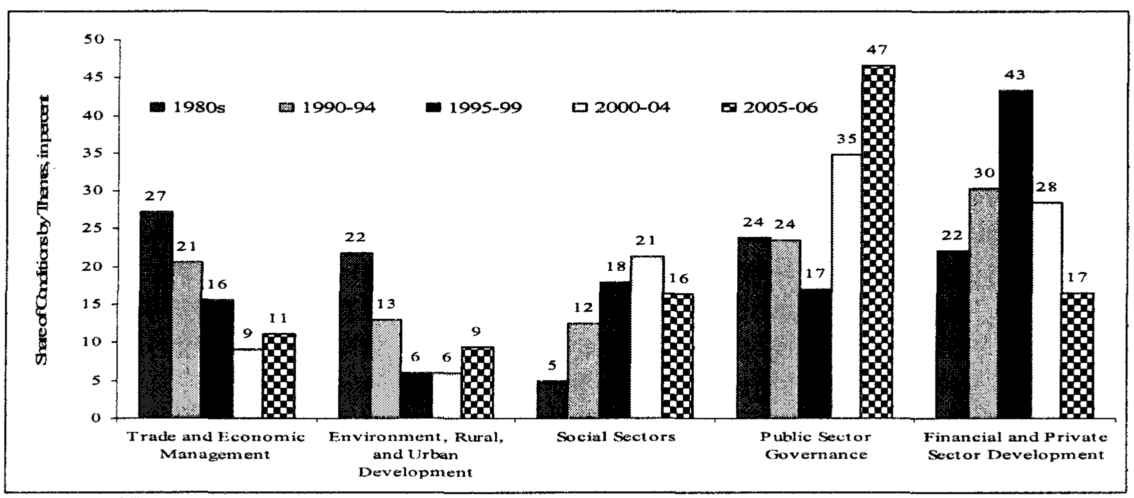
Figure 14. Average Number of Benchmarks by Fiscal Year



Source: Staff calculations using ALCID database.

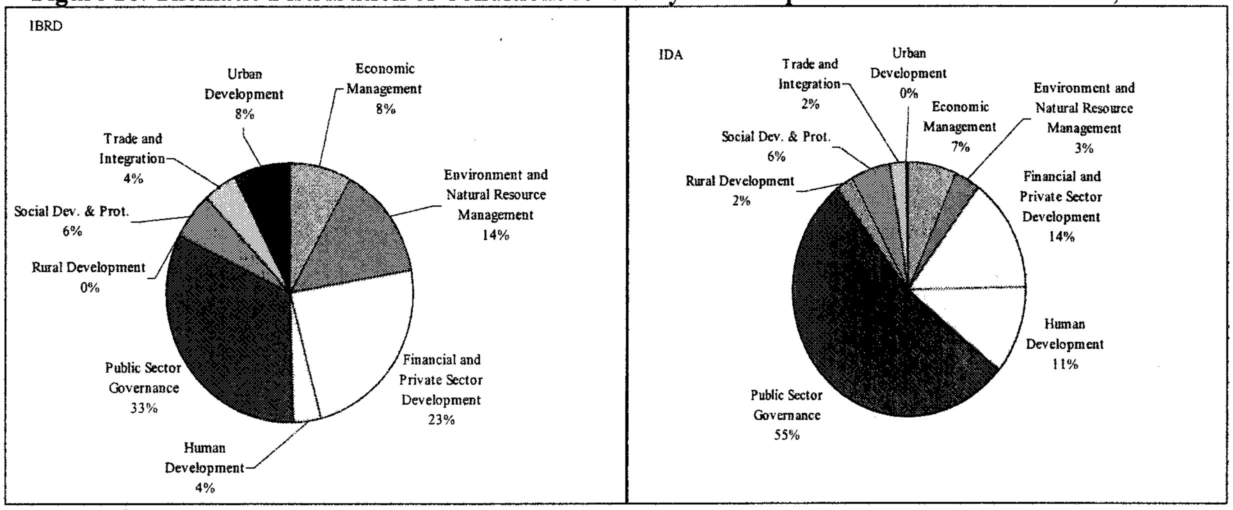
32. ***Thematic Coverage of Conditionality.*** As highlighted in the 2005 Review of Conditionality, the content of conditionality in recent years has been heavily focused on public sector governance. Economic management conditions and conditions related to privatization have declined in importance since the early and mid-1990s (see Figure 15). This trend has continued for FY05-06, and policy-based operations in both IBRD and IDA countries place a large weight on public sector governance in their conditionality. Given the fairly large number of financial sector reform loans in FY05-06, financial sector-related conditionality was also important, particularly in IBRD countries (see Figure 16). Human resource and social sectors are more important objectives in IDA countries, whereas environmental and natural resource management coverage has increased in recent years, mainly in IBRD countries.

Figure 15. Thematic Coverage of Conditionality in Policy-Based Lending



Source: ALCID.

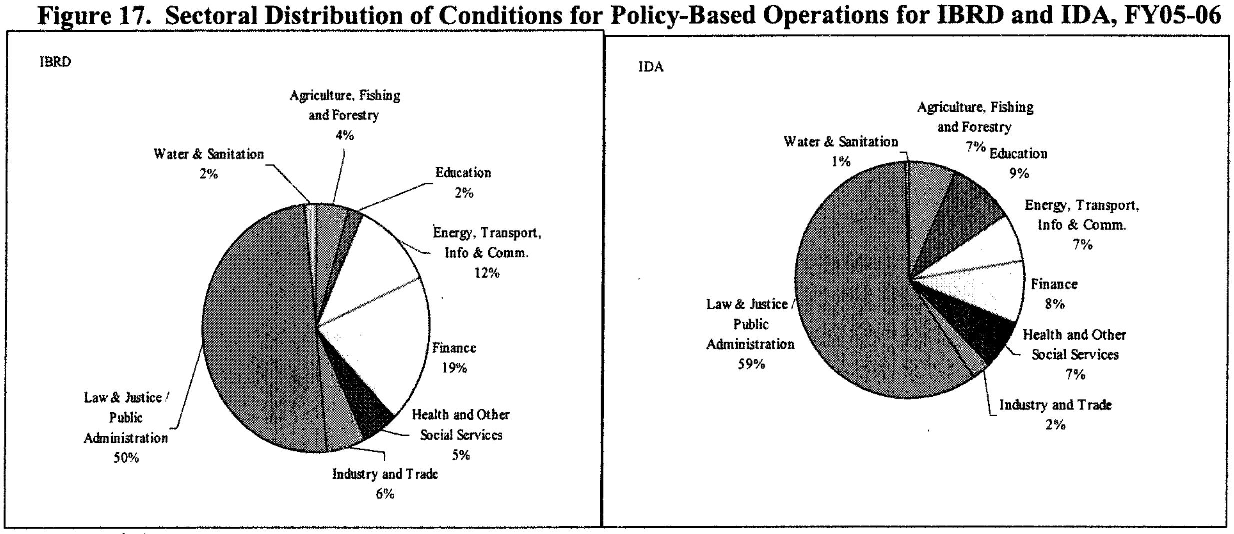
Figure 16. Thematic Distribution of Conditions for Policy-Based Operations for IBRD and IDA, FY05-06



Source: ALCID.

33. ***Sectoral Coverage of Conditionality.*** The sectoral coverage of conditionality in policy-based operations approved in FY05-06 closely mirrors their thematic coverage (see Figure 17). Law and public administration are important sectors for both IDA and IBRD countries, and account for more than 50 percent of conditions in IDA countries. Financial sector issues play a large role for IBRD countries, followed by energy and transport, whereas for IDA countries education, health, finance, energy and transport, and agriculture have been about equally important sectors in recent operations.[31]

Figure 17. Sectoral Distribution of Conditions for Policy-Based Operations for IBRD and IDA, FY05-06



Source: ALCID.

[31] As noted in the 2005 Review of Conditionality, conditions related to industry, trade, energy, transport, and communication now frequently focus on trade facilitation, business climate reforms, and improvements to regulatory environments.

III. Application of the New Operational Policy

34. The operational policy for development policy lending sets out areas in which lending documents are expected to provide systematic staff analysis and judgment. In several of these areas, the new policy more clearly states the Bank's accountability and the policy breaks new ground in clearly stating policy requirements for subjects that were treated as mere good practice (for example, on the environment and poverty and social impact analysis). At the same time, the new policy is not prescriptive on how analysis should be conducted or judgment be made, and thus more clearly separates policy requirements from good practice than was the case in the past. (Good practice has been elaborated and disseminated widely in separate good practice notes.) Drawing directly on the OP, this chapter identifies whether the policy has been applied consistently in line with the OP, discusses first experiences, and highlights good practice and possible weaknesses for further follow-up.

A. Macroeconomic Policy Framework

35. In accordance with OP 8.60, para. 5, "the Bank undertakes development policy lending only when it has determined that the country's macroeconomic policy framework is appropriate." The policy also clarifies in footnote 4 the relationship of any Bank assessment with programs supported by or views of the International Monetary Fund (IMF), noting that "the presence of an IMF program is usually an important input in this determination. If there is no Fund arrangement, Bank staff ascertain, before making their own assessment, whether the Fund has any major outstanding concerns about the adequacy of the country's macroeconomic policies. Any outstanding issues relevant to the adequacy of the macroeconomic policy framework raised by the IMF are communicated to Executive Directors."

36. ***Bank Accountability.*** Within the general framework of Bank-Fund collaboration,[32] OP 8.60 defines the Bank's own responsibilities in assessing the adequacy of macroeconomic policies for DPL. Previous policy statements for adjustment lending required staff to reach understanding with the government on "what will constitute satisfactory macroeconomic policies in the medium term." However, they also suggested that an ongoing Fund program is a necessary condition for adjustment lending.[33] With the adoption of OP 8.60, there was an expectation that lending documents would contain a separate and substantive macroeconomic discussion reflecting the Bank's own assessment of the macroeconomic policy framework—with a report on IMF views as warranted.

37. ***Description of Macroeconomic Policy Framework.*** In line with the policy, all reviewed program documents for DPOs provide an update of the recent economic developments in the country, describe the macroeconomic outlook, and identify related macroeconomic and credit risks and mitigating measures based on recent or ongoing analytic work. IMF views on the macroeconomic environment have also been adequately conveyed in all documents. However, at times there may still be scope to more clearly express staff views through a bottom-line assessment of the adequacy of the macroeconomic policy framework.

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[32] See *Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality* (SecM2001-0461), August 23, 2001; *Progress Report* (SecM2002-443), August 19, 2002; and *Progress Report* (SecM2004-0070), February 24, 2004.

[33] OD 8.60, *Adjustment Lending*, December 1992, paras. 40 and 46.

38. ***Macroeconomic Analysis.*** In the context of development policy lending, good practice suggests that the assessment should review the sustainability of external and fiscal balances, the contribution of the supported reform program and Bank financing to sound macroeconomic policies and growth, and the credit repayment risk associated with the operation.[34] Such assessment takes into account the IMF's views as well as the Bank's own projections. Box 1 discusses two examples for good practice in DPOs. In the reviewed operations, there has been varying quality in conducting such analysis. Sector-specific operations in particular tend to offer a more limited analysis of the overall macroeconomic policy framework and to rely to a greater extent on the analysis provided in parallel DPOs or IMF programs. There is also a tendency among the DPL documents to give more attention to a short-term macroeconomic assessment as compared to medium or long-term macroeconomic and growth outlooks, although medium and long-term growth forecasts should have an important role in the DPO design, as they provide the context for policy discussions with client countries and are a critical component of debt sustainability and risk analyses, particularly with the Bank's reimbursement horizon of 15-40 years. This finding corresponds to results of a recent study that the forecast horizon of the Bank growth-related analytic work produced during 1990-2004 was limited to three years.[35]

Box 1. Good Practice in Macroeconomic Analysis

Armenia Second PRSC includes a detailed discussion of the macroeconomic trends and projections covering 2005 to 2010. The projection is based on the clearly stated assumption that the government will be able to maintain its strong track record on reforms and economic management, and that Armenia will continue to attract large volumes of capital transfers, and will maintain foreign direct investment at current levels in relation to GDP. The outlook focuses in particular on the composition of government expenditures and revenues as they affect growth; the expected course of private investment implied by monetary policy; the expected impacts of exchange rate and trade policies on investment, growth, and exports; and a set of reforms or continuing policies that will ensure efficiency of resource use in the economy. Having analyzed several alternative scenarios, the Bank team concludes that Armenia has a low risk of debt distress with all debt indicators well below the relevant country-specific thresholds.

The *El Salvador Second Programmatic Broad-Based Growth DPL* provides a good overview of the growth and fiscal challenges facing the economy on the macro side. The discussion of medium-term sustainability is focused on crucial fiscal and debt projections, including a discussion of how they compare to those prepared at the time of the first DPL. The discussion builds on a detailed debt sustainability analysis in an annex that distinguishes three alternative scenarios based on different well-defined sets of assumptions and provides a sensitivity analysis to two key assumptions. Measures to address important aspects of the macroeconomic challenges identified are reflected in the policy matrix under support to promote macroeconomic stability and fiscal consolidation and in the triggers for the follow-up operation. The document frankly discusses risks to the macroeconomic and credit outlook and to the achievement of the operation's reform objectives, including fiscal, political, and external risks and risks arising from potential natural disasters and crime and violence.

39. ***IBRD Credit Risk Considerations and IDA Debt Sustainability Framework (DSF).*** Fast-disbursing lending such as DPOs can quickly raise country debt levels. As a result, macroeconomic considerations for DPOs, including any specific conditions related to macroeconomic performance, are closely interlinked with credit risk considerations for IBRD countries. It is expected that the program document would discuss the high-probability macroeconomic and credit risks associated with the program and indicate that maintenance of an appropriate macroeconomic policy framework is a prerequisite for moving to any subsequent

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34 *Good Practice Note on Designing Development Policy Operations*, Operations Policy and Country Services, October 2004.

35 *How to Forecast Long-Run Growth in the Developing World? Country Forecasts and Determinants*, PRMED Knowledge Briefs, May 2006; C. Lluch, *Economic Development: World Bank Analysis and Policy Recommendations*, December 21, 2005.

operation in a programmatic series. (Maintaining a satisfactory macroeconomic policy framework is also included in the legal agreements for the Bank's DPOs.) Where applicable, the operation would contain appropriate mitigation measures and monitorable indicators. When the Bank is particularly concerned about the macroeconomic policy framework, either because of actual or potential risks, teams have included particular macroeconomic policy measures as specific conditions of the operation. This serves as a signal to the country about the Bank's concern and the special attention given to macroeconomic policies. For example, to improve the fiscal, monetary, and financial situations, the two Indonesia DPLs include specific policy actions focused on controlling inefficient spending, enhancing revenues, and improving debt management. In IBRD countries, teams typically closely collaborate with the Bank's credit risk department to assess exposure and credit risk under different macroeconomic scenarios, particularly if economic parameters have changed from those in the CAS, and DPO macroeconomic scenarios reflect that collaboration. For IDA countries, there is a close link between macroeconomic projections and policies, on the one hand, and the current DSF, on the other; the intention is to take into consideration any effect of debt relief on financing needs and debt dynamics. (The DSF provides for an annual joint update of a debt sustainability analysis, or DSA, with the IMF.) DSA findings are typically conveyed to the Board either as an annex to CASs or DPOs. In case the original joint DSA is outdated, Bank staff can, in agreement with the IMF, update the analysis with more recent macroeconomic projections.[36] A recent example of good practice for a detailed DSA annex is Guyana's Poverty Reduction and Public Management Operation.

40. ***Analytic Underpinnings for Macroeconomic Projections.*** In projecting the country's medium-term macroeconomic outlook and judging the sustainability of its fiscal program and the balance of payments and of the associated debt dynamics, Bank staff regularly draw on the analysis in Country Economic Memoranda (CEMs) or similar reports. In 28 out of 37 countries with operations covered in the review, the CEMs or similar reports have been completed or their preparation has been sufficiently advanced to inform the macroeconomic analysis of respective development policy operations.[37] For example, in laying out macroeconomic prospects and scenarios, annual Development Reports have played an important role in the design of the PRSC series for Vietnam. Two DPOs for Indonesia have drawn on the Bank's extensive economic work over many years, and the program supported by two El Salvador loans was underpinned by substantial analytic work carried out by the Bank in partnership with the government.[38]

41. ***Bank-Fund Collaboration.*** The Fund Relations Note attached to the program document has become the Bank's primary vehicle to communicate IMF views to the Bank's Board, and this framework to convey IMF views has generally worked well. The Fund Relations Note typically contains either a Public Information Notice (PIN), a publicly released Chairman's Statement of an IMF Board discussion or, if these are more than six months old, an IMF assessment letter. Bank staff report that they can generally obtain IMF assessment letters without unreasonable

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[36] *Operational Framework for Debt Sustainability Assessments in Low-Income Countries—Further Considerations*, IMF and World Bank, March 28, 2005. For an update, see also *Review of Low-Income Country Debt Sustainability Framework and Implications of MDRI*, IMF and World Bank, April 18, 2006.

[37] Issues regarding the quality and depth of growth analysis are discussed in the next chapter.

[38] See Indonesia First and Second DPL, and El Salvador First and Second Broad-Based Growth DPL.

delay.[39] In addition, the existing framework also foresees a full upstream discussion of the issues between the respective staffs, and IMF staff frequently provide inputs during corporate reviews and are typically present at Board meetings to respond to questions by Bank Executive Directors. Although Bank staff report occasionally on disagreements (for example, on a country's fiscal policy stance), these are typically resolved among Regional staff in the process of preparing operations.

42. ***Link to IMF Programs.*** The majority of operations covered by this retrospective were approved for countries that either already had or were about to enter into a Fund arrangement. In particular, in low-income countries most DPOs proceeded in parallel with an IMF Poverty Reduction and Growth Facility (PRGF). The program documents for these operations generally refer to the status of the respective IMF program and annex a Public Information Notice or Chairman's Statement as the IMF Relations Note.[40] In the absence of an IMF program, Bank staff ascertained that Fund staff had no major concerns about the adequacy of the country's macroeconomic policies, or presented solutions that specifically addressed those concerns. Most cases without an IMF program, predominantly middle-income countries with regular Article IV consultations, had no major macroeconomic policy issues and IMF views were conveyed either through a PIN or an IMF assessment letter. In the few cases in which the Bank decided to proceed with DPOs despite IMF concerns, these concerns were specifically addressed in the program document and Executive Directors were fully informed through the Fund Relations Note. Examples include Lao PDR PRSC (lapse of completion of PRGF because of disagreement on structural policies), Ukraine First Development Policy Loan (disagreement on monetary and fiscal policy stance), and Vietnam PRSC-4 (lapse of PRGF because of noncompletion of central bank safeguard assessment).

B. Consultations and Participation

43. The complex policy and institutional reforms associated with DPOs can only be adopted and implemented if they have sufficient political support within the country. A well-implemented stakeholder participation strategy in various stages of policy reform can help develop this support and improve the quality of the reform program.[41] OP 8.60 explicitly recognizes the role of consultation and participation for ownership and in para. 6 states that "the Bank advises borrowing countries to consult with and engage the participation of key stakeholders in the country in the process of formulating development strategies." Drawing on the process of strategy formulation, a country would then determine the form and extent of consultations in preparing, implementing, monitoring, and evaluating the operation. The responsibility of Bank staff in this regard is to "describe the country's arrangements for consultations and participation relevant to the operation and the outcomes of the participatory

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[39] Under the Bank's disclosure policy, the Bank's program documents are made publicly available. Therefore, IMF staff also must obtain the borrower's agreement to publish the IMF assessment letter. In cases where such agreement could not be obtained in time for Board circulation of the program document, the assessment letter has been attached to the Memorandum of the President.

[40] In some operations, the Fund Relations Notes were undated and did not include the required contact information of the IMF staff. Three operations included the IMF-Bank Relations Annex (i.e., an annex prepared by the Bank staff) instead of the Fund Relations Note

[41] *Supporting Participation in Development Policy Operation,* Good Practice Note, Operations Policy and Country Services, October 2004.

process adopted in formulating the country's development strategy." Furthermore, "relevant analytic work conducted by the Bank, particularly on poverty and social impacts and environmental aspects, is made available to the public as part of the consultation process." In line with the policy statement, the discussion below addresses whether the Bank's lending documents adequately describe the extent to which DPOs build on prior participatory processes and record the consultation arrangements that have informed the operation. It also reviews whether program documents give any indication that relevant analytic work has been disclosed. In addition, the section discusses whether there is evidence that the programs supported by DPOs have benefited from participatory processes and consultations, and reviews the extent to which DPOs themselves promote participation, as suggested by the good practice note on participation.[42]

44. ***Documentation of Participatory Processes.*** Only about 20 percent of DPOs dedicate a specific section in the program document to the process of participation, with many documents making fairly limited references to participation when introducing the government's program. Moreover, even though not strictly required by the policy, the descriptions normally do not reflect the recommendations made by stakeholders and the extent to which these were taken into account during the design of the government program supported by the Bank. Only one of 39 DPOs reviewed describes the recommendations made during the consultation process, while none of the operations describes how these had been addressed or incorporated into the design of the program.[43] In addition, most DPL documents provide little information about the extent to which reforms have strong in-country constituencies, and in what cases there may be strong resistance from certain stakeholders for particular types of reforms that may put these program actions at risk.

45. ***Documentation of Disclosure of Analytic Work.*** Relatively few DPL program documents make reference to the disclosure of key analytic work as part of the consultation process. Only about 20 percent of program documents note that any kind of relevant analytic work has been disclosed to the public. Although such description is not required under the policy, the lack of adequate documentation of disclosure raises questions about whether analytic work conducted by the Bank is feeding into the participatory processes and consultations on government programs, as intended.

46. ***Participatory Processes Underpinning Program Design.*** Notwithstanding the weaknesses in documenting such participation in program documents, a majority of government programs supported by DPOs (28 out of 39) benefited from some form of participation or consultation (see Annex C). However, the lack of documentation in program documents does not allow judging the breadth of the participatory processes, how they may have influenced the reform agenda, and whether the processes offered information to stakeholders that allowed making meaningful contributions. The plurality of these processes were carried out as a part of the preparation of the country's development strategy (48 percent), which took place prior to the design of the DPO. An additional 14 DPLs were underpinned by participatory processes carried out to specifically inform the operation, and most of these consultations were either led or co-led by the borrower. As might be expected, in most low-income countries, operations tend to be based on a prior national process conducted in the formulation of the PRS. Most operations with a participatory or consultative process linked to the development of the DPO itself were sectoral

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[42] *Supporting Participation in Development Policy Operation,* Good Practice Note, Operations Policy and Country Services, October 2004.

[43] Thirty-nine operations approved through end-December 2005 were reviewed.

in nature or in non-PRSP countries. Several DPLs, such as Mexico's environmental and sustainable development DPL, Honduras's financial sector DPL and Tanzania's PRSC-3, offer good practice examples of how governments can promote inclusive processes of consultation on sector policies. These types of participatory processes provide legitimacy to governmental reforms and can assist in building the basis for their long-term sustainability by identifying potential obstacles for reform, identifying new priority areas, contributing to greater transparency and improved governance, and helping define monitoring mechanisms and results. In five cases, participatory processes of different types had been carried out with the specific purpose of receiving feedback on the DPL itself. For example, in Vietnam, a nongovernmental organization (NGO) assisted the Government in organizing a consultation workshop with international and local NGOs and business associations in order to receive feedback on the nature and contents of the proposed PRSC. In Timor-Leste, the Bank and the Government created a multi-stakeholder dialogue workshop focused on the DPO, which also included donors and civil society.

47. ***Fostering Participatory Processes through DPOs.*** More than half of the reviewed DPOs feature provisions to promote participation in the content of their operations. Prior actions for 21 of the 39 reviewed operations promoted stakeholder participation in the formulation, implementation, or monitoring of policies, strategies, budget, or services.[44] In many cases, temporary consultations aim at feedback primarily from civil society on specific strategies, policies and laws, or occurred to share results of studies. For example, consultations took place on the national housing policy in Brazil, the anti-corruption strategy in Honduras, and Uganda's National Strategic Framework for HIV/AIDs. In other cases, more permanent consultative frameworks were set up between the Government and nongovernmental stakeholders, such as a regular dialogue between the private sector and the Government in Lao PDR, the Education Council in Bolivia, or the National Conflict Prevention and Resolution Network in Uganda. One-fourth of measures aimed at participatory management of service delivery, such as health, education, water and sanitation, or forestry services. Box 2 on Peru's Social Reform Loan offers a good practice example.

Box 2. Promoting Participation in Service Delivery Monitoring in Peru

Building on a government program supported under previous loans, the Fourth Programmatic Social Reform Loan supported the institutionalization of participatory processes through their incorporation into a results-based and participatory monitoring and evaluation (M&E) system of the Priority Social Programs. The M&E system puts in place a mechanism through which the Government is able to effectively track progress in reaching the objectives of the Priority Social Programs within a decentralized context, while contributing to enhancing the transparency, quality, and efficiency of social expenditures and giving citizens and users the opportunity to influence decisionmaking. The M&E system tracks and evaluates the levels and appropriate mix of spending on the Priority Social Programs at the national, regional, and, when applicable, municipal level, as well as the critical inputs and outputs. Additionally, 33 social auditing committees created by the Participatory Budget track expenditures and procurement and target decentralized food programs, and all provinces have set up procurement committees involving civil society representatives. Easy access to budget and public expenditure information by nonexpert users is a central feature of the participatory dimension of the M&E system. The national-level Transparency Portal and future local government portals (with information on expenditures, the social services they offer, users' rights, eligibility criteria, and geographical coverage) are other key elements of the system.

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[44] Relative to the total number of policy actions related to participation, provisions that related to consultative mechanisms in support of policy formulation were the most common (39 percent).

C. Analytic Underpinnings

48. In accordance with OP 8.60, para. 9, a DPO "draws on relevant analytic work on the country undertaken by the Bank, the country, or third parties" and "the program document describes the main pieces of analytic work used in the preparation of the operation and how they are linked to the proposed development policy program." This section reviews in general terms the ways in which program documents have reflected analytic underpinnings and their link with the supported program, leaving discussion of specific analytic underpinnings to other sections covering specific topics.

49. ***Documentation of Analytic Underpinnings.*** All reviewed program documents for DPOs provide information on analytic underpinnings for the supported program. As documented in Annex D, most operations have benefited from multiple pieces of analytic work, most commonly Country Financial Accountability Assessments (CFAAs), Country Procurement Assessment Reports (CPARs), Public Expenditure Reviews (PERs), Poverty Assessments, and Country Economic Memoranda (CEMs) or Development Policy Reviews (DPRs). Poverty and Social Impact Analysis (PSIA) takes different forms of analytic reports on distributional impacts and impacts on vulnerable groups. Sectoral analytic work is also common, to inform the design and content of policy actions for sector reforms in the DPLs. For example, education and health sector analytic work is underpinning operations focused on social sectors (Peru Social Reform Loan, Bolivia Social Sector Credit) and some PRSCs (Rwanda, Ethiopia). Other examples of sectoral analysis used in designing the reform program are analytic work on the environment (Mexico Environment DPL), forestry, biodiversity, and timber sector (Gabon Natural Resource Management DPL), and studies under the Financial Sector Assessment Program[45] or financial sector notes (e.g., Morocco Financial Sector DPL and Serbia and Montenegro Private and Financial Sector DPL). Particularly important inputs for policy formulation have been made in fragile states (e.g., Afghanistan and Timor-Leste) on public financial management system, capacity-building program, poverty analysis, and sector work. In additional to formal analytic work, many DPOs benefit from "informal" work on narrower topics, as is often the case for PSIA work.

50. ***Link with Supported Program.*** The presentation in program documents of underlying diagnostic work often is not clear about how such analytic work underpins program measures and results. In a few cases, analytic work is simply mentioned. Many documents have a detailed list of analytic underpinnings but do not identify their concrete policy recommendations or how they were addressed in designing the supported program. Most documents give a comprehensive summary of both analytic work and related policy recommendations, but do not concretely identify how they relate to policy actions supported under the DPO. Relatively few operations contain both a clear presentation of the content of analytic underpinnings and an explicit discussion on how they have been used to inform the design and content of proposed reform program in the DPL. Annex E gives an example of such good practice from the Guatemala Broad-Based Growth DPL.

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[45] IEG recently noted that FSAP reports are a good quality diagnostic tool, but with some uneven coverage of specific sectors. IEG recommended to develop better approaches to analyze missing market and access issues and to better integrate findings into overall country programs. See *Financial Sector Assessment Program: IEG Review of the Joint World Bank and IMF Initiative*, Independent Evaluation Group, 2006.

51. ***Analytic Work by Government or Third Parties.*** The reviewed DPOs include a number of examples where the World Bank collaborated with or drew directly the work of the government, other donors, or research institutions. Indonesia's first DPL presents different analytic work used in a separate table for each core area of the DPL—showing, for instance, that analytic work supported by Netherlands helped in the design of the reform program in the areas of public financial management and anticorruption. The Morocco financial sector DPO drew on European Union-funded work on specialized public banks, and the Egypt financial sector loan benefited from analysis funded by the United States Agency for International Development (USAID). The Government of Mexico and the Mexican academic community have produced several studies and other reports that were used in the preparation of the Finance and Growth DPL. A good example of collaborative work is also the *Natural Resources Management and Growth Sustainability Study,* underpinning Ghana's second PRSC, prepared by Ghana's Institute of Statistical, Social and Economic Research, the United Kingdom's Department for International Development, and the Bank.

D. Poverty and Social Impact Analysis

52. OP 8.60 recognizes the importance of analyzing poverty and social consequences of policies supported by Bank operations, noting in para. 10 that the "Bank determines whether specific policies support by the operation are like to have significant poverty and social impacts, especially on poor and vulnerable groups." For those with likely significant effects, the Bank "summarizes relevant analytic knowledge of these effects and of the borrower's systems for reducing adverse effects and enhancing positive effects." If there are significant gaps in the analysis of shortcomings in borrower's systems, the program document is expected to describe how such gaps would be addressed before or during program implementation. This section reviews the extent to which lending documents have made the determination of likely significant impacts.[46] It then discusses the extent to which DPOs have incorporated relevant analytic work on poverty and social impact analysis (PSIA) and how PSIAs have been integrated into upstream engagement with borrowers and stakeholders, as suggested by the good practice note on PSIA.[47]

53. ***Determination of Likely Significant Impacts.*** The overwhelming majority of program documents discuss poverty and social impacts arising from country policies supported by the operation (see also Annex C). In more than 90 percent of the 39 reviewed DPL documentations, poverty and social impacts are addressed in a designated section within the document. Of the 35 DPLs that explicitly discuss impacts, 10 reference potential negative impacts of polices supported by the operation, and offer concrete measures to reduce these impacts. The remaining 25 DPLs either emphasize only positive effects or reference negative impacts but do not clearly describe measures to reduce them, generally because the negative impacts are not identified as likely and significant. Four documents did not identify whether supported policies had any distributional implications, in three cases because of apparent confusion about the nature of the policy requirement. Although most DPL documents mention distributional impacts, some fail to clearly link the general data on poverty and measures tailored to specific social groups to an analysis of distributional impacts of key reforms. These documents would have benefited from a more specific bottom-line assessment of the likely significant impacts and how they are being addressed, to convey that the supported policies have been adequately screened. Gender aspects,

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46 The review includes DPOs approved through end-December 2005.

47 *Using Poverty and Social Impact Analysis to Support Development Policy Operations,* Good Practice Note, Operations Policy and Country Services, October 2004.

which are covered under the PSIA provisions of the DPL policy, are addressed under many DPOs. The recent QAG quality-at-entry review rated the gender aspect of all DPOs in the sample as at least moderately satisfactory. Many social indicators used to track service delivery aspects in DPOs (see Chapter V) also are disaggregated by gender.

54. ***Use of Relevant Analytic Knowledge.*** Twenty-four of the 35 DPOs (69 percent) referring to distributional impacts summarize relevant analytic knowledge regarding poverty and social impacts of the reform program. However, in many cases a direct linkage is not made between such existing analytic work and the impacts of specific policy reforms. Eight documents offer a comprehensive distributional impact analysis, identifying both winners and losers of reforms (Box 3 describes a good practice example). Although the majority of operations summarize analytic knowledge, 50 percent of operations do not refer to the full set of available studies on distributional impacts.

Box 3. Analyzing the Distributional Impact of Petroleum Subsidy Reform in Indonesia

A good example of using analytic work to identify measures to reduce potentially negative effects of the reform program is provided by the Indonesia (DPL-2), where the controversial reduction of the regressive fuel subsidy was subject to PSIA work that substantially informed the government's reform decision. Although a reduction in subsidy and its reallocation to pro-poor spending was expected to have convincingly positive effects, it resulted in significantly higher fuel prices that directly affected the both poor and non-poor households. Therefore, prior to its policy decision, the Government undertook substantial analysis, including PSIA work, and considered inputs from various think-tanks and agencies and the World Bank, which then informed the DPO design. The Government decided to reallocate the funds and to develop rapidly the Unconditional Cash Transfer (UCT) program to offset fuel price increases for 15.5 million poor and near-poor families. Furthermore, PSIA results were used to inform the widespread public debate in the national media. This helped to sensitize the public to the rationale behind the reform before the price increase took effect. The Government's politically difficult decision to reduce the fuel subsidy was not only underpinned by substantial analysis, public debate, and political consideration of poverty and social impacts, but was also handled with substantial and thorough discussions with various stakeholder groups, including the private sector, political parties and parliamentarians, regional governments, and public transportation organizations.

55. ***Upstream Integration of PSIA Considerations.*** Systematic upstream consideration of PSIA (including gender aspects) in designing programs enhances program quality. Embedding PSIA work institutionally in the country's own planning processes makes it more likely that distributional impacts are systematically understood and considered in the context of DPOs. Embedding the selection of reforms that warrant further distributional analysis in national policy processes with a clear engagement of partner governments and other country stakeholders facilitates the incorporation of the analysis into the national policy debate. The support under Ghana's PRSC series offers one of the relatively few good examples in this regard; the series has the most comprehensive and institutionalized approach to engaging the partner government, key local stakeholders, and other donors in all stages of the process. The Government of Ghana, together with donor partners, identifies the reform areas in the PRSP that most need poverty and social impact analysis; and the process takes place early enough in the policy cycle to allow conclusions to be integrated into policy debate and the program supported under PRSCs. Another example for ex ante upstream analysis is Sierra Leone. Over the upcoming CAS cycle (FY06–09), a pre-identified gap in distributional analysis will be closed, allowing for upstream debate of policy options before their inclusion in future DPOs, rather than focusing on mitigating measures for already adopted reforms programs. A third example is Morocco's housing sector DPL, which explicitly integrates joint PSIA work with a particular focus on vulnerable groups in slum areas into the two-tranche operation. In general, it is advisable to more effectively disclose the plans for PSIA and the resulting findings, to ensure that they contribute to better decisionmaking and

consultation processes, promoting the use of PSIA in public debates for evidence-based policymaking.

E. Environment, Forests, and Other Natural Resource Aspects

56. Departing from the different treatment of safeguard policies between adjustment loans (which were not subject to safeguard policies) and sectoral adjustment loans (which were subject to safeguard policies), OP 8.60 sets out a unified framework for determining likely and significant environmental effects of DPOs. Under OP 8.60, para. 11, the "Bank determines whether specific policies support by the operation are like to have significant effects on the environment, natural resources, or forests" and for those with likely significant effects "summarize[s] relevant analytic knowledge of these effects and of the borrower's systems for reducing adverse effects and enhancing positive effects." If there are significant gaps in the analysis of shortcomings in the borrower's systems, the program document is expected to describe how such gaps would be addressed during the operation. This section reviews the extent to which lending documents have made the determination of likely significant effects. It then discusses to what extent DPOs incorporate relevant analytic work and whether environmental issues have been integrated into upstream considerations of DPOs, as suggested by the related good practice note.[48]

57. ***Discussion of Likely Significant Effects.*** All but one of the reviewed DPOs made an explicit determination in line with the policy as to whether specific country policies supported by the operation would likely to have significant effects on the environment, natural resources, and forests.[49] Not surprisingly, given the sectoral and thematic focus of supported policy and institutional actions (see above), only a few of the operations were identified as having likely and significant effects on the environment, natural resources, and forests, and only three operations identified likely negative effects alongside positive effects. Where such effects were identified—the Gabon Natural Resource Management DPL, the Cameroon Forestry and Environment DPL, and Vietnam's PRSC-4—the program documents examine how such effects would be addressed under the program and whether borrower systems were capable of adequately addressing them.[50] In cases of knowledge gaps, the program documents also identify the additional analytic work necessary to close these gaps before or during the implementation of the program—such as a socioeconomic and environmental mining review, embedded as second-tranche conditionality in the Gabon Natural Resource Management operation. Some operations (e.g., Mexico Environment DPL) also aimed directly at mainstreaming environmental considerations into development.[51]

58. ***Forestry Aspects.*** Forestry-related actions have gained more prominence under the new policy compared to previous adjustment lending, and were at the center of two dedicated operations (Gabon, Cameroon). A few operations also integrated forestry reform into the agenda supported under multisectoral operations (Lao PDR, Vietnam—see Box 4) or recognized the importance of forests (Burkina Faso, Ukraine). However, it also appears that the forest sector

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48 *Environmental and Natural Resource Aspects of Development Policy Lending,* Good Practice Note, Operations Policy ands Country Services, October 2004.

49 The operation that did not make such a determination was incorrectly processed under previously applicable safeguard policies and was categorized as a "C" (not requiring environmental analysis).

50 Both the Cameroon and Gabon operations benefited from the parallel preparation of operations under the Global Environment Fund, enhancing the breadth of analytic work underpinning these operations.

51 A similar operation in Colombia was processed under adjustment lending policies.

figures prominently in DPL operations only when there is a broader Bank agenda supporting a government program in the environment and natural resources sector, and thus building a policy dialogue on forestry aspects in a larger number of countries with a significant developmental role of forestry would help address these aspects in a wider range of DPOs.

Box 4. Forestry Sector Reform under Vietnam's PRSC-4

Recognizing the potential links between the government's program and environmental and forestry issues, the program explicitly included a sustainable development pillar that also addressed specific forestry concerns. The approval of the law on Forest Protection and Development was one of the prior actions of Vietnam's PRSC-4. The law provides the overall framework for the move toward more social and community-based forestry. It recognizes the forest use right of households, communities, and other sectors as well as their ownership of plantation forest In addition, it provides a framework for multiple-use of the vast areas of protection in uplands and exploitation rights in these areas, which could lead to new management systems combining protection with production. The law also provides terms and conditions for the leasing of production forests to economic units including farm households, and proposes to assign an economic value to each forest production area on the basis of its allocation or lease.

59. ***Supporting Country Environmental Capacity and Institution Building.*** Relatively few operations went beyond the policy requirement to describe more broadly the country's current environment management capacity. In most cases, there was limited information available on existing institutional capacity, which reflects the paucity of environment-related analytic work (see below). Nonetheless, some of the DPL programs contained actions supporting institutional capacity building for the environment. This finding reflects some of the potential of the new policy to highlight environmental and natural resource issues in program documents, even if the policies supported by the operation are not likely to have significant effects in these areas.

60. ***Analytic Underpinnings and Challenges.*** Emerging experience with OP 8.60 suggests that teams struggle with situations in which environmental effects of policies may be indirect or lagged and thus their magnitude and likelihood may be more difficult to identify. Operations with reforms that are clearly environmentally sensitive more readily identified likely significant effects. Many challenges remain in designing a framework for making the determination of such effects. Some reforms supported by DPOs may involve complex changes in incentive structures and can have cross-sectoral effects for which environmental implications may not be obvious and their importance difficult to predict.[52] In analyzing environmental effects and capacity, the first wave of DPOs also faced limitations from the lack of available analytic underpinnings (see Annex D), such as Country Environmental Analyses (CEAs) and Strategic Environmental Assessments (SEAs). A number of CEAs are now being prepared to inform future CASs and DPOs, and it is expected that about eight CEAs in total will be available to inform DPOs by end-FY06. However, this number is below the level anticipated in 2004 when the new policy was introduced,[53] which suggests a need for much more systematic integration of environmental analytic work in CASs for countries with strong use of DPL. In addition, specific questions of relevance and analytic work may be required to address environmental issues, including through use of additional SEAs and deep preparatory work, such as work undertaken for the Gabon and Cameroon Forestry DPOs approved in FY06.[54] In this regard, quality and comprehensiveness of coverage of environmental issues in DPOs, including an enhanced focus on capacity and

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[52] A good practice note was prepared by ENV in this regard, with a toolkit under preparation.

[53] See Box 2 in *From Adjustment Lending to Development Policy Lending: Update of World Bank Policy* (R2004-0135), August 2004. During consultations, CSOs also urged for continued progress on this front.

[54] In addition, forestry work was undertaken for operations in Democratic Republic of the Congo, Lao PDR, and Vietnam, with follow-on work currently being conducted in Congo.

institution building, relies on a continued emphasis on upstream identification of areas at high risk for likely and significant environmental, natural resource and forestry effects.

F. Public Sector Governance: Public Financial Management and Fiduciary Issues

61. OP 8.60 sets out a comprehensive framework for addressing public sector governance issues in form of public financial management and fiduciary aspects, with a strong emphasis on the linkages between analytic underpinnings, fiduciary and disbursement arrangements, and operation content. In particular, in accordance with paras. 17-19 of the policy, the Bank determines, "drawing on relevant analysis of a country's public financial management system, whether the operation should include measures to address identified fiduciary weaknesses." The policy identifies in particular that such determination would draw on relevant analysis of the foreign exchange control environment and management of budget resources, including public financial management and procurement. The Bank would decide, in the CAS or when considering an individual operation, on loan amounts, tranching, program content, conditionality, and risk mitigation on the basis of such fiduciary analysis. When weaknesses in public financial management or foreign exchange control systems are identified "or when an acceptable action plan to address these weaknesses is not in place, the Bank will identify the additional steps needed to secure acceptable fiduciary arrangements." This section discusses the broader aspects of fiduciary considerations in DPOs, reviews whether relevant analysis informs Bank decisions on fiduciary measures and program design, and identifies good practices.

62. ***Context for Assessing PFM Systems and Fiduciary Risks for DPOs.*** In DPOs, as under prior adjustment lending policies, the Bank and the borrower agree on a standard and limited set of items for which the resources may not be used (negative list), but otherwise Bank resources are made available for financing a country's budgetary expenditure.[55] Hence, any assessment of fiduciary arrangements for DPOs and attendant risks of the borrower's capacity to receive and manage the loan must take a holistic view of a country's entire PFM system and environment.[56] Since, in contrast to investment lending, Bank resources are not attached to any particular government activity, fiduciary risks, including for fraud and corruption, must be addressed through strengthening of country PFM systems rather than through any independent tracking or third-party audits of specific Bank-financed activities.[57] As highlighted in the good practice note for financial management in DPOs,[58] the Bank therefore reviews country PFM systems as part of DPO preparation. Such review draws on (a) the analysis of existing systems for budgetary and foreign exchange management; (b) an assessment of the strength of the government's program to address identified PFM weaknesses and progress made in its implementation; and (c) a judgment

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55 Under adjustment loans, goods supplied from the territory of the borrower were included on the negative list.

56 A similar vision applies to resources made available under the multilateral debt relief initiative, which are also allocated through country's own budget management systems. Moreover, for subnational DPOs, the PFM environment of the subnational government needs to be considered.

57 OP 8.60 allows, under exceptional circumstances, for the use of a positive list of expenditure ("expenditure for which resources may be used") as additional fiduciary arrangements, which would enable the identification and tracking of the ways in which Bank funds have been spent. However, any use of such arrangement would require application of Bank procurement policies. Its appropriateness would need to be carefully considered in assessing the strength of the country's policy and institutional environment and weighing the potential alternative of investment lending instruments.

58 *Financial Management Issues in Development Policy Lending,* Good Practice Note, Operations Policy and Country Services, October 2004.

on the government's commitment to implement any such program. In evaluating the fiduciary risks of DPOs—and in making attendant decisions on tranching, conditionality, and risk mitigation—the Bank therefore does not use the level of any single or composite indicator for distinguishing acceptable from unacceptable fiduciary environments for DPOs. Instead, DPL engagements build on a summary judgment whether there is government commitment to reform, an adequate and credible program of PFM reform, and evidence that improvements are occurring in a timely manner. The Bank assesses whether the existing system, the reform trajectory, and government commitment signal a sufficient level of country capacity to achieve the targeted development outcomes.[59] On this basis, the Bank occasionally and selectively engages in weaker, and potentially riskier, PFM environments as long as a strong enough program is in place and implementation remains satisfactory.[60] As outlined earlier, available quality indicators do not suggest that the Bank under this framework has jeopardized the quality of its lending. Moreover, whereas donor-funded projects typically focus on a fraction of total government spending, the DPL focus on addressing weaknesses in systems that govern all government revenue and spending—including domestic tax revenue—and gives scope for enhancing the governance and transparency of a larger pool of government resources. In this context, a recent comprehensive study notes that general budget support does not appear to foster corruption and fraud. [61] On the contrary, given the ability of budget support interventions to focus on countrywide and systemic issues, the study states that "corruption has been a salient issue in dialogue and donor decisions about budget support." Bank operations also tend to reflect corruption concerns: more than 80 percent of the reviewed DPL operations mentioned corruption as an issue. In terms of anticorruption measures, the study notes that administrative anticorruption measures were usually complied with but may have had limited impact, whereas "in terms of a practical effect on the environment for corruption, work on public finance management has been more significant." It notes that budget support-related policy dialogue "has continued to support improvement in transparency, procurement management, and auditing ... and added to the collective weight of donor pressure for improvements in government accountability systems."[62] Again, progress made in building such systems under policy-based lending broadly supports this finding; Box 5 summarizes a few examples of sustained progress. Beyond fiduciary concerns, budget reforms also often aim at improving expenditure allocations and their operational efficiency. These issues, which are central for achieving poverty reduction objectives, are reviewed in the context of the effectiveness of DPOs and budget support in the next chapter.

63. ***Analytic Underpinnings.*** All 37 countries receiving DPOs benefited from at least one prior fiduciary assessment by the Bank.[63] For the vast majority of operations (more than 85 percent), the documentation explicitly draws on a CFAA. All but two IDA countries could draw

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[59] For a more extensive discussion of this subject, see David Shand, "Managing Fiduciary Issues in Budget Support Operations," in *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*, Stefan Koeberle, Zoran Stavreski, and Jan Walliser (eds.), April 2006.

[60] For a more detailed discussion on fiduciary considerations for DPOs in fragile states, see later text.

[61] *Evaluation of General Budget Support: Synthesis Report*, International Development Department, University of Birmingham, and Associates, May 2006.

[62] *Evaluation of General Budget Support: Synthesis Report*, International Development Department, University of Birmingham, and Associates, May 2006, p. 111.

[63] Of the 50 operations, 2 were supplemental credits/loans and one was a debt relief credit. These operations were not expected to lay out the same analytic underpinnings on fiduciary aspects as other DPOs as they either follow different disbursement arrangements or rely on the original operation for much of the analytic underpinnings. However, relevant country fiduciary analysis was also available for these countries. The fiduciary assessment for one country was not a formal analytic product but a precursor to a CFAA.

on a completed CFAA or integrated fiduciary work, with the other two relying on other fiduciary assessments in a post-conflict environment. Sixty-eight percent of program documents also reference the CPAR, and more than 20 percent of operations were underpinned by integrated studies such as the country integrated fiduciary assessment, which combines public expenditure management, financial management, and procurement aspects in a single report. CFAAs and CPARs also cover many issues that have a bearing on the fight against corruption, to the extent that they include a review of systems for indications of lack of transparency and accountability, such as failure to respect internal controls or lack of procedures for reporting bribes and other measures to curb corruption. More than 50 percent of operations were informed by the findings of at least three PFM-related analytic underpinnings, indicating that the operations are benefiting from multiple sources on country PFM systems, not only from the Bank but also other development partners. Although the multidonor Public Expenditure and Financial Accountability (PEFA) PFM performance measurement indicator set was finalized only in mid-2005, six of the operations already make reference to an earlier or the current version to inform the preparation of current or future operations. For example, the program documents of Afghanistan (Second Programmatic Support Operation for Institution Building) and Cameroon (Forest and Environmental Development Program) both incorporate a complete scored set of such indicators in an annex.

64. ***Assessment of Public Financial Management Systems.*** Ninety-six percent of reviewed operations cover the status of analytic work; 87 percent provide a summary of analytic findings in assessing the strength and weaknesses of the PFM system; and more than 70 percent of all operations also summarize the findings of the CPAR. Box 6 presents a good practice example how fiduciary analysis, risk assessment, actions to improve the system, and indicators for tracking progress can be presented in a concise way. The description of the status of PFM diagnostic work and its results in program documents are generally comprehensive and 90 percent of operations give evidence for the implementation of PFM reforms over time. However, more efforts could still be made to document the Bank's judgment of the quality of the borrower's reform program and that implementation is satisfactory and occurring in a sufficiently timely manner (see also the discussion below on tracking progress). Some additional attention should also be given to fully and systematically integrating public procurement-related aspects in such assessments of existing systems, as about 25 percent of operations (all of them in IBRD countries) did not refer to procurement and 34 percent of operations did not contain a procurement risk assessment.

Box 5. Supporting Public Financial Management Reform under Policy-Based Lending

In **Burkina Faso,** the Bank supported a wide range of reforms under six PRSCs, including (a) introduction of a global medium-term expenditure framework (MTEF) and sectoral MTEFs for health and education; (b) implementation of a computerized expenditure monitoring system; (c) regular and timely production of budget accounts and budget execution reports; (d) creation of an independent General Auditor's Office; (e) improved recording of externally financed investment spending; (f) revision of procurement regulation and manuals; and (g) implementation of a system to track government property.

In **Ghana,** four PRSCs have supported a new Financial Administration Act and updated Financial Regulations, the Internal Audit Agency Act, and the Public Procurement Act. Improved oversight has been accomplished through ensuring a timely budget approval prior to the beginning of the fiscal year. The transparency of the budget documentation also improved considerably over the last two years, especially by incorporation in the Budget Statement for 2005 and 2006 of information for Ministries, Departments and Agencies (MDAs) on internally generated funds, donor disbursements, and HIPC funds, as well as information on incomes and expenditures for the Statutory Funds. Clearing the backlog of audit reports has strengthened the role of the Auditor General, and external oversight has improved through the more timely preparation and submission of Auditor General reports to Parliament and the clearance of the backlog of outstanding reports. At the same time, the Ministry of Finance and Economic Planning has strengthened its commitment controls to improve overall monitoring of expenditures and rolled out a new computerized budget management system.

In **Pakistan,** the Bank has supported fiscal and financial management reforms at the national and provincial levels with policy-based lending. At the national level, the PRSC program includes reforms to computerize budget execution, increase legislative and civil society oversight over public expenditures, and adopt international accounting standards. The National Assembly's Public Accounts Committee (PAC) now meets regularly and identifies areas for additional investigation and corrective action, and makes a summary of its conclusions available to news media. At the provincial level, policy-based lending to the Northwest Frontier Province has supported establishing an integrated, automated accounting system that connects all provincial level and district accounting offices to provide real-time information on budget execution. The education sector reform in the Punjab Province, which the Bank has supported with the three operations, also includes a component focusing on provincial PFM systems. The provincial government achieved progress in (a) consolidation of cash balances of the provincial and district governments into a daily report; (b) faster and timely review of audit reports and audited accounts by two provincial Public Accounts Committees, operating in parallel; (c) timely release of budgeted resources to spending departments; (d) improved timeliness in data reconciliation; (e) adoption and implementation of a new GFS-compliant Chart of Accounts by provincial and district governments.

In **Uganda,** the government developed a strong budget planning framework, relying on an MTEF and strong sectoral budget formulation processes. Under recent PRSCs the government also improved the timeliness and accuracy of the maintenance of books of account, and performance of reconciliations has improved significantly at the central and local level. Regular in-year financial reports are prepared by central and local government spending agencies. Central Government Financial Statements are in material respects prepared in compliance with the requirements of International Public Sector Accounting Standards. The Office of the Auditor General has a broad scope and mandate, and now has access to classified expenditure, although the office still has limited independence and control over its budget and human resources. The government has presented its Annual Report to Parliament within the statutory period for each of the last six financial years. Much of the PFM process is relatively open and transparent, and documents are in the public domain.

A recent study of general budget support, covering **Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Tanzania, Uganda, and Vietnam** concluded that general budget support has been an effective instrument to strengthen PFM, including planning and budgeting. It highlights, in particular, a significant strengthening of the budget process and improved comprehensiveness and transparency of the budget. Based on rudimentary ratings using the public expenditure and financial accountability framework, the study finds a dominant positive trend for the countries studied. It also notes increases in PRS priority spending and gains in allocative and operational efficiency where budget support has increased discretionary funding. The study underscores that there is scope for more systematic collaboration among donors to support capacity building strategies, and that technical solutions are neither effective nor durable without sustained government commitment. (*Evaluation of General Budget Support: Synthesis Report*, International Development Department, University of Birmingham, and Associates, May 2006.)

65. ***Assessment of Foreign Exchange Control Environments.*** Under the policy, the analysis of the foreign exchange control environment for DPOs relies on the IMF's safeguard assessment of the central bank, if the latter is available. In 60 percent of the reviewed operations, the Bank referred to an IMF safeguards assessments of central banks and in all these cases the program documents describe conclusions drawn from these assessments. Of the remaining 19 operations, only 6 mention that the IMF had not conducted such an assessment or explain the reason why such assessment is unavailable. Four of the latter operations note that Bank has adequate knowledge/experience of the foreign exchange control environment of the central bank and describe due diligence work conducted by the Bank. Hence, overall, 28 percent of reviewed operations either fail to mention the safeguard assessment (even though in many cases it exists) and/or did not include the expected summary discussion of the foreign exchange control environment. Further improvements in this area are necessary to assure that disbursement arrangements take into account weak foreign exchange control environments.

Box 6. Tanzania PRSC-3: Assessing the Fiduciary Environment

"In-depth assessments of Tanzania's public financial management and procurement systems have been carried out through a CFAA in 2001 and a CPAR in 2003 as well as in the context of annual Public Expenditure and Financial Accountability Reports. The Public Expenditure Management Country Assessment and Action Plan prepared in 2004 concluded that over the last three years Tanzania has made significant progress in the public expenditure management reform process and that Tanzania meets 11 out of 16 benchmarks. ... The assessment also identified where progress is yet to be made. The coverage of fiscal reports continues to be limited to the central government. Fiscal reporting needs to cover the GFS definition of the general government sector. ... The ongoing work on internal audit needs to be continued to make it effective. The procurement system does not meet the benchmark due to weak enforcement and limited accountability in the current system. Also, a Fiduciary Risk Assessment Report issued by the Department for International Development (UK) in May 2004 concluded that: 'The overall problems, however, remain those of a weak fiduciary contract between citizens and the state, inadequate domestic revenue collection, limited delivery of public goods, inadequate monitoring, inefficient capacity, non-compliance, lack of enforcement, and inadequate oversight.' The PRSC contains a strong focus on government's efforts to address residual weaknesses in the areas of internal and external audit as well as procurement. A Public Management Reform program is in place to ensure sustained improvements in Tanzania's public expenditure management system." (Tanzania PRSC-3 program document, para, 180-181.)

66. ***Disbursement Arrangements.*** All of the reviewed operations specify the disbursement arrangements (funds flow), including the bank and account(s) into which the proceeds would be deposited. Under OP 8.60—in contrast to prior arrangements for adjustment lending, which required a separate deposit account—funds are normally disbursed into a (general) government account that forms part of the foreign exchange reserve holdings, usually at the central bank. The government also credits these resources in local currency equivalent to its budget management system and applies them to budgeted expenditures that are not on the negative list.[64] Bank staff verify the flow of funds through confirmations submitted by the borrowers, and the Bank retains the right to request information about the loan and the account(s) in which it was deposited. However, 21 percent of the operations displayed apparent confusion with the new policy in noting the Bank's right to audit the deposit account, although they did not opt for use of such an

[64] The negative list is treated as a code of conduct protecting the Bank from reputational risk—for example, if proceeds of a Bank loan were directly transferred to a supplier of items on the negative list.

account.[65] Further clarification for teams on the application of the new policy in this regard is needed and is being put in place.

67. ***Additional Fiduciary Arrangements.*** In cases of identified weaknesses or when an appropriate action plan is not in place, the Bank's policy allows for additional fiduciary arrangements—for example, the use of dedicated accounts for foreign or local currency equivalents of loan proceeds. Eleven of the reviewed operations made use of additional fiduciary arrangements in form of dedicated accounts. However, only four explain why these arrangements were implemented and how the actual arrangements selected were addressing important reputational risks (for example in the Democratic Republic of the Congo's Transitional Support for Economic Recovery Operation). Three operations used dedicated accounts as additional arrangements without explaining the rationale for this action, and another operation chose disbursement arrangements that did not clearly correspond to the risks identified. Overall, these findings point to remaining gaps in the understanding of the potential value added of additional fiduciary arrangements afforded under the policy, and their link with fiduciary and reputational risks. No operation made use of a positive list (expenditure for which resources may be used) as an additional fiduciary arrangement, in which Bank resources would be tied to particular government expenditure. This finding is not surprising. Expenditures financed under such a positive list would be subject to Bank procurement and safeguard policies, which also apply to investment lending. Thus, in cases with high residual fiduciary risks or lack of an appropriate action plan to address them, careful consideration is typically given to using available investment lending instruments, which may be able to meet the same objectives in all but fairly rare circumstances (for example, repayment of bridge financing used to clear arrears).[66]

68. ***Integration of PFM Reforms into the Supported Program.*** Seventy-two percent of the reviewed operations supported PFM reform as part of the program and all but one of these operations had PFM-related conditionality. All but two sector-specific IDA operations included PFM reforms. Where PFM reforms form part of the program content, there are close linkages (in almost 90 percent of those operations) between the conclusions of the PFM assessment and the exposition of the program elsewhere in the document, and almost all such operations had conditionality that reflected PFM priorities. Forty-six percent of operations included between three and six such conditions. In line with the findings of the PRSC stocktaking,[67] programmatic operations in IDA countries, in particular, integrated findings of analytic work in a sequenced manner over time and traced implementation. The content of conditionality for operations with PFM conditions focuses on budget formulation and medium-term expenditure frameworks in the majority of cases, but 20-25 percent of operations also address areas of accounting, controls, and external audits (see Figure 18). Fifty-five percent of operations included prior actions and/or follow-on actions on public procurement reform (see Annex F for good practices). With one exception, even operations that did not include PFM measures and conditions provided some

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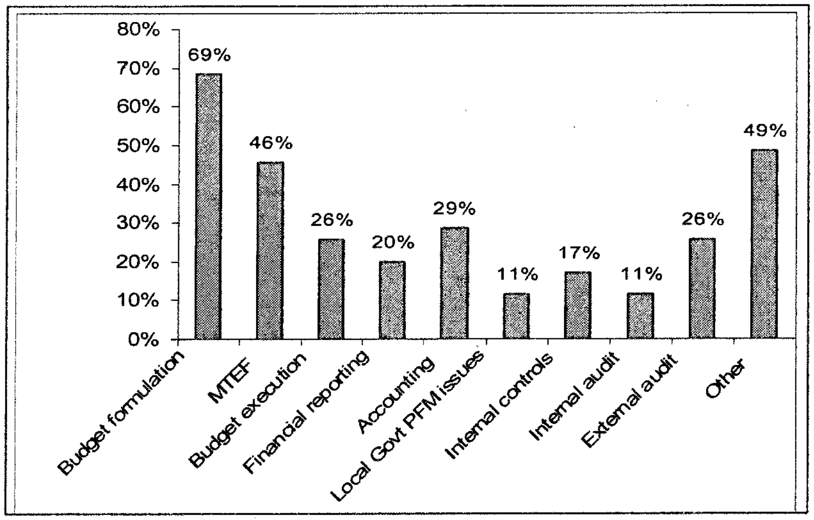
65 Some operations also referred to IDA's right to have access to the consolidated accounts of government and the fact that the central bank's accounts should be audited in accordance with international auditing standards and made available publicly. Such information has relevance for the Bank's assessment of fiduciary risk rather than disbursement.

66 The policy suggests in para. 3 that in deciding on the appropriateness of development policy lending the Bank would consider the policy and institutional framework as a well as the strength of and commitment to the reform program. As such, the policy would suggest careful consideration of the instrument choice before applying additional fiduciary arrangements in cases of weak fiduciary environment and/or lack of commitment to address them.

67 *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), May 12, 2005.

evidence of the government's commitment to PFM improvement/reform and of the implementation of the improvements. However, some areas for improvement in program design remain. Twelve percent of operations with PFM reforms did not identify appropriate results indicators to monitor progress. (The El Salvador Second Broad-Based Growth DPL and the Uganda's fifth PRSC provide good practice examples in this regard.) In a number of cases, policy actions were also vaguely formulated, reducing the ability of borrowers and development partners to demonstrate sustained implementation of a reform program. Finally, more than one-third of the operations supporting PFM reforms made no reference to technical assistance and implementation support. (Good practice examples for such references are Burkina Faso's fifth PRSC and Ukraine's first DPL.)

Figure 18. Percent of Operations with PFM Reforms Containing Conditionality in a Particular Area



Source: Staff calculations.
Note: Other category includes, among others, promulgation of laws, action plans, organizational reforms, public expenditure tracking studies; and agreed budget allocations for certain sectors.

69. ***Tracking Progress.*** A more systematic and comprehensive tracking of progress in reforming PFM systems would be useful. As highlighted above, the Bank's framework for assessing the PFM and fiduciary environment for DPLs relies strongly on an evaluation of progress made in the implementation of reforms. The discussion above also shows that the Bank generally builds on rich analytic underpinnings of PFM systems, and that PFM reforms play an important, if not central, role in content and design of many DPOs. However, additional efforts would be useful in tracking progress in improving PFM systems across countries. In this regard, the Bank is already drawing increasingly on the recently developed PEFA indicators and PFM Performance Measurement Framework (see Box 7).[68] The new framework supports the Bank's move toward integrated PFM assessments, allows for systematic tracking of progress of overall country PFM performance, and provides for assessing the impact of PFM reforms jointly with other multilateral and bilateral donors. Since PEFA indicators are not likely to change over very short horizons, they are more apt to track progress over a program cycle (3-4 years). Therefore, within program cycles, PFM discussion in DPOs would need to continue to include a systematic

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[68] See also *Strengthening the Bank's Public Financial Management Work,* joint note to staff by James Adams and Danny Leipziger, June 21, 2005.

evaluation of the timely implementation of reforms under the program. In addition, to be most effective, the approach will require more discipline in formulating integrated and prioritized action plans for improving PFM systems with governments.[69] Depending on individual country circumstances, other analytic work may still be needed to supplement the PEFA PFM Performance Measurement Framework—for example, to provide in-depth diagnosis of key systems requested by partner countries, to provide the detailed understanding of systems to inform the specific ratings in the PEFA assessments (such as work on government procurement systems in line with OECD-DAC performance indicators), and to address public finance policy aspects (level and composition of public spending) that are not addressed in other PFM diagnostic work. The importance of tracking progress over time in a systematic fashion was also highlighted by the European Union Court of Auditors in reviewing the experience of budget support provided by the European Commission (see Box 8), which follows a similar approach to PFM issues as the Bank.

Box 7. Public Expenditure and Financial Accountability (PEFA) Initiative

The **Public Expenditure and Financial Accountability (PEFA) program** started in December 2001 and has been jointly financed by the World Bank's Development Grant Facility, the European Commission, the UK's Department for International Development, the Swiss State Secretariat for Economic Affairs, the Royal Norwegian Ministry of Foreign Affairs, and the French Ministry of Foreign Affairs. The International Monetary Fund and the Strategic Partnership for Africa are also partners. The goals of the PEFA program are to strengthen recipient and donor ability to (a) assess the condition of country public expenditure, procurement, and financial accountability systems, and (b) develop a practical sequence of reform and capacity-building actions, in a manner that encourages country ownership; reduces the transaction costs to countries; enhances donor harmonization; allows monitoring of progress of country PFM performance over time; better addresses developmental and fiduciary concerns; and leads to improved impact of reforms.

The **PEFA PFM Performance Measurement Framework** has been developed as a contribution to the collective efforts of many stakeholders to assess and develop essential PFM systems, by providing a common pool of information for measurement and monitoring of PFM performance progress and a common platform for dialogue. The PEFA PFM Performance Measurement Framework incorporates a PFM performance report, and a set of high-level indicators (including for public procurement) that draw on the HIPC expenditure tracking benchmarks, the IMF Fiscal Transparency Code, and other international standards.

Implementation of the PEFA framework is progressing speedily. At end-May 2006, less than a year after finalization of the PFM Performance Measurement Framework, 21 countries had completed a PFM assessment at least in draft format. Sixteen further countries and one subnational government in India have commenced work, and 15 further countries and two subnational governments in Pakistan have agreed to undertake such assessment in the near future.

[69] CFAAs and CPAR and other donor analytic work on PFM often contain several hundred actions. These actions have to be converted into properly sequenced and realistic action plans by country authorities to be operational. Burkina Faso's 2002 *Programme de Renforcement de la Gestion Budgétaire* provides a good example of such integrative work.

Box 8. Fiduciary Arrangements for Budget Support: Review by the European Union Court of Auditors

In 2005, the European Union Court of Auditors reviewed the implementation of budget aid as regards its treatment of public finance management. The Audit Court summarized the European Commission's approach as follows:

"[Direct non-targeted budget aid] has several major advantages, chief of which are ownership and greater simplicity, but it also brings an element of risk. This risk differs from that affecting other types of aid: the objectives are more ambitious and the funds disbursed are merged with the revenue of the beneficiary countries, which then spend them in accordance with their own management systems, which are usually weak. The philosophy behind budget aid is to help beneficiary countries to reduce this risk while at the same time allowing them to manage their own development through growth and poverty reduction. [...] The Commission is prepared to transfer budget aid to countries with weak management systems, provided that reforms are put in place to improve them. This is a long-term process. It has therefore developed tools with the aim not only of making an initial diagnosis of the quality of the public finance management and proposed reforms, but also of evaluating management changes and the progress of those reforms."

The Court of Auditors broadly supported the Commission's approach and recommended, among other things, that:

"The Commission should demonstrate in a more formalized and structured manner, setting out the reasons leading to its conclusion that the direction being taken by a beneficiary country is satisfactory, that there is compliance with [...] the Cotonou Agreement, account being taken of the public finance management weaknesses revealed by the initial assessment [...].

The Commission should make use of performance indicators that genuinely encourage beneficiary countries to press ahead with their reforms and that focus more closely on results that reflect improvements in management.

The Commission must do everything within its power to see to fruition the public financial management performance measurement framework being developed within the framework of PEFA [...]. This major coordination project between donors must be improved by taking account of the results that will be available at the end of the testing stage. The Court's suggestions should also be considered [...], especially the proposal concerning tests of controls. It is crucial that donors (particularly those belonging to the partnership) adopt and implement the Framework in the near future.

Coordination between donors' local representatives should be strengthened as regards the production of assessments, evaluations and audits, the implementation of institutional support and the use of conditions and performance indicators, it being understood that each donor retains full discretion over its own aid disbursement [...].

Relations with the authorities in the beneficiary States should be systematically structured and taken beyond the government level to include parliaments and Supreme Audit Institutions, whose powers must be strengthened to enable them to undertake the reforms that concern them and to audit those that are a matter for the executive branch. It is therefore vital, in the context of negotiations with the government of a country, to consider how the Commission might approach parliaments and S[upreme] A[udit] I[nstitution]s."

Source: European Court of Auditors, *Special Report No 2/2005* concerning EDF budget aid to ACP countries: the Commission's management of the public finance reform aspect, 2005/C 249/01, July 2005.

70. ***Treatment of Fiduciary Risks.*** Although several of the reviewed program documents discuss fiduciary risks in a summary fashion in their fiduciary section or risk section, a more systematic discussion of residual fiduciary risks and their relation to program design would be helpful. The treatment of fiduciary risks differs fairly widely across reviewed DPOs. Only 30 percent of reviewed operations address fiduciary risks explicitly in the risk section of documents. Some of these merely state the fact that it exists for the operation; in some cases documents also

state the level of risk; and in a few cases documents elaborate on the weaknesses that increase the level of fiduciary risk. In some cases, fiduciary risks are likely to remain important even after implementation of reforms and/or use of additional fiduciary arrangements. Within the context of the strength of the government reform program and government commitment, it would be important to explicitly discuss fiduciary risks and how they influence Bank decisions on tranching and conditionality. Such discussion would also give more systematic information how the Bank is weighing potential benefits of an operation against its inherent risks. In addition, it would set out more clearly the effect the combination of policy actions has on risks (and that of any, additional fiduciary arrangements) and identify which risks cannot be mitigated in the short term.

IV. CUSTOMIZING BANK SUPPORT TO ACHIEVE COUNTRY-LEVEL RESULTS

71. One of the important changes in adopting the new operational policy in September 2004 was the absence of prescriptiveness as regards the policy contents of DPOs. At the same time, there had already been an increasing shift under previous adjustment lending instruments toward medium-term engagement with an increased focus on results. This chapter discusses—through the filter of customization and results focus—selected implementation topics. These include the treatment of growth aspects in DPOs as well as the questions related to the use of DPOs in different country settings. The reformed policy framework offers potential scope for customizing lending design and contents closely to country preferences and priorities, because of its absence of policy prescription and its adaptability to both sectoral and multisectoral policy reforms. It also offers a few additional explicit options—such as subnational lending, debt reduction loans, and supplemental financing. Although to date only a limited number of operations have been approved under the new policy, these offer a first overview of the potential of the instrument to respond to different types of demand for Bank support. A second broad topic covered in this chapter relates to the integration of results-focus into DPOs and the evidence on the effectiveness of policy-based lending in terms of supporting results and improving monitoring and evaluation.

A. Supporting Policies for Growth and Poverty Reduction

72. OP 8.60, para. 2, states that DPL operations "aim to help a borrower achieve sustainable reductions in poverty through a program of policy and institutional actions that promote growth and enhance the well-being and increase the income of poor people." Lessons from the 1990s on growth experiences highlight both the importance of institutions and the fact that there is not a simple set of actions that create circumstances for sustained faster growth.[70] They thus emphasize the importance of focusing on binding constraints in the right manner and right sequence. Empirical research also highlights the importance of growth for poverty reduction.[71] A recent multicountry study discusses how growth processes may be influenced to accelerate poverty reduction.[72] Other recent work has highlighted the possibility that poverty and inequality may need to be targeted through public interventions to unleash potential for growth.[73] Drawing on

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70 *Economic Growth in the 1990s: Learning from a Decade of Reform,* World Bank, April 2005.

71 Aart Kraay, *When is Growth Pro-Poor? Cross-Country Evidence.* Policy Research Working Paper 3225, June 2004.

72 *Pro-Poor Growth in the 1990s: Lessons and Insights from 14 Countries,* Agence Française de Développement, Bundesministerium für Wirtschaftliche Zusammenarbeit und Entwicklung, U.K. Department for International Development, and World Bank, June 2005.

73 Guillermo E. Perry, J. Humberto Lopez, William F. Maloney, Omar Arias, and Luis Servén, *Poverty Reduction and Growth: Virtuous and Vicious Cycles,* World Bank, February 2006.

this broad set of cross-country evidence and lessons, DPOs typically support a set of specific country policies with the intention to foster growth and alleviate poverty. Given limits to data as well as knowledge of the mechanisms of growth, growth analysis is not expected to lead to sharp conclusions linking any particular policy actions to precise increases in growth rates. However, growth analysis could identify a relatively small number of important impediments to growth in a country and explain their link with core policy actions that are being pursued under the government's policy agenda. This section reviews whether the first sample of DPOs yield evidence for customized support to the country's growth agenda.[74]

73. ***Identifying Growth Priorities.*** Although most documents justify the supported reform packages broadly with their link to government priorities or the Bank's country assistance strategy, relatively few undertake a rigorous analysis of growth impediments and link the supported activities to long-run growth impediments.[75] As such, a greater effort could be made to narrow the number of areas supported under DPOs to those that teams have identified as most critical for growth and poverty reduction. Among the limited set of good practices in this regard are Peru's decentralization and competitiveness DPL, Mexico's competitiveness DPL, and Mali's Economic Policy and Public Finance Management DPL. The Peru operation contained detailed information from a recent Investment Climate Assessment and numerous cross-country comparisons of various measures of the investment climate to identify the most important constraints for growth. Similarly, the team working on the competitiveness DPL for Mexico conducted a detailed growth diagnostic and impact analysis exercise. An exceptional effort at econometric analysis was presented in the operation for Mali, describing the sources of growth and explicitly linking supported actions to the financial developments that mattered for productivity growth.

74. ***Using Analytic Underpinnings.*** For growth purposes, most DPOs rely almost exclusively on Bank-generated analytic work and rarely draw on outside growth studies. Of 42 DPOs reviewed for the purpose of growth analysis, only 4 cite some academic research among their references. Although in many cases Bank studies may be more closely targeted to the research question relevant to Bank-supported policies and other research may be lacking, in some cases the Bank may still reap the benefit of a broader perspective from academic research, especially in larger countries with a significant academic community.

75. ***Horizon for Growth Analysis.*** Growth discussions in most DPLs have a horizon that is often too short to put the operation in the appropriate growth context. Typically, in their macroeconomic section, program documents discuss GDP growth and its sectoral composition over the last few years, and most also discuss the country's future growth prospects over a three- to four-year horizon. However, program documents rarely refer to any analysis of the factors contributing to a country's past longer-term growth performance, and in many cases assumptions and models used to generate these forecasts (including those for DSAs) are not made explicit or linked to supported reforms. As noted earlier, in many countries DPOs are part of a sequence of three to four single-tranche loans, and thus the measurable results of the operations (typically defined by, or jointly with, the government) are appropriately focused on specific areas of reform

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[74] The sample excludes the two supplemental financings and the debt relief credit, as well a two natural resource operations and a social reform loan.

[75] Niger's Public Expenditure Reform Credit frankly acknowledges that the loan "...does not focus on growth issues, because there is no analytical base for policy recommendations in this area." The document then mentions several pieces of planned analytic work to fill this gap.

where progress can be monitored over the time frame of the operation. However, such short-term focus would not necessarily preclude offering a longer horizon concerning growth benefits of the supported reforms, especially since DPOs often support complex and broad institutional reforms. Recent analysis of the quality of analytic underpinning (see Box 9) reveals that making such link in DPOs is constrained by similar weaknesses regarding the horizon of growth projections and justification of growth assumptions in underlying analytic work. Lengthening the horizon for growth analysis in analytic work would be beneficial for better establishing links between growth and poverty reduction scenarios in DPOs and would help align growth scenarios with the length of typical loan repayment terms.

Box 9. Macroeconomic Analysis in Bank Analytic Work

As part of an effort to improve the quality of economic growth analysis and growth forecasts the Bank has recently undertaken a review of growth-related analytic work produced from 1990 to 2004. The review assessed about 200 CASs, CEMs, Poverty Assessments, Development Policy Reviews, Public Expenditure Reviews, and loan documentation for 12 countries—Armenia, Bangladesh, Bolivia, Brazil, Cambodia, Egypt, Estonia, India, Madagascar, Morocco, Tanzania, and Thailand. The review raised several important issues with respect to the Bank's forecasting practices, overview of past developments, and analytic methods.

The forecasting practices in CEMs and other reports were evaluated against the requirements set out in the guidelines and operational policy notes dating back to late 1980s. Macroeconomic projections are required to cover the following: growth targets over the next five to ten years; "the shift in the major economic variables necessary to achieve the targeted growth rates"; and the policies needed to achieve such shifts. Debt and creditworthiness issues and projection of external financial balances were key elements of these projections. In practice, the review found no apparent link between policies and outcomes and a short forecasting horizon, down to two or three years. In many reports, the link between policy interventions and GDP growth has been mainly illustrative and the expected growth dividend from reforms has been mostly an assertion. The forecast horizon was largely limited to three years and, as a result, macroeconomic forecasting and growth analysis were not undertaken in an integrative manner.

Source: How to Forecast Long-Run Growth in the Developing World? Country Forecasts and Determinants (PRMED Knowledge Briefs), May 2006; C. Lluch, *Economic Development: World Bank Analysis and Policy Recommendations,* December 21, 2005.

B. Supporting IBRD Borrowers: Opportunities and Challenges

76. Half of the 50 DPOs included in this review were for 14 IBRD and blend countries. In contrast to IDA-only countries (25 operations for 23 borrowers), many IBRD and blend countries borrowed repeatedly from the Bank over this period. Whereas in IDA countries most operations are multisectoral, in IBRD countries frequently different programmatic DPL series run in parallel in the same country, supporting implementation of different sector-specific reforms. In many of these countries, the Bank has a potential role in supporting complex and technically challenging reform processes with its broad expertise. At the same time, most countries also have fairly easy access to capital markets and other lenders. The demand for Bank interventions in these countries thus depends on technical expertise and the quality of its analytic work as well as the terms of its financing. This section discusses some of the special characteristics and challenges of Bank engagement in IBRD and blend countries.

77. ***Support for Complex "Second Generation" Reforms.*** Bank support under DPOs in middle-income countries (MICs) and blend countries frequently focuses on sectoral reforms where governments have spelled out a strong reform program. Those reforms generally go beyond removal of simple economic distortions and frequently involve complex and politically

sensitive reform steps. In the DPO sample, Mexico exemplifies such engagement with four operations, as does Morocco with three operations and Brazil with two. In Mexico, the Bank is supporting environmental, housing sector, and financial sector reforms, as well as measures to improve competitiveness. In Morocco, the Bank is supporting public administration, housing sector, and financial sector reform. Likewise, two DPOs for Brazil have supported housing reform and social security reform—with other ongoing parallel lending series supporting human development, fiscal reform, and the fostering of sustainable and equitable growth. These engagements follow a similar pattern in that they build on strong government leadership in voicing priority areas for policy changes and defining key elements of the reform program. Bank staff assist the process, at government request, through in-depth analytic work, bringing to bear expertise and knowledge of solutions from other countries and regions. Interestingly, all three countries mentioned above saw improving the housing situation of the poor (especially dilapidated housing in large urban areas) as one of their emerging priorities. At the same time, the housing sector is traditionally subsidized in many different ways, and reforms touch on a host of complex issues and vested interests, ranging from preferential savings schemes and taxation to subsidized mortgages. In many ways, housing sector reforms exemplify the potential for DPOs in MICs, as customized and focused support for complex "second-generation" reforms that at the same time are closely linked to poverty and inequality issues. Several MICs also sought support for financial sector reforms, and in line with the recent recommendations of IEG, these were managed as stand-alone rather than multisectoral operations.[76] In terms of investment climate and competitiveness reforms, recent operations focus increasingly on institutional reforms and build on extensive analytic work and consultations to ensure adequate sequencing and customization of the reform program.[77] As regards portfolio synergies, DPO support in MICs is used both as stand-alone support to sector reforms and in conjunction with investment lending. For example, whereas many of the "microeconomic" and business climate reforms are covered only under DPOs and are excepted to more generally improve the efficiency of public and private investment, other operations, such as Brazil's Programmatic Human Development Loans, serve as an umbrella for broader policy reforms and directly support improvements in the implementation environment for investment operations (e.g., the Bolsa Famila program). In some cases, DPOs have been accompanied by technical assistance loans to provide for accompanying studies and measures for design and implementation of policies supported under DPOs.

78. ***Focused Operational Frameworks.*** Typically, the formulation of strong programs and the existence of sufficiently detailed government programs and broader analytic underpinnings allow DPL documentation in MICs and blend countries to stay focused on a few critical actions, even if they are underpinned by a broader dialogue. Summary descriptions of Bank-supported actions in policy matrices are typically short, a fact also borne out in conditionality figures (see Figures 13 and 14). For example, the key reforms supported by two Broad-Based Growth DPLs in El Salvador were summarized succinctly on two pages, with additional detail being available in various analytic work and government documents. Similarly, critical actions for two Indonesia

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[76] *World Bank Assistance to the Financial Sector: A Synthesis of IEG Evaluations*, Independent Evaluation Group, 2006. The report notes the significantly higher number of satisfactory outcomes of adjustment loans and technical assistance managed by the Financial Sector Network compared with financial sector components in multisectoral operations, even after controlling for country conditions.

[77] These issues were raised by IEG in *An Evaluation of Investment Climate Activities*, Independent Evaluation Group, October 2004.

DPLs were summarized on a single page in the text and in a three-page policy matrix. Even where, as in the recent Brazil Sustainable and Equitable Growth-2 DPL, a more complex reform matrix is maintained as an implementation tool of the government, an effort is made to focus the operation on a brief summary matrix with critical reform actions.

79. ***Opportunities and Challenges.*** Representatives from MIC and blend countries endorsed the DPL instrument as highly relevant instrument for Bank engagement and as an important ingredient in establishing a strong partnership with the Bank. They welcomed the Bank's engagement through policy dialogue and expressed strong demand for the Bank's analytic work in areas identified as government priorities. The Bank's move to medium-term programmatic and single-tranche operations over the past years was also mostly seen as a benefit, generally enhancing both predictability and flexibility in financially accompanying reform programs.[78] Such sentiment was echoed by several Bank staff, highlighting DPOs as instrument of choice to address institutional reforms over the medium to long term. Borrowers acknowledged that within a partnership framework, conditionality was mostly not seen as an impediment or burden, especially if the Bank continued to focus on a few critical actions. The adoption of the new policy on DPL was largely regarded as a "formalization" of practice that had evolved already under adjustment lending from "imposition" and "crisis lending" toward a medium–term and partnership approach of Bank policy-based lending. Some representatives, especially from MNA and EAP, noted their increasing or renewed interest in the instrument as they advance their policy reform agenda. However, several representatives of MICs, especially from ECA and LCR, noted that the Bank needed to continue to make efforts to stay "competitive," both in terms of its processing and pricing of loans and in terms of reducing the "hassle factor" of doing business with the Bank. Of particular concern was the interpretation of environmental provisions in the policy. Although representatives noted that analytic work, such as CEAs, was very useful input for developing actions to improve a country's framework for treating environmental issues, they were concerned that an expansive interpretation of the Bank's policy may require many upfront actions; in which case governments may decide to go ahead with reforms without Bank support. One area often mentioned in this regard was the increasing priority governments give to policies and reforms that create enabling environments for infrastructure investments. Some MIC representatives also urged the Bank to ensure that its products remain financially attractive, notably by paying close attention to the level of front-end fee waivers and by ensuring the continued availability of customized and sophisticated financial products.[79]

C. Supporting IDA Countries: Using DPOs to Support PRS Implementation

80. Half of the 50 DPOs considered in this report were for 23 IDA-only countries. Fourteen of these operations were PRSCs. Only three operations were sectoral DPL interventions. Six of the DPOs were in post-conflict and/or fragile environments and are subsequently discussed in more detail in another section. This section reviews some broader aspects of DPOs that emerged as important elements of Bank engagement in many low-income countries. A more detailed review of PRSCs has also been prepared in 2005.[80]

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78 During the consultations for the 2005 conditionality review, some borrowers noted that in cases of complicated approval procedures by the legislature, multitranche operations could reduce the government's transaction costs.

79 The Bank already offers a variety of financial products to meet clients' project or sovereign risk management needs, see treasury.worldbank.org.

80 *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), Operations Policy and Country Services, May 2005.

81. ***Medium-Term Financing.*** DPO engagements in IDA countries typically are recurrent, multisectoral support for the implementation of a country's PRS, generally in countries with above-average CPIA ratings and good track records. In these settings, supporting budget expenditure through DPOs over the medium term carries the potential to increase country ownership, strengthen domestic accountability systems, strengthen harmonization, and reduce government transaction costs for obtaining aid. The flexibility of DPO resources also permits governments to adjust recurrent and investment expenditure as needed to improve service delivery in pursuit of the MDGs. As noted above, the obverse of such flexibility is the expectation by the Bank and other donors of sustained country performance in program implementation (particularly in public financial management to improve the effectiveness of budget expenditure in addressing poverty reduction objectives).

82. ***Support for PRS Implementation.*** In IDA countries, the PRSP is the central vehicle for the government's definition of policy priorities, objectives, and actions, but aligning PRSs with Bank instruments comes with many challenges. Countries are frequently struggling with the translation of broader PRS priorities into concrete actions and monitorable results indicators to define implementation frameworks.[81] Moreover, even if individual policy reform measures may not be complex, the breadth of the reform program can add complexity and stretch capacity limits. The Bank is also facing a variety of issues and challenges in aligning with PRSs and supporting PRS implementation through DPOs. First, Bank and other donor support may catalyze the preparation by government and donors of more detailed implementation plans for the PRS customized to country circumstances. (Despite frequently similar priorities, PRSC matrices come in a large variety of formats and focuses). However, such interaction on implementation issues may also be seen as reducing the level of ownership, and this process has frequently resulted in large policy matrices annexed to Bank documents, a process that has been criticized as overly intrusive.[82] Second, under PRSCs and other DPOs in most IDA countries, the Bank simultaneously supports a broad set of reforms. These approaches have frequently allowed tackling important cross-sectoral constraints (e.g., weaknesses in central budget management that may limit social sector spending releases). However, multisectoral reforms can also be more difficult to manage, which can create tensions within governments (often related to the increased centralization of power by the Finance Ministry) as well as within the Bank's matrix management system. Sectoral reform content can be weak because of limited prior operational engagement or where prior involvement has not been able to build sufficient capacity, and many Bank sectoral staff therefore see a danger of declining quality in the sector dialogue when their sectors are folded into multisector operations.[83] Third, there is often need for continued capacity building alongside DPOs. The Bank is therefore at times linking DPO-supported reforms to technical assistance and capacity-building operations. However, where such approach is not feasible, the success of DPOs may greatly depend on capacity-building support by bilateral donors. Such support can take the form of trusts funds to finance preparation of programs that are supported by DPOs—such as the Japanese Policy and Human Resource Development trust fund, which supported many PRSCs—or direct bilateral technical assistance to implement

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81 *2005 PRS Review: Balancing Accountabilities and Scaling Up Results* (DC2005-0017), September 2005, p. 43.

82 The length of policy matrices, their complexity, and the number of benchmarks are a major area of concern for consulted CSOs, as they see them as an indication of the burden of Bank conditionality.

83 Building on guidance developed by the water sector, a good practice note on sectoral involvement in multisectoral operations is currently under preparation to address such questions and concerns and disseminate good practice examples.

complex technical measures. Fourth, relatively small country sizes, limited bank budgets, and constrained performance-based IDA envelopes may imply starker choices about the use of DPOs or investment lending to support a particular sector.[84] For example, human development activities are frequently completely folded into PRSCs, which requires a different approach to maintaining policy dialogue in these areas. Where parallel investment operations are maintained, DPOs often exploit complementarities with investment operations. For example, Ghana's PRSC series covers regulatory aspects of the electricity sector and policy issues in the health sector that have implications for, but are not directly addressed by, parallel investment operations.

83. ***Donor Collaboration and Harmonization.*** OP 8.60, para. 13, actively encourages the harmonization of conditions with other development partners, and DPOs in many IDA countries have become a primary vehicle for donor coordination, drawing on their intrinsic ability to focus harmonization and coordination efforts on support to government policies and reforms rather than disbursement procedures and procurement methods.[85] In almost all countries with repeated DPOs (and all but two PRSC countries), the Bank is now an active member of a donor group and usually has joined a memorandum of understanding or joint financing arrangement. In line with the good practice note,[86] these arrangements typically specify objectives, respective responsibilities, mechanisms for review and performance assessment, joint review calendar, timing of disbursement decisions, reporting requirements, and supporting capacity-building measures. After overcoming some start-up costs, most governments, Bank staff, and development partners report positively about the better coordination and better definition of respective expectations by donors and government, resulting in clearer communication, including of disbursement decisions. In many instances, well-coordinated support has over time leveraged additional financial resources from bilateral donors.[87] Where additional work may be needed is in aligning joint donor processes with country processes in order to reinforce domestic accountability mechanisms (for instance, by aligning the timing of joint donor reviews with sectoral and budget review processes of the borrower). Bank staff and many donors also acknowledge that transaction costs among donors remain high, with frequent coordination meetings, and Bank staff in particular noted the need for constant field presence to be an effective partner in donor groups. Some governments also remain wary of increasing pressure from harmonized donor groups and officials voiced concern that political conditionality could spill over into budget support groups, thus leading to abrupt suspensions of aid even by donors (such as the Bank) that do not use political conditionality (for example, in cases of bilateral aid suspension related to human rights violations).

84. ***Predictability of Resource Flows.*** One of the key issues for many governments receiving DPOs in aid-dependent countries is the predictability of support both in the short and medium terms. In several consultations and conferences, government representatives of low-income countries (LICs) voiced strong support for the performance-based approach of budget support, and noted that they are willing to enter such "performance-based aid compacts" to scale up expenditure for infrastructure and key social services and make progress toward the MDGs.

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[84] These choices may become even be more evident for countries benefiting from the multilateral debt relief initiative (MDRI).

[85] Further information will be provided in "Harmonization and Alignment for Greater Aid Effectiveness: Realizing the Bank's Commitments," Operations Policy and Country Services, forthcoming.

[86] *Budget Support Groups and Joint Financing Arrangements* (SecM2005-0361), June 20, 2005.

[87] Mozambique and Vietnam PRSCs, for example, have been either cofinanced by or coordinated with an increasingly large number of donors.

However, once recurrent budgetary costs increase sharply, even governments in strong performing countries feel vulnerable to unpredictable fluctuations and abrupt changes in budget aid flows. In general, donors have been improving their record on short-term predictability, according to a survey by the Strategic Partnership with Africa, although research also shows that deviations between budget support commitments and disbursements remain large—at 1 percent of GDP on average—even in countries with recurrent budget support.[88] The Bank's own record on short-term predictability has generally been good, with disbursements following a regular (usually annual) cycle of operations for PRSC countries that make broadly satisfactory progress in implementing their programs.[89] Rather than abruptly reducing aid, in some cases adjustments to originally anticipated credit/grant volumes have been made in response to weaker than anticipated performance. However, in some of these cases the reductions came too late in the country's budget year to be taken into account in the budget. In a few other cases, PRSC series were interrupted completely because of deteriorating country environments that were no longer consistent with DPL. Generally, within emerging budget support groups, decisions on aid volumes are made early enough, based on a systematic review of performance, to be taken on board by governments during budget preparation—and such mechanisms should help in the future to announce modulations of Bank support in a timely fashion. In Mozambique, an exceptional two-tranche PRSC was used to better align the Bank's disbursement cycle with the country's review cycle and budget calendar. On medium-term predictability, the Bank's horizon in IDA countries is usually constrained by the CAS horizon and lack of long-term certainty over the level of IDA resources. In this regard, the debt relief granted under the multilateral debt relief initiative (MDRI) has resulted in increased long-term predictability of part of IDA flows for countries having reached the completion point under the Heavily Indebted Poor Country (HIPC) Initiative.

85. ***Effectiveness of Budget Support.*** Government representatives from IDA-only countries generally saw DPOs as an effective way to support their own PRS programs, with concerns typically expressed about predictability of resource flows, and to some extent the number of conditions. The latter was a particular worry if it stretched country capacity and required complex interactions with multiple donors to secure disbursements. Country representatives typically strongly affirmed their own leadership in piloting programs and recognized benefits of budget support in terms of supporting alignment of aid with their priorities, scaling up, reduction of transaction costs, and reinforcement of PFM systems and domestic accountability mechanisms. Some of these country perspectives are also borne out by a variety of studies. Two recent studies indicate that PRSP processes in general may help focus government spending on priority areas and positively affect budget processes and allocations, and that budget support, when combined with nonfinancial budget support inputs, has proved effective in assisting efforts to strengthen PFM systems and outcomes.[90] This finding suggests that in those countries that were studied, in addition to improvements in the fiduciary environment, expenditure allocations

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[88] *Budget Support 2005: A Review and a Survey Report*, Strategic Partnership with Africa, December 2005 and Oya Celasun and Jan Walliser, "Predictability of Budget Aid: Recent Experiences" in *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*, Stefan Koeberle, Zoran Stavreski, and Jan Walliser (eds.), April 2006.

[89] See *Poverty Reduction Support Credits: A Stocktaking* (IDA/SecM2005-0238), May 2005, Table 9.

[90] Rosa Alonso, Lindsay Judge, and Jeni Klugman, "PRSPs and Budgets: A Synthesis of Five Case Studies," and Tim Williamson, "General Budget Support and Public Financial Management Reform: Emerging Lessons from Tanzania and Uganda," in *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*, Stefan Koeberle, Zoran Stavreski, and Jan Walliser (eds.), April 2006.

shifted to priority areas and became more effective in generating desired outcomes. Box 10 summarizes the salient findings of a recently concluded broad study on general budget support in seven countries, piloted by OECD-DAC. This study notes that budget support can be an efficient, effective, and sustainable way of supporting national PRSs, and that it can strengthen ownership, have positive effects on allocative and operational efficiency of public expenditures, and increase the general quality of aid. The study found no adverse effect of budget support on countries' revenue effort. A recent USAID synthesis study furthermore emphasizes that budget support tends to be more effective when there is strong commitment to poverty reduction, agreement between governments and donors on common approaches, sufficient government capacity or accompanying capacity-building measures, and low fiduciary risk.[91]

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91 Development Information Services, "General Budget Support: Key Findings of Five USAID Studies," in *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*, Stefan Koeberle, Zoran Stavreski, and Jan Walliser (eds.), April 2006.

Box 10. Findings of the Joint Evaluation of General Budget Support 1994-2004

The Joint Evaluation of Budget Support 1994-2004 was contracted by the UK Department for International Development on behalf of 18 bilateral donors, the European Commission, the Inter-American Development Bank, the IMF, OECD-DAC, and the World Bank to review to what extent, and under what circumstances, general budget support (GBS) is relevant, efficient, and effective for achieving sustainable impacts on poverty reduction and growth. The synthesis report links findings from seven country case studies: Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda, Uganda, and Vietnam. Its summary conclusions and findings are that:

GBS as a modality is distinctive in: (i) its orientation to the support of national poverty reduction strategies; (ii) its orientation to the strengthening of national government capacity, especially in the core areas of public finance management; (iii) its focus on results; (iv) its explicit intention to improve the quality and effectiveness of aid; (v) its aspiration to function as a partnership.

GBS designs vary across countries and have evolved over time. In every case GBS both embodied a particular set of relationships among the parties involved, and supported a particular country-specific, development strategy. The variety of designs and contexts required care in generalizing from observed performance.

GBS has been a relevant response to certain acknowledged problems in aid effectiveness.

GBS can be an efficient, effective and sustainable way of supporting national PRSs. It played a clearly positive role in five of the seven case study countries (Burkina Faso, Mozambique, Rwanda, Uganda, and Vietnam). In one country (Nicaragua) GBS was at such an early stage that firm conclusions about its effects were not yet possible. In another (Malawi), GBS was not successfully established during the evaluation period.

Provision of discretionary funds through national budget systems has produced systemic effects on capacity, and particularly PFM-related capacity, and these effects are government-wide in nature. GBS was not a panacea, but it strengthened government ownership and accountability, and in the short to medium-term, there were useful effects on allocative and operational efficiency of public expenditures, including aid; these were linked with medium to longer-term systemic effects on improving the links between policy and results.

There were enough positive spillover effects to suggest that GBS can be more than the sum of its parts. In particular GBS tends to enhance the country-level quality of aid as a whole, through its direct and indirect effects on coherence, harmonization and alignment, on partner government transaction costs, and on the overall efficiency of resource use. This makes GBS a particularly valuable addition to the array of aid instruments in use, and highlights the need to employ it as part of a strategy that takes account of the interplay between different aid modalities.

As regards poverty reduction, it was too soon for the ultimate effects of GBS inputs during the evaluation period to be manifest. Its initial effects have been mainly through supporting the expansion of basic public services. GBS is a vehicle that assists in implementing a PRS. Its ultimate effectiveness in reducing poverty is bound in with the quality of the PRS that it supports. Given the bias of early PRSPs towards the expansion of public services, most of the effects of GBS inputs so far are likely to have been on access to services, rather than income poverty and empowerment of the poor.

It is important not to overload the GBS instrument, but the Study found in all cases a capacity to learn from experience which suggests that GBS could become more effective, and have a broader scope, over time.

The evaluation also considered possible unintended effects of GBS, which need to be taken into account in GBS design. The Study did not find evidence of significant crowding-out of private investment nor of the undermining of domestic revenue effort. GBS did have a destabilizing effect in one country when basic conditions for disbursement were not met; but in other countries GBS design has been improved to limit short-term unpredictability. Corruption was a serious problem in all cases considered but there was no clear evidence that budget aid was affected more by corruption than other aid forms; whereas direct anti-corruption measures in GBS programs were not conspicuously effective, the work on public financial management was more significant in its practical effect on the environment for corruption.

More generally, the Study found that GBS as presently designed, is vulnerable to a number of risks, including political risks that threaten its ability to operate as a long-term support modality, and its sustainability depends on making it more resilient to these risks.

Source: Evaluation of General Budget Support: Synthesis Report, International Development Department, University of Birmingham, and Associates, May 2006.

D. Subnational Development Policy Lending

86. The Bank, under its Article of Agreement, can directly lend to political subdivisions of a member country provided that the national government guarantees the payment of principal, interest, and other charges on the loan. (However, under OP 7.00 the preferred choice of borrower for IDA is the national government, to ensure that the benefits of concessional lending accrue to the national government.) Subnational governments eligible under the policy include states in India and Mexico, provinces in Argentina and Pakistan, as well as republics and regions of the Russian Federation, among others. DPL to subnational governments requires both an appropriate macroeconomic policy environment on the national level, and appropriate fiscal framework on the particular state or province level, including its expenditure program and its fiscal relations with the central government. This section reviews experiences with subnational DPL.

87. ***Reforms on the Subnational Level.*** Policy-based lending to subnational governments is an important tool, which in recent years has been most frequently used by the Bank's South Asia Region (SAR).[92] Although, for reasons of timing, none of the DPOs in the sample for this report were subnational operations (except for one supplemental operation reviewed below), three subnational DPOs were approved for two provinces in Pakistan in June 2006 (see Annex B). These covered a policy reform credit (North-West Frontier) and education and irrigation policy reform operations in Punjab. SAR has a particularly rich experience with subnational lending in three Indian states (Andhra Pradesh, Karnataka, and Orissa) and the Pakistani provinces of Punjab and Sindh. Subnational lending to Indian states and Pakistani provinces, under the general oversight of the national government, offers scope for supporting policy reform for those areas in which responsibility has devolved to the decentralized level, which differ for India and Pakistan. In Pakistan, a national PRSC is supporting policy reforms in areas that remain the responsibility of the central government, with parallel sectoral operations addressing sector reforms on the provincial level. In India, more responsibilities have been delegated to the states, and the Bank supports policy reforms only on the state level. Subnational lending in large countries allows identification of provinces and states that have voiced interest in support and have formulated and own a program. For central governments, which may have limited power to influence the sovereign decision of subnational governments, World Bank involvement offers independent "third-party" support for state-level reform and at the same time provides a external financial incentive for maintaining subnational fiscal discipline.[93] Several important results have been achieved in the past with such support, including fiscal adjustment in Indian states and important improvements to education indicators in Pakistani provinces (also see below). Subnational lending also offers scope for further Bank engagement in large MICs, especially if the Bank can make resources available in local currency.

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92 Argentina, Brazil, and Mexico have made substantial use of subnational borrowing in the past as well. A subnational loan to the Brazilian state of Minas Gerais was approved in April 2006, albeit under previous adjustment lending policies. Past subnational lending to the Russian Federation was passed on in form of grants by the Federation to subnational entitities.

93 See also Shantayanan Devarajan and Shekhar Shah, "Budget Support and Poverty Reduction in South Asia" in *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*, Stefan Koeberle, Zoran Stavreski, and Jan Walliser (eds.), April 2006

E. DPL in Crisis, Post-Conflict, and Fragile States: Taking Calculated Risks

88. DPL in crisis and post-conflict countries offers an important tool for quick-disbursing financial support but it also comes with risks of failure. To allow for a rapid response, OP 8.60 makes certain policy exception for DPOs in crisis and post-conflict situations. To date, these policy exceptions have not been used, presumably because all of the post-conflict cases supported under DPOs had already re-entered into a regular relationship with the Bank with policy-based lending by the time the new operational policy was adopted. Among the 50 operations approved since September 2004 were four operations for post-conflict countries—Afghanistan, Democratic Republic of the Congo (DRC), Sierra Leone, and Timor-Leste, which met all the policy requirements. Two other operations were prepared for countries considered fragile, but not in a post-conflict environment (Lao PDR, Niger). This section reviews the rationale and some design aspects of DPOs in fragile states, drawing on guidance set out the related good practice note.[94]

89. ***Rationale and Good Practices.*** In cases of political transitions—rapid shifts in policy stance—the Bank in conjunction with other donors may be well-placed to provide quick support to help stabilize such transitions and support emerging reform processes. Governments in these cases, especially those emerging from a post-conflict situation with significant destruction of physical and human capital, often must meet high expectations of their populaces. Fast-disbursing DPO resources in situations of weak domestic revenue—a situation faced by all four post-conflict countries mentioned above—can help stabilize the macroeconomy and quickly reestablish some, even if rudimentary, function of the state (for example, by beginning to make salary payments on time and clear arrears), and thus can support rebuilding trust in government institutions. DPOs also carry the internal benefit of focusing programs on institutions and capacity building and enhancing the integrative feature of interventions. Experience shows that transitions are often fragile, and thus DPOs in these environments face multiple risks from possible collapse of a transition, insufficient information on social, economic, and political conditions, and weak fiduciary environments. However, research also shows that conflicts have large spill-over effects on neighboring countries, and thus any successes in supporting fragile states can have strong benefits beyond the country itself.[95] Transitions take time, and stabilization can rarely be achieved with a "one-off" engagement—with waning donor enthusiasm after years 4-5 of a transition being one of the dangers for sustaining progress. Thus, often a programmatic series of single-tranche operations, such as operations in Afghanistan and Timor-Leste, can help balance the need for ensuring sufficient progress with some flexibility in adapting triggers to newly emerging priorities in a fluctuating environment. Complex multitranche conditionality can be destabilizing if it leads to significant delays in financial assistance because of emerging capacity constraints or changing circumstances. Benefiting from sustained support, Sierra Leone now has a more stable environment and has greatly improved its CPIA rating and is entering a more mature phase of its transition under its first PRSP, a full CAS, and a multidonor budget support group. This progress comes after many years of donor assistance to accompany step-by-step governance, public financial management, and economic reforms. The environments in Afghanistan, DRC, and Timor-Leste remain fragile, with some recent setbacks. DPO engagement may also be beneficial in some slow-improving environments—for the set of DPOs

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94 *Development Policy Operations and Program Conditionality in Fragile States*, Good Practice Note, June 2005.

95 Lisa Chauvet and Paul Collier, *Development Effectiveness in Fragile States: Spillover and Turnarounds*, Oxford University, January 2004.

reviewed here such characterization applies more closely to countries that have low CPIA ratings but did not emerge from a conflict situation. Typically, in such "slow-improving" environments, DPO engagement would be limited to small volumes and have a fairly narrow policy reform focus on key governance constraints.

90. ***Donor Collaboration.*** Afghanistan and Timor-Leste present examples of strong donor collaboration around a common policy framework that has helped mobilize important financial support from the donor community and at the same time supported governments in setting priorities during the first transition years. Such frameworks, often referred to as transitional results matrices (in Timor-Leste now replaced with the results matrix of the consolidation support program) offer a single reference point for government and donor community as regards expected results and policy actions.[96] In both Afghanistan and Timor-Leste, the joint donor matrix includes security-related issues outside the Bank's mandate. Although these aspects were supported by other donors and not covered by the Bank's policy dialogue and support, their inclusion signals the comprehensive approach to managing post-conflict transitions. By contrast, support to DRC has benefited less from donor collaboration, as initial fast-disbursing Bank support enabled demobilization, arrears clearance, and some re-establishment of central government functions (including basic public financial management) without a joint donor framework. In all four countries under consideration, the DPO was twinned with a capacity-building project and technical assistance either by the Bank or other donors.

91. ***Fiduciary Considerations.*** Fiduciary issues are among the key concerns for donors in fragile states. Limited or nonexistent capacity to plan, execute, control, and audit budget spending makes it more likely that resources are being used outside the budget control environment or spent improperly. As discussed under the fiduciary section above, the Bank would typically include a strong PFM reform component in its operations to tackle weaknesses in PFM arrangements. It also can use additional fiduciary arrangements, such as dedicated deposit accounts, to monitor flow of funds, including foreign currency conversion into local currency equivalents, and verify compliance with the negative list. Agreeing on expenditures for which the Bank's resources may be used (positive list) is an option included in the policy, but, as noted in the discussion of fiduciary aspects, it triggers Bank procurement and safeguard policies. Use of a positive list would therefore need to be carefully considered against applying available investment lending instruments, including emergency recovery operations, which may be able to meet the same objectives in all but rare circumstances (for example, repayment of bridge financing used to clear arrears).[97] In general, there are limitations to reducing risks through additional fiduciary arrangements within the DPL instruments. However, weaknesses in fragile states can be addressed further through a variety of activities that can be included under the agreed program to improve budget monitoring and give greater assurances for effective use of budget resources. These measures include up-front agreements on budget allocations, frequent monitoring—involving donors and civil society—of budgetary releases and transfers, expenditure tracking surveys, and capacity reinforcement for control and auditing bodies. In Afghanistan and DRC, external fiduciary control bodies have also been used to verify procurement (Central Coordination Bureau in DRC) and compliance of expenditure with

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[96] See *An Operational Note on Transitional Results Matrices: Using Results-Based Frameworks in Fragile States*, United Nations Development Group and World Bank, January 2005.

[97] The Emergency Recovery Loans (OP 8.50) also allow for fast-disbursing components. The policy is currently under revision to modernize its provisions and it will be presented to Executive Directors for discussion at a later date.

fiduciary standards (Afghanistan Reconstruction Trust Fund) while programs to strengthen national procurement and internal control functions are being implemented.

F. Supplemental Financing and Other Options

92. The OP allows for a variety of options that were included under separate operational memoranda of prior adjustment lending policies. These include "special" DPOs for IBRD countries in crisis, debt and debt service reduction operations, deferred draw-down options (DDO) for IBRD borrowers, and supplemental operations. To date, neither special DPOs nor DDOs have been used since the inception of the new policy. This section describes briefly the experience with debt-reduction operations, DDOs, and supplemental financing.

93. ***Debt and Debt Service Reduction Loans and DDOs.*** Debt and debt service reduction loans as well as DDOs have been used rarely. Under DPL policies, two debt reduction operations were approved by IDA to reduce the net present value of debt for Cameroon and Honduras in the context of the HIPC Initiative. Debt and debt service reduction operations intend to help borrowers reduce their debt payments and free resources for investment through loan restructuring, equity conversion, or interest rate swaps, and they are not tied to many conditions, especially if a borrower is already implementing a program with Bank support. However, the option appears to suffer from the fact that borrowers with large interest rate spreads over IBRD terms, which could potentially benefit from loan restructuring to increase their fiscal space, typically have weaker macroeconomic and policy environments, at times limited involvement of the Bank under DPOs, and may face tighter credit risk constraints. Taken together, these factors appear to limit the pool of candidates for whom the option is attractive. Similarly, DDOs are used rarely; they have not yet been used under the new policy. Moreover, they have never been used by any of the "speculative grade" borrowers, for which the instrument was originally intended.[98] Instead, since its inception in 2001, the option has only been used by twice, and in both cases the countries were "investment grade" borrowers with fairly small risk of external shocks.[99] One can only argue why speculative grade countries with possibly important future risks that external markets may not meet their financing needs (for example, because of sudden capital flow reversals) find the DDO unattractive. Speculative grade borrowers may find commitment fees (1 percent, eligible for applicable waivers) too high for the insurance value of DDOs. They may also suspect that in their particular cases the policy provision requiring a certification of sound macroeconomic policies and satisfactory implementation of the program may lead to delays if such a draw-down was ever needed, even though that was not the case in the single incidence when a DDO was drawn down by an investment grade borrower.

94. ***Supplemental Financing.*** The Bank may provide supplemental financing to a program under implementation if the program continues to be implemented as agreed and the borrower cannot obtain additional financing from other sources in time or at reasonable costs. Supplemental financing offers, for countries that are already implementing a DPL-supported program, a possibility to obtain fast access to additional resources in case of shocks. A powerful and destructive earthquake hit Pakistan on October 8, 2005, which was implementing a program supported by fast-disbursing lending of the Bank. As part of the Bank's response package, two supplemental financing proposals were prepared for a total of $200 million and approved on an

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98 This rationale and target group for DDOs is noted in *Proposal to Introduce a Deferred Drawdown Option (DDO) for Use with IBRD Adjustment Loans* (R2001-0174), September 26, 2001.

99 A third DDO for an investment grade borrower was prepared but never submitted to the Board.

accelerated basis by the Board on October 25, 2005, supporting the government in addressing the most immediate needs. Supplemental financing can thus offer a quick means to relieve financial pressures on governments dealing with a sudden and unexpected external event affecting program implementation.

G. Results and Results Monitoring: Shifting Focus from Inputs to Outcomes

95. Since 2002 the Bank has begun to strengthen the results focus of its operations, both through the piloting and mainstreaming of result-based CASs and increased attention to results monitoring through measurable indicators on the level of individual operations.[100] The operational policy notes that "DPL operations set out the country's program being supported and the specific results for the operation expected from the resource transfer." In addition, the policy states "the program design includes contain measurable indicators for monitoring progress during implementation and evaluating outcomes on completion." This section reviews the results agenda from different angles by reviewing the use of results frameworks in DPOs approved under the new policy, discussing trends for results monitoring in ICRs for policy-based lending, and giving a snapshot of a few results actually being obtained in LIC environments with sustained policy-based support. Good practice in results management for DPOs was also set out in a good practice note.[101]

96. ***Challenges for Developing Results Frameworks for DPOs.*** Many teams continue to struggle with aspects of setting up results frameworks for DPOs, which are similar to challenges for results-based CASs.[102] These challenges first include choosing results and results indicators that are neither trivial (for example, just the action itself) nor difficult to influence over the medium term or measured only in very long intervals (for example, literacy rates or maternal mortality rates). Reviewed operations largely avoided trivial indicators but struggled with the balance between country-level goals and the "middle ground." A further constraint, especially in IDA countries, arose from weak statistical capacity, which limited the set of available indicators. A second frequent difficulty relates to institutional reforms, where it may be difficult to measure and quantify desired outcomes and where, typically, outputs (for example, to have functional payroll management system in place) are used more frequently than outcomes, which may require special surveys. A third challenges arises from multiple alignment issues between DPO results, CAS results, and—in IDA countries—PRS results. Theoretically, the PRS should guide the results-based CAS and DPOs, but if the quality of the PRS monitoring and evaluation framework is weak and/or includes unrealistic targets and indicators that are rarely collected, tensions may arise between the PRS, CAS, and DPO. Similarly, DPOs should support achievement of CAS results—but by the time a DPO is designed, CAS results may be outdated, requiring an adaptation of DPO targets. (With the mainstreaming of the result-based CAS, some good practice is emerging for aligning DPOs and CASs—both El Salvador and Guatemala Broad-Based Growth operations present good examples.)

97. ***Characteristics of Results Frameworks.*** All DPOs reviewed for this report included a results framework with some quantifiable results indicators—but much more could still be done to consistently include benchmarks for these indicators. Typically, indicators were included

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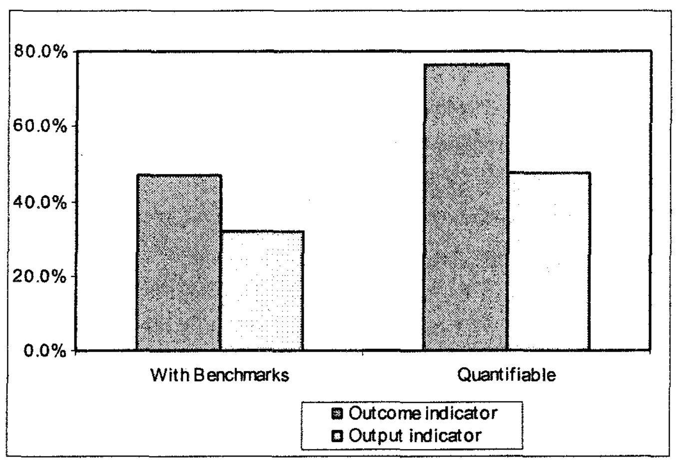
[100] *Results Focus in Country Assistance Strategies: A Stocktaking of Results-Based CASs* (R2005-0042), February 24, 2005.

[101] *Results in Development Policy Lending, Good Practice Note,* June 20, 2005.

[102] *Results Focus in Country Assistance Strategies: A Stocktaking of Results-Based CASs* (R2005-0042), February 24, 2005.

together with policy actions in a single policy matrix and set for either the end of the implementation period or of the program. Twenty-five percent of result indicators in reviewed DPOs were outcome indicators and 75 percent were output indicators. (Given the large share of institutional reform measures in DPOs, the number of qualitative output indicators in DPOs should not be surprising.) About 40 percent of outcome indicators were equivalent to country-level goals such as MDGs. In terms of measurability of progress over time, even though 76 (47) percent of outcome (output) indicators where quantifiable, only 47 (32) percent of outcome (output) indicators included benchmark values for the beginning of the program (see Figure 19). Although this finding constitutes significant progress over the 2001 Adjustment Lending Retrospective, which noted that only half of adjustment loans contained any monitoring indicators, it also points to areas needing continued attention.[103] Moreover, results frameworks showed great variation in the number of results indicators used—the average of 30 masks variation from 7 in a specialized sectoral DPO to 115 in a multidonor results matrix. Typically, results frameworks were more focused on core measurable outcomes when they were presented separate from the policy matrix. Although good practice suggests closely linking actions and indicators, there seems to be a temptation to define a separate results indicator for every policy action when both are combined in a policy matrix. Such overloading of the program with results indicators has limited value for measuring progress under the program if the indicators are not part of a functioning government monitoring and evaluation framework, are not regularly collected, and lack benchmarks. Instead, focusing on a core set of regularly available indicators may yield more value. An emerging good practice in PRSCs is annual reporting on changes in a core set of outcome indicators that are being monitored under the PRS. Rwanda's second PRSC is a good example in this regard, as is Burkina Faso's sixth PRSC.

Figure 19. Benchmarks and Quantifiable Indicators in Results Frameworks



Source: Staff calculations.

98. ***Building Results Management Capability.*** Many program documents mention monitoring and evaluation activities, but they do not always clearly distinguish whether these are general government activities, activities particular to the operation, or actions actively supported under the program. There is thus scope for additional clarity, as under the policy the borrower is responsible for monitoring and evaluation of the program, with the Bank assessing the quality of these systems. Most DPOs give limited attention to promoting or reinforcing country capacity for

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103 *Adjustment Lending Retrospective* (SecM2001-0215), April 2, 2001, p.88.

results management. Stakeholder participation in monitoring of DPO-supported programs also is generally weak, even though engaging a variety of stakeholders in the monitoring and evaluation of a policy reform through participatory M&E mechanisms and tools, such as citizen and community report cards, leads to more effective M&E systems. In case of weaknesses in these systems, it can be appropriate to support additional measures to reinforce these systems over time and to monitor improvements in their performance. Some operations include such measures. For example, the Peru Social Reform Loan supported measures for a new monitoring and evaluation system at the decentralized level; Ghana's PRSC supported the reinforcement of PRSP monitoring and evaluation; Tanzania's PRSC supported reinforcement of sectoral monitoring systems; Gabon's Natural Resource Loan supported actions to improve monitoring of logging; and Mali's Economic Policy and Public Finance Management Credit supported new budget monitoring indicators.

99. ***Quality of DPOs and Results Indicators.*** As noted, policy-based loans have consistently scored higher in satisfactory outcome ratings at exit than investment loans; most recently, 95 percent of policy-based operations evaluated in FY05 were found to have satisfactory outcomes. Some have ascribed such "bias" of policy-based lending to relatively short-term objectives if compliance with conditionality (for example, adoption of a law) was treated as satisfactory. However, as is the case for the set of DPOs discussed above, there is also evidence of a shift in operations and associated Implementation Completion and Results Reports (ICRs) from inputs and outputs toward short-, medium-, and long-term outcomes in assessing the quality of operations. As depicted in Figure 20, the use of inputs and outputs has decreased from 75 percent of indicators in ICRs for policy-based lending in FY02 to less than 60 percent in FY05. Forty percent of monitoring indicators in ICRs focus about equally on short-term outcomes, medium-term outcomes, and long-term country objectives. This shift follows closely on the more frequent use of programmatic lending, which has allowed teams to focus increasingly on results over a three to five year horizon. Jointly with IEG, efforts have been made during FY06 to further sharpen the results focus of programmatic operations and their ICRs. ICRs of programmatic series will evaluate the contribution of each operation in the series separately, but will do so in a single ICR at closing of the last operation in a series. The ICR then draws on the full information of how results indicators have evolved over the program.[104] The previous use of short, simplified ICRs for operations within a programmatic series frequently did not meet IEG's information needs on medium-term outcomes to comprehensively rate these operations. Experience with ICRs for programmatic DPOs will continue to be subject to close monitoring by IEG and Bank Management.

100. ***Assigning Results under DPO-supported Programs.*** One of the key questions frequently raised about DPOs is the contribution they make to country results. By construction, DPO funds are not assigned to any particular spending item whose impact could be monitored directly. Instead, funds are made available to finance a government's budget, which also is financed by tax revenue and possibly other financial partners. Thus, any measurable improvements in the lives of the population resulting from supported government policies are "shared" results and depend on the country's ownership of its own reform program with external financial support playing a supporting role. At the same time, once government programs are defined around a common set of objectives and indicators, it is sensible to monitor progress

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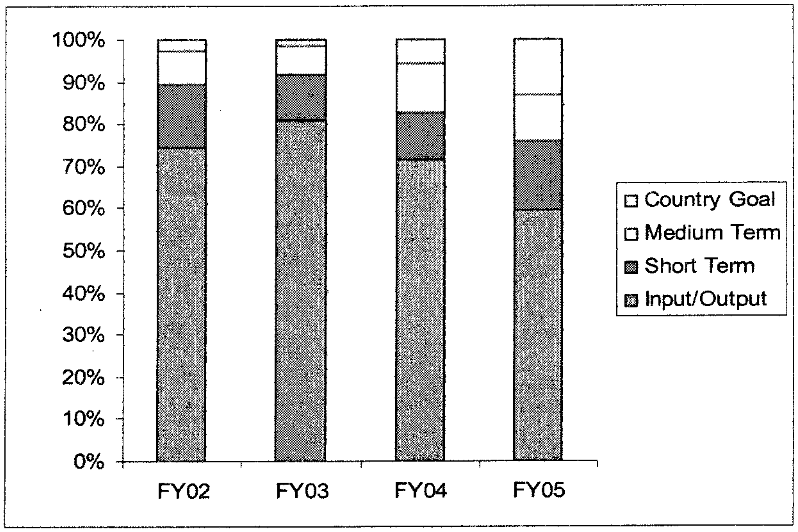
[104] *Implementation Completion and Results Reports for Programmatic Development Policy Lending*, joint note by James W. Adams and Vinod Thomas, March 23, 2006.

toward these objectives jointly with government and other financial partners, to judge whether supported policies are working and evaluate reasons for their success or failure. Such evaluations ultimately provide feedback into financing and instrument choices for the Bank. They also often enable more systematic tracking of country indicators that are linked with MDGs or to equivalent long-term country objectives than would likely be the case for sectoral investment operations with a narrower focus of intervention.

Figure 20. Type of Results Indicators Referred to in ICRs



Source: Staff calculations.

101. ***Results.*** Although policies for DPL were adopted too recently to permit discussion of concrete results associated with programs supported under only that instrument, it is possible to review progress made in countries that have received recurrent Bank support under adjustment lending and DPOs. In particular, a number of countries have now received three or more PRSCs without interruption and are therefore generally at the end of their first programmatic cycles. Without attempting to be comprehensive, this section reviews experiences with key service delivery indicators in a set of countries well-embarked in the PRSC process since inception of their programs. These indicators, intended to be a snapshot, are either part of or related to the MDGs and longer-term international development agenda, and at the same time illustrate country capacity in implementing scaled-up support for education and health.

- ***Burkina Faso.*** Recipient of six annual PRSCs since 2001, the country has seen a sharp increase in school enrollment rates since the beginning of the program.[105] PRSCs and other budget support flows have supported program implementation in the education sector alongside sector-specific operations, with budget support financing helping to compensate for disbursement delays in sector-specific support. Progress in the health sector in raising availability of budgetary funds and staffing has been slower, although targeted vaccination rates have been met. Recent survey results indicate that between 1998/9 and 2003 there were also improvements in higher-level indicators: poverty rates declined, literacy rates increased, and infant mortality rates

[105] Recent research has shown that the progress is exceptional by any historic standard. See Michael Clemens, *The Long Walk to School: International Education Goals in Historical Perspective.* Working Paper No. 37, Center for Global Development, March 2004.

declined. However, maternal mortality rates and malnutrition rates remain high.[106] (See Table 2.)

Table 2. Burkina Faso: Education and Health Indicators

	2001	2002	2003	2004	2005
Gross primary enrollment rate (for girls)	45.8 (38.4)	47.5 (41.0)	52.2 (46.3)	56.8 (51.0)	60.2 (54.5)
Gross primary admission rate (for girls)	46.9 (40.6)	52.9 (45.4)	66.0 (61.5)	69.9 (64.1)	69.7 (64.1)
Primary completion rate	n/a	n/a	26.7	32.8	34.9
Diphtheria/Tetanus (Measles) vaccination rate	64.0 (65.0)	69.1 (64.1)	78.3 (71.1)	88.4 (78.3)	96.2 (84.0)
Health facilities meeting staffing standards	74.4	76.6	76.8	75.8	n/a

Source: PRSC program documents.

- ***Ghana.*** Ghana has received four PRSCs since 2003. The early phase of the program was still influenced by macroeconomic stabilization concerns. However, notwithstanding early constraints on government spending, there are indications of improvements in education and health indicators, with increases in enrollment rates (for the first time since the early 1990s), availability of textbooks, assisted birth, and use of bednets for children. (Health also benefited from project support). It is too early to tell whether higher-level outcomes have already been affected. [107] (See Table 3.)

Table 3. Ghana: Education and Health Indicators

	2002/03	2003/04	2004/05
Gross primary enrollment rate (for girls)	81.3 (78.0)	86.3 (83.1)	87.5 (84.4)
Primary pupil textbook ratios	1:1.7	1:1.4	1:0.9
Supervised maternal deliveries (per 1000 births)	52.1	53.4	54.2
Percentage of children under 5 sleeping under insecticide treated bednets	8.0	20.0	24.5

Source: PRSC program documents.

- ***Pakistan (Punjab).*** Pakistan's Punjab province received three policy-based education sector credits since 2004. The program has substantively accelerated the increase in enrollment rates, and in absolute terms 20 percent more children are now in school than three years ago. The net primary enrollment rate increased from 45 to

[106] The first series of three PRSCs has been evaluated in a full ICR, and has had satisfactory outcomes. PRSC-4 was evaluated in a simplified ICR with satisfactory outcomes.

[107] PRSC-1 and 2 have been evaluated in simplified ICRs as having satisfactory outcomes. A fuller assessment will take place at the end of the series of three operations.

58 percent and from 43 to 55 percent for girls. The number of closed schools fell by 66 percent, and nonsalary resources for school districts increased by 100 percent on average.[108]

- ***Tanzania.*** Tanzania has received four PRSCs since 2002. Important progress was made under the program, also supported under an education sector adjustment loan, in raising school enrollment, with Tanzania now being close to reaching the enrollment MDG. Less progress was made in the health sector, although there is evidence for a doubling of outpatient visits.[109] (See Table 4.)

Table 4. Tanzania: Education and Health Indicators

	2001	2002	2003	2004
Gross primary enrollment rate (male/female)	86/84	101/96	109/102	112/108
Percent of student passing primary school leavers exam (male/female)	36/21	34/20	48/33	56/42
Diphtheria/Tetanus vaccination coverage	86	89	n/a	86
Number of outpatient visits per person/year	0.5 [a]/	n/a	n/a	1.24

[a] / 2000.
Source: PRSC program documents.

- ***Uganda.*** Uganda has received five PRSCs since 2001. Major progress in increasing school enrollment had already been made before the PRSC series began. Under the first PRSC series, more substantive improvements were achieved in vaccination coverage, health care provision, and extension of safe rural water coverage.[110] (See Table 5.)

Table 5. Uganda: Education and Health Indicators

	2001	2002	2003	2004
Net primary enrollment rate	87	85	87	89
Pupil teacher ratio	58	56	56	54
Diphtheria/Tetanus coverage	48	63	84	83
Outpatient visit per person/year	0.43	0.60	0.72	0.79
Rural water coverage	54	55	58	60

Source: PRSC program documents.

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108 The first operation was reviewed in a simplified ICR as having satisfactory outcomes. A fuller assessment will take place at the end of the programmatic series.

109 PRSC-1 and 2 have been evaluated in simplified ICRs as having satisfactory outcomes. A fuller assessment will take place at the end of the series of three operations

110 The first three PRSCs have been evaluated in a full ICR. The series was evaluated as having moderately satisfactory outcomes, with partial achievement of service delivery objectives.

- ***Vietnam.*** Vietnam received five PRSCs since 2001. The PRSCs supported a successful reform agenda, mostly focused on economic transformation. Nonetheless, the operations also monitored service delivery aspects and MDG indicators and showed that school enrollment rates during the program period increased sharply, most importantly on the level of lower secondary education. At the same time, infant and child mortality rates declined.[111] (See Table 6.)

Table 6. Vietnam: Education and Health Indicators

	Baseline (1998)	2004/2005
Net primary school enrollment rate	88	94
Net lower secondary enrollment rate	62	80
Infant mortality	37/1000	18/1000
Under-five mortality rate	48/1000	24/1000

Source: PRSC program documents.

As intended in the policy reform, Bank support in these countries has placed different emphases on different sectors and policy changes. Looking at a few consistently reported service delivery indicators and abstracting from many sectoral dimensions can only give an impression of the direction of change in these MDG-sensitive sectors. However, even such a crude measure shows that programmatic policy-based loans in IDA countries have supported governments that have made progress, albeit sometimes unevenly, in improving these indicators over a relative short period of time. In each country a somewhat different set of initial conditions prevailed and different instrument mixes were used.

V. Applying the Good Practice Principles for Conditionality

102. In September 2005, the Development Committee endorsed the findings of the 2005 Review of World Bank Conditionality and the associated Good Practice Principles (GPP) for the application of conditionality.[112] This chapter gives a first update on the application of these principles. Only few operations have gone through the full preparation cycle since the adoption of the GPPs, and thus this update mainly focuses on operations approved in the second half of FY06 (see the list in Annex A and B for relevant operations). Also, given the programmatic nature of many DPOs, those at the beginning of new programmatic series are particular important candidates for setting Bank support over the next three to four years and receive special attention below.

A. Roll-out and Dissemination of GPPs

103. The GPPs have been fully integrated into the Bank's internal training and good practice on DPL design, as well as the external outreach that took place since October 2005. After a range of specific events to share the GPPs with Regional task managers in the autumn of 2005, they

[111] PRSC-1 and 2 have been evaluated in ICRs as having moderately satisfactory outcomes. PRSC-3 was evaluated as having satisfactory outcomes in a simplified ICR. A fuller assessment will take place at the end of the series of five operations.

[112] *Review of World Bank Conditionality* (DC2005-0013), September 9, 2005.

now feature prominently in presentations and similar training events.[113] They are also being used as indicative frameworks in the internal corporate review process for DPOs. The corporate review was also used in the later part of FY06 to provide feedback on the design, size, and content of policy matrices, including on the use of benchmarks in the design of new programmatic series. In addition, interaction with government officials and financial partners, including during the events referred to in the introduction of this report, were used to communicate the Bank's approach to conditionality and receive further feedback on issues raised by the conditionality review. Particular emphasis was placed, drawing on good practice examples such as Mozambique, on the role of government-led accountability frameworks to foster harmonization, arrive at coherent and disciplined set of actions and indicators for monitoring progress, and ensure timely decisions on volume and timing of financial assistance. At different occasions, discussions were also held with civil society organizations and the press to clarify the Bank's approach on conditionality.

B. Ownership: Reinforce Ownership

104. The Bank, in deciding to extend DPOs, places strong weight on ownership. In addition, the GPPs suggest not only ascertaining but also reinforcing ownership in DPO preparation. In addition to government track record, the modalities of program development can be an important indicator for the in-country support of any DPO-supported government program. In this context, it is noteworthy that all DPOs in IDA-only and blend countries approved in the second half of FY06 built on a participatory PRSP.

105. ***Stepping Back When Needed.*** Beyond participatory processes, recently approved operations continue to offer evidence that the Bank can use conditionality in such a way that it does not interfere with internal consensus-building processes. In Guyana, which is characterized by a complex political economy situation and difficult relations between government and opposition, the program set out under the Bank's first PRSC turned out to be too ambitious. The recently approved new credit, rather than adding more conditions, is strategically focused on areas of broad consensus, such as fiscal transparency issues. Moreover, during credit preparation, opposition parties were actively consulted, with consent of the government, to ascertain that the supported agenda would not become hostage of "election politics" but would carry broader appeal. In some cases, the Bank also used analytic work to better understand the political economy of reforms, for example in Tanzania's PRSC-4. A further increase of such strategic works is being encouraged with support of different Networks.

106. ***Reinforcing Ownership with Analytic Work.*** The Bank recognizes the importance of upstream analytic work to feed into the decisionmaking process, although, as noted above, further improvements could be made. Ghana's PRSC-4 offers an example how PSIA has been applied strategically and upstream to inform several sensitive policy reform areas—for example the discussions on electricity tariff reform. In Turkey, the Bank over several years gave analytic support for the reform of public pensions, to help evaluate a number of options that could achieve the government's objective of long-term sustainability. Similar examples can be found in Tanzania (analytic work with local stakeholders on fiduciary aspects), Cameroon (multiyear work by government, Bank, and other donors on forestry management, with community participation), Mali (PSIA on cotton and oil price impact study), and other operations. Although still more could be done as regards use of PSIA work and its early disclosure, many recent

[113] For example, the biannual "DPL academy" and similar training events during PREM week.

operations give an account on how the broad set of analytic work supported by the government, Bank, or third parties has been used in the process of defining and evaluating policy options.

C. Harmonization: Agree Upfront on a Coordinated Accountability Framework with the Government and other Financial Partners

107. In all reviewed DPOs, the Bank agreed upfront on an accountability framework that specified how progress made under the government program would be evaluated. In practically all IDA-only countries with recurrent and frequent DPL, the Bank is part of a donor coordination framework, frequently in the context of a memorandum of understanding. (The most recent was established in April 2006 for budget support in Mali.) These frameworks serve to agree with government and other donors upfront on the basis for performance measurement under the supported program and typically use a coordinated policy matrix that presents a subset of the PRSP. In two countries, Tanzania and Uganda, coordination has or is being reinforced through Joint Assistance Strategies to support a second- and third-generation PRSPs, respectively. Other countries also include self-evaluation mechanisms of donor performance, such as the memorandum of understanding in Mozambique and Burkina Faso. Even where harmonization may be less formalized, the Bank is often agreeing upfront with governments on criteria that will serve to evaluate progress jointly under the program, such as for the financial sector reform in Egypt (jointly with AfDB, EC, and USAID) and Mexico (jointly with IADB).

D. Customization: Customize the Accountability Framework and Modalities of Bank Support to Country Circumstances

108. As the discussion in the previous section illustrates, the Bank has used DPOs to support a wide variety of different programs in different circumstances, ranging from pursuit of "gross national happiness" in Bhutan to sustainable and equitable growth in Brazil. Even within broader country groups, the focus, detail, and size of agreed frameworks to assess performance differ widely. The differences reflect both the preferences and priorities countries express in their own programs, the format of government programs, the place of accountability framework within the country dialogue and its use by government and financial partners, as well as the Bank's own selectivity in supporting reform programs. The Bank has also generally been flexible in adapting the timing of its reviews and disbursements to country circumstances—for example in accelerating the delivery of the second DPL for El Salvador.

109. ***Content of Conditionality and Sensitive Policy Areas.*** As regards particularly sensitive policy areas—such as privatization and trade reform—the aggregate numbers confirm that the content of conditionality remains within the trends identified during the 2005 conditionality review. Most conditions and trigger actions are concentrated in the area of public sector governance, with privatization and trade playing relatively small roles. Moreover, the limited number of privatization and trade reforms supported under the set of operations approved in the second half of FY06 respect government preferences and take into account government constraints. In Mali, the 2006 DPO focuses on the implementation of the price-setting rule for raw cotton to avoid destabilizing public finances. The government's medium to long-term strategy also includes the sale of parts of the cotton company to new investors, consistent with successful examples of sectoral reforms in the subregion. However, given uncertainties surrounding the exact timing of any future transactions, the agreed accountability framework focuses on preparatory actions, such as the definition of future structure of the sector. In Egypt, the supported privatization of the Bank of Alexandria comes after many years of consideration and consensus building within the country. In Vietnam, trade reform (including World Trade

Organization accession) and restructuring of state-owned enterprises are at the front of the government's own broad agenda of economic modernization. In other cases, where the government is not interested in changing any ownership structure, the Bank supports important work as part of the public enterprise restructuring process, such as the environmental and social aspects of the restructuring of Guyana's Skeldon sugar factory.

E. Criticality: Choose Only Actions Critical for Achieving Results as Condition for Disbursement

110. DPOs processed in FY06 have continued to give clear indications of the actions considered critical by the Bank, both in highlighting prior actions for disbursements and any future actions expected to be critical to determine Bank disbursements (tranche release conditions or triggers in programmatic series). It has also become common practice in programmatic series to report on how triggers have been converted into prior actions and to set out transparently any reasons for deviating from originally established plans. At the same time, there is no evidence that beyond their use as broad gauges of progress, benchmarks (i.e., policy actions not considered critical and binding) have been used to hold up lending or add new conditions (i.e., although programmatic series follow up on the implementation of benchmarks, their nonimplementation does not commonly cause reductions in credit amounts or delays in disbursements).

111. ***Presentation of Program and Size of Policy Matrices.*** Chapter 2 summarized recent trends in conditionality. The average number of conditions per loan has remained virtually unchanged during FY06. In IBRD-eligible countries the trend of declining number of benchmarks continued, whereas in IDA countries benchmarks increased slightly to 32 per operation, up from 30 in FY05. As noted above, these trends reflect the increasing use of small policy matrices in many IBRD countries, where these operations summarize only critical actions of the program rather than give a complete account of it in Bank documents. This trend is exemplified in the operations approved for Mexico in the second half of FY06. On average, such change does not yet seem to be occurring in IDA countries, for several reasons. (This is an issue highlighted as a concern by CSOs, which see benchmarks as part of Bank conditionality.) First, many programmatic series already anticipated benchmarks for follow-on operations and remained within the same original operational framework, thus repeating already anticipated program actions (triggers and benchmarks) in matrices of follow-on operations. Second, the challenge remains how to best present multisectoral interventions in circumstances where the PRSP or sector strategy processes do not yield monitorable action plans. In these cases, joint donor or Bank support may still end up being the focal point of the definition of "implementation road maps" in the context of defining accountability frameworks.[114] Beyond the aggregate numbers, it is also important to recognize the evolution that is taking place in several jointly supported budget support programs in IDA countries during FY06. For example, with PRSC-5, Uganda's documentation no longer contains a "Bank policy matrix" but draws selectively on

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[114] Some argue that it would be too much to expect the PRS process to deliver performance assessment frameworks that satisfy donor needs, that donors should recognize the tensions between recipient country and donor interests and find out what part of policy action monitoring can produce useful results and apply selectivity to conditions/actions based on such evidence. See David Booth, Karin Christiansen, and Paolo de Renzio "Reconciling Alignment and Performance in Budget Support Programs," in *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*, Stefan Koeberle, Zoran Stavreski, and Jan Walliser (eds.), April 2006.

actions in the PRS matrix developed during 2004-05. Thus, benchmarks no longer play a role as the Bank only highlights policy actions that constitute prior actions or triggers. In Tanzania, the experience with an unwieldy performance assessment framework resulted in a complete redesign of the framework with the adoption of the second PRSP, and it now is focused on a few selective actions, sector review outcomes, and selected outcomes. The Bank no longer uses a separate matrix with "benchmarks." In Guyana, which also began a new series of two operations, the Bank now also uses a two-page matrix, recognizing that previous designs had been too broad and complex. Yet, in other cases, under government leadership and representing government preferences for managing both the PRS process and donor relations, policy matrices agreed with donors have remained larger and a more central implementation and monitoring tool of the government. For example, in Ghana the multidonor budget support matrix for the second PRSP continues to contain about 40 benchmarks. Overall, these findings suggests that further monitoring by the donor community of the use of actions outside the core set of conditions is warranted to ascertain that they do not add to the complexity or burden of Bank-supported programs. Use of benchmarks in IDA operations approved in the second half of FY06 was at 28, on average, significantly below the level in the first half of FY06—but it is too early to tell whether this trend is stable.

F. Transparency and Predictability: Conduct Transparent Progress Reports Conducive to Predictable and Performance-Based Financial Support

112. The Bank continues to strive for performance-based and predictable support in the context of joint donor reviews, and generally it has a good record under PRSCs. As laid out earlier, joint donor frameworks increasingly fix timetables for reviews in such a manner that financing and disbursement decisions are firmed up before the beginning of the government's budget year, enhancing the effectiveness of the budget instrument to fully implement planned priority expenditure. Mozambique, and more recently Tanzania, present examples where the Bank has explicitly adjusted its own calendar to accommodate review cycles agreed with the government and other donors. The Bank has also continued to reduce loan amounts, where warranted by shortfalls in performance, although it fell short of doing so at an early date, and continued due diligence in this respect is still needed. The increasing combined use of policy actions and results indicators in accountability frameworks has also given rise to demand for more focused and concise annual reporting on key indicators, and systematic reporting on higher-level indicators through surveys (e.g., poverty rates, maternal and child mortality) at periodic intervals. Regarding transparency, all conditions, triggers, and decisions on lending volumes are publicly available through disclosure of program documents.

VI. Conclusions and Proposed Follow-up

113. The new operational policy for development policy lending has emerged as a robust and flexible framework that is adaptable to a variety of country circumstances and that incorporates a strong focus on results in supporting government-owned programs. The breadth of supported policy areas and the differences across supported countries are large, and underscore the flexibility of the instrument, and its ability to address countrywide issues. Consistent with the policy, the Bank has been selective, using the instrument predominantly in stronger policy environments, with occasional interventions in weak environments offering an opportunity to engage in an emerging reform process. The currently available evidence from CPIA ratings and quality-at-exit ratings for investment and policy-based lending operations suggests that the Bank's instrument choices in different policy environments have been consistent with

maintaining high quality. Across the board, borrowers voiced their appreciation for the instrument and confirmed its ability to accompany complex medium-term reform programs. A broader set of analytic work on which this report draws also indicates that in low-income countries budget support appears to be having the intended results and can be an efficient, effective, and sustainable way to support PRS implementation and harmonize donor assistance. On the results front, the evidence shows that over the past years indicators to measure the achievement of development objectives have moved increasingly toward outcomes and all DPOs are including a results framework. A snapshot of social indicators in six low-income countries with recurrent DPO engagement identifies some positive results on the ground achieved under the supported government programs.

114. ***Conditionality***. The report reaffirms the trends of the 2005 Review of Conditionality regarding number and content of conditions. It also highlights the usefulness of the good practice principles in guiding Bank operations. Recently approved DPOs broadly follow the principles on ownership, harmonization, customization, criticality, predictability, and transparency.

115. ***Policy Application.*** Underpinned by the mandatory corporate review process, policy compliance has been high even in areas where the policy sets new expectations and standards. Areas discussed in the retrospective in this regard are:

- All documents describe the underlying macroeconomic policy framework and report consistently on IMF views in a standard IMF Relations annex.
- DPOs make systematic use of a wide range of analytic underpinnings.
- A large majority of programs supported by DPOs are underpinned by participatory processes, with almost half of DPOs actively reinforcing participatory and consultative processes.
- In line with the policy, more than 90 percent of operations discuss distributional impacts and where warranted include a discussion of how such poverty and social impacts can be addressed under the program.
- Reflecting the policy requirements, virtually all operations include a determination of likely significant effects of the supported program on the environment, forestry, and natural resources and, where warranted, include a discussion of likely significant effects and their treatment.
- Under the new policy, operations draw on a consistently strong analysis of PFM systems, usually building on rich analytic work; actions to address identified weaknesses figure prominently in programs supported by the Bank; and operations contain a clear description of disbursement arrangements.
- DPOs offer enhanced opportunities for donor harmonization and coordination, in particular in LICs, where they tend to catalyze donor assistance and policy dialogue and help reduce transaction costs for governments.
- DPOs make consistent use of results frameworks, typically setting out a mix of qualitative and quantitative indicators to measure progress; there has been a visible shift in results monitoring (including ICRs) away from inputs and toward outcomes; and positive trends in key service delivery indicators can be observed in a group of countries under a series of programmatic operations.

116. ***Areas for Follow-up.*** Several areas also emerge where the Bank plans to follow up through (a) revisions to existing good practice notes as warranted; (b) additional focus of the corporate review process in these areas; and (c) efforts by Regions and Networks in improving quality of analytic work and identifying relevant analytic work upstream to further improve policy implementation:

- ***Macroeconomic issues.*** The quality of macroeconomic expositions could more be consistent. Macroeconomic projections could expand beyond their current focus on the short term to better relate macroeconomic developments and policies to debt sustainability issues provided that underlying macro-analytic work expands such analysis.

- ***Growth.*** Growth analysis could better identify a limited set of priorities for growth (rather than a large set of policy areas) and link findings to priorities supported under DPOs.

- ***Participation and consultation.*** Participation and consultation processes used by governments to define their programs should be documented more systematically in program documents, and further emphasis given in guidance on how to improve the practice of participation.

- ***Poverty and social impact analysis.*** Despite high levels of operational policy compliance, the quality and disclosure of PSIA engagements could be strengthened. PSIA work could be more strategically incorporated upstream into program preparation—with governments in the lead. Disclosure of PSIA work could be better documented, analytic work could be better linked to conclusions about a potential impact of the program, and more use could be made of already existing analytic work.

- ***Environment, forest and natural resource issues.*** Although policy compliance is high, quality of environmental work would benefit from screening for likely significant effects further upstream, giving more room for analytic considerations early in the program or the CAS, helping to expand the foundations for judgments made on likely significant effects of supported policies. Progress in preparing strategic analytic work (CEAs) for countries that make heavy use of DPOs should be tracked closely.

- ***Fiduciary Issues and Public Financial Management Aspects of Governance.*** Progress in PFM (including procurement) should be tracked more systematically and comprehensively, including with PEFA indicators. The Bank's judgment on strength of PFM programs, their timely implementation, as well as residual fiduciary risks could be discussed more systematically in program documents. The use of additional fiduciary arrangements should be clarified and match the analysis of existing fiduciary weaknesses and remaining fiduciary risks.

- ***Results.*** Additional efforts need to be made to strengthen results frameworks by systematically including benchmark values and focusing results indicators on a manageable set of readily available indicators—aligned with PRS and CAS results matrix—that can be used to track progress in program implementation. More attention could be given to actively reinforce monitoring and evaluation capacity under supported programs.

- ***Conditionality.*** The size of policy matrices and number of benchmarks should be monitored carefully and further incentives given to governments to take the lead in setting out the details of their policy program, obviating the need for such detail in Bank documents.

A. Issues for Board Discussion

117. Do Executive Directors agree that the 2004 Operational Policy on Development Policy Lending has emerged as a robust framework for guiding the Bank's policy-based lending?

118. Do Executive Directors concur with the plans of this retrospective as regards further follow-up to strengthen policy implementation in the areas noted above?

119. Do Executive Directors consider the existing Operational Policy and the findings of this retrospective to be a consistent and solid basis for preparing an outline of a framework for the assessment of readiness of recipient countries to make productive use of DPOs, to be endorsed by IDA Deputies at the IDA Mid-Term Review?

120. Do Executive Directors of IDA agree that satisfactory progress has been made in implementing the recommendations of the 2005 Review of World Bank Conditionality?

DEVELOPMENT POLICY OPERATIONS APPROVED THROUGH MARCH 31, 2006

Country	Project ID	Name	Approval date	IBRD	IDA
Ethiopia	P077749	PRSC-2	11/30/2004		130
Peru	P083968	Programmatic Social Reform Loan IV	12/07/2004	100	
Indonesia	P092663	First Development Policy Loan	12/21/2004	300	
Pakistan	P083079	Banking Sector Development Policy Loan and Credit	01/13/2005	200	100
Honduras	P083311	First Programmatic Financial Sector DPC	02/22/2005		25
El Salvador	P093133	Programmatic Broad-Based Growth DPL	02/22/2005	100	
Colombia	P084762	Programmatic Fiscal and Institutional DPL	03/22/2005	100	
Lao PDR	P075287	PRSC-1	03/31/2005		10
Honduras	P094450	Debt Relief Credit	04/05/2005		67
Burkina Faso	P078995	PRSC-5	05/03/2005		60
Niger	P083275	Public Expenditure Reform Credit	05/24/2005		40
Bolivia	P091365	Social Sector Programmatic DPC	05/26/2005		15
Brazil	P086525	Programmatic Fiscal Reform – Social Security Reform	06/02/2005	658.3	
Uruguay	P095028	Social Program Support	06/09/2005	75.4	
Brazil	P078716	Programmatic Loan for Sustainable and Equitable Growth: Housing Sector Reform	06/14/2005	502.5	
Sierra Leone	P083477	Economic Rehabilitation and Recovery Grant	06/16/2005		15.0
Morocco */	P083746	Housing Sector DPL	06/30/2005	150	
Vietnam	P086360	PRSC-4	06/30/2005		100
Ukraine	P079316	DPL	07/05/2005	251.3	
Guatemala	P094365	Broad-Based Growth DPL	07/07/2005	100	
Madagascar	P083326	PRSC-2	07/12/2005		80
Ghana	P078619	PRSC-3	08/25/2005		125
Mexico	P079748	Environment DPL II	09/06/2005	200.5	
Tanzania	P087256	PRSC-3	09/08/2005		150
Mozambique	P056201	PRSC-2	09/13/2005		120
Georgia	P088820	PRSO	09/15/2005		20
Timor-Leste	P088181	Consolidation Support Program	10/11/2005		0.5

Pakistan	P098866	North-West Frontier Supplemental	10/25/2005		50
Pakistan	P098867	PRSC-1 Supplemental	10/25/2005		150
Colombia	P094301	Business Productivity and Efficiency	10/27/2005	250	
Macedonia	P090303	Programmatic DPL	10/27/2005	30	
Rwanda	P092944	PRSC-2	11/10/2005		55
Gabon	P070196	Natural Resource Management	11/15/2005	15	
Mexico	P089852	Affordable Housing	11/29/2005	200.5	
Bangladesh	P090832	Development Support Credit III	12/01/2005		200
Serbia and Montenegro	P089116	Serbia Private Sector and Financial DPL	12/06/2005		55
Peru	P089826	Third Programmatic Decentralization and Competitiveness	12/08/2005	150	
Congo (DRC)	P091990	Transitional Support for Economic Recovery	12/08/2005		90
Afghanistan	P090829	Programmatic Support for Institution Building-2	12/13/2005		80
El Salvador	P094146	Second Broad-Based Growth DPL	12/13/2005	100	
Indonesia	P096594	Second DPL	12/15/2005	400	
Morocco	P088243	Financial Sector DPL	12/15/2005	200	
Uganda	P090881	PRSC-5	01/17/2006		135
Armenia	P093459	PRSC-2	01/19/2006		20
Mali	P083799	Economic Policy and Public Finance Management	01/19/2006		25
Cameroon	P070656	Forest and Environment DPL	2/28/2006		25
Mexico	P097159	Finance and Growth DPL	03/02/2006	501.3	
Bangladesh	P084567	Education Sector Development Support II	03/07/2006		100
Mexico	P098299	Competitiveness and Growth	03/14/2006	300.8	
Morocco	P089677	Second Public Administration	03/23/2006	120	
Senegal	P091051	PRSC-2	03/28/2006		30

*/ This operation was inadvertently omitted from the DPL sample covered under the review since it was originally not recorded as a DPO in SAP.

ADDITIONAL DEVELOPMENT POLICY OPERATIONS APPROVED IN Q4 OF FY06

Country	Project ID	Name	Approval date	IBRD	IDA
Guyana	P078703	PRPMO	04/27/2006		9.6
Cameroon	P100965	Debt relief	04/27/2006		31.5
Lao PDR	P096635	PRSO-2	04/27/2006		8
Tanzania	P095509	PRSC-4	05/09/2006		200
Bhutan	P078807	Development Policy Grant I	05/25/2006		15
Cape Verde	P090875	PRSC-2	06/01/2006		10
Pakistan	P090689	North-West Frontier Province DPC-1	06/01/2006		90
Pakistan	P096962	Punjab Irrigation DPL-1	06/01/2006	100	
Pakistan	P097636	Punjab Education DPC-3	06/01/2006		100
Brazil	P095675	Second Programmatic Broad-Based Sustainable and Equitable Growth	06/06/2006	600	
Niger	P096411	Rural and Social Sector Policy Reform Credit	06/13/2006		50
Egypt	P088877	Financial Sector DPL	06/15/2006	500	
Ghana	P095730	PRSC-4	06/15/2006		140
Burkina Faso	P078996	PRSC-6	06/20/2006		60
Vietnam	P086361	PRSC-5	06/22/2006		100
Turkey	P071052	PPDPL-1	06/29/2006	500	

PARTICIPATION AND PSIA IMPLEMENTATION ISSUES BY OPERATION

	Participation					PSIA			
	Participation in national development strategy informs DPL	Specific consultations or participation for DPL	Participation in DPL monitoring	Participation in DPL content	Relevant analytic work, made available to the public	Poverty and Social Impact of some reforms supported by DPL addressed in PD	PD summarizes relevant analytical knowledge	Existing country systems to address negative or positive effects identified	Gaps in analysis or country capacity addressed before or during DPL
AFR									
Ethiopia PRSC-2	X			x		X	x	x	
Madagascar PRSC 2	X			x		X	x		x
Ghana PRSC-3	X			x	x	X	x	x	x
Burkina Faso PRSC 5	X			x		X	x		
Niger Pub Expend Reform Credit	X				x	X	x		x
Sierra Leone ERRG-4	X					X	x		x
Tanzania PRSC-3	X	x		x	x	X	x		
Mozambique PRSC-2				x		X	x		
Congo DRC Transitional Support Credit	X			x		X			
Rwanda PRSC-2	X			x		X	x		
Gabon Natural Resource Management			x	x		X	x	x	x
LCR									
Bolivia Social Sector Programmatic Credit -2	X			x	x	X		x	
Brazil Programmatic Fiscal Reform – Social Sector Reform Loan						X	x		
Brazil Program Growth for Housing		x		x		X	x	x	x
Uruguay Social Program Support Loan DPL		x		x		X	x		
Peru DPL-3II	X	x				X	x		
Peru PE-Programmatic Social Reform Loan-4V	X	x		x	x	X	x	x	
El Salvador Program. Broad Based Growth-I		x				X			x
El Salvador SV Program. Broad Based Growth-2I		x			x	X	x	x	x
Honduras Financial Sector Reform		x		x		X			
Honduras Debt Relief Credit		x				X			
Colombia Business Product and Efficiency I						X			
Colombia Prog Fiscal and Institutional-3I	X					X		x	
Mexico Housing & Urban Pov. Red.-2I	X			x		X	x	x	
Mexico ENVDPL-2I		x		x		X		x	x
Guatemala Growth DPL-1						X	x		x

EAP									
Lao PDR PRSC-1	X			x			x		x
Vietnam PRSC-4		x		x		X	x	x	x
Indonesia First DPL	X	x	x			X			
Indonesia DPL-2I					x	X	x	x	x
Timor-Leste CSP-1		x	x	x		X			
MNA									
Morocco FINANCIAL SECTOR DPL		x							
SAR									
Afghanistan Prgr. Support for Inst. Bldg-2I 2nd PSIB						X	x		
Pakistan Banking Sector Dev. Policy Credit									
Bangladesh Development Support Cr.-3	X			x					
ECA									
Ukraine DPL-I			x			X	x	x	x
Georgia PRSO	X			x		X	x		x
Macedonia PDPL			x			X	x		
Serbia and Montenegro PFDPL						X		x	x

KEY ANALYTIC UNDERPINNINGS REFERENCED IN DEVELOPMENT POLICY OPERATIONS

Country	Project ID	Name	Analytic Underpinning
Ethiopia	P077749	PRSC-2	Poverty Assessment Country Economic Memorandum (CEM) Sector Report on Education Sector Report on Health Investment Climate Assessment (ICA) Gender Assessment CPAR Joint Fiduciary Assessment
Peru	P083968	Programmatic Social Reform Loan IV	PER CFAA CPAR Health Report Education Report Pension Report Poverty Assessment Governance Accountability Study
Indonesia	P092663	First Development Policy Loan	PER Development Policy Review (DPR) Fiduciary Assessment CPAR Trade diagnostics Debt Management Capacity ICA
Pakistan	P083079	Banking Sector DPO	CFAA
Honduras	P083311	First Programmatic Financial Sector DPC	FSAP CFAA CPAR
El Salvador	P093133	Programmatic Broad-Based Growth DPL	CEM PER CFAA CPAR Regional CAFTA analytic work
Colombia	P084762	Programmatic Fiscal and Institutional DPL-3	CFAA PER CPAR
Lao PDR	P075287	PRSC-1	CPAR Poverty Study CFAA PER CEM PSIA (PER, CEM) Poverty Assessment ICA Trade Diagnostics Education and Health Assessment
Honduras	P094450	Debt Relief Credit	
Burkina Faso	P078995	PRSC-5	PER Poverty Assessment CFAA CPAR

			ICA Gender Assessment Risk and Vulnerability Assessment Accountability Assessment and Action Plan
Niger	P083275	Public Expenditure Reform Credit	PER CFAA CPAR CEM (planned) Poverty Assessment (planned) PSIA of revenue-enhancing measures
Bolivia	P091365	Social Sector Programmatic DPC	PER CFAA/CPAR Health Education Water and Sanitation Poverty Assessment
Brazil	P086525	Programmatic Fiscal Reform – Social Security Reform	Pension ESW Poverty Assessment CFAA
Uruguay	P095028	Social Program Support	PER (Health Policy Note) Poverty Assessment CFAA
Brazil	P078716	Programmatic Loan for Sustainable and Equitable Growth: Housing Sector Reform	Housing sector policy notes CFAA
Sierra Leone	P083477	Economic Rehabilitation and Recovery Grant	Poverty Assessment PER CFAA CPAR
Vietnam	P086360	PRSC-4	PER CFAA CPAR CEA
Ukraine	P079316	DPL	PEIR CFAA CPAR PSIA
Guatemala	P094365	Broad-Based Growth DPL	Poverty Assessment CEM ICA PER CFAA-CPAR Regional CAFTA Study PSIA of tax reforms
Madagascar	P083326	PRSC-2	CEM CFAA DPR Public expenditure and financial accountability (PEFA) Poverty Assessment PER (several) CPAR ICA

			PSIA on health Integrated Framework study Health Sector Note
Ghana	P078619	PRSC-3	Poverty Update CFAA CPAR PFM Update
Mexico	P079748	Environment DPL II	PER CFAA Infrastructure PER Environmental performance review
Tanzania	P087256	PRSC-3	CEM Poverty Assessment PSIA of the reform of crop boards PEFAR CPAR CFAA
Mozambique	P056201	PRSC-2	Poverty Assessment CEM PER CFAA CPAR FSAP ICA PSIA on school fees
Georgia	P088820	PRSO	PER CPAR CFAA Poverty Assessment
Timor-Leste	P088181	Consolidation Support Program	CEM PER CPAR Poverty Assessment Sector Studies (education)
Pakistan	P098866	North-West Frontier Supplemental	PSIA
Pakistan	P098867	PRSC-1 Supplemental	PSIA
Colombia	P094301	Business Productivity and Efficiency	CEM Labor Market study FSAP CFAA
Macedonia	P090303	Programmatic DPL	CEM CFAA CPAR FSAP Judicial Reform Assessment
Rwanda	P092944	PRSC-2	CFAA CPAR FSAP PSIA on tea sector ICA Sector studies (health, water, education, energy, transport)
Gabon	P070196	Natural Resource	Studies on biodiversity, forestry, timber sector,

		Management	institutional strengthening Socio-environmental impact assessment Fiduciary assessment (CFAA in progress)
Mexico	P089852	Affordable Housing	CFAA Urban Strategy Low Income Hosing Study Urban Poverty Report
Bangladesh	P090832	Development Support Credit	CEM CFAA CPAR Trade study ICA Infrastructure study Public enterprise study PER Poverty Assessment ROSC Institutional and Governance Review
Serbia and Montenegro	P089116	Serbia Private Sector and Financial DPL	CEM Financial Sector Note Private Sector Note ICA PEIR CFAA (and fiduciary assessment update) CPAR FSAP
Peru	P089826	Third Programmatic Decentralization and Competitiveness	CEM PER CFAA CPAR ICA Sector studies
Congo, DRC	P091990	Transitional Support for Economic Recovery	CFAA CPAR Institutional review Forest Sector review Health sector
Afghanistan	P090829	Programmatic Support for Institution Building	Public Finance management review PEFA indicators PER
El Salvador	P094146	Second Broad-Based Growth DPL	CEM PER CFAA CPAR
Indonesia	P096594	Second DPL	Petroleum PSIA Development Policy Review (DPR) Fiduciary Assessment CPAR Trade diagnostics Debt Management Capacity ICA
Morocco	P088243	Financial Sector DPL	FSAP CFAA
Uganda	P090881	PRSC-5	CEM PER

			CFAA CPAR
Armenia	P093459	PRSC-2	CEM PER CPAR CFAA Sector work
Mali	P083799	Economic Policy and Public Finance Management	CFAA CPAR CEM ICA PSIA on cotton
Cameroon	P070656	Forest and Environment DPL	Forest sector expenditure review Forest sector taxation review CFAA CPAR PEFA indicators
Mexico	P097159	Finance and Growth DPL	Competitiveness and Trade AAA Report on Observation of Standards and Codes (ROSC) CFAA
Bangladesh	P084567	Education Sector Development Support	PER CFAA Poverty Assessment Education Sector review Country Environmental Analysis (CEA)
Mexico	P098299	Competitiveness	ICA PER CFAA
		Second Public Administration	CFAA
Senegal	P091051	PRSC-2	CFAA CPAR PER ROSC ICA

GOOD PRACTICE IN LINKING DPOS TO ANALYTIC UNDERPINNINGS

Box A: Links between DPL and prior analytical and fiduciary work

	A. Analytical Reports – Recommendations [2]	Links to DPL actions
Poverty Study (2003)	1. Maintain macroeconomic stability, with a careful plan for allocating public expenditures and strengthening tax collection.	**I.1 and II**
	2. Improve climate for growth, including governance and public sector mgmt.	**III**
	3. Reduce transaction costs in accessing markets by expanding and improving the road network, especially in rural areas.	*Rural roads proj.*
	4. Expand land titling and land markets programs.	**I.2 +** *Land admin. proj.*
Investment Climate Assessment (2004)	1. Facilitate commerce through Central American customs union and reducing operational times of ports and airports.	**I.2 +** *Tax admin. proj.*
	2. Reduce red tape in registering new businesses and general operating procedures.	**I. 3 +** ***Competitiveness proj.***
	3. Improve public infrastructure through the promotion of private sector participation and reform of the regulatory frameworks.	**I. 4**
	4. Improve access and lower costs of financial services, especially for SMEs.	**I.5 +** ***Financial TA proj.***
	5. Promote better education and training services.	**II.2 +** *Educ. proj.*
Country Economic Memorandum (2005)	1. Consolidate macroeconomic growth, while improving fiscal discipline and strengthening the tax base.	**I.1**
	2. Promote trade expansion, reduce trade barriers and enhance market access for exports, especially by taking advantage of CAFTA and regional integration.	**I.2**
	3. Improve investment climate by simplifying regulations and strengthening the current efforts under the agency for the promotion of investment.	**I. 3 +** *Tax admin. proj.*
	4. Facilitate participation of private investors in infrastructure.	**I. 4**
	5. Reforms that improve overall access to credit (legislation related to non-bank financial intermediaries and secured transactions, including Cadastre law).	**I.5 +** ***Financial TA proj.***
	6. Promote progressive public spending, esp. human capital and rural infrastructure.	**II.2 +** *Educ. Proj*
Public Expenditure Review (Draft report, 2005)	1. Improve and increase level of public spending through fiscal savings generated by greater efficiency gains, but mostly by increased taxation.	**II.**
	2. Foster effectiveness of public spending in priority sectors like health, education and housing	**II.2 +** *Ed. and Health/nut. Proj.*
	3. Enhance municipal capacity to provide basic services, especially through higher local tax collection and increased accountability.	**II.1 + III**
	B. Fiduciary Reports – Recommendations	**Links to DPL actions**
Country Fiduciary Assessment (CFAA/CPAR) (Draft report, 2005)	1. Continue expanding the integrated financial management system (SIAF) to decentralized agencies and municipalities.	**III Annex 6**
	2. Continue expanding use of the procurement information system (Guatecompras), under a comprehensive strategic plan for e-procurement.	
	3. Enhance quality of budget and fiscal reporting, and compliance with rules for budget execution accounting.	
	4. Continue enhancing transparency of municipal fiscal information.	
	5. Strengthen the government procurement policy and oversight functions, and modernize implementation tools.	
	6. Prepare and execute action plans to address results of institutional assessments of internal controls.	
	7. Strengthen the external audit function with, inter alia, effective use of the government auditing system (SAG) in planning and execution of financial audits.	

Source: Guatemala First Broad-Based Growth DPL.

GOOD PRACTICE FOR INTEGRATING CPAR ACTION PLANS INTO SUPPORTED PROCUREMENT REFORM

Colombia – Third Programmatic Fiscal and Institutional Loan

The prior action and several other planned actions relating to procurement mirror the action plan of the CPAR

Action plan point #	Description	Action plan mirrored in operation?
1	Develop procedures to rationalize existing budget management practices	
2	Revise Bill 85 and consolidate it with other bills amending Law 80	
3	Carry out an inventory and review of all public procurement related regulation and issuance of an integrated regulatory decree	
4	Establishment of a National Procurement Policy Unit consisting of a governing board comprised of representatives of the Government and stakeholders, and a Secretariat	√ (prior action)
5	Development, establishment and maintenance of an internet based National Procurement Information System	√
6	Development of model bidding documents and forms of contracts for general use in the country	√
7	Development and implementation of procurement training program for both the agencies of the executive branch and controlling entities	√

Vietnam – PRSC 4

The document lays out actions related to procurement already taken and planned actions under the PRSC. CPAR recommendations are being addressed sequentially through several PRSCs.

Action plan point #	Description	Action plan mirrored in operation?
1	Establish a new autonomous Public Procurement Office	√
2	Finalize the draft public procurement ordinance	√
3	Improve notification and advertising practices and transparency: a) Study methodology for development of a public procurement bulletin in both paper and electronic form b) Establish and trial use of the bulletin c) Mandatory notification of bidding opportunities and contract awards in the bulletin	√ (partly)
4	Develop and issue guidelines for implementation based on the new ordinance	
5	Prepare and make mandatory the use of SBDs for consulting services, goods and works	√ (only for goods)
6	Develop procurement training capacity	Mentioned in document
7	Build organizations specialized in procurement using procurement specialists	