

GOOD PRACTICE NOTES FOR DEVELOPMENT POLICY LENDING

1.
Designing Development Policy Operations

2.
Using Poverty and Social Impact Analysis
to Support Development Policy Operations

3.
Financial Management Issues
in Development Policy Lending

4.
Environmental and Natural Resource Aspects
of Development Policy Lending

5.
Supporting Participation
in Development Policy Operations

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ACRONYMS AND ABBREVIATIONS

CAS	Country Assistance Strategy
CEA	Country environmental analysis
CFAA	Country Financial Accountability Assessment
ECA	Europe and Central Asia Region
ESW	Economic and sector work
EU	European Union
FMS	Financial management specialist
GDP	Gross domestic product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IMF	International Monetary Fund
M&E	Monitoring and evaluation
MNA	Middle East and North Africa Region
NGO	Nongovernmental organization
OP	Operational Policy
PER	Public Expenditure Reviews
PFM	Public financial management
PRGF	Poverty Reduction and Grant Facility
PRSC	Poverty reduction support credit
PRSP	Poverty Reduction Strategy Paper
PSIA	Poverty and social impact analysis
SEA	Strategic environmental assessment
SSEP	Social Sectors Expenditures Program

FOREWORD

These Good Practice Notes are being issued in conjunction with the update of Operational Policy/Bank Procedure (OP/BP) 8.60, *Development Policy Lending*. Good Practice Notes 1 through 5 are intended to provide guidance to staff in the preparation of development policy operations and are not mandatory policy documents. Their contents will be updated periodically to reflect the lessons of experience. For further updates and other good practice notes, please check the Operations Policy and Country Services (OPCS) website under development policy lending or contact the Country Economics Unit in the OPCS Vice Presidency.

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GOOD PRACTICE NOTE 1— DESIGNING DEVELOPMENT POLICY OPERATIONS

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GOOD PRACTICE NOTE 1— DESIGNING DEVELOPMENT POLICY OPERATIONS

I. INTRODUCTION

1. This Good Practice Note provides advice to World Bank staff and their government counterparts on designing Bank-financed development policy operations (which may be IBRD loans, IDA credits, or IDA grants)—and particularly on tailoring such operations to the circumstances of the country and to the particular reform program associated with the operations. Box 1.1 provides definitions for terms that will be used throughout this note.

Box 1.1. A Vocabulary for Designing Development Policy Operations

Actions are the policy and institutional actions of the government that are expected to bring about desired outcomes. Actions usually involve *modifications* in policies or institutions. However, they may involve *sustained implementation* of policies or *analytic work*.

Outcomes are the desired changes directly resulting from the set of *actions* associated with the development policy operation. Generally outcomes are the effects on broader society of government action.

A **program** is the set of actions and outcomes supported by the development policy operation or, in the case of a programmatic operation, by a closely linked series of loans, credits, or grants.

Conditions are the actions that are deemed critical to achieving the outcomes of the program supported by the development policy operation *and* are included in the operation documents as legal conditions for disbursements under a Bank loan, credit, or grant. Conditions that must be met before presentation of a loan, credit, or grant to the Bank's Board are termed *prior actions*.

Triggers, as used in the context of programmatic development policy operations, are the planned actions in the second or later year of a program that are deemed critical to achieving the outcomes of the program and that will be the basis for establishing the prior actions for later operations. In other words, triggers are the expected prior actions for a subsequent loan, credit, or grant. The Bank evaluates the achievements with respect to triggers to decide on the scope, timing, and prior actions for each later operation in a programmatic series. The details of prior actions for a subsequent operation may differ somewhat from the triggers in the preceding operation due to changes in circumstances or information.

Milestones are progress markers of implementation of the program. A milestone can be an action or an outcome that is expected to be realized during the period of implementation, rather than at the end, of the operation. Milestones are *not* legal conditions for disbursement or triggers.

The **Program Matrix** summarizes all of the conditions, triggers (for a programmatic operation), milestones and outcomes of the program supported by an operation.

Results are the completed actions or outcomes of a program. **Indicators** are qualitative or quantitative measures of results. Well-defined indicators have baselines (the ex ante level of the indicator) and targets (the intended ex post level of the indicator). **Benchmarks** are the standards against which performance or achievements can be assessed; the standards refer to the performance that has been achieved in the recent past by comparable organizations.

2. **Operations Portal.** A web-based interface, known as the [Operations Portal](#), provides task teams with an easily accessible, integrated workspace to simplify day-to-day project preparation and management. The portal supports staff's efforts to compose task teams, plan operation

expenses and financing, and produce required documentation. Available on the site are operation calendars, references to similar operations, a list of staff with relevant backgrounds, country news, and operation press releases, along with online help, frequently asked questions, and a help-line contact telephone number.

II. COUNTRY OWNERSHIP

3. The often complex policy and institutional reforms associated with a development policy operation can only be adopted and implemented if they have sufficient political support within the country—support within the relevant parts of the government and often among non-governmental stakeholders. It is important to understand some basic principles about ownership.

4. ***Ownership implies that the government can build and maintain an adequate coalition of political support for the program.*** Ownership does not require national consensus. Building and maintaining ownership is a dynamic process that often involves persuading new groups to support a reform program as its net benefits become clear, and it sometimes requires modifying the program to reflect evolving experience and changing circumstances.¹ The World Bank can contribute to this process through its policy dialogue and its analytic work.

5. ***Ownership is a necessary but insufficient condition for Bank support.*** The Bank should finance development policy operations to support reform programs that have adequate ownership and, in the Bank's judgment, contribute to the country's development goals. Collaborative analytic work and policy dialogue help define the set of reforms that meet these dual criteria.

6. ***Assessing ownership can be difficult.*** One strong indication of ownership is the endorsement of a specific reform in a publicly debated and approved national development strategy document, such as an IDA country's Poverty Reduction Strategy Paper (PRSP). However, in such strategy documents, the reference to a particular reform may be vague, and the reform program may not be well defined in terms of ends and means. Also policymakers may overestimate or overstate the political feasibility and sustainability of a reform, especially for the sake of securing a loan or credit. In most cases, assessing ownership requires thoughtful inquiry by Bank staff. Because ownership can change over time, periodic reassessment is necessary. A key risk in assessing ownership is mistaking agreement on general objectives for support of specific means or measures by which to pursue those objectives. Box 1.2 includes some useful indicators for assessing country ownership.

¹ See Good Practice Note 5—Supporting Participation in Development Policy Operations.

Box 1.2. Indicators for Assessing Country Ownership

- The government has recently taken initial steps to implement elements of the reform program to be supported by the operation.
- The government has a good track record in implementing related reforms.
- The reform is specifically endorsed in the country's formally adopted national development strategy, PRSP, or similar document that has been widely discussed and formally approved.
- The government has taken the initiative in formulating the reform agenda and presenting it to the Bank.
- Key policymakers articulate their intellectual conviction that the reform is needed.
- Top political leaders have publicly stated their support for the reform.
- The government has undertaken efforts to build support for the reform among key constituencies.
- Relevant interest groups have been engaged in dialogue with the government about the reforms and have indicated general support. Potential beneficiaries have been mobilized, and the concerns of groups that might suffer losses from the reforms have been taken into consideration.
- The reform has been openly advocated during the campaign of an elected government.

7. ***Conditionality should complement ownership, not substitute for it.*** Conditions for development policy operations need to be agreeable to the government and the World Bank. When conditional lending is used to induce a government to undertake reforms that it does not wish to do, it is unlikely that these reforms will be fully implemented and sustained. Furthermore, the prospects for improving governance and the accountability of a government to its own citizens will likely be undermined.

8. ***A development policy operation can complement ownership in several ways.*** The process of preparing the Program Matrix of relevant actions and outcomes generates a dialogue among various parts of the government—and often with nongovernmental stakeholders—that can improve the design of the reform program and help build broader support for the reforms. Bank staff can play a useful role during the design phase by providing analysis and advice, drawing on experience in other countries, and facilitating communications among stakeholders within the country. Once agreement within the government and between the government and the Bank has been reached, the formal conditionality associated with development policy operations can complement country ownership:

- The Program Matrix can help keep the program on track during its implementation, in particular by creating a timetable and incentives for completing actions.
- The formal agreement to the conditions and triggers that are part of the Program Matrix signal to the broader government and to the public that the government is committed to carrying through the reform program, generating momentum in the reform process and strengthening expectations that the reform will be sustained. This is often important in inducing a positive private sector response to a policy change.
- The agreement between the government and the Bank on conditions and triggers also provides assurance to Bank Management and shareholders that the reform program will be sustained and will generate benefits that justify the loan, credit, or grant.

9. ***The way the policy dialogue is conducted can also build ownership.*** First, to ensure that conditions, triggers, and milestones both are owned by the government and reflect the best knowledge of country circumstances, the government is expected to take the initiative in drafting the Program Matrix. Presenting to the government a draft matrix that was prepared in Washington is clearly not good practice. Second, to avoid adversarial relationships and counterproductive bargaining, Bank staff may find it most productive to follow the basic tenets of “principled negotiation,”² in which all parties are encouraged to first identify their interests (rather than their positions) with respect to a particular issue, to encourage an open and creative exploration of options (without commitment), and to decide on positions only after a discussion of these interests and options. The interest of Bank staff, of course, is to agree on conditions for a program that, in their best professional judgment, serves the country’s long-term development needs and enjoys sufficient country ownership to be implemented and sustained. It is therefore counterproductive to view the dialogue and negotiation as an effort to extract unrealistic promises from government counterparts.

10. ***Public disclosure gives credibility to country ownership.*** The Bank recognizes the fundamental importance of transparency and accountability to the development process. Its disclosure policy provides that the Bank discloses the Program Documents for all poverty reduction support credits (PRSCs), and it presumes that borrowing governments will consent to Bank disclosure of the Program Documents for other development policy operations. The principle of country ownership of reform programs cannot be credible without such disclosure.

III. LINKING TO THE CAS, ASSESSING THE MACROECONOMIC FRAMEWORK AND CREDIT RISK, AND COORDINATING WITH PARTNERS

A. Country Assistance Strategy

11. Designing a development policy operation is a two-stage process. First, the Country Assistance Strategy (CAS) sets the strategic context for all of the Bank’s individual lending operations in the country. It also defines the country outcomes, which the Bank expects to positively influence and to which the individual lending operations should contribute. In the CAS, the Bank exercises judgments about *country selectivity* in the allocation of Bank resources and about the broad conditions in which a development policy operation would be appropriate. Through the CAS and its updates, the Bank makes clear the general direction of the reform program to which the government should be committed prior to active preparation of each possible development policy operation.

- Inclusion of a development policy operation in a CAS base-case lending scenario reflects a judgment that such an operation is justified by the country’s current level of policy and institutional development, its needs for Bank financing, its creditworthiness, and its general commitment to move forward in appropriate reform areas.

² Roger Fisher, William Ury, and Bruce Patton, *Getting to Yes: Negotiating Agreements without Giving In* (New York: Penguin Books, 1991).

- In some cases, a development policy operation may be included only in a high-case lending scenario—that is, after an improvement in specific dimensions of the country’s policy and institutional framework or a demonstrable increase in the government’s commitment to move forward with a reform program in specific areas.

12. When a government has achieved the relevant thresholds indicated in the CAS, including a sufficient indication of ownership of the associated reform program *in broad terms*, the country and Bank begin to design and negotiate the details of that operation. The amount and the timing of the operation may be adjusted relative to that envisioned by the CAS in response to (a) the quality and cost of the policy and institutional changes that the government decides to pursue, and (b) any significant changes in the country’s economic environment (such as terms of trade shocks that affect the fiscal balance).

B. Macroeconomic and Credit Risk Assessment

13. Preparation of a CAS or CAS Progress Report always involves assessing the country’s macroeconomic framework and credit risk. Such an assessment takes into account the IMF’s views as well as the Bank’s own projections, as discussed below. Unless a development policy operation is presented at the same time as the CAS or CAS Progress Report, the Bank’s assessment of the macroeconomic framework has to be updated during appraisal of the operation to determine the following:

- Are the country’s macroeconomic policies likely to achieve sustainable external and fiscal balances over the medium term (i.e., have sustainable debt dynamics);
- Will the development policy operation (including its associated reform program *and* its financing) support, rather than undermine, those macroeconomic policies;
- Should the amount of the loan or credit be reconsidered in response to shocks, taking into account the guidelines provided in the CAS on phasing, composition, and amounts of lending; and
- Can the Bank accept the credit risk associated with the operation, taking into consideration the country’s updated macroeconomic outlook and the risks arising from potential external and internal shocks.

14. **IMF Role.** In making its assessment of the macroeconomic framework, the Bank takes into consideration the views of the IMF, and normally regards the presence of an on-track IMF program as adequate evidence that the country’s macroeconomic policies are likely to achieve sustainable balances over the medium term. If there is no formal IMF program, in the early stages of preparation of a development policy operation Bank staff should ascertain whether Fund staff have any major outstanding concerns about the country’s macroeconomic framework. Before finalizing the operation, the Bank will request an assessment letter from the IMF that provides a factual overview of the country’s macroeconomic framework. The Bank will take this letter into consideration in forming a judgment about the appropriateness of Bank lending at that time.

15. **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, the Bank country economist normally uses a macroeconomic consistency model. (These projections are often prepared initially for and presented in detail in a country economic memorandum or similar report.) The country economist needs to construct scenarios to assess the risks and estimate the robustness of the current country outlook under alternative assumptions. Such scenarios should consider possible changes in domestic economic variables and in the global economic environment (including commodity price fluctuations, which could affect the country's terms of trade; shifts in G7 output growth and exchange and interest rates, which may affect export demand and debt servicing costs; and changes in investors' attitude toward country risks, which could affect access to capital markets). In assessing the sustainability of a country's medium-term macroeconomic framework, particular consideration should be given to the following:

- **Fiscal and debt sustainability risks.** The robustness of the fiscal outlook should be evaluated comprehensively, using broad definitions of the public sector and including contingent liabilities wherever possible. The assessment should highlight possible threats to public debt sustainability arising not only from different fiscal, growth, and interest rate and exchange rate paths, but also from financial sector crises, uncovered pension liabilities, or financial assistance to public or private corporations during sharp economic downturns. A detailed public sector financing plan may be needed to evaluate the sustainability and risks to the public sector accounts over time.
- **Balance of payment vulnerabilities.** The robustness of the current account projections should be assessed against potential risks from global trends and domestic economic and structural factors. Capital account vulnerabilities are often linked to large debt rollover requirements, high levels of short-term debt, high shares of floating rate debt, or high levels of portfolio investment relative to foreign direct investment. A detailed external financing plan may be needed to evaluate the sustainability and risks to the external accounts over time.
- **Monetary and exchange rate risks.** The assessment should evaluate whether monetary and exchange rate policies are supportive of macroeconomic stability and identify risks that may arise from any inconsistencies between monetary and exchange rate policies.
- **Risks of policy instability.** The credibility of the government's current policy framework and its macroeconomic stability may be threatened by the risk of policy instability, which may arise from political instability. Also, the government's political capacity and willingness to repay its creditors, particularly the Bank, are important factors to evaluate.
- **Financial sector risks.** Vulnerabilities in the financial sector and their potential effect should be assessed, since financial sector crises could pose a threat to macroeconomic stability.

- **Corporate sector risks.** Corporate sector vulnerabilities, such as high leverage or unhedged net foreign exposures, should be evaluated since they can trigger domestic crises that might threaten fiscal and debt sustainability.

16. **IBRD Exposure.** The evaluation of country credit risk should give particular attention to the projected levels of IBRD exposure and the projected debt service obligations to IBRD and other official creditors. In projecting the Bank's exposure, it is necessary to take into consideration estimated future levels of lending and disbursements, including those arising from a planned series of development policy operations. IBRD exposure in a country should normally conform to the following guidelines: the ratio of IBRD debt service to public debt service should be no more than 20 percent; the ratio of preferred creditor debt service to public debt service should be no more than 35 percent; and the ratio of IBRD debt service to exports of goods and services should be no more than 4 percent, 5 percent, and 6 percent in cases of high, medium, and low risk, respectively. Also, total IBRD debt outstanding to any IBRD borrower cannot normally exceed the single borrower exposure limit set by the Bank's Board of Executive Directors in accordance with IBRD's risk-bearing capacity—currently at US\$13.5 billion. The CAS normally addresses Bank exposure issues, but any additional issues that arise as a consequence of a development policy loan should be explicitly discussed in the Program Document.

17. **Including Macroeconomic Policy Measures within Development Policy Operations.** If the development policy operation is undertaken in a country whose policy framework is already well designed to achieve medium-term sustainability of the macroeconomic framework and well suited to managing the country's macroeconomic risks, the reform programs associated with the operation should be designed to accelerate and improve the quality of economic growth and poverty reduction, but they need not include measures intended to correct weaknesses in the macroeconomic policy framework per se. However, if the assessment of the macroeconomic framework indicates that a country's fiscal program or balance of payments and associated debt dynamics are not sustainable in the medium term, or that the risks to sustainability are excessively high, then the country's reform program should include corrective macroeconomic policy measures. In many cases, such measures are associated with a formal IMF program, and this should normally satisfy the Bank. But if they are not, the Bank needs to be satisfied that corrective measures are being undertaken. In such situations, the basic principles of country ownership, country selectivity, and conditionality still apply.

C. Coordinating with Partners

18. When a government invites several partners to support its reform program, all partners—the government, the Bank, and the others—must share a clear understanding about the modalities of their cooperation with a view toward minimizing transaction costs and avoiding inconsistencies in the conditions associated with the support from the various partners. The government might prefer joint support from several partners for a common program. In that case, all of the participating partners could agree to joint supervision missions and to accepting a common reporting document from the government. Alternatively, the government might want specialization among its partners, asking each to be engaged in different parts of the overall reform program.

19. ***World Bank and IMF Partnership Agreement.*** The World Bank and the IMF have an agreed framework for coordination intended to ensure that each institution is separately accountable and focused on its areas of special competence and that each is fully informed of the conditions associated with the other's programs. Under that agreement, "conditionality would be duplicated only when a policy measure was considered critical for the success of the programs supported by both institutions. In such cases, conditionality would be harmonized, using identical dates and benchmarks to the extent possible."³ Furthermore, the Board documents of each institution include a Bank-Fund annex that describes the division of labor and the conditionality of the other institution in its programs for that country.⁴

IV. CHOOSING THE COMPONENTS AND STRUCTURE OF THE OPERATION

A. Components

20. Governments often pursue policy and institutional reforms concurrently across a wide spectrum (for example, fiscal and monetary policy, civil service organization and rules, the judicial system, decentralization, trade, and specific sectors). A key task—which begins at the CAS stage and continues through the detailed design of a particular development policy operation—is to decide which components of the government's overall reform program the operation should support, and how the conditions associated with the operation will be helpful to the government's overall program. Decisions about coverage also need to take into consideration the quality of the analytic underpinnings of the program. Some of the important considerations in choosing the components of a particular development policy operation are as follows:

- ***The strategy and results framework set out in the CAS.*** The strategy and results framework of CAS provide guidance on which reforms the Bank should be supporting and how that support should be provided.
- ***The potential benefits or costs of conditionality.*** Linking a particular reform to a Bank loan can often help the government design and implement the reform. However, such linkage should be avoided in circumstances when it would only stimulate opposition and suspicion that the government does not really embrace the reform.
- ***The magnitude of expected developmental benefits, especially poverty reduction.*** The Bank aims to help the government pursue the reforms that are expected to have the greatest impacts on sustainable growth and poverty reduction.
- ***The quality of the analytic underpinnings.*** Reform programs can be designed in detail only when there is adequate diagnosis of the problems to be solved and sufficient clarity about promising solutions. In particular, poverty and social impact

³ IMF and World Bank, "Strengthening IMF-World Bank Collaboration on Country Programs and Conditionality," Washington, D.C., 2001.

⁴ World Bank, "Staff Guidance Note on Operationalizing Bank-Fund Collaboration on Country Programs and Conditionality," 2002.

analysis (PSIA) and, where relevant, environmental impact analysis should underpin important policy measures.

- ***The institutional capacity for implementation.*** Even important and well-understood reforms cannot succeed without adequate institutional capacity.
- ***The need to improve public expenditure management systems.*** Among the many elements of good governance, better public expenditure management systems are especially important in creating the basis for lending through development policy operations. Government ownership is particularly critical for the successful implementation of such measures. Countries with weak public expenditure management systems and inadequate ownership of measures to improve them are poor candidates for development policy operations.
- ***Opportunities to strengthen the voice of the poor.*** In the design and implementation process, the voice of the weakest, least organized stakeholders may not be heard. The Bank's involvement may be able to strengthen these voices.
- ***The Bank's comparative advantage.*** The Bank can be most useful in helping the government to design and implement a reform when it can make available Bank staff who combine the right expertise and country knowledge.
- ***The activities of other partners.*** Several development partners may be able to work together in the same areas, or specialization may be preferable.
- ***The need for risk mitigation measures.*** Measures to reduce the likelihood of adverse impacts from certain elements of the reform program—or to compensate those whose interests might be damaged by the reform program—should be an integral part of the overall program.
- ***Opportunities for Bank support through other vehicles and at a later time.*** The development policy operation is not the only possible modality of Bank assistance. Sometimes important support to a reform can be provided through an investment loan, technical assistance, or analytic work. Or the Bank's engagement in the reform process might be more productive at a later stage in the country's efforts to build support and implementation capacity.

B. Structure

21. Once the decision is made about which components of the government's overall reform program the development policy operation will cover, but before specific conditions are designed, the Bank and the government should agree on one of the following structures for the lending operation:

- ***Programmatic approach.*** A series of single-tranche loans, credits, or grants is usually the best approach for supporting a well-specified, medium-term program. Each Program Document indicates the prior actions that have been taken in advance of that

loan, credit, or grant as well as the triggers for subsequent operations in the series. A series normally involves three annual operations. This approach captures the medium- to long-term nature of most significant reform efforts but allows flexibility to adjust to new information and changing circumstances during implementation and to change the scope of the operation over time. A programmatic approach is especially useful when the government's implementation capacity is uncertain, and it can be a useful means to manage risks associated with the program.

- ***Multitranche operation.*** The conditions for each tranche are specified at the beginning of the operation. This approach is appropriate only when the details of key steps in a medium-term reform process are already well understood. A multitranche operation may be especially useful if the government wants to use the conditions of the development policy operation as a signaling device. In choosing between a multitranche operation and a series of programmatic single-tranche operations, the borrower needs to be aware that the commitment fee of the multitranche operation means a higher financial cost. If the policy and institutional actions of one component of a multitranche development policy operation can proceed independently of those in other components, the tranches can be “floating” (i.e., each tranche can be disbursed as the specific conditions for that tranche are fulfilled). This may be appropriate for discrete actions with uncertain timing (e.g., privatization of a specific state enterprise). If both the details and the desired sequencing of the key steps in a reform program are well understood, the sequencing of the tranches can be fixed in advance.
- ***Single tranche operation.*** The conditions for the loan or credit are met fully before the operation is presented to the Board (i.e., all conditions are prior actions), but there is no expectation of a series of loans/credits. In most cases, the reforms associated with the operation should be part of a reasonably well-defined, medium-term program. However, a single tranche operation may be appropriate in a crisis or a “turnaround” situation, in which the government needs financial support to deal with a short-term situation even though the medium-term program is not yet well specified.

V. DESIGNING CONDITIONS, TRIGGERS, AND MILESTONES

22. Once the government and the World Bank have agreed on the components of the program and the structure of the operation, the task is to design a set of conditions, triggers, and milestones that will be most helpful in clarifying, implementing, and monitoring the overall reform program supported by the development policy operation (see Box 1.3). This program is reflected in a Program Matrix that blends actions and outcomes. The creation of the appropriate conditions, triggers, and milestones can be difficult. It helps to bear in mind a few good practices:

- (a) ***Select a limited number of conditions and triggers.*** Conditions and triggers should receive priority attention during implementation. If a condition is not realized, normally the Bank does not disburse the associated tranche, or the Board must specifically waive the condition. If a trigger is not achieved according to the agreed timetable, the government and the Bank need to evaluate whether ownership of the program is

Box 1.3. Selectivity for Conditions and Triggers: Examples***Good examples***

- A reform supported by a programmatic operation involves an institutionally complex set of measures to improve public resource management and civil service performance. Of the 44 measures expected before the second annual credit, only 9 are triggers and the others are milestones. This indicates prioritization among the measures.
- As a condition for an agriculture sector operation, “A Law on Cadastre and Property Registration has been approved by the parliament, and a Cadastre Agency has been created.” These are reasonably well-defined actions that are critical to successful implementation of land titling.
- As a trigger for the next programmatic loan, “the Auditor General has completed final audits on all central government ministries within 12 months of the end of the fiscal year.” This was regarded as the most critical step to improving public expenditure management systems.

Bad examples

- The program matrix for a programmatic loan has 25 pages of “triggers” for the second proposed loan without specifying those that are really critical to implementation.
- As a condition, “Approval by the Council of Ministers of a draft Trade Practice Proclamation to address anti-competitive practices, unfair trade practices, and consumer protection.” This is a weak condition because it requires approval only of a draft document rather than final approval by Parliament.
- As a condition, “Prepare an Irrigation Sector Development Strategy.” This would be better as a milestone since the preparation of a strategy *per se* is not critical to successful implementation.

weakening or implementation capacity has been overestimated, and the timing or the amount of the Bank’s continuing financial support may need to be reconsidered.

- *Do* use only the highest-priority actions as conditions and triggers. Prioritization requires limiting the set of policy and institutional measures to those that are essential and practicable given financial, institutional, and political constraints.
- *Don’t* use outcomes (i.e., monitorable effects of actions) as conditions or triggers unless their realization is largely under the control of the government.
- *Don’t* exaggerate the importance of measures to expand the set of conditions and triggers. Some reform processes require many relatively small policy and institutional changes but have only a few measures that are critically important. In such cases, it may be possible to define a condition or trigger on the basis of a short-term outcome that captures the expected impact of many small changes.
- *Do* remember that, in the context of programmatic operations, triggers are the *expected* prior actions for a subsequent loan, credit, or grant. The Bank evaluates the achievements with respect to triggers to decide on the scope, timing, and prior actions for each later operation in a programmatic series. The details of prior actions for a subsequent operation may differ somewhat from the triggers in the preceding operation, but any changes need to be fully justified by changes in circumstances or information.

- *Do* include the approval of a new law as a condition or trigger when it is critical to achieving policy and institutional change, but remember that implementation of a law requires institutional capacity and often involves follow-up regulations.
- (b) ***Define many milestones and use them flexibly.*** A large number of milestones can be useful to the government and the Bank in defining the specific elements of the reform program and monitoring its implementation (see Box 1.4). Given the uncertainties inherent in the implementation of a complex reform program, it is expected that actions selected as milestones may not be achieved according to the initial timetable. And given imperfect knowledge about the relationship between actions and outcomes, it is expected that outcomes selected as milestones may not be realized as predicted.
- *Do* define milestones that will help track progress in implementing the reform.
 - *Do* use outcomes as milestones to monitor the short-term results of policy and institutional changes.
 - *Do* modify milestones in programmatic loans from year to year in response to new information and circumstances.
 - *Don't* include milestones that are not related to the components of the reform program covered by the operation.
 - *Do* include necessary analytic work as a milestone.

Box 1.4. Good Milestones

- As a milestone for the government's three-year strategic plan to reduce the level of tax arrears, "Reduce the percentage of collectible debt in 2001 to 8% of total tax collections (1998: 9%)."
- As a prior action for the first credit in a programmatic PRSC, the government launches a national recruitment campaign for teachers, and the third PRSC in the series includes a milestone that "all districts fill at least 95% of their established teacher staffing ceiling."
- As a milestone for analytic work: "Complete a study of market for raw hides and skins which estimates the overall impact of transforming the export ban into a tariff and is conducted by Steering Committee which includes representatives from farmers, traders, processors, and the tanneries." This not only defines the specific policy option to be studied but also describes a structure for undertaking the study that includes various stakeholders.

- (c) ***Find a balance between new measures and sustained implementation of previous measures appropriate to the country circumstances.*** In the early stages of a specific reform program, most conditions, triggers, and milestones should involve policy and institutional changes (i.e., actions) that constitute the key steps for implementing the reform program. When the reform program in a particular area is more advanced, sustained implementation, monitoring and evaluation, and modest adjustments to previous policies and institutional arrangements become increasingly important. The right balance between change and sustained implementation will vary significantly according to country circumstances. When a country is initiating major reforms in a new area or adjusting policies to a macroeconomic shock or other change in circumstances, an operation would appropriately focus on policy and institutional changes. For countries

which are already well-advanced in reforms across a broad front and which face stable conditions, the emphasis should be on sustained implementation.

- *Don't* establish a condition or trigger that specifies a policy or institutional change that is not well grounded in prior analytic work.
- *Do* use conditions, triggers, or milestones to reinforce the importance of sustained implementation of key policies and institutional behaviors.

(d) ***Be as specific as possible about what, by whom, and when.*** Specificity—meaning clarity, not excessive detail—is a key attribute of good conditions, triggers, and milestones (see Box 1.5). Poorly specified conditions or triggers may give rise to disputes about whether the key elements of the reform program are on track.

- *Do* indicate what actions are to be done, by which agency(ies) of the government, and approximately when.
- *Do* use the active voice as appropriate to clarify who is responsible for the action.
- *Do* use quantitative indicators, including baselines and targets, whenever possible.
- *Do* cross-reference another table or even other documents when the Program Matrix includes very complex, multi-faceted actions—such as agreement on a Medium-Term Expenditure Framework. For the sake of transparency and monitorability, refer only to documents that are in the public domain.
- *Don't* avoid specificity in milestones just because their achievement is uncertain since realization of milestones is, by definition, regarded as a lower priority than the achievement of conditions and triggers.
- *Don't* try to be very specific if the underlying analytic work is still weak.

Box 1.5. Specificity of Conditions, Triggers, and Milestones: Examples

Good examples

- “The government will reduce the fertilizer import tariff from 50 percent to 25 percent by January 1, 2000.”
- “Increase allocation in the 2002 Budget Law for non-salary operational expenditures in the education, health, and public works ministry by at least 10 percent over the allocation in the 2001 Budget Law.”
- “Satisfactory implementation including (i) operational and financial audit of customs operations, (ii) a census of customs personnel; and (iii) a survey of users’ perceptions of service.” Although “satisfactory implementation” of an action plan is by itself a poorly specified condition, in this case there is further elaboration of the criteria by which implementation will be evaluated.

Bad examples

- As a second-tranche condition: “Draft legislation completed redefining the roles and responsibilities across the three levels of the public administration.” This is not specific about what constitutes completion of the draft (e.g., approval by cabinet or submission to Congress) and does not indicate the principles according to which the roles and responsibilities should be redefined.
- As a milestone, “Improved social indicators” is too vague to be useful.
- “A system for auditing public sector bodies for compliance with requirements for identifying and resolving cases of conflict of interest is developed and implemented.” This milestone is not adequately specific about which agencies of the government bear responsibility.

(e) ***Include conditions or triggers that the government considers useful for signaling its commitment and for keeping implementation on schedule (see Box 1.6).***

- *Do* use conditions or triggers to establish a deadline when this might encourage the government bureaucracy to come to closure.
- *Don't* include conditions and triggers that might only stimulate political opposition before the government leadership can build its case and strengthen support for a particular reform.

Box 1.6. Conditions that are Useful for Signaling Commitment

- As a condition of Board presentation, “Since July 1, 2001, the territorial entities have received no bailouts or guarantees of their debt in accordance with Law 617/00.” This may help the government avoid pressures to circumvent its new law that imposes greater fiscal discipline on sub-national governments. It also serves as a signal to sub-national governments of the government’s commitment, and this may help affect their behavior.
- As a tranche release condition, “Agreed budget transfers for the Social Sectors Expenditures Program (SSEP) have been made in the second half of 2000; the government has budgeted for the SSEP in 2001 the highest of: (i) 15% of its central government (CG) budget or (ii) the amount specified in the SSEP; and the Government has budgeted at least 20% of its CG budget for total social sector expenditures.” This helps lock in a government commitment to protect social sector expenditures during a fiscal crisis.
- As a condition of second-tranche release in an agricultural sector loan, “The 2002 budget does not provide for credit or fertilizer subsidies and does not increase existing direct or indirect agricultural subsidies, in real terms, as compared to subsidies in effect on January 1, 2001.” This commitment may help agricultural producers anticipate and adjust to future policy and thereby may help the government avoid political pressures for its reversal.

(f) ***Include outcomes in the Program Matrix.*** Some development policy operations mistakenly focus almost exclusively on the actions without giving much attention to their intended outcomes. A results orientation requires the definition and monitoring of desired *outcomes* to determine whether the actions are having the expected effects (see Box 1.7). This permits learning during the process of implementation and, if necessary, making mid-course corrections in the reforms. However, many outcomes take some time to be realized, and there are often lags between their realization and the capacity to monitor or measure them. Therefore, particular attention should be given to finding both short-term outcomes that can be used as milestones to monitor effects during program implementation as well as outcomes that can be expected at the end of the implementation of the program.

- *Do* include at least one end-of-program outcome for each component of the program.
- *Don't* try to identify a separate end-of-program outcome for each action. Usually a set of actions may be needed to achieve each outcome.
- *Do* include as milestones short-term outcomes that are reasonably good proxies for longer-term outcomes that cannot be achieved quickly or monitored frequently.

- *Don't* include outcomes that are beyond the time frame of the program. The Program Document should indicate how outcomes beyond the time frame of program will be monitored, including through the CAS.
- *Do* try to identify outcomes that reflect the intended effects of a diverse set of actions that are rather “process-oriented”.
- *Do* check that the operation’s outcomes are consistent with and drawn from those in the CAS (this will become increasingly relevant as the Bank mainstreams results-based CASs).
- *Don't* use outcomes as conditions or triggers unless their realization depends largely on factors within the government’s control.
- *Don't* include outcomes that are not directly influenced by actions that are part of the program.

Box 1.7. Examples of Appropriate Uses of Outcomes as Conditions, Triggers, or Milestones

- | |
|--|
| <ul style="list-style-type: none"> • As a trigger for the next loan in a series, “Net public sector debt to decline to 46.5% of GDP by the year 2001.” This outcome is largely in the government’s control and can therefore be used as a trigger. • “Achieve on average, for a period of three consecutive months, the following milestones for port clearance of containerized merchandise in the main port: seven working days for imports and two working days for exports.” • Related to the objective of matching staffing profiles and numbers to new functional requirements of the civil service and containing the cost of government, the program sets a milestone that “30,000 government officials elect early retirement.” This provides a basis for evaluating progress in the implementation of the prior year’s approval of government-wide guidelines for rightsizing programs. |
|--|

(g) **Build on national strategies.** To ensure transparent country ownership of the program, the Program Matrix should draw from the actions and targets in a national strategy document (see Box 1.8). However, such strategy documents seldom include all of the relevant actions and outcomes appropriate for a particular reform program, and often they are insufficiently specific for a program supported by a development policy operation. Hence, the Program Matrix actions are typically more elaborate than those in the national strategy document.

- *Do* use the same words and quantitative targets as in national documents, whenever they are sufficiently clear and still endorsed by the government.
- *Do* cross-reference the relevant material with the national document to demonstrate ownership.
- *Don't* feel compelled to use the typical Bank terminology if it deviates from the language in the national document.

Box 1.8. Building Conditions and Triggers on Measures in National Strategy Documents**Good examples**

- National strategy document states that education's share in total government expenditures will increase from 20 percent in 2000 to 25 percent by 2010 without specifying annual targets. A trigger for the third credit in a programmatic series is that education's share will reach 22 percent by 2004.
- A national strategy for better governance includes a general commitment to improve public procurement based on a recently approved procurement law. The subsequent development policy operation, reflecting further discussions within the government about detailed steps, includes a condition that the cabinet approves a new procurement procedure manual by end of 2003, and a milestone that the auditing office reviews 30 percent of all procurement (by value) in 2005 to check compliance with the new law and procedures.

Bad example

- The national strategy document includes a general commitment to improve the efficiency of urban water companies. The development policy operation includes a condition to privatize the urban water companies even though there is no evidence of country ownership of this means to pursue the goal of improved efficiency.

(h) **Show the linkages among actions, milestones, and outcomes.** A well-designed Program Matrix should capture the entire logical chain of cause and effect, to the extent possible, within the timeframe of the program (see Box 1.9).

- *Do* try to include at least one milestone for each action that is used as a condition or trigger.
- *Don't* include milestones and outcomes that are unrelated to actions within the program.

Box 1.9. Linked Actions, Milestones, and Outcomes

From a programmatic loan covering pension system reform:

- Condition for first loan: "Parliament has adopted legislation to create the second tier of the pension system."
- Trigger for second loan: "Implementation of the second-tier has been satisfactorily initiated."
- Milestone at end of second loan: "All three tiers of the pension system are in place."
- Outcome at the end of the program: "Pension system deficit is reduced, savings increased, and equality of treatment within age cohorts has improved."

(i) **Ensure monitorability.** A key attribute of good conditions, triggers, and milestones is that their status can be monitored at reasonable cost. In every case, consideration must be given to *how* the status of each condition, trigger, and milestone can be monitored and *who* is responsible for such monitoring. The difficulty of monitoring may limit choices for conditions, triggers, and even milestones. Monitoring usually requires choosing a measurable *indicator* that is a proxy for the status of the action or outcome itself. Many of the changes in institutional behavior within the government and responses by nongovernmental actors are difficult to observe, and many outcomes are difficult to quantify and hard to monitor. For that reason, it is often necessary to choose indicators that provide only partial and approximate measures of the desired action or outcome (see Box 1.10).

- *Do* make note of the means for monitoring of each condition, trigger, and milestone in the program matrix or in a separate table.

- *Do* specify which government agencies are responsible for monitoring each major element of the program.
- *Do* include in the program measures to strengthen the government's capacity to monitor its implementation, evaluate its outcomes, and feed those evaluation results into the decisionmaking processes for improving the program.
- *Do* identify quantitative indicators whenever possible.
- *Don't* use indicators that might distort incentives and induce institutions to focus on the wrong outcomes.
- *Don't* define conditions, triggers, or milestones that are too vague or too expensive to monitor.

Box 1.10. Examples of Conditions, Triggers, and Milestones that are Too Vague to Monitor

- As milestones for the final credit in a series, "Reduction in the role of the state in the economy" and "improved competition."
- As a trigger, "Cases of judicial corruption are resolved in a satisfactory and impartial way."
- As a milestone for the second loan in a series related to decentralization, "Three levels of government complying with the newly defined roles and responsibilities."

(j) ***Allow adequate time for the completion of the various steps in the reform program.*** The set of conditions, triggers, and milestones should reflect realistic judgments about the time likely to be required to complete actions and for those actions to bring about their intended outcomes, especially when changes in the behaviors of large institutions are involved. Excessive initial optimism might lead to unwarranted judgments that the program is failing.

- *Do* allow enough time for parliaments to consider and act upon proposed legislation.
- *Don't* underestimate how long it takes most bureaucracies to change internal procedures.

(k) ***When appropriate, allow for the gradual implementation of a reform program in different parts of the country.*** Initial implementation of a reform program in only a select set of provinces or cities, or among a select set of government institutions, can focus the program on areas or institutions that have the strongest ownership and institutional capacity for implementation, demonstrating its benefits while capacity and support are being built elsewhere.

- *Do* consider "piloting" the program in selected areas and institutions so that, with good monitoring and evaluation, improvements in program design can be made before its wider application.

- *Don't underestimate the differences in institutional capacities or political support among different parts of the country.*
- (1) ***Remember that year 1 is not really year 1.*** Policy and institutional reforms are long-term processes, and many development policy operations build upon earlier phases of a government's overall reform efforts. The Program Matrix might include follow-up actions to policy changes that were made before the operation itself and that sustain implementation of previous reforms. In identifying possible conditions, triggers and milestones, it might also be useful to look at the recommendations from previous analytic work.

VI. MANAGING RISK

23. Every development policy operation should identify risks, present a strategy for mitigating those risks to the extent possible, and explain why the remaining risks are worth taking in terms of developmental benefits. Every Program Document should include a Risk Management Matrix. Annex 1.A provides a template with a checklist of risk factors. Broadly speaking, two categories of risk should be considered:

- ***Development impact risk.*** The operation fails to achieve the expected development impacts (for example, because of suboptimal implementation, lack of sustained country ownership, or weak institutional capacity), or it will have unanticipated adverse impacts on vulnerable groups or on the environment. These risks concern both the country and the Bank.
- ***Financial and reputational risk for the Bank.*** The operation damages the Bank's long-term ability to mobilize support and resources for its mission. Included in this is the risk that the country will lack sufficient capacity to service its Bank debt and that the program will damage the Bank's reputation among its member governments and other stakeholders. These risks are primarily of concern to the Bank, although borrowers also share an interest in the Bank's continuing financial strength and reputation.

24. ***Principles of Risk Management.*** Risk management is a process of deliberate, well-informed, risk-taking—not risk avoidance. Taking calculated risks in lending operations is essential to the World Bank's development effectiveness, and risk management should be an integral part of operational design. A few elements of risk management—in particular, country credit risk—involve unilateral Bank decisions, but most aspects of risk management require joint analyses and decisions by the Bank and the government. Similarly, most elements of a risk management strategy—in particular, mitigation measures—cannot be successfully implemented without country ownership. Following are some good practices for identifying and mitigating the risks associated with a development policy operation:

- (a) ***Early and continuing identification is essential.*** Perform an initial risk assessment at the beginning of the preparation process, and refine it as new information becomes available. The initial assessment should focus on identifying all risks in all categories, leaving mitigation strategies for later. The initial risk assessment should be reported fully in the

operation's Initiating Memorandum or Concept Note, and refinements should be included in the draft Program Document.

- *Do* assess risks broadly. Consider what might go wrong in terms of the strategic effectiveness of the operation and its operational efficiency and how that might affect the Bank's stakeholder support and financial soundness.
- *Do* include government counterparts. Secure country ownership of the risks by including representatives in the initial risk assessment and all subsequent phases of risk management.
- *Do* use existing documents that address risk management issues. Draw on risk assessments in the CAS and in Bank analytic work (poverty and social impact analyses, environmental assessments, the Country Financial Accountability Assessment, and the communication needs assessment) to help identify country-specific risks that might affect the operation.⁵ The CAS normally includes an analysis of many types of risks, especially those related to macroeconomic and political stability and implementation capacity. This assessment may need to be updated to reflect developments that are more recent as well as the impacts of the specific operation.
- *Do* perform continuous risk assessments. Use the initial risk assessment to identify and initiate more detailed analyses of the most important risks.
- *Do* identify separately the likelihood and the magnitude of impacts of possible risks. Focus attention on those events with the highest expected adverse impacts.
- *Do* note resource implications. Specify staff resources or expertise required to mitigate risks and seek appropriate budget.

(b) ***Incorporate risk control and mitigation into the design of the reform program.*** Details of program design affect the likelihood and magnitude of risks.

- *Do* use measures designed to control or mitigate risks as conditions, triggers, and milestones for the operation.
- *Do* ensure government ownership of risk management strategies and measures so that they are implemented. When a risk mitigation measure is necessary to meet Bank expectations as stated in OP 8.60, remind the government that this helps to sustain stakeholder support for the Bank and is therefore in the interests of all Bank member countries.
- *Do* focus on risks to vulnerable groups, particularly through measures by which the government can reduce or compensate for any adverse impacts of the program

⁵ See Good Practice Note 2—Using Poverty and Social Impact Analysis in Development Policy Operations.

on such groups. These measures should have committed fiscal resources, be an integral part of the program, and be included in the Program Matrix.

- *Do* include a communications strategy if there is a significant risk that political support for program implementation might be jeopardized by public misunderstanding of its intent or impacts.

(c) ***Integrate strategic communication interventions to address risks that might arise from political, social, and cultural dynamics related to the operation.*** A systematic communication intervention will help mitigate possible risks that are linked to issues such as ownership, political support for the operation, consensus building, public awareness, effective participation of stakeholders (both government and nongovernment), etc.

- *Do* integrate a communication program that includes a communication strategy and comprehensive action plan with short, medium, and long-term goals.
- *Do* ensure that the communication objectives are linked to the overall program objectives and also to the risk factors.
- *Do* conduct a communication needs assessment in order to develop a realistic and appropriate strategy and action plan; stakeholder analysis to identify their position, influence, advantage and disadvantage, etc.; and communication research focusing on knowledge, opinion, perception, and attitude of the stakeholders as necessary.

(d) ***Consider risk management issues when choosing a structure for the operation.***

- *Do* consider the programmatic approach if the risk assessment suggests that the operation will need to respond to unfolding events during implementation. A programmatic approach is especially useful if implementation capacity is uncertain or if political support for certain elements of the program might shift.
- *Do* use a multitranche operation if the government wants to use the operation's conditionality to mitigate the risk that the public will underestimate government commitment to the medium-term reform program.
- *Do* use floating tranches within a multitranche operation if there are significant risks that would affect the timing of key policy measures.

(e) ***Define a contingency plans for important risks.*** Certain events—for example, a major change in the country's terms of trade and hence its fiscal resources—would require adjustments in the scope or pace of program implementation.

- *Do* develop with the government a general understanding of how the program might be adjusted if the fiscal position deteriorated significantly.
- *Don't* try to have contingency plans for everything.

- (f) ***Use existing Bank resources for improving risk management.*** The Bank has many institutional resources to improve risk management. Task teams can select peer reviewers experienced in risk management. The Bank's Credit Risk Department can help assess the macroeconomic framework and evaluate the country credit risk and Bank exposure. The optional Quality-at-Entry Reviews by the Quality Assurance Group bring risk assessment expertise to task teams. Regional operations can call on the Development Communication Division in External Affairs to advise and provide technical assistance in designing a comprehensive communication program, and supervise the implementation and management of the communication activities associated with the operation. A strategic communication intervention will address the potential political, social, and cultural risks.
- (g) ***Ensure that the amount of the loan or credit reflects the country's current country credit risk.*** Development policy operations are typically included in the most recent CAS, which sets the approximate size of the loan amount on the basis of considerations of country credit risk and Bank exposure. However, as the operation is developed, Bank staff should revisit the country credit risk and Bank exposure in light of the most recent macroeconomic performance and outlook and a current analysis of political risks. This is especially important for IBRD loans.
- (h) ***Ensure that the operation's monitoring and evaluation program will signal manifest risk and evaluate the effectiveness of mitigation measures.*** A good monitoring program will provide early warning that a potential risk is becoming more likely or has in fact occurred so that the government can mitigate it or pursue contingency plans. The program should evaluate the effectiveness of these measures so that improvements can be made. This feedback loop is essential because risk management is a dynamic process that should continue throughout implementation of the program.
- (i) ***Include a full explanation of the operation's risk assessment in the Program Document.*** Full disclosure of identified risks and mitigation strategies is necessary for Management and the Board to evaluate the Bank's risk-taking.
- *Do* differentiate between risks that can be reduced through mitigation measures that are part of the program and risks that cannot be mitigated.
 - *Do* include in the Program Document a full discussion of the assessment of the macroeconomic framework, including country credit risk, and any issues related to Bank exposure.
 - *Do* indicate whether the Bank should commit extraordinary staff resources during implementation to assist the government's risk management strategy.
 - *Do* ensure that the country has exercised its right under the revised disclosure policy to delete sensitive material before the Bank discloses a Program Document.
 - *Do* use informal channels to communicate particularly sensitive risks to senior Bank Management.

VII. PROGRAM MATRIX AND PROGRAM DOCUMENT

25. The government and the Bank must agree on a Program Matrix that summarizes the conditions, triggers, milestones, and end-of-program outcomes associated with a development policy operation. Annex 1.B provides a good model of a Program Matrix *for programmatic lending*. Key features of the Program Matrix are:

- The matrix covers the full-time period of the operation. For a programmatic operation, it typically presents conditions, triggers, milestones, and outcomes over a three-year horizon. For a programmatic operation, triggers and milestones may be less specific in the second and third year, since greater specificity will be achieved as each annual loan/credit is prepared and negotiated. The first-year program is more likely to include analytic work that will provide the foundation for more specific program elements in subsequent years.
- The broad components of the program are described briefly in a row of the matrix, and all of the actions and outcomes that are logically linked are presented in that section of the matrix.
- The matrix includes conditions, triggers, milestones, and end-of-program outcomes. Conditions and triggers are indicated by bold type, as a note at the top of the matrix explains, and are also listed separately in the Program Document.
- The left-most column provides a succinct statement of the qualitative issue or problem addressed by each component of the reform program, and the right-most column indicates the desired outcome (quantified, if possible) expected at the end of the time period covered by the development policy operation (or by a series of programmatic operations).

26. The Bank's Program Document should be written as a complement to the Program Matrix, providing background material and a comprehensive explanation of the matrix. Other important components of the Program Document are:

- A discussion of the relationship between the CAS and the operation, explaining any changes in the operation's content or amount relative to that envisioned in the CAS.
- An update of the Bank's macroeconomic and credit risk assessment (unless the operation is presented to the Board together with a CAS).
- In the case of a programmatic operation, a table that compares the triggers as originally formulated in the preceding loan with the conditions—that is, prior actions—specified for the current loan.
- A discussion of arrangements for monitoring and evaluation of the reform program supported by the operation.

VIII. RELATED READINGS

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RISK ASSESSMENT TEMPLATE FOR LENDING OPERATIONS

<i>Risk Factors</i>	<i>Description</i>	<i>Mitigation measures</i>	<i>Rating^a prior to mitigation</i>	<i>Rating^a of residual risks</i>
<i>(1)</i>	<i>(2)</i>	<i>(3)</i>	<i>(4)</i>	<i>(5)</i>
Country and sector factors				
	Macroeconomic policy framework			
	Sector policies and institutions			
	Political stability and governance			
	Borrower and other official ownership			
	Beneficiary and civil society ownership			
	Institutional capacity (project agency and country)			
External factors				
	Economic (market) developments			
	International NGO concerns			
Social and environmental factors				
	Compliance with Bank safeguard policies where applicable			
	Country social/environmental protection systems			
Fiduciary factors				
	Compliance with Bank fiduciary guidelines			
	Country public financial accountability systems			
Communication Factors				
	Nature and extent of stakeholder participation (ownership, consensus, support)			
	Availability of and access to information (channels, disclosure policy)			
Internal and other factors				
	Staff skills (incl. stability in assignment)			
	Supervision resources			
	Other factors			
Overall risk				

^a Rating on four-point scale according to probability of occurrence and magnitude of adverse impact.

ANNEX 1.B

Sample Program Matrix: Conditions, Triggers, Milestones, and Outcomes for a Programmatic Development Loan or Credit
(Conditions for Loan 1 and triggers for Loans 2 and 3 are indicated in boldface type.)

<i>Issue</i>	<i>Operation 1</i>	<i>Operation 2</i>	<i>Operation 3</i>	<i>End-of-program outcomes</i>
Component I. Macroeconomic Policy Framework				
	The Government has maintained an adequate macroeconomic policy framework	The Government maintains an adequate macroeconomic policy framework	The Government maintains an adequate macroeconomic policy framework	
Component II. Improving Fiscal Management				
Allocations and actual spending for directly poverty-reducing expenditures are not yet consistent with priorities of the National Strategy for Growth and Poverty Reduction.	In the annual public expenditure review, Government has completed MTEF for 2001-2003 with increased allocations to directly poverty-reducing expenditures as defined in national strategy and has executed 2001 budget through first two quarters consistent with the agreed allocations.	In the annual public expenditure review, Government completes MTEF for 2002-2004 with increased allocations to directly poverty-reducing expenditures as defined in national strategy and has executed 2002 budget through first two quarters consistent with the agreed allocations.	In the annual public expenditure review, Government completes MTEF for 2003-2005 with increased allocations to directly poverty-reducing expenditures as defined in national strategy and has executed 2003 budget through first two quarters consistent with the agreed allocations.	Directly poverty-reducing expenditures as a share of actual expenditures increase from 24 percent in 1999 to about 36 percent in 2003.
Donor-funded projects are not included in the Public Investment Plan, limiting the utility of MTEF as a fiscal management tool.	Ministry of Finance has integrated donor projects for education, health, and water in 2002-2003 MTEF.	Ministry of Finance integrates donor projects for at least two additional sectors in 2003-2005 MTEF.	Ministry of Finance integrates donor projects for the remaining sectors in 2004-2006 MTEF.	Streamlined and simplified M&E arrangements as assessed by Ministry of Finance.
Lack of attention to and coordination in monitoring and evaluation (M&E).	Cabinet has approved the national M&E strategy.	Ministry of Finance <i>agrees on</i> common M&E arrangements across Government and donors.	Ministry of Finance <i>implements</i> common M&E arrangements across Government and donors.	
Component III. Improving Governance				
Pay systems and practices are inconsistent with sustainable capacity building and performance. Pay for professional and managerial staff is not competitive.	Cabinet has approved and published the pay strategy consistent with MTEF and improved public service performance.	Ministry of Public Service effects salary adjustments consistent with the pay strategy and linked to performance.	Ministry of Public Service contracts for independent survey of impacts of new salary structure on recruitment.	Government better able to recruit, motivate, and retain skilled staff as evidenced by independent survey of new staff and their qualifications.
Weak legal framework for and poor enforcement of procurement rules and regulations.	Ministry of Finance has tabled new Procurement Bill in Parliament.	Parliament approves new Procurement Law.	Auditor General carries out and publishes independent procurement audits covering at least 30% of the value of central government procurement during previous 12 months.	Increased transparency and reduced corruption in procurement as evidenced by independent audits.

	Ministry of Public Service has issued instructions to all ministries to establish procurement units with defined capacities.	Procurement units are created in all ministries. All staff receive training about the new law.	Share of misprocurement based on audits falls below 20% of value.	
Corrupt acts not exposed and sanctioned effectively.	Inspector General has proposed to Parliament a stronger follow-up mechanism for its reports.	Parliament approves and the Government begins implementing the stronger follow-up mechanism.	Share of open cases at year-end declines to 40% (from 60% in 2000). Inspector General reviews implementation and proposes changes, if necessary.	More effective follow-up of corruption cases as evidenced in part by declining share of open cases at year-end.
Component IV. Increasing Agricultural Productivity and Sustainability				
Access to and effectiveness of agricultural advisory services limited. Survey indicates that only 10% of farmers nationwide are satisfied with services.	Ministry of Agriculture (MoA) has contracted agricultural service providers in at least 10 districts.	MoA contracts agricultural service providers in at least 20 additional districts.	MoA contracts agricultural service providers in at least 40 additional districts. Inspector General has conducted survey of farmer satisfaction with services, and MOA has conducted survey of agricultural productivity in these districts.	Improved quality of and access to agricultural advisory services, and higher agricultural productivity. At least 65% of farmers in the districts covered by new contracts report satisfactory services.
Agro-processing and marketing constraints inhibit domestic sales and exports of agricultural products.	Based on last year's study of constraints to agricultural exports, Ministry of Agriculture and Agency for Export Promotion have agreed on agro-processing and marketing strategies for strategic exports, which was endorsed in the National Strategy for Growth and Poverty Reduction.	Government implements strategy, including eliminating the export tax on processed vegetables and fruits.	Government continues implementing the strategy.	Agricultural exports increasing.
Implementation of the 1998 Land Act to address land tenure insecurity is being poorly implemented because of inadequate institutional capacity and defects in legislation.	Cabinet has agreed on financial and institutional arrangements for strengthening the Land Administration Agency (LAA).	National budget and MTEF include approved financing for LAA.	LAA grants new titles at a rate of 4000 annually. Ministry of Agriculture completes evaluation of previous year's performance by LAA in granting titles and adjudicating conflicts.	Increased agricultural productivity.
	Cabinet has submitted amendments to the Land Act to Parliament.	Parliament approves amendments to Land Act.		
Although expanding activities of the National Environment Management Agency (NEMA) is included in the National Strategy, NEMA budget is not within MTEF. Its budget allocations have been variable, impairing agency effectiveness and staff recruitment.	Ministry of Finance includes increasing funding for NEMA within MTEF 2001-2003.	NEMA budget for 2002 increased by 25% over 2000.	NEMA budget for 2004 maintained at least at previous year's level. NEMA extension agents provide training in at least 25 districts.	

**GOOD PRACTICE NOTE 2—
USING POVERTY AND SOCIAL IMPACT ANALYSIS
TO SUPPORT DEVELOPMENT POLICY OPERATIONS**

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GOOD PRACTICE NOTE 2— USING POVERTY AND SOCIAL IMPACT ANALYSIS TO SUPPORT DEVELOPMENT POLICY OPERATIONS

1. Good Practice Note 2 provides advice to World Bank staff and their government counterparts on promoting poverty and social impact analysis (PSIA) in-country and integrating it within development policy operations.¹ This note focuses on good practices in setting priorities for policy reforms and policy actions for analysis, designing the analytic work and the PSIA process, and integrating the findings in the design and implementation of operations. Development policy operations vary considerably by country context and reform program. Given the difficulty in analyzing the distributional impacts of a wide range of policy reforms, PSIA cannot be based on rigid rules. See Box 2.1 for a fuller description of PSIA.
2. The PSIA design, including the choice of tools—and the depth of the analysis—will depend on the nature of the reform, the timeframe for the analysis, the information base, and the resources (including domestic capacity).² Where information is sparse and time short, the core issues may have to be addressed on the basis of knowledge of the country and international experience of similar reforms. (In these cases, it is advisable to include a plan for improving the information base.) Where countries are better placed in terms of the information base, time, and resources, these assets should be taken into account when deciding the extent of the analysis.
3. This note provides a framework to help staff and governments acquire information on the possible distributional impact of planned reforms—to improve policy design, outcomes, and sustainability of the reform program. It covers three main topics: (a) embedding PSIA in country work, (b) selecting reforms for PSIA, and (c) following good practices in the PSIA process.

Box 2.1. What is PSIA?

Poverty and social impact analysis refers to analysis of the distributional impact of policy reforms on the well-being or welfare of different stakeholder groups, with a particular focus on the poor and vulnerable. PSIA also addresses sustainability and the risks to policy reform and help to monitor poverty and social outcomes and impacts of policy changes.

The World Bank assists clients in analyzing the poverty and social impacts of reforms of country policies and institutions as part of its core mandate. It has an important role—with other development partners—in helping countries undertake PSIA to inform their national poverty reduction strategies, specific reform programs, and the Bank operations that support them.

For the Bank, PSIA is neither a new product nor a fiduciary requirement. It is a systematic approach to integrating analysis of potential distributional impacts of policy reforms in the Bank's operational work.

¹ Development policy operations may involve IBRD loans; IDA credits, including IDA poverty reduction support credits (PRSCs); or IDA grants.

² See *User's Guide for Poverty and Social Impact Analysis* (PRMPR/SDV, The World Bank, June 2003). Also see <http://www.worldbank.org/psia>.

I. EMBEDDING PSIA IN COUNTRY WORK

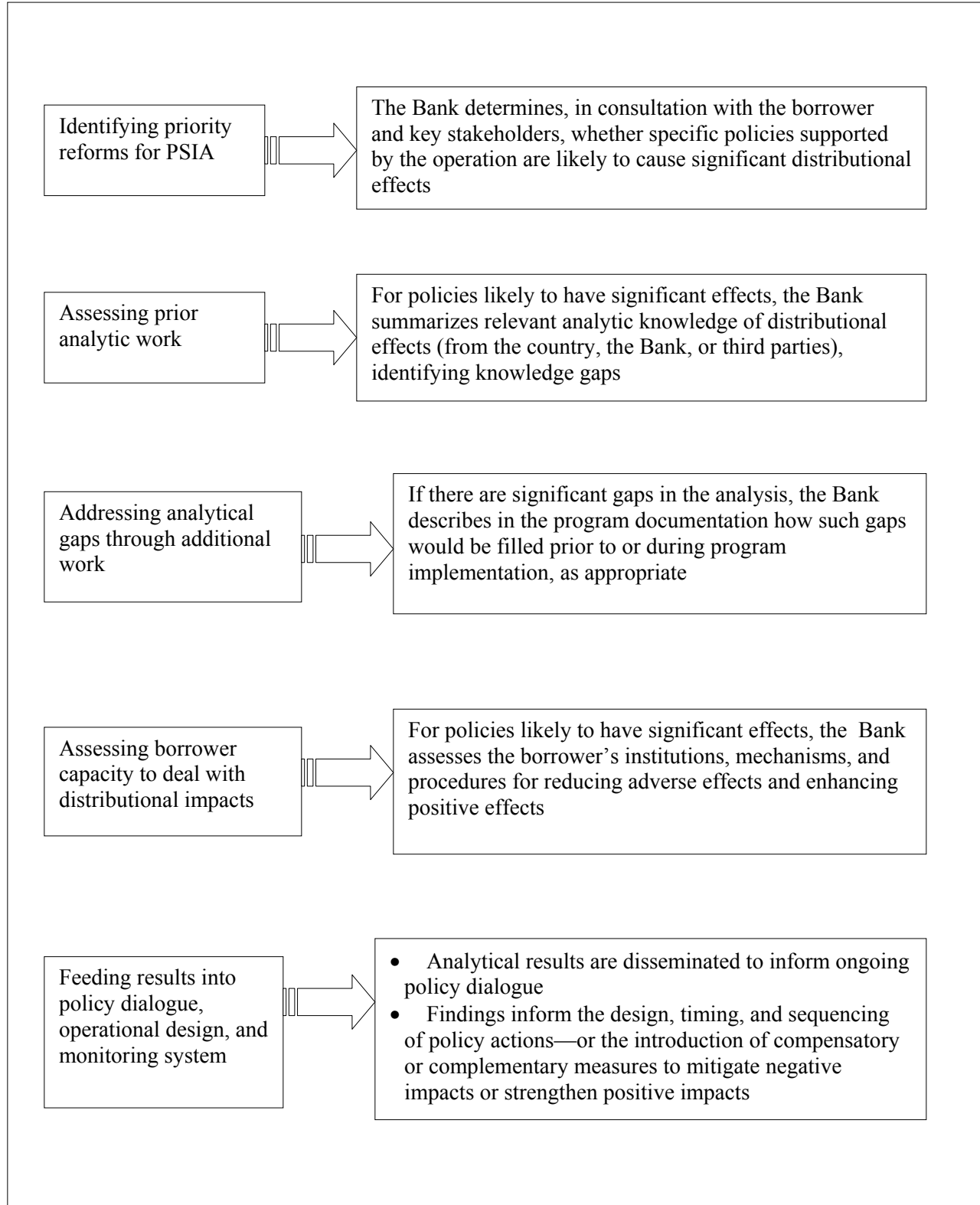
4. The adoption of the Poverty Reduction Strategy Paper (PRSP) approach and of the Millennium Development Goals framework has increased the need for more systematic analysis of the poverty and social implications of reforms. Poverty reduction responds to changes either in growth or in distribution. Because poverty reduction has become the main goal of development, a debate has emerged over the distributional implications of many of the policies implemented within the framework of pro-growth strategies. By paying more systematic attention to distributional consequences of policy reforms, PSIA also informs that debate. PSIA is primarily the responsibility of borrower governments. But the Bank and other development partners have a major role in building local capacity for PSIA, and in helping countries fill analytical gaps and use PSIA to inform their national strategies and policy design. The Bank also needs to ensure that sound analysis underpins the reforms it supports.

5. ***A Multiyear Programmatic Framework.*** Development policy lending is expected to support reform efforts by borrowing countries. In IDA countries the policy reforms are likely to emerge from the PRSP process. Since most policy and institutional reforms are long-term processes, it is likely that many operations will build on earlier phases of a government's reform efforts.³ So these reforms normally have a gestation period long enough to do relevant analytic work before preparing a lending operation. A multiyear programmatic framework makes PSIA feasible

6. ***Integrating PSIA Within ESW.*** Reform programs and the operations that support them can be designed in detail only when there is enough analysis of the problems to be solved and enough clarity on the likely impact of the proposed interventions. For the Bank, planning for PSIA should take place within the standard cycle of economic and sector work (ESW). This is important because good analysis requires long lead times. PSIA of broad structural or macroeconomic reforms is normally carried out in conjunction with country-level ESW, such as Poverty Assessments, Public Expenditure Reviews, and Country Economic Memoranda—if the reforms and policy actions are sufficiently clear for their possible impacts to be assessed adequately when the ESW is carried out. PSIA may also be carried out through specialized sector work, as is often done for sectoral reforms. PSIA is a natural extension of the analysis underpinning a reform agenda with a potentially significant distributional impact.

7. In considering PSIA for a lending operation, Bank staff will draw on PSIA conducted upstream within the standard ESW cycle. It is highly desirable to carry out PSIA work upstream, prior to the preparation of the development policy operation. Where the country or other development partners have undertaken adequate analysis (say, through the PRSP process), the Bank can substitute this for its own analytic efforts. If there are analytical gaps, Bank staff can identify additional analysis that may be needed, taking into account the views of the government and other stakeholders. If upstream analytic work is not available and the country team or borrowing government feels the need to assess poverty and social impacts of a particular reform, further work to support the operation may also be undertaken within the constraints of data, time, and resources—to be part of the program documents or a self-standing document.

³ See *Good Practice Note 1— Designing Development Policy Support Operations*.

Box 2.2. The PSIA Process for Development Policy Lending

8. Under the revised policy for poverty reduction (OP 1.00, which replaced OP 4.15), the Country Assistance Strategy (CAS) will summarize existing knowledge on poverty, identify analytical gaps, and present the work program by the Bank and others to fill these gaps. Bank assistance for PSIA will be described—and budgeted for—in the CAS. Typically, the CAS

would set out key policy reform areas, identifying those for which PSIA will be undertaken and laying out the plan for integrating PSIA within existing Bank instruments. If reforms are to be supported in the outer years of the CAS and their details are not fully known during CAS preparation, the need for analytic work may be identified subsequently. Development policy support operations summarize the results of PSIA associated with specific reforms—except when the borrower or the country team feels that disclosure may compromise the success of the operation.⁴

9. ***PSIA in Development Policy Operations Supported by the Bank.*** Operational Policy (OP) 8.60, *Development Policy Lending*) requires Program Documents for development policy operations to specify which policies supported by the operation may have significant distributional consequences. For those policies, the Program Document summarizes the analytic knowledge (based on work by the country, the Bank, donors, or other agencies), and the country's ability to minimize adverse impacts and enhance positive impacts. If PSIA is carried out in the context of a specific policy-based lending operation, (a) the analysis may be conducted by the Bank or other partners before the operation goes to the Board or (b) the operation may proceed to the Board with an action plan (including a timeline) for the PSIA, describing how the analytical gaps will be filled prior to or during implementation.

10. PSIA may not be possible in emergencies or crises where there is no time for analysis. In such cases, teams are advised to state their assumptions about the expected impacts and monitor actual impacts so that the policy design and implementation can be modified as necessary.

11. ***Promoting Evidence-Based Decisionmaking by Building an In-Country PSIA Constituency.*** Countries may require substantial support from the Bank and other development partners to carry out PSIA. Building an in-country constituency and capacity for PSIA will strengthen country ownership and increase the prospects for mainstreaming PSIA work. Good practice involves three levels of capacity building:

- Strengthening the capacity of research organizations and government agencies to undertake PSIA data collection and analysis. This implies that the tools and methods used should be realistic, understandable, and replicable.
- Enhancing the ability of government policymakers to review the results and recommendations and consider policy alternatives based on the findings. This implies that the findings have to be shared with policymakers in a transparent and credible manner, easy to understand and communicate.
- Providing key stakeholders and opinion makers with evidence to consider during their internal policy debates and to build ownership for the reform.

II. SELECTING REFORMS FOR PSIA

12. Selectivity is essential in the choice of reforms to be analyzed. It is not possible to meaningfully undertake PSIA for overall PRSP or Poverty Reduction and Grant Facility (PRGF) programs. Two constraints limit the ability to analyze impacts of entire programs. First, many

⁴ In some cases, such as the PSIA of a market-sensitive reform (such as an exchange rate devaluation), a fully open process might jeopardize the effectiveness of the reform.

policy reforms identified in PRSPs are stated as priority thematic areas where the policy actions that could be subjected to analysis have not yet been developed. The lack of specificity of policy actions can preclude meaningful PSIA at that stage. Second, the interactions among the proposed reforms create further complexities, making it difficult to assess precisely the impact of an entire program of reforms simultaneously.

13. The PSIA User's Guide recommends that country teams identify reforms in the government's agenda likely to have significant distributional impacts on different stakeholder groups, with a special focus on the poor and vulnerable. Reforms may be included in the government's agenda and considered a high priority for the operation for a variety of reasons, including their macroeconomic or fiscal impact, or because certain structural legacies constrain a country's development potential, or because a government would like to transform the governance structures for improved service delivery. If time and resources permit, PSIA should be carried out for all reforms with significant distributional impacts. But not all reforms are expected to have sizable impacts. For example, measures for improving budgetary processes may have only limited distributional impacts and not need PSIA in their design stage.

14. The selection process will inevitably be a matter of judgment at the country level (see Box 2.3 for suggested criteria). Even if some reforms typically have distributional implications, it may become clear that distributional impacts are negligible. For example, reforms of income tax brackets could have minor consequences for the overall income distribution of the country if the share of the population reporting income taxes is relatively small. In many low-income countries the share of the population filing for income tax can be as low as 10 percent. In such cases the usefulness of PSIA of tax reform would be low and should not be pursued.

Box 2.3. Suggested Criteria for Selecting Reforms for PSIA

- The expected size and direction of the poverty and social impacts
- The prominence of the issue in the government's policy agenda
- The level of national debate surrounding the reform, and.
- The timing and urgency of the underlying policy or reform.

15. But even if the expected distributional impact is small, the national debate surrounding the reform may be such that PSIA would enhance the policy dialogue. For example, in many countries privatization of public assets may be perceived as being potentially detrimental to the poor, but it could have significant positive economic impacts. In these circumstances, PSIA can help understand the real distributional implications of such reforms and contribute to the design of policy actions and appropriate mitigation strategies, thus improving the likelihood of acceptance. And in countries with high ethnic tensions, or high levels of gender inequality, even a small perceived or realized gain of one group over another one may lead to serious social consequences. PSIA could help in dispelling wrong perceptions or in designing the reform in a socially acceptable form.

16. ***Working with In-Country Stakeholders and Other Development Partners.*** With the increased emphasis on country ownership and partnerships, the benefits of consulting with in-country stakeholders and development partners outweigh the transaction costs. In many cases, the PRSP process and the CAS process provide a useful basis for consulting the client on reform priorities for PSIA. Typically, the following stakeholders can help identify priorities for PSIA in any given country—central ministries of finance and planning, parliamentarians, key implementing agencies, private firms, civil society organizations, and other development

partners. If the PRSP and CAS process did not provide an opportunity to consult more broadly on PSIA priorities, consultation with key stakeholders can take place subsequently—either through formal consultation workshops, or more informally through a scoping mission. In several borrowing countries this has helped with selectivity and enabled transparency in the selection process, providing a justification for limiting PSIA to a few key reform areas. To be effective, consultation on reform priorities for PSIA should be undertaken as far upstream of the operation as possible to enable completion of the analysis in time to help the operation’s design.

17. The following questions can help guide decisionmaking on the need for PSIA:

- Has PSIA of priority reforms relevant to the development policy operation been carried out during formulation of the PRSP or the CAS?
- If not, has PSIA of priority reforms relevant to the development policy operation been carried out through core diagnostic ESW?
- If not, has PSIA of priority reforms relevant to the development policy operation been carried out through specialized sector work?

18. If the answer to any of the above questions is yes, the findings of the PSIA would be expected to be summarized in the Letter of Development Policy and in the documentation being prepared for Board submission. Annex 2.A provides a format to summarize essential PSIA information in a matrix. If the answer to all three questions is no, and if the operation is intended to support reforms with significant distributional impacts on different stakeholders, additional PSIA work may be warranted.

19. ***Focus on key policy actions within the reform.*** Most reforms involve significant policy and institutional changes, and impacts are generated by the policy actions emanating from these changes. Poverty and social impacts typically refer to changes in poverty, employment, asset endowments, access to goods and services, and inequality as a result of policy actions proposed or under implementation.⁵ Good PSIA is possible only when the policy actions related to the proposed reforms have been clearly specified. If there is ambiguity on the policy actions, the task team should interact with the proponents of the reform—including those in the government and relevant line ministries, as well as those among development partners—to clarify the policy choices being contemplated.

III. GOOD PRACTICES AND INTEGRATING THE FINDINGS IN OPERATIONS

20. The approach to PSIA should be country-specific and context-specific and should depend on the data, the capacity and analytical constraints, and the timeframe for the analysis. Given the challenges in practice, the tools and techniques used for PSIA typically vary greatly across countries, reforms, and circumstances. In some cases, international experience of similar reforms and knowledge of the country will form the basis of the analysis. In others, the use of analytical

⁵ The sustainable livelihoods framework, first popularized by the U.K.’s Department for International Development, describes five types of assets (sometimes called five types of capital)—physical, financial, natural, human, and social—that determine peoples’ livelihoods. Livelihoods can be affected by changes in the asset endowments, and in changes to the returns on those assets.

frameworks that exploit social and economic tools should be carried out. Regardless of the method chosen, the analysis should address the core issues outlined in annex 1. With the Bank in the process of mainstreaming poverty and social impact analysis, further country experiences are likely to provide lessons to be reflected in future staff guidance.

21. Although there is no methodological template for analyzing the poverty and social impacts of policy, it is possible to identify a number of elements that make for good practice PSIA (see Annex 2.A).⁶

22. **Anchoring PSIA in National Poverty Strategy.** Carrying out PSIA will vary according to the national political context, the enabling environment for participation, and the reform issues. An emerging good practice is for PSIA to be anchored in the formulation and implementation of national poverty reduction strategies to strengthen country buy-in and the impact of the analysis on policy. This is also critical to fostering greater national demand for analysis and a culture of evidence-based policymaking. Other emerging good practices include the following:

- (a) **Focus on upstream analysis.** To allow discussion of reform alternatives, PSIA should be carried out as far in advance of the policy decision as possible.⁷
- (b) **Build on prior analytic work.** PSIA should as far as possible make use of earlier analytic work and information pertinent to the reform.⁸
- (c) **Coordinate analytic work with operational design and policy dialogue.** PSIA work is more useful when closely coordinated with country operations and policy design, and when its results feed directly into the policy dialogue. Ensuring consistency between the analysis and operational design requires real-time interaction between the team conducting the analysis and the teams designing the operation.
- (d) **Build country capacity to sustain PSIA work.** When selecting analytical tools and methods, in addition to data limitations, capacity constraints to undertake PSIA, use its results effectively, and sustain PSIA through systematic monitoring and evaluation must be considered. PSIA should be carried out in a manner, and with a time frame, that maximizes the opportunity for national capacity building.
- (e) **Ensure stakeholder involvement and transparency.** The PSIA process should involve as many key stakeholders in the reform as possible, including civil society. The choice of the reform issue⁹ and the research questions should emerge from broad discussion of the national poverty reduction strategy. The results of the analysis should be made public, wherever possible.¹⁰ And the process of tracking impacts—and adjusting policy in the light of these impacts—should be inclusive.
- (f) **Integrate gender concerns systematically.** Women and men consistently encounter differing constraints and opportunities the world over, and their needs, interests, and

⁶ More detailed guidance can be found in the *PSIA User's Guide* (2003), while guidance on individual tools is being published in a PREM-DEC toolkit on economic tools. In addition, Social Development has published a Sourcebook on Social Analysis, and further guidance on social tools is forthcoming.

⁷ A good rule of thumb is 6–12 months before the policy decision is taken. If ex ante analysis is not possible, plans for the analysis should be included in the next phase of the program.

⁸ These may be available for the country concerned or for similar countries facing the same reform issue.

⁹ Country experience suggests that PSIA is more manageable where the analytic work is done separately for one or two reforms. Multiple reforms are best addressed sequentially or in parallel.

¹⁰ Good Practice Note 1—Designing Development Policy Operations.

access to resources often diverge, particularly in poorer countries. If policy impacts are expected to have differential impacts on men and women, the PSIA design should capture these disparities, and the PSIA process should ensure that they are adequately addressed and monitored. Good practice involves including gender indicators and intrahousehold data, gender balance in the research team, gender balance in the selection of respondents, and a gender-neutral environment often requiring separate interviews or focus groups with women. Finally, when the analysis explores the sensitivity of proposed institutional arrangements to gender impacts, it becomes more feasible to identify opportunities to redress gender constraints during reform implementation.

- (g) ***Ensure flexibility in the choice of institutions conducting the PSIA.*** Depending on the country, different institutions may be best placed to carry out the PSIA. Besides the government, these might include the Bank, the IMF, bilaterals, civil society, research groups, and other development partners. The key is to embed the PSIA within the national strategy process—and conduct it such that it builds national capacity.
- (h) ***Coordinate with development partners.*** In countries where other development partners—such as multilateral and bilateral agencies, international NGOs or in-country organizations—are willing and able to engage in PSIA work, coordinating PSIA priorities and harmonizing analytical approaches can ease the pressure on the available analytical capacity. In several countries bilateral agencies are taking the lead on some PSIA. Coordinating with development partners does not relieve the Bank team of its responsibility to assess the relevance of the PSIA or to take account of its findings within the proposed operation.
- (i) ***Conduct client consultation workshops.*** Organizing workshops to discuss interim results with in-country stakeholders and development partners can help to interpret the results, provide insights to refine operational recommendations, facilitate donor coordination for country programs, and increase the likelihood of country ownership of reforms that draw on the PSIA. These workshops provide an opportunity to disseminate results more widely, demystify some myths about reform impacts, and encourage evidence-based dialogue on the reform.
- (j) ***Integrate multidisciplinary approaches.*** Policy and institutional reforms affect economic relations and social relations. Policy reforms need to be based on a proper understanding of how these interconnected relations may affect the proposed policy change, and how the policy change will alter these sets of relations. Sound policy design relies on multidisciplinary approach for understanding these relationships. Good practices in PSIA emerging from country experience suggest the following:
- *Don't* assume that policy changes will affect everyone equally and will lead to similar behavioral responses.
 - *Do* combine analytical techniques to analyze economywide impacts as well as impacts differentiated by social diversity and differences in asset endowments. Use social analysis to generate hypotheses that can be tested through econometric techniques. Complement economic modeling with social analysis to provide more detailed insights about particular stakeholders, such as the poor and vulnerable groups, or politically powerful interest groups, relevant to the reform.
 - *Do* combine quantitative and qualitative data to inform the analysis. Don't abandon the analysis if reliable, quantitative data are not available for some

countries. Do look for existing sources of information; often valuable sociological, political, and even microeconomic information can be pulled together to inform the analysis and policy dialogue.

- *Do* draw on economic, social, and political insights when considering policy reform options and assessing risks, including how political economy and social relations might affect reform outcomes and how the proposed reform might alter economic, social or political relations.
- *Don't* ignore the political economy. Many perfectly sound reforms have failed because of lack of ownership or political support for the reforms.

(k) **Initiate PSIA ex ante and monitor results during implementation.** Ideally, PSIA should be initiated ex ante. But poverty and social impacts cannot be fully known ex ante. In practical terms, policy reforms in any given domain tend to involve multiyear programs. For ongoing programs, it is feasible to look at poverty and social impacts of past policy actions to draw lessons for future reforms. Ex ante PSIA provides the empirical baseline and analytical structure for continuing analysis, but the results should be monitored and validated during implementation. Good practice suggestions include the following:

- Integrate monitoring of poverty and social impacts within national monitoring systems, such as the poverty monitoring established for the PRSP.
- Add relevant questions to ongoing household surveys to generate time series data for monitoring and evaluation. These could specify key indicators for relevant transmission channels to track the impacts of major reforms. If not already part of the survey design, add indicators on income inequality, mobility (including livelihood and physical mobility), and risk coping mechanisms (including social protection and social capital).
- Establish control groups for both quantitative and qualitative research.
- Establish systems to generate panel data. Look for disadvantaged groups based on geography, social, or livelihood characteristics, for whom the impacts could be tracked over time by building a system for purposive surveys and participatory monitoring and evaluation during implementation, to supplement the analysis of national household surveys.

KEY QUESTIONS TO BE ADDRESSED BY PSIA: A SUMMARY MATRIX

1. Annex 2.A presents an example of a summary matrix that integrates the various elements of a good PSIA, as outlined in the PSIA User's Guide. It provides a framework for considering and articulating key aspects of PSIA for a given reform. It also offers a template for making explicit some of the results and assumptions underlying such analysis. The matrix can be used to summarize the core issues for each relevant PSIA in program documents for development policy operations. If necessary, it can also be adapted, as appropriate, within operational documents.
2. The matrix can be useful during the PSIA process. For instance, an analyst may wish to sketch out the priors in each of the seven key questions of good PSIA before undertaking an analysis—and then return to the matrix to validate or correct these hypotheses. The matrix can also help in assessing the value and relevance of prior analytic work as PSIA for the operation under consideration.
3. The matrix calls for the analyst to set out the reform components and the reasons for selecting that reform for PSIA (question 1) and the institutional mechanisms to carry out the reform (question 2). It then allows the analyst to summarize the anticipated impact of the policy reform on different stakeholders, as transmitted through five channels: employment, prices, access to goods and services, assets, and transfers and taxes (questions 3, 4, and 5). The analyst should explicitly recognize the stakeholders likely to gain from the reform, those likely to lose, and those likely to have significant influence over the reform.
4. The matrix also calls for an explicit statement of the assumptions underlying the reform. Depending on the country, conclusions on likely policy impacts will draw on different information bases and tools. In one country the matrix may be filled out using informed reasoning based on secondary data and qualitative field research. In another the conclusions may be based on empirically simulated effects derived from modeling techniques using data from recent household surveys and existing social analysis. In either instance, the matrix calls for a description of the information base and analytical methodology. The matrix also calls for the analyst to specify key risks associated with the reform, their likelihood and expected magnitude (question 6). Finally, it presents the impact that the analysis has had on national policy discussions (question 7).
5. Here are seven key questions and further guidance for filling in the matrix:

(1) What reform was chosen for PSIA and why?

Criteria might include prominence of the reform within the national policy debate, uncertainty of impact (particularly between short-run and long-run effects), size of likely impact, and controversy about the magnitude or direction of impacts.

(2) *What are the implementation mechanisms for carrying out the reform?*

These mechanisms could be institutions and organizations¹ directly or indirectly involved in the reform and affecting its outcome. Examples include markets, legal systems, and government agencies.

(3) *Which stakeholders are likely to be affected by the reform, positively or negatively? Which stakeholders are likely to affect the reform?*

Stakeholders might include:

- Affected groups such as the poor or non-poor, regional groups, socio-demographic categories, occupational groups, and ethnic and religious groups.
- Organized interest groups such as government agencies, trade unions, producer groups, civil society, the media, and other lobby groups.

(4) *What are the principal channels for each of these groups or institutions to be affected by (or to affect) the reform?*

Impacts are transmitted through five main channels: employment and wages, prices of goods and services, access to goods and services, assets, and transfers and taxes.

(5) *What are the expected direction and order of magnitude of the impact on the groups likely to be most affected? What are the key assumptions on which these impacts are predicated? (Specify the information or tools.)*

- Impacts involve attention to income and non-income measures of well-being (these may include access to basic services, vulnerability, inclusion, and human and social capital).
- Impacts should also be differentiated for short-run and long-run effects and direct and indirect effects.
- Examples of key assumptions are the entry of private firms following the easing of market restrictions, the existence of government capacity to regulate the private sector, the efficient administration of social protection payments so that targeted benefits reach the poor, and the improvements in local services for the poor following decentralization.

(6) *What are the main risks that could change the expected impact of the reform? What is the likelihood and expected magnitude of these risks?*

Risks might arise from the political economy (the possibility that interest groups undermine the reform or capture benefits), exogenous shocks (a worsening in the terms of trade), the institutional context (the risk that the private sector does not respond as expected to the incentives), or other country conditions (conflict or social tensions).

(7) *What is the process for feeding the analysis into national policy discussions? What impact has the PSIA had (is PSIA expected to have) on policy? (Ideally, give an*

¹ Institutions are rules of the game (codes of conduct, norms of behavior, and conventions). Organizations are groups of individuals, bound by a common purpose, involving a defined set of authority relations and dedicated to achieving objectives within particular rules of the game.

indication of how actual impacts will be tracked and how reforms will be adjusted in the light of findings.)

- There could be various channels for feeding analysis into policy debate, including the country's PRSP team, consultation meetings around the national poverty reduction strategy, and the media.
- Policy impacts could include a fundamental rethinking of the reform, a decision to change the timing or sequencing of the policy, or the introduction of compensatory or complementary measures to mitigate negative impacts or strengthen positive impacts.

ANNEX 2.A. PSIA SUMMARY MATRIX

Reform:						
1—What reform was chosen (major components) and why?						
2—What are the institutional mechanisms through which the reform will be carried out?						
3—What stakeholders are likely to be affected by the reforms? Which stakeholders are likely to affect the reform and how?	4—Through which channels are the stakeholders affected?					5—What are the expected direction and order of magnitude of impact(s)? What are the underlying assumptions?
	<i>Labor market</i>	<i>Prices</i>	<i>Access to goods & services</i>	<i>Assets</i>	<i>Transfer and taxes</i>	
Stakeholders affected (positively and negatively):						
Stakeholders with significant influence over the reform:	Possible support or opposition:					
What information basis and techniques were used to answer questions 3, 4 and 5?						
6—What are the main risks which would change the expected impact of the reform? What are their likelihood and expected magnitude?						
Type/nature of risk:				Likelihood	Expected magnitude	
Political economy risks:						
Exogenous shocks:						
Institutional risks:						
Other country risks:						
7—What impact has the analysis had on national policy discussions?						

TEN KEY ELEMENTS OF THE PSIA APPROACH

Chapter 3 of the *PSIA User's Guide* outlines 10 key elements of the PSIA approach. The degree of attention to each of these elements will vary by the country and reform:

- (1) Asking the right questions.
- (2) Identifying stakeholders.
- (3) Understanding transmission channels.
- (4) Assessing institutions.
- (5) Gathering data and information.
- (6) Analyzing impacts.
- (7) Contemplating enhancement and compensation measures.
- (8) Assessing risks.
- (9) Monitoring and evaluating impacts.
- (10) Fostering policy debate and feeding back into policy choice.

(1) **Formulate the right research questions.** Once the policy action choices have been clarified, task teams can go about formulating the key questions for analysis. Typically, the research questions should be derived from a scoping exercise that includes clarity on the policy change and assumptions about its design and expected consequences. Essential elements to consider include the following:

- Get clarity from the borrower on the desired impact of the reform, best stated by making transparent the assumptions about expected benefits, such as fiscal benefits, greater financial sustainability of the sector, or improved quality of services
- Identify the proposed institutional arrangements or institutional alternatives for reform implementation
- Make assumptions about the interests and concerns of key stakeholders
- Identify stakeholder groups, especially those vulnerable to impoverishment, whose welfare is of principal concern
- Make assumptions about the outcomes and impacts of the policy actions on poverty, employment, assets, access to services, and inequality.
- Make assumptions about behavioral responses of different stakeholders to the policy change.
- Consider the counterfactual—would people be better off without the reform? Can the country afford to not change existing policies?

(2) **Identify stakeholders.** Stakeholder analysis identifies the people, groups, and organizations that are important to consider when looking at the poverty and social impacts of reforms (Box 2.B.1). The analysis should examine:

- Stakeholders who may be affected by the reform, positively or negatively.
- Stakeholders who may affect the reform, by supporting or resisting it.

Box 2.B.1. Stakeholders who may affect reforms

- The borrower (Finance and Planning).
- Parliamentarians that ensure political support for the reform.
- Key implementing agencies that clarify policy actions under consideration and assumptions about impacts. They are relevant sector line agencies, appropriate levels of local government, and other partners such as private sector, NGOs with implementation role.
- Civil society stakeholders—research institutions, media, trade unions that can articulate and influence perceptions about reforms.
- Development partners that include donors and international NGOs.

- (3) ***Differentiate impacts based on expected transmission channels.*** Policy reforms can be expected to have an impact on various stakeholders through five main transmission channels—employment, prices (production, consumption, and wages); access to goods and services; assets; and transfers and taxes.¹ Each policy reform may have impacts through more than one channel. All applicable channels should be considered in PSIA design.
- (4) ***Assess institutions.*** Institutions determine the framework in which policy reforms may affect households and individuals and are the main arenas in which stakeholders interact with one another. PSIA needs to consider:
- How institutions and interests mediate the impact of policy reforms.
 - How the analysis of markets and organizational structures reveals the necessary conditions for the benefits of interventions to reach the poor.
- (5) ***Use existing sources of information.*** Over the years a wealth of knowledge and analysis has been generated on most borrowing countries. Nationally representative household survey data, while reliable, may not be available in many. So tapping alternative sources of information, especially those generated by in-country organizations and donor partners, can be invaluable.
- Draw on experiences of similar reforms in other countries, but control for variations in the country context.
 - Tap the often underused wealth of information in dissertation research on borrowing countries.
 - To obtain useful insights, examine the analysis of the effects of prior reforms conducted by non-Bank sources—the government, bilateral donors, local universities and research institutions, and civil society organizations.
- (6) ***Formulate testable hypotheses about likely distributional impacts of policy and select tools and methods to analyze the impacts.*** Organize research questions to test critical links between the policy objectives, policy actions, and their impacts on key stakeholder groups. Hypotheses should consider the expected nature of impacts.
- Long-term impacts may be different from short-term impacts. It may be easier to assess short-term impacts ex ante and long-term impacts ex post. But it is crucial that both short-term and long-term impacts are considered ex ante.

¹ See pages 4–6 and page 12 of the *PSIA User's Guide* for further discussion of transmission channels.

- Impacts may be direct or indirect. Typically direct impacts are easier to measure but some indirect impacts may need to be included for the analysis to be realistic.

The nature of effects also needs to be considered. Depending on the reform, the effects can be incremental (that caused by tariff increases, tax revisions) or involve major transformations in livelihoods (loss of employment due to restructuring of an entire sector) or asset entitlements (land reform) that can result in more complex and lasting effects on some people. In the latter case, the analysis should consider the nature of alternative opportunities available and the conditions needed to promote viable alternatives. The effects and the alternative opportunities may vary by:

- Geographic location.
- Age (younger workers being able to find alternative employment more easily than middle-aged workers).
- Gender (outmigration may be easier for men than women with child-rearing responsibilities).

In addition to individual characteristics, effects on institutions that provide risk-coping mechanisms should also be considered—such as government-administered social protection schemes or community-based social capital.

- (7) **Consider enhancement/compensation measures.** If the ex ante analysis reveals adverse effects on the living standards of the poor or other vulnerable groups:
- *Consider alternative design.* The design of the reform can be improved by including enhancement or mitigation measures, or a different sequencing of public actions.
 - *Consider direct compensatory mechanisms.* When adverse effects are unavoidable, consider compensatory measures on poverty, equity, or political economy grounds.
 - *Consider delay or suspension of reforms.* If the benefits of the reform are lower than the costs of mitigating or compensating the poor.
- (8) **Assess risks.** Risk assessment addresses the risk that some of the assumptions underlying the analysis may not be realized. These include the consideration of institutional risks, political risks, exogenous risks, and other country risks.
- (9) **Monitor and evaluate impacts.** Poverty and social impacts should be tracked during the introduction of the reform and evaluated ex post so that any necessary policy corrections can be made.²
- (10) **Foster policy debate and seek feedback for policy design.** PSIA results should be fed back into the development policy support operations at three levels:
- Feeding results back into the policy dialogue process.
 - Feeding results into operational design of the reform.
 - Integrating PSIA concerns into national monitoring and evaluation systems.

² Monitoring and evaluation should be integrated within existing national monitoring systems.

RESOURCES AVAILABLE TO TASK TEAMS

PSIA Website: Includes details on country examples, resources on tools and methods and PSIA training material

www.worldbank.org/psia

PSIA User's Guide:

<http://lnweb18.worldbank.org/ESSD/sdvext.nsf/81ParentDoc/PovertySocialImpactAnalysis?OpenDocument>

Toolkit For Evaluating the Poverty and Distributional Impact of Economic Policies:

<http://www.worldbank.org/poverty/psia/tools.htm>

Consultants Roster: A roster of consultants with various skills in poverty and social impact analysis has been prepared and will be periodically updated. The roster can be accessed at <http://www-wbweb.worldbank.org/prem/prmpo/psia/index.htm> or by sending an email to psia@worldbank.org.

Learning Program: Country teams should communicate to the PSIA team if they have specific learning requirements. As new Learning Events are organized they will be posted on the PSIA website under the Training section.

Reform Briefings: Guidance documents on selected, key reforms are currently being prepared. When available, these will be posted on the website under a 'Reform' section.

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**GOOD PRACTICE NOTE 3—
FINANCIAL MANAGEMENT ISSUES IN DEVELOPMENT POLICY LENDING**

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GOOD PRACTICE NOTE 3— FINANCIAL MANAGEMENT ISSUES IN DEVELOPMENT POLICY LENDING

I. INTRODUCTION

1. Development policy support is rapidly disbursing policy-based financing, which the World Bank¹ provides in the form of lending or grants to help a borrower address its actual or anticipated financing requirements that have balance of payments or fiscal origins. The objective of such support is to help a borrower achieve sustainable reduction in poverty through a program of policy and institutional actions. The Bank may provide development policy support to a member country, or to a subnational division of a member country. Some key features outlined in Operational Policy (OP) 8.60, *Development Policy Lending* that are important background for the financial management of such operations, are highlighted in Box 3.1.

2. ***Purpose of this Note.*** These good practices are intended to assist financial management specialists (FMSs) and task teams on financial management issues in development policy lending. The framework for the Bank's fiduciary policies in development policy operations recognizes the need for professional judgment in each individual case; this note is intended to assist (but not replace) such judgment. In this context, staff should become familiar with the Bank's operational policies and procedures relating to development policy support.² It is expected that the good practices note will periodically be updated as operational lessons are learned.

3. ***Structure of this Note.*** Following this introduction, Section II discusses the main financial management issues in development policy operations, and how these would be addressed. Section III discusses the documentation of financial management issues in development policy operations. Section IV deals with supervision, monitoring and evaluation of financial management aspects of development policy operations.

4. ***Role of FMSs.*** FMSs, as part of the task team, work collaboratively with government counterpart teams and should be involved from an early stage of development policy operations, and should be involved throughout the operation (concept, preparation, appraisal, negotiations, supervision, and completing reporting). It is especially important that FMSs coordinate their work with the task team leader and other relevant team members (e.g., those working on public expenditure management, fiscal and governance issues) in many instances from the Poverty Reduction and Economic Management (PREM) Network.

¹ "Bank" includes IBRD and IDA, "loans" includes credits and IDA grants, "borrower" includes borrower and IDA grant recipient, and "subnational divisions" refers to states or provinces.

² Refer to [OP 8.60](#) and [BP 8.60](#), *Development Policy Lending*, August 11, 2004. For additional guidance, refer to *Good Practice Note 1—Designing Development Policy Operations*. Good practice FM examples are also provided in the OPCS-FM website [<http://opcs.worldbank.org/fm/index.html>].

Box 3.1. Key Features of Development Policy Lending Outlined in OP 8.60

- *Country Assistance Strategy (CAS).* The appropriateness of development policy lending is determined in the context of the CAS and the country's policy and institutional framework. The CAS assesses the country's ability to effectively implement the program to be supported and describes the country's capacity-building efforts.
- *Macroeconomic framework.* The Bank undertakes development policy lending in a country only when it has determined that the country's macroeconomic policy framework is appropriate. For development policy operations to a subnational entity, the state or region must have an appropriate expenditure program, as well as appropriate fiscal arrangements with the central government.
- *Coordination with development partners.* In preparing development policy operations, the Bank collaborates with the IMF and other international financing institutions and donors, as appropriate, while retaining responsibility for its financing decisions.
- *Analytic underpinnings.* A development policy operation draws upon analytic work on the country, including relevant analyses of the country's public expenditure management, procurement, and financial accountability systems. Such analytic work may be carried out by the country, the Bank, or third parties. Drawing on a consultative process, the CAS assesses the adequacy of analytic work on the country and indicates how gaps will be addressed.
- *Development objectives.* The program documentation sets out the specific outcomes expected from the resource transfer and the country program being supported. The program design includes measurable indicators for monitoring progress during implementation and evaluating outcomes upon completion.
- *Program funding and size of operation.* The size of each development policy operation is based on country circumstances, including the following factors: (a) projected financing requirements at the time of the operation (including the costs of reform, if applicable), the availability of alternative financing, debt sustainability, and creditworthiness (IBRD) or relative claim on available concessional resources (IDA); (b) the envisaged lending envelope and share of development policy lending in total lending in the CAS; and (c) compliance with country performance triggers set out in the CAS.
- *Conditions.* The program conditions set out the agreed policy and institutional actions by the country that are necessary to implement the development policy operation. The Bank makes development policy lending available to the borrower when the program conditions are met. The Bank seeks to harmonize conditions with other development partners.
- *Tranching.* Development policy lending can be provided in one or more tranches, depending on the country's policy environment and capacity, the country's financing requirements and other available financing, and the content and phasing of the reform program. Development policy operations can also follow a programmatic approach (i.e., consist of a series of operations within a medium-term framework of policy and institutional actions). Such operations involve (a) clear monitorable indicators and progress benchmarks, (b) triggers for moving from one operation in the series to the next, and (c) notional timing and amounts of subsequent operations. In a country with a Poverty Reduction Strategy Paper (PRSP), development policy operations following a programmatic approach may be called poverty reduction support credit (PRSC). Single-tranche and programmatic development policy operations are embedded in an explicit medium-term framework of policy and institutional actions.
- *Risk management.* The Bank independently identifies the risks (financial and nonfinancial risks such as operational, developmental, macroeconomic, political economy, governance, reputational, and capacity/implementation risks, as appropriate) associated with the program and ensures that the operation contains appropriate mitigation measures and monitorable indicators to track high-probability risks.
- *Disbursements.* Development policy operational funds are disbursed against satisfactory implementation of the program, including compliance with tranche release conditions and maintenance of a satisfactory macroeconomic policy framework.

II. FINANCIAL MANAGEMENT IN DEVELOPMENT POLICY OPERATIONS

5. Development policy lending provides both balance of payments and budget support to the country. Financial management in development policy operations focus on two major issues: (a) funds flow arrangements giving reasonable assurance that the foreign exchange from loan proceeds are deposited into an account of the central bank that forms part of the country's foreign exchange reserves, and that an equivalent amount is credited to an account of the government available to finance budgetary expenditures; and (b) the appropriate management of the country's budget resources through the country's public financial management (PFM) system. Bank reviews of the above inform decisions on development policy loan amounts, tranching, program content, conditionality, and risk mitigation measures.

6. ***Tracking Use of Bank Funds and the "Negative List."*** Given the fungibility of foreign exchange reserves and budget resources, it is not required (and normally not possible) to track the ultimate use of the Bank funds in development policy operations. The borrower provides an undertaking, documented in the legal agreements, that it would not use the proceeds of development policy lending to finance ineligible items (called "the negative list").³ This is in effect a self-implementing "code of conduct" for borrowers, which, if breached, would trigger the enforcement by the Bank of its legal remedies.

A. Funds Flow Arrangements and Management of Foreign Exchange

7. The Bank disburses the loan proceeds into an account that forms part of the country's official foreign exchange reserves (normally held by the central bank). An amount equivalent to the loan proceeds is credited to an account of the government available to finance budgeted expenditures (e.g., Consolidated Fund or Single Treasury Account). The Bank requires assurance that the full amount of the loan proceeds reaches the country's budget resources, as outlined below.

8. ***Foreign Exchange.*** It is not possible to track the ultimate use of the foreign exchange provided by the Bank loan proceeds, given the fungibility of the country's foreign exchange reserves. However, it is relevant to review the control environment within which foreign exchange is managed by the borrower. The IMF reviews this control environment through its safeguards assessments of central banks.⁴ Therefore, Bank staff review, and discuss with IMF

³ The "negative list" for development policy lending covers items such as alcoholic beverages, tobacco, radioactive and associated materials, nuclear reactors and parts thereof, jewelry of gold silver or platinum, expenditure for goods intended for a military or paramilitary purpose or for luxury consumption or expenditures for environmentally hazardous goods. It is contained in Schedule 1 of the Model Form of Loan Agreement following issue of OP 8.60 which is currently in the process of being finalized.

⁴ The purpose of safeguards assessments is to identify vulnerabilities in a central bank's control, accounting, reporting, auditing systems, and legal structure to identify any weaknesses that may impair the integrity of central bank operations, and to determine if resources, including those provided by the Fund, are adequately monitored and controlled. A safeguards assessment does not seek to validate the actual use of foreign exchange reserves; it is limited in its scope to a review of control systems. For more details on the safeguards assessment, see <http://opcs/FM/ESW/esw-IMFsafeguardsassessment.html>. Copies of the IMF's safeguard assessment reports are held by the FM Anchor; and are available to staff on request. The staff member's manager should be copied on the request. The staff member will be asked to confirm in writing that the report will be treated confidentially, and that it will only be used for official business.

staff as appropriate, the IMF's most recent safeguards assessment of the borrower's central bank; and review the available published annual audit reports and financial statements of the central bank to determine the possible:

- (a) Where the IMF's safeguards assessment shows that the control environment of the central bank is satisfactory, or reveals issues for which the borrower has agreed to take remedial actions that are monitored by the IMF, the World Bank takes no further action. Bank staff do not address matters concerning the management of foreign exchange reserves beyond the scope of the safeguards assessment, such as foreign exchange management policy. These are addressed by the IMF.
- (b) Where the World Bank has inadequate knowledge of the borrower's central bank control environment (e.g., where the IMF has not carried out a safeguards assessment), and audit reports of the central bank indicate weaknesses (e.g., no independent audit of the central bank, major issues regarding foreign exchange management indicated in audit reports), or no acceptable IMF-monitored plan to deal with identified control weaknesses is in place, the Bank may apply additional fiduciary arrangements (outlined in Section II-C below).

9. ***Credit of Loan Proceeds to the Government's Budget Resources.*** The foreign exchange should be promptly converted into local currency and equivalent amounts credited into an account of the government that is available to finance budgeted expenditures (normally within 30 days of disbursement).⁵ The country's regular or established procedures should be used for this purpose. The government should provide a confirmation to the Bank that the amount of the loan has been credited to an account that is available to finance budgeted expenditures (including the date and name/number of the government's bank account in which the amount has been deposited, and that it has been credited to an account of the government available to finance budgeted expenditures, e.g., Consolidated Fund or Single Treasury Account).

10. ***Subnational Operations.*** When Bank loan proceeds are passed on from the borrowing government to other entities (e.g., to subnational governments/entities), on-lending terms and funds flow arrangements (into an account of the subnational government/entity that is used to finance its budgetary expenditures) should also be developed and agreed, again using the country's regular procedures.

B. Public Financial Management System

11. A development policy operation draws upon analytic work on the country that includes relevant analyses of the country's PFM systems. Such analytic work normally focuses on aspects such as the comprehensiveness and transparency of the budget, systems that facilitate implementation and monitoring of the budget, fiscal transparency (reliable information on fiscal results and position), and financial accountability for use of public resources. The country, the Bank, or third parties may carry out such analytic work. The Bank's own principal instruments for such analytic work on the country's system are Country Financial Accountability

⁵ In some countries, the local currency is the same as the currency in which disbursements are made. In such cases, the conversion into local currency is not relevant; the only relevant aspect is credit of the amount to the government's account available to finance budgeted expenditures.

Assessments (CFAAs) and Public Expenditure Reviews (PERs). In addition to these, the Bank reviews the available published annual audit reports and financial statements of the government, and other relevant reports to inform itself on the working of the country's PFM system.⁶

12. ***Design of Program Content, Conditionality, Tranching, and Risk Mitigation Measures.***⁷ No minimum standard of public financial management has been established which may be used as a precondition for development policy lending. Development policy operations could be provided in a country that has a weak public financial management environment but has committed itself to an adequate program of public financial management improvement/reform, and there is reasonable evidence that improvements are occurring in a timely manner. Improved PFM performance may indeed be an outcome, rather than a precondition, of development policy lending. In some countries, PFM improvements may be supported by other donors, rather than by the Bank through the development policy operation.

13. Development policy operations may include measures to develop country PFM capacity and address key weaknesses and risks identified in the diagnostic reviews. Such measures draw on key elements of the government's PFM improvement program or plan. While there cannot be rigid rules, some general principles for designing conditions, triggers, and benchmarks, based on review and experience of past operations, are outlined below (see Box 3.2).

- ***Link PFM conditions, triggers, and benchmarks to diagnostic work.*** Results of diagnostic work, particularly major weaknesses and risks, should have adequate follow-up.
- ***Appropriately sequence PFM benchmarks, conditions and triggers.*** Ensure continuity of actions (actions should not disappear after one year, particularly in programmatic operations and multitranche operations). Determine conditions and triggers for each operation in a programmatic series building incrementally on progress and results achieved, and push boundaries as far as possible. In some cases, it may be appropriate to initially agree on a package of short-term measures (covering to the extent possible the various elements of the PFM cycle) that could serve as a platform or step for deeper improvements.

⁶ For more details on CFAA, see <http://opcs/FM/documents/CFAA/CFAA%20Guidelines%20May%2027.%202003.pdf>. The parts of PERs that deal with public expenditure management and institutional issues are most relevant for this analysis (as contrasted with parts that deal with aspects such as public expenditure policy, and size and composition of public expenditures). Examples of other reports are HIPC expenditure tracking assessments, IMF Fiscal Transparency Reports on Observance of Standards and Codes, diagnostic reports prepared by other donors, and relevant parts of Institutional and Governance Reviews and Country Procurement Assessment Reports. [A new approach to PFM work, which includes public expenditure management, procurement, and financial accountability, is being developed to help countries develop and implement a sequenced program of PFM improvements.

⁷ *Conditions* are the agreed policy and institutional actions of the government which are deemed critical to the long-success of the reform program *and* which are included in the development policy operation documents as legal conditions for disbursements. In the context of programmatic development policy operations, *triggers* are the progress benchmarks in the second or subsequent year of a reform program, which are expected to become prior actions for subsequent operations. The details of prior actions for a subsequent operation may differ somewhat from the triggers in the preceding operation due to changes in circumstances or information. *Benchmarks* refer to outputs, intermediate outcomes, or final outcomes that are monitored as part of the reform program but are not legal conditions for disbursements.

- ***To the extent practicable, focus PFM conditions and triggers on results***, rather than inputs/processes; and spell out the expected results of the PFM improvement program. Results should be specific, significant, observable, time bound and measurable as far as practicable. Focus on fewer and better conditions and triggers — not all the actions included in the country’s PFM improvement program need to be included as conditions or triggers. In some cases, input or process-oriented conditions/triggers may be appropriate in the early operations (e.g., first and second) in a programmatic series, with a gradual move to more results-oriented conditions/triggers e.g., year 1 pass a law, year 2 show capacity and implement it, year 3 show results. Intermediate outcomes can be used as needed to progressively lead to final outcomes e.g., regular and timely reconciliations could be an intermediate outcome that would facilitate the final outcome of timely and reliable annual financial statements.
- ***Ensure that appropriate implementation arrangements for the PFM improvement program are in place***, for example, training and technical assistance to assist the government in implementing the PFM improvement program.

Box 3.2. Summary List of Good Practices for Designing Conditions, Triggers, and Benchmarks in Development Policy Operations

- Select a small number of conditions and triggers.
- Give particular attention to policy and institutional changes that contribute to desired outcomes.
- Be as specific as possible about what, by whom, and when.
- Include conditions and triggers that the government considers useful for signaling its commitment and for keeping implementation on schedule.
- Define many benchmarks and use them flexibly.
- Include intermediate outcomes.
- Build on national strategies.
- Show the linkages among outputs, intermediate outcomes and final outcomes.
- Ensure monitorability.
- Avoid conditions and triggers that create perverse incentives.
- Allow adequate time for the completion of the various steps in the reform program.
- When appropriate, allow for the gradual implementation of a reform program in different part of the country.
- Remember that year 1 is not really year 1. The policy matrix might include follow-up actions to policy changes that were made prior to the operation itself and sustained implementation of previous reforms.

Source: Good Practice Note 1—Designing Development Policy Operations.

14. Where the Bank has inadequate knowledge of the country’s PFM system, or where an acceptable action plan to deal with identified weaknesses in the country’s PFM is not in place, the Bank may apply additional fiduciary arrangements (outlined in Section II-C below). In exceptional cases, it may be appropriate to recommend (to the task team and in management reviews) one of the following actions: (a) delay the operation until adequate diagnostic information is available or certain conditions are met; (b) reduce the size of the operation; (c) tranche the operation, with appropriately sequenced actions as conditions for each tranche release; or (d) not proceed with the operation.

15. **Subnational or Sector Operations.** In development policy operations to a subnational entity, the PFM diagnostics as outlined above would be carried out at the relevant subnational level, and corresponding actions would also focus at the subnational level.⁸ Similarly, in sector-specific development policy operations, the PFM diagnostics would be carried out at the sector level, and corresponding actions would focus on PFM improvements in the sector. Relevant links between the PFM system at the subnational/sector level and the country's overall PFM system should be recognized.

C. Additional Fiduciary Arrangements in Some Circumstances

16. The need for additional fiduciary arrangements should be judged in the context of particular country circumstances. Circumstances in which additional fiduciary arrangements may be required include the following examples:

- (a) The World Bank has inadequate knowledge of the borrower's central bank control environment (e.g., where the Fund has not carried out a safeguards assessment) and audit reports of the central bank indicate weaknesses (e.g., no independent audit of the central bank, major issues regarding foreign exchange management indicated in audit reports), or no acceptable IMF-monitored plan to deal with identified control weaknesses is in place.
- (b) The World Bank has inadequate knowledge of the country's PFM system, or an acceptable plan to deal with identified weaknesses is not in place. These include cases where there may not be sufficient time or country capacity to draw on adequate analytic underpinnings or to determine how weaknesses in fiduciary arrangements might be addressed.⁹
- (c) Additional fiduciary arrangements may also be appropriate where Bank management considers that there is a significant possibility of "reputational risk" that Bank loan proceeds could be identified with being used for ineligible expenditures (the "negative list").

In judging the need for and potential effectiveness of such additional arrangements, aspects such as the size of the Bank's loan relative to the country's overall public expenditures and foreign exchange reserves held by the central bank should also be considered.

17. **Mechanisms.** These additional fiduciary arrangements could comprise any of the following:

⁸ Annex A of the CFAA Guidelines also provide guidance on diagnostic work at sub-national level.

⁹ For example, in development policy support to countries affected by crisis or conflict, and similar exceptional situations that call for an unusually quick response from the borrower and the Bank.

- (a) **Deposit of Bank loan proceeds into a dedicated account.**¹⁰ Satisfactory mechanisms need to be in place to ensure that the amount disbursed by the Bank reach a specific deposit account in the central bank, used exclusively for this operation.¹¹
- (b) **An audit of the dedicated account.** When agreed upon, the scope of the audit in such cases would normally cover the following: (i) the accuracy of the *summary of transactions* of the dedicated account, including accuracy of exchange rate conversions; (ii) that the dedicated account was used only for the purposes of the operation (i.e., no other amounts are deposited into this account); and (iii) that all payments out of the dedicated account were or were not used for specified purposes. The format of the summary of transactions of this dedicated account and the periodicity of the audit and time period for submission of the audit report to the Bank should also be agreed. While the audit should be carried out at least annually, in some cases, it may be necessary to agree on a shorter time period (e.g., within six months after the funds in the dedicated account have been fully utilized). The time period for submission of the audit report to the Bank should normally not exceed six months. The approach should be normally used regarding the need for and contents of the terms of reference of the audit, the selection of the auditor (including use of Supreme Audit Institutions), auditing standards, timing of auditor appointment, and audit reports.¹²
- (c) **Agreeing on specified purposes for which loan proceeds may or may not be used.**¹³ In most instances, purposes for which payments from the dedicated account may not be used (the “negative list”) would be agreed upon (rather than purposes for which these may be used).¹⁴

¹⁰ Where the concerns underlying these additional arrangements relate to foreign exchange management control weaknesses, it may be appropriate for the dedicated account to be maintained in the currency of Bank loan disbursements. In other circumstances, the amounts of the loan could be converted into local currency, and the dedicated account maintained in local currency.

¹¹ While such additional arrangements require loan funds to be deposited in a dedicated (separate) bank account, and for tracking payments from this account, such funds should be included in the country’s budget and be subjected to the country’s normal PFM processes.

¹² The approach is outlined in *Guidelines: Annual Financial Reporting and Auditing for World Bank-Financed Activities*, <http://opcs.worldbank.org/fm/documents/Audit%20Policy/AuditGUIDELINES.pdf>. Specifically, Terms of Reference (para 16), the auditor (paras 17-20), the auditing standards (paras 21-22), timing of auditor appointment (para 27), and audit reports (paras 28-31).

¹³ Where specific purposes for which funds will be used are agreed, also refer to [OP 6.00](#), *Bank Financing*, regarding policies on retroactive financing (para 7). The Bank may finance payments made by a borrower out of its own resources before the date of the loan agreement provided that such payments do not exceed 20 percent of the loan amount; and the payments were made by the borrower not more than 12 months before the expected date of Loan Agreement signing.

¹⁴ Only the payments made directly out of the dedicated account itself would be tracked, to confirm that they are (or are not used) for specified purposes. The end-use of such funds will not be tracked since this will not be feasible in many instances (given fungibility and mingling of these funds with other funds after they are paid out of the dedicated account).

III. DOCUMENTATION OF FINANCIAL MANAGEMENT ISSUES

18. Documentation required for development policy operations is described in Box 3.3.

19. ***Financial Management Issues in the Concept Document.*** The objectives, expected outcomes, and provisions of financial management aspects of the proposed operation should be outlined. If sufficient information is not available, the proposed approach to develop these should be indicated. The current status of and proposed plans on diagnostic work (IMF safeguards assessment and on the PFM system) should also be indicated.

Box 3.3. Documentation for a Development Policy Operation

A *Concept Document* is prepared during the preparation stage of the operation.

A *Program Document*, that includes a policy matrix, describes the program in details, and sets out the objectives of the operation in terms of the specific outcomes expected from the resource transfer and the government program being supported. It includes measurable indicators for monitoring progress during implementation and evaluating outcomes upon completion; and the considerations, design provisions, and fiduciary arrangements. The policy matrix summarizes all of the conditions, triggers, and benchmarks that constitute the reform program supported by the development policy operation.

In a multitranche operation, for each tranche after the first a *Tranche Release Document (TRD)* is prepared that reports on the status of the program being supported under the operation.

In addition, the borrower's *Letter of Development Policy* that sets out the program of objectives, policies, and measures to be supported by the development policy operation is attached to the Program Document.

An *Implementation Completion Report* is prepared upon completion of an operation, and, for programmatic development policy lending, a simplified implementation completion report is prepared for each operation in the series and a full report is prepared upon completion of the program.

20. ***Financial Management Issues in the Program Document.*** The following issues should be covered (financial management should also be appropriately reflected in the legal documents):

- (a) ***Funds flow arrangements.*** (i) Describe briefly the funds flow arrangements, including the account into which Bank loan proceeds would be deposited (and which forms part of the official foreign exchange reserves), and the mechanisms by which equivalent amounts would be credited to an account of the government available to finance budgeted expenditures; if applicable, highlight any deviation from the country's regular or established procedures and reasons for these; and in this section also describe (ii) whether the IMF has completed a safeguards assessment of the central bank, and if the latest assessment has been reviewed; and summarize its major findings (e.g., whether the control environment is satisfactory) and the status of major agreed follow-up actions. (Note that Bank reports should only record information contained in the summaries of safeguards assessments that are submitted to the IMF's Board.)

- (b) ***PFM system.*** Include (i) the status of PFM diagnostic work and its results in summary form; (ii) a summary of the country's PFM improvement program/plan to address weaknesses and risks (this includes actions taken and committed by the borrower, and an assessment of adequacy of commitment toward and progress in PFM improvement); (iii) PFM conditions, triggers and benchmarks (these would be normally covered in the policy matrix and should be consistent with the discussion of PFM issues in the Program Document); and (iv) indicators for monitoring progress during program implementation and evaluating outcomes upon completion.¹⁵ Implementation arrangements should also be outlined. For multiple-tranche operations, the Program Document should indicate conditions for tranche releases; and the Tranche Release Document should indicate the borrower's progress toward meeting the conditions for release of the tranche. In programmatic operations, the Program Document should indicate the progress in implementing the agreed triggers for the particular operation; and the proposed trigger for the subsequent operation.
- (c) ***Additional fiduciary arrangements.*** Description of such arrangements, in cases where such arrangements are used (Section II-C above).

IV. SUPERVISION, MONITORING, AND EVALUATION

21. ***Supervision and monitoring.*** The borrower implements the development policy operation, monitors progress during implementation, and evaluates results upon completion. Bank staff review implementation progress to verify fulfillment of program conditions and compliance with legal covenants, and to validate monitoring and evaluation findings. The task team consults and coordinates with the IMF and any cofinanciers in carrying out its supervision work. In this context, major FM supervision issues involve the following:

- (a) Monitoring that the agreed funds flow arrangements were complied with, following the disbursement of Bank loan proceeds; and that the required confirmation is received from the government.
- (b) Reviewing implementation progress of the agreed PFM actions. A periodic (e.g., annual) assessment of PFM performance indicating the extent of improvements should be carried out. For multiple-tranche operations, the borrower's progress toward meeting the conditions for release of the next tranche should be assessed. For programmatic operations, the borrower's progress in implementing the agreed triggers for the operation should be assessed. The borrower's monitoring and evaluation findings on the progress and results of program implementation should also be validated.
- (c) Monitoring that any agreed additional fiduciary arrangements (as outlined in Section II-C) were complied with. Where an audit of the dedicated account is required, timely submission of the audit report should be monitored, and the audit report should

¹⁵ These should be covered in the Program Document and in the policy matrix as appropriate and generally follow the presentation format used for all the policy and institutional issues covered by the operation. Whenever needed, the main text could be supplemented with an Annex on PFM aspects.

be reviewed. Where such arrangements were not complied with (e.g., the audit report is not submitted or indicates problems such as noncompliance with agreed arrangements), appropriate actions indicated in the legal agreements should be taken (e.g., enforcing the Bank's right to request the borrower to return that amount to the dedicated account or to refund the amount directly to the Bank; and, in extreme cases, to also cancel an equivalent undisbursed amount of the loan).

22. **Evaluation.** As appropriate, financial management issues should also be covered in the ICR. The ICR assesses (a) the degree to which the program achieved its development objectives and outputs as set out in the Program Documents; (b) other significant outcomes and impacts; (c) prospects for the program's sustainability; and (d) Bank and borrower performance, including compliance with relevant Bank policies. It draws upon the data and analysis to substantiate these assessments, and it identifies the lessons learned from implementation.

**GOOD PRACTICE NOTE 4—
ENVIRONMENTAL AND NATURAL RESOURCE ASPECTS
OF DEVELOPMENT POLICY LENDING**

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GOOD PRACTICE NOTE 4— ENVIRONMENTAL AND NATURAL RESOURCE ASPECTS OF DEVELOPMENT POLICY LENDING

I. INTRODUCTION

1. Good Practice Note 4 provides guidance on assessing the links between development policy lending and the environment for operational staff designing such operations and environmental staff engaged in their review. While the note presents frameworks for analyzing linkages, there is a body of good practice (presented in Annex 4.A), which should also guide staff in dealing with environmental aspects of development policy lending. This good practice list will be updated in future editions of this note.
2. A key point for staff to consider as operations are designed and reviewed is that adjustment lending has changed considerably in the last two decades. While structural adjustment programs in the 1980s focused on correcting the major macroeconomic distortions that were hindering development, more recent operations, classified in section IV below, have focused on issues such as governance, public sector management and reform of the social sectors, particularly health and education. This in turn changes the potential linkages between policy-based operations and the environment and natural resources.
3. A critical input in the design and analysis of development policy operations is the availability of current and relevant analytic work on the environment and natural resources. Traditional environmental economic and sector work (ESW) has tended toward the measurement of conditions and trends (important information in its own right) or the design of national environmental action plans. The new generation of ESW, with a stronger focus on policies and institutions in client countries, is considered in section III.
4. The environmental and natural resource implications are driven to a large extent by the nature of the operation. For instance, if any investment lending subcomponent—involving a physical investment—is included in a development policy operation, the impact on the environment is more likely.¹ In that case, the operation should be subject to the relevant operational policies for investment lending, and corresponding mitigatory action needs to be undertaken.² Specific policy reforms on the other hand, may have environmental effects that may present many potential benefits and costs to different stakeholders.³ For example, energy price reforms in general promote fuel efficiency with attendant positive environmental effects.

¹ According to OP 4.01, an investment is likely to have significant adverse environmental impacts if (a) the impacts may be irreversible (e.g., lead to loss of a major natural habitat) or diverse, or unprecedented; and/or (b) impact is directly on human populations or environmentally important areas, including wetlands, forests, grasslands, and other natural habitats.

² See OP/BP 10.00 *Investment Lending*.

³ *Environmental effects* means a policy-induced change in human activity that in turn leads to a change in the quantity or quality of an environmental resource (for example, loss of forest cover or habitat, or a change in the concentration of pollutants in air, soil or water). *Significant effects* are environmental changes of sufficient magnitude, duration and intensity as to have non-negligible effects on human welfare.

However, retaining subsidies on diesel could lead to negative environmental effects through excess diesel consumption, with adverse effects on air quality and subsequently on human health. Section V reviews the many positive effects that policies can have for the environment and natural resources, drawing on experience in Europe and Central Asia Region (ECA). Negative environmental effects of development policy lending often occur in the presence of other pre-existing policy, market and institutional failures in the environment, or natural resource sectors. In some instances, they may even exacerbate the existing environmental conditions. Efforts in such cases should be targeted at establishing the proper price signals to guide the use of the environment and natural resources—possibly through environmental charges and/or regulations.

5. The tools at our disposal to analyze the potential linkages between development policy operations and the environment and natural resources are highly imperfect, in part because of the sheer difficulty of the problem. A companion toolkit is under preparation to guide the selection of tools and approaches that can be applied in various instances.⁴

6. While consideration of environment and natural resource issues in the design and review of development policy lending operations is certainly good practice, it is important at the outset to quote what Operational Policy (OP) 8.60 requires in this regard. The policy requires that operational design draw upon relevant analytic work on the environment, as well as requiring that environmental issues be considered under the heading of risks to the operation. However the key paragraph is as follows:

Environmental, Forests and Natural Resource Aspects.⁵ The Bank determines whether specific country policies supported by the operation are likely to cause significant effect on the country's environment, forests and other natural resources. For country policies with likely significant effects, the Bank assesses in the Program Document the borrower's systems for reducing such adverse effects and enhancing positive effects, drawing upon relevant country-level or sectoral environmental analysis (undertaken by the country, the Bank, and third parties). If there are significant gaps in the analysis or shortcomings in the borrower's systems,⁶ the Bank describes in the Program Document how such gaps or shortcomings would be addressed before or during program implementation, as appropriate.

7. The language of policy thus *requires* that as a part of development policy operations, one should do the following:

- Carry out due diligence in “determining likelihood of significant effects” on the environment and natural resources;

⁴ Kirk E. Hamilton and Muthukumara Mani, [Toolkit For Analyzing Environmental and Natural Resource Aspects of Development Policy Lending](#), Preliminary draft, ESSD, World Bank, 2004.

⁵ Natural resources include renewable and nonrenewable resources defined as naturally occurring material within the boundaries of human activities.

⁶ Borrower's or country systems broadly refers to the capacity underlying the policy and institutional framework to identify and address environmental problems/priorities in an effective manner taking into account concerns of stakeholders (including the most vulnerable groups). It also embodies processes to adequately monitor and evaluate progress to overcome these problems.

- Assess country systems to determine whether there is appropriate environmental management capacity to handle potential effects; and
- Recommend actions within or outside of operation with emphasis on building required institutional capacity.

Good practice in designing and reviewing development policy operations should embrace the potential positive effects of policy reforms on the environment. This includes suggesting changes to the design of operations in a way which decreases/minimizes negative effects and increases positive effects.

II. FRAMEWORK

8. Linkages between development policy lending and the environment may be positive or negative from an environmental perspective. These linkages often can be complex and differ across countries.⁷ But the essential lesson for policy is simple: safeguarding the environment and resource base—both over the long term and against immediate impact of lending operations—requires measures directly targeted to these ends, serving as a complement to sound macro policies in enabling sustained high quality growth. As a matter of good practice, staff designing and reviewing development policy operations should aim to enhance the positive effects of the operation, assuming that any steps in this direction are germane to the operation, while at the same time taking steps to ensure that any negative effects are dealt with either through change in the design of the development policy operation or through complementary actions in the broader country program. For making this judgment, it is important to view environment as a “development” issue (i.e., the use of natural resources today should not undermine the long-term prospects for development and improved welfare in the future).

9. Development policy lending, whether sectoral or macro scale, is characterized by (a) a focus on policy reforms, rather than physical investments and (b) rapid disbursement. Both of these characteristics influence the treatment of environmental issues at the operational level. For example, the effect of policy reforms on the environment is often felt only indirectly (mostly through changing consumption and production patterns), which may limit our ability to forecast the environmental effect of any specific reform.⁸

10. Policy reforms in developing countries often take place in a context where there are market, policy, and institutional failures.⁹ Under these circumstances there is no guarantee that any individual reform will be welfare-improving overall (because of the existence of

⁷ The literature on adjustment and the environment, however, contains remarkably few quantitative analyses of links between policy-based lending and the environment; see A. Gueorguieva and K. Bolt, *A Critical Review of The Literature on Structural Adjustment and the Environment*, Paper No. 90, Environmental Economics Series, Environment Department, The World Bank, April 2003.

⁸ There is also a high level of contingency of such outcomes on how the reforms are specifically regulated and implemented and on the response of other actors/forces.

⁹ Market failure happens when the prices do not adequately reflect environmental externalities (e.g., pollution); a policy failure is when a government policy fails to achieve the desired objectives resulting in unforeseen environmental effects (e.g., energy subsidy); and an institutional failure occurs when the designated institution is incapable of monitoring and implementing the policies.

these other distortions). So, while as a general proposition we might assume that a policy reform is good for the economy as a whole, including the environment, operational design needs to be sensitive to the effects of distortions in other parts of the economy.

11. Even where the effects of an operation on the environment are likely and significant, there remains the question of whether measures to reduce adverse effects should take place within the operation or in the broader country program. The first approach should generally be to avoid or diminish effects through the design of the operation itself. If there remains a risk of significant effect on the environment, and strengthening country systems can be done in the short time, there is an argument for building short-term actions into the development policy operation. In most other circumstances, particularly where effects are uncertain in magnitude and likely to be lagged, the appropriate place to deal with environmental effects is at the level of the country program. In either case, the program documentation should acknowledge the potential effects and the measures taken to deal with them within or outside the program. Moreover, any growth-linked effects on the environment are likely to appear well beyond the life of the operation. This suggests toward having an explicit monitoring and evaluation strategy to review progress during, as well as beyond, implementation.

12. The broader country program may include assistance by the World Bank or other development partners, in reforming environment/natural resource institutions and the policy framework, as well as in capacity building for ministry staff. Because OP 8.60 stipulates that managing the environmental effects of development policy operations is a responsibility of the borrower, the key issues to be faced in countries undergoing economic restructuring and reform will revolve around the *country systems*.¹⁰

III. ROLE OF KNOWLEDGE AND ANALYTIC WORK

13. Country-level analytical or diagnostic work is a sound basis for ensuring that environmental considerations enter the development planning process at an early stage. Priorities, including the costs of environmental degradation, identified by an existing country-led environmental work, as well as assessments by the World Bank and development partners, are important to inform and deepen understanding of key environmental challenges, particularly in connection with the preparation of Poverty Reduction Strategy Papers (PRSPs) and Country Assistance Strategies (CASs). An assessment of environmental policy, regulatory, and institutional capacity is also essential to gain an understanding of institutional capacity strengths and challenges in order to ensure that environmental implications of lending programs are properly considered, including monitoring of environmental trends with specific attention to resources at risk.

14. In the absence of availability of any structured analytic work, the second best option would be to rely on a number of tested heuristic tools available in the literature.¹¹ The most

¹⁰ Borrower's or country systems broadly refers to the capacity underlying the policy and institutional framework to identify and address environmental problems/priorities in an effective manner taking into account concerns of stakeholders (including the most vulnerable groups). It also embodies processes to adequately monitor and evaluate progress to overcome these problems.

¹¹ Kirk E. Hamilton and Muthukumara Mani, "Toolkit for Analyzing Environmental and Natural Resource Aspects of Development Policy Lending," Preliminary draft, ESSD, World Bank, 2004.

powerful tool in the analyst's toolkit, however, is going to be the availability of current environmental economic and sector work (see Box 4.1).

Box 4.1. Environmental Analytic Work in Support of Development Policy Lending

Appropriate analytic instruments for assessing the effects of development policy operations on the environment include country environmental analysis (CEA) and strategic environmental assessments (SEAs) since development policy lending involves economywide or sectorwide policy programs rather than physical investments.

Country environmental analysis covers countrywide policies and institutions dealing with the environment forests and natural resources. The CEA focuses on the major environment issues in a country; reviews the policy and institutional framework; assesses institutional capacity to implement the framework; and makes recommendations for priority reforms. It does this all at the level of the country or, in large countries such as India, a state. The CEA is a relatively new approach, with five full CEAs having been delivered to the client, including recommendations on which both the World Bank and the country agree.

Strategic environmental assessment concentrates more on policies, plans, and programs within a specific sector. Policy SEA considers the linkages between a given sector (energy, for example) and the environment and natural resources; reviews the policy and institutional framework for dealing with environmental issues within the sector; assesses institutional capacity; and may make recommendations for reforms of policies or institutions. Policy SEA is an evolving tool with few examples of application in the World Bank's work to date.

15. In the absence of any useful analytic work, however, there may be a need to initiate such work, either to study issues linked to the operation or to better understand issues at the level of the country program. In all cases, there is a general set of questions that need to be posed:

- What are the priority environmental problems in a country or a region? Is there a danger of these problems getting exacerbated by ongoing reforms in the country?
- Do the environmental and natural resource management institutions have the capacity to identify environmental priorities, monitor the priority environmental problems, and respond accordingly? Do these institutions have the policy framework and legislative authority to act when problems arise?
- Do governmental organizations have the capacity to respond to environmental problems? Are there conflicting or unclear responsibilities across governmental organizations?

16. The purpose of this screening mechanism is to determine, on a case-by-case basis, whether the particular operation is "likely to cause significant effects on the country's environment and natural resources." If the conclusion of the screening is *negative* (i.e., the program is unlikely to cause significant negative or positive effects on the country's environment), no further action is required. If the conclusion does turn *positive*, then one may have to proceed with the analytic work outlined in Box 4.1. This type of screening could be undertaken at the program preparation/appraisal stage by the environmental specialists in the

program team or the region.¹² Box 4.2 provides useful examples of recent analytic work that has supported capacity and institutions building efforts in the various regions.

17. The Bank considers it important and a matter of good practice in its analytic work to consult and engage the stakeholders in the process of defining country priorities and in identifying and designing appropriate interventions.¹³

IV. TYPOLOGY OF POLICY-BASED OPERATIONS AND POTENTIAL ENVIRONMENT LINKAGES

18. The environmental and natural resource effects of the main policy instruments are often complex and context specific. The nature, even the direction, of these effects is highly sensitive to the structural characteristics of the economy affected. The presence of other market and policy failures often makes it difficult to determine the magnitude of the change, which in turn makes it difficult to forecast the direction of effects. For example, devaluation of the domestic currency, which makes it cheaper for foreigners to purchase domestic goods, will tend to increase the production of tradable goods in the devaluing country. Environmental problems may be worsened insofar as the production of tradables tends to be “dirtier” than that of nontradables (such as many services). Additionally, the devaluation may encourage over-exploitation of tradable resources (such as hardwood), especially in the face of other policy failures (such as uncontrolled illegal logging or excessively low stumpage fees). At the same time, however, it may also lead to an increase in the price of imported fertilizers and pesticides, which will have beneficial effects to the extent that—as is often the case—the pricing of these products does not fully reflect the social damage (in terms of soil degradation and contamination of the food chain) that their use can cause.

19. Table 4.1 presents a breakdown of typical policy-based operations,¹⁴ at both sectoral and macro level, together with the potential links between elements of the reform programs and the environment and natural resources. This can serve as no more than a guide to thinking, however. The initial conditions in a country—the nature of its environmental problems, its resource endowment, the policy and institutional setting—are critical in determining the direction and magnitude of effects of individual reforms on the environment.

V. RISKS AND OPPORTUNITIES IN POLICY-BASED LENDING OPERATIONS

20. The literature on structural adjustment and the environment¹⁵ has attempted to identify the risks that policy-based operations may present to the environment. Many of the concerns in this literature are in fact concerns about the effect of liberalization and giving markets greater sway in developing countries. This literature demonstrates that in general policy reforms represent an opportunity for better management of the environment and natural resources as well.

¹² Each region will have to develop its own procedures to ensure that environment and natural resource aspects are addressed adequately in accordance with OP 8.60.

¹³ See *Good Practice Note 5— Supporting Participation In Development Policy Operations*.

¹⁴ Drawn from recent (2000-2003) policy-based operations.

¹⁵ See the review in Gueorguieva and Bolt, *op. cit.*

Box 4.2. Selected Good Practice Examples of Economic and Sector Work

The following examples demonstrate how environmental analytic work contributes to the broader country programs:

Poland: Complying with EU Environmental Legislation (2000). This report examines the implications for Poland of complying with the European Union's environmental directives and suggested ways to reduce the cost. As a result of the paper, the Ministry of Finance focused on the costs and the need to plan carefully for compliance. The Ministry of Environment also successfully used some recommendations in its negotiations with the EU (e.g., establishing a long transition period for compliance with the urban wastewater directive). The EU financed some of the recommended actions, such as manure management to reduce nitrate pollution and encouraging households to switch from coal for domestic heating to tackle urban air pollution.^a

The Cost of Environmental Degradation in the Middle East and North Africa (2003). Analytic work is underway in MNA (Algeria, Egypt, Jordan, Lebanon, Morocco, Syria, and Tunisia) to assess the cost of environmental degradation. These studies provide decisionmakers with a first order of magnitude of the cost of environmental degradation as a percentage of GDP as regards to the health impacts of urban air pollution and waterborne illnesses, the economic cost of water resources and soil/land degradation, impacts related to waste management, and the cost of coastal zone degradation. The studies rely on existing data and analysis of environmental issues, and apply commonly used methodologies of valuation and quantitative impact assessments to country specific issues in order to arrive at estimates of the cost of degradation. They have so far provided a basis for dialogue in the country programs and in training for ministries, agencies, and interested institutes to incorporate assessments of the costs of environmental degradation in policymaking and environmental management.^b

Poverty-Environment Nexus Study (2002). A major analytic exercise investigating poverty/environment linkages was initiated in Cambodia, Lao PDR, and Vietnam. Poverty data for the three countries was mapped using a Geographical Information System (GIS) and then overlaid with individual environmental variables for visual assessment of spatial associations. The three key environmental indicators chosen included deforestation, access to sanitation, and fragile lands. The data from Lao and Vietnam showed evidence of poverty/environment linkages for fragile soils. By establishing evidence of the vulnerability of poor people to specific environmental problems the study was particularly useful in the preparation of PRSPs and CASs.^c

Causes of Deforestation in the Amazon (2003) aimed at finding coherence and a better understanding of the factors associated with the expansion of deforestation in Brazil and the public policies attempting to arrest it. The findings suggest that, in contrast to the 1970s and 1980s when occupation of Brazilian Amazonia was largely induced by government policies and subsidies, recent deforestation in significant parts of the region is basically caused by medium- and large-scale cattle ranching. However, private benefits from large-scale cattle ranching are largely exclusive, having contributed little to alleviate social and economic inequalities or to environmental sustainability. As a result, while rural income tripled on average from US\$410 in 1970 to US\$1,417 in 1995, this increase did not translate into quality of life improvements for the poorest local population groups. The study compares a number of different scenarios and proposes recommendations for the region.^d

^a G. Hughes and J. Bucknall, *Poland: Complying with EU Environmental Legislation*, World Bank Technical Paper 454, ECA Environmentally and Socially Sustainable Development Series, Washington DC, 2000.

^b For details see www.metap.org.

^c S. Dasgupta, U. Deichmann, C. Meisner, and D. Wheeler, *The Poverty/Environment Nexus in Cambodia and Lao People's Democratic Republic*, World Bank Policy Research Working Paper 2960, Washington, DC, 2003.

^d Sergio Margulis, *Causes of Deforestation of the Brazilian Amazon*, World Bank Working Paper No. 22, Washington, DC, 2004.

Table 4.1. Typical Reforms in Policy-based Operations and Potential Environment Linkages

<i>Sector</i>	<i>Reforms</i>	<i>Potential opportunities to attain environmental benefits</i>	<i>Potential to reduce/manage any negative outcomes</i>
Energy	Pricing, subsidies, ownership, and regulatory issues.	Price-induced reductions in demand and the environmental regulatory regime within the energy sector.	Differential pricing of dirty vs. clean fuels could lead to adverse environmental and health effects.
Agriculture	Land markets; product markets; subsidies; rural finance; input prices; trade taxes; irrigation institutions; and reform of government institutions, such as marketing boards and stabilization funds.	Positive effects on resource management from land market reforms and increasing access to credit.	Manage environmental risks from changes in prices of inputs such as irrigation water, fertilizers and pesticides.
Financial	Privatization, writing down of bad loans, re-capitalization of banking system, and regulatory issues (among many possibilities).	Promotion of responsible and sound investments.	Innovative financial instruments (catastrophe bonds) can help securitize catastrophe risk resulting from climate-induced extreme weather events.
Health, education	Financing, resource allocation, level of access, and effectiveness of expenditures.	Environmental linkages manifest through improvements in environmental health.	
<i>Macro</i>	<i>Reforms</i>	<i>Potential opportunities to attain environmental benefits</i>	<i>Potential to reduce/manage any negative outcomes</i>
Public expenditures, public sector management	Expenditure frameworks; budget transparency; financial management; accountability; priority setting; service delivery efficiency; and the skills, professionalism, and remuneration of the public service.	Priority setting and efficient allocation of public expenditures will benefit the environment.	Protect public environmental expenditure during major fiscal consolidation.
Tax reform	Tax incidence (income, assets, corporations, consumption); tax rates; exemptions; deductions; and the complexity of the tax system.	These reforms are potentially positive for the environment, even more if pollution taxes, taxes on polluting inputs such as energy, and resource royalties are part of the reform program.	
Fiscal federalism/ decentralization	Decentralization reforms aim at increasing the efficiency of service delivery, accountability,	The issues from an environmental management perspective include strengthening budget and	

	effectiveness, capacity, and adequacy of regulatory frameworks at the local level; they may also embrace fiscal decentralization.	capacity at local levels.	
Private sector development	Business climate issues—business taxation, regulation of entry, operation and exit, bankruptcy procedures, protection of property rights, and operation of capital markets.	Attracting businesses into the formal sector may be positive for the environment (since environmental policies are more readily applied).	Ensure adequate monitoring and enforcement of regulatory framework.
Trade reform	Elimination of non-tariff barriers, reduction and simplification of tariff rates, reform of customs procedures, and regulations relating to foreign direct investment.	Increased foreign direct investment can be positive for the environment, through access to cleaner technologies.	Reforms undertaken in the presence of pre-existing market, policy or institutional imperfections in the environment or natural resource sector may lead to adverse effects.

21. Policy-based lending operations can and do have positive effects on the environment. Below are a few cases where these effects have been found to be positive (with an emphasis on the ECA Region where the experience with structural reforms has been particularly broad):

- **Privatization.** In a cross-section analysis of 44 countries from 1987 to 1995, it was found that the higher the share of the private sector in total production, the lower the rate of environmental degradation. Similar correlations are found between a well functioning capital market and the level of foreign direct investment in a country.¹⁶ Hence development policy loans that promote private sector development in this way should, in general, have a beneficial effect on the environment. If, however, this effect is to be maximized, a proper regulatory framework needs to be in place.
- **Land reform and the environment.** A number of studies have noted the positive environmental effects of the establishment of secure tenure and property rights on agricultural land,¹⁷ and the phase-out of collective farming.¹⁸ This is particularly the case in such programs implemented in a number of countries in the ECA Region. These programs were reviewed in some detail and in all cases the environmental effects are considered to have been positive. As in the case of privatization, however, not all reforms will be equally effective as far as the environment is concerned. Reforms that, for one reason or another, result in a

¹⁶ D. Talukdar and C. Meisner, "Does the Private Sector Hurt or Help the Environment? Cross-Country Evidence from Carbon Dioxide Pollution," *World Development* 29(5), 2001, pp 827-840. Environmental degradation is approximated using CO₂ emissions.

¹⁷ *World Development Report 2001/2002: Building Institutions for Markets* (New, York: Oxford University Press for the World Bank, 2002); see Gueorguieva and Bolt *op. cit.*

¹⁸ B. Libert, *The Environmental Heritage of Soviet Agriculture* (Wallingford, UK: CAB International, 1995).

concentration of ownership can result in an increase in landless laborers with adverse consequences for the environment.

- **Water use.** In the ECA Region, the link between the rate of economic reforms and the level of water pollution was investigated. It was discovered that while the use of inputs such as fertilizers and pesticides fell much more than crop production across all countries, the rate of decline in these inputs was notably greater in the fast reforming countries.¹⁹
- **Energy sector reforms.** By and large, a move toward economic pricing of energy has beneficial environmental effects. World Bank studies in Sri Lanka, Poland, and other countries have confirmed this overall conclusion. In the ECA Region, the faster reforming countries (which inevitably implement more rapid increases in their commercial energy prices) reduced their energy intensity more than slower reforming ones and, although overall energy consumption may have increased more in the fast reformers, they were becoming more pollution efficient. Some of the same effect is also achieved when coal subsidies are reduced or phased out, as the consequent shift to other fuels such as oil and gas is less polluting.

22. These desirable effects may, however, be cancelled by an increase in the use of noncommercial fuels (e.g., fuelwood), if the increase in commercial energy becomes unaffordable. The resulting deforestation and higher levels of indoor air pollution are both unwelcome environmental effects.²⁰

23. The key message that comes out of this short review is the fact that, in many policy-based loans and for many key effects, the reforms favor the environment. This does not guarantee that the environment will in fact benefit from the actions, or that it will result in the maximum benefits that could have been realized. That will need extra attention being given to the environmental dimension.

24. In addition to the benefits of typical policy-based loans, there have been special cases where policy reforms have been *specifically* designed to address environmental issues. Two examples of such loans are the Bulgaria Environment and Privatization Support Loan (EPSL) and the Mexico Programmatic Environment Structural Adjustment Loan (EnvSAL). The objective of the Bulgaria EPSL (described in Annex 4.1) was to assist the Government in achieving environmental improvements, supporting the privatization of highly polluting enterprises, and harmonizing national environmental regulations with those of the EU. As a result of the loan, the main effects on the environment are the following:

- **Water.** A number of measures in the loan act to improve the level of water quality in Bulgaria, reflecting the need for improvement in water resource management identified in the CAS. An important area is the issuance of permits to reduce

¹⁹ G. Hughes and M. Lovei, *Economic Reform and Environmental Performance in Transition Countries*, World Bank Technical Paper 446, ECA Pollution Management Series, World Bank, 1999.

²⁰ G. Hughes and M. Lovei, *op.cit.*; and P. Meier, et al., "Energy Sector Policy and the Environment : A Case Study of Sri Lanka," in M. Munasinghe (ed.), *Environmental Impacts of Macroeconomic and Sectoral Policies*, (Washington, D.C. : World Bank, 1996).

pollution and to bring water pollution in line with the EU Integrated Pollution Prevention and Control Directive.

- **Air pollution.** Measures to control air pollution including permits and controls on levels of pollution were advocated under this loan, again to bring Bulgaria closer to meeting EU standards.
- **Regulation.** Regulation is featured in a number of ways. The creation of integrated permits is important, but one should not ignore the importance of the measures on the last line of the AIM—that of increasing institutional capacity for oversight and increasing compliance.
- **Privatization.** The project explicitly included legal changes to address the issue of environmental liability and to develop a program for addressing some of the damages resulting from past pollution.

This loan is an exception in the sense that it was *designed* around a number of environmental improvements. The Government was provided finance for balance of payments support in exchange for undertaking certain changes in environmental regulation. To date it appears to have been successful in that goal.

25. The Mexico Programmatic Environment Structural Adjustment Loan (EnvSAL 1) consists of three operations to support the Government of Mexico's (GOM) efforts to balance socioeconomic development with environmental protection.²¹ The EnvSAL 1 focused on (a) mainstreaming of environmental concerns in key sectoral development agendas, as prioritized by the GOM; and (b) improving the effectiveness and efficiency of local environmental management processes. The key sectors supported by the EnvSAL 1 included water, energy, forestry, and tourism, based on criteria jointly defined with the GOM. Most notably, it supported the approval and implementation of fiscal instruments to promote the payment of municipal water fees and investment in municipal hydraulic works and for revenue generation from the use of national marine-protected areas and corresponding reinvestment in the environmental management of these areas. The program witnessed significant achievements under the first tranche with respect to mainstreaming environmental concerns. One of the more challenging aspects of the program was in trying to achieve interinstitutional coordination, which nonetheless provided valuable lessons for future such operations.

VI. LESSONS FROM EXPERIENCE

26. Section II on framework issues strongly suggests that we should be fairly humble about our ability to forecast with any precision the effects of individual adjustment operations on the environment and natural resources. The accumulated experience of the World Bank on this topic offers a number of practical considerations that we should take into account in this task:

²¹ *Implementation Completion Report*, First Programmatic Environment Structural Adjustment Loan, Report No. 29259, World Bank, 2004.

- ***Feasibility of analysis.*** The fact is that very few OECD countries mandate environmental assessment and analysis of policy reforms and the anecdotal evidence is that there is a high degree of dissatisfaction with the robustness of the analyses performed. There is a lesson here for the sort of issues outlined in this good practice note.
- ***Country program vs. individual operation.*** Given the difficulty associated with predicting the environmental effects of individual operations, a stronger emphasis must be put on the country program. Especially, in countries where there is a large development policy operation in the pipeline, it would be good practice to assess the needs for analytic work and corresponding needs for strengthening country systems in an integrated way as part of the country program.
- ***Measures to deal with environmental risks.*** The tight time frame of most policy-based operations means that it is highly unlikely that complementary actions to deal with environmental risks, if required, can take place within the operation. This implies that such action should often be relegated to parallel or subsidiary operations (by the World Bank or other development partners).
- ***Conditionality.*** Evolving good practice on development policy lending²² strongly suggests that limiting the number of conditions in a loan increases its effectiveness. This will preclude specific environmental conditionality in most instances, but it does not preclude (a) influencing the overall design of an operation, or (b) influencing the design of specific conditions in the loan to be more environmentally benign or beneficial.
- ***Predictability of effects.*** As a general rule, it is more difficult to predict environmental effects of broader macroeconomic policy operations (e.g., trade reform and fiscal reform) than of sectoral operations in environmentally sensitive sectors (e.g., energy and water).
- ***Advanced tools.*** Partial equilibrium analysis or CGE models will generally not be practical or cost-effective in the context of individual operations, but they may constitute a valuable part of any research program in the country.
- ***Costs*** of undertaking analytic work may vary considerably across regions/countries. A comprehensive CEA may cost on average about US\$300,000 depending on the country and the issues covered. A policy SEA on the other hand may cost on average about US\$150,000. Considerable synergies could be exploited and costs minimized if undertaking CEA and SEAs in the same country. Efforts are underway to develop and pilot rapid assessment CEAs and SEAs to help expand the menu of instruments available to support development policy operations. Once tested, these more agile tools may prove useful, given the abbreviated time-frame of development policy lending.

²² See Good Practice Note 1—Designing Development Policy Operations.

- ***Disclosure.*** Development policy lending requires that relevant analytic work be made available to the public as part of the consultation process in line with the Bank's disclosure policy.

SELECTED GOOD PRACTICE EXAMPLES

1. While it is important to present good practice—and it does exist, it is important to note—there is a limit to how much we can generalize from particular instances. Good practice generally reflects the confluence of a number of favorable factors: (a) environmental issues that are large-scale; (b) relatively direct linkages between environmental management and development outcomes; (c) a sound body of analytic work to guide the design of the operation; and (d) a client and country department that is aware of these conditions and is willing to embrace environmental reforms as part of the larger reform program. Selected examples are discussed below.

2. The *Madagascar Structural Adjustment Credit II* (April 1999) features: (a) a description of the natural endowment as a source of wealth in the Country Context section; (b) policy reforms in land tenure in order to permit tourism developments; (c) reforms in the mining sector, including a new Mining Code with transparent granting of concessions and the application of environmental standards; (d) conditions on petroleum sector privatization to deal with environmental cleanup; and (e) reforms in the fishery sector, including the auction of quotas. This wide range of environmental interventions is integral to the wider reform program.

3. The *Bulgaria Environment and Privatization Support Adjustment Loan* (January 2000) presents a comprehensive program for dealing with environmental liability as a companion to the Financial and Enterprise Sector Adjustment Loan II. The loan (a) prescribes amendments to the Privatization Law to clarify the liability of the state for environmental damages resulting from past actions; (b) establishes Environmental Impact Assessment requirements and risk assessment methodologies for privatization; and (c) requires remediation plans and execution agreements as part of the privatization process. Privatized establishments become subject to Bulgarian regulations for environmental management. This loan effectively sets the standard for other countries seeking to deal with issues of environmental liability in privatization.

4. The *Mali Third Structural Adjustment Credit Supplemental Grant* (November 2003) illustrates two of the techniques that can be used to mitigate environmental risks associated with a structural adjustment loan. The original Mali Third Structural Adjustment Credit (SAC III, a FY02 operation) included public sector reform, judged to have no negative environmental impacts; reforms in the cotton production subsector that had the potential to increase production and agrochemical use. Specific measures to address the effects of the cotton sector recovery component were incorporated in the Mali Agricultural Services Project (also a FY02 operation), which included a pest management initiative and rehabilitation of a pesticides residues laboratory. SAC III itself required the preparatory studies for privatization to include (a) environmental audits of the plants to be privatized; (b) integration of the audit results (i.e., environmental restoration cost, environmental and human safety, and liability issues) into the bidding documents; and (c) assessment of the readiness of existing national environmental legislations to deal with the above issues. The documentation for the SAC III Supplemental reported on the following results:

- Recent assessments show no evidence of major expansion of cotton cultivated areas and attendant increase fertilizer/pesticide use, thus environmental risks strictly associated with the SAC III cotton sector program are virtually non-existent;

- However, an Integrated Pest Management implementation plan has been designed under the Agricultural Services Project and is ready for implementation; and
- In the first phase of cotton privatizations, action plans from environmental audits have been integrated into the privatization documents, with implementation to be the responsibility of the purchaser upon conclusion of the sale.

5. The *Indonesia Water Resources Sector Adjustment Loan* (WATSAL, May 1999) provides balance of payments assistance to Indonesia to support a structural adjustment program of policy, institutional, regulatory, legal, and organizational reforms in the management of water resources and the irrigation sector. The project aims (a) to improve the national institutional framework for water resources development and management; (b) to improve the organizational and financial frame work for river basin management; (c) to improve regulatory institutions and implementation instruments for regional water quality management; and (d) to improve irrigation management performance and fiscal sustainability through farmer organization empowerment for participatory irrigation management.

6. Environmental and social sustainability in water resources and irrigation management was a prime goal of the WATSAL. This project is often cited as good practice as it was used to pilot Strategic (Sectoral) Environmental Assessment. The use of the SEA allowed the government and task team to (a) assess the environmental and social benefits and costs associated with policy reforms using risk analysis, and (b) address the issue of transparency and consultations in the project, which were emphasized by the government and often a criticism of past Bank projects. The WATSAL SEA addressed the possible outcomes of the reforms, assessed the risk associated with these reforms, and outlined options to address potential negative effects associated with the program.

7. The *Uganda Poverty Reduction Support Credit* (PRSC2, May 2001) offers programmatic lending to support policy and institutional reforms through a series of annual credits with a rolling three-year reform program based on PRSP. It provides untied budget support and aims to use and strengthen government's own systems and processes. Its broad multisectoral reform program aims to improve (a) delivery of education, health, water, and sanitation; (b) rural development (agricultural research and extension, rural finance, land tenure, natural resource management, rural roads); and (c) public expenditure management and monitoring and evaluation and governance (public service management, public procurement, financial management, legal and judicial reform, and civil society participation). A component on environment added to the reform program under PRSC2 to increase co-ordination and integration of environmental sustainability in government programs, with oversight from a sustainable authority for environmental management. This is expected to contribute toward reducing the level and risk of environmental degradation, including deforestation that is key for sustained growth.

8. Achievements of the program so far include (a) development of overall guidelines for strategic and sectoral environmental assessment; (b) development of sector specific EIA guidelines for road, water supply and sanitation, energy, and mining sectors; and work ongoing on guidelines for agriculture, forestry and wildlife sectors; (c) local government planning manuals adjusted to promote environmentally sustainable planning; (d) guidelines for

environmental screening of sector plans and programs developed for the government budget process; (e) development of several districts environment action plans; and (f) development and implementation of National Forestry Plan.

**GOOD PRACTICE NOTE 5—
SUPPORTING PARTICIPATION IN DEVELOPMENT POLICY OPERATIONS**

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GOOD PRACTICE NOTE 5— SUPPORTING PARTICIPATION IN DEVELOPMENT POLICY OPERATIONS

I. INTRODUCTION

1. Operational Policy (OP) 8.60, *Development Policy Lending*, states that “the Bank advises borrowing countries to consult with and engage the participation of key stakeholders in the process of formulating the country’s development strategies.¹ For a development policy operation, the country draws on this process of strategy formulation to determine, in the context of its constitutional and legislative framework, the form and extent of meaningful consultations² and participation in preparing, implementing, and monitoring and evaluating the operation. Bank staff describe in the Program Document the country’s arrangements for consultation and participation relevant to the operation, and the outcomes of the participatory process adopted in formulating the country’s development strategy.” Good Practice Note 5 provides advice to guide staff in assessing participatory processes and advising borrowers on the type, breadth, and scope of participation in development policy operations.

2. **Rationale.** The often complex policy and institutional reforms associated with a development policy operation can only be adopted and implemented if they have sufficient political support within the country. A well-implemented stakeholder participation strategy can help develop this support and improve the quality of the reform program in several ways.

- **Coalitions for change.** Poverty reduction and policy implementation require the involvement of multiple stakeholders united by a convergence of objectives and goals. The participation of different stakeholders in the dialogue around development strategies and policy reforms helps build alliances and coalitions—sometimes across conflicting immediate interests—for change.
- **Ownership.** The World Bank is committed to country-led policies and programs because it recognizes that reform can succeed only when the country itself has ownership of the process. Stakeholder participation in the policy process helps build ownership by involving a variety of groups in formulating the policy and thus engaging their interest in its implementation.
- **Sustainability.** Country and stakeholder ownership, in turn, increases the likelihood that the reform program will be sustained beyond the duration of the policy support operation and the period of a specific government administration.
- **Effectiveness.** Involving stakeholders can increase the effectiveness of the policy reform process because the knowledge and viewpoints of stakeholders contribute to

¹ Development strategies refer to the PRSP process in IDA countries or the government’s overall development strategy in IBRD countries.

² Consultations are defined “as a process through which subjects or topics of interest are discussed within or across constituency groups. It is deliberation, discussion, dialogue; seeking information and advice; taking into consideration opinions, facts, interests.” See “Draft Consultation Sourcebook,” May 2003, p. 2.

definition of priorities and more informed decision-making; the process can also reduce the social risks of policy reform by clarifying misperceptions about the policy.

- **Accountability.** Stakeholder participation in the policy reform process enhances transparency and strengthens upstream and downstream accountability—which is key for improving governance and public sector efficiency.

3. **Definition.** Participation is the process through which stakeholders (those affected by the proposed reform or capable of affecting the outcome of the reform; see Box 5.1) influence or share control over setting priorities, making policy, allocating resources, and ensuring access to public goods and services. Bank staff should bear in mind, and should convey to partners, that participation does not imply final consensus or that the views garnered through a participatory process will necessarily be reflected in the reform program. (Box 5.2 discusses various myths about participation.)

Box 5.1. Who Are the Stakeholders?

In the context of policy reforms, there may be a wide range of stakeholders. Stakeholders include the central government (particularly line ministries) and parliament; but implementing agencies, and subnational and local governments, which often have important roles to play in implementation, are stakeholders as well. Parliamentarians can contribute information on the interests of their constituents. Stakeholders can also include business sector representatives, citizens, and civil society organizations,³ who can give guidance on the issues and needs that are most relevant to the groups that they serve or represent. In the context of a development policy operation, the term “key stakeholders” includes public sector, private sector, non-profit sector, and donor organizations relevant to the operation, as well social groups directly affected by the operation. Where relevant, special consideration should be given to stakeholders who may be traditionally excluded, such as women, indigenous peoples, people with disabilities, and youth.

4. **Principles.** Two general principles guide World Bank support for stakeholder participation in the context of policy-based lending:

- **Country ownership.** The decision to initiate a participatory process and the responsibility for defining its scope and carrying it out rest with the borrower; the process should not be imposed or led by the World Bank. The Bank’s role is to facilitate, providing support and technical advice in the engagement between the government and the stakeholders of the policy reform.
- **Country specificity.** The modality and extent of participation depend on the country and reform contexts (legislative framework, institutional arrangements, range of stakeholders). Not all policy reforms benefit in the same degree from participation. Appropriate participation may range from dissemination of public information to create awareness about proposed reforms, to specific consultation on design or implementation arrangements, to involvement of selected stakeholders in monitoring and evaluation.

³ Civil society refers to the wide range of nongovernmental and not-for-profit organizations that have a presence in public life, expressing the interests and values of their members or others, based on ethical, cultural, political, scientific, religious or philanthropic considerations. The term excludes for-profit businesses, although it may include professional associations or business federations. Civil society organizations can also include NGOs, trade unions, community-based organizations, research centers, foundations, student organizations, professional associations, and many others (Draft Consultation Sourcebook, May 2003).

Box 5.2. Myths about Participation

Myth: Participation means reaching consensus or at least reflecting views of all participants in the final policy.

Reality: Participation enables policymaking choices and trade-offs to be better informed, but does not imply that consensus will result or that the views of all those consulted will be reflected in the final product.

Myth: Participation means holding a meeting.

Reality: Holding one participatory event does not mean that the government has embraced participation as a strategy.

Myth: Participation has no costs.

Reality: Participation has costs, both for those who participate and for those who organize it.

Myth: Participation creates conflict.

Reality: Participation rarely creates conflicts that were not already latent, but it can help channel those conflicts in more organized forms.

Myth: Participation is culturally neutral.

Reality: Participation is conditioned by the country's culture and prior experience with involving multiple stakeholders in public debate.

5. **Risks.** It is important to acknowledge that participation also carries risks (see Box 5.3). By understanding these risks, Bank staff and borrower can take them into account in planning and managing a participatory process or in some cases deciding against one.

Box 5.3. Participation Risks

Exclusion. If the issue of representation is not appropriately handled, participation can reproduce social exclusion and existing unequal power relationships.

Creating unrealistic expectations. It is important to communicate the goals of the participatory process up front lest the credibility and legitimacy of the process be damaged by expectations that may prove impossible to fulfill.

Conflict context. Participation may risk accentuating or aggravating existing conflicts between stakeholders with different priorities and interests.

Bypassing or undermining existing institutional structures and processes. Bypassing existing processes of deliberation and dialogue and creating parallel structures may undermine formal channels of representation such as parliaments and local governments.

II. COUNTRY CONTEXT AND TYPE OF REFORM

6. Both the specific country context and the type of reform contemplated influence the type and extent of participation that is appropriate.

A. Country Context

7. Once upstream analytic work identifies the country-specific conditions (e.g., regulatory frameworks, institutional arrangements, access to information and voice, presence of dialogue

and negotiation spaces)⁴ that are relevant to various forms of participation, Bank staff can tailor their recommendations to the borrower. The following scenarios illustrate the relationship between enabling factors and possible forms of participation:

- ***The country has a culture of public debate and legal and other institutional arrangements for representation.*** Bank staff may advise coordinating the participatory process with existing mechanisms of representation provided for in the constitutional or legislative framework, so as not to undermine those mechanisms or create parallel structures.
- ***The country has no culture of public debate and no legal and other institutional arrangements for representation.*** Bank staff may advise a gradual participatory process that can contribute to institutionalizing permanent channels of communication among public authorities, civil society, and the business sector. Bank staff may advise the borrower to conduct participatory assessments to capture the views of different stakeholders, particularly primary stakeholders.
- ***Fragile channels of representation do not fully represent the views of different stakeholders.*** In such situations civil society is often weak, and its involvement in public dialogue is limited to the capital city and small elites. To ensure credible and relevant participatory processes and encourage broader coalitions for change, Bank staff may advise use of stakeholder analysis and the creation of new channels of information and participation.
- ***Deep conflict and political stress prevail.*** Participation may not be advisable if it increases existing confrontation and unnecessarily delays the approval and implementation of urgent policy reforms. However, after carefully assessing the viability of participation, Bank staff and other donors may encourage national authorities to explore participation around policy reform as a potential avenue for opening new channels of dialogue and conflict resolution.

In all cases, it is desirable to conduct some analytic work and, if necessary, focused consultation to assess the conditions for participation in a particular country. A sound stakeholder analysis is the key instrument to assess the capacity and the potential of different actors to contribute to the effectiveness and sustainability of policy design and implementation.

B. Type of Policy Reform

8. Not every policy reform lends itself to the same type, level, and extent of stakeholder participation, as in the following examples:

⁴ Channels of representation and voice and forms of exclusion within civil society are also decisive elements affecting the way nongovernmental actors can engage in public debate. The Participation and Civic Engagement Group in the Social Development Department is developing an analytic tool to assess the enabling environment for participation in development policy. See “Enabling Environments for Civic Engagement in PRSP Countries,” Social Development Note No. 82, World Bank, March 2003; and “A Roadmap to Effective Civic Engagement in Low Income Countries Under Stress: Conceptual Framework for Civil Society Assessment Tool,” Working Draft, World Bank, June 29, 2003.

- **Macroeconomic reforms.** Large segments of society, even the entire population, usually feel the effect of broad macroeconomic reforms. Such reforms may be very contentious, as their final impact may not be felt for some time and in the short run those who appear to lose from the reform often outnumber the winners, particularly among poor people. Certain macroeconomic reforms (e.g., tax increases, expenditure cuts) risk arousing significant opposition as citizens protest against perceived losses or adverse impacts. Particular interest groups may also mobilize against reform. In such situations, public information campaigns can help reduce social tensions and possible misperceptions by explaining the objectives of the reform, emphasizing the long-term benefits, and helping manage public expectations. Analytic work, including poverty and social impact analysis (PSIA),⁵ may help assess the distributional impact of these reforms, informing the design of the reform itself and the development of a suitable process for stakeholder engagement. The decision to disclose information or initiate stakeholder consultations may need to be weighed against the risks of social tensions and negative impact on markets. Disclosure of information before the adoption of macroeconomic reforms that directly affect interest rates and macroeconomic stability may cause damaging speculative spirals, and Bank staff should exercise caution in advising wide participation.
- **Structural reforms.** Public information campaigns before the adoption of such reforms as privatization, decentralization, public sector reform, civil service reform, or financial sector reforms can strengthen ownership and reform sustainability. Stakeholder participation in design may be more appropriate for some structural reforms than others. For example, privatization reforms, particularly in social sectors, can be highly controversial, because the negative effects of job losses are immediate, while the potential gains remain, at best, distant and more difficult to establish. The collaboration of a wide range of stakeholders—civil society organizations, the private sector, and those responsible for social mitigation—in the design of such reforms allows the concerns of particular groups to be voiced, mitigates social risks, and improves implementation. Similarly, the design of public sector reforms with a direct impact on governance, including decentralization reforms, may also benefit from stakeholder participation.
- **Sectoral reforms.** The involvement of line ministries, implementing agencies, parliamentarians, regional and local governments, and civil society may help assess implementation capacity, timeframes, and beneficiary needs for sectoral reforms. Stakeholder participation in the monitoring and evaluation of these reforms helps strengthen accountability between the government and citizens and may provide valuable feedback into the implementation of the reform.

⁵ See Good Practice Note 2—Using Poverty and Social Impact Analysis to Support Development Policy Operations.

III. PARTICIPATION IN VARIOUS STAGES OF THE POLICY REFORM

9. Stakeholder participation can take place in all phases of the policy cycle (strategy, design, monitoring and evaluation) or be designed into the content of the policy reform itself (in implementation).

A. Strategy Formulation

10. Ideally, participation begins at the strategy formulation stage—during the Poverty Reduction Strategy Paper (PRSP)⁶ or other broad national strategies—so that stakeholders can participate in defining policy priorities. In many countries, the Country Assistance Strategy (CAS) process also draws on a participatory process to define strategic priorities. In these cases, the borrower can build on the earlier participatory processes to create the process for the development policy operation.

B. Design

11. Participation in designing the policy can inform the content of the reform program by helping to do the following:

- Improve the *prioritization* of issues to be addressed by a policy reform,
- Identify *triggers* for the reform that are realistic in terms of timing and implementation capacity,
- Develop *performance benchmarks* that will be able to accurately assess the achievement of the reform goals,
- Identify relevant *monitoring indicators* to accurately assess the progress of the reform, and
- Assess *implementation capacity*.

Actors that will be participating in the implementation of the reform (e.g., line ministries, implementing agencies, local governments) can be involved in providing realistic estimates of implementation capacity and timing. Civil society and private sector participants can provide feedback on the relevance and perceived impacts of the reform program both during the preparation of analytic work, such as PSIA and environmental impact analysis, as well as in the discussion of analytical results to development policy operations. Where available, analytical results are disseminated prior to such consultations. Methods to encourage participation in this stage include workshops, focus groups, formal surveys of relevant groups, roundtable discussions, electronic consultations, and communications campaigns.⁷ (Box 5.4 provides good practice examples of stakeholder participation in design.)

⁶ Go to <http://www.worldbank.org/poverty/strategies/chapters/particip/orgpart.htm> for guidance on participation in PRSPs.

⁷ Large meetings are useful for imparting information to large groups, but they are less effective for gathering information or soliciting inputs.

Box 5.4. Stakeholder Participation in Design

Case 1. A single-tranche economic restructuring structural adjustment loan in South Asia aimed to reform the fiscal system and public expenditures, increase the transparency and efficiency of public administration through decentralization and civil service reform, and improve the business environment through deregulation and privatization of public enterprises. The loan also supported the establishment of a poverty and human development monitoring system to enable the state to better track the impact of its services, policies, and reforms on poverty and social indicators. In preparation for the design of the loan consultations were held with various stakeholder groups, including farmers, unions, NGOs, academics, and key government and implementing agencies. The ultimate project design was thus based on a good understanding of which stakeholders were likely to be supportive and which were likely to resist changes, and a strategy was put in place to overcome potential resistance to the reform.

Case 2. a public services and social sectors structural adjustment loan and a special structural adjustment loan project in Latin America aimed to support reforms to restore economic growth; improve competitiveness; and improve the population's welfare through greater efficiency in the provision of public services, particularly in education, health, and infrastructure. To provide input to the design of the loan, the government put in place a consultative process with civil society organizations that would allow both the government and civil society to analyze the reform proposals included in the loan framework. The government was supported in preparing a document that described the reforms and their goals and expected impacts. The process included feedback on the reform strategy and a monitoring plan to track final goals at the regional and national levels. The process provided useful information to both government and civil society organizations on the degree of coverage of social protection programs (and any overlaps or duplications), the degree of coordination between central and departmental administrations, and the efficiency of public spending on these programs.

C. Policy Content and Implementation

12. Stakeholder participation in the content of a policy reform is usually the result of a broader government strategy to enhance the legal frameworks and institutional arrangements for participation in public affairs, or to involve a range of government agencies and nongovernmental partners in the delivery of public services.⁸ Participatory mechanisms may include multi-stakeholder coordination bodies, collaborative arrangements for involvement of different stakeholders in provision of services, or the integration of legal or other institutional provisions in the loan matrix that support participation in public policy decisionmaking and monitoring and evaluation (M&E).⁹ See Box 5.5 for good practice examples of participation in implementation of policy reform. Building this kind of participation can help in several ways:

- Improve coordination between local and national as well as government and nongovernment actors through the formation of cross-sectoral, multi-stakeholder implementation committees and local, regional, and national councils with capacity to influence and monitor policy formulation, planning, and budgeting;
- Enhance governance, with increased accountability, transparency, and credibility, through the participation of external bodies; and

⁸ For additional information on the role of stakeholder participation and accountability in the delivery of public services, see *World Development Report 2004: Making Services Work for Poor People* (New York: Oxford University Press for the World Bank, 2003).

⁹ In some sectoral reform and decentralization operations the loan matrix has included a set of legal reforms or other institutional arrangements supporting the government's decision to create an enabling environment to promote participation and accountability. Approval of transparency laws and the establishment of accessible financial information services have featured among the benchmarks or triggers of the loan.

- Improve implementation effectiveness—for example, if participation results in contracting service provision to private sector, NGO, or community-based organizations that may be able to provide services more effectively.

Box 5.5. Good Practice Examples of Participation in Implementation of Policy Reform

Case 1. Mechanisms for national and community-level participation were designed into the implementation of a multitranche loan to an East European country in the context of a coal sector restructuring. A commission was created to provide a forum for discussion and resolution of issues by government stakeholders, and an inter-ministerial group was formed to ensure that the different stakeholders had taken the necessary actions before the release of funds for each tranche. Each release of funds required actions from different ministries, creating incentives for cooperation and mutual oversight related to a complex reform. At the community level, a local development program funded by the loan fostered coordination within communities by requiring stakeholders to make decisions about allocating funds to job creation and small business support.

Case 2. A multitranche programmatic social reform loan in Latin America provides support to a government strategy aimed at improving the transparency and social control of resource allocation in the country. The strategy seeks to provide a legislative framework for institutionalizing improved access to information and for enabling citizen participation in public policy formulation, budgeting, and monitoring. The loan has supported legal frameworks and permanent mechanisms to allow citizen participation in subnational planning and budgeting.

Case 3. The implementation arrangements of a poverty reduction support credit (PRSC) in an African country aimed to improve service delivery by decentralizing the delivery—including planning, management, and implementation—of programs in health, water, and agricultural extension services to local governments. To increase the capacity of local governments to deliver these services effectively, the PRSC also aimed at public service, procurement, and financial management reforms by improving monitoring and evaluation and by strengthening downward or social accountability and anticorruption measures.

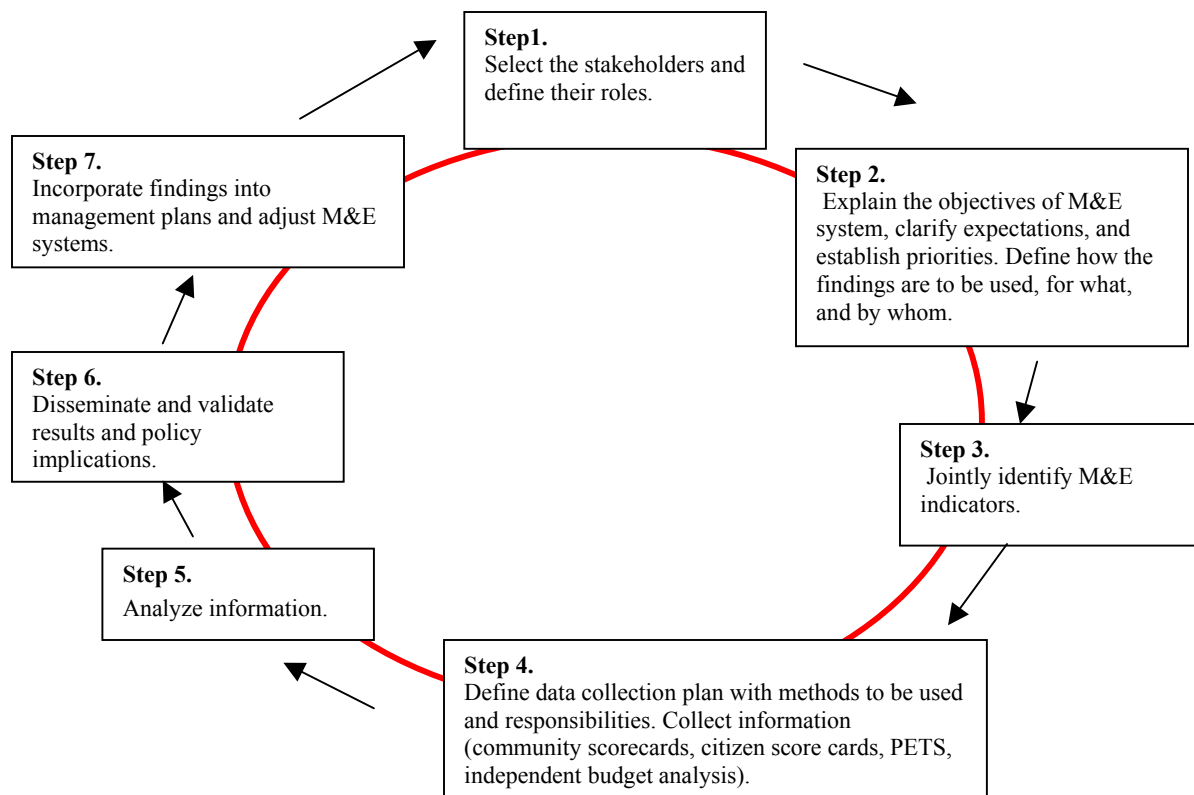
D. Monitoring and Evaluation

13. Engaging a variety of stakeholders in the monitoring and evaluation of a policy reform helps to provide feedback and alternative insights, giving a more complete picture of the effects of the reform and leading to a more effective monitoring and evaluation system (see Figure 5.1).

14. **Stakeholders.** The stakeholders can include national institutions of statistics (providing official statistical information and results of household surveys), line ministries, implementing agencies, regional and local governments, the private sector, academia, think tanks, and civil society. Parliaments, through their budget and public accounts committees, can play a key role in monitoring the outcomes of policy reforms, as can the offices of the comptroller general (which often reports directly to parliament) and ombudsman (where they exist) by providing a channel for citizens to voice their complaints about public service delivery. Civil society participation in M&E can provide insights into reform outcomes, particularly with regard to impacts on, and perceptions of, poor and vulnerable people. It can also help identify possible resource leakages, reducing opportunities for corruption, and it can supplement the government's own system for monitoring results. (Box 5.6 describes tools civil society can use to conduct independent monitoring of policy reforms.) Bank staff should advise governments that effective participatory M&E requires them to open up institutional space and appropriately incorporate feedback from all stakeholders.

15. **Information.** Reliable, timely, pertinent, and accessible public information is crucial to the effectiveness of participatory M&E. Staff can provide advice to governments on how to make program implementation, budget, and public expenditure information easily available to the public through Internet portals. Good practice in public information systems includes linking planned and actual expenditures to performance and physical goals, and providing practical information to actual and potential users about what their entitlements are and how they can benefit from public programs. Data are usually disaggregated down to the local level, so that all interested stakeholders can monitor actual implementation and results and access the services the policy reform promotes and regulates. Since Internet access is often limited to a small sector of the population, local and grassroots media can be encouraged and supported to disseminate the information included in the portal down to the local level. Box 5.7 includes good examples of participatory M&E.

Figure 5.1. Participatory M&E Cycle



Box 5.6. Participatory M&E Mechanisms and Tools

Citizen and community report cards draw on the private sector practice of soliciting feedback from clients of services. By systematically gathering and disseminating public feedback on service provision, citizens can credibly and collectively inform agencies about their performance and produce pressure for change. Report cards provide rich information on where and how basic services are failing poor people and on key constraints poor people face in assessing public services. There are two report card practices: a quantitative client survey (citizen report cards), and more qualitative approaches (focus groups, participatory rapid appraisal) to assess client satisfaction at the community-level (community score cards).

Public expenditure tracking surveys are quantitative exercises that enable citizens to monitor how money allocated by the government is spent, by tracing the flow of resources from origin to destination and determining the location and scale of any anomalies. Experience shows that participatory tracking can lead to greater resources and improved services for poor people. Participatory tracking can also bring about government savings by helping to identify leakages and institutional bottlenecks.

Participatory social auditing incorporates participation into tracking of public expenditure budgets. Social auditing involves verifying whether expenditures actually reach their intended social aim.

Independent budget analysis is a means by which civil society can review the impact and implication of different policy proposals and allocations. This can help demystify the process and content of budget preparation and help improve budgetary planning.

Note: From “Voices and Choices at a Macro-Level: Participation in Country-Owned Poverty Reduction Strategies. A Workshop Report,” February 2002, p. 13-20. For more information, see www.worldbank.org/participation.

Box 5.7. Good Practice Examples of Participatory M&E

Case 1. In a series of three poverty reduction strategy credits (PRSCs) focused on basic service delivery in an African country, a major focus area has been setting up monitoring arrangements that use several participatory methodologies. These methodologies include participatory poverty assessments, public expenditure tracking surveys, and service delivery surveys that include user feedback components similar to citizen report card surveys. Each of these will be conducted periodically along with traditional survey and monitoring instruments during the implementation of the credits.

Case 2. M&E is an essential part of a PRSC in a South Asian country. The PRSC incorporates arrangements for a broad-based monitoring system, some elements of which will be based on participatory methodologies. These include the development of report cards on government services by NGOs and civil society representatives, and other approaches to assess client satisfaction.

Case 3. The PRSC of an African country has as one of its integral elements an M&E system based on a master plan agreed by various stakeholders. This system involves the participation of different stakeholders—in particular academic think-tanks, civil society, and the media—through membership in technical working groups and a national committee in charge of aspects of M&E ranging from routine data collection, research and analysis, to dissemination, sensitization, and advocacy. Thus the entire framework of the M&E system is marked by participation of different stakeholders at different levels.

IV. SOME FUNDAMENTALS OF PARTICIPATION

16. Experience with participatory processes within the Bank (e.g. consultations on operational policies) and at the project level has yielded a number of broad rules of thumb that should be useful to Bank staff advising borrowers on the design and implementation of participation strategies for development policy operations:

- **Identify key stakeholders.** Use stakeholder analysis to broadly define the key players and groups likely to be affected. Then make explicit choices about who will decide on

the appropriate participants, who are to be invited and what is the nature of their expected contribution to the discussion.

- ***Assess the country context.*** Before a participatory process is undertaken, people with country knowledge and local insights should assess the overall environment for stakeholder participation, including such factors as the historical relationship among the public and private sectors and civil society; the existing legal, fiscal, or social and political environment; and the existence of interethnic conflicts.
- ***Consider the type and stage of reform.*** The nature of the reform affects the decision to promote participatory processes: for example, public sector reform or reforms with elements of service delivery may be more amenable to participation than macroeconomic policy reform. When policy reforms combine different types of interventions, some components may lend themselves better to stakeholder participation than others. Similarly, in some policy reforms, stakeholder participation may be more desirable and feasible in specific stages of the reform rather than in all of them.
- ***Clarify scope, objectives, and roles to manage expectations.*** Before beginning a participatory process, it is important to clarify the scope and objectives of the exercise and explain the expected roles and inputs of each participating actor. It is also useful spell out whether and how views will be incorporated, how often participants can comment, and how the final product will be shared with participants. It is important not to oversell the participatory process.
- ***Build the process into a participation strategy.*** Wherever possible, stakeholder participation in a specific policy reform should not be a one-off event, but should be part of a broader participation strategy and process, in which stakeholder dialogue is promoted from strategy formulation, through policy dialogue, to the lending operation. Such coherence enriches the policy dialogue and strengthens the ownership and sustainability of reforms.
- ***Build on existing structures, processes, and dialogues.*** Participatory processes should supplement and build on, not duplicate or undermine, the country's existing mechanisms for deliberation, participation, and dialogue. Building on areas where agreement has already been reached around broad strategic directions facilitates the policy dialogue and provides a foundation for continued discussions.
- ***Disseminate information. For effective participation, stakeholders must be informed.*** The sharing of the results of analytic work (such as PSIA) can be a meaningful first step to inform the public debate on the potential impacts of the reform and on possible policy alternatives. Stakeholders should receive adequate information well before the consultations, and it should be in an appropriate language and style. It may be necessary to simplify texts, explain technical content, avoid jargon, and translate into local languages.

- ***Budget adequately.*** The budget for a successful participatory process should include adequate provision for travel and expenses for stakeholder participants, especially if the activities are limited to the capital or big cities only. It should also include provisions for skilled facilitators and interpretation. Activities should be commensurate with the kind and amount of financial and human capacity resources available. These costs are an investment to ensure greater effectiveness of the policy reform.
- ***Document the process.*** Documenting the participatory process—its activities, the participants, their feedback and inputs, and lessons learned—can help to increase the transparency of the borrower’s actions, and can help strengthen the knowledge base of experience in participation in policy-based lending across countries and regions.
- ***Provide feedback to participants.*** The feedback process builds the relationship for future interactions and dialogues. If stakeholder participation changes the shape of a project, participants should be informed of how the original design was modified to reflect their input.