

DISCUSSION DRAFT

**2008 DEVELOPMENT POLICY LENDING
RETROSPECTIVE
CONCEPT NOTE**

**OPERATIONS POLICY AND COUNTRY SERVICES
SEPTEMBER, 2008**

2008 Development Policy Lending Retrospective Concept Note

**Discussion Draft
August 12, 2008**

I. INTRODUCTION

1. Policy-based lending is broadly defined as financial assistance that supports a medium-term program and is channeled directly to a recipient country's budget.¹ In the World Bank, policy-based lending is extended to client countries through development policy operations (DPOs) in the form of unearmarked loans or grants which are supportive of, and consistent with, the country's economic and sectoral policies and institutions. Bank DPOs are, therefore, a quick disbursing financing instrument that helps a borrower address actual or anticipated development financing requirements.² They typically aim to promote pro-poor growth through encouraging fiscal and macroeconomic stability and more efficient allocation of public funds. Decisions to extend DPOs rely on an assessment of a country's institutional and policy framework, the country's commitment to and ownership of a reform program, and its track record (Box 1 in the annex presents different definitions of budget support used by other aid providers).

2. ***Objectives of the Retrospective.*** The World Bank carries out reviews of its development policy operations on a regular basis with the last retrospective having been concluded in July 2006. The main objective of the 2008 Development Policy Lending Retrospective is to assess the effectiveness of World Bank DPOs in supporting the design and implementation of a borrower's medium-term development policy agenda. The retrospective will also present the main features of World Bank DPOs; discuss emerging issues arising from the experience with policy-based lending; and report on recent trends in the design and processing of World Bank DPOs and on progress with the implementation of the good practice principles on conditionality.

3. ***Coverage.*** The retrospective will cover a set of 121 DPOs approved since the conclusion of the last DPL retrospective in FY06, including 17 operations approved in the last quarter of FY06 (that were not covered by the 2006 retrospective)³, 57 operations approved in FY07, and 47 in FY08. Of these totals, 63 (61 percent) were IDA-only operations and 38 (37 percent) were IBRD or blend operations in FY07 (FY08). The sample also includes the first two DPOs financed from IBRD surplus, the first supplemental DPO from the surplus, as well as the first 2 DPL – DDOs approved in

¹ See Koeberle, Stephan and Zoran Stavreski (2006), *Budget Support: Concept and Issues*, Chapter 1 in Koeberle, S., Z. Stavreski, and J. Walliser (orgs), *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*, The World Bank, Washington, DC.

² See OP8.60, *Development Policy Lending*, The World Bank Operations Manual, August 2004.

³ The 2006 Development Policy Lending Retrospective reviewed a set of 50 DPOs approved between September 1, 2004 and March 31, 2006.

FY08 following the approval in March 2008 by the Board of Executive Directors of new features for the existing Deferred Drawdown Option for development policy operations.

4. ***Outline of the Concept Note.*** This concept note identifies the main questions to be addressed in the retrospective and sketches its proposed elements. Section II presents a brief summary of main findings of previous reviews of development policy lending. Section III discusses some recent trends and approaches used by the World Bank in the provision of policy-based lending. Section IV presents the proposed issues to be discussed in the retrospective and its corresponding suggested structure, and Section V concludes with a brief description of the proposed methodology, process and timeframe for the retrospective.

II. INTERNAL AND EXTERNAL VIEWS

5. The Bank has been analyzing its experience with policy-based lending since the introduction of this instrument in the early 1980s.⁴ More recently, the Bank has carried out a review of experience with Poverty Reduction Support Credits (PRSCs) in 2005,⁵ a Development Policy Lending Retrospective in 2006,⁶ a comprehensive review of conditionality in 2005⁷ that led to the development of the Good Practice Principles for the Application of Conditionality, and a recent assessment of the use of conditionality in development policy lending in 2007.⁸ There have also been several reviews of the experience with development policy lending by independent researchers, other development partners, and civil society organizations. The next paragraphs briefly present the main findings of these reviews and summarize the main issues that continue to be the focus of attention by outside parties.

6. ***Stocktaking of PRSCs (2005).*** The PRSC is a programmatic approach to development policy lending in low-income countries which typically consists of three or four annual, single-tranche operations, phased to support the government's medium-term development objectives. The stocktaking paper published by the Bank in 2005 reviewed the experience with PRSCs since their inception in May 2001 totaling 33 PRSCs up to March 2005. The paper concluded that the PRSC has evolved as an integral part of the PRSP process, helping to improve the operational relevance of the PRSP and providing key support to the government's policy reform agenda. The review noted that PRSCs varied in respect to content, scope and coverage, and their role within country portfolios.

⁴ For earlier reviews, see: *Structural Adjustment Lending: A First Review of Experience*, Operations Evaluation Report No. 6409, World Bank, September 24, 1986; *Report on Adjustment Lending: Policies for the Recovery of Growth* (R90-51, IDA/R90-49), March 26, 1990; and *The Third Report on Adjustment Lending: Private and Public Resources for Growth* (R92-47, IDA/R92-29), March 24, 1992.

⁵ *Poverty Reduction Support Credit: A Stocktaking*, Operations Policy and Country Services, The World Bank, June 24, 2005.

⁶ *Development Policy Lending Retrospective*, Operations Policy and Country Services, The World Bank, July 7, 2006.

⁷ *Review of World Bank Conditionality*, Operations Policy and Country Services, The World Bank, September 2005.

⁸ See, respectively, *Good Practice Principles for the Application of Conditionality: A Progress Report*, Operations Policy and Country Services, The World Bank, November 2006; *Conditionality in Development Policy Lending*, Operations Policy and Country Services, The World Bank, November 2007.

They were also found to have a strategic selectivity in favor of good performers, strong analytic underpinnings and a sustained, yet flexible support for complex medium-term institutional and policy improvements. The stocktaking exercise also highlighted that the PRSC's flexible design has established a strong record of stabilizing and improving resource predictability while maintaining a clear performance orientation.

7. ***Development Policy Lending Retrospective (2006)***. The 2006 DPL retrospective focused primarily on process issues and compliance with the new operational policy on development policy lending introduced in 2004. It reviewed 50 DPOs for 37 countries approved in FYs 05-06 through end-March 2006 and concluded that OP 8.60 provides a robust policy framework for development policy operations. The retrospective noted that compliance with the policy has been high, even where policy sets new expectations, and that good practice standards are generally being followed. DPO quality at completion was also found to be high. The retrospective noted that a large majority of DPOs have been extended to countries in the upper ranges of CPIA ratings and that higher CPIA ratings are positively correlated with satisfactory DPO outcomes (as they are with investment loan outcomes).

8. ***Other Reviews of Development Policy Lending***. There have been other reviews of the content, coverage, and trends in the use of policy-based lending by the World Bank, independent researchers, and other budget support providers. Recent World Bank reviews⁹ show that the Bank has made important strides in supporting country ownership for development effectiveness and has been disclosing all documentation on disbursement conditions and loan terms transparently and systematically.¹⁰ On a positive note, Morrissey (2004) stresses that, by its own nature, policy-based lending fosters the development of a policy dialogue that culminates in a consensual choice of policy actions to be supported by donors and that this policy dialogue approach has the merits of promoting ownership and facilitating donor coordination.¹¹ A policy paper recently produced by DFID¹² recognizes that budget support builds the capability of governments to manage their public finances effectively equipping governments to prioritize more resources according to their own national development strategies and their public finance management systems. Finally, a joint report recently published by ODI and other development partners¹³ evaluated different forms of budget support and concluded that policy-based budget support, as opposed to outcome-based budget support, is a more

⁹ See *Good Practice Principles for the Application of Conditionality: A Progress Report*, Operations Policy and Country Services, November 2006; *Conditionality in Development Policy Lending*, Operations Policy and Country Services, November 2007.

¹⁰ These findings were corroborated by consultations led by bilaterals in 2007 in 8 aid recipient countries that showed considerable improvement in the nature of the dialogue underpinning development policy operations.

¹¹ Morrissey, Oliver (2004), *Alternatives to Conditionality in Policy-Based Lending*, CREDIT and School of Economics, University of Nottingham. This is a view that is actually shared by earlier research on adjustment lending, such as for example in Collier, Paul et al. (1997), *Redesigning Conditionality*, World Development, 25, pp. 1399-1407.

¹² *Poverty Reduction Budget Support: A DFID Policy Paper*, Department for International Development, February 2008.

¹³ *Good Governance, Aid Modalities and Poverty Reduction: From Better Theory to Better Practice – Final Synthesis Report*. Research Report (RP-05-GG) of the Advisory Board for Irish Aid, jointly prepared by ODI, CDD-Ghana, ESRF, and CMI.

effective means of bolstering policy changes and signaling particularly important reforms that are necessary to achieve outcomes in a medium-term reform program.

9. **External Critiques of Policy-Based Lending.** Policy-based lending has also inspired considerable controversy, with much of the debate revolving around the use of disbursement conditions, which are often criticized as being ineffective, intrusive, and sometimes even harmful.¹⁴ Much of this concern is voiced by civil society organizations such as Christian Aid, Eurodad, Oxfam, and Action Aid International, which believe that the policy-based lending approach is incompatible with government ownership of policy and hence reduces the space for aid recipient governments to make their own decisions in dialogue with their citizens.¹⁵ In addition, these CSOs are also of the view that development policy operations tend to be overloaded with disbursement conditions of a sensitive nature, such as privatization and trade liberalization; that they do not fully account for possible poverty and social impacts of the policy actions being supported; and that more could be done in the area of donor coordination and harmonization in order to improve aid predictability.

10. **Emerging Issues.** In view of this debate and of the existence of a multiplicity of budget support approaches and instruments available, a number of issues have emerged. These include design and process issues, such as: (a) advocacy for the adoption of an **outcome-based approach** to development policy lending – an approach that is seen by CSOs as a way to increase the policy space available to governments and therefore strengthen country leadership of reform and enhance country-led development policies¹⁶; (b) the criteria used by donors to assess **readiness** for policy-based lending; (c) and the effects of increasing **donor coordination and harmonization** in low-income countries to enhance the predictability of aid *vis à vis* the need for flexibility on the part of donors to influence performance¹⁷. Since these issues can affect policy-based lending in different ways, the retrospective will present a discussion of the main questions that underpin the debate that revolves around them (see Section IV below).

¹⁴ For a summary of the controversy, see Koberle, Stephan (2003), *Should Policy-Based Lending Still Involve Conditionality?*, The World Bank Research Observer, Vol. 18, pp. 249-73.

¹⁵ See, for example, the following reports: *Turning the Tables: Aid and Accountability under the Paris Declaration – A Civil Society Report*, Eurodad, April 2008; *Challenging Conditions: A New Strategy for Reform of the World Bank and IMF*, Christian Aid, July 2006; *What Progress? A Shadow Review of World Bank Conditionality*, Action Aid International, September 2006; and *From 'Donorship' to Ownership? Moving Towards PRSP Round Two*. Oxfam, 2004.

¹⁶ Recent reports that advocate this preference include, *Outcome-Based Conditionality: Too Good To Be True?* Eurodad Report, February 2008; Barder, Owen and Nancy Birdsall, *Payments for Progress: A Hands-Off Approach to Foreign Aid*, Working Paper 102, Center for Global Development, December 2006.

¹⁷ On donor harmonization and predictability, see Celasun, Oya and Jan Walliser (2006), *Predictability of Budget Aid: Recent Experiences*, in Koberle, S. et al. (org.), *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*, The World Bank, Washington, DC; and Hermias, J. and H. Kharas (2008), *Thrive on Competition*, available at www.inwent.org.

III. RECENT TRENDS IN THE PROVISION OF DPOs

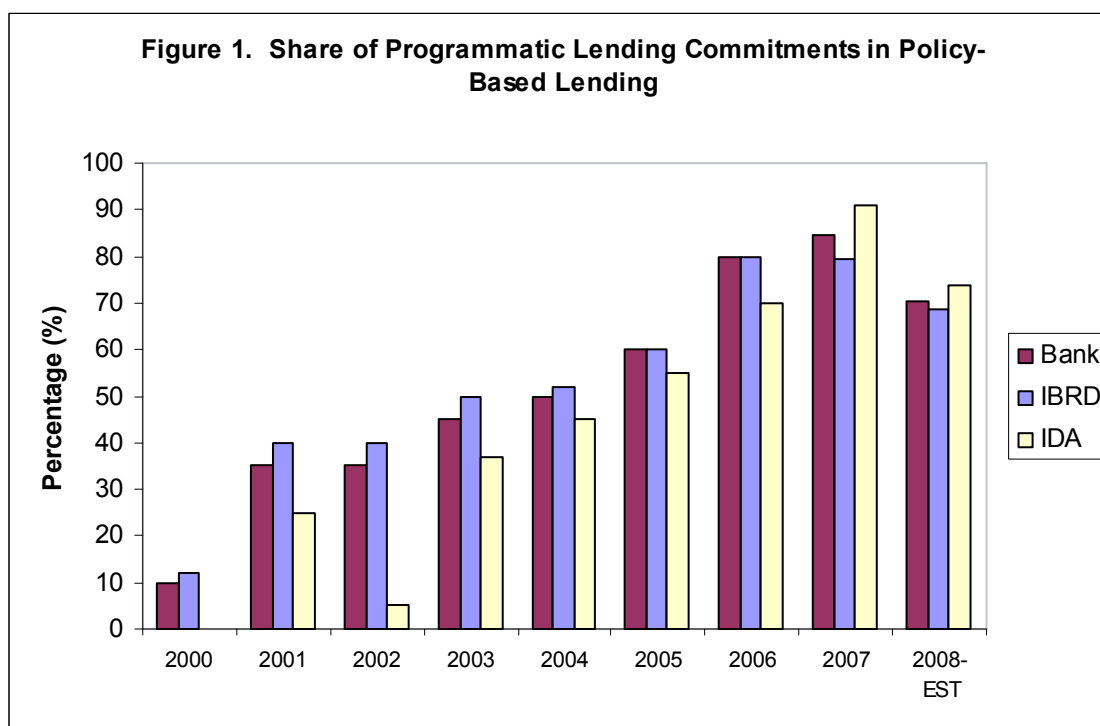
11. ***The Adapting Nature of DPOs.*** Over the past two decades, the primary focus of Bank DPOs has moved away from short-term macroeconomic adjustment and removing major economic distortions toward support for medium-term institutional changes. To a large extent, this shift reflects considerable progress on policy reform during the 1990s and the resulting change of focus of many developing countries' policy agendas.¹⁸ On the one hand, trade policy issues have become less important, following the significant reduction of trade barriers across the world and the realization that institutional change was needed. On the other hand, there has been a growing emphasis on the need for budget and public finance management reforms and on the new challenges constraining economic development and growth. This has meant that more attention is now devoted in developing economies to the microeconomic foundations of growth that range from support to higher education, to benefit from new knowledge and innovation, and the consequences of climate change.¹⁹ As a result, in more recent years, the content of DPOs has become more focused on public sector governance, strengthening of the financial sector, support to social sectors, and natural resource management. Demand for policy support in the areas of environmental and natural resource management and financial sector-related reforms has been relatively more frequent in IBRD countries whereas human resource and social sector reforms are more important objectives in IDA countries (see Figure XX to be added).

12. ***Increasing Use of Programmatic Design.*** Reflecting the experiences under structural adjustment lending related to rigidities in multi-tranche settings, as well as the increasing demand for Bank support of complex institutional reforms requiring a flexible step-by-step approach, the share of programmatic Bank operations and commitments has risen sharply since 2000 (see Figure 1). The Bank's programmatic approach to policy-based lending, based on a limited set of completed (as opposed to promised) critical actions that reflect country priorities, has contributed to establishing a regular review cycle that is aligned with the country's processes and provides a more predictable medium-term flow of resources. In low-income countries, the PRSC has helped improve resource predictability and, where early disbursement is critical, the Bank attempts to accelerate the PRSC preparation and negotiation process to improve alignment with the government's domestic timetables.²⁰ In FY07, more than 85 percent of policy-based lending commitments for IBRD countries and more than 90 percent for IDA countries were programmatic – in IDA countries these operations typically used the PRSC label. Preliminary figures for FY08 suggest that the share of programmatic operations in policy-based lending dropped to pre-FY07 levels.

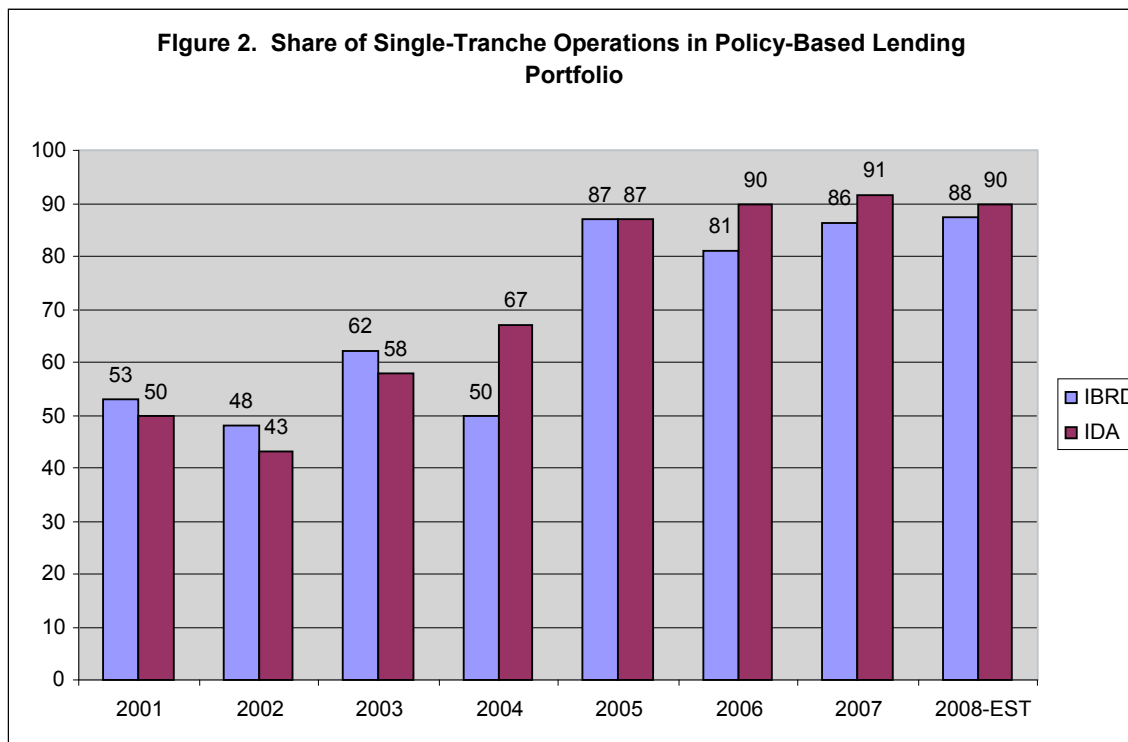
¹⁸ See Koeberle and Walliser (2006) World Bank Conditionality: Trends, Lessons, and Good Practice Principles, Chapter 13 in Koeberle, S., Z. Stavreski, and J. Walliser (orgs), *Budget Support as More Effective Aid? Recent Experiences and Emerging Lessons*, The World Bank, Washington, DC.

¹⁹ See *The Growth Report: Strategies for Sustained Growth and Inclusive Development*, Commission on Growth and Development, The World Bank, May 2008.

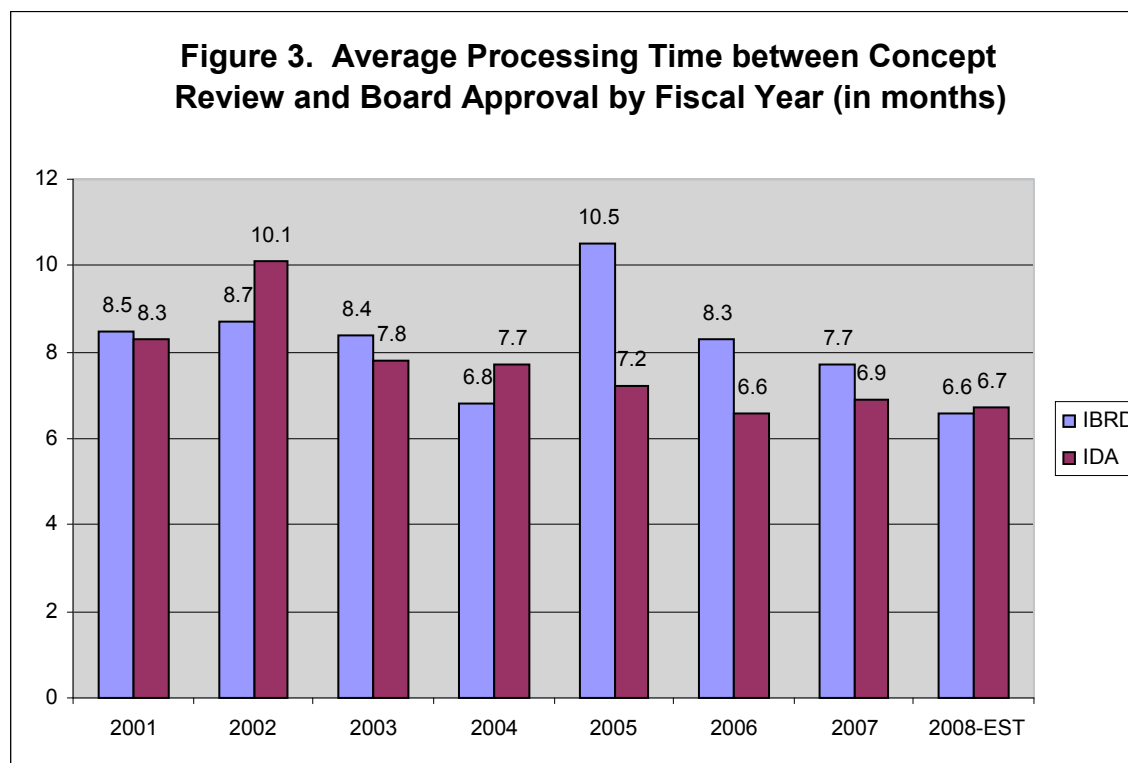
²⁰ See *Poverty Reduction Support Credit: A Stocktaking*, Operations Policy and Country Services, The World Bank, June 24, 2005.



13. ***Declining Use of Multi-tranche Designs.*** A corollary of the increasing use of programmatic lending approaches is the increasingly rare use of multi-tranche designs (see Figure 2). Multi-tranche operations have a bad track record of performance because they rely on the completion of future actions to justify disbursements which are usually influenced by factors beyond the control of the government and are therefore hard to meet. This tends to create unwanted interruptions in the flow of funds and/or demand extensive negotiations between the Bank and the borrower to waive the unmet tranche release requirements. On the other hand, each single-tranche operation under a programmatic approach is approved following actual performance, based on the assessment of completed actions, and therefore tend to contribute in a more effective way to systematic policy implementation. Since FY03, only a minority of policy-based operations have been multi-tranche loans. During FY05 and FY06, more than 81 percent of IBRD and 90 percent of IDA policy-based operations were single-tranche. This trend has been accentuated for IBRD countries in FY07-08 with an increase in the share of single-tranche operations by more than 10% over the levels observed in FY06.



14. **Shorter Processing Times.** Use of less complex loan designs, increased reliance on programmatic lending, and the streamlining of operational policy requirements appear to have yielded positive results for average preparation times of policy-based lending operations (see Figure 3). This trend is consistent with the increasing use of the programmatic approach since follow up operations in a programmatic series of DPOs take less time to prepare and process than a stand-alone DPO. On average, processing times between concept review and Board approval declined by more than 20 percent between FY01 and FY08 for both IBRD and IDA policy-based operations. Similar figures apply comparing FY08 outturns against average preparation times during FY01-08.



15. ***Policy-Based Lending Remains Important.*** For both IDA and IBRD, policy-based operations accounted for 31 percent and 25 percent of lending commitments in FY06 and FY07, respectively (see Table 1). When disaggregated, the share of policy-based lending by IBRD and IDA has fluctuated over time. IBRD's policy-based lending share spiked as a result of crisis lending during FY02, whereas IDA's share fell sharply in FY04 during a rapid acceleration of IDA investment lending. This trend has been reversed since then with the share of policy-based lending of IDA growing steadily since FY04. Preliminary estimates for FY08 indicate that IBRD's share of policy-based lending was 59 percent while IDA's share stood at 41 percent.²¹ The number of policy-based lending operations approved by the Bank's Board increased from 30 during FY01 to 47 (excluding supplemental financing) during FY08.

²¹ As part of the operational policy change in 2004, the prior 25 percent ceiling for the Bankwide share of policy-based lending was removed and substituted by an annual report by Bank Management on the anticipated Bankwide share of development policy lending in total lending. Based on that report, Executive Directors would issue guidelines for the average annual Bankwide share of development policy lending on a rolling three-year basis. In the context of the IDA-15 Replenishment discussions, it was agreed that Management would seek additional guidance from IDA's Executive Directors if the projected share of DPO commitments exceeds 30 percent for any future year. See page 11, footnote 41 in *Additions to IDA Resources: Fifteenth Replenishment. IDA: The Platform for Achieving Results at the Country Level*. Report from the Executive Directors of the International Development Association to the Board of Governors, February 28, 2008.

Table 1. IBRD/IDA Lending, FY06 and FY07

<i>Category</i>	<i>2006</i>	<i>2007</i>	<i>Change</i>
Number of operations	286	301	
IBRD	113	112	
IDA	173	189	
Commitments (\$ billions)	23.6	24.7	+4%
IBRD	14.1	12.8	-9%
IDA	9.5	11.9	+25%
Investment	16.3 (69%)	18.4 (75%)	
Development policy	7.3 (31%)	6.3 (25%)	

Note: Lending includes loans, credits, guarantees, and grants.

IV. MAJOR ISSUES FOR THE RETROSPECTIVE

16. ***Focus on Development Policy Agenda.*** The previous sections highlighted major trends in process issues related to design, content, and volume of DPOs. These are useful to identify major trends and patterns in the use of development policy lending related to areas of coverage and customization to different clients that can be used to monitor compliance with policy and reveal where improvements might be necessary to correct imbalances. However, the Bank's interest is to help countries achieve development goals. In that context, the key focus of the 2008 DPL Retro will be on the effectiveness of World Bank policy-based lending in supporting client countries to design and implement their medium-term development policy agendas. In what follows, the concept note presents the proposed issues to be discussed in the retrospective and its corresponding suggested structure.

17. The retrospective will be structured in four chapters. The first chapter would discuss the World Bank policy-based lending approach and existing modalities and definitions of budget support instruments used by different aid providers. The second chapter would focus on the effectiveness of World Bank DPOs in supporting the design and implementation of a medium-term development policy agenda. The third chapter would discuss some of the main issues that have recently emerged from the experience with policy-based lending. The fourth chapter would report on trends in the processing of Bank development operations, including volumes and shares, tranching, programmatic nature, joint operations with other donors, and processing times. The next paragraphs explain how these issues are proposed to be addressed in the retrospective.

Chapter I – The World Bank Approach to Development Policy Lending

18. **Key Features of WB DPOs.** The first Chapter of the retrospective will highlight key features of World Bank DPOs. These features are reflected in current Bank policy on development policy lending approved by the Board of Executive Directors in August 2004 and internalize lessons from the experience with adjustment lending in the 1980s and 1990s. In particular, the Chapter will discuss how DPOs are expected to be aligned with country priorities and objectives and support a medium-term program of reforms that is anchored on national development programs and/or sectoral strategies within a transparent and results-oriented framework. The Chapter will also discuss how the policy dialogue and the package of technical assistance and analytical and advisory work associated with DPOs is expected to strengthen the design of a country's medium-term reform program and enhance the coordination between the Finance Ministry and sectoral ministries. Finally, the Chapter will look at the key features and rationale for DPOs in fragile and conflict-affected states (FCS), as reflected in the "Good Practice Note for Development Policy Lending: Development Policy Operations and Conditionality in Fragile States".

Chapter II – The Effectiveness of World Bank DPOs

19. **Effectiveness of WB DPOs.** The 2008 DPL retrospective will place significant emphasis on the assessment of the effectiveness of policy-based operations provided by the World Bank in supporting the design and implementation of a medium-term development policy agenda. For the purposes of this retrospective, the effectiveness of DPOs will be assessed through the following complementary angles: (a) their capacity to reflect **country priorities and objectives**; (b) the **flexibility** with which Bank policy-based operations can accommodate shifts in country priorities and country circumstances to provide customized support to both IBRD and IDA countries alike; and (c) the extent to which they are **results-orientated**. In addition, to illustrate this discussion, this Chapter will discuss how DPOs are being used to promote the Good Practice Principles for conditionality.

20. In this context, the retrospective proposes to focus on the following questions to assess the effectiveness of DPOs in each of these three areas:

(a) *Country Priorities and Objectives* – How well DPOs are aligned with country priorities in IBRD countries and with the overall PRS agenda in IDA countries? Are DPOs clearly aligned with CAS objectives? How effective have DPOs been in helping countries prioritize and operationalize key policy measures emanating from existing national and sectoral strategies? How effective have DPOs been in helping FCS clear arrears and reengage with the MDBs?

(b) *Results Orientation* – To what extent does the policy dialogue attached to DPOs help countries be more selective in the design of their reform programs? What type of reforms and development outcomes are most commonly supported

in DPOs and to what extent is the design of DPOs informed by existing analytic work? To what extent do DPOs focus on policies that can be seen as conducive to poverty-reducing growth? Do DPOs pay adequate attention and describe existing and necessary mitigating measures to address likely poverty and social impact as well environment, forest and other natural resource impacts of policy actions supported by the operation? Does the policy dialogue attached to DPOs contribute to help countries achieve macroeconomic stability?

(c) *Flexibility and Customization* – Is the instrument of policy-based lending flexible enough to provide customized financing in response to changing country circumstances and priorities? Do DPOs respond in a flexible way to the changing objectives and priorities of IBRD countries? Have DPOs been effective in advancing the policy dialogue and the reform agenda on growth and service delivery in fragile and conflict-affected states?

Chapter III – Emerging Issues in the Provision of Policy-Based Lending

21. ***Emerging Issues.*** As discussed earlier, a number of emerging issues have arisen in the context of current debate surrounding the policy-based lending instrument (see paragraph 10). These emerging issues include: (a) the challenges associated with the implementation of an outcome-based approach to budget support; (b) the criteria used by donors to assess client countries' readiness to policy-based lending; (c) and the effects of increasing donor coordination and harmonization in low-income countries to enhance the predictability of aid *vis à vis* the need for flexibility on the part of donors to influence performance.

22. The retrospective will address these emerging issues and how they relate to World Bank DPOs by focusing on the following main questions.

- *Outcome-based approach.* The retrospective will discuss the main features of the outcome-based approach and examine issues related to attribution and results measurement. In this context, the following questions are of interest: (a) are there enough outcome and impact indicators of sufficient quality available on a timely basis to monitor progress toward development objectives?; (b) is the outcome-based approach capable of separating the contribution of country policies to development outcomes from the effects of exogenous shocks?; (c) to what extent is this approach pro-cyclical – i.e., does it tend to reward countries when overall country conditions are favorable to them and to “punish” countries when the domestic environment is deteriorating and outcomes are slower to materialize?; and (d) what is the Bank's experience with monitoring development outcomes in countries with a well structured programmatic series of development policy operations?
- *Readiness for policy-based lending.* In many cases, aid recipient countries may not be considered ready to receive budget support for reasons that can

vary from a perceived weak public finance management framework to weaker than expected institutions which may render the country vulnerable to corruption and misuse of public funds. The retrospective will discuss what factors have been considered as key elements to assess readiness for policy-based lending by the World Bank and others. Specifically, it will discuss whether and how the following criteria have been used to assess readiness: (a) country ownership of a reform program; (b) country capacity to design and implement programs; (c) soundness of the policy and institutional framework, including public finance management and fiduciary arrangements; and (d) the track record of macroeconomic performance.

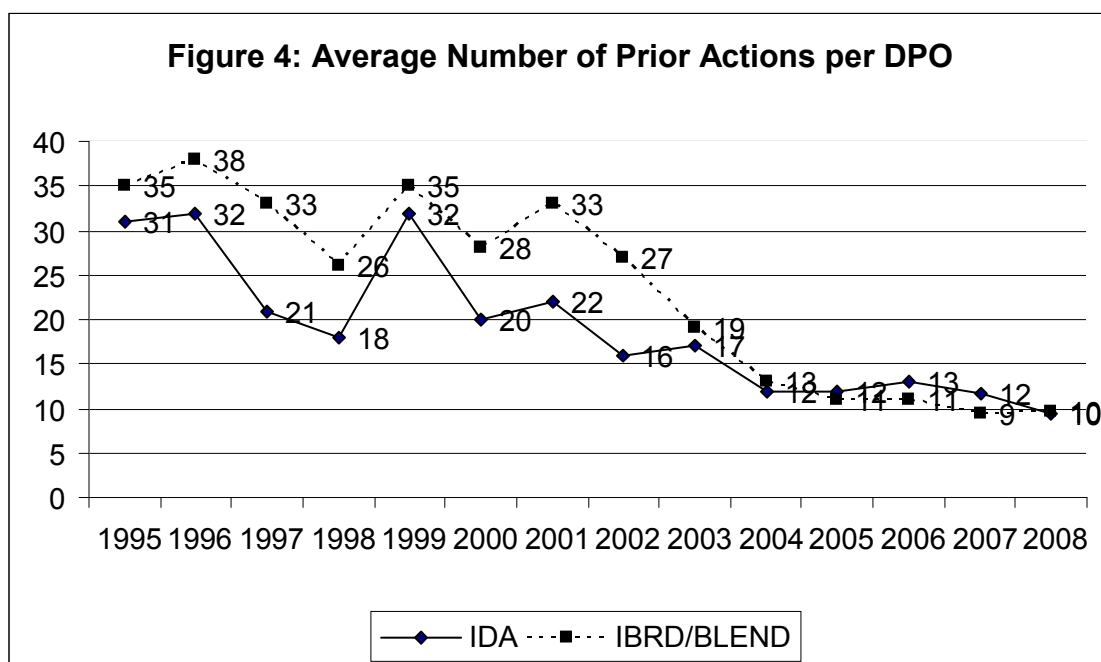
- *Donor coordination, harmonization and predictability.* The retrospective will discuss the effects of increasing donor coordination and harmonization. The topic has been increasingly debated because donor coordination is a critical aspect of budget support, especially where the latter represents a large share of donor flows. The questions that will be addressed in the retrospective in this regard include: (a) To what extent better donor coordination and harmonization of donor requirements have contributed to local ownership, reduction in transaction costs and enhancement of the overall effectiveness of development assistance?; (b) How effective has the donor harmonization process been in homogenizing different donor approaches (e.g., on how to measure fiduciary risks and the degree to which donors scrutinize the budget and disbursement allocations)?; (c) In what concerns PRSCs specifically, what has been the experience under increased donor coordination and harmonization with modulating support in line with performance?; and (d) What are the risks that the provision of budget financing, irrespective of country performance or financing needs, erode the incentives for governments to remain accountable to their citizens and to further develop their own revenue sources?

Chapter IV – Recent Trends in World Bank Policy-Based Lending

23. ***Relevance, Flexibility, and Simplification.*** Finally, the retrospective will discuss recent trends in World Bank policy-based lending as regards volumes, share of DPOs in total Bank lending, average processing time of DPOs, and the sectoral coverage of DPOs in IBRD countries, IDA recipients and fragile states. In terms of design features, the Chapter will assess recent trends in the use of multi-tranche operations, the programmatic nature of DPOs, the pattern and track record of joint operations with other development partners *vis à vis* stand-alone operations, and how effectively Program Documents report on financial and non-financial risks and identify appropriate mitigating measures. This Chapter will also include an assessment of how Bank operations have used selectivity in the choice and number of prior actions²² which have declined sharply from an average of

²² An operation is presented to the Bank's Board of Executive Directors for approval and the funds are made available once the prior actions agreed with the government have been met. In addition to completion

35 in the 1990s to an average of 9 in IBRD/blend countries and 10 in IDA countries in FY08 (see Figure 4).



24. A description of the main features which are expected to be covered in Bank DPOs, as per operational policy requirements, is presented in Box 2 in the annex along with an indication as where they will be addressed in the retrospective.

V. METHODOLOGY, PROCESS AND TIMEFRAME

25. **Methodology.** The methodology to be used in the retrospective will rely on the following three-pronged approach:

- *Literature and desk review:* The first prong will be based on the review of the literature on the effectiveness of development policy lending and on the desk review of Program Documents and ICRs of DPOs. This will inform the retrospective regarding emerging issues and current views on the instrument of development policy lending, provide source data, and take stock of design and implementation aspects of DPOs. While there are some 121 operations in the total universe to be covered by the retrospective, it is anticipated that a much smaller number of ICRs will be available for the review, which will limit the extent to which the desk review will be able to assess the country-

of prior actions, the Bank assesses the adequacy of the macroeconomic policy framework and performance in program implementation before deciding on the disbursement of DPO funds. The number and the explicit content of prior actions in all Bank DPOs are always explained in the operation's program document and are listed in a schedule accompanying the legal agreement.

level achievements of DPOs. They will be therefore supplemented by interviews, literature reviews, assembly of key performance indicators, CAS Completion Reports, and Country Assistance Evaluations. The retrospective will also be informed by the currently ongoing IEG Evaluation of PRSCs and the joint PREM/SDN evaluation of PSIAs.

- *Linking design to effectiveness*: The second prong will look into how design aspects of DPOs can influence their effectiveness in contributing to a broader development policy agenda in borrowing countries. This will be done by considering the inputs used in the preparation of DPOs and the output indicators used to monitor progress under a reform program supported by the Bank. This will inform the assessment of the effectiveness of DPOs in reflecting country priorities and objectives, supporting growth-enhancing and poverty-reducing policies, being results-oriented, and allowing for flexibility to accommodate shifting priorities and changing country circumstances.
- *Client, donor, and staff consultations*: The third prong consists of consultations that would take place in a representative number of countries to collect views from stakeholders and government officials on the effectiveness and results-orientation of DPOs. The consultations would focus as well on progress made with the application of the good practice principles for conditionality. A select number of Bank staff who have been involved with DPOs will be interviewed to gauge their assessment of this instrument as an effective tool to support results-oriented country reforms.

26. **Process.** As in previous retrospectives, OPCS will enlist the assistance of the Networks and Central Departments that systematically review and comment on different aspects of DPOs. These groups will collaborate with OPCS in evaluating the Program Documents and ICRs of DPOs for their respective areas according to the criteria used in the last retrospective. A suggested outline is included in the annex.

27. The **proposed timeframe** for the retrospective is the following:

- October – Internal review of concept note
- November-December – Feedback from stakeholders
- Mid-December - Inputs from other units in the Bank
- January-February – In-country consultations
- March - First informal draft (powerpoint) to serve as a basis for consultations
- April - Consultations with stakeholders
- Mid-May - First draft and internal review in OPCCE
- End-May - Final draft and Bank-wide review meeting
- June - Board presentation

ANNEX: SUGGESTED OUTLINE OF THE RETROSPECTIVE

I – BUDGET SUPPORT: THE WORLD BANK APPROACH TO DEVELOPMENT POLICY LENDING

- A – Definition of Policy-Based Lending
- B – Main Features of the WB Approach
- C – Brief Overview of Previous Experience with DPOs

II – ASSESSING THE EFFECTIVENESS OF WB DPOs

- A – Ownership
- B – Review of Country Cases to Illustrate Results Orientation
- C – Flexibility and Customization
- D – Progress in Implementing the Good Practice Principles on Conditionality

III – EMERGING ISSUES IN THE PROVISION OF POLICY-BASED LENDING

- A – Outcome-based approach
- B – Readiness criteria
- C – Donor coordination, harmonization, and predictability

IV – RECENT TRENDS IN WB POLICY-BASED LENDING

- Volumes and numbers
- Programmatic nature
- Tranching
- Joint operations vs. stand alone DPOs
- Processing times
- Risk assessment

Box 1: Existing Definitions of Budget Support

Policy-based lending: Provision of untied donor resources directly through the government's budget, using the government's own financial management, procurement, auditing, and implementation processes and systems. This lending is based on a set of policy or institutional reforms.

Development policy lending (DPL): The Bank's term for policy-based lending, development policy lending (DPL), replaced adjustment lending as the Bank's financing instrument to provide quick-disbursing resources to client governments.

Poverty reduction support credit (PRSC): A form of budget support used by the World Bank in low income countries that is closely tied to the PRSP and typically consists of a series of three or four single tranche operations.

Program-based approach (PBA): A general term that refers to coordinated donor support to implement a comprehensive program (e.g., PRSP) or a specific sector/thematic strategy (e.g., in education or environment) that is country-led and relies on a single budget framework and domestic processes. PBAs include budget support and SWAps.

Budget support: Donor instruments (including the PRSC) that support the implementation of a country's medium-term poverty reduction strategy and consist of regular (annual) disbursements of untied resources to the budget. Budget support is typically based on an agreed set of performance indicators in the form of institutional or policy reform measures or outcome indicators.

Direct Budget Support: Some bilateral donors distinguish between two types of non-project aid that they refer to as direct budget support. Within that category, they differentiate *general budget support* from *sector budget support*. The former is defined as a general contribution to the overall budget (sometimes referred to as *macro support*). The latter is defined as financial aid earmarked to a discrete sector (with specific conditionality relating to these sectors).

Sector-wide approach (SWAP): An approach that involves financing of a specific sector through various financing modalities, including budget support and investment financing.

Box 2: Main Design Features of DPOs and Policy Requirements

Design Features of DPOs	Policy Requirements under OP8.60	Where They Will Be Addressed in the Retrospective
Macroeconomic policy framework	"the Bank undertakes development policy lending only when it has determined that the country's macroeconomic policy framework is appropriate." (para 5)	Chapter II
Alignment and ownership	"the Program Document sets out the country's program being supported and the specific results expected from the results transfer" (para 8)	Chapters II and III
Consultations and participation	"the Bank advises borrowing countries to consult with and engage the participation of key stakeholders in the country in the process of formulating development strategies" and "the Bank staff describe the country's arrangements for consultations and participation relevant to the operation" (para 6)	Chapters II and III
Coordination with Development Partners	"the Bank collaborates with the IMF and other international financing institutions and donors, as appropriate, while retaining the responsibility for its financing decisions" (para 7)	Chapters II and III
Analytic underpinnings	"the Bank draws on relevant analytic work on the country ... and describes the main pieces of analytic work used in the preparation of the operation and how they are linked to the proposed development policy program." (para 9)	Chapter II
Poverty and social impact	"the Bank determines whether specific policies support by the operation are likely to have significant poverty and social impacts, especially on poor and vulnerable groups" and for those with likely significant effects "summarizes relevant analytic knowledge of these effects and of the borrower's systems for reducing adverse effects and enhancing positive effects." (para 10)	Chapter II
Environmental, forests, and natural resource aspects	"the Bank determines whether specific policies supported by the operation are likely to have significant effects on the environment, natural resources, or forests" and for those with likely significant effects summarizes relevant analytic knowledge of these effects and of the borrower's systems for reducing adverse effects and enhancing positive effects." (para 11)	Chapter II
Fiduciary arrangements	the Bank determines, "drawing on relevant analysis of a country's public financial management, whether the operation should include measures to address identified fiduciary weaknesses". The determination includes foreign exchange control environment and budget resources. (paras 17-19)	Chapter III
Monitoring and Evaluation	"Bank staff review implementation progress during supervision to verify fulfillment of program conditions and compliance with legal covenants, and to validate monitoring and evaluation findings. Supervision includes a focus on development impact, assessing the changes in outputs and outcomes resulting from the operation". (para 16)	Chapter II
Risk assessment	"the Bank independently identifies the financial and non-financial risks associated with the program and ensures that the operation contains appropriate mitigation measures and monitorable indicators to track high-probability risks". (para 15)	Chapter IV