

Experience with World Bank Conditionality

Stefan Koeberle and Thaddeus Malesa

1. **Summary.** This note summarizes key trends in the application of conditionality in World Bank policy-based lending since fiscal year 1980. Many of the findings indicate that over time the World Bank has adopted a number of lessons learned and incorporated them into business practices. The main conclusions of the analysis and questions going forward are:
 - The volume of adjustment lending has stabilized at around 30% of World Bank lending in the past decade;
 - The average number of conditions has decreased;
 - Loans with fewer conditions are generally of higher quality;
 - Single tranche adjustment operations are usually of higher quality;
 - World Bank adjustment lending is selective, favoring better performing countries;
 - The average number of conditions is lower in better performing countries; and
 - The focus of conditionality has changed from short-term reforms, to longer-term and more complex issues;
 - Given the experience with conditionality, should the World Bank continue to use it in its present form? And
 - Programmatic lending emerges as a fairly robust approach to reconcile numerous tensions and concerns.

2. ***The volume of adjustment lending has stabilized at around 30% of World Bank lending in the past decade.*** Adjustment operations have accounted for 10-20% of all Bank lending operations (see Figure 1) in recent years, with a far smaller share in the early 1980s. There has been a greater fluctuation in the share of lending volumes, with adjustment lending commitments representing around one third of the World Bank portfolio on average (see Figure 2). The number of adjustment operations approved to date has been almost evenly split between IBRD and IDA countries (see Figure 3), but the share of commitments to middle-income countries (IBRD) has been far larger (see Figure 4). This is also reflected in regional lending comparisons: the Africa region accounts for 34% of adjustment operations, but only 16% of commitments (see Figure 5).

Figure 1

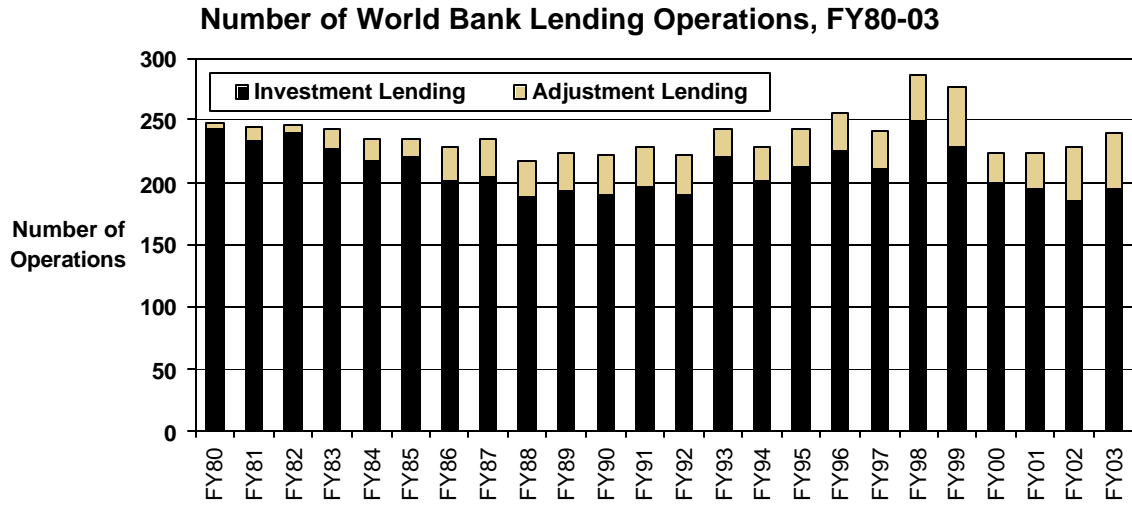


Figure 2

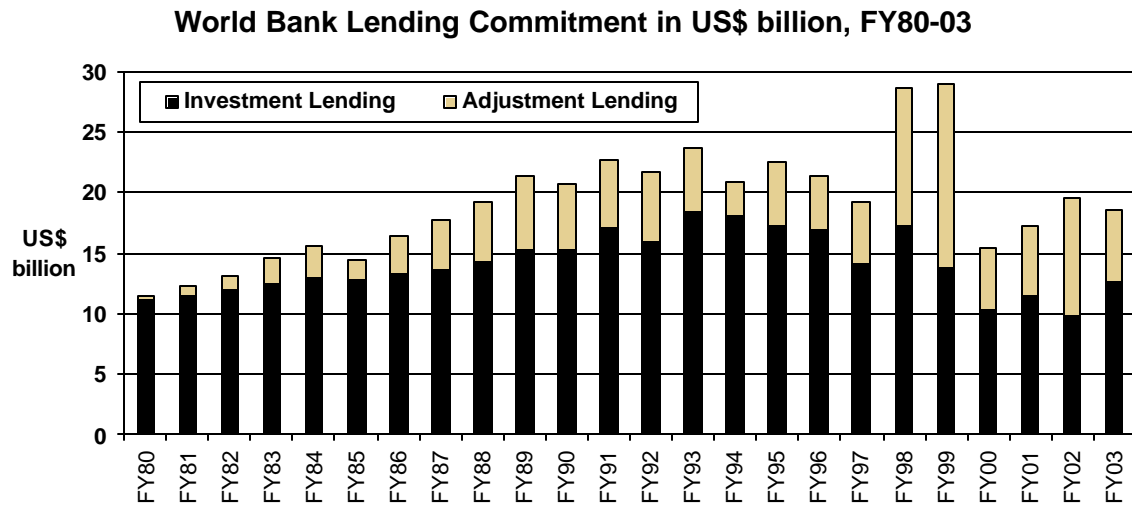


Figure 3

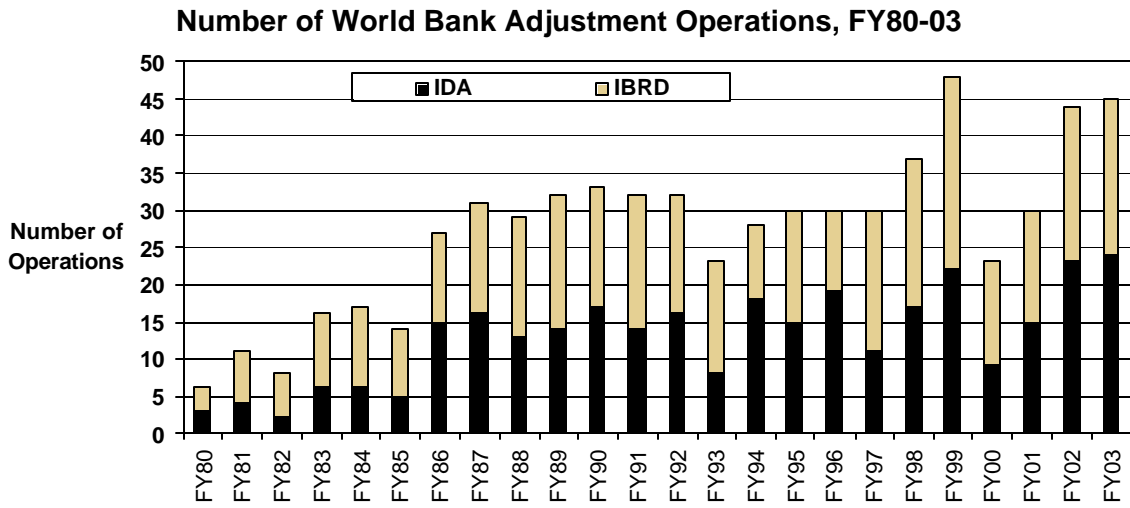


Figure 4

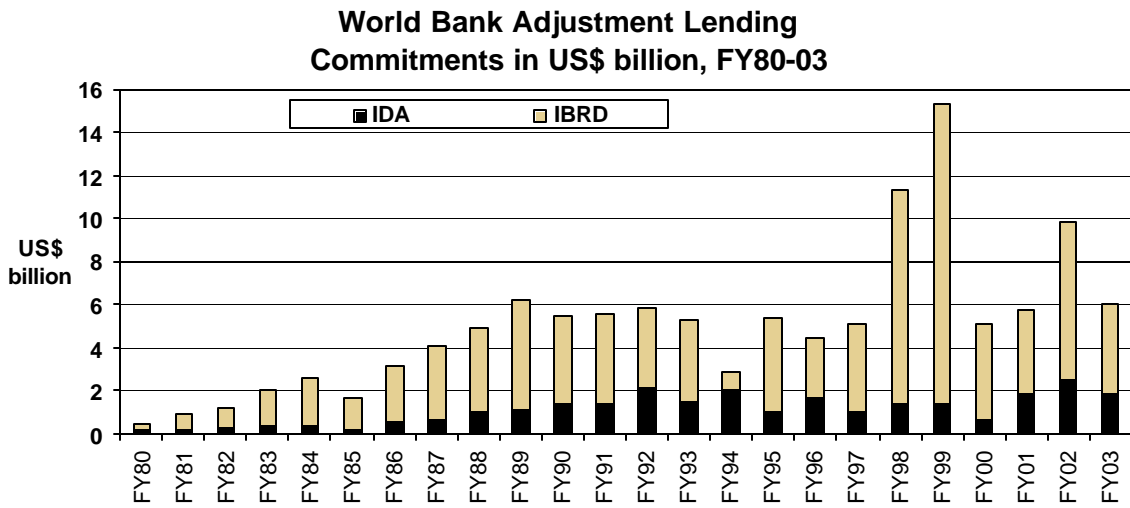
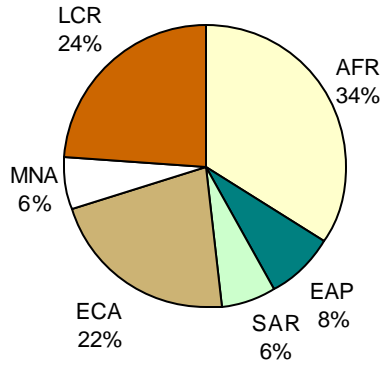
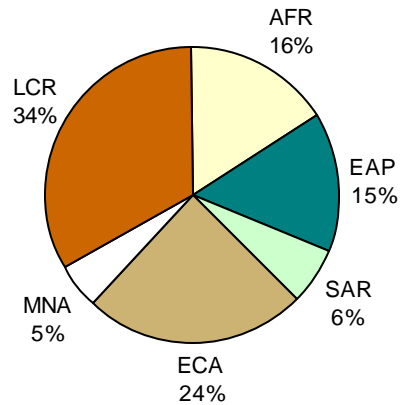


Figure 5

Regional Share of Adjustment Lending by Number of Operations, FY80-03



Regional Share of Adjustment Lending by Volumes, FY80-03



3. **The average number of conditions has decreased.** The average number of conditions¹ fell from above 35 in the late 1980s to below 18 in FY03 (see Figure 6), with the exception of FY92-93 where the average number of conditions was over 40. If non-binding conditions or desired actions are included,² the total number has fallen from around 60 to 42 during the same time—somewhat above previous years’ averages (34 in FY01 and 27 in FY 02). Furthermore, the average number of conditions has been decreasing across all types of adjustment lending³ used by the Bank in recent years (see Figure 7). While the average number of conditions has decreased across all Bank adjustment loans, the number of conditions in IBRD and IDA countries has been converging (see Figure 8).

¹ Legally binding conditions are prior actions preceding Board presentation, effectiveness conditions, and conditions for tranche release set out in the legal agreements signed by the borrowing government and the World Bank.

² Non-binding conditions are other desired actions included in the loan documentation but not included in the legal agreement. Client government compliance with these actions is not tied to the release of funds.

³ The different types of adjustment lending are grouped as follows: SAL & SSAL – Structural Adjustment Loans and Special Structural Adjustment Loans; SECAL – Sectoral Adjustment Loans; PRSC & PSAL – Poverty Reduction Support Credits and Programmatic Structural Adjustment Loans.

Figure 6

Average Number of Conditions and Desired Actions per WB Adjustment Loan/Credit, FY80-03

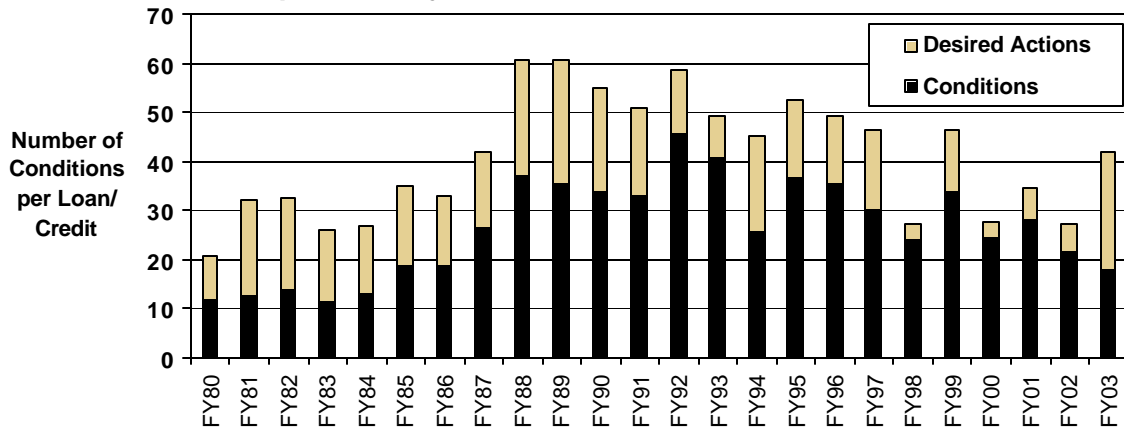


Figure 7

Average Number of Conditions per WB Adjustment Loan/Credit by Different Types of Adjustment Lending, FY80-03

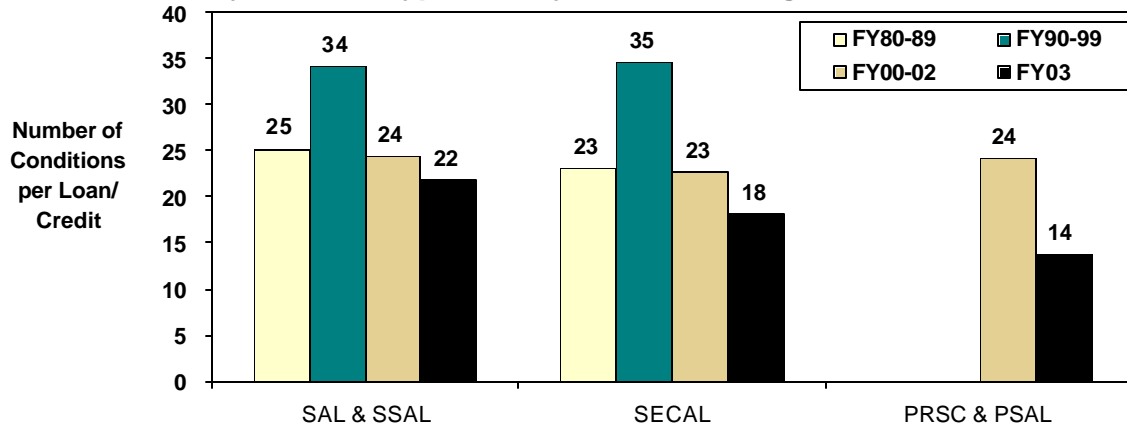
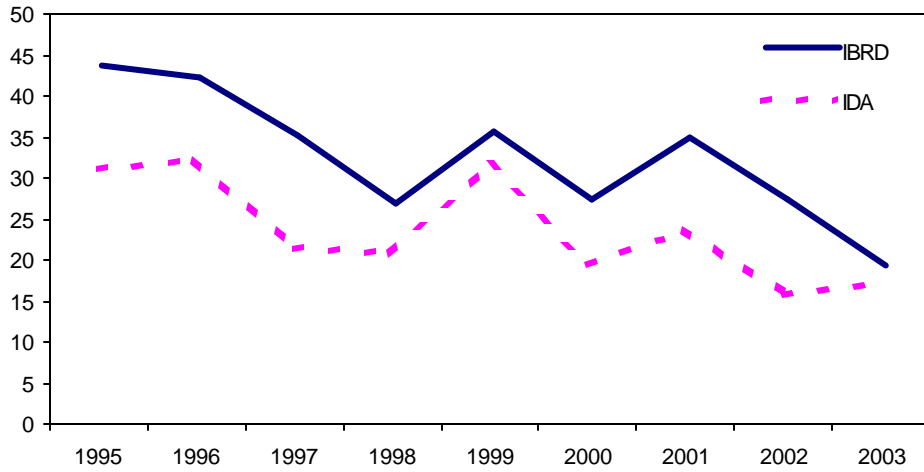


Figure 8

Average Number of Legally-binding Conditions by Agreement Type, FY95-03



4. *Loans with fewer conditions are generally of higher quality.* In general, quality of adjustment operations, as judged by the independent Operations Evaluation Department, has markedly improved in the last decade from 69% of operations with satisfactory ratings exiting in FY92, to 81% of operations with satisfactory ratings exiting in FY03 (see Figure 9). A lower number of legally binding conditions is generally associated with higher quality (see Figure 10).

Figure 9

OED Quality-at-Exit Ratings of WB Adjustment Lending Operations, Exit FY90-03

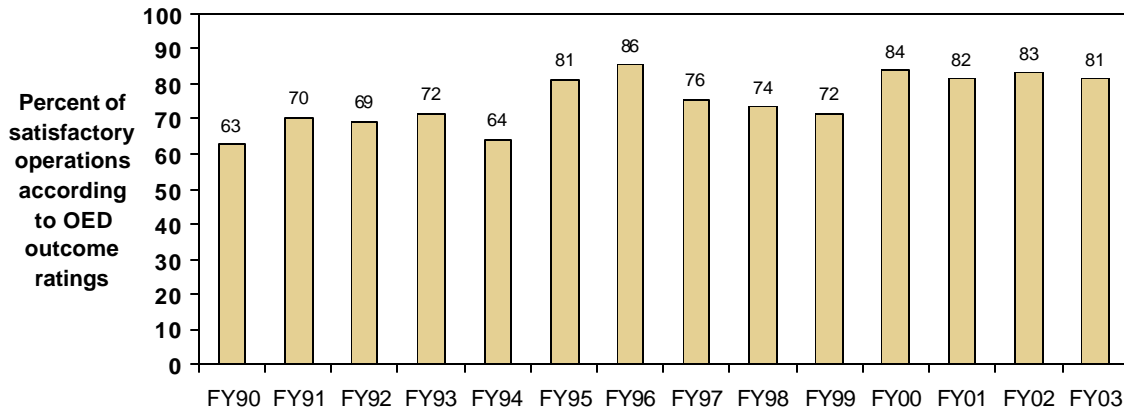
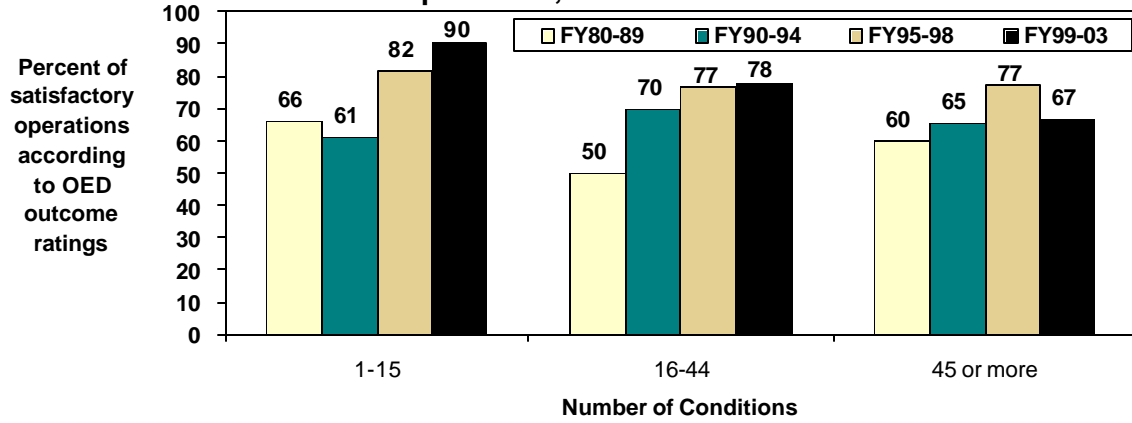


Figure 10

Average OED Quality-at-Exit Ratings of WB Adjustment Lending Operations by Number of Conditions, Weighted by Operations, Exit FY80-03



5. *Single tranche adjustment operations are usually of higher quality* (see Figure 11). This was not affected by a significant increase in the share of single tranche adjustment operations in the overall portfolio (see Figure 12).

Figure 11

OED Ratings of WB Adjustment Lending Operations by Number of Tranches, Exit FY90-03

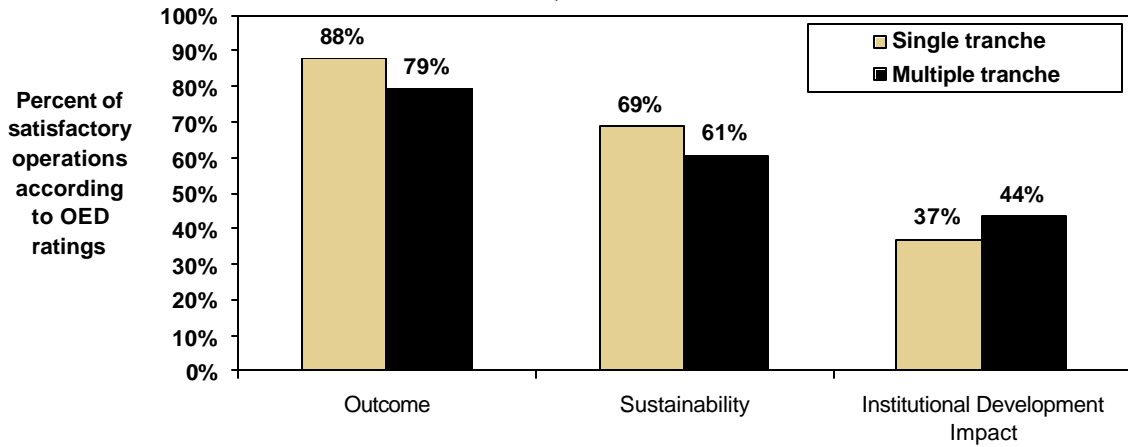
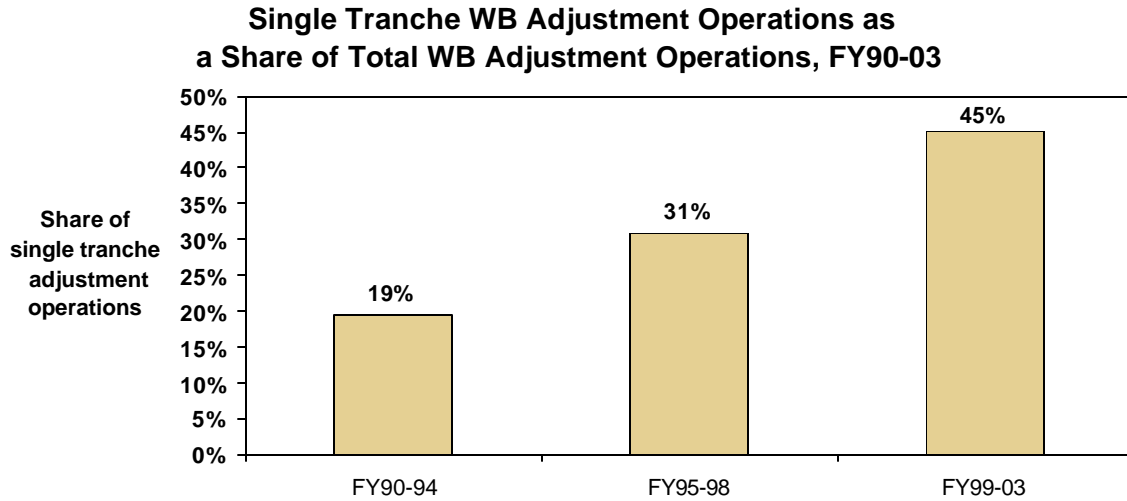


Figure 12



6. *World Bank adjustment lending is selective, favoring better performing countries.* The majority of adjustment lending commitments go to high and good performing country groups⁴, according to the countries' CPIA rating (see Figure 13).

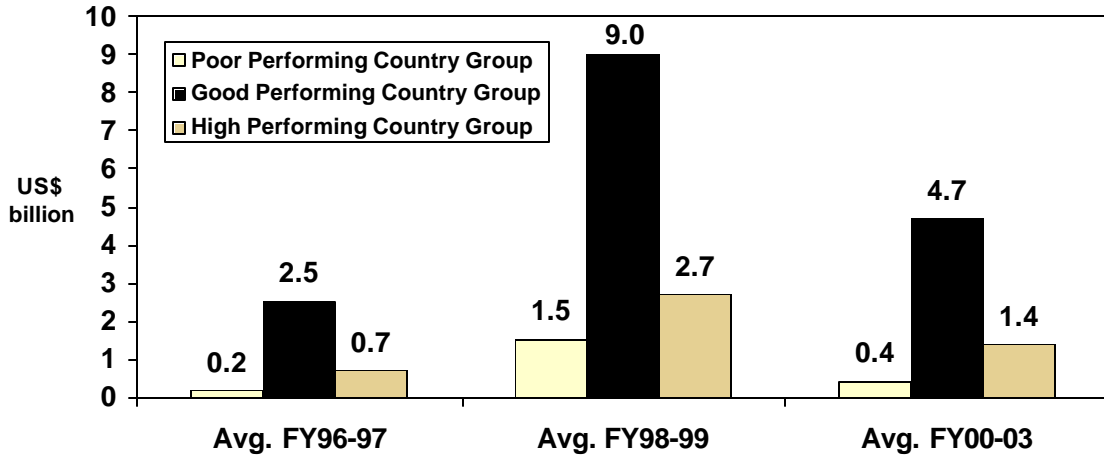
The CPIA Rating

The CPIA rating is carried out once a year. It's main purpose is to assess the quality of a country's current policy and institutional framework on the basis of observable policies, not on the amount of improvement since the previous yearly exercise, nor on intentions for future change, unless the latter are virtually in place. "Quality" means how conducive that framework is to fostering poverty reduction and sustaining growth and the effective use of development assistance. Bank staff follow specific guidelines and rate countries based on these guidelines and to benchmark countries in each region. Bank staff assess and rate 20 policy and institutional performance areas every year, which are then grouped and averaged into the four clusters: (a) economic management, (b) social inclusion and equity, (c) public sector management and institutions, and (d) structural reform policies. The CPIA rating (a numerical value between 1 and 6) is then discussed and agreed to by Regional management. Some aspects of the CPIA ratings are disclosed. CPIA ratings for 1995 existed only for IDA countries, IBRD ratings for 1995 were staff estimates. CPIA ratings for 1995-1997 were rescaled from a 1-5 scale to 1-6 scale.

⁴ The unofficial groupings of high, good and poor performers were made using CPIA (Country Policy and Institutional Assessment) ratings over the period between fiscal years 1996 and 2003. A country with a CPIA rating of 4.00 and above are assigned to the "high" performing group, those countries given a rating between 3.00 and 3.99 are assigned to the "good" performing group, and the countries with an overall CPIA rating 2.99 and below are included in the "poor" performing group. These groupings have been made exclusively for this exercise, and are not in line with any official World Bank classifications.

Figure 13

Average Annual Adjustment Lending Commitments by Country's CPIA Rating, in US\$ billion

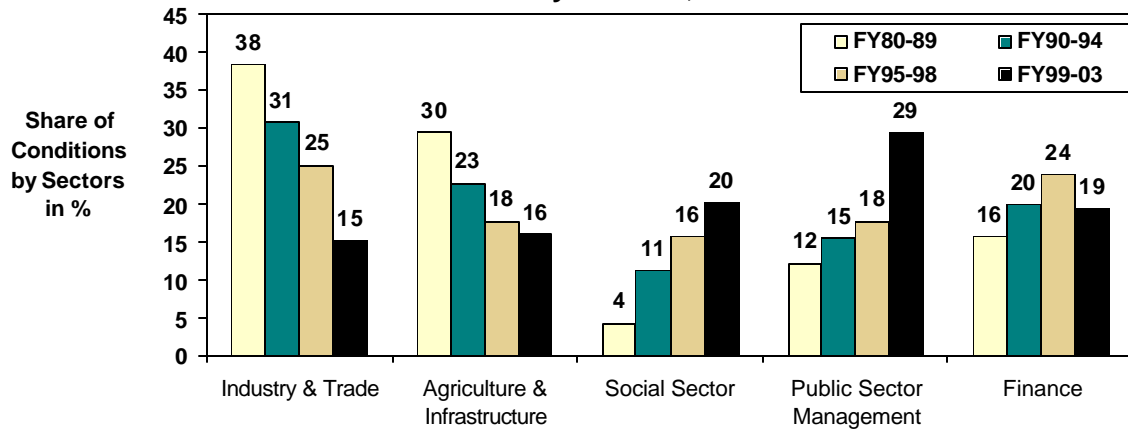


7. *The average number of conditions is lower in better performing countries.* On average for FY98-03, adjustment loans in very high performing countries (CPIA 4.5 or more) contain an average of 23 legally binding conditions, whereas for very low performing countries (CPIA 2.49 or less) the average number of conditions is 47. Operations in countries with higher overall CPIA ratings have higher average outcome ratings.

8. *The focus of conditionality has changed from short-term reforms, to longer-term and more complex issues.* The focus of overall conditionality has also changed: from an initial focus on short-term macroeconomic and trade-related reforms, to longer-term and more complex social sector and public sector management issues (see Figures 14 and 15). The change in concentration of policy-based lending is also reflected in the sharp decline of supported public enterprise restructuring and privatization reforms in recent years (see Figure 16).

Figure 14

Share of Conditions Associated with WB Adjustment Loans/Credits by Sectors, FY80-03



Sectors

Sectors are high-level, mutually exclusive grouping of economic activities based on the types of goods or services produced. Sectors are used to indicate which part of the economy is supported by the WB intervention. For our analysis we classified the sectors into 5 categories:

–*Industry & Trade* - Industry & Trade Sector Group;

–*Agriculture & Infrastructure* - Agriculture, Fishing and Forestry Sector Group, Information and Communications Sector Group, Energy and Mining Sector Group, Transportation Sector Group and Water, Sanitation and Flood Protection Sector Group;

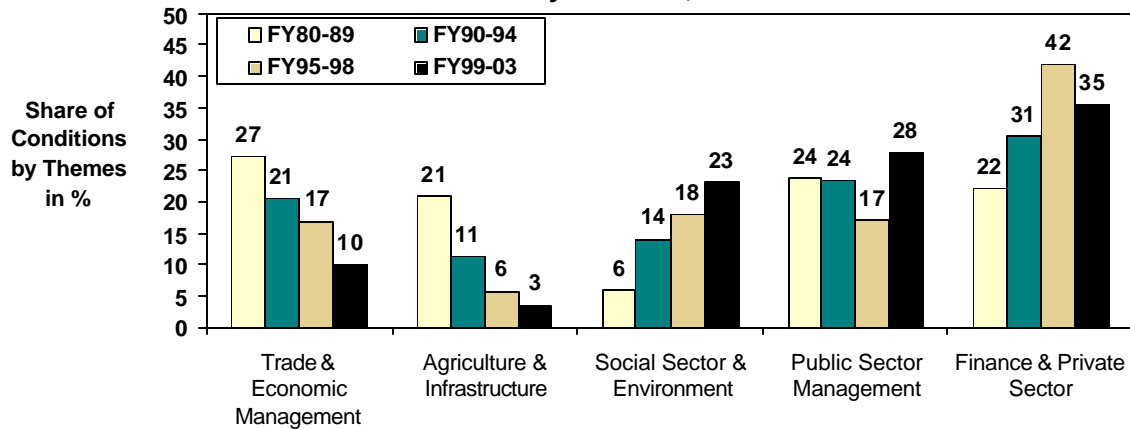
–*Social Sector* - Education Sector Group, Health and Other Social Services Sector Group, Compulsory Pension and Unemployment Insurance Sector and Health Insurance Sector;

–*Public Sector Management* - Central Government Administration Sector, Law and Justice Sector, Sub-national Government Administration Sector and General Public Administration Sector; and

–*Finance* - Banking Sector, Capital Markets Sector, Housing Finance and Real Estate Markets Sector, Non-compulsory Pensions, Insurance and contractual savings Sector, Payment Systems, Securities Clearance and Settlement Sector and General Finance Sector, Micro- and SME Finance Sector.

Figure 15

Share of Conditions Associated with WB Adjustment Loans/Credits by Themes, FY80-03



Themes

Themes are goals/objectives of WB activities. Themes are used to capture WB support to the Millennium Development Goals. For our analysis we classified the themes into 5 categories:

–*Trade & Economic Management* - Trade and Integration Theme Group and Economic Management Theme Group;

–*Agriculture & Infrastructure* - Infrastructure Services for Private Sector Development Theme, Access to Urban Services for the Poor Theme, Other Urban Development Theme, Rural Non-farm Income Generation Theme, Rural Policies and Institutions Theme, Rural Services and Infrastructure Theme and Other Rural Development Theme;

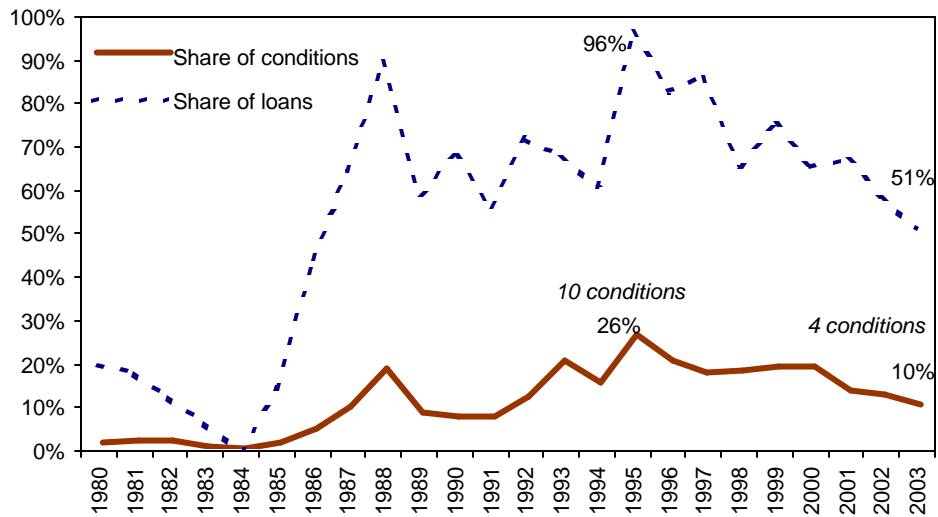
–*Social Sector & Environment* - Social Protection and Risk Management Theme Group, Social Development, Gender and Inclusion Theme Group, Human Development Theme Group and Environment and Natural Resources Management Theme Group;

–*Public Sector Management* - Public Sector Governance Theme Group, Rule of Law Theme Group and Municipal Governance and Institutional Building; and

–*Finance & Private Sector* - Corporate Governance Theme, Regulation and Competition Policy Theme, Small and Medium Enterprise Support Theme, Standards and Financial Reporting Theme, State Enterprise/Bank Restructuring and Privatization Theme, Other Financial and Private Sector Development Theme, Rural Markets Theme and Municipal Finance Theme

Figure 16

Loans with State enterprise/bank Restructuring and Privatization Conditionality, FY80-03



9. **Given the experience with conditionality, should the World Bank continue to use it in its present form?** While *ex ante* conditionality has often been criticized as corrosive and ineffective, leading to volatility of resource flows, straining the donor-recipient relationship and undermining the respective country's sovereignty, it is still a necessity. If for no other reason, donors have a fiduciary responsibility to exercise due diligence while spending their taxpayers' money. However, alternative approaches such as *ex post* conditionality and outcome-based conditionality have been under consideration as possible ways forward. Yet such approaches are thought to be fraught with practical difficulties including the identification of meaningful intermediate indicators on which to base disbursements, and the considerable time lag resulting from the collection and measurement of results indicators in often challenging circumstances.

10. **Programmatic lending emerges as a fairly robust approach to reconcile numerous tensions and concerns.** Many concerns remain with outcome-based adjustment lending such as the diminishing predictability of available aid resources for the client, as well as having a country's aid program tied to indicators that are not necessarily under their control. Programmatic lending on the other hand, emerges as a promising way to reconcile focus on performance with resource predictability by having support be reflected by a country's track record while supporting sustained engagement for a prudent mix of medium-term institutional and policy reforms. Not only is the lending product able to assist the implementation of complex reforms, but it also serves as a vehicle for policy dialogue that also typically involves transfer of advice and knowledge.