Evaluation of Policy Based operations in the African Development Bank, 1999-2009
Review of Literature and Experience

High Level Evaluations Division (OPEV.2)

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Executive Summary

This review of literature and experience aims to summarise the main lessons that have emerged from the use of policy based operations (PBOs) since they first emerged in the late 1970s and early 1980s, focusing on lessons from the academic and policy literature as well as from the implementation experience of different agencies undertaking PBOs including the emerging evidence on good practice.

PBOs have developed from instruments aimed principally at addressing short-term macroeconomic problems and bringing about specific policy reforms to instruments primarily directed (through budget support) at the support of agreed programmes of government action through applying principles of aid effectiveness. This development has had implications for key aspects of PBO design including the structure and tranching of operations, the way in which conditions are applied and used (including whether they are conceived as a way of bringing about policy change), and the assessment and management of risk.

The review of the literature on PBOs has shown that there have been important shifts in what has been conceived of as international best practice in PBOs over the last decade. These changes have been a response to the problems of implementing PBOs and the shifts that have also occurred in development thinking aimed at making aid more effective. The experience of PBOs over the past decade has led to an emerging consensus on best practice in the design and implementation of these operations. The firm empirical evidence base on which conclusions have been drawn remains quite limited however.

Experience suggests that PBOs should be designed and implemented in the following way:

- Use *ex post* rather than *ex ante* conditionality (that is, focus on defining agreed prior actions and disbursing against these).
- Use dialogue to support policy reform rather than expecting conditions to achieve this.
- Support specific policy reforms as part of a longer-term support to national poverty reduction strategies.
- Be integrated into the national budget and public expenditure management processes, with PBO mechanisms being explicitly intended to strengthen further this process.
- Be part of joint donor operations rather than stand alone operations.
- Provide complementary capacity building and technical assistance.
- Involve a focus on results and outcomes using joint assessment frameworks.

Effective PBOs need to be designed in partnership with recipient governments and other donors to ensure country ownership, as well as for a strong focus on developing an appropriate complementarity between PBOs and other forms of support, for instance those focused on strengthening capacity in key areas, most notably public financial management. There is strong evidence that in general the use of *ex ante* conditionality to leverage policy reform does not often work well and that successful policy change needs to be domestically led. It can though be successfully externally supported through dialogue and support to research, analysis and capacity development. PBOs require complementary actions including, but also policy dialogue to discuss budget priorities and reform agendas. This implies that IFIs and donor agencies will require sufficient technical capacity in country to engage in this type of dialogue.
Although major shifts have occurred in the thinking underpinning PBOs, this model is not always implemented. Several factors may influence this.

- First, the attempt to use grant or loan conditionality as an instrument to bring about policy change has not been entirely abandoned, and the use of multiple tranche operations is often seen as a way of trying to retain and exert influence over partner actions.

- Second, implementation of effectively harmonised approaches is often difficult to achieve in practice. Donor procedures and priorities differ, and the tendency remains for different agencies to seek to include “components” (i.e. specified policy actions) of particular interest within a common policy framework in order to be able to demonstrate action against particular areas of interest, although the causal link between the specifying of particular actions and the outcome of the operation may be unclear.

- Third, there are differing donor approaches to the risks of using PBOs. These relate in particular to fiduciary risk (where it is important to distinguish the risk of resources supplied being misused, from the risk of resources being used within the government budget, but this not leading to the specific results providers of support are seeking) and to the ability effectively to monitor results. PBOs that incorporate assistance aimed at strengthening PFM systems and audit functions, good performance monitoring frameworks and design and collection of baseline data prior to the start of the PBO, and that are accompanied by clearly specified and resourced complementary actions, are likely to be the best equipped to deal with risks.

The review of experience from other agencies suggests some more specific conclusions and comparisons with current African Development Bank practice:

- First, other agencies have simplified and unified the instruments they are using for PBOs, as well as preparing detailed procedures to guide all aspects of decision-making that are specific to the PBO instrument. The AfDB appears to significantly lag all the other agencies reviewed in both these respects with a considerable lack of clarity about the instruments and guidance for PBOs.

- Second, there is generally recognition that the distinction between budget support and balance of payments support is not a clear cut one (especially in the modern context where currencies are largely convertible) and that while there are distinct design issues related to PBOs directed at addressing short-term externally driven shocks, embedding a distinction between budget support and balance of payments support in policy guidance would not be particularly helpful.

- Third, there is a general (though not universal) move towards single tranche operations, often based on prior actions, though with these occurring, as with the World Bank, in a programmatic framework of repeated operations in support of a medium-term government plan of action (like a nationally owned PRS).

- Fourth, other agencies do not appear to operate specific quantitative restrictions over the proportion of total loans or grants that are provided using PBOs, unlike the situation for the African Development Fund where the share of PBOs is capped, although agencies may set targets for the use of PBOs for fiduciary risk management or other strategic purposes or as part of an overall country strategy.

- Fifth, in relation to engagement in fragile situations and the role of PBOs, there are some differences in agency practice but it is generally recognised that there is an important need for the use of fast disbursing instruments but that these need to be supported to a greater degree than elsewhere by complementary actions to improve effectiveness and to manage risks.
• Sixth, the difference between general and sector budget support relates to the scope of policy dialogue and the extent to which funds are earmarked, either notionally or through the management of funds through special accounts to ensure that they are used in particular agreed ways.

• Seventh, a general weakness of donor practice with PBOs has been a failure adequately to set out the intervention logic by which the different elements of the PBO (finance provided, definition of conditions, policy dialogue, and complementary measures) are supposed to contribute to achieving defined results, and a consequent failure to establish effective monitoring of intermediate results. A particular weakness has been in relation to the link between a PBO and the achievement of PFM improvement results. This is likely also to be an area in which AfDB practice could be improved.

• Eighth, in comparison to other agencies using PBOs, and seeking to use these as a means to participate in policy dialogue, the AfDB lacks policy and analytical capacity, particularly in-country.
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## Abbreviations

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<tbody>
<tr>
<td>ACP</td>
<td>Africa, Caribbean and Pacific</td>
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<tr>
<td>ADF</td>
<td>African Development Fund</td>
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<td>AfDB</td>
<td>African Development Bank</td>
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<td>AsDB</td>
<td>Asian Development Bank</td>
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<td>AsDF</td>
<td>Asian Development Fund</td>
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<td>BP</td>
<td>Bank Procedures</td>
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<td>CAP</td>
<td>Country Assistance Plan</td>
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<td>CAS</td>
<td>Country Assistance Strategy</td>
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<td>CFSP</td>
<td>Common Foreign and Security Policy</td>
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<td>CIDA</td>
<td>Canadian International Development Agency</td>
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<td>CPA</td>
<td>ACP-EU Cotonou Partnership Agreement</td>
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<td>CPIA</td>
<td>Country Policy and Institutional Assessment</td>
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<td>CPS</td>
<td>Country Partnership Strategy</td>
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<td>CSF</td>
<td>Countercyclical Support Facility</td>
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<td>CSO</td>
<td>Civil Society Organizations</td>
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<td>CSP</td>
<td>Country Strategy Paper</td>
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<td>DAC</td>
<td>Development Assistance Committee (of OECD)</td>
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<td>DCI</td>
<td>Development Cooperation Instrument</td>
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<td>DDO</td>
<td>Deferred Drawdown Option</td>
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<tr>
<td>DFID</td>
<td>UK Department for International Development</td>
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<tr>
<td>DG</td>
<td>Directorate General</td>
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<tr>
<td>DGIS</td>
<td>Directorate General for International Cooperation (Netherlands)</td>
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<tr>
<td>DMC</td>
<td>Developing Member Country</td>
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<td>DMF</td>
<td>Design and Monitoring Framework</td>
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<td>DPL</td>
<td>Development Policy Lending</td>
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<td>DPO</td>
<td>Development Policy Operation</td>
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<tr>
<td>Abbreviation</td>
<td>Full Form</td>
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<td>EB</td>
<td>Executive Board</td>
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<td>EC</td>
<td>European Commission</td>
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<td>ED</td>
<td>Executive Director</td>
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<td>EDF</td>
<td>European Development Fund</td>
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<td>ENPI</td>
<td>European Neighbourhood and Partnership Instrument</td>
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<td>EP</td>
<td>European Parliament</td>
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<td>EU</td>
<td>European Union</td>
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<td>FY</td>
<td>Fiscal Year</td>
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<td>GBS</td>
<td>General Budget Support</td>
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<td>GPN</td>
<td>Good Practice Note</td>
</tr>
<tr>
<td>H&amp;A</td>
<td>Harmonisation and Alignment</td>
</tr>
<tr>
<td>HIPC</td>
<td>Heavily indebted Poor Countries</td>
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<tr>
<td>HIV/AIDS</td>
<td>Human Immunodeficiency Virus/ Acquired Immunodeficiency Syndrome</td>
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<tr>
<td>IBRD</td>
<td>International Bank for Reconstruction and Development</td>
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<td>ICR</td>
<td>Implementation Completion Report</td>
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<td>IDA</td>
<td>International Development Association</td>
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<td>IEG</td>
<td>Independent Evaluation Group</td>
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<td>IFI</td>
<td>International Financial Institution</td>
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<td>IFS</td>
<td>Instrument for Stability</td>
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<td>IL</td>
<td>Investment Lending</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IPA</td>
<td>Instrument for Pre-Accession Assistance</td>
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<td>JEGBS</td>
<td>Joint Evaluation of General Budget Support</td>
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<tr>
<td>M&amp;E</td>
<td>Monitoring and evaluation</td>
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<tr>
<td>MDBS</td>
<td>Multi-donor budget support</td>
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<td>MDG</td>
<td>Millennium Development Goal</td>
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<td>MFF</td>
<td>Multi-Tranche Financing Facility</td>
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<tr>
<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>NDP</td>
<td>National Development Plan</td>
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<tr>
<td>NGO</td>
<td>Non-Governmental Organisation</td>
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<td>OC</td>
<td>Operations Committee</td>
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<tr>
<td>OCR</td>
<td>Ordinary Capital Resources</td>
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<tr>
<td>ODA</td>
<td>Official Development Assistance</td>
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<td>ODI</td>
<td>Overseas Development Institute</td>
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<tr>
<td>OECD</td>
<td>Organisation of Economic Cooperation and Development</td>
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<tr>
<td>OECD-DAC</td>
<td>Organisation for Economic Co-operation and Development - Development Assistance Committee</td>
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<tr>
<td>OP</td>
<td>Operational Policy</td>
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<tr>
<td>OPCS</td>
<td>Operations Policy and Country Services</td>
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<td>OPM</td>
<td>Oxford Policy Management</td>
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<tr>
<td>PAD</td>
<td>Project/Programme Appraisal Document</td>
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<tr>
<td>PAF</td>
<td>Performance Assessment Framework</td>
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<tr>
<td>PBA</td>
<td>Programme-Based Approach</td>
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<td>PBL</td>
<td>Policy Based Lending</td>
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<tr>
<td>PBO</td>
<td>Policy Based Operation</td>
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<td>PCA</td>
<td>Programme Cluster Approach</td>
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<tr>
<td>PEFA</td>
<td>Public Expenditure Financial Assessment</td>
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<td>PFM</td>
<td>Public Financial Management</td>
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<tr>
<td>PID</td>
<td>Public Information Document</td>
</tr>
<tr>
<td>PL</td>
<td>Programme Loan</td>
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<tr>
<td>PRBS</td>
<td>Poverty Reduction Budget Support</td>
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<tr>
<td>PRGF</td>
<td>Poverty Reduction and Growth Facility</td>
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<tr>
<td>PRISM</td>
<td>Performance Reporting Information System for Management</td>
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<tr>
<td>PRS</td>
<td>Poverty Reduction Strategy</td>
</tr>
<tr>
<td>PRSC</td>
<td>Poverty Reduction Support Credit</td>
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<tr>
<td>PRSP</td>
<td>Poverty Reduction Strategy Paper</td>
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</table>
ROC  Regional Operations Committee
RRP  Report and Recommendation of the President
SAL  Structural Adjustment Loan
SBS  Sector Budget Support
SBSiP  Sector Budget Support in Practice
SDP  Sector Development Programme (Loan)
SDPL  Special Development Policy Lending
SP  Sector Programme
SPL  Special Programme Loan
SPSP  Sector Policy Support Programme
STR  Sector Track Record
TA  Technical Assistance
TAP  Technical and Administrative Provisions
TORs  Terms of Reference
WB  World Bank
1 Introduction

This review of literature and experience aims to summarise the main lessons that have emerged from the use of policy based operations (PBOs) since they first emerged in the late 1970s and early 1980s, focusing on lessons from the academic and policy literature as well as from the implementation experience of different agencies undertaking PBOs including the emerging evidence on good practice.

The literature review draws on academic and research literature and begins by examining the development of PBOs from structural adjustment lending (SAL) in the 1980s, to budget support in the late 1990s onwards: including the theoretical underpinnings of these various approaches. It looks at some of the key changes that have occurred in the aid environment over this period. One key change has been the move away from conditionality designed to bring about (or even “buy” reforms), to an approach to aid that is aimed at supporting government plans and priorities. The review examines why these shifts occurred, highlighting aspects such as changes in the aid environment facilitated by the Paris Declaration, the move towards an aid effectiveness agenda and a greater focus on results. The review also explores the main concerns that relate to PBOs. It assesses the issue of risk, particularly fiduciary risk, which needs to be managed when using PBOs, as funds are channelled through government systems. It examines conditionality and how it can most effectively be used, the extent to which aid can influence policy and the measurement of results and the attribution of results to PBOs.

Specifically, Section 2 of the report outlines the history of PBOs and the various different instruments have been used and how they have evolved. Section 3 explores key issues for the effectiveness of PBOs including risk management, the influence of aid on policy, the use of conditionality, measurement and attribution issues, and evidence on what PBOs have achieved. Section 4 summarises the findings from reviews of the policies and experience of multilateral development banks and other development agencies in providing PBOs. The main features of how PBOs are designed and managed in each agency are reviewed, as well as emerging views of good practice. Section 5 presents overall conclusions of the review, including in relation to specific issues facing the African Development Bank.

Annex A presents OECD-DAC principles for providing budget support. Annex B reviews the experience of the World Bank in using PBOs, Annex C that of the European Commission, Annex D that of the Asian Development Bank, and Annex D summarises the practices and experience of four bilateral donors (Canada, the Netherlands, the UK and Sweden).
2 The History of Policy Based Operations

2.1 Definitions

Policy-Based Lending is defined by the African Development Bank as involving “quick-disbursing loans with the primary objective of supporting policy reform programmes.” While this definition highlights two principal features of PBOs (the form of accountability required and the overall objective), it requires elaboration since there may be some tendency to confuse definitions based on disbursement modalities with those based on the objectives of the operation. In general PBOs are disbursed against an agreed programme of action (which may or may not involve policy reform), rather than to finance a specific set of expenditures or outputs. It is important to distinguish between the agreed programme itself, and the specific set of conditions agreed for disbursement to take place (which is usually a subset of actions in the wider programme). Whether disbursement is in fact “quick” relative to other forms of aid depends on the length of the operation and the tranching structure. One of the major attractions of PBOs is though that the form of accountability required does in principle allow rapid disbursement compared to aid modalities linked to expenditures on specific items.

PBOs can be designed and implemented in several ways:

- In general, PBOs may disburse funds either into a foreign exchange account at the aid receiving country’s Central Bank, or into the consolidated account of government in local currency. The former is the typical approach used for balance of payments support with the principal objective of funding imports (usually monitored against a negative list). The latter is the approach used for budget support aimed at funding government spending. Some agencies (such as the African Development Bank) draw a distinction between these instruments. However in practice this distinction is not a clear cut one (particularly in the context of generally convertible currencies) since the sale of the foreign exchange proceeds of the grant or loan generates counterpart funds that will be available to government to spend, while the transfer of domestic currency into the Treasury account will involve the sale of foreign exchange. So either form of operation will finance both imports and government spending, although the form of accountability and the specific objectives set may differ.

- While in general resources provided under PBOs are not earmarked against particular expenditure items, they could be in principle. For instance, the AfDB’s emergency grant to the DRC in 2009 was earmarked to fund specific items in the government budget (including teachers’ salaries and the electricity bills of government agencies), and the resources were managed through a separate account to ensure that this happened.

- In cases where resources are not earmarked to fund specific expenditure items, the link between the level of resources provided and the “content” of the operation in terms of the programme of actions specified as supported (for instance in a Policy Matrix) may be tenuous, although the operation may be conceived as meeting a funding gap to enable the government budget to be implemented, or as bridging a foreign exchange gap to allow imports to be financed.

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1 AfDB (2008, p.3)
2 The European Commission defines “targeted” budget support as involving the transfer of EC funds to the national treasury of an amount equal to eligible expenditures clearly identified within the budget (European Commission, 2007, p. 17).
While PBOs support an agreed programme of action, they may or may not support a process of “policy change”. As discussed below, PBOs have their origin in structural adjustment programmes that sought to use loan conditionality to lever policy change. However, budget support which is the now the dominant form of PBO is better understood as supporting an agreed programme of public expenditure, together generally with specific policy actions and institutional and organizational strengthening.

While budget support may be labeled as sectoral or general (or as containing specific sectoral “components”) based on the content of the policy matrix the causal link between the items in the matrix and the resources provided is likely to be difficult to establish. The range of different types of operation defined as Policy-Based means that caution should be exercised in drawing conclusions at the level of PBOs as a whole.

In general, it is important to distinguish for purposes of evaluating impact between the impact of the financial resources provided (to support imports or government spending), and the impact of the inclusion of particular policy actions in a policy matrix or an agreed set of conditions. It may be that a dialogue process linked to the operation, or complementary projects focused on institutional strengthening or policy analysis, contributes more directly to the policy actions taken than does the provision of financial resources as such. Where disbursement is made against conditions that have already been fulfilled (“ex post” conditionality) as has become increasingly common, it may be difficult in principle to argue that achievement of the condition can be regarded as one of the effects of the PBO.

PBOs may also be classified (in addition to by their objectives, conditions, and the mode of disbursement) according to whether they involve joint action by several donor agencies or individual action by one, whether they are conceived in a specific time framework or as a one-off operation, and whether they involve disbursement through a single tranche or multiple tranches within one operation.

### 2.2 Structural adjustment lending

PBOs first emerged from the late 1970s in the form of structural adjustment loans (SALs), which were designed to give balance of payments (and to some extent public expenditure) support to countries facing a foreign exchange crisis, in return for a commitment to undertake macroeconomic reforms. Structural Adjustment Lending activity increased rapidly in the 1980s as multilateral development banks sought to complement the traditional role of the International Monetary Fund (IMF) in addressing balance of payments problems through using instruments that sought to provide rapid access to resources and to address structural problems as well as short-term imbalances, for which traditional project-based forms of aid were not well-suited. The Asian Development Bank (AsDB) introduced what was termed Policy-Based Lending in 1978 with Structural Adjustment loans, the World Bank introduced Structural Adjustment Loans in 1979, the IMF the Structural Adjustment Facility in 1986 (and the Enhanced Structural Adjustment Facility in 1987) and the AfDB Structural Adjustment Lending in 1986.

Structural Adjustment Lending aimed to use aid that was quick-disbursing and provided conditional on the implementation of an agreed package of macroeconomic and structural reforms. These generally reflected an agenda (usually termed the “Washington Consensus”) to reduce the role of the state and to liberalise and deregulate economies and typically included (Barkan, 2007):

- Reduction of the government deficit
• Deregulation of the economy to reduce rent-seeking and free up internal markets
• Elimination of price controls for basic commodities and consumer subsidies for these products
• Privatisation of state owned companies
• A liberalisation of external trade policies
• A shift from fixed to market determined exchange rates (accompanied by substantial nominal devaluation).

Issues about the effectiveness of structural adjustment related both to the specific programme of reforms (widely criticised as reflecting a neo-liberal model of at best dubious relevance to many developing contexts) that international financial institutions were promoting, and way in which this promotion was undertaken, through the use of aid conditionality in a context of economic crisis and typically highly unequal power relations between aid-receiving countries and international financial institutions.

While in some cases (usually in relatively developed middle income economies) structural adjustment reforms were largely successful, in many other contexts and particularly in low-income economies in Africa, the results were highly problematic both in terms of the development results (despite attempts to mitigate the “social dimensions” of adjustment) and the extent to which programmes were successfully implemented. From the late 1980s to the mid-1990s, only a quarter of World Bank programmes were completed on time and from 1992 to 1998 less than half the IMF’s programmes were successfully completed (Riddell, 2007).

Critiques of the structural adjustment approach focused both on the inappropriateness of the structural adjustment policy prescription in countries with weak institutions (where liberalisation alone was insufficient to generate growth), and on problems with the use of policy conditionality which was typically perceived in aid-receiving countries as a means to impose policy changes that were not domestically accepted.3 In practice, IFIs facing strong pressures to disburse aid were often unable to enforce ex ante conditions. A typical pattern in many African countries was a long series of repeated adjustment operations that were only partially implemented and that contributed to escalating debt as growth performance remained weak.

A number of studies by the Operations Evaluation Department of the World Bank outlined reasons for the disappointing performance of structural adjustment lending. The main lessons learned from these studies are summarised in Box 2.1.

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**Box 2.1**  
**Key lessons learned from World Bank Structural Adjustment Lending**

<table>
<thead>
<tr>
<th>Conditions:</th>
<th>Multi-year, multi-tranche operations worked less well than single year operations and smaller numbers of conditions work better than large numbers</th>
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<tbody>
<tr>
<td>Sequencing reforms:</td>
<td>The sequencing of reforms was crucial, especially trade policy and financial reform, which should be undertaken after macroeconomic stabilisation and liberalisation in the real economy.</td>
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<tr>
<td>Public enterprise reform and privatisation:</td>
<td>The main goal should be to enhance efficiency of public enterprises, not to reduce the fiscal burden.</td>
</tr>
<tr>
<td>Public spending:</td>
<td>In many countries, public expenditure reductions worsened existing biases and inefficiencies</td>
</tr>
<tr>
<td>Social Dimensions:</td>
<td>Emphasis should be placed on basic long-term issues of poverty and human development, rather than solely concentrating on compensatory measures.</td>
</tr>
<tr>
<td>Environmental dimensions:</td>
<td>More emphasis was needed on the environmental impact of SAL.</td>
</tr>
<tr>
<td>Borrower ownership:</td>
<td>Experience showed a strong correlation between program ownership and the success of the programme.</td>
</tr>
<tr>
<td>Funding of adjustment programs:</td>
<td>Under-financing undermines an adjustment program, while excessive financing could reduce the incentive to adjust.</td>
</tr>
</tbody>
</table>

Source: Jayarajah and Yue, 1993

Attention focused specifically on the question of “ownership”, understood as the depth and breadth of national commitment to the objectives and policies promoted by structural adjustment. National governments undertook structural adjustment lending in order to obtain quick disbursing aid, but failed to implement key reforms to which they were not committed or that were judged to be politically infeasible. IFI commitments not to disburse aid against non-compliance (or more specifically partial compliance, because of the tendency to load a large number of conditions into the policy matrix) were not generally credible.

### 2.3 The aid effectiveness agenda

Concern about the poor performance of structural adjustment especially in Africa developed in parallel with increasing criticism of the effectiveness of project approaches that continued to provide the bulk of aid (especially of bilateral aid). By the mid-1990s it was becoming apparent that there were serious drawbacks with the project approach in these and other areas, again especially in Africa. These (as summarised in Box 2.2) related to the proliferation of separately managed projects, the creation of parallel systems which bypassed government systems, and high transaction costs due to donors insisting upon using their own, different, procedures for managing and monitoring projects, in a context where national systems were too weak to be relied on for accountability purposes by donors. Again, as with Structural Adjustment Lending, concern focused on the way in which project approaches undermined national “ownership” by resisting incorporation into nationally-led priority setting and resource allocation through the national budget.
Box 2.2  The potential weaknesses of a project approach

- Donors forcing their own priorities on government and insisting on specific management requirements and implementation procedures
- Multiple projects with similar objectives leading to fragmentation, and a duplication and overlap between them, hindering the development of a coherent recipient-led national sector policy
- Funding of multiple investments by donors leading to unbalanced sectoral development and imbalances between recurrent and investment budgets
- A large number of aid projects, with different reporting and accounting requirements increasing transaction costs for host governments
- Reliance on parallel, non-government project management structures and special staffing arrangements undermining the development and effectiveness of government systems
- The use of donor accountability rules and processes which marginalises and thus undermines the development of national accountability systems


The instrument developed by the World Bank during the mid-1990s to address these problems was the Sector Investment Programme (SIP), which was conceived as a way of providing donor support to an agreed sector strategy rather than to a fragmented set of projects, with resources envisaged as in principle being disbursed through government systems, or otherwise through a single (rather than multiple) set of donor financing arrangements, such as a basket fund. This approach encountered a number of implementation problems related specifically to the difficulties of establishing a workable set of financial and management arrangements that could encompass the needs of all donors while being manageable by government. SIPs were largely replaced by the more flexible model of the Sector Wide Approach which focused on agreement of a common sector strategy and alignment of donor (project) support around this, along with the establishment of regular joint sectoral review processes and stakeholder forums, with rationalisation of donor financing and management arrangements being undertaken where, and as, this was judged feasible.

From around 2000 onwards, growing recognition of the flaws in both project approaches and in structural adjustment lending, particularly in Africa and other low-income countries, combined with the results of research on aid effectiveness, led the donor community towards the development a set of principles and international agreements to guide the provision of aid and to improve the effectiveness of aid based around promoting rather than undermining the need for “national ownership”.

Three major developments underpinned this shift. These were:

i) A view as discussed above that there was a need for changes in aid management which stemmed from criticism over the effectiveness of project approaches and donor-imposed conditionalities.

ii) The need for debt relief from the Heavily Indebted Poor Countries (HIPC) as the burden of debt (especially to IFIs and bilateral donors) had become unsustainable and the particular approach adopted to address this.
iii) The establishment of and global commitment to the achievement of the Millennium Development Goals (MDGs), to which donors increasingly linked their aid, which provided a common framework of objectives for aid, combined with the commitment by donors to scale up aid, and aid receiving countries to seek to achieve the MDGs.

The enhanced HIPC debt relief initiative was launched by the IMF and the World Bank in 1996 and the new emphasis on poverty reduction and ownership led to the development of Poverty Reduction Strategy Papers (PRSPs) conceived as setting out the commitments by countries receiving debt relief to address poverty. In practice early PRSPs existed in parallel to national planning and policy processes and were largely prepared with external support. These PRSPs were then financed by the World Bank through Poverty Reduction Support Credits (PRSCs) and by the IMF through the Poverty Reduction and Growth Facility (PRGF) which provided a new form of PBO. As PRSPs became also the instrument by which commitments to the MDGs were set out, there were increasingly strong reasons for other donors to align their aid around the strategies set out in the PRSP.

The new approach to aid effectiveness was further crystallised by commitments made at the Monterey Conference which examined development financing needs in the light of the MDGs in 2002, in the Rome Declaration in 2003. These initiatives were provided with greater impetus by the Paris Declaration on Aid Effectiveness of 2005 which committed both recipient countries and donor agencies to set of five principles to guide the provision of aid (ownership, harmonisation, alignment, mutual accountability, and managing for results) and established an agreed international process for reporting on progress towards a defined set of aid effectiveness objectives. The Accra Agenda for Action was agreed in 2008 as an action plan for more effective implementation of the Paris Declaration.

While the Paris Declaration is not prescriptive on the particular instruments to be used for aid provision (reflecting the unwillingness of some donors to commit to the use of government systems), it does involve a commitment towards greater use of Programme-Based Approaches (PBAs) which are defined in Box 2.3.

**Box 2.3 Programme Based Approaches**

Programme based approaches (PBA) are a way of engaging in development co-operation based on the principles of co-coordinated support for a locally led and owned programme of development, such as a national development strategy, a sector programme, a thematic programme or a programme of a specific organisation. Programme based approaches share the following features:

(i) Leadership by the host country or organisation;

(ii) A single comprehensive programme implemented within a single unified budget framework;

(iii) A formalised process for donor co-ordination and harmonisation of donor procedures for reporting, budgeting, financial management and procurement, and;

(iv) Efforts to increase the use of local systems for programme design and implementation, financial management, monitoring and evaluation.

Source: OECD/DAC (2006)
2.4 General budget support and sector budget support

These changes in the aid architecture have led to some shifts in the way that aid, and as a consequence PBOs, were conceived and delivered (though rather less change in terms of actual aid practice). Rather than PBOs being a way to alleviate foreign exchange constraints while leveraging policy reform, they were now seen as an instrument to support poverty reduction strategies and development partnerships. This led to a change in the objectives of aid away from stand-alone operations to the use of government systems by aid agencies, improved integration of donor funds in national budgets and public financial management (PFM) processes more generally and a move from individual to joint donor operations. There has also been more attention paid to explicit donor engagement in the budget process with funds being given by donors to support recipient government budgets and policy priorities. There was also a move to a more medium-term framework of support and towards ex-post rather than ex-ante conditionality based on long-term mutual accountability frameworks.

These various changes have resulted in general budget support and sector budget support becoming a preferred aid delivery modality for many recipient countries and some donors (see Box 4 for further explanation of the main trends which caused the move to budget support). The OECD DAC definition for general budget support is:

A method of financing a partner country’s budget through a transfer of resources from a donor to the partner government’s national treasury. The funds thus transferred are managed in accordance with the recipient’s budgetary procedures. (OECD, 2006)

General Budget support normally consists of funds that are not earmarked, but mixed with those of the recipients’ budget using their own allocation, procurement and accounting systems. This is supported by policy dialogue and agreement on budget priorities and expenditures. This approach recognises implicitly that financial assistance is fungible, which means that it makes sense for dialogue to concentrate on overall budget allocations and priority sectors for poverty reduction. There is also often technical assistance and or capacity building activities given to complement the financial flows.

Sector budget support (SBS) is similar to general budget support, with the difference being that there is a sectoral focus in the policy dialogue and conditions (though not usually specific earmarking of expenditure to the sector or on specific items). SBS is defined as those aid programmes where:

“Aid uses the normal channel used for government’s own-funded expenditures. Aid is disbursed to the government’s finance ministry (or “treasury”), from where it goes, via regular government procedures, to the ministries, departments or agencies (MDAs) responsible for budget execution. The dialogue and conditions associated with the aid should be predominately focused on a single sector” (ODI, 2009).

The key characteristics of budget support include the following:

i) The channelling of donor funds to a partner country using its own allocation, procurement and accounting systems;

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4 Source: Koeberle et al (2005)
ii) The funds provided support a recipient country’s own development programmes: typically focusing on growth, poverty reduction, fiscal adjustment and strengthening institutions, in particular budgetary process;

iii) The policy content and performance assessment and accountability framework of budget support is focused on policy measures and benchmarks related to overall budget and policy priorities, as set out in its own country’s strategy (PRSP) and medium-term expenditure framework (MTEF);

iv) The donor funding is provided at regular intervals, ideally in alignment with the country’s annual budget cycle

v) With agreement on general budget priorities and expenditures, in principle there is no need for the earmarking of funds for specific budget expenditures.

For advocates of budget support this set of arrangements was seen as a step change in the way in which aid was provided to the beneficiary countries since the focus was now on improving the poverty impact of public expenditure and implementing more effective development strategies. This new approach involved four principles, which were country ownership, comprehensiveness and long-term perspective, results orientation and partnership. Furthermore, there was a clear expectation that budget support would make aid more effective by achieving the following results (Koeberle et al, 2006, p. 9):

i) Strengthening country ownership and ensuring the sustainability of reforms;

ii) Reducing transaction costs for the government;

iii) Increasing the predictability of funding;

iv) Addressing cross-cutting government-wide policy, expenditure and institutional priorities;

v) Promoting government accountability (internal and external);

vi) Improving the efficiency and transparency of budget spending;

vii) Buttressing the recipient country’s own budget process and public finance management; and

viii) Encouraging a greater orientation to medium-term results.

ix) Facilitation of greater harmonisation and coordination of donor assistance.

As discussed in Section 4, some IFIs introduced new PBO instruments that were envisaged as moving beyond structural adjustment approaches to be more suitable for supporting government development programmes, including the introduction of Poverty Reduction Support Credits by the World Bank and the Poverty Reduction and Growth Facility by the IMF). By 2005 support through PRSCs accounted for 50% of all IDA lending and 49% of all Bank lending to Africa (Barkan, 2007). Some bilateral agencies also adopted budget support. For example this now accounts for around a quarter of DFID assistance.

However in general bilateral aid remained largely focused on the use of projects, even where this was done in the framework of Programme Based Approaches (PBAs), such as SWAps. Many bilateral aid agencies are however still constrained in using PBOs by headquarters’ audit and fiduciary risk management requirements (Bartholomew, 2009). Derogations to allow the use of country systems are required by other donors. These are usually aimed at managing the perceived risks of PBOs using country systems, such as requiring
additionality, traceability and additional audit requirements to overcome weaknesses in local PFM systems or additional reporting and performance assessment frameworks.

Where budget support has been provided, this has generally involved joint operations with a number of donors. There has also been a move towards joint *performance assessment frameworks* (PAF) for PBOs where actions to be undertaken and outcomes to be achieved are agreed between donors and the recipient government and jointly monitored. PAFs are used to enable partners to monitor progress and adjust policy and implementation as necessary and to provide the basis for disbursement decisions for budget support. PAFs in turn link with the process of dialogue that is part of the budget support package. Policy dialogue takes place through joint forums with often a division of labour so that donors participate in the related policy dialogue in those working groups where they have a particular interest. Monitoring occurs through annual review processes where recipient governments and donors jointly assess progress and donors make disbursement decisions on this basis.

While budget support has been the main PBO instrument used by IFIs, responses to the food and the financial crises of 2007-2009 focused on quick disbursing loans to provide balance of payments support. In 2008 the AfDB developed an instrument to give support to countries affected by increased food and energy prices. This enabled that institution to provide help over the short to medium term including an emergency liquidity facility for countries affected by the financial crisis. The World Bank, the Inter-American Development Bank (IDB) and the AsDB had similar crisis response facilities involving quick disbursing loans or grants already in place.
3 Policy Based Operations in Practice: Key Issues

There is a general consensus among IFIs that PBOs have significant advantages over stand-alone projects in many contexts particularly in relatively aid dependent countries where aid constitutes a significant share of public expenditure. However, concerns remain regarding their implementation in practice and there is still debate over how they should most effectively be designed. This section considers key issues surrounding PBOs and discusses those concerns relating to the management of risk, particularly fiduciary risk, the debate about whether aid can affect policy, the design of conditionality and the monitoring and evaluation of PBOs, and evidence on the impact of PBOs.

3.1 Managing risk

PBOs are subject to the same type of risks as other forms of aid, but this takes different forms, largely because of the explicit recognition of the fungibility of aid that PBOs involve.

The first main risk is *fiduciary risk*, which refers to the possibility that aid money may not be used as intended. In the context of a PBO the main fiduciary risk stems from the quality of domestic PFM systems and the extent to which they are able to ensure that funds are used as authorised and that the risk of corruption and fraud is avoided. While in a project the direct use of funds can be audited, the explicit recognition of fungibility in PBOs means that donors in effect face the same level of fiduciary risk as the government as a whole.

The second risk is *development risk*, which is the possibility that an intervention may not achieve its intended objectives. For a PBO this risk is likely to stem from some mix of an unstable macroeconomic environment, poor design and implementation of policies, weak results monitoring, limited ownership, non-disbursement of funds and poor sustainability of outcomes.

The third risk, *political risk* relates to the likelihood of political changes in a country resulting in PBO objectives not being achieved or the pre-conditions for the PBO being affected in a manner that means that the PBO cannot continue to be provided.

The fourth risk, *reputational risk* refers to the fact that the donors may be constrained in their ability to provide future support because of a negative event, which undermines the willingness of shareholders, donor parliaments and taxpayers to provide further funds for development support.

*Ex ante* assessment of the recipient governments’ ability to use resources effectively is crucial for risk management. In practice to assess the level of risk a variety of *ex ante* assessments are undertaken of a recipient country’s systems. These include the use of tools such as fiduciary risk assessments, public expenditure and financial accountability studies, country financial accountability assessments and country procurement assessment reports. Often these assessments are undertaken jointly or donors rely on assessments by other agencies in order to reduce the transaction costs to government by limiting the number of studies. This in itself causes problems, as different donors have different requirements for measuring risk and different thresholds for the level of risk for they are prepared to accept.

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5 This section draws on Folscher et al. (2008).
Despite this, a risk assessment allows risk management and mitigation measures to be put in place, in an attempt to diminish the level of fiduciary risk. These measures tend to be aimed at enhancing the ability of governments to track expenditures, strengthening internal and external audit mechanisms, capacity building support and additional safeguard measures.

There are also typically preconditions put in place by donors that outline the minimum conditions that need to be present. These normally relate to minimum thresholds for PFM systems, commitments to reform and sufficient capacity to undertake the reforms needed. The main problem is that it is often countries that have the greatest need for budget support that have the weakest financial management systems. The systems for budget formulation and execution, financial reporting, procurement and oversight systems are sometimes inadequate, often severely so. This leads to concerns that funds might be misused or not properly accounted for, particularly in fragile states where PFM systems are extremely weak. In this situation, bilateral donors and IFIs have been prepared to provide PBOs where there is a strong government commitment to strengthen otherwise weak PFM systems and there are clear expenditure priorities. In this case, PBOs have been used where it has been judged that risk is at an acceptable level compared to the potential benefits.

There is anyway in the case of PBOs a linkage between the objectives of the PBO and the management of risk. An objective of PBOs is to strengthen PFM systems, but the extent to which this is achieved often depends on the complementary inputs that go with the PBO such as technical assistance and capacity building support.

There is also some evidence that the process of implementing the PBOs themselves can help assist in reducing fiduciary risk. The OECD Joint Evaluation of General Budget Support (IDD, 2006) found that GBS had helped reduce fiduciary risk by improving comprehensiveness and transparency of partner government PFM, thus strengthening the basis for accountability. GBS had helped to focus the attention of donors on the PFM capacity requirements of government and national systems, while the dialogue around GBS created a demand for coherent medium-term planning documents and also reinforced efforts to strengthen PFM generally (See also Mokoro, 2008: 40).

### 3.2 Can aid influence policy?

There has been an extensive debate about the extent to which aid can influence policy. The belief that conditionality could influence policy reform was the basis of the structural adjustment approach, which as discussed in Section 1.2, was found not to work as well as had been hoped, in part because too many conditions were applied and reform programmes were not owned by recipient governments. These findings have been confirmed by a variety of studies that have found that a reliance only on conditionality to achieve policy reform does not work (Gilbert, Powell and Vines 1999) and that aid cannot buy reform (Devarajan, Dollar and Holgren, 2001, Easterly, 2005, Mosley, Harrigan and Toye, 1991, Browne, 2006).

Other studies have stressed the need for country ownership in successful reform programs (Collier et al 1997 and Killick et al 1998) and good domestic governance and institutions as a central factor for the success or failure of reforms (Barro and Sala-i-Martin, 1997 and Barro, 1996). The influential World Bank report Assessing Aid (World Bank, 1998) emphasised that the effectiveness of aid was not decided by the amount received, but the institutional and policy environment of the recipient country. As a result, that particular report made three main recommendations for making aid more effective, including (i) targeting financial aid to poor countries with good policies and strong economic management; (ii) providing policy-
based aid to demonstrated reformers; and (iii) using simpler instruments to transfer resources to countries with sound management.

This and other research led to a view that PBOs should be focused on the best performing countries as the funds provided were likely to be better used. More recent evidence on this is more mixed. Although Burnside and Dollar (2000) concluded that aid had a positive impact on growth in the presence of good policies, Hansen and Tarp (2001) found that aid worked irrespective of the policy environment. Other studies have also found that there is little or no correlation between aid and growth even when there were good policies in place (Rajan and Subramanian (2005a, 2005b, 2008); Arndt, Jones and Tarp (2009)).

To date no studies have been able to definitively attribute changes in policies or development impacts to the use of budget support. Most evaluations do however attempt to develop a model of the logic linking inputs to intermediate outputs and outcomes (see Figure 3.1 below) with the expectation that increased funding, policy dialogue, technical assistance and donor harmonisation and alignment will lead to better policies.

Figure 3.1 Intervention logic of Budget Support

3.3 Conditionality

Conditionality has always been at the centre of the aid debate and as described above, in the era of SALs, policy-based conditionality was promoted by IFIs because it was thought
likely to leverage reform as it provided funding as an incentive for reform. From around 2000 onwards, the evidence of the failure of this approach among leading IFIs and other donors led to the examination of alternative approaches where the provision of PBOs was conceived as being based on jointly agreed policies to achieve progress over a specific time period which was measured by an agreed set of indicators with an established track record of successful reform, rather than to promises of future policy change.

This change implicitly acknowledged the fact that it is difficult to leverage policy reform through conditions, as it is not easy to define the causality chain through which aid attempts to influence outcomes, even if there is a firm basis for agreeing what the “correct” policies to achieve growth and policy reduction are in any given context. This is illustrated by Bourguignon and Sundberg (2007) who show the causality chain between aid and outcomes and the attempts to influence them through conditionality with three links as shown in Figure 3.2 below.

**Figure 3.2** The causality chain from donor aid to country outcomes

The first link is through policies to outcomes. Any reliance on this makes it necessary to know which is the correct policy to deliver a certain outcome. This can rarely be determined in advance in the real world. The second is the link between policy makers and policies. This relates to the capacity and willingness to implement the ‘right’ policies, which mainly reflects institutional capacity as well as the political willingness/ability to do so. The third link is between donors and policy makers, where through aid and technical assistance, donor agencies try to influence policy by imposing conditionality. The problem is that the donors typically have only an imperfect knowledge of the local environment and more importantly, imperfect control over the implementation of these policies.

This difficulty in identifying the correct policies and controlling implementation of policy has led to the greater use of the record of performance as a condition for providing aid, as well as the linking of the provision of aid to the ex post achievement of specific results. As
Bourguignon and Sundberg (2007) note, this is the logical solution where the donor cannot monitor the aid recipient’s commitment to reform, nor the real implementation of those reforms needed to strengthen outcomes. The newer approach suggests an aid model based on country ownership of the development strategy and aid allocations based primarily on monitorable results.

There is increasingly a general consensus (at least at a rhetorical level) that aid recipient countries need to be free to choose their own development policies and to implement them, and that conditionalities should be based on observed or possibly foreseeable progress in development outcomes and the general quality of policies.

There are however three problems with this approach, which relate to the setting of targets and how to do this most effectively.

- The first is time inconsistency. Specifically, if performance is measured over too short a period of time, results are not likely to be achieved. This can lead to some unpredictability of aid outcomes. However, if the time period chosen is too long, the incentives to perform are weaker.
- The second problem is the balance between (a) the need to reward good performance against (b) the need to provide support to those countries that need it the most but which are unlikely to achieve results quickly (particularly in fragile contexts and countries emerging from conflict). It is argued by some that this problem can be overcome by the use of fiduciary controls in countries with weaker PFM systems (Bourguignon and Sundberg, 2007:8-10, Mold, 2009).
- Third, there is a problem over how to make targets realistic. Countries have an incentive to make targets unambitious if they are asked to set them themselves and there are also pervasive problems of moral hazard about how indicators are measured. Donor agencies face a similar incentive if their loan officers are under strong pressures to achieve target levels of disbursements. Particularly when there is uncertainty over how realistic a target is, then the recipient country has the incentive to be cautious (Gunning, 2005).

In practice there has not yet been a wholesale shift to using ex-post conditionality and payment against results. IFIs are still using a mix of conditions that are both ex-ante and ex-post, while conditions are still sometimes used to leverage policy reform. It is important to note that the differences in conditions/ performance monitoring systems used by different agencies and the focus on different types of indicators stems from the pressure felt by donor agencies to demonstrate results.

### 3.4 Measurement and attribution of development outcomes to PBOs

The measurement of results and the attribution of development performance to PBOs have proved to be difficult and remains a problem for IFIs and bilateral donors. There is always pressure to demonstrate the results of PBOs in order to prove that funds have been spent effectively and objectives have been achieved.

The difficulty in attributing results to a PBO (such as budget support) arises from the fact that it is extremely difficult to formulate and test an appropriate counterfactual, both because of the general lack of a clearly justified basis for judging what the pattern of public expenditure and of policy reforms undertaken would have been in the absence of the PBO, and where
development outcomes are influenced by a whole variety of factors of which the provision of public funding is only one and the underlying causal links are complex and uncertain. This is a challenge that not only faces developing countries, but also OECD countries that have also found it difficult to measure the impact of their own public expenditure.

The use of results-based approaches has meant that effectiveness should be measured in terms of public expenditure outputs and outcomes. This implies the need to measure whether PBOs have led to outputs such as more predictable budget financing, increased efficiency of public spending, stronger budget processes and accountability and outcomes such as enhanced capacity for poverty reduction and better delivery of public services.

There are a variety of challenges to measuring whether these outputs have indeed occurred. In part, this is because the specification of good indicators is rarely easy: there is often a lack of data and a baseline from which progress can be measured, as well as practical difficulties in data collection. The chains are not always clear and recipient governments are not keen to use output and impact targets as conditions or triggers for funding, as they are not always directly within their control.

It is important to distinguish two commonly used but different definitions of impact (White, 2009).

“The tradition in evaluation has been that "impact" refers to the final level of the causal chain (or log frame), with impact differing from outcomes as the former refers to long-term effects. For example, the DAC definition of impact is "positive and negative, primary and secondary long-term effects produced by a development intervention, directly or indirectly, intended or unintended". Any evaluation which refers to impact (or often outcome) indicators is thus, by definition, an impact evaluation.

But this definition is not shared by many working on impact evaluation .... Impact is defined as the difference in the indicator of interest (Y) with the intervention (Y1) and without the intervention (Y0). That is, impact = Y1 – Y0 (e.g. Ravallion 2008). An impact evaluation is a study which tackles the issue of attribution by identifying the counterfactual value of Y (Y0) in a rigorous manner .... Note that such impact evaluations cannot easily be done in retrospect. The baseline data need to be collected at the outset of a programme in order to try to measure change over its duration."

The first definition focuses on monitoring the achievement of outcomes of a specific (set of) intervention(s). The second definition is not restricted to outcomes (it also covers indicators lower down the causal chain) and also places emphasis on tackling attribution.

There have been a variety of attempts to evaluate the impact of general and sector budget support and develop frameworks to attribute results. To date evaluations have been undertaken in two ways. The first approach has not employed any particular intervention logic, relying instead on an assessment of whether objectives have been achieved, without any more formal attempt to map out the causal linkages through which this might have occurred. The second approach has been to develop an intervention logic to trace through causal relations and map the extent to which objectives have been achieved and which underlying processes have led to that progress (see Figure 2 above). The latter studies have gone furthest in trying to assess the effects of budget support, but have still been limited by not being able to clearly show attribution (see below, OECD DAC Joint Evaluation of Budget Support, 2006, ODI and Mokoro, 2009 and ODI and CDD, 2007).
Currently a programme of joint donor evaluations of budget support is being undertaken that seeks to mix both qualitative and quantitative techniques. It is intended that these evaluations will provide empirical evidence on the contribution of budget support to the realisation of its objectives such as economic development, poverty reduction and improved service delivery. This will be done by using statistical methods that have been successfully applied for the evaluation of projects, combining them with common qualitative methodologies. Thus far these evaluations are in their early stages, but the conclusions of evaluations already undertaken are considered in the next section.

**Box 3.1 Evaluating budget support**

Following a presentation to the OECD/DAC Evaluation Network, a methodology for evaluating budget support was developed. Pilots for this methodology were launched during the course of 2009 in Tunisia, Mali and Zambia. The European Commission is leading the two first studies, while Germany and the Netherlands are leading the one in Zambia. If the results of the tests are positive, the finalised methodology will allow evaluation of budget support to take place in a harmonised way in all countries. The results of the pilots are expected by early 2011, with final methodology available by mid-2011. Based on the Commission’s geographical evaluations finalised in 2009, some preliminary conclusions can be drawn: in nearly all countries (Uganda, Botswana, Nicaragua, and Vietnam) and in the MEDA region where budget support was introduced, the external evaluators gave a positive assessment of the shift toward this aid channel. They noted the improvement of dialogue between the EC and the governments of partner countries, the improved harmonisation and coordination amongst donors, the improvement of public financial management, the positive effect on the budget allocation towards the social sectors of health and education, and the important role of budget support in accompanying and stimulating partners’ policy reforms. These findings are based on a limited number of cases and cannot be generalised.

Source: EC (2009), p. 168

**3.5 What have PBOs achieved?**

This discussion draws on evaluations of GBS and SBS, as these are the aid instruments that in recent years have had large scale evaluations undertaken. Various evaluations have tried to measure the effects of budget support. The largest study has been the OECD DAC Joint Evaluation of General Budget Support (2006), which included seven country case studies of Burkina Faso, Malawi, Mozambique, Nicaragua, Rwanda and Uganda. This study pointed out that the question "does budget support lead to poverty reduction" is incoherent. Budget support is a way of supporting a government strategy, so its effects will differ according to the effectiveness of the strategy it supports. However, the study was able to analyse a number of different causal relationships and in some cases draw firm conclusions about some positive benefits that had been achieved.

Thus, budget support was found to have contributed positively to the objectives of greater harmonisation and alignment and to policy development in all the countries reviewed, as well as bringing funds on-budget which had strengthened the budget process significantly as well as the allocative and operational efficiency of public expenditure. There were positive systemic effects on capacity building, and initial effects on poverty mainly through expanding public services. There were found to be negative impacts on predictability in some cases, as
the short-term instability of budget support had delayed budget disbursements, leading to macroeconomic instability.

The Sector Budget Support in Practice (SBSip) study (ODI & Mokoro, 2010) reviewed SBS in seven countries (Tanzania, Uganda, Mali, Mozambique, Rwanda, Tanzania and Zambia). The study concluded that SBS has helped to support the expansion of service delivery, through financing a major share of service delivery inputs. SBS has also supported greater efficiency in the use of public resources, through facilitating improvements in planning, the budget cycle, financial management and accountability. It found that SBS had not effectively addressed the quality of service delivery because non-financial SBS inputs had focused more on upstream policy and monitoring processes, but the contribution that SBS has made to service delivery inputs has certainly ensured that the quality and equity of services was higher than it would have been otherwise.

The Joint Evaluation of Multi Donor Budget Support in Ghana (ODI & GCD 2007) found some evidence that budget support funds were both more predictable and involved lower transaction costs than other aid modalities. They also had their most significant immediate effects on policy dialogue and conditionality. There had been a modest contribution to improving public policy processes and a limited impact on the performance of the PFM system. Budget support had also been a facilitating factor in increasing expenditure on health and education.

There have not been many studies of budget support in fragile states, although the AfDB Evaluation Department (OPEV) is currently undertaking an evaluation of support to fragile states, which will include an analysis of budget support. Studies of budget support in Sierra Leone (Bartholomew 2009 and Lawson 2007) found that budget support had been important in providing additional budgetary resources to allocate to priorities and increase recurrent expenditure and had strengthened public financial management. However, it had not been provided in a predictable manner, resulting in expensive short-term government borrowing, expenditure cuts and crowding out of the private sector.

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6 There remains little firm evidence about the size and impact of transactions costs. What evidence there is to date does not suggest that aid reforms aimed at improving harmonization and alignment are generally reducing transactions costs, although these reforms may be increasing the relevance and effectiveness of aid. Cavalcanti (2007) argued that Multi Donor Budget Support (MDBS) in Ghana created three additional sources of transaction costs (coordination failures, the costs of collective action, and measurement costs). However, the structure of MDBS evolved to mitigate these transaction costs, for instance by delegating policy dialogue to sector-specific groups so that agreements could be reached over a narrower range of issues.
4 Experience of PBOs in Other Development Agencies

This section summarises the key lessons from experience from other development agencies using Policy Based Lending. This experience is presented in more detail in Annexes B to E.

4.1 Overview of experience

World Bank

The World Bank’s approach to what it terms “Development Policy Operations” (DPOs) has evolved over the past three decades from structural adjustment and conditionality in the 1980s to a greater focus on country ownership of its policy reform agenda, and more flexibility, consistent with the Paris Declaration. To enhance ownership, in 2001 the Poverty Reduction Support Credit (PRSC) instrument was introduced to align Bank operations with the countries’ own strategies—the Poverty Reduction Strategy Paper (PRSP). Other policy based lending has converged toward a similar design and the PRSC guidelines have been subsumed under new operational policies for DPOs issued in 2004. The 2004 unification of all policies and guidelines of development policy operations has produced a robust and useful instrument for providing financing and policy advice in support of a country’s medium-term development agenda. The DPO has shown to have flexibility to adapt to unexpected changes in circumstances, and the ability to customize—tailor the operation to the country needs. In addition, the production of clear guidelines for the various components of the DPO design and process and streamlining of the approval process have helped to shorten processing time of operations and reduce the number of prior actions. Importantly, they have also helped to make resource flows to countries more predictable and better aligned with the countries’ budget cycle.

DPOs have provided financing and policy advice in areas where borrowers lack expertise and technical knowledge. IBRD countries have requested DPOs that focus on single sectors or themes requiring specialized Bank knowledge—such as housing, energy, and climate change. In IDA countries, DPOs have also served as a platform for dialogue, harmonization, and alignment around the key policy and institutional reforms. In both IBRD and IDA countries, the majority of the operations in recent years have supported public sector governance reforms.

While the DPO has proven to be a useful instrument some issues have emerged, as have been highlighted in the IEG evaluation of the PRSC, and the OPCS retrospective. The problems and shortcomings identified relate primarily to the analytical underpinning of operations, programme design, the results framework, and donor harmonization.

- On the analytical underpinning of DPOs, Bank operations are required to draw upon analytical work on the country. The OPCS Retrospective (p. 41 and p. 51) and the IED evaluation (IEG, 2010 p. xviii and p. 73) noted that in many cases the links between the

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7 In practice, PRSPs have often had large doses of Bank staff input in their drafting although the level of national ownership and leadership of PRSSs is increasing as they are integrated into national planning and policy processes.
findings of recent analytical work and the programme were not reflected in the programme design nor were they appropriately articulated in the programme documents.

- On the macroeconomic framework, there has frequently been an excessive focus on past economic performance and sometimes insufficient assessment of sustainability of the macroeconomic framework.

- The poverty and social impact analysis is still not always used effectively to underpin DPOs in determining whether specific policies supported under the operation would have substantive poverty or social impact, what groups are likely to be affected, and what actions can be taken to mitigate such negative effects.

- Results frameworks are key to evaluating the effectiveness of programmes. In practice, the quality of results frameworks in operations has varied; they have not always defined the appropriate causality between the actions supported by the DPO and their expected results. Weaknesses remain in terms of clearly defined and consistent outcome indicators, intermediate milestones, and baseline data; and indicators for poverty outcomes are also lacking.

- A prominent area of weakness has been the public financial management results framework, which was completed or largely completed in only half of the PRSC operations reviewed (for the 2010 IEG evaluation). Importantly, there is little evidence that PRSCs have improved governance and levels of corruption.

- While all operational policies and guidelines on DPO were unified in 2004, there is some remaining confusion on the relationship between the PRSC and the DPO and the rationale for a distinct title for the former.

- Donor coordination and harmonization remains a problem area. In the context of joint budget support groups, the Bank has moved to harmonize its processes and operations with the MDBS operations. However, it has sometimes been difficult to adjust the content of the PAF to reflect new or emerging structural or medium-term issues, such as a food and financial crises. This is due in large part to the rigidity of the harmonization framework stemming from differences in approaches of different donors.

- The length of the approval process of DPOs has been considerably reduced, but an average processing time of five months time is still regarded as too long.

- Finally, a great deal has been done to enhance ownership of reform programmes and streamline conditionality by aligning DPOs with countries’ reform programmes and through a reduction in the number of prior actions and other means. However, there are still in practice important tensions between ownership and the use of conditionality conceived as a means to effect policy change.

While structural adjustment programmes in the 1980s aimed at correcting major macroeconomic distortions that were hindering development, more recent World Bank operations have focused public sector management and governance, and reforms in the social sectors, particularly health and education. The DPO has served as a robust but flexible instrument in support of both IDA and IBRD countries moving away from the “one size fits all” approach. While the World Bank appears to have been effective in improving its processes, its impact on outcomes is less clear.

**European Commission**

The EC has been one of the prime movers behind the use of budget support in the donor community. It has developed a relatively sophisticated technical approach in terms of its
guidelines for design, monitoring and mechanisms for triggering the release of disbursements for both general and sectoral budget support. The EC’s clear guidelines on the entry conditions for budget support and on the eligibility conditions for its PBLs are examples of this more general point. The increasing willingness of the EC to decentralise its specialist staff to country delegations is another example of improving practice.

However, the EC’s enthusiastic adoption of direct budget support in particular has been surrounded by great controversy and differences of view within the European family. There remains concern from some countries that budget support will lead to the replacement of well-planned projects and programmes by massive, untargeted and fungible transfers, and will also reduce the visibility of national cooperation efforts. Recipient governments while generally espousing the move to direct budget support also express significant reservations over matters such as intrusiveness, and excessive political interference. Although the EC’s guidelines nominally attach a high priority to results-based principles, the ability to apply these principles in practice remains questionable. The challenges of finding appropriate sanctions for failures of performance are similarly difficult.

The EC has made a major commitment to the principle that a large and expanding part of its total aid-delivery should be provided via the mechanisms of GBS and sector programmes: the mechanisms that this paper has interpreted as the EC-equivalent of policy-based lending. However, the relatively limited structures for evaluation that have been available within the EC system until recently – as of 2007 there was no standard methodology for the evaluation of budget-support operations - make objective judgements about performance somewhat difficult to reach. While the evidence base is therefore weak in some respects, the following points may be made about the EC’s use of budget support:

- In terms of the range of instruments and their design features, the EC has a well-specified and structured decision process and detailed guidance for decision-making about budget support, although this still appears to be slow and potentially cumbersome at times, and processes (particularly in EDF countries) that should to some extent at least facilitate national ownership.
- The EC’s approach to budget support is in general characterised by multi-tranche operations, usually undertaken in conjunction with other donor support, which also include a variable element that whose disbursement depends on performance. The broad approach of EC budget support is to base the provision of aid on actions already taken so as to establish a favourable environment for aid, an element of ex post conditionality remains. While evidence on the effectiveness of this approach is incomplete, there are a number of concerns that it creates uncertainty and increases aid unpredictability without significantly increasing leverage over policy.
- EC experience with sector support is generally regarded as most effective when the sector supported coincides with the area of responsibility and budget of a single government institution.
- The EC has a policy towards the provision of budget support in fragile states which favours single year operations as opposed to multi-tranche, multi-annual operations.
- The EC generally has an in-country presence through its Delegations. However the capacity to engage effectively in policy dialogue is variable and highly dependent on the skills of particular individuals.

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8 Hauck et al 2005
The EC has a well-developed monitoring procedure for budget support. However, although an attempt is being made to pilot a more comprehensive results framework, evaluation, particularly of the impact of EC budget support, appears to be relatively weak.

Asian Development Bank

“Programme lending” has been the primary instrument through which the Asian Development Bank (AsDB) has supported policy reforms in developing countries. The AsDB does not have a specific budget support instrument though programme lending has on occasion been used in the context of mult donor budget support operations (for instance in Vietnam). Policy based lending or programme lending was introduced in 1978 primarily for balance of payments support (particularly for agricultural imports) as it was quick disbursing. However, in 1987, the criterion was extended to recognise the policy environment. In 1996, programme lending was again extended to reflect a more holistic approach to sector development. These Sector Development Programmes (SDPs) focused on substantive policy reform and large scale investment. The programme cluster approach (PCA) was introduced to allow a broader focus on institutional reforms and capacity development over a longer timeframe. Finally, special programme loans were introduced as a result of the 1997 Asian Financial Crisis to restore immediate financial stability. The special programme loan modality was introduced to focus on crises.

The AsDB appears to have rather less deep and broad range of evaluation information on PBO performance (compared to the World Bank) which may limit the extent to which firm conclusions may be drawn about its performance, the development impact of its programme lending, and the lessons that emerge. The AsDB has though gone considerably further than the AfDB in developing comprehensive guidance and procedures for the use of PBOs. The AsDB is undertaking both sectoral and multisectoral operations.

The AsDB also has limited engagement in fragile contexts (and lacks a specific policy for its use of PBOs for its engagement in such situations). Programme lending is the predominant form of lending used by the AsDB and is concentrated in economically and institutionally more mature countries, particularly during the period when the AsDB moved away from its past focus on infrastructure towards supporting more broadly based development policy reforms (a shift that has subsequently been partially reversed).

There has been a marked shift in AsDB practice away from two tranche towards single tranche operations, reflecting both the experience of delays in second tranche release, and the move away from ex ante conditionality which seeks to exert leverage over borrower policies. There has also been recognition of the importance of complementary technical assistance and other forms of institutional support, and for this to be more closely integrated into the design of programme lending.

Bilateral donors

Annex E summarises information on the policies and procedures of four bilateral donors (Canada, the Netherlands, the UK and Sweden) who are major providers of budget support (or in the case of CIDA, programme based approaches that include budget support). Several

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Senapty (2009, p. 15)
general points can be made about bilateral use of PBOs in comparison to use by multilateral agencies:

- The extent to which bilateral donors use budget support depends on: (i) the degree of political commitment to harmonised and aligned approaches to aid provision as opposed to approaches stressing the need to have aid visibly “flagged”; (ii) related to this, the extent to which domestic accountability and fiduciary risk requirements are seen to constrain the use of national budget systems to manage and account for aid; and (iii) the level and rate of increase of the aid budget where increased pressures to spend are likely to favour quick disbursing instruments especially using aid modalities which are relatively light in terms of their management requirements per dollar disbursed.

- Compared to multilateral organisations which operate in a more complex accountability framework (i.e. with accountability to a group of shareholders with differing interests and priorities as compared to accountability primarily to a national parliament) bilateral policies on PBOs may exhibit a higher degree of discretion and less consistency in the treatment of different countries and contexts depending on specific political considerations. One example of this is the more widespread use by bilateral agencies of variable, performance related, tranches compared to multilateral development banks which tend to disburse more strictly against the achievement of tightly defined conditions or benchmarks (or that require a formal waiver process to be gone through).

- Policies are also likely to be subject to change following shifts in the domestic balance of political power. For instance political change in both the UK and Sweden has led to a greater degree of focus on audit and attribution issues for budget support.

The main issues and concerns about the use of budget support among the bilateral donors reviewed were the following:

- The need for a consistent approach to assess risks and to relate guidance to the level and nature of risks faced.
- The need to ensure agency staff (particularly in-country) have the skills and experience required to design and manage PBOs and to engage effectively in policy dialogue.
- The need to find more effectively harmonised ways of providing PBOs.
- The need to develop appropriate performance indicators and effectively to apply results-based approaches, including developing ways to assess and attribute impact.
- The need to clarify policies on conditionality and the extent to which ex post rather than ex ante conditions are used.

4.2 Instruments and guidance

All the agencies reviewed have clearly defined policies and guidance which define specific instruments for PBOs and the procedures by which they should be managed. These policies and procedures have been specifically tailored for PBOs as distinct from other forms of operation like investment lending. For instance for the World Bank all Development Policy Operations are governed by Operational Policy 8.60 which was approved by the Bank’s Executive Board in 2004 and which replaced and updated all previous Bank documents on PBOs. The policy is complemented by a series of Good Practice Notes. In the case of the World Bank one main instrument is defined (which encompasses budget support and adjustment operations), while the EC separately identifies instruments for general and
sectoral budget support, as well as a sector programme aid instrument (which is not classified as a PBO in relation to the AfDB’s classification of instruments). The Asian Development Bank uses the concept of a programme based operation (as does CIDA) and defines three main types of programme approach based on the timeframe and context (crisis or non-crisis) envisaged for programme support. The AsDB does not have a specific budget support instrument or a budget support policy. The UK, Sweden and the Netherlands have policies that define budget support instruments.

All the instruments reviewed have a generally similar structure and set of preconditions. In the case of the World Bank DPO the key features are:

- A country assistance strategy which includes an overall assessment of the country’s policies and institutional framework;
- An appropriate macroeconomic framework (to achieve sustainable external and fiscal balance);
- Coordination with other development partners;
- Analytical underpinnings, drawing on economic and sector work;
- A specification of development objectives including measurable indicators to monitor implementation and provide a framework for evaluating outcomes;
- Definition of the form of programme funding and the size of the operation;
- Programme conditions necessary for implementation of the operation;
- Risk assessment including identification of appropriate mitigation measures;
- Disbursement process.

4.3 Design and management issues

Major issues for donor practice in the design of PBOs have included the structure and tranching of operations, how conditions are defined and used, the approach to fiduciary risk assessment, and the definition of objectives and results and how these are monitored and evaluated.

Tranching and structure of operations

The World Bank has moved away from multiple tranche operations as a result of the persistent difficulties in appropriately defining subsequent tranche conditions that can be met. The World Bank identified three approaches to tranching:

- A Programmatic approach involves a series of single-tranche loans, or grants for supporting a well-defined, medium-term programme. Such a series spans up to four annual operations over a period of four-five years. The programmatic approach captures the medium- to long-term nature of the reforms but allows flexibility to adjust to new information or circumstances. Each programme document indicates the prior actions that have been taken in advance as well as the triggers for subsequent operations in the series. The programmes in question can embrace a wide range of different sectoral areas – e.g. financial sector and telecoms can both be in the same programme.
- A Multi-tranche operation sets release conditions for each tranche at the beginning of the operation in the context of a medium-term reform process in which the key policy and institutional actions are fairly well defined. If the actions of one component of the
operation can proceed independently of those of other components, the tranche can be “floating”—can be disbursed when the specific conditions for that tranche are satisfied. In choosing between a programmatic approach and a multi-tranche approach “the borrower needs to be aware that the commitment fee of the multi-tranche operation means a higher financial cost.”

- A Single tranche operation applies when the prior actions are fully met before the operation is presented to the Board and there is no expectation of a series of loans being necessary. Here too it would generally be expected that the operation is part of a medium-term reform programme. Single tranche operation may be particularly appropriate in a crisis situation in which the government needs financial support to deal with a short-term situation even though the medium-term programme is not yet well specified.

The World Bank has increasingly moved towards using a programmatic approach which is seen as providing the best combination of a longer-term perspective on engagement together with short-term flexibility on the definition of specific objectives and conditions.

The Asian Development Bank generally used two tranche operations but encountered persistent problems in ensuring second tranche conditions were met. A study in 2009 (OED, 2009) reviewed the tranche approval process with regards to Board approval and in the sequencing of tranche payments. It developed revised staff instruction to more clearly guide multi-tranche operations where the major elements of the policy sector reform are introduced after the loan agreement becomes effective. Single tranches are allowed under certain criteria including where the most important policy reform(s) can be implemented prior to effectiveness and where they are part of a DMC’s medium term reform plan. The share of single tranche based in AsDB operations has increased from 42 percent in 2006 of total programme lending to 70 percent in 2007 and 78 percent in 2008.

The policy for AsDB tranches (Operational Manual D4) is that ‘tranching conditionalities must be formulated with a view to optimising the sequencing of reform steps, as well as minimising short-term costs of adjustment. Staff should adopt a flexible approach to conditions in programme loans, and apply the following good practice principles in the design and implementation of conditionality in programme loans: (i) conditions should reinforce country ownership, (ii) they should be agreed with the government and linked closely to national development strategies, (iii) only actions critical for achieving programme outputs and outcomes should be selected as conditions for disbursement, and (iv) transparent progress reviews that contribute to predictable and performance-based financial support should be conducted regularly’. Single tranche proposals must be presented to the Board at an earlier informal discussion to support the overall approval process.

The key point emphasised in the guidance is that staff are encouraged to be flexible and only identify those policy reforms/actions that are critical as the trigger points for further disbursement. Each programme loan is or should be considered on a case by case approach and the conditionality attached results focused, flexible and realistic.

The European Commission, together with some bilateral donors including DFID, has often by contrast to the multilateral development banks used a variable tranche element where the

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10 i.e the full commitment fee is payable even though some of the tranche releases may be delayed for some time. (World Bank, 2009a p. 12).

amount of resources released is dependent on an assessment of performance. EC budget support can be released in the form of fixed and variable tranches. For GBS programmes that are supporting a national agenda of reform (e.g. a PRSP) the conditions for release are related to the content of those programmes. For example in many country operations, the fixed tranche, known as the ‘all or nothing’ component, has often been based on the review by the IMF of its Poverty Reduction and Growth Facility (PRGF). This review assesses whether general conditions, such as a satisfactory macro-economic situation or any specific fiduciary requirements, are in place. The variable tranche by contrast is released gradually, depending upon the progress made by the government in meeting agreed poverty reduction targets. In principle, targets can be drawn from the PRSP with measurement usually based on ‘outcome indicators’ in areas such as education and health. The situation is made somewhat more complex by also factoring in certain targets for public finance management as additional conditions for tranche release in some cases. The balance as between these various conditions can vary on a case-by-case basis and once again involves a large judgmental element. The rationale for the variable tranche approach is that it provides incentives for performance while preventing the aid receiving country being excessively penalised for failing to meet all predefined conditions.

Use of conditions

In defining conditions for PBOs, the World Bank distinguishes the following:

- “Prior actions” are actions that are deemed critical to achieving the results of the programme supported by the DPO. Prior actions are taken by a country before presentation of the operation to the EB and are included in the operation document as legal conditions for disbursement.12
- “Triggers” are the expected prior actions for subsequent operations in the context of a programmatic series of DPOs. These are deemed critical to achieving the results of the programme. Importantly, however, triggers are not legal conditions for disbursement.
- “Benchmarks” are progress markers of programme implementation but they are not legal conditions for disbursement.

The programme document typically includes a programme matrix which summarizes all the prior actions, triggers (in the case of a programmatic series), benchmarks and expected results. Results are the outputs, outcomes or other developmental impacts of a programme. Indicators can be quantitative or qualitative measures of results.

The general trend in donor practice is therefore to focus on the appropriate definition of prior actions for a single tranche, and to move away from the rigid definition of conditions for subsequent tranches. This is done either through adopting a series of single tranche operations with appropriate prior conditions being defined for each, or using variable performance-based approaches that avoid an “all or nothing” result which can cause grave problems for aid predictability including in response to factors outside the aid recipient’s control.

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12 In some cases there can be a pre-agreement release of funds to support Project Preparation and the meeting of Prior actions – these funds then becoming part of the loan when it is eventually agreed.
Risk assessment and management

The general approach to fiduciary risk assessment focuses on two main elements, as with World Bank DPOs:

- Flow of funds arrangements that give reasonable assurances that the foreign exchange proceeds from the loan or grant are deposited into an account at the central bank that forms part of the country’s official reserves and the equivalent amount is credited to the government; and
- The appropriateness of the management of the country’s budgetary resources through its public financial management (PFM) system.

The World Bank’s Good Practice Notes on designing DPOs require that every operation should identify risks, present a strategy for mitigating those risks, and explain why the remaining risks in terms of the developmental benefits are worth taking. Every programme document should include a section on risks and risk management. The checklist of risk factors include country and sector factors: macroeconomic policy framework, political stability and governance, country and civil society ownership, and institutional capacity; external market developments; social and environmental protection system; fiduciary factors: compliance with World Bank fiduciary guidelines, and country public financial accountability system; availability and access to information; and internal and other factors including staff skills and supervisory resources. The initial risk analysis is conducted at the time of the CAS, which typically precedes the DPO. The guidelines also call for incorporating risk control and mitigation into the design of the reform programme. The loan or credit amount needs to reflect the country credit risk and Bank exposure. The programme documents also need to define contingency plans for important risks. As the operation is developed World Bank staff are required to revisit the country credit risk and Bank exposure in light of the most recent macroeconomic performance and outlook, and present a current analysis of political risk.

The risk management components of the operation that are within the domain of the Bank, can use Bank institutional resources such as the Bank’s Credit Risk Department to help evaluate the country credit risk and Bank exposure. In defining contingency plans for important risks Bank staff are also expected to develop with the government a general understanding of how the programme might be adjusted if, for example, the fiscal position deteriorates significantly. In assessing macroeconomic risks the Bank relies on IMF assessments. In this context a recent review of Bank DPOs notes that there has been excessive focus on past economic performance and sometimes insufficient assessment of medium-term macroeconomic sustainability. The review consequently recommends that the DPOs in future should present a clear assessment of the adequacy of the macroeconomic framework (World Bank, 2009e, p.50).

To ensure that the full amount of the loan proceeds reaches the country’s budget there is a further requirement to review the control environment within which foreign exchange is managed. World Bank staff generally rely on the IMF’s most recent safeguards assessment of the borrower’s central bank. World Bank staff also review the available published audit reports and financial statements of the central bank. If this assessment is not satisfactory or no safeguards assessment had been carried out, the World Bank may apply additional fiduciary arrangements. These may comprise the deposit of loan proceeds into a dedicated account; a periodic audit of the dedicated account; and agreeing on specific purposes for which loan proceeds may or may not be used.
In the case of the Asian Development Bank, a Draft Development Policy Letter sets out the essential features of any agreement with the Government, the IMF letter and the policy matrix, which includes a table setting out the overall objectives of the programme, measures already taken, specific actions to be taken under the programme, their timing, and further actions needed over the medium term. There does not appear to be a specific fiduciary risk assessment done for each programme loan. However, OMD 08 provides that when the AsDB makes a loan to a DMC, the full faith and credit of the member country stands behind the obligations of repayment. Therefore, the policy manual states that no special safeguards to protect AsDB in the event of default are considered necessary. When it makes a loan to an institution or sub-regional entity, it would expect that the DMC would provide a government guarantee. This approach minimises the risk of loan non-repayment, but does not address the risk that resources provided will not be used to achieve agreed objectives.

Fiduciary risk assessment has appeared to be a more problematic issue for bilateral donors probably because of the more direct and less structured form of scrutiny they may face from their legislatures and also limited capacity (particularly at field office level) which can limit the extent to which bilateral donors can exercise effective monitoring. Sweden's National Audit Office reviewed the use of budget support in aid by Sida (2007) and found a lack of clarity in Sida's guidelines on budget support – making it unclear how they should be applied – and an inadequate approach to the management of risk, concluding that: "in most cases, Sida’s risk analysis is incomplete and has not been performed in a structured manner. For instance, there is usually no discussion of how the risks concerned can be dealt with" (NAO, 2007: p.43). The NAO also expressed concern that monitoring and technical assessment of budget support was usually dependent on a single staff member in a country office.

### Monitoring and evaluation and results

While all donor agencies express commitment to the principle of results-based management and a strong focus on monitoring and evaluation, in practice this is an area of concern even among those agencies (such as the World Bank) that generally have the strongest approaches to evaluation. The main problem appears to be a failure to adequately specify the intervention logic that links the actions supported by the PBO to the expected results. The evaluation of the World Bank’s use of PRSCs found, as noted above, weaknesses in the choice and definition of outcome indicators, intermediate milestones, and a general lack of baseline data. A particular area of weakness in PRSC practice was the PFM results framework, with insufficient attention being paid to either the definition of the causality by which the operation was supposed to improve PFM (and governance more generally), and to the monitoring and reporting on performance in this area.

### 4.4 PBOs in fragile and conflict-affected situations

While weaknesses in institutional structures are recognised as increasing fiduciary risk in fragile and conflict-affected situations, the advantages of quick-disbursing instruments that also seek to strengthen key country systems mean that PBOs including budget support are widely used in fragile contexts.

The World Bank has recognised that countries affected by crisis or conflict may require a quick response from it even though there may be insufficient time or country capacity to adequately address design considerations or develop a strong policy programme with
stakeholder consultations. In such circumstances, DPOs are justified on an exceptional basis and the Bank may process them for both IBRD and IDA countries on an accelerated basis with accelerated processing and internal review. In seeking EB approval of such operations, Bank staff are required to describe in the programme document when and how remaining design considerations would be addressed.

The European Commission’s approach The EC seeks to mitigate these risks in two specific ways:

- First, as regards macroeconomic stability and the overall situation of the national budget, the Commission bases its judgment on the assessments of the IMF, which has the available instruments (such as the PRGF programme) to deal with the inherently greater instability seen in such country cases.
- Second, as regards public-finance management (PFM), the Commission bases itself on prior assessments of the situation carried out either by itself or by other donors (often the World Bank) and a further assessment as to whether the government is giving clear signals that it intends to undertake serious reforms. The Commission, based on its own experience, notes that even positive signals in these areas in fragile political systems might not be translated in practice in the manner needed to allow for the effective use of GBS or SBS.

In response to these greater risks the Commission has also opted for a shorter-term approach to aid to fragile states than is normal - providing this for a maximum of one year. This provides the opportunity over this transition period to check that the conditions for more normal support (often over three years) are in place. DFID has also seen budget support as an instrument that encourages state-building, and regards its long-term involvement (together with the EC and World Bank) in providing budget support in the aftermath of conflict in Sierra Leone as an important success. However, budget support alone will not build the systems necessary for effective public finance management. Complementary support in the form of institutional development and technical assistance will also be required.
5 Conclusions

5.1 Emerging models of “good practice”

The review of the literature on PBOs has shown that there have been important shifts in what has been conceived of as international best practice in PBOs over the last decade. These changes have been a response to the problems of implementing PBOs and the shifts that have also occurred in development thinking aimed at making aid more effective. The experience of PBOs over the past decade has led to an emerging consensus on best practice in the design and implementation of these operations. The firm empirical evidence base on which conclusions have been drawn remains quite limited however.

A set of overarching principles for PBOs have been outlined by the OECD DAC which still remain relevant (see Annex A) These emphasise the need for ensuring partner country ownership, assisting in enhancing the performance and accountability of partner countries PFM systems, minimising transaction costs for recipient governments, focusing on results and delivering budget support in a predictable manner, as well as the need for a systematic approach to capacity building.

More specifically experiences that have been documented suggest that PBOs should be designed and implemented in the following way:

- Use *ex post* rather than *ex ante* conditionality (that is, focus on defining agreed prior actions and disbursing against these).
- Use dialogue to support policy reform rather than expecting conditions to achieve this.
- Support specific policy reforms as part of a longer-term support to national poverty reduction strategies.
- Be integrated into the national budget and public expenditure management processes, with PBO mechanisms being explicitly intended to strengthen further this process.
- Be part of joint donor operations rather than stand alone operations.
- Provide complementary capacity building and technical assistance.
- Involve a focus on results and outcomes using joint assessment frameworks.

Effective PBOs need to be designed in partnership with recipient governments and other donors to ensure country ownership, as well as for a strong focus on developing an appropriate complementarity between PBOs and other forms of support, for instance those focused on strengthening capacity in key areas, most notably public financial management. There is strong evidence that in general the use of ex ante conditionality to leverage policy reform does not often work well and that successful policy change needs to be domestically led. It can though be successfully externally supported through dialogue and support to research, analysis and capacity development. PBOs require complementary actions including, but also policy dialogue to discuss budget priorities and reform agendas. This implies that IFIs and donor agencies will require sufficient technical capacity in country to engage in this type of dialogue.

Although major shifts have occurred in the thinking underpinning PBOs, the model presented above is not always implemented. Several factors may influence this.
• First, the attempt to use grant or loan conditionality as an instrument to bring about policy change has not been entirely abandoned, and the use of multiple tranche operations is often seen as a way of trying to retain and exert influence over partner actions.

• Second, implementation of effectively harmonised approaches is often difficult to achieve in practice, as is noted in particular in the recent evaluation of PRSC by the Independent Evaluation Group of the World Bank. Donor procedures and priorities differ, and the tendency remains for different agencies to seek to include “components” (i.e. specified policy actions) of particular interest within a common policy framework (such as a PAF) in order to be able to demonstrate action against particular areas of interest, although the causal link between the specifying of particular actions in a PAF and the action being taken may be unclear.

• Third, there are differing donor approaches to the risks of using PBOs. These relate in particular to fiduciary risk (where it is important to distinguish the risk of resources supplied being misused, from the risk of resources being used within the government budget, but this not leading to the specific results providers of support are seeking) and to the ability effectively to monitor results. PBOs that incorporate assistance aimed at strengthening PFM systems and audit functions, good performance monitoring frameworks and design and collection of baseline data prior to the start of the PBO, and that are accompanied by clearly specified and resourced complementary actions, are likely to be the best equipped to deal with risks.

5.2 Lessons for the African Development Bank

The review of experience from other agencies suggests some more specific conclusions and comparisons with current AfDB practice:

• First, other agencies have simplified and unified the instruments they are using for PBOs, as well as preparing detailed procedures to guide all aspects of decision-making that are specific to the PBO instrument. The AfDB appears to significantly lag all the other agencies reviewed in both these respects with a considerable lack of clarity about the instruments and guidance for PBOs.

• Second, there is generally recognition that the distinction between budget support and balance of payments support is not a clear cut one (especially in the modern context where currencies are largely convertible) and that while there are distinct design issues related to PBOs directed at addressing short-term externally driven shocks, embedding a distinction between budget support and balance of payments support in policy guidance would not be particularly helpful. Specific objectives need to be defined for a specific operation. More generally, it is important to regard PBOs as supporting an agreed programme of action or policies, rather necessarily than as an instrument for policy change or reform, though this confusion appears still to be widespread in donor practice and may reinforce the tendency to continue to use conditionality, and to consider results in terms of policy changes effected, rather than in terms of the use which has been made of donor support to increase public spending, which should be what is principally used to judge the results of a PBO, with policy change usually related more directly to complementary actions such as policy dialogue and advice, rather than to the provision of funding. Ability to engage effectively in dialogue may depend on the extent to which authority is delegated to country offices and teams, and to the quality and quantity of in-country representation.
Third, there is a general (though not universal) move towards single tranche operations, often based on prior actions, though with these occurring, as with the World Bank, in a programmatic framework of repeated operations in support of a medium-term government plan of action (like a nationally owned PRS). While there is evidence that single tranche operations provides reasonably predictable within-year aid flows compared to multiple tranche operations, they may risk unpredictability over the longer term without a programmatic framework. This may be difficult for the AfDB to implement specifically for ADF operations without some changes to the ADF framework. However, addressing this appears to be an important requirement for improving the effectiveness of AfDB use of budget support.

Fourth, other agencies do not appear to operate specific quantitative restrictions over the proportion of total loans or grants that are provided using PBOs, unlike the situation for the African Development Fund where the share of PBOs is capped, although agencies may set targets for the use of PBOs for fiduciary risk management or other strategic purposes or as part of an overall country strategy.

Fifth, in relation to engagement in fragile situations and the role of PBOs, there are some differences in agency practice but it is generally recognised that there is an important need for the use of fast disbursing instruments but that these need to be supported to a greater degree than elsewhere by complementary actions to improve effectiveness and to manage risks.

Sixth, the difference between general and sector budget support relates to the scope of policy dialogue and the extent to which funds are earmarked, either notionally or through the management of funds through special accounts to ensure that they are used in particular agreed ways.

Seventh, a general weakness of donor practice with PBOs has been a failure adequately to set out the intervention logic by which the different elements of the PBO (finance provided, definition of conditions, policy dialogue, and complementary measures) are supposed to contribute to achieving defined results, and a consequent failure to establish effective monitoring of intermediate results. A particular weakness has been in relation to the link between a PBO and the achievement of PFM improvement results. This is likely also to be an area in which AfDB practice could be improved.

Eighth, in comparison to other agencies using PBOs, and seeking to use these as a means to participate in policy dialogue, the AfDB lacks policy and analytical capacity, particularly in-country.
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Annex A  OECD/DAC guiding principles for providing budget support

**Budget support should reinforce partner countries ownership**  
*Refrain from targeting support*: there should be no restrictions on the use of funds once these are transferred.  
*Reflect partner countries priorities*: conditionality should draw as much as possible on the partner countries’ policy agenda and objectives.  
*Focus on results*: focus on outputs and outcomes that are linked to the policies pursued by the partner

**Budget support should enhance the performance and accountability of partner countries’ PFM systems**  
*Follow good practices in PFM diagnostic and assessment work*: avoid burdensome and costly duplications of work by sharing the results of your own work and use work of others.  
*Directly support the capacity development of partner country PFM systems*: align with countries’ reform strategies through the inclusion of specific conditionality and the provision of targeted technical assistance.  
*Avoid undermining country systems*: where possible rely on partner countries’ systems for expenditure and control.

**Transaction costs incurred by budget support should be minimised**  
*Streamline conditionality*: partners should have a single comprehensive national budget and a single national strategy and budget support providers should link funding to a single framework of conditions.  
*Rationalise fiduciary assessments*: donors should try to coordinate common diagnostic reviews.  
*Align processes*: align dialogue and monitoring processes with the partner countries’ national budgetary cycles.  
*Tap the potential of joint donor frameworks*: avoid the risk of creating additional layers of institutional processes or simply adding all donors’ individual concerns into one new framework.  
*Time disbursements to facilitate the smooth execution of budgetary payments*: agree with a partner country’s budgetary authorities on the most appropriate timing for the release of funds.

**Budget support should be delivered in a way that enhances the predictability of resources**  
*Programme budget support over several years*: programme and commit budget support (subject to performance) over a rolling multi-year framework in order to match with partner countries’ medium term budgetary planning.  
*Align support with partner country budget cycles*: provide early indicative commitments to facilitate budget planning, & complete negotiations before the start of the new budget year.  
*Design conditionality to enhance the predictability of disbursements*: donors should consider the timing of the review of performance, the clarity of conditionality, its evaluation process and the use of political conditionality.  
*Time disbursements in a predictable manner* following a positive assessment of conditionality.  
*Avoid stop-and-go cycles and allow for graduated responses*: mitigate the financial, planning and macroeconomic risks associated with volatile and uncertain aid flows.  
*Build public support*: donors should engage in an active communication strategy with their political constituencies and civil society in order to enhance the understanding of budget support.

Source: OECD DAC 2006
Annex B  Case study of PBOs in the World Bank

B.1 Overview of use of PBOs

The World Bank’s approach to what it terms Development Policy Operations (DPOs) has evolved over the past three decades from structural adjustment and conditionality in the 1980s to a greater focus on country ownership of its policy reform agenda, and more flexibility, consistent with the Paris Declaration. To enhance ownership, in 2001 the Poverty Reduction Support Credit (PRSC) instrument was introduced to align Bank operations with the countries’ own strategies—the Poverty Reduction Strategy Paper (PRSP). Other policy based lending has converged toward a similar design and the PRSC guidelines have been subsumed under new operational policies for DPOs issued in 2004.

The Bank has two basic types of financing instruments, investment lending and development policy operations (DPO), both of which can be in the form of IBRD loans, IDA credits, or IDA grants.

Investment or project lending (IL) operations are historically (pre the 1980 Board decision) the primary mode of delivering Bank development assistance, provide funding to governments to finance the purchase of goods, works and services in support of specific economic and social development objectives in the various sectors. IL continues to be the primary lending instrument of IBRD and IDA, accounting for the largest share of their lending—about two-thirds of combined IBRD and IDA annual commitments and over 90 percent of their active lending portfolio. IL is used in all sectors where the Bank is active, with concentration in the infrastructure, human development, agriculture, and public administration sectors. IL finances a wide range of activities, including capital-intensive investments, rehabilitation and maintenance, service delivery, credit and grant delivery (including micro-credit), community-based development, and institution building.

A major effort is underway to reform the Bank’s investment lending model (World Bank, 2009d). In particular, the IL reform aims to sharpen the focus on results and improve the management of risk that can affect the achievement of these results. It will address issues related to project preparation and focus more on implementation support to help borrowers achieve better development results.

Development policy lending is intended to be a more rapidly disbursing form of financing with an explicit focus on policy reform. The Bank provides this in the form of loans or grants to help a borrower address actual or anticipated development financing requirements. The Bank may provide development policy lending to a member country or to a sub-national division (e.g., state government in a federal system) of a member country.

Development policy operations provide direct budget financing that is not earmarked to specific expenditure items to governments for policy and institutional reforms aimed at achieving a set of agreed development results. World Bank DPOs aim to support countries

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13 In practice, PRSPs have often had large doses of Bank staff input in their drafting although the level of national ownership and leadership of PRSs is increasing as they are integrated into national planning and policy processes.

14 The Investment Lending Reform Concept Note was discussed at the Bank’s Board in February 2009. A Progress Report went to the Board on October 22, 2009.
design such reforms and to help implement the countries’ medium-term development policy agendas to achieve development results.

Within the framework of the DPO there is a flexibility which allows an operation to be tailored to a country’s circumstances. In countries where institutional and technical capacity is relatively strong, DPOs cover a broader spectrum of reform areas and sectors. In countries with weaker institutional and technical capacity, DPOs tend to be simpler and focused on fewer sectors, themes and policy and institutional actions. In the latter cases, they also place a stronger emphasis on public sector governance and public financial management.

In a country with a Poverty Reduction Strategy Paper (PRSP), a DPO following a programmatic approach—a series of operations within a medium-term framework of policy and institutional reform—is called a Poverty Reduction Support Credit (PRSC).\(^\text{15}\)

The PRSC was introduced in 2001. Within four years of its introduction, PRSCs came to account for almost 60 percent of IDA policy-based lending and a quarter of total Bank policy-based lending. During the past decade the Bank has approved 99 PRSCs. Africa has the largest portfolio of PRSCs among the Regions, with about half of all ongoing series, typically in the context of multi-donor budget support (MDBS). As of June 2009, 80 countries are eligible to borrow from IDA,\(^\text{16}\) including 14 'blend' countries which are credit-worthy enough to borrow from IBRD as well.

IBRD programme support to middle-income countries varies widely. Some borrowers have sought annual budget financing, others flexible and competitively priced funds to meet financing requirements, and a few requested assurances of access to IBRD funds should unforeseen financing needs arise. Increasingly, IBRD countries have requested Bank support with a focus on single sectors or themes that require specialized Bank knowledge (e.g., housing, energy and climate change) and may involve the Bank only in the implementation of a programme articulated by the government. Demand for Bank support tends to be stronger in areas in which governments seek Bank expertise to help them solve new and complex problems such as imperfect markets for financial services. The Bank has faced a challenge with countries that can raise their external financing on competitive terms in the bond market but still have structural problems to resolve and where Bank help is needed. In such cases, narrow TA can take over some of the DPO role (e.g., TA in transport infrastructure to Saudi Arabia).

### B.2 Policy and guidance on PBOs

The DPO has a number of features for different country needs:

\(^{15}\) All operational policy and guidance on DPOs were unified with the introduction of OP 8.60 in 2004 and since then PRSCs do not have a separate existence. PRSC is a title given to operations to signal their alignment with a country’s PRSP. In its 2010 evaluation of Bank support under the PRSC the IEG recommends that the PRSC be phased out as a separate brand name for DPO or that the Bank clarify when it is appropriate to use it. Bank Management, in its response stressed that the PRSC is simply a “title” given to operations, usually programmatic, to signal their alignment with a PRSP. (See IEG (2010) Box 1.1 p.36).

\(^{16}\) The cutoff level of eligibility for IDA funding was US$1,095 of gross national income per capita (FY09).
(i) Supplemental financing may be provided for a DPO for which an unanticipated financing gap emerges;

(ii) the Deferred drawdown option (DDO) allows IBRD borrowers that have no immediate need for funding to postpone drawing down a loan for a defined period after the loan agreement goes into effect;

(iii) Catastrophe DDO provides IBRD borrowers with the assurance that they can withdraw funds for a period up to 15 years when a natural disaster occurs that requires them to declare a state of emergency;

(iv) the Debt restructuring facility can help borrowers reduce their debt payments through loan restructuring, equity conversion, or interest rate swaps;

(v) the Special development policy lending (SDPL) is targeted at IBRD countries that are approaching or are in a crisis with substantial structural and social dimensions and have urgent and extraordinary financing needs; and

(vi) DPOs for countries in crisis or post-conflict, which may be processed on an accelerated basis (see below).

DPOs are guided by OP (Operational Policy) 8.60, approved by the Executive Board (EB) of the Bank in August 2004. OP 8.60, replaces and updates various policy documents that had been used by the Bank since the late 1980s. DPOs are accompanied by Good Practice Notes (GPN) for Development Policy Lending, which have been developed in recent years to help with the preparation and implementation of these development operations; GPNs are also approved by the EB of the Bank.

The key features of a DPO are:

- **Country Assistance Strategy (CAS).** The appropriateness of a DPO is determined in the context of the CAS. The Bank’s decision to extend DPO is based on an assessment of the country’s overall policies and institutional framework—including the country’s economic situation, governance, environmental and natural resource management, and poverty and social aspects—and its ability to implement the programme.

- **Macroeconomic framework.** An appropriate macroeconomic framework is a requirement for a DPO to be undertaken: “appropriate” implying that the country’s macroeconomic policies are likely to achieve sustainable external and fiscal balances over the medium term and that the DPO will support rather than undermine those policies.

- **Coordination with development partners.** In preparing an operation the Bank is required to collaborate with the IMF and other IFIs and donors, as appropriate.

- **Analytic underpinning.** A DPO draws upon the Bank’s substantial outputs of economic and sector analytic work on the country, including the assessments of the country’s public expenditure management, procurement, and the financial accountability systems. The CAS assesses the adequacy of this work and indicates how to address remaining gaps.

- **Development objectives.** The programme documents set out the specific outcome expected from the resource transfer under the programme. The programme design includes measurable indicators to monitor implementation and evaluate outcomes upon completion.
• **Programme funding and size of operation.** The size of the operation is based on projected financing requirements, the availability of alternative financing, debt sustainability and credit worthiness (for IBRD countries), or relative claim on available concessional resources and the Country Policy and Institutional Assessment (CPIA) ranking\(^{17}\) (for IDA countries); the envisaged lending envelope and share of DPO in total lending in the CAS; and compliance with performance triggers set out in the CAS;

• **Programme conditions.** The programme conditions set out the agreed policy and institutional actions necessary for the implementation of the DPO. Funding becomes available upon meeting the programme conditions.

• **Tranching.** DPO can be provided in one or more tranches, depending on the country’s circumstances, financing needs, and the content and phasing of the reform programme (see below). Complex programmes over several years typically involve 2-3 tranches. As discussed in section 3.1 below, the Bank distinguishes between multi-tranche operations and programmes of single tranche operations.

• **Risk management.** The Bank independently identifies the financial and non-financial risks associated with the programme and ensures that the operation contains appropriate mitigation measures (see below).

• **Disbursements.** DPO funds are disbursed against satisfactory implementation of the programme as assessed by country teams on the ground and signed off by senior management.

### Role of the country assistance strategy

As noted above, the appropriateness of providing DPO to a country is generally determined in the context of the CAS. The CAS document sets the strategic context for all of the Bank’s individual lending operations in the country. The preparation of a CAS involves assessing the country’s macroeconomic policy framework and the country’s priorities across a wide range of possible structural areas. In making its assessment of the macroeconomic policy framework, the Bank takes actively into consideration the views of the IMF and normally regards the presence of an on-track IMF-supported programme as a pre-condition in its determination that the country’s macroeconomic policies are likely to achieve sustainable balance over the medium term. For a DPO to a sub-national entity, the state or region must have an appropriate expenditure programme in place, as well as appropriate fiscal arrangements with the central government.

A DPO draws upon analytical work on the country produced by the Bank’s own Economic and Sector work (ESW) on the country or on that of others (particularly where there are Joint Assistance Strategy initiatives with other aid providers) including relevant analyses of the country’s public expenditure management, and financial accountability systems.

All Country Assistance Strategies take as their starting point the country’s own vision of its development goals and its strategy for achieving them. For IDA-eligible countries, the vision is usually set out in a poverty reduction strategy (PRS). Low-income countries have in recent years received IDA support through DPOs in five major areas of reform: public sector governance and public financial management; private sector-led growth; human development; environmental and natural resource management; and economic

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\(^{17}\) The Bank’s annual CPIA gauges the quality of a country’s policy and institutional framework in fostering sustainable, poverty-reducing growth and the effective use of development assistance. Using 16 criteria, the CPIA ranks policies from one (low) to six (high).
management, trade and integration. Many IDA-eligible countries have prepared integrated sector strategies, which cover social sectors as well as cross-cutting aspects of development such as infrastructure, private sector development, governance, gender, HIV/AIDS, and the environment, into the national development strategy.

### B.3 Design and management of PBOs

#### Operation structure and tranching

Once the decision is made about which components of the government’s reform programme the DPO will cover the Bank and the government need to agree on the structure of the lending operation among the following three structures: programmatic approach, multi-tranche operation, and single tranche operation:

- **A Programmatic approach** involves a series of single-tranche loans, or grants for supporting a well-defined, medium-term programme. Such a series spans up to four annual operations over a period of four-five years. The programmatic approach captures the medium- to long-term nature of the reforms but allows flexibility to adjust to new information or circumstances. Each programme document indicates the prior actions that have been taken in advance as well as the triggers for subsequent operations in the series. The programmes in question can embrace a wide range of different sectoral areas—e.g. financial sector and telecoms can both be in the same programme.

- **A Multi-tranche operation** sets release conditions for each tranche at the beginning of the operation in the context of a medium-term reform process in which the key policy and institutional actions are fairly well defined. If the actions of one component of the operation can proceed independently of those of other components, the tranche can be “floating”—can be disbursed when the specific conditions for that tranche are satisfied. In choosing between a programmatic approach and a multi-tranche approach “the borrower needs to be aware that the commitment fee of the multi-tranche operation means a higher financial cost.”

- **A Single tranche operation** applies when the prior actions are fully met before the operation is presented to the Board and there is no expectation of a series of loans being necessary. Here too it would generally be expected that the operation is part of a medium-term reform programme. Single tranche operation may be particularly appropriate in a crisis situation in which the government needs financial support to deal with a short-term situation even though the medium-term programme is not yet well specified.

Once there is agreement on the components of the programme and the structure of the operation, the task is to design a set of prior actions, triggers, and benchmarks that will help in clarifying, implementing and monitoring the overall programme supported by the DPO.

- “Prior actions” are actions that are deemed critical to achieving the results of the programme supported by the DPO. Prior actions are taken by a country before

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18 i.e the full commitment fee is payable even though some of the tranche releases may be delayed for some time. (World Bank, 2009a p. 12).
presentation of the operation to the EB and are included in the operation document as legal conditions for disbursement.  

- “Triggers” are the expected prior actions for subsequent operations in the context of a programmatic series of DPOs. These are deemed critical to achieving the results of the programme. Importantly, however, triggers are not legal conditions for disbursement.
- “Benchmarks” are progress markers of programme implementation but they are not legal conditions for disbursement.

The programme document typically includes a programme matrix which summarizes all the prior actions, triggers (in the case of a programmatic series), benchmarks and expected results. Results are the outputs, outcomes or other developmental impacts of a programme. Indicators can be quantitative or qualitative measures of results.

Since 2000 the share of programmatic Bank operations and commitments has risen sharply at the expense of multi-tranche operations. The programmatic approach to PBL—lending based on a limited set of completed critical actions that reflect country priorities—has contributed to establishing a regular review cycle that is aligned with the country’s processes. The programmatic approach allows, to the extent possible, for the alignment of disbursements with the country’s financial needs during the annual budget cycle. In FY07, more than 90 percent of PBL commitments for IDA countries were programmatic. In FY08 and FY09, however, the proportion of single-tranche operations to programmatic operations increased in comparison with previous years, largely as a reflection of the global financial crisis, and the food and fuel crises encountered by low income countries.

**Conditionality**

Based on the application of the Good Practice Principles on conditionality in DPOs, conditionality is supposed to be guided by five principles:

- **Reinforcement of ownership.** DPOs are now more closely aligned with the government’s PRSP or medium-term development strategy;
- **Harmonization.** Ongoing process to establish a donors’ streamlined common monitoring and assessment framework that derives from the government’s medium-term strategy;
- **Customization.** The use of conditionality in DPOs has been increasingly customized to country circumstances and broadly reflects governments’ priorities and strategic interests;
- **Criticality.** The focus of DPOs on the most critical aspects of country reforms; and
- **Transparency and predictability.** The Bank now discloses the content of its DPOs by publishing on line its database on development policy actions that are used as disbursement conditions (http://worldbank.org/dlpretrospective); the Bank also makes all policy documents of operations approved by the EB available for public consultation.

The main modifications in the intended application of conditionality in DPOs in general and PRSCs in particular, in relation to adjustment lending operations prior to 2000 are: (i) greater use of measurable indicators; (ii) less intrusive nature because conditions are drawn increasingly from a country’s own strategy (PRS in the case of PRSCs); (iii) focus on development, as opposed to the correction of imbalances; and (iv) output-based policy

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19 In some cases there can be a pre-agreement release of funds to support Project Preparation and the meeting of Prior actions – these funds then becoming part of the loan when it is eventually agreed.
lending under the PRSC, compared with input-based conditionality under sector adjustment credit.

Indeed, the 2010 IEG evaluation notes that:

- PRSCs have enjoyed a higher level of country ownership compared with preceding structural adjustment lending;
- PRSC operations have been characterized by fewer legally binding conditions than earlier adjustment loans and a gradual decline in programme benchmarks;
- PRSCs have been markedly more flexible than earlier adjustment lending operations as demonstrated by the high number of trigger modifications or actions for subsequent operations;
- The sectoral focus of PRSCs has shifted from macroeconomic adjustment, trade, and private sector development toward public sector management and social service delivery;
- Programme support through PRSCs has been somewhat more stable than under previous adjustment lending.

A summary note on the views of international and local NGOs, and government officials on key conditionality aspects of PRSC operations in Vietnam (expressed at meetings (in September 2007) helps to shed more light on how the changed Bank approach is perceived by CSOs and other stakeholders. Participants recognized that PRSCs had become increasingly aligned to government’s own strategy, noting that the Vietnam PRSCs included economic policy actions that had already had the government’s commitment. At the same time there was an emerging need to strengthen and enable the voice of the civil society to monitor and raise concerns regarding the economic agenda pursued by the PRSCs.

A 2008 report (Cabello et al., 2008) for European CSOs examines six Bank case operations in poor countries (Bangladesh, Malawi, Mozambique, Nicaragua, and Zambia) primarily in the power, agricultural and energy sectors and is critical of the Bank’s streamlined conditionality. According to the authors “the case studies illustrate that privatisation and liberalisation policies, that are neither designed, nor desired by the affected communities or countries, are still pushed through by the World Bank”. (p.33).

Whereas the PRSC has not replaced sector operations, it has played a supporting role in sectoral operations through reinforcing conditionality, without attempting to bring the sectors wholly under the umbrella of the PRSC. The 2010 IEG report (IEG 2010) notes that compared with policy-based loans prior to the introduction of the PRSC, PRSCs have certainly increased the focus on sectors associated with pro-poor service delivery. This is most notable in the health sector, which accounted for 13 percent of all sectoral conditions among the 87 PRSC operations that took place from FY 2001 to FY 2008, compared with only 5.7 percent of conditions among the 92 IDA adjustment operations in the preceding six years (FY 1995–2000). PRSCs also exhibited a considerably greater sectoral emphasis in water supply and sanitation (4.0 percent compared with 0.6 percent) and in education (8.1 percent compared with 3.6 percent). However, despite attention to MDGs, only two fifths of PRSC objectives in education, half in health and less than a fifth in water supply and sanitation had an explicit pro-poor focus.

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An important issue though (going beyond the classification of conditions and how their sectoral focus has changed) is the actual effect that the existence of specific PRSC conditions has had, and the political economy of the process by which conditions are negotiated. For instance, changes in the menu of conditions may reflect a perceived requirement to reflect a particular discourse and sensitivity to objectives, and it needs to be established whether the existence of a condition (or their sectoral distribution) had any actual effect.

**Complementary support**

Technical Assistance (TA) and institutional development strengthening is often provided in parallel with the DPO and is coordinated with it. Typically the Bank provides financing for the parallel TA. Many of the TA operations are in the area of public financial management (PFM), which are critically important for fiduciary considerations. PFM TA support has been provided in particular to fragile states. In conjunction with Bank country operations, Bank staff conduct Public Expenditure Financial Assessment (PEFA) exercises, the results of which form a basis for future capacity building and TA. In addition in 2004 the Statistical Capacity Building Program (StatCap) was set up at the Bank. StatCap provides a sector-wide approach to building capacity for providing reliable and timely data on countries’ core development outcomes. The Bank also provides capacity building for assessing the environmental impact of reform measures including natural resource aspects of DPOs.

**Fiduciary and other risk assessment**

DPOs provide both balance of payments and budget support. Fiduciary risk management in DPO focuses on: (a) flow of funds arrangements that give reasonable assurances that the foreign exchange proceeds from the loan or grant are deposited into an account at the central bank that forms part of the country’s official reserves and the equivalent amount is credited to the government; and (b) the appropriateness of the management of the country’s budgetary resources through its public financial management (PFM) system.

OP 8.60 states that “the borrower is responsible for managing operational risks affecting the development effectiveness of the DPO. The Bank independently identifies the financial and non-financial risks associated with the programme and ensures that the operation contains appropriate mitigation measures and monitorable indicators to track high-probability risks”.

The guidelines (Good Practice Notes) on designing DPOs require that every operation should identify risks, present a strategy for mitigating those risks, and explain why the remaining risks in terms of the developmental benefits are worth taking. Every programme document should include a section on risks and risk management. The checklist of risk factors include country and sector factors: macroeconomic policy framework, political stability and governance, country and civil society ownership, and institutional capacity; external market developments; social and environmental protection system; fiduciary factors: compliance with Bank fiduciary guidelines, and country public financial accountability system; availability and access to information; and internal and other factors including staff skills and supervisory resources.

The initial risk analysis is conducted at the time of the CAS, which typically precedes the DPO. The guidelines also call for incorporating risk control and mitigation into the design of the reform programme. The loan or credit amount needs to reflect the country credit risk and Bank exposure. The programme documents also need to define contingency plans for important risks. As the operation is developed Bank staff are required to revisit the country
credit risk and Bank exposure in the light of the most recent macroeconomic performance and outlook, and present a current analysis of political risk.

The risk management components of the operation that are within the domain of the Bank, can use Bank institutional resources such as the Bank’s Credit Risk Department to help evaluate the country credit risk and Bank exposure. In defining contingency plans for important risks Bank staff are also expected to develop with the government a general understanding of how the programme might be adjusted if, for example, the fiscal position deteriorates significantly. In assessing macroeconomic risks the Bank relies on IMF assessments. In this context a recent review of Bank DPOs notes that there has been excessive focus on past economic performance and sometimes insufficient assessment of medium-term macroeconomic sustainability. The review consequently recommends that the DPOs in future should present a clear assessment of the adequacy of the macroeconomic framework (World Bank, 2009e, p.50).

To ensure that the full amount of the loan proceeds reaches the country’s budget there is a further requirement to review the control environment within which foreign exchange is managed. Bank staff generally rely on the IMF’s most recent safeguards assessment of the borrower’s central bank. Bank staff also review the available published audit reports and financial statements of the central bank. If this assessment is not satisfactory or no safeguards assessment had been carried out, the Bank may apply additional fiduciary arrangements.

Additional fiduciary arrangements may comprise the deposit of loan proceeds into a dedicated account; a periodic audit of the dedicated account; and agreeing on specific purposes for which loan proceeds may or may not be used.

**Management and decision-making practices**

This section reviews how the decision to use a PBO is undertaken and the involvement of different Bank departments in the process.

The process of the DPO generally begins with the CAS which is developed by the Bank country team (in some cases this is done as a joint strategy with other development agencies). The CAS sets the strategic context of all Bank lending operations to an individual country. The CAS also identifies and justifies DPO operations including total volume of development policy lending. The CAS goes through a detailed internal review process, first within the region and later with other departments and units, and the regional operations committee. At the end of this process, which can be cumbersome and at times result in a somewhat diluted document, the CAS is presented to the EB for approval.

The DPO process starts with the **identification stage**, which includes terms of reference for the identification or preparation mission, a pre-mission *Issues Paper*, and a back-to-office report. Next is the concept stage in which a programme document and a Program Information Document (PID) are prepared. These documents are then circulated and a concept review meeting takes place. The PID is made publicly available at an early stage. The region invites the networks involved and other interested units from outside the region, including the Operations Policy and Country Services (OPCS), all of whom are encouraged to flag issues and engage early on with the task team. The draft legal documents are prepared and the IMF is asked to provide a note on its relations with the country.
The next stage is the preparation stage in which the programme appraisal document (PAD) and letter of development policy are drafted and circulated for corporate review to the Regional Operations Committee (ROC) or (in some cases such as high risk or substantial departure from the CAS), to the Operations Committee (OC). The level of the corporate review (ROC or OC) is decided by the region in consultation with OPCS. ROC reviews are chaired by the regional vice president and OC reviews by the Managing Director in charge of the region. The ROC or OC decides whether to proceed with the proposed operation, and authorizes appraisal and determines if further authorization is required for subsequent steps, including negotiations. Importantly, the corporate review considers whether the risk mitigation strategy of an operation is adequate.

At the appraisal stage, terms of reference are prepared for an appraisal mission, and the country is notified. The appraisal details the final version of the proposed operation. Then negotiations take place in the field or at headquarters at the end of which a statutory committee report is prepared by legal staff and the package of the operation is cleared by management and sent by the Secretary’s Department to the EB. The borrowing country prepares a Letter of Development Policy which is included in the loan documentation presented to the EB. Prior to the formal EB meeting there is a pre-board meeting with Executive Directors. Once the EB meets and approves the operation the borrowing country is notified, the credit/loan documents are signed and tranches are released in accordance with the programme design. In a multiple-tranche DPO, for each tranche after the first one, the Bank prepares a Tranche Release Document that reports on the status of the programme supported under the operation.

Supervision of a DPO covers monitoring, evaluative review, and reporting.21 These are designed to: (a) ascertain whether the borrower is carrying out the programme so as to achieve its development objectives in conformity with the legal agreement; (b) identify problems as they arise and recommend ways to resolve them; (c) recommend changes in programme concept or design, as the programme evolves or circumstances change; (d) identify key risks to programme sustainability and recommend appropriate risk management actions to the borrower; and (e) prepare the Bank’s Implementation Completion Report (ICR), and draw lessons to improve the design and policies of future operations.

In supervising a DPO, the task team monitors the country’s overall economic performance and the timely adoption of programme conditions. For multi-tranche operations, the team assesses progress toward meeting the conditions for release of the next tranche. For programmatic operations, the task team assesses the borrower’s progress in implementing the expected actions for the subsequent operation in the series. The task team also validates the borrower’s M&E findings on the progress and results of programme implementation.

The increasing use of programmatic operations in recent years has contributed to a shortening of processing time: processing time of DPOs has been reduced from an average of 10 months in IBRD and 7 months in IDA in FY05 to around five months in FY09.

The amount of the loan or credit under a DPO is determined on the basis of considerations of country credit risk and Bank exposure. In exceptional cases supplementary financing may be provided for a DPO for which an unanticipated financing gap jeopardizes a reform programme that is otherwise proceeding on schedule and in compliance with the agreed policy agenda. As part of the operational policy change of 2004, the 25 percent ceiling for the Bank-wide share of PBL was removed and substituted by an annual report by Bank

21 See BP 8.60 – Development Policy Lending.
Management on the anticipated Bank-wide share of DPL in total lending. On this basis, EDs would issue guidelines for the average annual Bank-wide share of DPL on a rolling three-year basis.

In the context of the IDA15 Replenishment discussions, it was agreed that Bank Management would seek additional guidance from IDA EDs if the projected share of DPO commitments exceeds 30 percent for any future year.

The country office and the country director (CD) play a major role in the identification of DPOs, first in the context of the CAS and later in the operations themselves. The CD is the primary Bank official responsible for managing a country's lending and non-lending portfolio. In many cases, CDs reside and work in one of the countries within their jurisdiction. In Africa in particular, one CD often oversees operations in more than one borrowing country. In addition to fulfilling this key role, the CD is also responsible for maintaining diplomatic relationships with host governments in coordination with the regional management team (which includes country managers, country coordinators, senior operations officers, sector directors, etc.).

Monitoring and evaluation

This section reviews the monitoring and reporting procedures and the Bank's internal and independent evaluation system.

Monitoring of PBOs

The main instruments for conducting the evaluation of results are the borrower’s evaluation of the programme at completion and the Bank’s Implementation Completion Report (ICR). Paragraph 23 of the Bank's BP 8.60 stipulates that the task team should prepare an ICR on completion of an operation. For programmatic development policy lending, a simplified ICR is prepared after each operation and a full ICR on completion of the programme. The ICR assesses (a) the degree to which the programme achieved its development objectives and outputs as set out in the programme documents; (b) other significant outcomes and impacts; (c) prospects for the programme’s sustainability; and (d) Bank and borrower performance, including compliance with relevant Bank policies. It draws on the data and analysis to substantiate these assessments, and it identifies the lessons learned from implementation. The Good Practice Note for Development Policy Lending on results in DPL suggests that the ICR also evaluate the performance of borrower M&E systems and of capacity improvements.

To guide monitoring and assessment of performance three key features are called for under the GPN: a results framework, a system of performance indicators for M&E and arrangements for collecting and using M&E. A results framework lays out the objectives of the operation and the causal relationships and underlying assumptions about how the programme actions will lead to the intended outcome. The results framework is expected to be summarized in a programme matrix. The programme matrix communicates the key relationships in the results framework of the operation. It includes a definition of programme objectives and a selection of the results that are expected to be directly influenced or achieved by the operation; actions that are expected to bring about the desired results, including prior actions, triggers and tranche-release conditions, when applicable; and results indicators with baselines and targets to measure progress along the way and at completion.

The programme matrix consists of three basic components: actions, results and indicators together with time-bound targets and dated baselines and target values for the indicators. Bank guidelines require that indicators should be reliable, valid, comparable, specific, measurable, realistic and targeted. To be a useful tool guiding the process of implementation
and measuring the impact of an operation the set of indicators need to be carefully selected and should track the key links in the causal chains underlying the results framework.

Multiple-tranche DPOs should set out the conditions for each tranche at the beginning of the operation. The programme matrix contains end-of-programme results that will be monitorable at the time of completion. Bank staff are encouraged to include, where possible, intermediate results and indicators to allow regular and more frequent tracking of progress.

For programmatic DPOs in which the operations are linked to a medium-term framework, end-of-series results should be selected. In addition, policy actions for the next operation should be identified as triggers on which the Bank would base its decision to proceed with the next operation.

Single-tranche DPOs, while having a shorter time horizon, are also required to include end-of-programme results that will be monitorable at the time of completion in the programme matrix. The programme matrix should have an additional column on medium-term policies and expected outcomes of the government’s programme (outside the timeframe of the operation) with indication how the results will be monitored.

In the context of joint budget support groups, the Bank has moved to harmonize its processes and operations with the multi-donor budget support (MDBS) operations. The joint reform actions are summarized in performance assessment frameworks (PAFs) which are supposed to be based on the policies and outcomes of the government’s development strategy. However, the 2009 retrospective report of the Bank’s OPCS notes that governments and CSOs tend to perceive the PAF as a collection of individual donors’ matrices and not as an integrated package. Other difficulties with donor harmonization have also been flagged. The main difficulty is with the rigidity of the harmonization framework stemming from the differences in approaches of different donors. Where the MDBS framework is at an advanced stage, it has sometimes been difficult to adjust the content of the PAF to reflect new or emerging structural or medium-term issues, such as the food and financial crises.

Evaluation of PBOs
The Bank has elaborate internal and external review frameworks under which periodic reviews of its DPOs are audited and analysed.

The mandate of the Bank’s Independent Evaluation Group, IEG\textsuperscript{22} is: (a) Making periodic assessments of the adequacy and effectiveness of the Bank’s operations; and (b) carrying out reviews of the Bank’s completion reports and other self-evaluations, and undertaking performance assessments on selected completed projects, impact evaluations, and evaluation studies focusing on ongoing or completed operational programmes, policies, strategies, processes, and partnerships. To discharge these functions, IEG has unrestricted access to the staff and records of the Bank. The IEG has also a capacity building function in assisting member countries and development partners to develop their own operations evaluation capacities. All IEG reports are available on the external web site of the Bank.

\textsuperscript{22} The IEG reports to the Board and not to the Bank’s management and is not answerable to the President; at least one previous head of IEG fought off an attempt by the Bank President to have him fired.
IEG's ICR reviews assess Bank-supported projects on a number of dimensions. The primary rating is on an operation’s outcome, or the extent to which its major relevant objectives were, or are expected to be, achieved efficiently. These outcomes are rated on a six-point scale, ranging from "no shortcomings" to "severe shortcomings".

The Annual Review of Development Effectiveness (ARDE) highlights the findings of recent IEG evaluations around a common theme, synthesizing lessons that can be used to increase the development effectiveness of World Bank assistance. Recent reviews in the series have focused on the World Bank’s contribution to poverty reduction, how the Bank's programmes are helping client countries achieve the Millennium Development Goals, and the effectiveness of Bank support for policy reform.

The Biennial Report on Operations Evaluation reviews the progress, status, and prospects for monitoring and evaluating the development effectiveness of World Bank activities and examines how effectively evaluation findings are used to improve results and enhance accountability.

Country Assistance Evaluations\(^{23}\) examine the performance of programmes and projects in a particular country, usually over the past 10 years, against the objectives laid out in the Bank’s Country Assistance Strategy and the country’s own development priorities.

Sector and Thematic Reviews examine performance and experience in a specific sector (such as agriculture, transportation, or education) or thematic area (e.g., poverty, gender) over 5–10 years. These reviews report on how performance conforms to the Bank's policy and practice, as well as on the development effectiveness of the Bank’s activities.

Most recently, the IEG carried out a review of experience with PRSC (2010); prior to this report it conducted a similar review of PRSC in 2005. IEG reviews are generally examined by a team of outside experts and its assessment is also published with the report. The importance of independent evaluations is highlighted by the observation in the 2010 IEG report that staff ratings of PRSC performance tended to be more rosy than those of IEG—staff rated 76 percent of PRSCs as satisfactory, while IEG rated only 49 percent as satisfactory (Table 6.10, p. 82).

Operations Policy and Country Services supports World Bank operations at the interface of the Board, Senior Management, and the operations complex. Its main functions are: (a) on policy OPCS works with Senior Management to support the Board in its policymaking role by proposing policies and policy revisions designed to adapt the Bank’s work to an evolving development agenda;

(b) on strategy OPCS supports Senior Management and Bank teams with advice, reviews, and knowledge-sharing on the country- and sector-level strategies that provide the framework for operations. OPCS also coordinates the development and implementation of strategies for particular groups of countries, such as middle-income countries and small states;

(c) on operations, OPCS provides upstream reviews and advice, as well as hands-on assistance, in a wide range of areas that are central to Bank operations, including financial management and procurement, investment and development policy operations, non-lending services, and safeguards; and

\(^{23}\) Prior to 2000 such reports were called Country Assistance Reviews.
(d) on corporate priorities, OPCS spearheads the Bank’s work in areas of corporate and international priority, including, the harmonization and alignment agenda, and the results agenda.

As part of its functions the OPCS, carries out periodic reviews of DPO. Most recently, it carried out a review entitled: 2009 Development Policy Lending Retrospective, Flexibility, Customization and Results. This report updates a similar report carried out in 2006. In 2005 OPCS carried out a review of conditionality, which led to the development of good practice principles for the application of conditionality in 2007.

B.4 PBOs in fragile and post-conflict contexts

The PRSC evaluation (IEG, 2010) noted that a high level of fiduciary capability and overall good country performance has been an explicit part of PRSC selection strategy in the Africa region where PRSCs became a reward for sustained reform. This may have introduced a bias to the disadvantage of countries with a new commitment to reform but without such an obvious track record.

The term *Fragile State* at the Bank refers to countries with Country Policy and Institutional Assessment (CPIA) ratings of 3.2 and below (compared with 3.0 at the AfDB). From a financing perspective, IDA classifies fragile states into: (i) those receiving IDA resources through the Performance-Based Allocation (PBA) system; (ii) those qualifying for exceptional post-conflict allocations; (iii) those qualifying for exceptional allocations upon re-engaging with IDA after a prolonged period of inactivity; and (iv) those in “non-accrual” status (that is with payment arrears of more than six months). The list of fragile states is updated annually, based on the computation of the countries’ individual CPIAs.

The Bank has recognised that countries affected by crisis or conflict may require a quick response from it even though there may be insufficient time or country capacity to adequately address design considerations or develop a strong policy programme with stakeholder consultations. In such circumstances, DPOs are justified on an exceptional basis and the Bank may process them for both IBRD and IDA countries on an accelerated basis with accelerated processing and internal review. In seeking EB approval of such operations, Bank staff are required to describe in the programme document when and how remaining design considerations would be addressed.²⁴

The Good Practice Note (GPN) on CAS in fragile states offers four differentiated approaches across the spectrum of fragile states:

- **Deterioration.** Interim strategy in these cases focuses on stemming the decline in governance and social services, and contributing to multi-donor conflict-prevention efforts. It provides limited new financing.
- **Prolonged crisis or impasse.** The Interim strategy here focuses on maintaining operational readiness for re-engagement and providing economic inputs to early

²⁴ The Good Practice Note (World Bank, 2005b, p. vii) notes that the Bank “is still learning what approaches work in fragile state contexts. Going forward, it will be critical that the Bank continue to evaluate operational experiences carefully and adjust and improve approaches based on lessons learned.”
reconciliation dialogue. It provides small grant-based finance through non-government recipients for local development and service delivery

- **Post-conflict or political transition.** Interim strategy in these cases focuses on rebuilding state capacity and accountability, and delivering rapid visible development results. It can provide exceptional IDA allocations.

- **Gradual improvement.** The CAS in these cases focuses on building state capacity and accountability to boost support for reform. It can provide moderate IDA allocations.

Between FY06 and FY09, macroeconomic management, fiscal transparency and institution building were the objectives of grants to four countries that had stopped receiving budget support from the donor community (Central African Republic, Côte d’Ivoire, Liberia and Togo). However, these countries sought support mainly to clear arrears to the World Bank and other multilateral and bilateral creditors so that donors could re-engage. The 2009 Operations Policy and Country Services (OPCS) retrospective report notes (World Bank 2009e, p.13) that “these operations and their very limited and light policy content illustrate a tension inherent in the use of the DPL instrument for clearing arrears”.

The Bank’s focus in fragile and conflict-affected states has often included support for service delivery—most frequently in the education and health sectors. DPOs in Sierra Leone and Burundi have supported efforts to align the budget with the PRSP and, in particular have monitored budget shares to health and education (Sierra Leone), or pro-poor expenditures (Burundi).

The DPOs to fragile states in recent years have dealt with weak PFM systems and have helped to provide PFM assistance prominently, with technical assistance provided by a parallel project. In this context the IEG has evaluated as “satisfactory” the “Re-engagement and Institution Building Support Program” DPO in the Central African Republic (CAR), which facilitated an IMF medium-term supported programme and two additional DPOs from the Bank.

**B.5 Findings from evaluation of PRSCs**

The 2010 IEG evaluation of Bank support under PRSCs concludes that “upstream harmonization of the PRS process and its integration in the policy matrix has been limited.” The evaluation also notes that in many large budget support groups the Bank had limited influence in shaping the overall agenda. It observes that “more also remains to be achieved in the harmonization of results indicators, capacity building, and in reporting arrangements (IEG, 2010, p. xvii). Explaining the difficulties of harmonization and their high transaction costs, which are not always recognized and sometimes crowd out substantive issues, the IEG evaluation report finds that the Bank has sometimes reverted to means outside the joint matrix to achieve its objectives.

The recent retrospective report of OPCS notes that during consultations some governments voiced concerns about the rigidity of the harmonization framework. These difficulties have emerged at the time when there was a need to adjust the content of performance assessment frameworks (PAF) to reflect new structures or issues that have arisen as a result of the food and financial crisis. (Box 6, p. 35 of the 2009 OPSC report).

Stakeholders indicated that budget support provided through the PRSCs has been fairly or very predictable (that is, over the short-term or in-year). Shortfalls were not a major issue.
Yet other donors have managed to achieve a higher proportion of first quarter disbursements than the Bank did. This may suggest that the Bank is rather more rigid than others in its enforcement of conditionality. Data from the Strategic Partnership with Africa Budget Support Working Group, which compares commitment and disbursement data for 11 African PRSC countries, show that close to half of total budget support aid was committed for the first quarter (49 percent). Most of this (42 percent) was disbursed. By the last quarter, disbursement proportions exceeded commitments. Disbursement delays may also be due to lags in country actions for loan effectiveness. However, good alignment has required not only matching disbursement with the expenditure cycle but, ideally, matching the annual budget preparation and review cycle with PRSC preparation and follow up. This latter matching has evidently been much more difficult to achieve.

Nonetheless, aid flows from all sources have improved in predictability in recent years (see IEG 2010 evaluation). PRSC countries did benefit, though not dramatically, from greater stability in year-to-year aid flows, perceptibly, increased stability in volume, and a more stable share of fast-disbursing funds in total Bank resources. These conclusions change little if non-PRSC policy-based lending is included with PRSCs. Quarterly regularity was good although not optimal for budget planning. Governments generally also saw room for improvement in terms of timing of disbursements, the level of co-financer resources that would be available and the ability to commit finances beyond the current year.

The IEG evaluation observes that borrowing countries strongly concur that the PRSC is well-aligned with countries’ development strategies and overwhelmingly note that alignment had improved over time, as government teams had gained knowledge of the PRSC and work with Bank counterparts. Task team leaders also consider that alignment of broad directions has been very good (95 percent agreement) and a majority (56 percent) affirm that alignment has improved over time.25 PRSCs have been selective about the areas of the PRSPs that they emphasize, sometimes including themes (in the sense of specifying actions in the policy framework) beyond the scope of PRSPs. About half of surveyed clients (54 percent) believe that the PRSC introduced new elements, outside the national development strategy. Yet, an overwhelming number (91 percent) believe that such contributions have generally been a positive contribution.

An independent evaluation of PRSCs in Vietnam26, which was carried out in 2006, concludes that “there are clear benefits of PRSP support to the government’s reform programme”. The benefits are in the highlighting of the policy dialogue; improving policies and locking-in government’s commitment to specific reforms; speeding up the implementation of policies; and providing additional resources to support policy actions, as well as strong national ownership of the reform agenda. On the less positive side the evaluation notes that PRSCs have been less effective in influencing “strategic breakthroughs and grassroot level reform.”

### B.6 Overall assessment and lessons

The 2004 unification of all policies and guidelines of development policy operations has produced a robust and useful instrument for providing financing and policy advice in support of a country’s medium-term development agenda. The DPO has shown to have flexibility to

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25 IEG independent surveys of task teams and clients as reported in its 2010 evaluation (pp. 54-55).
26 The Independent Evaluation was conducted by Ann Bartholomew and Catherine Dom of Mokoro, Oxford, and summarized in the World Bank 2006 Vietnam Development Report (p.35)
adapt to unexpected changes in circumstances, and the ability to customize--tailor the operation to the country needs. In addition, the production of clear guidelines for the various components of the DPO design and process and streamlining of the approval process have helped to shorten processing time of operations and reduce the number of prior actions. Importantly, they have also helped to make resource flows to countries more predictable and better aligned with the countries’ budget cycle.

DPOs have supported reforms in a broad range of countries with different needs—from middle-income countries to fragile states emerging from conflict. They have supported borrowers in designing and implementing medium-term development programmes and have provided emergency financing to meet crises or exogenous shocks. The programmatic approach of DPOs has allowed the Bank to respond more flexibly to changing country circumstances and government priorities. This flexibility and streamlining of conditions may have been instrumental in strengthening ownership of reforms supported by the Bank.

DPOs have provided financing and policy advice in areas where borrowers lack expertise and technical knowledge. IBRD countries have requested DPOs that focus on single sectors or themes requiring specialized Bank knowledge—such as housing, energy, and climate change. In IDA countries, DPOs have also served as a platform for dialogue, harmonization, and alignment around the key policy and institutional reforms. In both IBRD and IDA countries, the majority of the operations in recent years have supported public sector governance reforms.

DPOs have been associated with positive results and outcomes in the delivery of social services in the sectors of health and education, and in PFM.

While the DPO has proven to be a useful instrument some issues have emerged, as have been highlighted in the IEG evaluation of the PRSC, and the OPCS retrospective. The problems and shortcomings identified relate primarily to the analytical underpinning of operations, programme design, the results framework, and donor harmonization.

- On the analytical underpinning of DPOs, Bank operations are required to draw upon analytical work on the country. The OPCS Retrospective (p. 41 and p. 51) and the IED evaluation (p. xviii and p. 73) noted that in many cases the links between the findings of recent analytical work and the programme were not reflected in the programme design nor were they appropriately articulated in the programme documents.
- On the macroeconomic framework, there has frequently been an excessive focus on past economic performance and sometimes insufficient assessment of sustainability of the macroeconomic framework.
- The poverty and social impact analysis is still not always used effectively to underpin DPOs in determining whether specific policies supported under the operation would have substantive poverty or social impact, what groups are likely to be affected, and what actions can be taken to mitigate such negative effects.
- Results frameworks are key to evaluating the effectiveness of programmes. In practice, the quality of results frameworks in operations has varied; they have not always defined the appropriate causality between the actions supported by the DPO and their expected results. Weaknesses remain in terms of clearly defined and consistent outcome indicators, intermediate milestones, and baseline data; and indicators for poverty outcomes are also lacking.
- A prominent area of weakness has been the public financial management results framework, which was completed or largely completed in only half of the PRSC
operations reviewed (for the 2010 IEG evaluation). Importantly, there is little evidence that PRSCs have improved governance and levels of corruption.

- While all operational policies and guidelines on DPO were unified in 2004, there is some remaining confusion on the relationship between the PRSC and the DPO and the rationale for a distinct title for the former.
- Donor coordination and harmonization remains a problem area. In the context of joint budget support groups, the Bank has moved to harmonize its processes and operations with the MDBS operations. However, it has sometimes been difficult to adjust the content of the PAF to reflect new or emerging structural or medium-term issues, such as a food and financial crises. This is due in large part to the rigidity of the harmonization framework stemming from differences in approaches of different donors.
- The length of the approval process of DPOs has been considerably reduced, but an average processing time of five months is still regarded as too long.
- Finally, a great deal has been done to enhance ownership of reform programmes and streamline conditionality by aligning DPOs with countries’ reform programmes and through a reduction in the number of prior actions and other means. However, there are still in practice important tensions between ownership and the use of conditionality conceived as a means to effect policy change.

The Bank has demonstrated an ability to adapt to changes in the global economy and to views and needs of stakeholders. While structural adjustment programmes in the 1980s aimed at correcting major macroeconomic distortions that were hindering development, more recent operations have focused public sector management and governance, and reforms in the social sectors, particularly health and education. The DPO has served as a robust but flexible instrument in support of both IDA and IBRD countries moving away from the “one size fits all” approach. While the Bank appears to have been effective in improving its processes, its impact on outcomes is less clear. Hence lessons going forward relate to the analytic underpinning of programmes and programme design, the results framework, and to establishing or reinforcing the link between DPO measures and economic growth and poverty alleviation outcomes.

**Analytic underpinning and programme design.** There is a need to pay greater attention to growth and poverty analysis and to demonstrate how the programme would help to enhance economic growth and reduce poverty, through the establishment of a growth strategy. This is particularly pertinent given the ongoing debate on aid effectiveness. The macroeconomic framework should be better integrated to the programme design, and be more forward looking with greater focus on macroeconomic sustainability.

**PFM reform.** In view of the mixed results with many aspects of PFM reforms in DPOs, there should be a reassessment of their effectiveness and perhaps greater attention should be paid to TA and capacity building, in coordination with the IMF and other donors.

**Results framework.** The results framework is a critical component of the DPO. However, its current application does not always demonstrate the link between programme measures and outcomes. There is a need to reinforce the results framework in Bank supported programmes. In particular, a greater effort is required to link programme actions with economic growth and poverty alleviation.

The Bank’s audit and evaluation system of effectiveness of DPOs has played a useful role in its improvements in recent years. It is important to continue to critically assess the effectiveness of DPO through internal, independent and external reviews and strengthen modalities and, when necessary, develop new modalities to improve outcomes.
The World Bank has made significant progress in the development of a single principal instrument for policy based operations, and in addressing some of the shortcomings of structural adjustment approaches. The World Bank has a highly flexible instrument and is not constrained by ad hoc limits on the composition of its lending. By contrast, the AfDB still has a number of different instruments developed over a long period of time whose relationship to each other is not fully clear, and for which complete guidance remains to be developed. The World Bank’s example shows the case for rationalisation of the range of instruments as well as the development of comprehensive guidance.

Generally and partly as a result of changes in Bank practice, national ownership of poverty reduction strategies has strengthened and the World Bank’s policy based operations are regarded as generally closely aligned to national policy priorities. There are clear procedures and guidance on each aspect of planning and implementation, and a very strong focus on monitoring and evaluation. The programmatic approach, with linked single tranche operations, appears to be a preferred mode of operation in many circumstances, and may provide more flexibility than multi-tranche, multiyear operations.

Despite this progress, some significant difficulties remain particularly around harmonization, and in establishing the link between Bank support and development outcomes. There appears (as with the AfDB) to be a tendency to judge the focus (and hence the planned results) of an operation on the basis of the actions specified in the policy matrix, although the logic linking the inclusion of any particular actions with the impact of the funding provided may be tenuous, particularly since the approach to conditionality as embodied in the conditionality principles is that external agencies generally have little capacity to exert leverage on policy and that when such leverage is applied it may be counterproductive.
Annex C  Case Study of PBOs in the European Commission

C.1 Overview of use of PBOs

The main PBO instruments used by the European Commission (EC) are Budget Support that includes both General Budget Support and Sector Budget Support (SBS). In the earlier generations of PBLs, in the 1980s, the EC in common with the regional development banks did contribute to programmes involving macroeconomic conditionality often in support of the structural adjustment lending (SAL) of the World Bank and the IMF. In recent years the PBOs of the European Union have evolved to have a much more central focus on General Budget Support and various types of Sector Support. This present review of EC practice reflects this more recent emphasis, as well as more general developments in EC aid policy as summarised in Box C.1.

Schmidt (2006, pp 4-5) characterises the EC's budget support (in terms of the underlying concept and objectives, if not necessarily of practice) as follows:

- As a rule the EC's budget support is direct and untargeted, i.e. the support provided is channelled directly to the recipient government's single treasury account for budget implementation and is not earmarked for any specific use.
- The EC’s budget support programs are normally designed for three years in order to increase predictability. EC budget support is disbursed in several tranches, with a distinction made between fixed and variable tranches. Normally, a fixed and a variable tranche will be released each financial year. Disbursement is conditioned on the implementation of a macroeconomic reform program and on good results on performance indicators, respectively.
- The aim of budget support is to assist partner countries in implementing their PRSPs. This requires the programs to be aligned materially and procedurally to national PRSP and budget calendars.
- The EC’s budget support replaces traditional ex ante conditionality with performance-based ex post conditionality. The link between performance and disbursement is established through a gradual disbursement mechanism.
- Priority is accorded to overall assessment and improvement of partner public financial management systems.
- In this respect donor coordination has become more important than ever before.

27 In its revised Guidelines published in 2007, the EU replaced the phrase “Macroeconomic Budget support” by the term General Budget Support” (or GBS). The previous guidelines from 2002 gave GBS (or macroeconomic budget support) three objectives namely (i) support to economic reforms; (ii) ad-hoc complementary support; and (iii) emergency aid for stabilisation and rehabilitation. In the new 2007 guidelines the objectives were simplified to cover either medium-term objectives (to support a development or reform policy and strategy) or short-term objectives (to support stabilisation and rehabilitation). See, Europeaid, Guidelines on the Programming, Design & Management of General Budget Support, January 2007 p. 8.
Box C.1 Recent developments in EC aid

In recent years the EC has committed itself to a number of initiatives to improve its own performance in aid delivery and to respond to criticisms from the European Parliament and elsewhere that the EU’s role as a major player has not always translated into effective leadership. In particular, in December 2005, the Commission, the Council, the European Parliament (EP) and the Member States approved the European Consensus on Development. The Consensus provides a common vision of values, objectives, principles and means to development for both member states’ bilateral efforts and the EC. Then in May 2007, the Council also approved the EU Code of Conduct on Complementarity and Division of Labour in Development Policy. The Code contains 11 guiding principles for a better division of labour among EU donors and for a global presence of the EU in developing countries. If implemented as intended, its impact could be considerable in limiting the number of donors involved in any one country or sector.

The Commission itself has also undergone important reforms since the late 1990s to turn itself into a more effective development institution. These include the establishment of the EuropeAid office as the single implementing agency, the introduction of Country Strategy Papers (CSPs) as a core planning mechanism, and the shift of more responsibilities from headquarters in Brussels to EC delegations in partner countries. The EC has also introduced and refined a series of financial instruments to simplify a system of relatively complex and burdensome structures and to facilitate greater coherence and consistency. The number of regulations that govern external cooperation has been reduced from more than 35 to a total of nine instruments. However these reforms have not yet included the consolidation of the EDF system within the main budget of the EU.


The European Commission provides two types of budget support, both of which are used to finance national budgets. They are both based on the same eligibility criteria, but differ in their goals. These are:

(A). General Budget Support (GBS) where funds are transferred to the general budget without being earmarked for pre-identified purposes.

(B). Sector Budget Support (SBS) which also involves a transfer of funds to the general budget without allocation to pre-identified purposes; but designed to support policy implementation in specific sectors.

Table C.1 summarises information on the use of budget support as a share of total EC aid commitments.

Table C.1 EC Use of Budget Support, 2005-2008 (€ million)

<table>
<thead>
<tr>
<th>Aid modality</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>External aid commitments total (€ million)¹</td>
<td>7,349</td>
<td>9,148</td>
<td>9,339</td>
<td>11,229</td>
</tr>
<tr>
<td>General Budget Support</td>
<td>906</td>
<td>366</td>
<td>715</td>
<td>2,382</td>
</tr>
<tr>
<td>Percentage of ODA Budget Support</td>
<td>12%</td>
<td>4%</td>
<td>8%</td>
<td>21%</td>
</tr>
</tbody>
</table>

Source: EuropeAid, Annual Reports, table of sectoral breakdown per instrument, 2004-2009
C.2 Policy and guidance on PBOs

The EC currently distributes aid using four major but different mechanisms, namely: project aid, sector programme aid, general budget support and sectoral budget support. The last two of these are together referred to as “budget support” in most official documents. The EC has for some time been promoting the use of budget support as its preferred mechanism and has more ambitious internal targets than those set out in the Paris Declaration. The reasoning behind this is as follows:

“… where circumstances permit, the use of general or sectoral budget support should increase as a means to strengthen ownership, support partner’s national accountability and procedures, to finance national poverty reduction strategies (PRS) (including operating costs of health and education budgets) and to promote sound and transparent management of public finances.” (European Commission, 2005: p10)

However, it is noted that the EC literature rarely if ever uses the terms “Policy-based Lending” (PBL) or “Policy-based Operations” (PBO) as such. The EC followed the broad international trend from financing and economic stabilisation alone to poverty-oriented macro-economic support from 1995, when it made budget support a specific form of programme aid. However, Folscher et al. (2008) report that prior to 2007, there were 30 legal community-based instruments in place of some relevance to this topic in addition to the European Development Funds. After 2007 the community-based instruments were streamlined into a more simple structure of regional and horizontal instruments. It is noted also that the legal bases for EC support were changed from January 2007. From this date onwards a number of new instruments were introduced, including three main instruments that include budget support as a financing modality: the Development Cooperation Instrument (DCI), the European Neighbourhood and Partnership Instrument (ENPI), the Pre-Accession Instrument (IPA), and the Instrument for Stability (IfS).

Budget support is used by the EU as a way of implementing aid only in countries satisfying a variety of eligibility criteria. But an overriding consideration is that democracy, human rights and governance are regarded as essential elements of EU cooperation, as provided for in Article 9 of the Cotonou Agreement. Indeed, that agreement authorises the suspension of all forms of EU aid - not only budget support, if this is justified by adverse changes in the general governance context (Article 96). Using this authority, EC aid has on occasion been suspended. For example, this happened in the case of Cameroon under the 9th EDF, and also in the cases of Guinea-Bissau, Malawi and Chad.

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28 These are additional to explicit balance-of-payments-support operations. These in turn consist of the provision of convertible currencies to augment imports or for debt servicing purposes. By contrast, budget support aims to finance state expenditure in priority development sectors. The qualitative monitoring of this financing process and its outcomes is a key ingredient in this approach (Hauck et al 2005).

29 The European Union subscribed to the commitments of the Paris Declaration but also established even more ambitious objectives. In particular it committed to channelling 50% of the EU’s programmable aid (from Member States and the Commission) through national systems in developing countries and to increasing the percentage of aid provided in the form of budget support and sectoral programmes. However, it is noted also that programmable aid represents only 50% of the overall aid provided by the EC, (EU (2008) p. 14.

30 GBS Guidelines p. 28. Table 3.2 in the Guidelines provides full detail of which countries are potentially eligible under which instrument.
The EU began providing budget support to their main group of client developing countries – the 79 ACP signatories of the Cotonou agreement - with EDF No.7 (1990-1995). Thereafter, the use of these instruments was widened with the EDF No 9 (2001-2007) in which budget support grew to represent approximately 30 % of total funding. This upward trend continues, with budget support expected to reach approximately 45 % of programmable aid under the EDF No.10 (2008-2013). The total budget support to the ACP countries increased from €681 million per annum in 2002 to € 795 million by 2007.

C.3 Design and management of PBOs

Common procedures and guidelines

The EC framework for deciding on and delivering General Budget Support (GBS), Sector Budget Support (SBS) as well as for Sector Policy Support Programmes (SPSP) has been evolving along with the EC’s overall approach to the delivery of aid (see Box 3.1 below). That framework begins with the Country Strategy Paper (CSP) for each recipient country (i.e. up to 128-140 countries in total). The process of developing each CSP is led by the staff of DG Development or DG External Relations (Relex), working in conjunction with the in-country EU Delegation and the partner government. This also involves consultations with both local stakeholders and other donors. The work is undertaken according to the procedures defined in the EU’s “Common Framework” for the preparation of Country Strategy Papers. Since GBS is believed to provide a unique opportunity to maintain dialogue around the overall policy priorities of the partner country and to support its broad reform process, its proposed use by the EC can be – and often is - included explicitly in the Country Strategy Paper. However, the actual decision about whether to make use of such an instrument is based on a comparison between the expected benefits and risks for the objectives set out in the CSP. As regards sector programmes (SBSs and SPSPs), the guidelines for the Common Framework for the CSP establish that wherever possible, the focus on individual projects should be gradually replaced by a sector programme or policy-based approach. Where this approach can indeed be adopted, the EC obtains potentially more traction over the policies in particular sectors than can be achieved on a project-by-project approach.

In the cases of both GBS and the Sector programmes, the EC refers to seven main areas of assessment to guide the decisions to proceed or to hold back. These diverge somewhat in their precise definitions in the two cases but do have much useful commonality. For example, a reasonable degree of macroeconomic stability, an improving system of public finance management and the willingness/ability of the country authorities to use outcome-based performance measurement to assess progress with the EC programmes are present in both cases. But in the sectoral programmes the emphasis of the assessments is shifted, not surprisingly, away from broad national strategies to sectoral ones.

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31 It is not clear how many actually have CSPs in operation at any one time but in 2008 the EC was delivering budget support programmes in 55 of the 140 countries in which it worked (Richelle, 2009).

32 This is done by the partner country including GBS in their response strategy and indicative programme as provided to the EC. The country needs to clearly indicate the bases of this decision in terms of the expected benefits of GBS, prospective eligibility and risk of non-utilisation of budget support resources. A contingent statement about “possible future GBS” can be included in Country Strategy Papers where the country concerned does not include the need for it in their response strategy. (General Budget Support Guidelines p. 38)
Beyond this commonality of approach in launching and managing the EC’s involvement, there are obvious divergences in the processes that are applied to GBS and Sector Programmes respectively. So in the remainder of this section they are discussed separately albeit with the common approaches again being emphasised where this seems particularly appropriate.

**The entry decision for GBS: basic assessments**

In its 2007 Guidelines, the EC describes **two** different internal assessments that condition its decision to provide (or not) GBS. These are as follows:

1. The first assessment involves an analysis of the **expected impact** of GBS and its potential contribution to the objectives of the EC’s overall strategy (for the country). The EC recognises explicitly that, by providing financial resources to the national budget, GBS can support the implementation of a national development or reform policy and strategy (such as the PRSP in ACP countries, or National Action Plans in ENPI countries) while also contributing to improved macroeconomic stability. Helped by the dialogue on policy conditions that GBS makes possible, it can in principle also support the goals of national policies and strategies, including stability-oriented macroeconomic policies, and improvements in public financial management. This general proposition then suggests a number of criteria that EC teams consider in making their recommendations. These criteria include: the scope and depth of the reforms that are envisaged; the relative significance of the funds that the EC might provide to the budget; the need to (importance of) improving public financial management; the readiness of the partner government to monitor progress in the reform areas seriously using results/outcome indicators; and the importance of harmonisation (both with partner country systems and with the objectives of joint donor groups). These various elements are used to rank the case for GBS on a scale of from “low” to “high”.

2. The second assessment examines the country’s prospective **eligibility** for budget support and the **risk of difficulty during implementation**: including the risk of non-utilisation of budget support resources. This analysis is typically based on the country’s previous track record with GBS and its likely evolution with respect to the EC’s eligibility criteria. This second assessment seeks to divide countries into **three** categories. These in turn are: (i) **strong candidates** for which the risk of non utilisation of budget support is very limited: typically countries that have received and successfully utilised GBS in the past; (ii) **potential candidate** countries for which there is some risk of non utilisation of budget support: typically countries for whom the prospects of becoming or remaining eligible is fair but somewhat uncertain, or countries that have received GBS in the past but have encountered some difficulties in implementation or countries that have not yet received any GBS and whose eligibility needs to be assessed more closely. This second group of countries is typically investigated further; (iii) **weak candidate** countries for which there is a high risk of non-utilisation of budget and/or where there has been a poor previous record with GBS. It is noted that the risks of **non-disbursement** are combined in this assessment with various **eligibility conditions**.

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33 This is also the first of the seven assessment areas noted earlier.
Country eligibility for GBS

The conditions that the EC uses to establish the eligibility of any country for GBS (and to a lesser extent its sector programmes) are rooted to varying degrees in the different aid instruments described above that are used to provide the funding. However, the EC in its guidelines for GBS (with some overlap to SPSP) refers to three main types of eligibility condition. These three criteria are a part of the seven assessment areas of the common EC framework and they are as follows:

National Policy. The first eligibility criterion is that a well defined national policy and strategy should be in place and also be credible. This is needed because all GBS operations have at their heart the need to support “national development or reform policy and strategy”. (GBS Guidelines pg 29.) It needs to be remembered that the EC regards budget support and the innovations that come with it as a promising means of phasing out old-style structural adjustment programmes based on conditionalities. The EC argues that if this laudable objective is to be achieved and if GBS is to realise its potential benefits a first step must be to assess the extent of commitment to and, above all the “local ownership” of the declared national policy and strategy. There is also some legal pressure to include this first criterion. For example, the new legal instruments as of January 2007 governing aid to the ACP, can be interpreted as requiring a national reform programme to be in place.

Macroeconomic Policy. The second eligibility criterion is that a stability-oriented macroeconomic policy should be in place or under implementation (EC documentation uses the word “implementation” but this probably means “preparation”). The EC argues quite reasonably that budgets prepared within a stable macroeconomic framework will contribute greatly to ensuring the conformity of actual expenditures with budget allocations. In contrast, in the absence of a stable macroeconomic framework, outcomes are likely to diverge significantly from forecasts, and the risk of crisis or a sudden change in fortunes is likely to lead to significant changes in actual expenditures, undermining the programmes that budget support intends to support. Once again there is an additional legal basis for including the criterion.

Public Financial Management. The EC also looks for a credible and relevant programme to improve public financial management. It argues again quite reasonably that “success or failure of implementation of national policies and strategies is strongly affected by the quality of the PFM system.” But it goes further by arguing that it is improvements in PFM and not necessarily the prevailing level of performance that is the critical issues here. Indeed, “one of the objectives of budget support is to enhance the goals of national policy and strategy by strengthening the PFM system”.

34 Hauck, Hasse and Koppensteiner (2005)
35 Article 61 of the Cotonou CPA agreement states that direct budgetary assistance in support of macro-economic or sectoral reforms may be granted if, (i) public expenditure management is sufficiently transparent, accountable and effective and (ii) well defined macro-economic or sectoral policies established by the country itself and agreed to by its main donors are in place. In reality, this and other similar conditions are hard to meet in most ACP countries and, if used as the criteria upon which a decision to use budgetary assistance necessarily had to be based, then very few countries would be eligible for budget support in practice. So, in practice the legal condition seems to be interpreted with some flexibility (Hauck et al 2005)
36 GBS Guidelines pg 30.
In principle these three EC criteria are supposed to be applied as an integrated and coherent whole. This means that trade-offs between poor performance in one area are in principle not supposed to be offset against strong performance elsewhere. In practice this calls for a variety of difficult judgement calls in any country case with the outcomes being only as good as those judgements.

**Fixed and Variable Tranches**

Budget support from the EC is intended to help promote both economic growth and poverty reduction. This has some implications on how funds are transferred. EC budget support can be released in the form of *fixed and variable tranches*. For GBS programmes that are supporting a national agenda of reform (e.g. a PRSP) the conditions for release are related to the content of those programmes. For example in many country operations, the *fixed tranche*, known as the 'all or nothing' component, has often been based on the review by the IMF of its Poverty Reduction and Growth Facility (PRGF). This review assesses whether general conditions, such as a satisfactory macro-economic situation or any specific fiduciary requirements, are in place. The *variable tranche* by contrast is released gradually, depending upon the progress made by the government in meeting agreed poverty reduction targets. In principle, targets can be drawn from the PRSP with measurement usually based on 'outcome indicators' in areas such as education and health. The situation is made somewhat more complex by also factoring in certain targets for public finance management as additional conditions for tranche release in some cases. The balance as between these various conditions can vary on a case-by-case basis and once again involves a large judgmental element. Even in cases where no formal substantive conditions are involved, the process requirements of the EC for audit and similar matters can be a source of delay and critical comment.  

**Management and decision-making practices**

**The Project Cycle**

Both general budget support and sector programmes involve the same cycle of programming and implementation process as followed for other EC development support. These various stages of the decision-making process are summarised in brief as follows:

- **Programming**: This takes place during the drafting of the Country Strategy Paper and involves balancing the importance of realising budget or sector support objectives, against risks and country eligibility as explained more fully above.
- **Identification**: This phase occurs before the formulation of the details of a budget support or sector operation and involves the establishment of a road map, preliminary identification of objectives, purpose, and expected results and complementary inputs and the identification of implementation modalities for the non-financial aspects.
- **Formulation**: This phase involves compiling a complete set of decision-making documentation for the relevant committee. It requires setting out the rationale, a description of the country context, a description of the details of the programme and how it will be implemented.

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37 Hauck et al (2005 )
- **Financing**: This phase involves the formal decision-making on budget or sector support. In the case of EDF facilities, for example, the amounts of the annual tranche(s) are specified in the financing proposal/action fiche which goes to the EDF Committee — there receiving the opinion of the Member States — and then also appear in the ‘technical and administrative provisions’ and the financing agreement, which together constitute the true contract between the government of the beneficiary country. The financing proposal/action fiche also contains the indicative timetable of payments and the prior performance evaluations.38

- **Implementation**: Important aspects of implementation are joint donor assessments and joint donor agreements, promoting ownership and accountability; tranche release decisions and the production of monitoring reports

- **Evaluation**: The Guidelines stipulate that evaluation should be jointly undertaken with other donors providing budget or sector support; the evaluation should be based around a hypothesised causality framework and relevant "evaluation questions" and should be evidence-based.

### Departments and documentation involved39

All phases of the process through programming, identification and formulation are led by the EU country delegations but with regular contact back to headquarters. At specific points, various Quality Support Groups review the documentation to ensure consistency, coherence and quality. At the programming stage, for example, this quality assurance (QA) is carried out by the Inter-service Quality Support Group. The various quality support groups are comprised of senior officials from different commission directorates. The Inter-service Quality Support Group is a permanent inter-service institution which supports programming and the monitoring of programmes. The other two Quality Support groups are convened by Aidco, but include representation from both DG Development and DG Relex.

Following the approval of the decision to provide finance by the relevant management committee the formulation documentation is used as a basis for the financing decision adopted by the Commission.

The documentation that emerges from the programming and approval process includes the following elements:

The decision to use budget or sector support is normally documented and explained in the Country Strategy Paper.

When there is a decision to programme budget, a document referred to as the Identification Fiche is the first formal document that emerges from the process.

During the formulation phase the official programming documentation is prepared. The elements include a Financing Proposal (EDF) or Annual Action Programme/Action Fiche

38 The Commission usually disburses the fixed tranche at the beginning of a financial year and any variable tranche(s) in the middle of the year when, for example, the previous year’s budget performance can be evaluated and input given for the preparation of the following year’s budget. (Michel, Budget Support – Mutual Trust, 2008 pg 40.). For the other countries supported under the DCI and ENPI procedures, the practice is the presentation once a year of an Annual Action Programme which for each country summarises in particular the strategic framework. In addition for each project or programme an Action fiche is also prepared.

39 This section is based on Folscher et al. (2008).
followed by a Financing Agreement including the Technical and Administrative Provisions (TAPs) to be signed jointly with the partner country.

Implementation

Implementation is carried out in three ways:

- There is first an ongoing monitoring of progress on implementation and continued dialogue with the recipient country on issues such as the national or sector strategy and policy, macroeconomic stability, public financial management etc. This is a process for which there is no simple recipe or standard formula. However, the EC over the years has evolved certain principles of good practice which it recommends are followed. These include: the close monitoring of disbursement conditions as an opportunity for a wider debate with the partner country; active use and diagnosis of performance indicators; coordination wherever possible of EC monitoring with national budget timetables and procedures; and the active use of joint donor agreements to help structure the dialogue with partner country and other donors.

- Secondly, periodic reporting to headquarters on these issues takes place.

- Thirdly, periodic submissions of recommendations and decisions on tranche releases are undertaken. Clear links between monitoring and dialogue are expected in these processes. For example the EU delegations are certainly expected to monitor disbursement and performance criteria through dialogue with the partner country.

The disbursement of budget support funds occurs after the recipient country has submitted a request for a tranche release, supported by full documentation to justify the release. The country delegation then prepares a dossier to be submitted to Aidco setting out the conditions for disbursement, assessing whether or not they have been fulfilled and the sources of information used to make such an assessment. The relevant Aidco geographical unit in turn prepares a Note Dossier for the relevant director, who signs a payment decision and sends it to the delegation.

The standard documentation referred to above that recommends and triggers the release of tranches is typically defined by the financial management requirements of the underlying legal instrument. But in addition, a variety of other documentation will commonly be required including:

Regular economic and sector reports. These are reports on the country’s macroeconomic situation and outlook, sectoral performance, as well as structural changes and other major economic, financial and social developments. These reports are required to be sent to Aidco, DG Development and to DG Relex.

An annual report on public financial management. The main purpose of this report is to ensure that the country remains eligible for budget support. It must be valid for at least six months ahead of its publication and should also be sent to Aidco, and the two DGs.

Early warning reports. These reports are only produced when required and they are intended to report any problems or likely problems that could affect the smooth implementation of the budget support programme. Examples of possible component problems are slippages on national policy and strategy, macroeconomic management and public financial management.

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Heads of delegations must be sent such as a report as soon as they become aware of the situation or potential situation. The use of the early warning system is especially important should issues come to light in the time gap between the recommendation by the delegation for a tranche release decision, and the approval by the relevant Director.

**Monitoring, reporting and evaluation**

The EC’s work on direct budget support has been characterised by some commentators as being strongly results-based. (e.g. Hauck et al 2005). However, the recent Mokoro study (Folscher et al, 2008) has characterised the *evaluation* of budget support as the ‘missing leg’ of the Commission’s array of programming, implementation and evaluation instruments. The EC in its own documentation acknowledges the inherent difficulties with undertaking evaluations of GBS and SPSPs. Specifically in their 2007 Guidelines on Aid Delivery Mechanisms, they note that “by virtue of the fact that budget support resources are “mixed” with other resources in the treasury account of a government, it is not possible to identify or attribute certain “outputs” with certain “inputs”, as is the case when using EC procurement procedures. There is consequently an “attribution” problem with evaluating budget support” (EC 2007 pg 74).

As of the date of that 2007 document, no specific, widely recognised, standard methodology for the evaluation of budget support operations had been developed. An evaluation framework was, however, prepared in 2004-2005, on the basis of the standard OECD DAC criteria (relevance, efficiency, effectiveness, sustainability, and impact) and then tested on the budget support provided to seven countries as part of a joint assessment of GBS. Although joint donor country-level evaluations are taking place, these is not yet to a commonly agreed and robust framework and might at times fall short of a properly independent evaluation.

However, certain principles about evaluation seem to be well accepted in the EC if not fully implemented in practice. These include:

- The inherent need for *joint evaluations* both with other contributing donors and with partner governments
- The need to find and use *an evidence base* to establish links between inputs and impacts
- The need to give careful consideration to the *timing of evaluations* to ensure that any conclusions can be taken into account as soon as possible in the design of a subsequent programme.

**C.4 PBOs in fragile and post-conflict contexts**

In the more difficult cases of *fragile states* – especially those suffering or emerging from a recent conflict – the risks associated with any policy based lending are obviously much greater because of ongoing doubts about the quality of governance in many dimensions. The EC seeks to mitigate these risks in two specific ways:

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• First, as regards macroeconomic stability and the overall situation of the national budget, the Commission bases its judgment on the assessments of the IMF, which has the available instruments (such as the PRGF programme) to deal with the inherently greater instability seen in such country cases.

• Second, as regards public-finance management (PFM), the Commission bases itself on prior assessments of the situation carried out either by itself or by other donors (often the World Bank) and a further assessment as to whether the government is giving clear signals that it intends to undertake serious reforms. The Commission, based on its own experience, notes that even positive signals in these areas in fragile political systems might not be translated in practice in the manner needed to allow for the effective use of GBS or SBS.

**Box C.2 EC Approaches to Budget Support in Fragile Situations**

An annex to the European Commission's 2007 guide on general budget support was drafted in 2009 to clarify the methodological approach to budget support for countries in fragile situations (post-conflict, post-crisis). The Commission considers that, in certain circumstances of fragility, budget support is the most appropriate aid instrument to underpin stabilisation and avoid deterioration of the economic and political situation.

However, it is often hard for such countries to meet the eligibility criteria for obtaining budget support. Thus, while under 'classical' budget support programmes the beneficiary countries need to have a poverty reduction strategy in place, countries in fragile situations need to demonstrate that they make satisfactory progress in the PRSP process. All other eligibility criteria remain the same.

On PFM, the baseline situation will have to be determined (e.g. through PEFA assessments or work done by the IMF Fiscal Affairs Department) and basic functions of a PFM system need to be in place to ensure transparent execution of public resources (the "ultra-basics elements") before BS can be provided. The relevance and sequencing of the PFM reform plans will also have to be scrutinised. In the course of the programme implementation, progress made against the initial situation will be assessed so as to confirm eligibility in accordance with the dynamic interpretation before any disbursement.

Coordination with the other donors is key to the success of budget support programmes. The role of the IMF, both on the maintenance of macro-stability and on PFM reforms is crucial. To be eligible, countries in fragile situations should have access to an IMF programme. If this is not the case, an assessment letter confirming that a stability oriented macro-economic policy is in place will be required from the IMF.

Programmes will be designed in such a way that risks are mitigated while ensuring a proper use of the "window of opportunity" immediately following a conflict or a crisis situation. Thus programmes can address specific issues such as: targeting or not, the duration of the programmes (e.g. one year), the size of the financial envelope and the specific conditions (pre-conditions and /or variable tranche indicators).

Source: EC (2010, p. 173)

In response to these greater risks the Commission has also opted for a shorter-term approach to aid to fragile states than is normal - providing this for a maximum of one year. This provides the opportunity over this transition period to check that the conditions for more normal support (often over three years) are in place. It is argued that without clear signals in the two areas noted above, the Commission could well be accused of not upholding the
Cotonou criteria. Box C.2 sets out the approach proposed for the provision of budget support in fragile situations.

C.5 Evaluation evidence

One external assessment that focused on budget support is the 2008 study by the London-based Overseas Development Institute (ODI) and supported by evidence from three country case studies. That study (Menocal et al, 2007, 2008) found a mix of improving EC performance and some residual problems. ODI found in general that “...the EC performed relatively well in some areas, such as promoting government ownership and alignment with country priorities, but its procedures tend to be overly complicated and bureaucratic.”

Some of the more specific problem areas as assessed by ODI included the following:

- **Effectiveness of the national institutions.** In all three country case studies – Cambodia, Mozambique and Peru - weaknesses in government institutions had constrained national ownership of the development agenda and, more broadly, aid effectiveness itself. This of course is not a problem unique to the EC – but it does point up the apparent tendencies in some EC documents to underestimate the scale of the institutional challenge associated with policy-based lending and the real achievement of “local ownership”.

- **Harmonisation and alignment. (H & A).** There are examples of good evolving practice in this area. However, progress on H & A has largely focused on the level of sharing and spreading information, and has not necessarily resulted in joint activities in the short-term. ODI argues that the …” EC and other donor harmonisation efforts need to be scaled up to include agreements on joint technical assistance and the streamlining of systems and procedures. Without a major and sustained effort on these more difficult issues, it is not clear how the EC and other EU members will be able to implement the division of labour envisioned in the EU Code of Conduct”. Other reviewers also allude to problems in this area.

- **Damage to local capacities.** In the cases of both Cambodia and Peru the ODI team found …“a general feeling that it is better to rely on parallel systems to speed up disbursements and avoid red tape” However, they argue that this attitude (by the EC and other donors) is very harmful to the longer term development of appropriate local capacities. In Cambodia for example, an extremely fragmented aid system had imposed unreasonably high transaction costs on the government, drained valuable resources, and fundamentally weakened state capacity.

- **EC procedures and structures.** Notwithstanding the streamlining that has been partly described earlier in this paper, the ODI team found that some EC procedures and structures still remain unnecessarily complex and bureaucratic. Process requirements such as project audits are a common cause of delay and complaint. Another recurring complaint was that there are still too many thematic and budget lines, even if their number has been considerably reduced. Because many thematic and regional budget lines are managed from Brussels or from other regional locations, the European

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43 Examples cited by the ODI study include formalised thematic taskforces or technical working groups intended to strengthen cooperation and facilitate technical-level dialogue on particular areas and sectors; high-level fora for government-donor interactions; and the elaboration of centralised databases on international aid (such as ODAMOZ in Mozambique – and a similar matrix in Peru).
Parliament is able to retain tight control which is good for accountability. But … “the impression that emerges from the field is that the EC is slower and less effective than it could be as a result of such complexity, and that it also imposes high transaction costs on partner countries.”

- **Quality of staff and individuals, and internal communication.** Based on its three case studies, the ODI report notes significantly that some EU delegations have managed to accomplish a most impressive set of results in spite of the limited resources at their disposal. The message seems to be to offer more discretion to able individuals in the field, listen more to their experiences and, by implication, become a bit less reliant on over-formalised procedures. Certainly, “poor communication among EU actors remains a problem, with different entities not fully informed about what others are doing. As a result, different actions undertaken at different levels may end up at cross purposes…”

- **Country Strategy Papers.** ODI found that the process through which Country Strategy Papers (CSPs) are elaborated is of varying quality and depth. They suggest that a more sustained effort is needed to engage in meaningful dialogue with key actors and make the process as participatory and inclusive as possible. Failing this the CSP cannot be the central coordination tool that it is designed to be.

Surveys amongst the beneficiaries of PBLs have identified a number of further difficult issues which embrace both the EC’s own procedures as well as those of some other donors. Chief amongst these is the inevitable intrusiveness of the donor processes involved in, for example, direct budget support. Neither the EC nor other donors have yet found a wholly effective way to truly recognise the supremacy of "local ownership" of reform while at the same time delivering against the accountability and value-for-money concerns of domestic constituencies.

Hauck et al. (2005) however provide specific examples to illustrate that the recipients do have a point. They refer to the case of Kenya, where the EC suspended the transfer of a €150m grant into the government’s treasury after the British High Commissioner made allegations of corruption. Similarly in the case of Uganda, in 2004 donors expressed their dissatisfaction with the increase in funding for the military, and the UK then blocked €14.6m of aid. The EC contemplated cutting its own development assistance for the same reason. The central point is that political pressures on aid delivery in the EC are complex, varied and to a degree unpredictable. Recipient governments feel genuinely exposed to the vagaries of this situation and more so when accepting “harmonised” help through mechanisms such as GBS rather than more traditional forms of aid.

The recent Mokoro study (Folscher et al, 2008) focused on the role of the European Parliament in overseeing the EC budget-support effort, and made a number of additional observations. In particular, it urged the EP to take care not to prejudice the system against or for budget support. The study noted that the ultimate aim of parliamentary oversight is to achieve value for money in development aid. In other words aid needs to be assessed according to whether it is used effectively to produce sustainable development outcomes. From such a perspective, the instruments of GBS or SPSP should be used only when merited for their developmental benefits, but should not be used when the risks are too high.

**C.6 Overall assessment and lessons**

The EC has been one of the prime movers behind the use of budget support in the donor community. It has developed a relatively sophisticated technical approach in terms of its guidelines for design, monitoring and mechanisms for triggering the release of disbursements. There is much of merit in these EC approaches and so they contain some
clear lessons for the AfDB and other donors who are somewhat less advanced in the development of guidelines. The EC's clear guidelines on the entry conditions for budget support and on the eligibility conditions for its PBLs are clear examples of this more general point. The increasing willingness of the EC to decentralise its specialist staff to country delegations is another example of improving practice.

However, the EC's enthusiastic adoption of direct budget support in particular has been surrounded by great controversy and differences of view within the European family. There remains concern from some countries that budget support will lead to the replacement of well-planned projects and programmes by massive, untargeted and fungible transfers, and will also reduce the visibility of national cooperation efforts. Recipient governments while generally espousing the move to direct budget support also express significant reservations over matters such as intrusiveness, and excessive political interference.

This problem of oversight of a process which is inherently about conceding greater local ownership of reform, is a particularly problematic issue given the widespread opinion that the guidelines on the effective use of the GBS funds are frequently interpreted too loosely. This is a frequently stated proposition regarding some of the EDF operations. However, central to this debate is the absence of reliable data for measuring results in most low-income countries and particularly in fragile states. Although the EC’s guidelines nominally attach a high priority to results-based principles, the ability to apply these principles in practice remains questionable. The challenges of finding appropriate sanctions for failures of performance are similarly difficult.

The lesson here is that the EC along with other donors needs to work harder to agree feasible PFM strategies and objectives for individual beneficiary countries and to be wholly realistic in determining whether or not these can be (or have been achieved). At present the status quo seems to be one of “agreed obfuscation” where minor improvements are held up as being significant while egregious failures are quietly ignored. Such an approach merely fuels the political opposition to GBS-type instruments and intensifies the pressures for individual donors to pursue their own non-harmonised tests of compliance with what their political masters expect.

The EC has made a major commitment to the principle that a large and expanding part of its total aid-delivery should be provided via the mechanisms of GBS and sector programmes: the mechanisms that this paper has interpreted as the EC-equivalent of policy-based lending. However, the relatively limited structures for evaluation that have been available within the EC system until recently – as of 2007 there was no standard methodology for the evaluation of budget-support operations - make objective judgements about performance somewhat difficult to reach. Partly for this reason there is intense controversy within the EU family about certain types of PBO and especially about general budget support. Hauck et al (2005) note that “... there has been a fierce dispute about its (i.e. GBS') practical feasibility, with a number of member states expressing concern that it is being put into practice too rapidly. Other member states disagree fundamentally with the principle of budget support, on the grounds that it runs counter to their practice of project support, direct control and the visibility of assistance. The debate has been intense within the European Parliament, which has very little control over the funds disbursed under the CPA – the ACP-EU Cotonou Partnership Agreement”.

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44 Hauck et al 2005
There are a number of respects in which the European Commission differs from the AfDB in terms of its objectives and the constraints faced. In general EC aid is likely to be subject to a wider range of more complicated political pressures reflecting the range of primary stakeholders (the EU member states) and the mixture of development and other political objectives that are likely to influence decision-making on European aid. While EU members collaborate through the EC aid programme and to some extent through common European approaches and agreements important differences in approach, analysis, and interests remain, although initiatives like the EU division of labour appear to have had some positive results in reducing duplication in some contexts.

While as the evidence base for drawing conclusions relevant to the AfDB about the extent to which the EC approach to budget support and policy based operations can be taken to reflect good practice, some comparisons can be made and tentative conclusions drawn:

- In terms of the range of instruments and their design features, the EC has a well-specified and structured decision process and detailed guidance for decision-making about budget support, although this still appears to be slow and potentially cumbersome at times, and processes (particularly in EDF countries) that should to some extent at least facilitate national ownership.

- The EC’s approach to budget support is in general characterised by multi-tranche operations, usually undertaken in conjunction with other donor support, which also include a variable element that whose disbursement depends on performance. The broad approach of EC budget support is to base the provision of aid on actions already taken so as to establish a favourable environment for aid, an element of ex post conditionality remains. While evidence on the effectiveness of this approach is incomplete, there are a number of concerns that it creates uncertainty and increases aid unpredictability without significantly increasing leverage over policy.

- EC experience with sector support is generally regarded as most effective when the sector supported coincides with the area of responsibility and budget of a single government institution.

- The EC has a policy towards the provision of budget support in fragile states which favours single year operations as opposed to multi-tranche, multi-annual operations.

- The EC generally has an in-country presence through its Delegations. However the capacity to engage effectively in policy dialogue is variable and highly dependent on the skills of particular individuals.

- The EC has a well-developed monitoring procedure for budget support. However, although an attempt is being made to pilot a more comprehensive results framework, evaluation, particularly of the impact of EC budget support, appears to be relatively weak.
Annex D  Case study of PBOs in the Asian Development Bank

D.1 Overview of use of PBOs

“Programme lending” has been the primary instrument through which the Asian Development Bank (AsDB) has supported policy reforms in developing countries. Policy based lending or programme lending was introduced in 1978 primarily for balance of payments support (particularly for agricultural imports) as it was quick disbursing. However, in 1987, the criterion was extended to recognise the policy environment. In 1990, programme lending was again extended to reflect a more holistic approach to sector development. These Sector Development Programmes (SDPs) focused on substantive policy reform and large scale investment. The programme cluster approach (PCA) was introduced to allow a broader focus on institutional reforms and capacity development over a longer timeframe. Finally, special programme loans were introduced as a result of the 1997 Asian Financial Crisis to restore immediate financial stability. The special programme loan modality was introduced to focus on crises. The programme cluster approach provided a facility that focused on longer term policy reform interventions. The sector development programmes combined both project and programme lending into one overarching sectoral response.

From 1997 to 2000, about 72 per cent of total loan amount related to programme lending. During 2001 to 2007, about 80 per cent of total programme loan amounts were concentrated in law, economic management and public policy; Finance; and, Multi-Sectoral programmes. Within these categories, the share of programme lending has increased significantly for more broadly based economy-wide reforms (the share of multisector programme loans increased from 3% to 20% over the same period), and for reforms designed to improve the enabling environment (the law, economic management, and public policy share increased from 10% to 39% over the same period), while the share of finance sector decreased from 59% to 21% (Senapaty, 2009, p.20).

The AsDB approved a total of 75 programme loans for a total value of US$ 9.73 billion from 2001 to 2007. Since the introduction of programme loans in 1978, a total 173 loans with a value of US$ 22.25 billion have been issued to 2007, which have averaged 21.79 per cent of total AsDB lending. It is also interesting to note that programme lending is 81.69 per cent of total OCR lending which recognises that developing countries that have a level of economic maturity are more likely to access programme loans, rather than more concessional based funding through the Asia Development Fund (AsDF). Programme loans and technical assistance loans have fixed repayment and grace periods that are shorter than those for financing investment projects and floating interest rates are linked to LIBOR. Programme loans from AsDF resources have a fixed-term, 24-year maturity including a grace period of 8 years, a 1.0% interest charge during the grace period and 1.5% during the amortization period, and equal amortization.

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46 OCR only countries in 2008 were the Cook Islands, People’s Republic of China, Fiji Islands, Indonesia, Kazakhstan, Malaysia, Philippines, Thailand, and Turkmenistan. Those countries that were AsDF only included Afghanistan, Bhutan, Cambodia, Kiribati, Kyrgyz Republic, Lao People’s Democratic Republic, Maldives, Mongolia, Myanmar, Nauru, Nepal, Samoa, Solomon Islands, Tajikistan, Timor-Leste, Tonga, Tuvalu, and Vanuatu. A combination of OCR/AsDF countries were Armenia, Azerbaijan, Bangladesh, Georgia, India, Marshall Islands, Federated States of Micronesia, Pakistan, Palau, Papua New Guinea, Sri Lanka, Uzbekistan and Vietnam.
Programme lending includes a broad review of budgetary allocations to and within the sector, with a view to ensuring that essential expenditures are met. The AsDB will ensure that, to the extent possible, obtaining matching expenditure commitments from the borrowing government in exchange for the counterpart funds generated.\textsuperscript{47} The AsDB considers that budget support for OCR and AsDF countries can be provided with standard programme lending for structural reforms.

Overall, the practice and processes of programme based lending in the AsDB have changed over the last twelve years as the Bank has shifted to more of a development focus and there has been a convergence in aid effectiveness practices as the Paris Declaration principles are built into policies and in loan instruments with country partners. The AsDB has a corporate wide operational manual which details policies and procedures on all aspects of programme based lending, performance, evaluation, accountability and financial systems and accounting underpinning the Bank’s activities. The AsDB has revised its policies and procedures to recognise the shift to programme lending. There is now a higher degree of planning in the appraisal period including on the macroeconomic environment, recognition of the political economy factors and greater flexibility in conditionality to recognise the longer term nature of policy reform.

D.2 Policy based instruments and guidance

Instruments

The AsDB definition of Policy based lending or operation is that policy-based programme loans and guarantees:

- Are not linked to specific project activities but to the implementation of policy reforms,
- Are relatively quick-disbursing to support policy reforms by DMCs; and
- Have sector-wide and economy-wide impact.

Essentially, a programme based loan supports broad-based sector reform and development that will enhance sector efficiency and performance, comprising in particular policy changes and institutional change. In broad terms, there are three policy based lending instruments used by the AsDB:

Standard Programme Loan Instrument

The standard programme loan (PL) instrument is used in normal situations where relatively short term incidences of adjustment costs are expected in a particular sector with a short to medium time horizon and disbursements are relatively quick (about three years). The focus of the PL is normally to improve the policy environment. For example, seeking to improve the level of investment in a particular sector through enhanced resource mobilisation, increased cost recovery, reducing or eliminating subsidies and rationalising interest rates.\textsuperscript{48}

If the time horizon extends over the medium term a number of PLs may be sequentially approved to sustain the process.


Programme Cluster Approach

The Programme Cluster Approach (PCA) is an extension of the PL modality. However, it addresses policy and institutional reform over a longer period of between four and seven years. Disbursements are slower than for the PL and can chronologically disbursed, disbursed to different levels of government or intersectorally. The PCA is designed to provide a flexible approach to addressing complex policy objectives into implementable policy action steps. The PCA instrument provides for a phased programme of policy reforms over a longer period of time within a coherent yet flexible framework. The second type of PCA consistent with vertical packaging of policy reforms reflects the involvement of several layers or levels of government. That is, follow up on a PCA will require an adequate timeframe and at the different levels of government to gauge the success of the programme. Finally, the horizontal PCA involves cross sectoral policy reform where the change is thematic and solutions to problems are multi-faceted.

Special Programme Loan

The Special Programme Loans (SPL) are designed to support extraordinary crisis situations principally as a result of global capital market instability and its impact on specific DMCs. As previously mentioned, the SPL was designed to support countries during the Asian Financial Crisis in 1999. The SPL is primarily focused on the more developed countries and would not normally be used to support DMCs at early stages of development and/ or emerging from conflict. The SPL is characterised by providing large scale lending as part of an international rescue effort usually in concert with the IMF and the World Bank. To avail of SPL assistance, the country must be eligible for ordinary capital resources lending and not through the Asia Development Funding only. This reflects the nature of the SPL- it is to support a country that has a level of economic maturity and is affected by a global financial crisis (Capital crisis), not in an economic maturity position of trying to attain access to the global financial markets in the first place.

The AsDB also has a Sector Development Loan (SDP) facility which was introduced in 1996 and focused on targeted sector support. A sector development programme (SDP) is a combination of an investment (project or sector) component and a policy-based (programme) component as well as, where appropriate, attached technical assistance (TA), with a view to meeting sector needs in a comprehensive and integrated fashion. The SDP is not a separate lending modality, but represents a combination, under appropriate circumstances, of policy and investment based assistance to support an overall reform agenda. During 2001 to 2007, 31 SDP Loans were issued for a total US$2.57 billion.

In order to deal with the Global Financial Crisis in 2009, the AsDB set up another transitory instrument to address fiscal policy at the macroeconomic level, called the Countercyclical Support Facility. The Countercyclical Support Facility (CSF) provides short-term loans faster and cheaper than under AsDB’s existing special programme loan (SPL) facilities, and will be available to DMCs who qualify for loans from AsDB’s Ordinary Capital Resources (OCR).

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The CSF is a new budget support instrument which will allow the AsDB to provide more effective countercyclical support to its DMCs. Such an instrument will complement standard programme loans and special programme loans (SPLs), and is only available to OCR designated countries, that is, those countries that cannot access concessional AsDF resources.

**Policy and guidance**

The AsDB has an extensive on-line operational manual\(^5^4\) that provides guidance to staff in the development of policy based instruments. The key issue is that the AsDB and the Government have a clear understanding of the reform programme as a prerequisite for a programme loan, and the ability and political will to implement the needed reforms. The operations manual requires that any consideration for programme lending must coordinate with other donors. All AsDB members can access programme loans if they meet the criteria, can demonstrate political commitment and the programme appraisal process supports the loan development.

This has changed since the first programme loans were introduced in 1978. Initially, the DMC had to demonstrate a balance of payment problem however this requirement was dropped in 1987. The key eligibility requirements now include a development plan (or letter) reflecting the proposed sectoral policy reforms, investment plans and institutional developments. The DMC country must also demonstrate a firm commitment to the reform within the particular sector but where economic financial or social costs impede progress and where a programme loan would support the sectoral reform.

The AsDB’s operational policies and guidelines have all been updated from 2003. Since 1996 the AsDB has become a more broad-based development multilateral agency and has engaged more directly with policy based lending and institutional reform rather than focusing exclusively on investment loans.

**D.3 Design and management of PBOs**

**Design**

The design of programme based lending instruments has become more complex as their success depended on a greater number of extraneous factors and stakeholders. Key features of the changes to programme lending include\(^5^5\):

- A detailed sector analysis (or multisector analysis for multisector operations) is conducted and is a mandatory requirement for the President of the AsDB. This analysis includes a comprehensive sector and intersectoral analysis, an assessment of past performance and policy issues, problems, constraints and Government commitment.


A link with the sector strategy, macro-economic environment and country partnership strategy must be established. An IMF assessment letter is required covering the macro-economic environment and development trends.

A development policy letter and policy matrix to reflect the DMC’s commitment and ownership of the programme and the identified reforms. The policy matrix represents actions that are crucial for policy reform and addresses any identified problems.

Policy actions are apportioned to tranches to ensure proper sequencing and implementation of policy actions. Single tranches are allowed under certain criteria.

Technical assistance to support policy reform is now linked to programme lending.

The adjustment costs (that is, the cost of the policy reforms to the Government) need to be identified.

A development coordination matrix is now completed to support the reform process and coordinate donor involvement.

A design and monitoring framework is developed to summarise the impact, outcomes, outputs, and activities for that programme loan. The framework also provides for key performance indicators to monitor performance.

A poverty analysis that links the programme to the poverty reduction strategy for the DMC.

Detailed disbursement procedures according to the identified impact(s) (or milestones) of the programme loan.

The Operations Evaluation Department (OED) also undertake ex post reviews and evaluations of country and loan instruments.

**Tranching, conditionality and programme design**

There has been a shift in thinking on single, multiple and milestone based tranches over time. From 1987, nearly all programme loans were designed with two tranches. OED studies (e.g. OED, 2001) have found that a delay in the second tranche was the norm rather than exception and recommended that greater flexibility was introduced into the process including multiple, floating and single tranches with clearer identification key events or milestones. The 2001 study also identified that the ambitious and complex nature of policy changes and how to measure this was reflected in ‘the delays in tranche releases and programme completion rather the proportion of programme conditions finally met’.56

The 2009 study (OED, 2009) also looked at tranche approval process with regards to Board approval and in the sequencing of tranche payments. It developed revised staff instruction to more clearly guide multi-tranche operations where the major elements of the policy sector reform are introduced after the loan agreement becomes effective. Single tranches are allowed under certain criteria including where the most important policy reform(s) can be implemented prior to effectiveness and where they are part of a DMC’s medium term reform plan. The AsDB suggest that the single tranche programme lending operations are similar to the World Bank’s operations. The share of single tranche based lending has increased from 42 percent in 2006 of total programme lending to 70 percent in 2007 and 78 percent in 2008.57

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The policy for tranches (Operational Manual D4) is that ‘tranching conditionalities must be formulated with a view to optimising the sequencing of reform steps, as well as minimising short-term costs of adjustment. Staff should adopt a flexible approach to conditions in programme loans, and apply the following good practice principles in the design and implementation of conditionality in programme loans: (i) conditions should reinforce country ownership, (ii) they should be agreed with the government and linked closely to national development strategies, (iii) only actions critical for achieving programme outputs and outcomes should be selected as conditions for disbursement, and (iv) transparent progress reviews that contribute to predictable and performance-based financial support should be conducted regularly.’ Single tranche proposals must be presented to the Board at an earlier informal discussion to support the overall approval process.

The key point emphasised in the guidance is that staff are encouraged to be flexible and only identify those policy reforms/ actions that are critical as the trigger points for further disbursement. Each programme loan is or should be considered on a case by case approach and the conditionality attached results focused, flexible and realistic.

**Complementary Support**

One of the weaknesses of programme lending in the past identified by OED has been the absence of technical assistance facility within the instrument. The conditionality attached to the loans for capacity building was generally deemed to be ineffective. Programme loans since 2001 have generally included more substantive analysis of policy issues, usually including substantive prior involvement and technical assistance addressing sector development issues. Technical assistance is one part of policy based lending operations. A programme is supported by a programme loan and may also include a technical assistance (TA) loan. An SDP includes a programme loan and a project loan, and may also include a TA loan. However, they tend to be as a sub-project to programme lending rather than integrated into the actual lending instrument. The TAs attached to policy components of a programme loan must be carefully targeted to meet key capacity-building needs in the sector and/or address major policy issues having a bearing on future strategy decisions. The operations manual provides for a number of technical assistance sub-projects that support programme based lending operations, including:

- Policy and advisory technical assistance (PPTA) which is focused on a sector- or economy-wide context technical assistance.
- Capacity development technical assistance (CDTA) which assists in (i) establishing or strengthening organisations and institutions in DMCs; (ii) implementing, operating, and managing AsDB-financed projects; and/or (iii) enhancing knowledge management.
- Research and development technical assistance (RDTA) involves TA activities conceived to address global or regional development issues which require further analysis or understanding.
- Small-scale technical assistance is a useful and convenient means of rapidly providing expertise including (i) updating feasibility studies; (ii) initiating or completing project preparation work; (iii) addressing narrowly defined development issues; and (iv) financing assessments in an emergency situation as a rapid response tool.
- Technical assistance cluster comprises a series of TA sub-projects over an extended period to address constraints in a DMC through a comprehensive and holistic approach.

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TA cluster assumes a long-term perspective and partnership between AsDB and the DMC concerned and flexibility in the design of the sub-projects.

- Regional technical assistance is the principal instrument for financing AsDB’s research agenda for Asia and the Pacific, which usually covers more than one DMC.

A study on AsDB programmes in the Pacific\textsuperscript{59} found that technical assistance attached to programme lending needed greater focus and design to focus on institutional development rather than individual counterparts. The study also indicated that the institutional reform process needed to be extended beyond the central agencies to line agencies, and wider civil service reform.

**Risk and programme design**

The first consideration in the wider governance perspective is that the DMC and the AsDB have a country partnership strategy in place, which will define AsDB’s strategic approach in the country that is aligned with the AsDB’s Strategy 2020, the country’s own development strategy, and AsDB’s comparative strengths, and complement efforts by its development partners. Given that the AsDB traditionally focuses on the micro and sector level reforms, it is also important to consider the macroeconomic environment as part of any interventional design especially when considering poverty reduction impacts.

The project/loan appraisal stage also requires a sector analysis which looks at social and environmental issues, the relative roles of the public and private sectors, and institutional development needs. An assessment of poor and vulnerable groups is also undertaken. It also considers the technical assistance needs and bolt-ons to the proposed programme lending. A review of macro-economic conditions and the link to the proposed programme are considered.\textsuperscript{60} The analysis also looks at issues of aid coordination as part of the Paris Declaration.\textsuperscript{61} When developing a programme loan, the implementation staff are required to consult with the IMF to help assess the macroeconomic situation and development trends of the concerned country. The IMF letter forms part of the ‘evidence’ to support the approval process for the loan the President.

When developing a programme loan, the decision to initiate preparation of programme loans requires a comprehensive assessment of sector or cross-sectoral issues and their analyses. The AsDB also requires (or prefers) full commitment by the government to institute a reform programme is a prerequisite for a programme loan, as are the ability and political will to implement the needed reforms. The operations manual requires that any consideration for programme lending must coordinate with other donors.\textsuperscript{62}

The Draft Development Policy Letter (DPL) includes the essential features of any agreement with the Government, the IMF letter and the policy matrix, which includes a table setting out


\textsuperscript{60} The macroeconomic assessment includes economic growth performance, macroeconomic policy and management, an assessment of key structural policies, economic outlook and an assessment of the overall macroeconomic framework.


the overall objectives of the programme, measures already taken, specific actions to be
taken under the programme, their timing, and further actions needed over the medium term.

There does not appear to be a specific fiduciary risk assessment done for each programme
loan. However, OMD 08 provides that when the AsDB makes a loan to a DMC, the full faith
and credit of the member country stands behind the obligations of repayment. Therefore, the
policy manual states that no special safeguards to protect AsDB in the event of default are
considered necessary. When it makes a loan to an institution or sub-regional entity, it would
expect that the DMC would provide a government guarantee. This approach minimises the
risk of loan non-repayment, but does not address the risk that resources provided will not be
used to achieve agreed objectives.

OM 07 requires that borrowers submit audited financial accounts consistent with
international accounting standards. The timing and content of the financial accounts are
preferably agreed at the project identification stage. The procedures also require that the
executing agency appoints an auditor with suitable qualifications and experience, preferably
in compliance with INTOSAI, acceptable to the AsDB. The selection process should take
place before or at the commencement of project activities. OM L2 also provides for an
internal audit function, which has the authority to conduct reviews and audits on projects and
loans. Finally, the AsDB has an accountability mechanism which supports the link to the
project/loan in the country and allows local concerns to be considered by an independent
unit within the AsDB. As part of due diligence process, the AsDB stresses that it is important
that an understanding is reached on detailed programme objectives and content, conditions
of loan effectiveness, tranching and conditionalities for tranche release, use of counterpart
colts, procurement and disbursement and how key elements of the programme will be
monitored. These issues are considered in the draft Recommendation to the President
(RRP) and the minutes of the management review meeting (MRM) and/ or the staff review
meeting (SRM).

Management practices and decision-making processes

The objectives of programme lending are different from project or sector lending, however
the operational procedures for processing programme loans are generally the same. In the
case of project lending, the emphasis is on understanding the existing policy framework in
the sector (or sectors) and on assessing the need and scope for reform and development.
This sector analysis should precede formulation and appraisal of a programme loan.

The Operational Manual (A2, D4, D11) provide details of the process for approving
programme loans. In summary:

- Consideration of a programme loan is normally commenced when it has been included in
  the indicative rolling country operations business plan (COBP).
- A concept paper for the specific programme loan is developed for approval by the
  operations vice president. The concept paper includes the rationale, indicative impact,
  outcome, and outputs, financing plan and implementation arrangements. It also includes
  the required due diligence with details about the requirements for staff, staff consultants,
  or project preparation technical assistance (PPTA).

64 Ibid, Operational manuals A2, D4 and D11.
The project team leader and project team of the responsible operations department prepare the draft concept paper, where appropriate in consultation with the resident missions concerned.

A departmental meeting is held to consider the draft concept paper. The meeting determines the merits of the proposed project.

Peer review of the concept paper

Risk categorisation and quality assurance process where all loans are considered as either low risk or complex. A complex risk category will require closer scrutiny and a more intensive quality assurance process, including more in-depth due diligence and management and peer review.

Loan projects are classified by: type of financial product; financial modality (in order to highlight partnerships); sector and subsector(s); location impact; themes; and targeting.

A design and monitoring framework is developed.

Project screening and safeguard categorisation is carried out when sufficient information is available for this purpose to reflect the significance of potential impacts or risks that a project might present; identify the level of assessment and institutional resources required for the safeguard measures; and determine any disclosure requirements.

Project preparation usually involves several steps, including project preparatory support, project fact-finding mission, management review meeting (MRM) or staff review meeting (SRM) depending on risk categorization, loan negotiations, and Board consideration

Due diligence to establish the viability of the project, including detailed programme objectives and content, conditions of loan effectiveness, tranching and conditionalities for tranche release, use of counterpart funds, procurement and disbursement, how key elements of the programme will be monitored.

A major objective in programme loan processing is to reach an understanding with the government on the medium- and long-term development framework in the sector and on the schedule of policy steps to be undertaken during the programme period which will be formalized as the government’s policy statement in the form of a letter (the development policy letter [DPL]) from an appropriate government official to the President of AsDB. The DPL is a key document throughout programme loan processing. The letter must spell out in appropriate detail medium- to long-term sector objectives, the measures already taken and those to be taken to achieve them, and various indicators to be used in monitoring programme implementation and sector performance. The AsDB and the government must agree on the essential features of the DPL prior to loan negotiations.

A report to the President (RRP) is prepared with the appropriate documentation listed in section 3.1 (design stage)

Loan negotiations are commenced with the DMC government at the same time as the above steps are being undertaken. When loan negotiations have been completed, the RRP is edited by the Office of the Secretary (OSEC).

Board consideration and approval

Loan documents are publicly available in accordance with the requirements of the public communications policy.

Peer Review in the Course of Loan Processing

Retrospective Stocktaking of Approved Loans

The AsDB has resident missions and other forms of field offices in most of its DMCs. Some project team leaders for policy-based lending are based in relatively large resident missions. In many cases, the Country Partnership Strategy (CPS) and its country operations business
plan (COBP), that is, pipelines that may include programme lending, are prepared by resident missions. Country team leaders /country economists based in DMCs may make intellectual contributions to design of policy-based lending on the macroeconomic and structural reform fronts. However, and whilst some programme loans are processed in resident missions, the majority are processed at Headquarters and in general AsDB policy and programme design processes remain more centralised than is the case with the World Bank.

Operational manual D4 states that there are no individual country ceilings for programme lending. The general policy is total annual programme lending for standard programme loans, PCA loans, the policy-based component of SDP loans, and policy-based guarantees is not to exceed 20% of total public sector lending on a 3-year moving average basis under normal circumstances. Similarly, lending from AsDF is subject to a ceiling of 22.5% of total lending.

However, this ceiling has been exceeded in the last few years at the request of the DMCs and with full knowledge of the Board. In 2006, the total programme lending represented 32 per cent. The study goes on to explain that this was more of a timing issue as a number of large loans were processed in the same year. The Evaluation Department has implicitly suggested that, consistent with the World Banks lead in this area, that a ceiling should not be prescriptively set, rather a guide that programme lending remains at about one third of total Bank commitments over a three year period.

**Implementation**

The implementation of programme lending is detailed in the operational manual. Essentially, once the loan negotiations are completed and the first tranche is released, the next key steps are the progress reports to the Board requesting authorisation of subsequent tranches. The programme progress report assesses progress and compliance with conditionalities.

Disbursement of tranches under programme loans normally takes the form of reimbursement to the central bank of the DMC acting as a depository. The central bank is generally responsible for administering programme loans in close consultation with the government and sector-specific entities responsible for implementing the sector programme.65

As part of the programme appraisal process, AsDB staff are required to coordinate with other donors, including the World Bank, IMF and other bilaterals in developing a coordinated and harmonised programme for reform (OM D4 section 23). Policy OM E3 provides for continuing cooperation as part of the AsDBs commitment to aid coordination. However, the policy does not provide any details on the extent of cooperation during a programme apart from generalities about formal partnership arrangements.

There was no indication from the literature and the operational manual that, as part of the project appraisal process, and during implementation that both the programme and the disbursement of tranches are aligned with the Government budget cycle. However, the project appraisal process does require that Government ‘leads’ the programme and we can assume that the overall programme objectives, and milestones (or performance indicators) are aligned to maximise the impact for the Government and the success of the policy reforms.

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The AsDB have a number of loan instruments to support policy reform over the short to medium term. Essentially, the standard programme loan focuses on the short term and the programme cluster approach focuses on longer term policy reforms over four to seven years. Programme lending continues to increase as a percentage of total lending operations in the AsDB. Therefore, the AsDB provides adequate programme lending coverage over the short to medium term.

The literature has suggested that in the past (pre 2001), over 70 per cent of the disbursement of the second tranche for programme loans was delayed. This was primarily due to the design of loan, the number of condition and the complexity of policy reform. The treatment of disbursement also imposed a higher level of rigidity that project based lending. However, there has been a shift to more flexibility and ‘smarter’ milestones (conditions) which will reduce the incidence of second tranche delays according to the study by Senapaty. Practically speaking, programme lending has built-in characteristics of rewarding compliance with conditionality with tranche releases. The quicker that conditionality is met, the quicker tranche are released. Apart from that, the size of overall assistance from the Asian Development Fund (AsDF) to eligible countries is determined through the country performance assessment, which is not specific to programme lending.

In terms of implementation, the AsDB Evaluation Department suggest that the success rates of programme loans has increased over the years and that, increasingly, DMCs are demanding these loans to support key policy and institutional reforms. However, the reform agenda should not be too ambitious and there is a critical need for consensus building as part of the reform process. They continue to reinforce the need for continuous dialogue, even after the loan has closed to consider the ongoing progress of reform. The literature consistently suggests that government ownership of the technical assistance and capacity development is crucial for successful policy reform. A study by the Evaluation Department suggested that project implementation supervision was not considered as important as project preparation and considered that continued project quality suffered as a result. They suggested that current resource allocation for project implementation supervision should be re-examined for adequacy to reinforce the implementation phase of project and programme life cycle.

**Monitoring, reporting and evaluation**

The AsDB operations manual provides some guidance as to the monitoring and reporting during the implementation phase of programme lending. Operations manual J1 provides for regular project performance reports (PPR) prefaced on the design and monitoring framework. Progress toward the performance targets is tracked and reported in the PPR from the baseline using the indicators and their respective data sources and reporting mechanisms contained in the design and monitoring framework, and as verified in the project administration memorandum.

Regional departments hold PPR meetings at least quarterly to review the performance of projects for which they are responsible, and to discuss specific project implementation

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issues. At the conclusion of the project a project evaluation is conducted by both the borrower and the relevant operations department to assess the programme’s success.

The AsDB also conduct regular review missions (the policy suggests semi-annual) with the executing and implementation agencies to consider programme (and/or project) progress. The review missions consider the project outputs and whether they are being delivered and any changes in the scope and outcomes of the programme are required. The PPR is updated to reflect the mission findings and recommendations to change the focus and linked back to the design and monitoring framework.

A project completion evaluation (report) (PCR) is prepared to establish whether the programme outcomes were achieved and what lessons have been learnt. The policy requires that the PCR is used as a measure of AsDB’s development effectiveness for accountability and as an input to country strategy formulation. However, the process to feed lessons learnt into future planning is not considered as strong as it should be in the AsDB. One of the issues identified by the Operations Evaluation Department are that whilst evaluations are undertaken of project and programmes, the outcome and recommendations of those evaluations are not feeding back into the overall project life cycle process. This has led to the same issues and problems being raised in current evaluations that were reported 14 years ago. If project quality and performance are to be improved, the AsDB must learn from its evaluations of past and ongoing projects. To date, there seems to be some systemic inability to do so.68

The AsDB has been implementing a results based management framework and has introduced tools to support MfDR, training courses, and undertaken preliminary work to support the development of a new corporate management information system. A recent study found that managerial decisions within AsDB were not routinely informed by relevant outcome data. The study considered that the AsDB had not yet achieved the full implementation of Managing for Development Results (MfDR).69

We have previously mentioned that the AsDB has continued to strengthen understanding of the results chain in programme lending to further reinforce a results focus. We have also mentioned that the AsDB is focusing on greater flexibility in programme lending and focusing on key outcomes or milestones as part of the loan conditionality. The Operations Evaluation Department has recommended that ‘only actions critical for achieving programme outputs and outcomes should be selected as conditions for disbursement’.70

The final element of monitoring and evaluation of outcomes is the Project Performance Management System (PPMS) is the independent evaluation of a sample of projects. Operations evaluation takes place about 3 to 5 years after completion, when development impacts should become evident. Again, the design and monitoring framework, reflecting, where applicable, the revisions made during implementation, provides the basis for performance evaluation. Operations Manual K1 requires that evaluation practices are coordinated with the evaluation practices and activities of other multilateral development banks (MDBs).

The auditing function also supports accountability and performance in programme lending operations. As previously mentioned, the AsDB (Operations Manual J7) requires the executing agency to prepare accounts ‘consistent’ with international accounting standards and to have those accounts audited by an independent auditor acceptable to AsDB and in accordance with auditing standards that are also acceptable to AsDB. Auditors are to comment on the executing agency's compliance with financial management and audit covenants. The cost of audit compliance is to be met through the loan agreement.

The AsDB's accountability mechanism (Operations Manual L1) also has a compliance review phase which is essentially a Compliance Review Panel (CRP), which investigates alleged violations of AsDB's operational policies and procedures that have resulted in direct, adverse, and material harm to project-affected people; and makes recommendations to ensure project compliance. The CRP reports directly to the Board on all activities.

Finally, the Office of the Auditor General is an internal audit function that undertakes independent reviews of AsDB operations, encompassing financial, administrative, information technology, and project-related activities, including those relating to loans and technical assistance (TA). According to Operations Manual L2, the OAG reports directly to the President and meets periodically with the Audit Committee of the Board of Directors on OAG’s work programmes, reports, and the status of its recommendations. It does not appear that specific arrangements are in place for the audit of PBOs.

D.4 PBOs in fragile and post-conflict contexts

According to the AsDB, fragile states are eligible for concessional loans through the Asia Development Fund while some post-conflict countries, including East Timor, are eligible through both AsDF and OCR funding. The AsDB also have a Disaster and Emergency Assistance funding policy to support, according to the operations manual, the phases of the disaster management cycle, from prevention and mitigation through preparedness and recovery. It appears that there is guidance for AsDB that calls for the relaxation of business processes for fragile states, while that may not be specific to programme lending, will impact on PBOs. Conditionality for programme lending is discussed with the DMC authority on account of the various country-specific contexts, and there is no fixed formula, and the AsDB is understood to be in general that since governments in weakly performing countries either have weak capacities and/or they are not committed to reform, aid conditionality is unlikely to be effective. There is however no specific policy for programme lending in fragile situations. The AsDB is involved in a number of countries that are generally regarded as exhibiting aspects of fragility, including Afghanistan, Cambodia and Nepal. Programme lending has been used to some extent in these contexts but the assessment of the scope for its use has been made on a case by case basis.

The AsDB has, for example, provided Afghanistan with a $167.18 million Post-conflict Multi-sector Programme loan, approved in late 2002, which supported policy and institutional reforms directed at improvement in governance and the strengthening of the finance, transport, and energy sectors. The AsDB has also provided support to economic

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71 The policy suggests that auditing standards of the International Organization of Supreme Audit Institutions (INTOSAI) are the appropriate standard for the ADB. However the policy recognises that capacity may not necessarily be available in some DMCs. In this case, supplementary auditing may be requested by the ADB.
management and governance through the $55 million Fiscal Management and Public Administration Reform Programme and the $60 million Private Sector and Financial Markets Development Programme, approved in 2006, has helped the government establish a clear and comprehensive legal basis for private sector development.\textsuperscript{72} It appears that most new programme operations are to be provided as sector based Multitranche Financing Facility (MFF) loans (other than programme or a sector development programme loans), grants, guarantees, or AsDB-administered cofinancing projects.\textsuperscript{73} MFF loans do not include programme lending or sector development programmes. Instead the MFF is used for financing projects, whether sector wide or individually.

\section*{D.5 Evaluation evidence}

A study by the AsDB using various programme completion reports and programme performance audit reports identified the factors that support and hinder policy based lending operations. The following factors were identified as favouring reform\textsuperscript{74}:

- Stable political environment
- Clear understanding across stakeholders of the objectives of reform
- Shared commitment to reforms and ownership of the reform programme from the design stage to the implementation stage
- Close involvement of the Government in policy dialogue
- Definition of the policy objectives according to the Government’s development agenda.

Factors deterring reforms were identified as:

- Complexity of the political economy of decision-making
- Inadequate analysis of reform options and the feasibility of recommended actions
- Difficult macroeconomic environment
- Labour disputes and legal challenged to divestments
- Limited capacity of the Government to manage reform processes (change process and management of change)
- Shortfalls of the executing agency in informing and educating political leaders, decision-makers, and the general public on the objectives, costs/benefits and expected results of policy reforms
- Lack of broad-based support for reforms involving sector restructuring/opposition from labour unions
- In consistencies in government policies, mainly in the agriculture secture
- Political and security instability

The success rate for programme loans during 1978 to 1995 was that only 33 per cent were rated as successful. From 1996 to 2004, over 67 percent were rated as successful.


\textsuperscript{73} http://www.adb.org/projects/mff.asp

Unfortunately, given that programme loans tend to be medium term in focus, more up to date results are not available to cover the period 2005 to 2010.

The AsDB study into programme based lending in Sri Lanka\textsuperscript{75} provided a number of general lessons that were judged likely to be more widely applicable:

- Policy based lending requires careful analysis of the reform environment. In developing the proposed programme, there is a fundamental need to establish the political economy of decision making, stakeholders (both direct and indirect); the commitment of the Government to promote, direct and manage reforms. There is also a need to consider the complex social and political structure, the macroeconomic environment, and broader issues including conflict.

- Policy and institutional reforms must have national ownership if the reforms are to be meaningful in terms of development. The study states that country ownership and political will for policy development and its associated reform agenda are requisites for which AsDB assistance cannot serve as a substitute.

- Policy reform is an art of making reform popular through civil participation and win-win outcomes for stakeholders. That is, ‘policy reform is a process that requires a mechanism to accommodate the views of diverse interests and to make adjustments as necessary’.

- Reforms involve change processes and initiatives for change can face significant resistance from entrenched institutional structures and processes. There is a need for greater stakeholder analysis.

- Policy reforms that involve major legislative changes can take more time to accomplish that is typically provided for in a typical loan period for policy based loans. Therefore, the reform process must take into account in the programme design phase and a level of flexibility adopted for major reforms in the loan period.

- Obtaining continued support from stakeholders for policy reforms is essential for sustaining the reform process. There is a need for continued consultation with stakeholders built into the programme reform process.

- Policy based programmes are a powerful tool to assure top level support for difficult reforms. There is a risk that with changes in government and/ or coalition, the reform process may lag or indeed reverse.

- There has been a tendency to consider non-tranche conditions as a lesser priority and the overall monitoring of policy based loans suffers after a programme loan is fully disbursed. The AsDB needs to continue to emphasis policy dialogue and analysis of the effects of policy loans even after loans are disbursed.

- Perseverance to remain engaged in policy dialogue is critical even in times of policy reversal and when the prospect of further policy based lending appears low.

- The AsDB must recognise that policy conditions should not go beyond the Government’s capacity to manage reforms, monitor change and prepare the groundwork for future efforts.

Finally, programme lending can be an effective instrument to support the reform process when a number of requisites are met, including\textsuperscript{76}:

1. The programme is based on broadly supported reforms within a country
2. The objectives are clearly defined and reforms are clearly prioritised, sequenced and limited to manageable proportions
3. Performance indicators are clearly defined
4. Adequate flexibility for adjustments is built into the programme
5. Policy reform is a long process and there must be consensus building among decision makers
6. Consideration of stakeholders, including the political leadership and general population
7. A sound macroeconomic environment and policies are an essential complement to sector reform efforts.

The use of PBAs in the design of programme loans is considered desirable as far as possible so long as due diligence validates the technical quality of the Government programme and the fiduciary arrangements in the DMC. Another issue that has been identified by the AsDB is the need for more time and care in the preparation of programme based loans and in ensuring greater ownership by the Government which has been built into the planning process. There is a need for greater ex ante analysis in the programme loan appraisal process to support this. The 2007 OED review focused on the need for upfront analytical work and due diligence, continuous dialogue and a commitment for the medium term as critical to the success of programme lending in support of DMC poverty reduction strategies and other medium term development plans. It also reinforced the need for clarity in the purpose and use of programme loans as a basis for improving accountability and supporting the use of Government systems and processes. It cautioned against overly prescriptive conditionality which (from the 2001 study) has meant that second tranches were often not disbursed due to conditions not being met by the DMC. The key was a stronger commitment in the design of the loan, continued flexibility and dialogue. The 2007 study strongly supported the increased use of single tranche loans and the commitment to supporting a country’s national development strategy (Paris Declaration). The study recognised that the AsDB should relax overall programme lending limits as a proportion of total AsDB lending. Finally, there was a need to understand and articulate the results chain at the design stage to identify the outcomes, lead to better decisions and to focus evaluations. It should also be noted that, for all AsDB operations, there needs to be a closer focus on aid coordination and, there may be a case, to be cognisant of political issues in terms of planning and engagement with DMCs rather than adopting an apolitical position.

80 Ibid, 2007, page 33
D.6 Overall assessment and lessons

The AsDB has been conducting programme lending operations since 1978 and in that time there has been a shift to more sectoral and policy based reform programmes. In that time, the process by which the Bank has developed programme loans has changed markedly. The operations manual now has a stronger up front process that considers the macroeconomic environment, the level of commitment by the Government, political economy factors and more flexible conditionality.

The AsDB appears to have rather less deep and broad range of evaluation information on PBO performance (compared to the World Bank) which may limit the extent to which firm conclusions may be drawn about its performance, the development impact of its programme lending, and the lessons that emerge. The AsDB has though gone considerably further than the AfDB in developing comprehensive guidance and procedures for the use of PBOs. The AsDB is undertaking both sectoral and multisectoral operations.

The AsDB is also has less engagement in fragile contexts (and lacks a specific policy for its use of PBOs for its engagement in such situations). Programme lending dominates lending from OCR, and so is concentrated in economically and institutionally more mature countries, particularly as the AsDB moved away from its past focus on infrastructure towards supporting more broadly based development policy reforms. It will be important to examine further the extent to which programme lending may or may not be appropriate for infrastructure support, since both AsDB and AfDB are re-emphasising the need for boosting infrastructure investment in their regions.

There has been a marked shift in practice away from two tranche towards single tranche operations, reflecting both the experience of delays in second tranche release, and the move away from ex ante conditionality which seeks to exert leverage over borrower policies. There has also been recognition of the importance of complementary technical assistance and other forms of institutional support, and for this to be more closely integrated into the design of programme lending.
Annex E  Summary Case Studies of PBOs and Bilateral Donors
## E.1 Canada

**Case Study: CIDA – CANADA**

**Policy Based Operations: Definition, Instruments and Policies**

| What are the main instruments that are defined as Policy Based Operations? | CIDA defines PBLs as "program support that is provided directly to host- country institutions to be spent as part of their budgets using their own financial management systems" (2003: p.23)

CIDA has guidelines for Program-based approaches (PBAs) and does not have separate guidelines on budget support. The guidelines are 'CIDA’s Operational Guide to Program-based approaches', November 2007.

CIDA uses the term PBA to refer to the approach in which aid effectiveness is improved using the most appropriate delivery modality. As a result budget support, pooled funds, traditional projects and TA that are aligned with the strategies of the recipient government and are harmonized with the activities of other donors are considered by CIDA to be PBA (CIDA, 2008). |
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<tr>
<td>What are the guidelines for the use of PBO and criteria used for selection of countries?</td>
<td>An assessment of whether the conditions for CIDA participation in a PBA are present is performed by the country desk. The criteria are assessed through an examination of the composition of the country program and staff, including staff capacity, finance and procurement expertise. The ability of the recipient country to benefit is examined through an assessment of: the recipient country's ability to engage in more harmonised approaches; existence of emerging partnerships with other donors; the capacity and track record of the recipient country to deliver results and to scale-up efforts in a cost-effective way; evidence of a satisfactory and agreed-upon programming framework; policy and/or institutional reforms for the increased use of local systems are promoted; If these conditions are met a concept paper is prepared for initiatives over CAN $500,000. (Mokoro, 2008:p.15).</td>
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</table>
| How have guidelines and policy changed over the evaluation period? | The PBA approach to aid delivery developed slowly over a number of years and was formally endorsed when Canada signed the Paris Declaration in March 2005. Prior to this CIDA had been relying on policies and guidelines which were developed for bilateral projects these were not adequate for pooled funds and budget support. A PBA policy document was finally published in 2009 but prior to this program staff relied upon personal experience rather than a clear Agency wide approach. Prior to this in 2007 a policy for Fiduciary Risk Assessment was approved by CIDA’s President and in 2008 an Operational Guide to Program-Based Approaches was published (CIDA, 2008).

In February 2008 a definition of PBA was approved by CIDA this re-affirmed the definition laid out in the 2003 documentation.

There has clearly been more thinking in terms of the guidelines and policy which has led to more detailed instructions for example within a PBA when budget support should be used. In the words of CIDA's most recent PBA audit: "CIDA has made considerable effort and progress in delivering this new approach to
**Case Study: CIDA – CANADA**

aid however, an overall agency approach is required. CIDA needs to approve an overarching policy on PBAs, develop a risk management framework, set a clear direction for the involvement of the agency in direct budget support and use program rather than project specific indicators” (CIDA 2008, p.35).

<table>
<thead>
<tr>
<th>What is the policy on using PBO in fragile states?</th>
<th>&quot;Countries affected by violent conflicts and fragile states do not satisfy all the conditions for a PBA expressed above, but might nevertheless require urgent support for peace-building, reconstruction or accelerated reform. The risks in these countries may be overridden by the strategic importance of a strong and immediate donor response. Support under these circumstances will require that special safeguard and monitoring mechanisms be put in place to ensure that funds are used for intended purposes. Such situations could rely upon the use of multilateral trust funds to manage the funds involved.” (CIDA, 2009: p.5)</th>
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<tr>
<td>Does economic and sector work guide the choice and shape PBOs?</td>
<td>Yes it does and the CIDA program strategy would choose and shape PBA and the modalities used within it.</td>
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**Policy Based Operations: Practice and Processes**

**Design**

| Outline the main elements of the PBO instruments. Are they sectoral or multi-sector, what type of conditionality is used and how are they designed? | "Support under a PBA can be provided through a range of funding modalities, including budget support (general budget support and sector budget support), pooled funds, and/or project funding. Based on specific country situations, CIDA will use an appropriate mix of complementary aid modalities. The decision to enter into PBAs, and the choice of funding modality, should be based on a rigorous analysis of expected benefits and risks typically set out or confirmed in the CIDA program strategy for the country” (CIDA, 2009:p.11). |
| Is disbursement undertaken on an annual basis with annual tranches or is it multi-annual with annual or multi-annual tranches? | **Disbursement:** |
| Are disbursements adjusted in relation to predefined parameters or on the basis of actual performance? | "In association with other donor partners, CIDA will clarify with each recipient the critical conditions for disbursements, drawing them, whenever possible, from recipient countries’ own development strategies” (ibid, p.6). |
| For multi-sector budget support are conditions related to a particular sector or cross-sectoral? | CIDA will in conjunction with other donor partners assess performance annually, this will be done based upon mutually agreed benchmarks or indicators. In certain cases jointly agreed procedures will be put in place to enable disbursements to be increased or decreased in response to performance. |
| Is there TA or other support linked to the PBO? | For multi-sector budget support conditions would be cross-sectoral and would be measured according to Performance Assessment Frameworks (PAFs). |
| What appraisals are undertaken prior to lending (fiduciary risk assessments etc and are these done jointly or are other donors work used)? | |


### Case Study: CIDA – CANADA

**Technical support** is promised by CIDA for audits and evaluations of country programs and strategies if necessary and in collaboration with other donors. Under PBA's projects can be carried out which would include technical support, however it is recognised that any technical support provided by CIDA would provided in line with country strategies and in harmonization with other donors (CIDA, 2008).

**Assessments:** wherever possible CIDA endeavours to carry out assessments jointly and to work with other donors.

<table>
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<th>Management practices and decision-making processes</th>
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<tr>
<td><strong>How is the decision undertaken to use a PBO?</strong></td>
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<td>At what stage are different departments involved?</td>
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<td>What is the process for approving PBOs? Which departments are involved?</td>
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<tr>
<td>Is there a cap on the amount of a country programme that can be covered by PBOs or is there a cap on overall policy based operations?</td>
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<tr>
<td>How decentralised is the process? Are decisions made at country office level?</td>
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<tr>
<td>The decision and recommendation comes from the Sida field office although it was stressed that “there was an expectation by CIDA Corporate Headquarters, recipient governments and other donors that CIDA would use a PBA approach whenever possible” (SIDA, 2008p.11).</td>
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<tr>
<td>&quot;All initiatives under PBAs exceeding $5M must first be presented for consideration to the Project Review Committee (PRC), a sub-committee of the Policy Committee. PRC’s role is to review proposals from a corporate perspective before they are presented for approval (Vice-President; President; Minister or Treasury Board) and to make recommendations regarding the approval or revision of these proposals. The PRC is composed of 13 members from across the Agency.</td>
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<tr>
<td>All PBA initiatives that exceed the minister’s aid approval authority (this limit is currently set at $20M) or do not meet the requirements of the CIDA Terms and Conditions require a Treasury Board submission (TB). A TB submission is an official document submitted by the Minister of CIDA seeking the approval or authority from TB ministers to carry out a proposal that is beyond CIDA’s delegated authorities or to seek a special approval” (Mokoro, 2008:p.15).</td>
</tr>
<tr>
<td>&quot;The decision to enter into PBAs, and the choice of funding modality, should be based on a rigorous analysis of expected benefits and risks typically set out or confirmed in the CIDA program strategy for the country” (CIDA, 2009:p.2).</td>
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<tr>
<td>The process of managing and implementing PBAs is decentralised and this has highlighted a need for building up staff capacity.</td>
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### Implementation
| Case Study: CIDA – CANADA |  |
**Case Study: CIDA – CANADA**

| How harmonised are PBOs with other donors in-country? | "PBAs involve a coordinated approach amongst a group of development partners: the recipient country and members of the donor community. They are anchored in the development strategy or program(s) of a recipient country or organisation, providing important opportunities for high-level policy dialogue on strategic issues and operational policies. By supporting a framework in which the recipient leads on program planning and delivery, financial administration and reporting, PBAs increase democratic governance through strengthened institutional capacity and accountability to citizens or constituents" (CIDA, 2009: p.2). One of the defining features of the PBA for CIDA is that it is defined by its alignment with partner country strategies and harmonization with the activities of other donors. |
| Is support aligned with government budget cycles? | **Predictability:** In CIDA’s PBA policy (2009) it sets out the following means by which it will try to make its aid predictable, CIDA will: |
| How predictable has support been in the short- and medium- to long-run? | "Adopt a long-term approach involving multi-year commitments, subject to the Appropriation Act, the Treasury Board Policy on Transfer Payments and CIDA's Terms and Conditions Unless circumstances preclude this, announce payments for the coming budget year in time for inclusion in the client country’s budget; and |
| To what extent are PBOs used for engagement in policy dialogue and in what areas? | Emphasize overall performance over the medium-term, thus avoiding a stop-and-go approach to payments” (CIDA, 2009: p.6). |

**Monitoring, Reporting and Evaluation**

| What are the procedures for monitoring and reporting? | Monitoring occurs through the PAF, agreed with the recipient government and other donors. Monitoring of progress toward results consists of: continuous assessment of the program developments based on an established action plan and indicators; continuous review of identified risks and assumptions as part of the normal program management process; and effectiveness of the safeguards. |
| Were baselines created to guide monitoring and assessment of performance? | The five levels at which monitoring should be done are: strategies, policies and systems (including the financial systems and institutional context of the budget support or pooled funding initiative); inputs, including CIDA’s processes for donor harmonization and capacity building; performance within the given sector or programming area impacted by the program; outcomes/results (the medium-term effect of the support); and impacts on the reduction of poverty and/or other long-term objectives. |
| Are common Performance Assessment Frameworks (PAFs) used when there are multi-donor operations? | The country desk produces an annual performance report for HQ. Evaluations are undertaken as part of the evaluation of a country programme or country offices can undertake them independently (Mokoro, 2008:p.17). |
| How are results measured and to what extent does measurability determine the choice of results indicators? | CIDA are currently developing performance indicators that allow better reporting of the results of PBA initiatives such as policy dialogue. This is in response to a recommendation from its internal audit of PBA |
### Case Study: CIDA – CANADA

management practices in November 2008.

### Conclusions and Issues

| Outline any problems or issues that have emerged from the use of policy based instruments. | The use of PBAs has occurred in a fairly organic manner in CIDA as a result for sometime PBAs were influenced more by staff experience and past practice than by a clear policy or guidelines. |
| From the literature reviewed what have been the main benefits from using policy based instruments and what have been the main achievements? | As an output of the audit of PBA at CIDA the following recommendations were agreed. These shed some light on some of the lessons learnt by CIDA and some of the problems or issues experienced: |
| Achievement of objectives | “Need for a consistent approach to assess PBA risks, define risk tolerance levels, and provide guidance on the use of modalities based on level of risk… Apply a risk-based decision process…to determine the modality and funding amount for new PBA initiatives…” |
| Lessons learnt | When approving a PBA initiative, ensure all key risks have been assessed… |
| | Require program managers to identify specific PBA-related skills required in posting notices for individual country programs, so as to attract required expertise within the harmonised, in-country donor community… |
| | Performance indicators appropriate for PBAs be developed and reported against |
| | Establish processes to systematically gather, classify and share PBA experiences, lessons learned and best practises within the Agency in a timely manner. |
| | Develop and implement performance measures that allow CIDA to better report the results of PBA initiatives such as policy dialogue” (p.44-49). |
## E.2 The Netherlands

<table>
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<th>Case Study: The Netherlands – DGIS</th>
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<tr>
<td><strong>Policy Based Operations: Definition, Instruments and Policies</strong></td>
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<tr>
<td><strong>What are the main instruments that are defined as Policy Based Operations?</strong></td>
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<tr>
<td><strong>What are the guidelines for the use of PBO and criteria used for selection of countries?</strong></td>
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</table>
### Case Study: The Netherlands – DGIS

from a perspective of overall aid effectiveness and development.” (Goudriaan, 2009: p.198)

<table>
<thead>
<tr>
<th>How have guidelines and policy changed over the evaluation period?</th>
<th>The Netherlands has a long-standing commitment to partner country-led approaches to poverty reduction going back to the mid-1990s. The Netherlands is committed to implementing the principles of the 2005 Paris Declaration on Aid Effectiveness. Their commitment to alignment and harmonisation are key components of their policy framework. Whilst Paris Declaration targets are embedded in the annual budget process. The MFA has a strong preference for programme-based approaches and the sector-wide approach has been the organising principle for Dutch bilateral development co-operation since 1999 (OECD-DAC, 2006).</th>
</tr>
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<tr>
<td>What is the policy on using PBO in fragile states?</td>
<td>&quot;MFA has indicated that it is now starting work on developing an overall policy for its engagement in fragile states, building on its active engagement in the DAC Fragile States Group&quot; (OECD-DAC, 2007: p.17). The Netherlands is currently providing budget support to Burundi which is classified as a fragile state.</td>
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<tr>
<td>Does economic and sector work guide the choice and shape PBOs?</td>
<td>Yes Once a decision has been made to give budget support, however primarily budget support would be used to maximise the potential benefits – the OECD/DAC good practise for donors checklist that would be used (Goudriaan, 2009).</td>
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### Policy Based Operations: Practice and Processes

#### Design

| Outline the main elements of the PBO instruments. Are they sectoral or multi-sector, what type of conditionality is used and how are they designed? | The Netherlands include all of their aid modality guidelines in one document which lays out general principles and conditions for budget support, but does not give detailed guidelines on how they should be designed. Instead the design is largely left to the discretion of country offices that are able to adapt to country circumstances (Bartholomew, 2009). Disbursement: Dutch aid is programmed on a multiannual long-term basis over more than 3 years. Country programming is now done for 4-year periods. Disbursements generally have a planned calendar during the year and all efforts are made to respect this (very often with success). Paris indicator 7 shows that at least 90% of aid as scheduled by donors is recorded as disbursed by recipient governments in Tanzania (90%), Cape Verde (98%) and Senegal (99%). According to the HIPC-CBP survey, more than 75% of Dutch aid is through multi-year programmes in Bolivia, Ethiopia, Mali and Uganda. Dutch aid also scores well on pledges matching disbursements, especially in Ethiopia and Guyana (HIPC, 2009: p.8). Dutch conditionality is not seen as heavily constraining and therefore it only causes minimal disbursement delays. “The Dutch position is to have the minimum of conditionality, even on budget support. Recently, there has been a shift from ex ante conditionality (certain number of conditions must be satisfied) to ex post conditionality (performance driven). (ibid, p.7) |
| Is disbursement undertaken on an annual basis with annual tranches or is it multi-annual with annual or multi-annual tranches? | |
| Are disbursements adjusted in relation to predefined parameters or on the basis of actual performance? | |
| For multi-sector budget support are conditions related to a particular sector or cross-sectoral? | |
| Is there TA or other support linked to the PBO? What appraisals are undertaken prior to lending (fiduciary risk assessments etc and are these done jointly or are other donors work used)? | |
### Case Study: The Netherlands – DGIS

Appraisals prior to lending: see section on track record below. Also since 2001 a new system of Multi Annual Strategic Plans (MASPs) has been rolled-out across the Netherlands’ partner countries. Under the MASPs embassies have financial responsibility for aspects of ODA classified as delegated bilateral cooperation (around EUR 481m for priority sectors in 2004), and receive 4-year financial envelopes for this. The funding agreements are effective once a ‘sharing agreement’ has been signed by the partner – there are no special formalities required for this (HIPC, 2009).

### Management practices and decision-making processes

| How is the decision undertaken to use a PBO? At what stage are different departments involved? | The budget support investigation is delegated to embassies, but the Directorate of Effectiveness and Quality – dealing with many issues related to the Paris agenda such as budget support, aid modalities, capacity development etc. – assesses and approves the country level work. The final decision on budget support at the point of including its potential use in country plans, is taken by the Minister. Subsequently the implementation decisions are delegated within the ministry, depending on the type of decision taken. In order to decide on the level of alignment, including budget support, the Track Record is used which is a structured assessment instrument. The full track record is undertaking when the Multi-annual Country Assistance Plan is drafted. In the years in between a ‘light’ Track Record is done. Track Record assessments may be over ruled by political factors, for example in crisis or fragile states. So far the general policy has been that programme aid (including budget support) will be used where possible, and project aid where necessary. From 2007 onwards, the Track Record assessment has been complemented by more detailed assessments of performance in those sectors in which the Netherlands is substantially involved. Sectoral performance as assessed and documented in the sector track records (STRs) is to feed into the overall track record analysis. The assessment of overall policy may be more positive or more negative than the assessment of performance in one or more sector. However, if macro-level and sector-level assessments differ considerably, the mission must explain these differences and justify its position in each relevant cluster. (Mokoro, 2008, p.20) Dutch embassies have delegated responsibility for policy dialogue with partner country governments and other donors, formulation of Dutch country and sector policy, and the assessment, approval and monitoring of implementation activities within the limits of the “delegated funds”. Since 2006 general budget support has not been approved centrally but instead has been delegated to embassies in the 15 partner countries where general budget support is being used (ibid). |
| What is the process for approving PBOs? Which departments are involved? |  |
| Is there a cap on the amount of a country programme that can be covered by PBOs or is there a cap on overall policy based operations? How decentralised is the process? Are decisions made at country office level? |  |

### Implementation

| How harmonised are PBOs with other donors in- | Harmonisation: “The Netherlands also promoted the preparation of the EU action plan on co-ordination, |
### Case Study: The Netherlands – DGIS

<table>
<thead>
<tr>
<th>Question</th>
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<tbody>
<tr>
<td>country?</td>
<td>Harmonisation and alignment. As compared to the 2001 DAC Peer Review, there is now a clear political will to increase the focus on European co-operation and promote a stronger engagement at all levels within the MFA. (OECD-DAC, 2006: p.32)</td>
</tr>
<tr>
<td>Is support aligned with government budget cycles?</td>
<td>The Netherlands is very flexible in budget support design; willing to be a silent partner in SBS programmes, delegating responsibility for their funds to another donor agency. (Bartholomew, 2009).</td>
</tr>
<tr>
<td>How predictable has support been in the short- and medium- to long-run?</td>
<td>Alignment: In 2004, the Netherlands launched ‘the Track Record’, whose aim is to select which aid modality is most appropriate to use in a partner country. Based on this annual assessment framework, “the Track Record determines what level of alignment is feasible in a partner country and what range of aid modalities would be appropriate for the country context” (DAC, 2006, p.57).</td>
</tr>
<tr>
<td>To what extent are PBOs used for engagement in policy dialogue and in what areas?</td>
<td>“Recipient countries (HIPC-CBP) indicate a very high willingness on the part of the Netherlands to align their choice of sectors to work in with the partner countries’ priorities. The average for this indicator is second only to the UK’s score” (HIPC, 2009: p.7).</td>
</tr>
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</table>

Predictability: In the 2006 DAC peer review it was noted that Dutch Embassies were allowed to commit up to 90% of their delegated funds on a multiyear basis without time limit. However budget support cannot be committed for more than four years in advance. Multi-year commitments are included in bilateral agreements with partner governments and memorandums of understanding when multi-donor financing is involved (OECD-DAC, 2006: p.73).

Policy Dialogue: See above policy dialogue has been delegated to the Embassies nut is considered to be a key part of budget support: “on-budget funding must be accompanied by an effective policy dialogue with the recipient country on improving governance, including the political dimension, and reducing poverty” (DGIC, 2003: p.27).

“Dutch aid is not directly linked with execution of a programme with the IMF or World Bank, and the government makes independent decisions on disbursements. It also aims to participate actively in the policy dialogue and to take an independent position, though the application of this depends somewhat on the strength of Dutch representation in-country. Accordingly, the HIPC-CBP survey finds quite a high level of Dutch engagement with country authorities, with top scores given by Ethiopia, Ghana, Guyana and Mali” (HIPC, 2009: p.8).

### Monitoring, Reporting and Evaluation

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<tr>
<th>Question</th>
<th>Answer</th>
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<tr>
<td>What are the procedures for monitoring and reporting?</td>
<td>As part of the Ministry’s planning cycle, the missions in partner countries are required to draw up a full track record every four years. The track record forms the basis for the obligatory context analysis underlying the multi-annual strategic plan (MASP). After the multi-annual strategic plan has been drawn up, updates of the track record (a track record &quot;light&quot; format), are to be drawn up annually to monitor progress and to assess whether the chosen strategy is still adequate.</td>
</tr>
<tr>
<td>Were baselines created to guide monitoring and assessment of performance?</td>
<td>The track record’s analyses are supplemented by underlying analyses, which are not part of the mission’s annual report obligations. The mission can make an analysis of this kind at any time of the year, provided</td>
</tr>
<tr>
<td>Are common Performance Assessment Frameworks (PAFs) used when there are multi-donor operations?</td>
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harmonisation and alignment. As compared to the 2001 DAC Peer Review, there is now a clear political will to increase the focus on European co-operation and promote a stronger engagement at all levels within the MFA” (OECD-DAC, 2006: p.32)

The Netherlands is very flexible in budget support design; willing to be a silent partner in SBS programmes, delegating responsibility for their funds to another donor agency (Bartholomew, 2009).

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**Case Study: The Netherlands – DGIS**

| How are results measured and to what extent does measurability determine the choice of results indicators? | the conclusion and ratings are fully incorporated into the track record and the information is up to date (less than a year old). The review frameworks drawn up to prepare the underlying analyses have an independent objective and function besides their relevance to the track record. The information for the previous year would impact on disbursements in the subsequent year to get the balance right between risk management and predictability. The Netherlands have a sanctions policy, which sets out concrete steps that need to be taken when problems arise in countries, and explicit criteria for decisions on disbursement (Mokoro, 2008:p.22) PAFs or PEFA would be used for multi-donor operations as the aim is to harmonise. |
| What are the procedures for auditing? How often have internal reviews and external and independent evaluations been undertaken? | |

**Conclusions and Issues**

| Outline any problems or issues that have emerged from the use of policy based instruments. From the literature reviewed what have been the main benefits from using policy based instruments and what have been the main achievements? Achievement of objectives Lessons learnt | The following recommendations relevant to budget support emerged from the peer review of the Netherlands aid: In order to fulfil its ambitious policy agenda the MFA should continue its efforts to ensure that embassies have the right human resources (skills mix and capacity levels). The MFA is encouraged to consider options to simplify the planning and monitoring system, potentially by combining certain of its components. In developing the new strategic plans, The Netherlands could move towards a more collaborative approach involving partner country governments and other key stakeholders. The Netherlands is encouraged to move forward with its plan to develop an overall aid effectiveness strategy to better communicate how the Paris Declaration agenda is to be implemented at headquarters and in different partner country circumstances. In conjunction with other donors, the Netherlands needs to clarify the approach to conditionality in order to ensure that general budget support contributes effectively to both ownership and predictability as well as poverty reduction objectives, while paying due attention to governance issues (OECD-DAC, 2006). |

|
### E.3 United Kingdom

#### Case Study: DFID, UK

**Policy Based Operations: Definition, Instruments and Policies**

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
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| What are the main instruments that are defined as Policy Based Operations? | DFID uses budget support or poverty reduction budget support (as defined by DFID's key terms glossary)  
“Poverty reduction budget support is a form of financial aid in which funds are provided directly to a partner government’s central exchequer to support that government’s programmes. This can be in the form of general budget support (not directed at particular sectors) or sector budget support.” (from [http://www.dfid.gov.uk/about-dfid/glossary/?key=P](http://www.dfid.gov.uk/about-dfid/glossary/?key=P)). |
| What are the guidelines for the use of PBO and criteria used for selection of countries? | Guidelines for Poverty Reduction Budget Support (PRBS) were issued in February 2008 as part of a policy paper.  
The pre-conditions for budget support are:  
Governments are committed to 3 partnership principles:  
Reducing poverty  
Upholding human rights  
Improving financial management, promoting good governance and transparency and fighting corruption  
Provision of budget support will produce significant benefits relative to other forms of aid delivery.  
Assessment of these criteria is undertaken as part of DFID’s Country Assistance Plans. As part of the budget support appraisal process, analysis is also undertaken to determine whether budget support would deliver benefits similar to other forms of aid by focusing on:  
The government’s strategy, budget and capacity  
Fiduciary risk  
Political risk  
The expected benefits of budget support  
Programme documentation sets out:  
What benefits are expected to be achieved over time.  
Features of budget support that will maximise its impact  
Additional activities to complement and maximise program impact  
Risks to achieving benefits and how they will be managed.  
There are also clear objectives and monitoring frameworks outlined. The analysis required for the |
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<th>Question</th>
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<tr>
<td>How have guidelines and policy changed over the evaluation period?</td>
<td>DFID was pushing hard to increase the proportion of aid it gives through budget support – and committed in 2005 to provide more than 50% of its country programme resources in the form of PRBS or sector wide support by 2007/08 (DFID, 2005b). Over time as DFID has become more confident about the impact of budget support it has allowed and then encouraged the use of budget support. In February 2008 they published a PRBS policy which replaced the 2004 policy. This aimed to incorporate and learn from lessons and evidence gathered from recent evaluations as well as linking in policy from the 2006 White Paper. The policy update aimed to ensure that DFID was making use of the latest evidence and would therefore maximise the use of budget support.</td>
</tr>
<tr>
<td>What is the policy on using PBO in fragile states?</td>
<td>DFID believes that budget support is effective in reinforcing and building effective states. &quot; While risks of delivering budget support may be high in many fragile states, possible benefits are also likely to be high and so PRBS may well be an appropriate way to deliver aid, provided risks are well managed&quot; (DFID, 2008: p.14) As a result DFID does use budget support in fragile states, this approach has developed on the back of successes in countries like Sierra Leone where &quot; efforts to rebuild the state concentrated on governance reforms and a bold political decision was taken to use budget support, although out of step with DFID thinking about work in fragile states&quot; (DFID, 2008:p.1).</td>
</tr>
<tr>
<td>Does economic and sector work guide the choice and shape PBOs?</td>
<td>When considering the use of budget support DFID considers the impact that budget support might have through three channels: &quot;flow of funds effects - increased and more sustainable spend on particular services or infrastructure might lead to improved health or education outcomes or stronger economic growth, efficiency of public expenditure might increase. Policy effects - more pro-poor or effective policies to improve the impact of education on literacy rates or to ensure macro-economic stability. Institutional effects - stronger government institutions able to formulate policy, plan and budget better, deliver more effective services, manage public finances better or be more accountable to citizens&quot; (DFID, 2008: p.13). By looking at the impact of a budget support programme on these three areas DFID hopes to make sure that there are improvements to basic services, strengthening of government institutions, planning, budgeting and accountability systems. The analysis required to decide whether to use PRBS and to design the programme comes from the DFID country office and would therefore be influenced by their economic and sector work.</td>
</tr>
</tbody>
</table>
Outline the main elements of the PBO instruments. Are they sectoral or multi-sector, what type of conditionality is used and how are they designed? Is disbursement undertaken on an annual basis with annual tranches or is it multi-annual with annual or multi-annual tranches? Are disbursements adjusted in relation to predefined parameters or on the basis of actual performance? For multi-sector budget support are conditions related to a particular sector or cross-sectoral? Is there TA or other support linked to the PBO? What appraisals are undertaken prior to lending (fiduciary risk assessments etc and are these done jointly or are other donors work used)?

“DFID will always agree a monitoring framework (either within a particular sector or across multiple sectors) with the recipient government as well as a formal arrangement for regular review of the progress being made against the objectives of the PRBS programme and any implications for policy content and policy processes. DFID will always set out any specific conditions that must be met in order for budget support to continue” (DFID, 2008:p.5).

“Despite the stronger focus on social infrastructure and service delivery, DFID is involved in a wide range of sectors. In a given partner country, it could consider focusing on fewer sectors where it can strengthen its comparative advantage, and adopting a more specialised approach” (OECD-DAC, 2006).

Disbursements: DFID have agreed in their recent policy paper to “increasingly adopt multi-year budget support arrangements, and be clear about the basis on which decisions to deliver aid in the future will be taken” (DFID, 2008:p.18).

DFID promises to be clear “about how much future aid is dependent on particular conditions being met, performance against monitoring indicators and how much additional aid may be available subject to internal resource allocation decisions” (ibid).

DFID recognises that performance conditions can disrupt aid predictability. DFID has put the following mitigating actions in place to reduce disruption of aid. They will ensure that governments know in advance what benchmarks we will monitor and how progress against them will affect payments.

Determine the appropriate size of the performance tranche, after weighing up the impact that less predictability may have on the results that our aid achieves with any benefits stemming from the performance tranche itself.

Ensure that the performance tranche affects the following year’s commitment, rather than disbursements in the current financial year (ibid:p.19).

DFID will provide TA to complement their budget support either to particular sectors or to build capacity in national institutions (ibid:p.5).

Management practices and decision-making processes

How is the decision undertaken to use a PBO? At what stage are different departments involved? What is the process for approving PBOs? Which departments are involved? Is there a cap on the amount of a country programme that can be covered by PBOs or is there a cap on overall policy based operations?

DFID’s policy is to strongly recommend the use of PRBS however whilst recognising that its success or otherwise will be context specific. Therefore no internal targets as to how much aid must be channelled through budget support are provided (DFID, 2008). Whilst guidelines are provided on PRBS for country offices, there appears to be a certain amount of flexibility as to the design of PRBS – instead DFID HQ provides an outline of the principles and concepts to be followed but allow some flexibility in design to allow for the adaptation to the context and systems of the partner country (Bartholomew, 2009).
How decentralised is the process? Are decisions made at country office level?

How there are certain rules that are laid out in the DFID Blue Book on PRBS:

Programme staff must ensure that; a full Fiduciary Risk Assessment (FRA) is carried out for all General or Sector Poverty Reduction Budget Support (PRBS). (DFID, 2005a:p.17).

All Financial Aid (including General & Sector Poverty Reduction Budget Support (PRBS)) must be channelled through Crown Agents Financial Services Ltd (CAFSL). CAFSL must be provided with copies of agreed MOUs (ibid: p.24)

Furthermore PRBS programmes which are 2 or more years old with an approved commitment of £1M and over must be reviewed and scored annually on PRISM. (p.18). PRISM review forms have been specially adapted for GBS and SBS.

Within DFID the process for deciding if PRBS is the right modality is assessed at country level and documentation is prepared by the DFID country office as part of preparation of the Country Assistance Plan (CAP). Support is provided for country offices for CAP by the cross-divisional Quality Assurance Group. Risk assessments are reviewed by the Programme Guidance Risk and Assurance Group in Finance and Corporate Performance Division. Governance assessment if undertaken by the country team is Peer reviewed by the Effective States Team, Policy and Research Division. When new CAPS are being drawn up or a major change is being made this decision would be made by the Secretary of State (Bartholomew, 2008).

Implementation

How harmonised are PBOs with other donors in-country?

Is support aligned with government budget cycles?

How predictable has support been in the short- and medium- to long-run?

To what extent are PBOs used for engagement in policy dialogue and in what areas?

DFID endorsed the Paris Declaration in 2005 and has signed up to the EU Action Plan on Harmonisation in November 2004 (DAC, 2006, p68).

DFID has entered into basket funds and pooled funding arrangements in a number of countries and has been willing to enter into joint assistance strategies (replacing their own Country Assistance Plan), e.g. in Tanzania. In Rwanda, the country plan was developed jointly with the World Bank and aligned with the country’s PRSP cycle.

DFID has also participated in silent partnerships (or “delegated cooperation”), e.g. with France for the education sector in Niger. As a member of the EU, the UK committed in 2005 in Paris to reduce the number of uncoordinated missions by 50%. According to the 2008 Paris Survey, the UK has exceeded its pledge and only 39% of its missions were uncoordinated in 2007. (HIPC, p.8)

Alignment: DFID places alignment at the centre of its aid modality selection and design. It stresses “predictability and alignment are particularly important for maximising budget support’s impact” (DFID, 2008:p.17).

In the most recent DFID PRBS policy they emphasis alignment through providing a list of promises. One of which is that they “will align our financial flows and monitoring and review processes with governments’ own processes and systems. We will use governments’ own indicators and targets wherever possible and draw data from governments’ own data sources, using governments’ collection systems. We will draw on governments’ own financial management reports for information about how the government is allocating
and spending its resources. Where government systems are weak, we will support governments to
develop more comprehensive and reliable systems and will avoid elaborate parallel monitoring or other
procedures that divert resources and attention from strengthening their own systems" (DFID, 2008:p.19).

Predictability:
DFID acknowledges the importance of predictability in its PRBS policy; "
"We know that all aid including PRBS is most effective when it is delivered in a predictable way over a
number of years" (DFID, 2008: p.17).

The HIPC evaluation found that according to partner countries "best practice (top scores on the two
relevant indicators) in terms of multi-year commitments and disbursements matching pledges in the
intended fiscal year can be found in Ethiopia, Gambia and Sierra Leone. There looks to be quite a close
link again between the amount of programme support and on-budget aid and predictability (see Paris
Indicator 7 for Rwanda, Tanzania, and Afghanistan where respectively 84%, 89% and 94% of aid is
delivered on-budget). However, DFID also provides highly predictable aid in countries where there is no
programme support (Albania and Nigeria)." (HIPC, 2006:p.8)

Policy dialogue: this is suggested as one of a number of complementary supports that can help increase
the effectiveness of PRBS. DFID also notes, "Conditionality that attempts to buy reform from an unwilling
partner has rarely worked. So we won’t design budget support programmes to try to impose particular
policies on governments" (DFID, 2008:p.18).

### Monitoring, Reporting and Evaluation

<table>
<thead>
<tr>
<th>What are the procedures for monitoring and reporting?</th>
<th>Monitoring of budget support is undertaken through performance assessment frameworks (PAFs) these are agreed between development partners and recipient governments.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Were baselines created to guide monitoring and assessment of performance?</td>
<td>It is also monitored through overall monitoring of the country programme by country offices in output to purpose reviews. This information is sent to the Corporate Performance Division.</td>
</tr>
<tr>
<td>Are common Performance Assessment Frameworks (PAFs) used when there are multi-donor operations?</td>
<td>Specific reporting on budget support is undertaken by country offices before disbursements are made and these go to the Secretary of State in order to provide an update on partnership commitments and fiduciary risk assessment.</td>
</tr>
<tr>
<td>How are results measured and to what extent does measurability determine the choice of results indicators?</td>
<td>The main evaluation of budget support was through the Joint Evaluation of Budget Support (JEGBS). There have been a few of ad-hoc evaluations of budget support undertaken since at the request of country offices. E.g. Zambia, Ghana and Sierra Leone.</td>
</tr>
<tr>
<td>What are the procedures for auditing?</td>
<td>There is no intention to carry out further evaluations of budget support, instead budget support is</td>
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<tr>
<td>How often have internal reviews and external and independent evaluations been undertaken?</td>
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evaluated through evaluations of country programmes (Mokoro, 2008:p.33-34).

Auditing: according to the Blue Book the basic accounting discharge is provided by Crown Agents Financial Services Ltd. through whom all payments are made. As mentioned above it is obligatory for a Fiduciary Risk Assessment to be carried out prior to PRBS and in the design arrangements should be agreed and put in place to monitor the partner government’s financial management. Such monitoring for reasons of alignment and in order to make the most of BS would usually be based on the output of the partner Government’s reporting and accounting systems, and the reports of the partner Government Auditor General backed up by additional information or safeguards where necessary. DFID will try to integrate their assessment and monitoring with that of other donors (DFID, 2005a: p.34).

**Conclusions and Issues**

| Outline any problems or issues that have emerged from the use of policy based instruments. From the literature reviewed what have been the main benefits from using policy based instruments and what have been the main achievements? | DFID lays out in its 2008 policy document the lessons it has learnt since the 2004 policy document from evaluations and the practice of PRBS. These include to some extent the problems and issues that have also emerged.

"The effect of budget support on poverty-related outcomes depends on the quality and focus of the national strategies and policies that it supports. Initial Poverty Reduction Strategies concentrated on improving public service delivery and so budget support was more effective at expanding service delivery than at generating growth" (DFID, 2008:p.10).

There is a need to better communicate how budget support is spent and what impact it has. "Data, methodology and timescale problems all make it difficult to attribute progress made in a country directly to the delivery of budget support" (ibid). Therefore country specific monitoring must include impact and evaluations should be carried out.

"Budget support leads to stronger accountability between sector ministries and the ministries of finance and planning, and makes more government expenditure subject to the country’s system of Parliamentary accountability. While this helps to improve accountability between citizens and governments it is not sufficient – additional support is often required to strengthen Parliaments’ scrutiny function; and to strengthen civil society’s ability to hold government to account. Budget support needs to be combined with technical assistance and support to non-government institutions to tackle the wide-range of development challenges facing most countries. Different ways of delivering aid need to be carefully managed so that they complement each other and maximise the impact of all donors across all sectors.

Budget support is most effective when it is predictable and careful risk assessment and management are imperative for predictable support to be delivered over the long term. GBS in particular is more susceptible to political governance risks than SBS and other sector programmes because it is associated with supporting the whole government’s programme.
At both sector and central levels, high quality policy engagement by the donor community is needed to effectively monitor progress alongside the budget support programme, discuss policy and implementation and design appropriate complementary interventions (such as technical assistance to build capacity). Technical assistance to strengthen public financial management should be better coordinated across donors so that support is more coherent and achieves better results" (ibid).
### E.4 Sweden

**Case Study: SWEDEN, SIDA**

**Policy Based Operations: Definition, Instruments and Policies**

<table>
<thead>
<tr>
<th>Question</th>
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<tr>
<td>What are the main instruments that are defined as Policy Based Operations?</td>
<td>Sida uses the term budget support but also recognises that this is just one financing mechanism that can be used within the general commitment to use Programme Based Approaches (PBAs). PBAs are defined using the OECD-DAC definition, they are a &quot;way of engaging in development cooperation based on the principle of co-ordinated support for a locally owned programme of development, such as a national poverty reduction strategy, a sector programme, a thematic programme or a programme of a specific organisation&quot;. PBAs share the following features: a) leadership by host country or organisation; b) a single comprehensive programme and budget framework; c) a formalised process for donor co-ordination and harmonisation of donor procedures for reporting, budgeting financial management and procurement; and d) efforts to increase the use of local systems for programme design and implementation, financial management, monitoring and evaluation.&quot; (Sida, 2008: p.20-21).</td>
</tr>
<tr>
<td>What are the guidelines for the use of PBO and criteria used for selection of countries?</td>
<td>The use of budget support is a priority as illustrated by it being one of three targets for each country: &quot;Sweden is reducing the sectoral spread of its aid by concentrating its activities in each country to three sectors. These three sectors are in addition to its engagement with civil society, support to research, budget support and humanitarian assistance&quot; (OECD-DAC, 2009: p.14). New guidelines for budget support have been introduced in April 2008. These are 'Clarification of the Guidelines Relating to the Management of Budget Support for Poverty Reduction', Ministry of Foreign Affairs, Sweden. &quot;Before a decision is taken to provide budget support each of the following five fundamental prerequisites must be met at the same time: Fundamental respect for human rights and democracy, as well as clear commitments and measures taken to strengthen human rights and democracy; A national strategy for development and poverty reduction (PRS or equivalent) that has democratic support and that is viewed, in an overall assessment, as relevant, credible and feasible;</td>
</tr>
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</table>
### Case Study: SWEDEN, SIDA

A growth-enhancing and long-term sustainable economic policy with the objectives of development and poverty reduction that includes macroeconomic stability as a necessary prerequisite; Systems for public financial management that are sufficiently transparent, robust and effective to reach the objectives of the support, along with a positive development of these systems; A clear commitment from and measures taken by the government of the partner country to combat corruption in the public sector. Weaknesses and risks in each area are to be analysed and an assessment is to be made of how to manage them (for example through reforms or supplementary measures)" (MfFA, 2008: p. 3).

### How have guidelines and policy changed over the evaluation period?

If one looks at the use of different financing modalities since 2005 there does not seem to have been significant change in attribution as almost half of Sida's total bilateral aid continues to go into project support. Meanwhile programme support has increased a little from 11.4% of Sida's total development co-operation budget in 2005 to 13.6% in 2007. Within this the shares of general budget support and sector programme support have remained steady, at about 5% each since 2005 (OECD-DAC, 2009: p. 44).

However, guidelines and policy have changed and budget support is being increasingly prioritised by Sida. In Sida's 2007 Annual Report Sida stated that it was supporting the implementation of nationally owned poverty reduction strategies. The majority of this support was in the form of programme support, under which general budget support, sector budget support and sector programme support were the options for funding modalities (Sida, 2007). The report also claimed an increase in programme support through general budget support, which out of the three modalities had increased most from SEK 725 million in 2005 to SEK 966 million in 2007 (ibid, p.18).

A scathing report by the Swedish National Audit Office in 2007 led to Sida clarifying the guidelines for budget support, their implementation and their risk assessments.

### What is the policy on using PBO in fragile states?

Sida recognises that in fragile states "where democratic structures, systems and capacity are often weak and interventions tend to be poorly coordinated " nevertheless in such circumstances it stresses the importance of promoting "broad ownership, alignment, harmonisation etc. in relation to relevant actors, is just as important (if not more so)". Sida would assess the use of budget support in fragile states in the same way that it would in other countries using the criteria listed above (Sida, 2008: p.16). Sida would seek in the design of a PBA in a fragile state to, balance capacity development, reform and regular operations thus adapting the PBA to the particular context.

In the current consolidation of Sida's partners fragile states and conflict affected partners have been included as a priority group for Swedish aid The OECD-DAC peer review has recognised that this new focus for Sida will require new staffing needs and incentives and longer term predictability for partner countries (2009).

### Does economic and sector work guide the choice and shape PBOs?

Yes the choice of funding mechanism will be shaped by economic and sector work. "The analysis performed by Sida must include an evaluation of both the present situation and development trends. The
expected results of budget support must be weighed against the risks involved. Sida must provide a detailed description of how it has arrived at its overall assessment. While its analysis may build on analytical work already done, Sida must always draw its own conclusions". (NAO, 2007: p.28)

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| outlined the main elements of the PBO instruments. Are they sectoral or multi-sector, what type of conditionality is used and how are they designed? Disbursement undertaken on an annual basis with annual tranches or is it multi-annual with annual or multi-annual tranches? Are disbursements adjusted in relation to predefined parameters or on the basis of actual performance? For multi-sector budget support are conditions related to a particular sector or cross-sectoral? Sida uses both sector budget support and general budget support (multi-sector). The design is done in accordance with Sida guidelines but also bearing in mind the context. However, the Swedish National Audit Office notes in its assessment of Sida's budget support that "as a result of the 'general nature' of budget support, stricter requirements can be imposed on recipient countries receiving budget support than on recipient countries participating in other forms of development cooperation." (NAO, 2007: p.27). Disbursements: have to be approved annually, even when they are part of a three-year indicative plan and amounts can be altered. Sweden often uses variable and non-variable tranches in its GBS. In Mozambique, in 2008 Sweden decided to withhold 33% of the 2009 variable tranche as not all of the governance principles of the MoU had been met. Sweden was the only donor to withhold aid and "there were mixed views amongst the rest of the donor community on the appropriateness of the action and whether the rationale for it was well communicated" (OECD-DAC, 2009: p.66). In terms of multi-year agreements this is something Sida encourages this as a means of increasing predictability for partner countries and reducing risk for Sida. They also encourage the adaptation of commitments and disbursements to the country's budget cycle (MIFFA, 2008). Sweden's non-variable tranches are disbursed only if the mutually agreed principles of the joint MoU are respected and the Swedish pre-requisites are met. Both are re-assessed annually before Sweden will confirm any planned disbursement. All decisions to disburse budget support are taken by Sida in Stockholm. And prior to the decision to release funding "Sida has to assess whether the conditions are met. Some of these conditions are performance-related while others are based on the conditions for the provision of budget support. The latter, which are often referred to as ‘underlying principles’, have to be met by the recipient countries under all circumstances" (NAO, 2007: p.57). Technical Assistance: "Sweden has in principle decided against a continuation of technical assistance, but it is still provided at a very reduced level. Sweden opposes the sending of bilateral technical assistance professionals for project implementation. Local consultants have been increasingly employed in the last years in Swedish technical assistance" (Unesco, 2010).  

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<th>Policy Based Operations: Practice and Processes</th>
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Outline the main elements of the PBO instruments. Are they sectoral or multi-sector, what type of conditionality is used and how are they designed? Disbursement undertaken on an annual basis with annual tranches or is it multi-annual with annual or multi-annual tranches? Are disbursements adjusted in relation to predefined parameters or on the basis of actual performance? For multi-sector budget support are conditions related to a particular sector or cross-sectoral? What appraisals are undertaken prior to lending (fiduciary risk assessments etc and are these done jointly or are other donors work used)? Is there TA or other support linked to the PBO? | |
### Case Study: SWEDEN, SIDA

Fiduciary risk assessments are done jointly wherever possible in fact Sida guidance to staff recommends seeking out prior DFID reviews: "it is mandatory for DFID to carry out a Fiduciary Risk Assessment (FRA) based on this approach when providing budget support. Hence, in many cases the work has already been done or could be done jointly with DFID and, of course, other partners" (Sida, 2007b: p.24).

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<th>Management practices and decision-making processes</th>
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<td><strong>How is the decision undertaken to use a PBO? At what stage are different departments involved?</strong></td>
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<td><strong>Is there a cap on the amount of a country programme that can be covered by PBOs or is there a cap on overall policy based operations?</strong></td>
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<td><strong>How decentralised is the process? Are decisions made at country office level?</strong></td>
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<td><strong>As part of the process of developing a country strategy, Sida makes a judgement on whether the criteria (listed above) for using budget support are met. If budget support is deemed viable, then Sida notifies the Ministry of Foreign Affairs and a decision is made by the government (Council of Ministers) on whether to use budget support for a specific country. Once this decision is made, Sida then receives a mandate from government to implement budget support.</strong></td>
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<td><strong>When the five pre-conditions for budget support are assessed, an analysis of current and future risk in each area is also undertaken and how it might be possible to manage any risks identified. How this should be undertaken is specified in the April 2008 guidelines. Sida would present this information to the Government of Sweden for its decision as to whether budget support is the most appropriate modality. Once a decision has been taken the Government authorises Sida to work out amounts, contractual arrangements and terms and conditions. As far as possible the Government recommends that &quot;the handling of matters of budget support should be decentralised as far as possible to the relevant mission abroad&quot;. (NAO, 2007, p.28)</strong></td>
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<td><strong>Before any disbursement of budget support, Sida must check again that the country is still meeting the five required criteria. If the country is not, then the disbursement is cancelled and the reasons for it are documented (Mokoro, 2008: p.25-6).This process would usually occur during whilst the cooperation strategy for a country is being drawn up by the Ministry of Foreign Affairs and Sida. The strategy is then adopted by the Government of Sweden.</strong></td>
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<td><strong>Whilst Sweden has made progress in decentralising its development cooperation by delegating financial authority to increasing numbers of field offices decisions concerning budget support have to be made by Sida based on documentation submitted by the country office. &quot;Issues of responsibility for the handling of budget-support matters are described in 'handling regulations' adopted by Sida's Director-General in November 2006. Under these regulations, decisions will be taken by the Director-General if the amount exceeds SEK 50 million, otherwise by the head of the regional department concerned. Decisions to disburse budget support are taken by the head of the regional department concerned.&quot; (NAO, 2007: p.38)</strong></td>
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<td>Case Study: SWEDEN, SIDA</td>
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<td>Implementation</td>
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<td>How harmonised are PBOs with other donors in-country? Is support aligned with government budget cycles?</td>
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| Harmonisation: “Sweden invests considerable resources in donor co-ordination. Staff are to be commended for their attempts to identify more inclusive mechanisms for dialogue, for example by promoting a —Code of Conduct‖ for all donors in Mozambique. However, Sweden is not yet on course to achieve targets agreed on the proportion of joint missions and the use of common arrangements. Furthermore, while more than half of Sweden’s technical co-operation is co-ordinated, Sweden is not on track to achieve the EU target to co-ordinate all technical co-operation by 2010. Sweden enters into arrangements with other donors, such as with budget support, in which conditions are agreed with partner governments” (OECD-DAC, 2009:p. 18).

The same report however also highlights that as indicated by the 2008 monitoring survey “globally since 2005, Sweden has actually reduced its common arrangements and procedures, as well as the share of its missions which were conducted jointly” (ibid, p.68).

Alignment: Sweden definitely prioritises the Paris principles and Accra Agenda for Action and this can be seen in their policy documentation (OECD-DAC, 2009). The HIPC-CBP survey shows that Swedish alignment with PRS processes is considered highest in Guyana, Mali and Ethiopia, all of which gave Sweden the top score (HIPC, 2009: p.5). Sida guidelines stipulate that Sida funds should “always be integrated with, and reflected in, the planning and budgeting process of the partner country” (ibid,p.6).

Predictability:
Sida was previously limited to making one-year commitments, but in 2005 2-year budget support agreements were concluded with Burkina, Mali, Mozambique, Nicaragua, Rwanda and Zambia. Since then Sida has indicated a willingness to increase the length of its commitments but as yet there are no tangible results.
Predictability as measured by Paris indicator 7 (disbursements recorded by Government / aid scheduled by donors) is highest in Honduras (94%), Burkina Faso (83%), Ethiopia and Mozambique (82%). The HIPC-CBP gives the highest score regarding multi-year planning to Ethiopia, Bolivia, Nicaragua, Honduras and Uganda. Best practice on disbursement timetables being in line with the national budget cycle can be found in Mali. Still according to HIPC-CBP, 100% of aid was disbursed in the intended fiscal year in Ethiopia, Guinea-Bissau, Guyana, Malawi and Mali. (HIPC, 2009: p.6)

Policy dialogue:
“SIDA is an active participant in policy dialogues with recipient governments” (HIPC, 2009: p.6). Sida makes its own assessments of PRSPs as part of the process of determining how much Swedish aid will
## Case Study: SWEDEN, SIDA

The assessment includes looking at the process that the partner country went through to write the PRSP. In countries where it has a significant programme, it has frequently supported recipient government positions in discussions with the Breton Woods Institutions (BWIs).

"According to the HIPC-CBP, Sweden exercises the most independence vis-à-vis the BWIs in Guyana (top score), closely followed by Ethiopia, Guinea-Bissau, Uganda and Zambia. Engagement in the policy dialogue is considered highest in Ethiopia, Guyana and Malawi, which give the top score" (ibid).

### Monitoring, Reporting and Evaluation

| What are the procedures for monitoring and reporting? | Sida’s April 2008 guidelines indicate that Sida should continuously monitor the development of the fundamental prerequisites, conditions in country and performance indicators. Budget support monitoring information is included in the annual report of the embassy or the section for development cooperation within the framework for reporting on implementation of the cooperation strategy. The monitoring of budget support is also reflected in the results matrix in the country plan. |
| Were baselines created to guide monitoring and assessment of performance? | " Sweden is to enter into and actively promote joint reviews of the conditions for budget support and of the implementation of the country's PRS, headed by the government of the country in cooperation with other bilateral and multilateral actors" (MfFA, 2008: p.17). |
| Are common Performance Assessment Frameworks (PAFs) used when there are multi-donor operations? | Usually Sida aims to monitor and assess the performance of budget support through the country's poverty-reduction strategy. Progress will therefore be measured against the objectives and reforms in the strategy (NAO, 2007: p.28). |
| How are results measured and to what extent does measurability determine the choice of results indicators? | An overall report on budget support is also included in the results of aid in Sida’s annual report. |
| What are the procedures for auditing? | Sida relies upon Public Finance Management (PFM) assessments as a fundamental prerequisite of whether or not a country can be given budget support. This assessment would include review of external audits and reporting on PFM progress would be an important part of Sida's M&E (MfFA, 2008). |
| How often have internal reviews and "external and independent evaluations been undertaken? | Since the Joint Evaluation of Budget Support, there have been no other evaluations of budget support. However, the April 2008 guidelines envisage that evaluations of budget support will be undertaken, in conjunction with other donors and the government of the recipient country (Mokoro, 2008: p.26). |

## Conclusions and Issues

| Outline any problems or issues that have emerged | Sida has clearly learnt that it needs to focus its aid on fewer sectors and countries in order to be more |

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<th>Case Study: SWEDEN, SIDA</th>
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<td>from the use of policy based instruments. From the literature reviewed what have been the main benefits from using policy based instruments and what have been the main achievements?</td>
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<tr>
<td>Achievement of objectives</td>
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<td>Lessons learnt</td>
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Effective. It is seeking to do this in conjunction with other donors. OECD-DAC encourages this move and pointed out in Sweden's peer review that they needed to "work more systematically with other, like-minded donors who are similarly able to generalise their involvement in delegated partnerships" (OECD-DAC, 2009: p.84).

Changes global in the aid sector have also impacted Sweden; "second generation budget support" reflects a new approach to aid policy, based on increased cooperation and coordination – not only with recipient countries, but with other donors as well. This policy dialogue, which previously focused on structural adjustment programmes and ex ante conditionality has been replaced by a dialogue that aims to support the recipient country's own poverty reduction strategies and the partner country's management and "ownership" of reforms... As Sweden's partner countries achieved the completion point in the HIPC initiative, according to the HIPC initiative definition, the need for debt relief was no longer as large and a shift toward GBS became a natural consequence. Even if GBS does not account for a large percentage of Sweden's total development cooperation, it accounts for a large percentage of the development cooperation with certain individual countries. Moreover, we conclude that combinations of several different support forms are mainly found among Sweden's older partner countries, which may not be so surprising. But, even if old forms of support remain in these countries, the cooperation has changed with the development of the new forms of support" (Sida, 2004: p.24).

Sweden's National Audit Office reviewed the use of budget support in aid by Sida (2007) and came up with the following conclusions:
- They found a lack of clarity in Sida's guidelines on budget support – making it unclear how they should be applied;
- They felt that risks were not being adequately discussed: "in most cases, Sida's risk analysis is incomplete and has not been performed in a structured manner. For instance, there is usually no discussion of how the risks concerned can be dealt with" (NAO, 2007: p.43).
- Staff capacity to carry out the work relating to budget support in country offices were often limited, or dependent upon one staff member. This is concerning when the "principal responsibility to prepare and monitor matters of budget support, including the production of assessment memoranda, rests with the missions abroad" (ibid).

Some similar issues are raised by the OECD-DAC peer-review (2009): "there are some areas where Sweden has not yet been able to address previous recommendations, notably in reducing the complexity of the policy framework and providing independent monitoring and evaluation of policy coherence for development" (p.12)
### Case Study: SWEDEN, SIDA

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<th>However overall Sweden is seen to be &quot;proactive in responding to the recommendations of the last DAC peer review and, more generally, in constantly seeking to improve Swedish development co-operation&quot; (ibid).</th>
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